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For the attention of Alan McGuinness
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20 June 2014

Dear Sir

HM Treasury and HM Revenue and Customs consultation
Implementing a capital gains tax charge on non-residents

We welcome the opportunity to respond to the consultation document, published on 28 March 2014, regarding proposals for the implementation of a capital gains tax charge on non-residents.

Baker Tilly

Baker Tilly is a leading firm of accountants and business advisors that specialises in providing an integrated range of services. We provide our growing and established business clients with audit, accountancy, personal and corporate taxation, VAT, management consultancy, corporate finance, IT advisory, restructuring and recovery, and forensic services. The firm has national coverage through its network of offices and is also represented through its international network membership.

Our client base includes a significant number of UK and non-UK resident individuals to whom we provide specialist taxation advice. We believe that many of our clients will be affected by the proposals.

General Comments

The consultation document does not invite comments as to whether the proposed changes should be made at all. It is designed to seek views on the proposed design and likely impact of the changes.

Whilst it would appear to be a straightforward change to bring the UK into line with other key comparative countries in taxing non-UK residents on the sale of residential properties situated in those countries, the need to overhaul the current UK reliefs is not a simple and straightforward matter.

The possible removal of the private residence relief (PRR) election will result in increased uncertainty and complexity, which is at odds with HMRC's stated aim to simplify the tax legislation.

The proposed changes may also entail further valuations of UK residential property, in addition to those already required under the ATED regulations, increasing costs for taxpayers.

The consultation states that "The charge will come into effect in April 2015 and apply only to gains arising from that date." This is ambiguous. Does it mean that it will apply to a gain arising after April 2015 using the normal method of calculation, or does it mean that there will be a rebasing at April 2015? It seems likely that a rebasing at April 2015 is intended, but this needs to be set out clearly in any subsequent consultation and legislation. We understand that a time apportionment method is also being considered, but, although this might alleviate the necessity for an April 2015 tax valuation, we do not believe that this will necessarily produce the fairest result. If such a simplified method is to be made available, our view is that taxpayers should also have the choice of adopting a normal method of calculation supported by a valuation.

It is not always clear whether a non-resident entity should be treated as opaque or transparent. The consultation document refers to partnerships, trusts and companies (in addition to fund structures and REITs), but there may be occasions where the distinction, and hence the proposed new UK tax treatment, would not be clear. Where this is the case would existing rules be adequate to establish the UK tax treatment?

As a final general comment, we note that the proposed changes would continue to give rise to differing tax treatments for non-UK residents when compared with UK residents, albeit that the overall tax cost impact is designed to be comparable. In designing the new regime, it will be necessary to take care to ensure compliance with EU non-discrimination policy.

Detailed responses to questions for consideration

In the appendix to this letter, we have set out our specific comments on the questions posed in the consultation document. We have confined our comments to those areas on which we are able to offer an informed view and note the following key points:

On the issue of the interaction of the proposed changes with other legislation: Baker Tilly believes that further consideration needs to be given to the interaction of the proposed changes with the rules for capital gains on properties within the Annual Tax on Enveloped Dwellings (ATED) regime, as there appears to be potential for tax to be applied at different rates and for losses arising in one regime to be unavailable for offset against gains in the other regime.

On the issue of the PRR election: Baker Tilly acknowledges that the PRR election needs to be reviewed in the context of the proposed changes. It is, however, unfortunate that it is proposed to remove the ability to make a PRR election from all taxpayers, including those who are UK resident. This will take away the certainty currently provided by a valid election and will lead to significant uncertainty, placing onerous record-keeping burdens on all individuals with more than one home.

On the issue of the method of collecting and administering the tax: Baker Tilly believes that this will need to be considered carefully, particularly as the actual tax liability in the early years is unlikely to be significant if properties are to be subject to rebasing at 5 April 2015. It is hoped that the actual burden of collection could be alleviated either by incorporation of the tax liability within the existing Stamp Duty Land Tax (SDLT) return or via the self-assessment regime. We understand that alternatives are being considered to the proposed requirement for third parties to collect the non-residents' capital gains tax (CGT) liability. Payments on account, submission of 'actual' computations, or their inclusion in self-assessment tax returns all appear to be alternatives worthy of further consideration.

Conclusion

If it is HMRC's intention, in introducing these new rules, to tax non-UK residents on gains accruing after 5 April 2015 on UK residential property, then the new rules should be squarely aimed at those non-UK residents.

This would allow the retention of the PRR election for UK residents, maintaining the simplification and certainty this brings to UK residents in claiming exemption from capital gains tax on their principal residence.

Should you wish to discuss this response, please feel free to contact

Yours faithfully

Baker Tilly Tax and Accounting Limited

APPENDIX

Detailed response to questions for consideration

Question 1: ***Would an exclusion of communal residential property from the scope of the new regime result in any unintended consequences?***

We believe not, as it appears that this exclusion would not permit abuse by residential property investors. Once these rules are operational, monitoring for potential abuse would need to take place and any abuse found would need to be blocked by amended legislation.

Question 2: ***Are there any other types of communal residential property that should be excluded from scope?***

We believe not, if the proposed exclusions are complete, which they appear to be. It may, however, be that there will be unintended inclusions that are discovered once the new rules are operational. These would need to be monitored and added to the exclusions through amendment to the legislation.

Question 3: ***Are there any particular circumstances where including non-resident partners in scope of the charge might lead to unintended consequences?***

We believe there may be occasions where there could be scope for double taxation in the UK; for example, where a non-resident partner is liable to capital gains tax on the disposal of assets used in the UK by a branch or agency of a partnership (s.10 TCGA 1992). There might also be scope for double taxation in the UK where a non-resident partner leaves the partnership and a charge arises under s.25 TCGA 1992 in addition to a charge under these proposed new rules. Attributed gains under s.13 TCGA 1992 might also result in double UK taxation. Appropriate provisions would be required to prevent double UK taxation, as seemingly acknowledged at the end of paragraph 2.10 in the consultation document.

Question 4: ***Are there any particular circumstances where including non-resident trustees in scope of the charge might lead to unintended consequences?***

As outlined in Table 2.A, a capital gain arising on a UK situs property, that has been the principal residence of a beneficiary of a trust who is allowed to occupy the property under the terms of the trust deed, would normally qualify for the PRR exemption. Will PRR still be available in this situation under the new rules?

There might be scope for double UK taxation if there is also a charge on the settlor under s.86 TCGA 1992, or a charge on the beneficiaries under s.87 TCGA 1992 (including gains of dual resident settlements under s.88 TCGA 1992). Attributed gains under s.13 TCGA 1992 might also result in double UK taxation. Again, appropriate provisions would be required to prevent double UK taxation.

Question 5: ***Is a genuine diversity of ownership (GDO) test an appropriate way to identify funds that should be excluded from the extended CGT regime, and to ensure that small groups of connected people cannot use offshore fund structures to avoid the charge?***

We believe so.

Question 6: ***Are there any practical difficulties in implementing a GDO* test?**

We have not identified any particular difficulties in implementing such a test.

Question 7*:* *Is there a need for a further test in addition to a GDO? If so, what would this look like and how would it be policed?*

Based upon our understanding of the issues, we have not identified circumstances where such a further test would be necessary.

Question 8: ***What are the likely impacts of charging gains (and allowing losses) incurred on disposals of residential property by non-resident property companies that are not already operating a trade in the UK?***

An offshore company could be subject to two separate taxing regimes dependent on the value or nature of the UK properties held. Those UK residential properties falling within the ATED regime would be subject to a CGT rate of 28%, whilst those UK properties outside of the ATED regulations would be potentially taxable at a different rate of CGT. On the face of it, this would appear unnecessarily complex and cumbersome, but it is difficult to identify an alternative unless other areas of tax law, such as the capital gains charge on ATED properties, are subjected to change.

To ensure consistency and non-discrimination, it seems to us that a capital loss arising on an 'ATED' property' should be available for offset against a capital gain arising on a 'non-ATED property' and vice versa.

Question 9: ***Are there other approaches that you believe would be more appropriate to ensure that non-resident property investment and rental companies are subject to UK tax on the gains that they make on disposals of UK residential property?***

Please see our comments incorporated in our answer to question 8 above.

Question 10: ***Are there any particular circumstances where changing the PRR election rules might lead to unintended consequences?***

Would the position pre-change be grandfathered; i.e. would there be no retrospection, so that previous PRR elections will still remain valid after the introduction of the new rules? If not, when will the PRR election be deemed to cease if the elected property no longer qualifies as a principal residence under the new rules?

The intention is to tax non-residents on gains accruing post 5 April 2015. Is the intention to consider PRR only during this period? Will there be any time apportioning over the entire period of ownership where the property meets the requirements to be the principal residence before this date, but subsequently does not.

Subject to specific measures needed to deal with leavers and time apportionment, would it not be simpler to restrict the ability to make a PRR election to UK resident individuals? Could this be achieved by making it a requirement that the property must be occupied for the minimum number of days each tax year (or part thereof) that would breach Part B (conclusively resident) or Part C (sufficient ties and day counting) of the statutory residence test?

How would the proposed new rules affect husbands and wives where one spouse is UK resident and the other is non-UK resident, and are they are deemed to be living together for the purposes of s.222(6) TCGA 1992?

Question 11: ***Which approach out of those set out in paragraph 3.5 do you believe is most suitable to ensure that PRR effectively provides tax relief on a person's main residence only?***

The complete removal of the PRR election is a major change. A significant number of UK individuals do genuinely split their time between two homes, e.g. one for work in the week and one at the weekend, and the election removes the need for extensive and detailed records to be kept.

Under Option 1, the factors that HMRC would consider may not give a true reflection of the property that is the main residence. There are bound to be situations where one property is not "demonstrably the person's main residence" such as in the example above.

Whilst Option 2 provides a fixed definitive test, it would mean that individuals with more than one property would have to keep meticulous records of their whereabouts.

How would HMRC be able to monitor/prove the accuracy of these records?

It could also lead to far more "swapping" of residences as annual day totals may vary. There would also have to be rules to exempt periods of temporary accommodation elsewhere due to work, inability to occupy (e.g. storm damage, flooding, etc.), holidays, other days/nights spent at temporary locations, stays in hospital etc.

Of the two options proposed, option 1 seems to be the only workable solution having considered this matter in the round.

Question 12: ***Are there any other approaches that you would recommend?***

The aim is to prevent non-residents claiming PRR in situations where only one property is owned in the UK and this property is not the property in which the individual lives for most of the time. Could this be achieved by requiring there to be a minimum number of days, during which the property must be occupied by the owner each year before a property can even be considered a principal residence?

Subject to specific measures needed to deal with leavers and time apportionment, consideration could be given to the complete removal of PRR for non-resident individuals on the basis their UK property could rarely, if ever, be their main residence if they were not spending sufficient time in the property to trigger the days tests for UK residence purposes. In particular, such an approach would need to ensure that UK outbound individuals would still retain the benefit of PRR, and all the other reliefs in s.222 TCGA 1992, even if they were not UK resident at the time of sale, due to working abroad for example.

An alternative would be to limit the ability to make a PRR election to individuals with more than one residence in the UK. This would have no effect on the many UK resident individuals with two UK properties who have an existing main residence election in place. However, it could have an adverse effect on a UK resident individual with one UK residence and an overseas residence, who has elected for the UK residence to be his main residence but whose main residence under Option 1 or 2 may be his overseas property. Furthermore, wealthy non-resident investors could easily exploit the legislation by purchasing a second, low-value UK property.

Question 13: ***Do you believe that solicitors, accountants or others should be responsible for the identification of the seller as non-resident, and the collection of the withholding tax? If not, please set out alternative mechanisms for collection.***

We understand that the proposed withholding tax may no longer be something that is being considered and that the current proposal provides three options; i.e. the making of a payment on account, the submission of a computation of the actual amount due, or the reporting of the gain on the relevant self-assessment tax return. We believe that these options are preferable to a withholding tax.

However, if the above options (or appropriate variations) are not adopted, and a withholding tax were to be the only option, we have some observations.

Estate agents, solicitors and accountants already have to undertake a process to identify clients for Money Laundering purposes, but for practical purposes we believe that solicitors/conveyancers would be best placed to operate any withholding tax, on the basis that they are generally directly involved in the transfer of funds in property transactions.

If a withholding tax system is adopted, we would suggest implementing a system similar to the 'non-resident landlord scheme' where the onus is on the agent or tenant (in this scenario it would be the solicitor/conveyancer) to withhold CGT on sale unless a direction is obtained that no withholding tax should be applied.

We would further suggest that the SDLT return, currently required on the purchase of a property, is replaced by a single property transaction return to be completed on any sale to cover SDLT, CGT withholding tax, appropriate reliefs, and the residence/domicile status of the seller. This return would ensure that non-PRR property sales are notified to HMRC promptly and would enable HMRC to know what to expect on the subsequent self-assessment tax return.

It is the tax residence status that it is the focus here and there could therefore be circumstances where a seller owns UK residential property but has no requirement to complete a UK tax return (i.e. no UK source income). The solicitor/conveyancer should have an obligation to obtain details of the tax residence status of the seller, but the onus of proof should rest with the seller concerned (and the seller should consult a suitably qualified accountant or lawyer accordingly); i.e. the seller must have to declare whether they are UK tax resident or not and provide evidence, as appropriate, where UK residence is claimed, such as a UTR number or a prior clearance obtained from HMRC.

A system could therefore be appropriate whereby the seller must prove that they are UK tax resident; otherwise withholding tax might be applied. If there were to be an incorrect declaration, penalties should be incurred. We note this, together with collection of any underpaid tax, could be difficult to enforce if the seller is not resident in the UK and so the level of proof should be set at a suitably high level.

Question 14: ***Are there ways that the withholding tax can be introduced so that it fits easily with other property transactions processes?***

Yes, as detailed in our response to question 13 above. If automatic withholding is implemented, together with the completion of a property transaction return, then any overpayment can be claimed on the individual's self-assessment return and a final reconciliation performed on the return, with the same deadlines as for UK resident taxpayers in the same position.

The date of exchange is normally the disposal date for CGT purposes but the funds are not transferred until the completion date. In certain circumstances, there can be a significant delay between the date of exchange and completion. We would therefore suggest that any withholding tax deducted should only be payable to HMRC after completion, in line with SDLT and the concept of a single property transaction return.

Question 15: ***Do you think that the government should offer the option of paying a withholding tax alongside an option to calculate the actual tax due on any gain made from disposal, within the same time scales as SDLT?***

Please see our responses to Questions 13 and 14 above.

As with the non-resident landlord scheme, the ability to register and pay CGT on the normal basis (including the normal 31 January due date for payment) would be welcome for many individuals, rather than a withholding based on the proceeds received. This is especially the case where the actual CGT payable is likely to be insubstantial and disproportionate when compared to the sales proceeds; for example, for a sale in June 2015 where the capital gain will be calculated by reference to the market value of the property at 6 April 2015.

We understand that an option to pay the actual tax due is also being considered (by submitting a computation of the actual amount, or by including the gain in the taxpayer's self-assessment tax return). In addition, we understand that there may also be an option to make a payment on account. These options appear to be appropriate and constructive and should be pursued.

Question 16: ***Is it reasonable to ask non-residents to use self-assessment or a variant form to submit final computations within 30 days? If not, what processes would be preferable?***

We believe that there may be issues here with an obligation to file final computations within 30 days of the sale. This could lead to perceived unfairness when UK residents have until 31 January following the tax year end to file their self-assessment return and make their balancing payments. This may also potentially be in conflict with European laws concerning discrimination.