Response to the Consultation Document: Implementing a Capital Gains Tax Charge on Non-Residents

This response is prepared by and represents both her views and the views of the Expat Tax Forum (the Association of Independent Expat Tax Practitioners "AIETP"). It is prepared in response to the March 2014 consultation document on "Implementing a Capital Gains Tax Charge on Non-residents".

The AIETP is an association of tax practitioners specialising in expat taxpayer clients. As such, it is largely a private client group, with a range of clients from standard employees moving in and out of the UK, to ultra high net worth non-doms. Charter Tax Consulting Ltd similarly has a large number of clients in this category. The proposed changes to the capital gains tax regime will therefore significantly impact upon this client group.

Below is a summary of the questions raised, and our responses thereto. Overall we would, though, like to thank government for taking the time to have a proper consultation on these points.

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

It is noted that it is the stated intention of government to ensure that residential property that is primarily for communal use, such as boarding schools and nursing homes, are not affected by the extension to the CGT charge. We can see no objection to this strategy.

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

Our group has no strong views on this.

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

It is noted government believes that it is right to tax non-residents on gains on UK residential property and that as part of this, government understands that it is necessary to consider charging gains made on disposals of UK residential property through different forms of non-resident entity, as well as disposals made by non-resident individuals who own and dispose of UK residential property that they own directly.

With regard to the use by non-residents of partners as a vehicle to own UK residential property, it is noted that government believes that the current basis of taxation of partnerships should continue to apply – in other words that the partnership should be transparent such that any capital gains are taxed on the partners.

We would agree with government that there is no need to change the existing partnership rules; partnerships would remain as transparent and it would be a natural consequence of the extension of the capital gains tax charge to non-residents that if the partnership has non-resident partners then those partners will then start to be taxed on "their" share of any partnership gains.

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

Where the trust is a non-resident trust, with entirely non-resident beneficiaries, then the proposition to charge the non-resident trustees on disposals of residential property should be relatively straightforward. However, the position of UK resident beneficiaries/ a UK resident & domiciled settlor would complication the position. It may be useful here to consider the different charging mechanisms as follows:

Where the trust is settlor interested and subject to s.86, TCGA 1992, the gain would be attributed to, and taxed on, the settlor. In this case the legislation must be clear as to whether the trustees still pay the capital gains tax, and then the settlor gets a credit for this against his s.86 charge, or whether it may be simpler to just draft the extension to the capital gains tax charge on the basis that where s.86 is in point, there is in fact no charge on the non-resident trustees. The latter would seem a simpler solution.

With regard to the s.87, TCGA 1992 charge, as discussed during the consultation meetings, a key issue is that potentially an offshore trust may realise a gain, on which the new capital gains tax charge is paid. However, potentially any trust gains are matched to benefits given to trust beneficiaries (sometimes in effect retrospectively, if the benefit was given prior to the making of the gain). In effect a double charge could therefore be created. The potential solutions to this would appear to be either to give a tax credit to the beneficiary with the s.87 charge or to take the gain out of the s.87 pool altogether.

The way in which the s.87 matching system works could potentially mean that, for example, the residential property gain is not immediately attributed and would stay in the pool. As and when later gains are made in the trust, these would mean that discrepancies could arise between the date on which the residential property gain is matched and the date that other gains are matched such that, for example, an individual who has been a trust beneficiary using the trust property might find that the s.87 pool matches gains to them other than the actual property gain. Potentially this could give results that a beneficiary who has occupied property might not expect. A tax credit system to bring a tax credit into the s.87 pool could go some way to alleviating any perceived unfairness in this respect.

An alternative, and arguably simpler route, would be to exclude the residential property gains from the s.87 pool. This does have the advantage of simplicity. However, if the trust potentially pays a different rate to the beneficiary, then unfairness could arise either in the eyes of HMRC or of the taxpayer, depending upon whom the rate differential favours!

The calculation requirements of the Schedule 4B, TCGA 1992 pool must also be considered; the deemed disposal requirements therein could create a double charge to taxation unless there is some sort of offset against the actual charge when it later arises. A simpler approach could be just to remove residential property gains from the calculation requirements of Schedule 4B.

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?

This (and the answer to points 6 & 7 below) was discussed to good effect in the consultation group meetings and HMRC's willingness to ensure that genuinely diverse funds should be protected is appreciated.

As the GDO regime already exists, it would seem unnecessary to "reinvent the wheel" in this respect, as the legislation could be used more or less as is, subject to just clarifying that REITS can still give rise to a diverse ownership and to also clarifying the position with regard to partnerships (such that for large partnerships, when considering whether parties are connected, their connection by virtue of just being in a partnership should be ignored).

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

See Question 5 above.

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?

See Question 5 above.

Question 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?

The first thing to note here is the interaction between the new capital gains tax charge for non-residents owning UK residential property and the existing (recently introduced) ATED regime. To have some property disposals within the ATED regime and some property disposals within the newly extended capital gains tax charge would, in our view, create excessive compliance issues, not to mention the possibilities for additional cost, complication and arbitrage between the two systems. ***We therefore would strongly urge government to repeal the ATED capital gains tax related charge, in favour of simply applying the same (newly extended) capital gains tax charge to all non-residents.***

We understand that government wishes to retain the ATED legislation and that the ATED regime is designed to be deliberately penal. However, if this is the desire of government, this can still be achieved by, for example, increasing the ATED annual charge, rather than maintaining a higher ATED related capital gains tax charge and thus manufacturing a need for the ATED related capital gains tax charge regime to run along side the newly extended capital gains tax regime for non-residents disposing of UK residential property. We note that this point was made strongly by all parties at the consultation meetings.

It may also be interesting for government to consider that in effect the introduction of the extended capital gains tax charge to non-residents owning UK residential property will mean that it could become more favourable for non-residents to own UK residential property through offshore companies, so that they might later sell the shares in the company (and avoid a capital gains tax charge) rather than sell the property. Although it will naturally be tempting for HMRC to have legislation to deal with this problem, our anticipation would be that at least some double taxation treaties would override any such attempt. If the view is taken that government will not be able to successfully tax such share disposals in all situations, then in fact it may therefore become genuinely more attractive for government to increase the annual ATED charge but yet feel able to remover the ATED related capital gains tax charge.

Another key point will be the impact of s.13, TCGA 1992. If the non-UK company making the UK residential property disposal is closely held, then any UK participators may experience an attribution under s.13, TCGA 1992. Presumably HMRC will accept that the tax paid by the non-resident company can be given as a credit, or alternatively be regarded as outside of the s.13 regime.

Government should also consider the ability to offset losses not just from other UK property disposals but from any other property disposals of other EU properties should potentially, in the light of the EU anti-discrimination position.

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?

As noted at our answer to question 8 above, we strongly feel that there should be one capital gains tax regime for all non-resident owners of UK residential property, and the existing ATED related gains charge should be replaced.

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

As raised during the consultation group meeting, the key issue here is the ability for taxpayers to have certainty over which property will qualify for the PRR. The ability to use the election, as it exists at present, gives the ability for taxpayers to obtain such certainty, thus massively reducing compliance costs for taxpayers and government alike.

The world has moved on significantly since the initial writing of the PRR election rules. Nowadays it would be very common for individuals to have more than one home, whether in the UK and abroad. Indeed, some may have three or more homes. Consider in particular the case of an international executive, travelling between a number of different countries, with a property in each country; he stays in each, has his set of clothes in each and has social circles at each place. Perhaps he has no wife and family. Which property is he resident in? Or consider the couple with a home in Manchester, where the wife and kids are based, but the husband works in London mid-week and spends his time at the London flat; the family also have a holiday home in the West Country and increasingly spend time there, and will intend to move there in due course. On a day count basis maybe the husband spends most of his time in London but the family are not there and indeed the family home is migrating from Manchester to the West Country. Which must we consider to be the main residence, and from who's perspective, given that husband and wife may only have one "main residence"?

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?

Both approaches are highly problematic. We would strongly favour continuing with the ability to make the PRR election where there are multiple homes that could be regarded as one's main residence. See Question 12, though, for further comment.

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

As discussed during the consultation meeting, we would have some sympathy with HMRC wishing to introduce certain minimum requirements in order for a property to be regarded as a taxpayer's main residence, eligible for PRR. Potentially one might envisage something such as the taxpayer having to satisfy one of a number of possible criteria in relation to the residence, such as spending at least, say 45 days there, or that the property has been an individual's only home in one of the last 5 years (say), etc.

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 would suggest that it would be virtually impossible for accountants acting to be able to become an effective mechanism for the application of withholding tax as accountants would seldom be in receipt of client funds in order to achieve this. Potentially the conveyancing solicitors could be in this position but not necessarily reliably so – for example what would happen if the property is transferred as a gift or at an undervalue? Or what would happen if there are competing demands on the solicitors, such as an undertaking to first pay off debt secured on the property?

As such, we would not be in favour of trying to require any third party to act as some sort of collecting agent for the tax.

In terms of alternatives, it will anyway often be the case that the property is let, and thus the owner is already registered under the NRL scheme. So potentially this existing self assessment scheme could be used to collect the tax. Likewise, for companies already under the ATED regime. Where it I possible to use existing systems then this must be the obvious choice.

An approach of having the purchaser apply a withholding tax could be considered, if desired, and there would be precedent for this in other countries (e.g. the USA).

QUESTION 14: ARE THERE WAYS THAT THE WITHHOLDING TAX CAN BE INTRODUCED SO THAT IT FITS EASILY WITH OTHER PROPERTY TRANSACTIONS PROCESSES?

In terms of a reporting mechanism, tying this in with the SDLT reporting regime would seem sensible.

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?

Definitely.

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?

Use of self assessment does indeed seem sensible. However, the 30 day time limit could be problematic; for example, what if the property was held in a more complex structure (e.g. partnership) and the gain must be calculated and allocated between the partners.

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