Consultation RESPONSE

Implementing a capital gains tax charge on non-residents

Date: 19 June 2014

Introduction

1. The CLA is the membership organisation for owners of land, property and businesses in rural England and Wales. We help safeguard the interests of landowners and those with an economic, social and environmental interest in rural land and the rural economy. Between them they own and manage about half of the rural land in England and Wales.

2. The CLA welcomes this opportunity to respond to the consultation document 'Implementing a capital gains tax charge on non-residents' published on 28th March 2014 (the consultation).

3. It is clear from the foreword to the consultation by the Exchequer Secretary that the policy aim is to remove an existing disparity in the UK tax regime. The effect of this disparity is that UK resident individuals are subject to capital gains tax (CGT) on disposals of any residential property that is not their primary residence whereas the UK does not generally charge CGT on disposals by non-residents.

4. The CLA welcomes the statement by the Exchequer Secretary that the proposals are intended to address the current imbalance between the treatment of UK and non-UK residents disposing of UK residential property. Nevertheless, the proposals in the Consultation, as they stand, will leave a significant imbalance between UK resident and non-UK resident taxpayers in relation to properties acquired before April 2015. The non-UK resident will only be taxed on gains arising after April 2015, while the UK resident may be taxed on gains going back as far as March 1982. To correct this imbalance, it is suggested that UK resident owners of residential property acquired before April 2015 be given a right to elect that they be treated for CGT purposes as having acquired it on 31st March 2015 for its value at that date.

5. Whilst we understand the Government 's objective and desire to remove this disparity, this should not be done by changing the existing CGT regime in a way that will penalise UK tax residents by limiting or removing the right to elect which of two or more residences is the main residence.

6. We would summarise our views, which are explained in more detail below as follows:

   (a) There should be no change to the ability of UK taxpayers to make an election as to which home is their main residence.

   (b) The right to elect should not be extended to non-residents who are resident outside the EEA but should be extended to EEA residents.

(c) Non-residents are to be given the ability to make the election but if they exercise this ability they will be treated as resident for all other tax purposes (see paragraph 14 and the proposed amendment to the statutory residence test in Annex A).

(c) If the right to elect is removed, the test to determine which residence is the main residence should not be a day counting test but should take a holistic approach to ascertain the nature of the occupation as suggested at paragraph 3.5 point 1 of the consultation (i.e. which one is "home" (see paragraph 11)).

The right to elect the main residence

7. The consultation proposes withdrawing a taxpayer's right to elect which of two or more residences are to be treated as the taxpayer's main residence for the purposes of private residence relief (PRR). We object strongly to the removal of the ability of UK taxpayers to make an election.

8. We believe that the suggested options for determining a taxpayer's main residence (see paragraph 3.5 of the consultation) instead of making an election will be detrimental to some UK taxpayers. The proposals will have a particularly harsh effect on the individual who owns only one property, which he lives in when he can, but lives elsewhere in rented accommodation for work reasons; the proposals may mean that he loses PRR altogether. In our view this does not meet one of the stated overarching objectives of the consultation, namely fairness.

9. We are also concerned that the proposals will lead to onerous record keeping requirements as a result of the suggestion in paragraph 3.4 that "taxpayers may be asked by HMRC to demonstrate their entitlement to [PRR]." We anticipate that this will require taxpayers to document the time spent in and other relevant ties to each residence, a requirement that is not currently generally necessary. This will be an added burden for taxpayers. The ensuing tax calculations would result in applying periods of PRR exemption for each period of occupation thus creating another layer of complexity. It is inappropriate to change the tax regime to remove the ability to make an election (a process that is understood by taxpayers and advisers) and to replace it with one where there is an element of uncertainty as to whether relief will be available (and where it is likely that taxpayers will have to instruct advisers to assist them to claim the relief). This does not meet the overriding objectives as to fairness (as there will be an increase in costs to taxpayers) or simplicity.

10. The consultation also confirms in paragraph 3.7 that apart from the removal of the ability to make the election the Government does not intend to make other changes to the rules for the CGT exemption. The CLA encourages this stance, in particular in relation to section 222 (8) TCGA 1992 (exemption for property intended to be occupied by person required to live in job-related accommodation). This exemption is important in ensuring that farm and estate employees who have to live on the farm, or estate, and tenant farmers required to live in farmhouses on let farms, are able to provide themselves with retirement homes.

11. Apart from those who are obliged to live in job-related accommodation as defined in the above noted provisions of TCGA 1992, members of farming families and other families in the countryside often have to seek work in towns and cities for economic reasons. As a result these individuals have no choice but to live in rented accommodation close to their place of work. They may nevertheless own part of the family property, perhaps as a result of inheritance. These individuals would be particularly harshly treated by the loss of the right to make the election if the main residence were to be defined by the rigid rules suggested in paragraph 3.5 of the consultation taking account only of the physical presence of the taxpayer.

12. If the right to elect is removed, then option 1, in which a holistic approach is taken to the nature of occupation, would be preferred. The CGT exemption is intended to be given to the gain arising when a taxpayer disposes of his home. It might not be possible simply to adopt the test suggested by Pliny the Elder ("Home is where the Heart is"). However, the approach taken by Nourse J in *Frost v Feltham* (1981) STC 115 and the guidance in CG64545 of the HMRC CGT Manual ("Home is where HMRC send tax returns and assessments") have much to commend them.

A European right to elect?

13. The Government has suggested that, pursuant to the objective of charging CGT on disposals of residential property by non-residents, the right of UK resident taxpayers to elect which of two or more properties shall be treated as their main residence shall be removed or severely curtailed.

14. The consequence of this is that to benefit from PRR a property must factually be an individual's main residence. This might continue to limit the relief to individuals actually resident in the UK for *all* tax purposes.

15. The simple solution may be to limit the ability to make an election to those who are UK resident for all tax purposes. There does not seem to be any legal objection to taking this course so far as it applies to those who are resident outside the European Economic Area (EEA). It could be provided that an election by a non-EEA resident to treat a UK property as their main residence is also treated as an election by that person that they are to be treated as UK resident for all tax purposes. This can be achieved by a simple amendment to the statutory residence rules in Schedule 45, Finance Act 2013. See Annex A for our suggested amendment to paragraph 8.

16. However, we appreciate the concerns the Government has to ensure that it is not seen to discriminate against citizens within the EEA, particularly as there is a legal objective in the Treaty on the Functioning of the European Union relating to free movement of capital (see Articles 63 and 65 which are set out in Annex B).

17. It is suggested that the Government objective could be substantially achieved, without offending the sensibilities of its own citizens or the terms of EU legislation by:

(i) limiting the right to make the election to persons resident in the EEA and
(ii) limiting the exemption to a property situated in the EEA.

For further information please contact:

www.cla.org.uk

ANNEX A

Amended paragraph 8, Schedule 45 Finance Act 2013

(1) The second automatic UK test is that—

(a) P has a home in the UK during all or part of year X,

(b) that home is one where P spends a sufficient amount of time in year X, and

(bb) P has elected to treat his home in the UK as his main residence for the purposes of obtaining relief under section 222 Taxation of Chargeable Gains Act 1992; or

(c) there is at least one period of 91 (consecutive) days in respect of which the following conditions are met—

(i) the 91-day period in question occurs while P has that home,

(ii) at least 30 days of that 91-day period fall within year X, and

(iii) throughout that 91-day period, condition A or condition B is met or a combination of those conditions is met.

Suggested amendment highlighted in bold italics

ANNEX B

Treaty on the Functioning of the European Union (OJ C 326, 26/10/2012, p. 47–390)

ARTICLE 63 (ex Article 56 TEC)

1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited

ARTICLE 65 (ex Article 58 TEC)

1. The provisions of Article 63 shall be without prejudice to the right of Member States:
   (a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;
   (b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.

2. The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with the Treaties.

3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63.

4. In the absence of measures pursuant to Article 64(3), the Commission or, in the absence of a Commission decision within three months from the request of the Member State concerned, the Council, may adopt a decision stating that restrictive tax measures adopted by a Member State concerning one or more third countries are to be considered compatible with the Treaties in so far as they are justified by one of the objectives of the Union and compatible with the proper functioning of the internal market. The Council shall act unanimously on application by a Member State.

This is amplified by **Directive 88/361/EEC of 28th June 1998**, the relevant provisions of which seem as follows:

ARTICLE 1

1. Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I.

2. Transfers in respect of capital movements shall be made on the same exchange rate conditions as those governing payments relating to current transactions.

ANNEX I - NOMENCLATURE OF THE CAPITAL MOVEMENTS REFERRED TO IN ARTICLE 1 OF THE DIRECTIVE

II - INVESTMENTS IN REAL ESTATE (not included under I)

A - Investments in real estate on national territory by non-residents

B - Investments in real estate abroad by residents