Ashurst LLP
Broadwalk House
5 Appold Street
London EC2A 2HA

Tel +44 (0)20 7638 1111
Fax +44 (0)20 7638 1112
DX 639 London/City
www.ashurst.com

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capitalgains.taxteam@hmrc.gsi.gov.uk

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Dear Sirs

Consultation on non-residents and capital gains tax on disposals of residential property

We are grateful for the opportunity to submit our comments on the questions raised in the consultation entitled "Implementing a capital gains tax charge on non-residents" (the "**Consultation**"). We have set out below both our general observations on the proposals contained in the Consultation, and comments on the specific questions asked.

General points

Rebasing

The Consultation refers to the new regime applying to gains which arise after April 2015 (see, for example, the fifth paragraph on page 3 and paragraph 11 of page 5, each of which refer to " gains arising from that date"). Our understanding is that the new regime will only apply to gains which accrue from April 2015, i.e. there will be an opportunity for rebasing as at 1 April 2015. This is in line with the current ATED-related capital gains tax charge (hereafter "**ATED CGT**") provisions, which only apply to gains which would have accrued to the taxpayer had the taxpayer acquired the relevant property on 5 April 2013 for a consideration equal to its market value on that date. The use of the term "arising" in the consultation does not appear to us to place the position in this respect beyond doubt.

In terms of how that rebasing would operate, we note that there has been some discussion of time apportionment as a different method of rebasing. We consider that this would be more disruptive and distortive than a rebasing to an April 2015 market value.

Interaction with ATED CGT

There is very little insight provided as to the proposed interaction between the new CGT regime, and the current ATED CGT provisions, but we understand the current proposal is that the two taxes should sit side by side.

If that is the case, at the very simplest level there would be difficulties in applying the rules to many taxpayers if properties move between the two regimes. For example, a non-resident company which lets a property commercially but later fails to meet the requirements for the relevant relief at a later point will have a relevant fraction for ATED CGT purposes and be chargeable to ATED CGT for a proportion of the gain made on disposal. At the same time, as a non-UK resident it will be chargeable to non-resident CGT so will, as matters stand, have to apply different rates of tax to different periods of ownership. To further complicate matters, the non-resident will be required to look at the property value (and thus its base cost) at two different points in time (5 April 2013 and April 2015) in order to calculate the chargeable gain. The policy rationale for maintaining the ATED-related charge seems to us to be largely irrelevant: all UK and non-UK residents will, post-April 2015, be subject to a capital gains charge, regardless of the value of the property. Our understanding is that ATED CGT was designed to discourage individuals from continuing to hold high value residential property through a corporate envelope. Whilst we understand this concern, we do not consider that the complexity created by allowing the two regimes to subsist is proportional to the rationale of ATED CGT. The appropriate penal rates of SDLT are payable accordingly, as well as the annual tax on enveloped dwellings itself.

GDO test

We have addressed our concerns on the proposed genuine diverse ownership test in the context of funds below in relation to the specific question raised in the Consultation. In addition, we note that HM Treasury intends to exclude pension funds from the regime, seemingly on the basis that "some funds are not subject to UK tax at all". We note that foreign pension funds are often subject to UK income tax, and accordingly, the availability of any exemption for foreign pension funds should be clarified. Further, pension funds often hold property through another vehicle, for example, a company. Any exemption should take account of this type of arrangement, and look to the beneficial ownership of the asset. For example, suppose a foreign pension fund (which falls within section 150 of the Finance Act 2004 but not section 153) is the sole shareholder in an offshore company holding residential property. We need to ensure that the offshore holding company is not treated as close and failing the GDU test.

Rates

No detail is set out in the Consultation as to the rates at which the new charge will apply. Our view is that the rate should be set in line with the rates charged on UK residents. Accordingly, a corporate rate of 20 per cent and an individual rate of 28 per cent should apply.

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We emphasise our comments set out above again in relation to the interaction between ATED CGT and the new non-resident charge.

Questions raised in the Consultation

We now address the questions raised in the Consultation, adopting the numbering used therein.

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

Subject to the point below, we do not consider that the exclusion of communal property as described in the Consultation from the scope of the regime should result in any unintended consequences.

However, we find it difficult to understand both the rationale for not excluding all purpose built residential accommodation for students, and the apparent distinction made in the consultation between halls of residence "attached" to an institution and other residential accommodation provided for students which is not "attached". We are unsure what "attached" means in relation to a hall of residence:

(a) Where an institution owns a hall of residence, is it covered by the exemption if the hall of residence is "off campus"?

(b) If the hall of residence is not owned by an institution does this mean it must be physically attached to the institution it serves?

(c) Does it follow that a hall of residence can only serve one institution to be considered "attached"?

Purpose built student accommodation should not be subject to the CGT regime by reference to whether or not it is "attached to an institution" as it would produce, as indicated by our questions above, some odd results. It does not reflect the education sector in 2014, where a great deal of purpose built student accommodation serves students of several institutions.

In our view, provision of accommodation of this type is inherently a commercial property concern. We would expect, from a policy rationale, that HM Treasury would seek to encourage this type of investment in the UK. If there are particular types of student accommodation HM Treasury is seeking to exclude, it would be useful to understand the reasoning behind this so that any exemption can be drafted accordingly.

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

Please see above in relation to residential accommodation supplied to students.

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

In instances where the tax treatment of a partner in a partnership differs in other jurisdictions (for example where the overseas tax treatment differs such that a UK LLP is not treated as transparent) there may be issues regarding the availability of a foreign tax credit against tax paid in the UK by the partner.

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

Consideration should be given to those provisions such as section 87 TCGA 1992 which attribute gains of trustees to beneficiaries. If non-resident trustees themselves are subject to a tax charge from April 2015, such an attribution is no longer required to the extent a direct tax charge is imposed upon the trustees.

We make a similar point in response to question 8 below and section 13 of the Taxation of Chargeable Gains Act 1992.

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?*

Whilst we agree that in the context of funds, the concept of "genuine diverse ownership" addresses HM Treasury's avoidance concerns, the GDO test requires a higher level of sophistication to recognise the different types of fund and property holding structures adopted in this area. If a charge along the lines suggested in the Consultation is brought in, then it follows that all tax opaque entities (here meaning entities that would be subject to tax in the UK, rather than being treated as transparent in the UK) will need to pay this charge.

We will consider "fully transparent" funds below. However, it should be appreciated that most funds currently have one or more tiers of opaque entities in their structure, whether that is the fund vehicle itself and/or sometimes beneath the fund vehicle. We have set out in an Appendix some reasonably typical fund structures in this regard. Accordingly, in crafting any exemption for "funds" it is important to be clear that what is actually required is an exemption for the lowest vehicle in the structure that would otherwise be subject to the new CGT charge. As can be seen from the examples set out in the Appendix, that may not be a fund vehicle at all, but may be some sort of subsidiary of a fund vehicle.

We agree that a good starting point when considering a company holding real estate would be to consider whether the fund vehicle itself was close (but using the modified test in the REITs legislation). There are some further points that would need to be considered, particularly in relation to structure 3 in the Appendix. In considering structure 3, it should be appreciated that all the partners in the partnership will be connected as a result of section 1122 CTA 2010 and that accordingly HoldCo will itself be close no matter how widely held the partnership interests are. We would thus suggest disapplying section 1122 CTA 2010 when carrying out this test.

Turning now to open-ended funds, there are a number of ways HM Treasury can meet their policy objective, but we generally agree with the GDO test. We wonder though whether instead of focussing on whether the fund itself is closed-ended or open-ended the focus should be as to whether the opaque entity holding the property is closed-ended or open-ended. If one adopted the latter approach then instead of looking at the fund vehicle and certain of its subsidiaries as obtaining an exemption, one could instead just consider whether:

(a) any open-ended company holding the real estate satisfies the GDO test; and

(b) any closed-ended company satisfies the modified close-company test set out above.

The advantage in adopting this approach is that it is not then necessary to consider what sorts of subsidiaries (companies act, group relief tests etc) are relevant when deciding if something is "really" a subsidiary of a fund vehicle. Whilst there are some funds which are difficult to classify as either open-ended or closed-ended, we agree with HMRC that two different tests make sense here.

In terms of opportunities for abuse, the use of the close companies test is relatively tried and tested. The only work-around of which we are aware which is used to any material extent is the use of protected cell companies ("PCC"). If the price paid for a useful, practical and fund-structure-agnostic exemption is that PCC companies would be considered for these purposes as a number of separate companies (in the same way as sub-funds under the offshore funds rule in section 361 TIOPA), then our view is that that would be a price very much worth paying.

We have not focussed on the economics or political argument but rather the legal points. We do however take it as a given that there is a need for more residential property funds, as evidenced by the almost daily news about the lack of housing capacity in the UK.

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

Please see our comments in relation to question 5.

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?*

We have set out our comments in this respect pursuant to questions 5 and 6 above.

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

Section 13 of the Taxation of Chargeable Gains Act 1992 will require amendment (we note that it is disapplied in relation to ATED CGT) such that there is not a charge to tax at both the non-resident and shareholder level.

The attraction of transferring a non-UK property holding company may be that it does not carry a latent capital gains tax charge. We are not convinced that this is a common commercial deal but if it is, the introduction of the non-resident CGT charge may discourage this type of transaction.

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?*

No comment.

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

The Consultation does not make clear whether or not the PRR election applies on a global basis. We would be surprised if it did, as it would be very unlikely for a non-UK resident individual to have his or her principal residence in the UK without being UK tax resident.

HM Treasury's intentions regarding lettings relief is not set out in the Consultation. We would expect that it would also need to be made available to non-residents in the same way that it is to UK residents, if it is to remain.

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?*

No comment.

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

No comment.

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 do not consider that it solicitors or accountants should be responsible for identifying a non-resident seller, nor should they be responsible for collecting withholding tax. This would be avoidable by not instructing professionals subject to the requirements or instructing non-UK solicitors or accountants. There is also no detail provided as to whether this proposal is aimed at solicitors acting for the purchaser, or the vendor.

One of the main issues with collecting tax via a withholding tax is that HMRC will never receive the correct amount of due; the purchaser will have to withhold at a standard rate of withholding and a subsequent adjustment will need to take place between HMRC and the seller. This will require significant resource from HMRC, and so we would expect that a self-assessment which is open for HMRC to dispute with the seller commands less resource and impact upon cashflows.

One option for HM Treasury to consider is whether the payment of the tax should somehow be linked to Land Registry procedures. This would ensure, as it does with SDLT, that the tax is paid. One way of doing so may be to create a charge over the property on the register, which is visible to the purchaser on searches carried out in the sale process in the usual way, but also requires release in order for the seller to make the disposal.

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

If HMRC proceed with a withholding tax collection mechanism, this could operate in a similar manner to the non-resident landlord scheme. Non-resident owners of residential property would register with HMRC so that they did not suffer a withholding tax on the purchase price.

15. *Do you think 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 timescales as SDLT?*

We are not sure how these options would interact; the advantage of the withholding tax is that HMRC is able to obtain the tax from the sale proceeds. If the seller has the option of declaring the tax within 30 days, the purchase price will already have been paid.

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 would expect any tax which is self-assessed to be subject to the same time limits as is available to UK residents.

Please let us know if we can be of further assistance.

Yours faithfully

Ashurst LLP.

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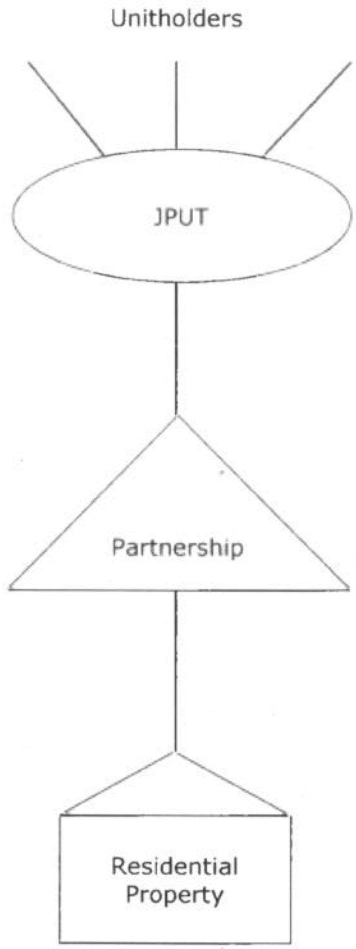
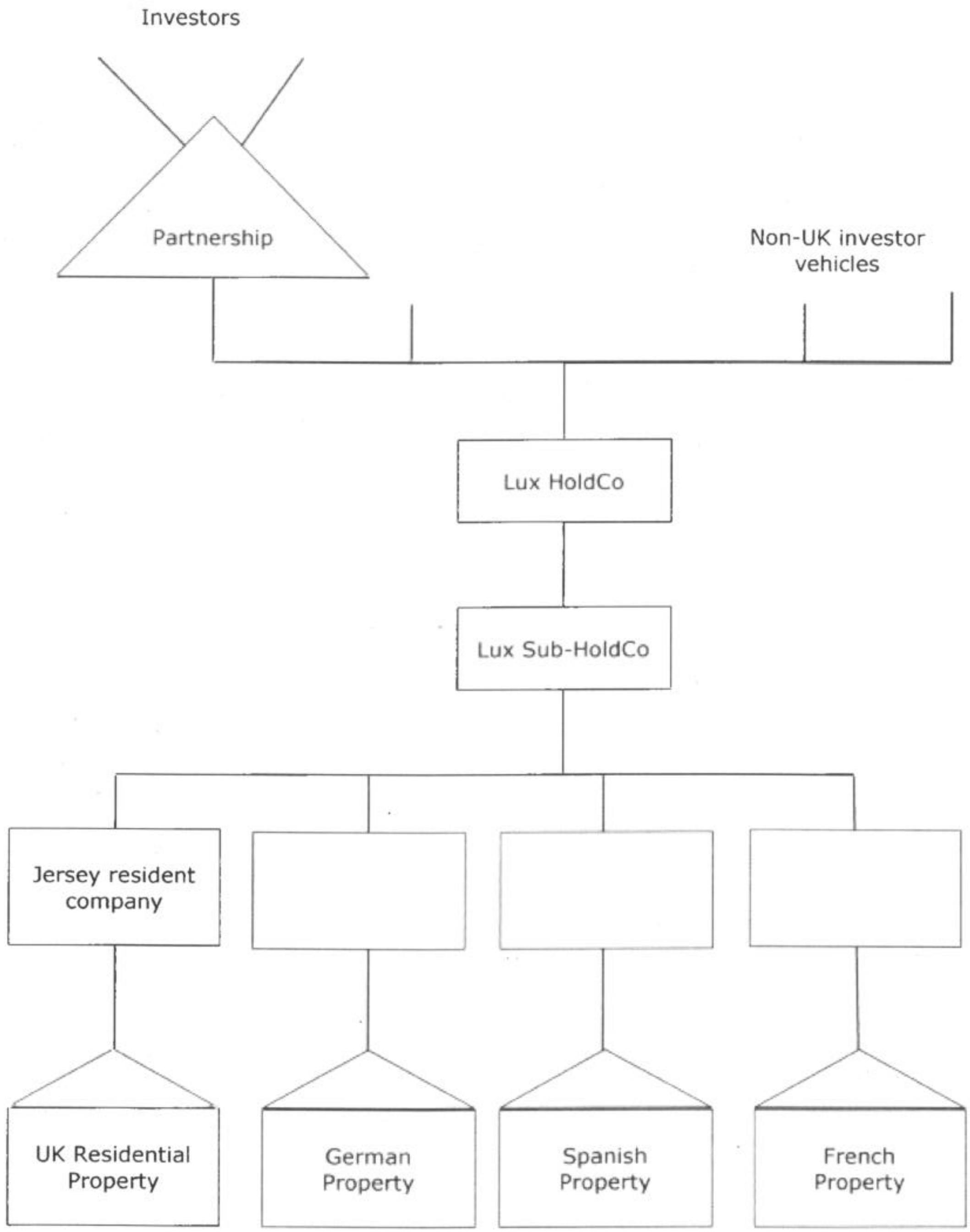
APPENDIX

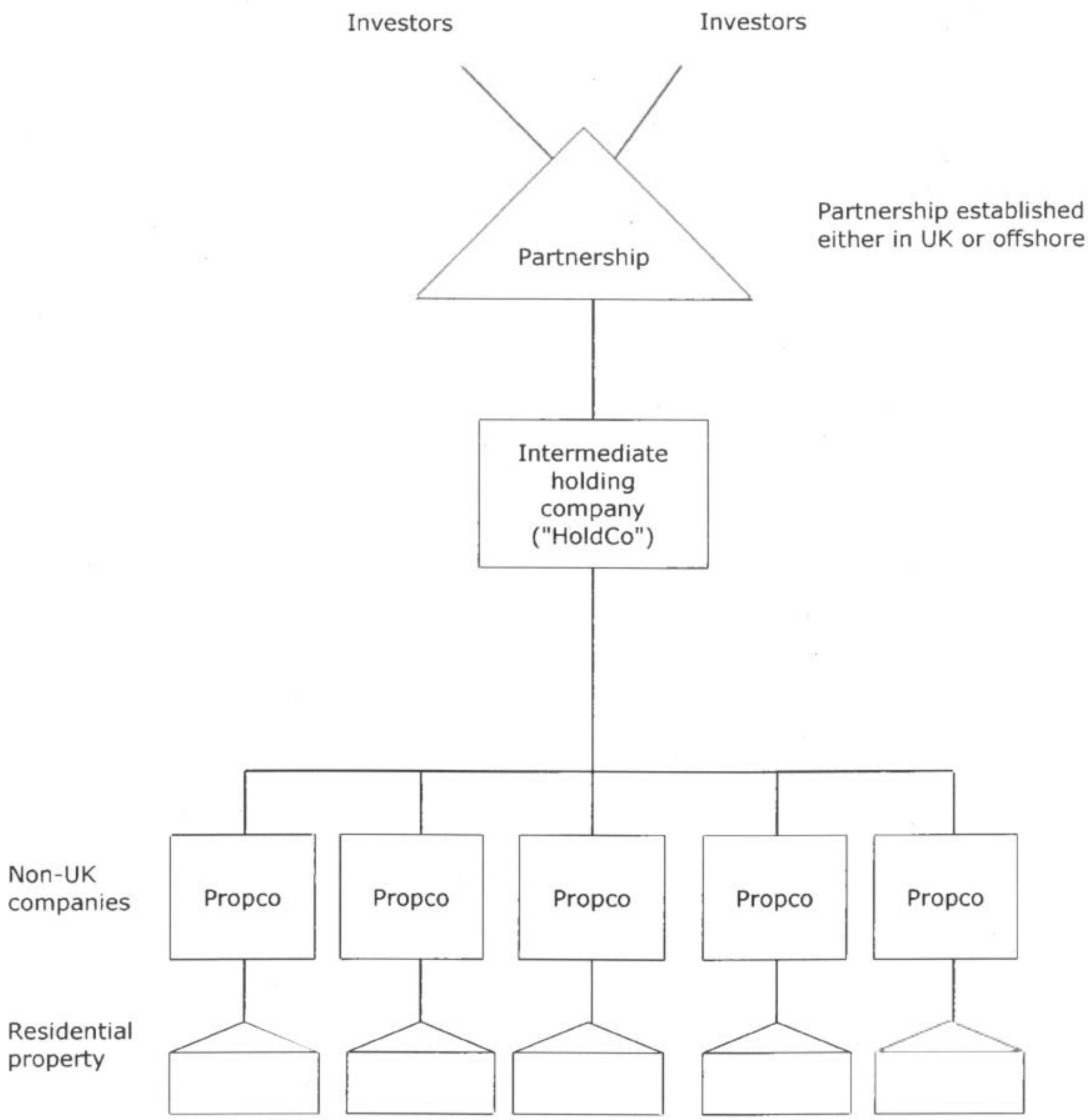
Structure 1



Structure 2


Investors
Partnership
Non-UK investor vehicles
Lux HoldCo
Lux Sub-HoldCo
Jersey resident company
UK Residential Property
German Property
Spanish Property
French Property

Structure 3


Investors
Investors
Partnership
Partnership established either in UK or offshore
Intermediate holding company ("HoldCo")
Non-UK companies
Propco
Propco
Propco
Propco
Propco
Residential property