aat

AAT RESPONSE TO HM TREASURY AND HMRC CONSULTATION DOCUMENT ON: IMPLEMENTING A CAPITAL GAINS TAX CHARGE ON NON-RESIDENTS

1 EXECUTIVE SUMMARY

1.1 The Association of Accounting Technicians (AAT) is pleased to be given the opportunity to respond to HM Treasury (HMT) and HMRC's (HMRC) consultation document (Condoc) "Implementing a Capital Gains Tax charge on non-residents", which will apply from April 2015.

1.2 AAT acknowledges that the Condoc seeks to introduce a fundamental change to the UK's capital tax treatment of property and is concerned that it seeks to introduce further change shortly after the Annual Tax on Enveloped Dwellings (ATED) regime in 2013. Furthermore, although we recognise that in the popular imagination bringing non-residents into a tax charge already incumbent on residents will be regarded as fair, in reality it will introduce more piecemeal legislation which will inevitably add further layers of complexity to what is generally held to be an overly complex tax code.

1.3 AAT notes that the overarching objectives for the capital gains tax (CGT) charge on non-residents disposing of UK residential property are:

- **Fairness**: the primary aim of the new regime is to ensure that the tax treatment of non-residents who own and make gains on UK residential property is comparable to that of UK residents.
- **Sustainability**: the new regime will be introduced in a way that can be maintained without risk of significant abuse going forwards.
- **Simplicity**: the new regime will be introduced in a way that minimises complexity as far as possible.

1.4 HMT and HMRC acknowledge that they need to balance these different objectives against each other in deciding on the appropriate design for the extended capital gains tax regime.

1.5 AAT particularly notes the objective of simplicity. However, any change is certain to add to the complexity of the UK's tax legislation once anti-avoidance measures are introduced.

1.6 AAT notes that the **HMT and HMRC** intend to focus the extended CGT charge:

> "on property used or suitable for use as a dwelling i.e. a place that currently is, or has the potential to be, used as a residence. This will include property that is in the process of being constructed or adapted for such use. "

1.7 AAT notes that that it is stated within the Condoc that there is no intent to change the tax treatment for property, such as office and industrial buildings, which cannot be used as and are not in the course of being converted to a place to live.

1.8 If it is the Government's aim to strive for simplicity, then we would recommend considering standardising the definition of "dwelling" across the UK's tax legislations. At present there are different definitions for:

- VAT
- Stamp Duty Land Tax (SDLT)
- ATED
- CGT

1.9 AAT has reservations about the term "suitable for use as a dwelling" we are concerned that uncertainty already exists as to which buildings would qualify as being recognised as a dwelling and which would not.

1.10 This may drive non-residents to adapt their UK properties such that they are not suitable, hoping that the tax implications will be more favourable.

1.11 AAT believes that any legislation seeking to introduce the proposed changes would need to clarify what would happen if a former residence was demolished and subsequently sold as a plot.

1.12 It would also need to clarify whether or not a building plot with planning permission for a residential property to be built would fall within the scope of the proposed charge.

1.13 AAT also believes that mixed-use buildings are likely to prove to be a problem area and that consideration will be needed into how the proposed regime deals with their classification. Will such properties be deemed to be mixed residential and non-residential or forced to be treated as solely residential or non-residential?

1.14 Whilst AAT notes that the purpose of what is being proposed is that it is intended to capture lower value properties that are not caught by the ATED, we believe that it would be prudent to set a de minimis value to balance revenue collection against administrative costs.

1.15 Whilst we have not undertaken a costing exercise we consider that a practical de minimis ceiling would be £50,000.

1.16 AAT notes that the proposed regime will apply to domestic properties whether occupied or rented out, whether owned by individuals, partnerships, trusts or companies. Therefore, the new charge will only apply to UK residential properties held through an offshore company and where they are not already caught by the ATED regime.

1.17 We believe that the absence of a suggestion that non-residents will be taxed on gains arising from the disposal of shares in companies holding UK residential property such as Real Estate Investment Trusts (REITs) may push non-residents into REITs structures as a way of avoiding the new charge.

1.18 Similar behavioural changes have occurred under the extended CGT regime for non-natural persons, this leads to the somewhat perverse result that a non-UK resident company may have to pay CGT on the sale of a UK residential property, but a sale of shares in the company itself may fall outside the scope of CGT.

1.19 Another area that we consider will need further consideration is the issue of losses. Any ensuing legislation will need to clarify whether or not the normal offset rules for current and brought-forward losses will still operate.

1.20 Taking into account that under existing legislation a UK resident can offset a gain arising from the disposal of a UK property against a loss on an overseas property we consider any legislation that might arise out of this particular consultation will need to reflect on and clarify whether or not such rules will be available for a non-resident.

For example: a Hong Kong resident with capital losses which have arisen both in Hong Kong and the UK and who also has a UK capital gain arising from the disposal of an residential property will need to know to what extend his losses be available for set-off.

1.21 AAT believes that further consideration needs to be given to the operation of the mechanism that will capture gains accruing only after April 2015.

1.22 In particular we believe that clarification will be needed in respect of whether or not gains will be apportioned across the whole period of the ownership, or whether there will be a level of rebasing as at April 2015.

1.23 If there is to be a rebasing we foresee that there will be requirements for valuations to be prepared by a suitably qualified valuer at the time of disposal which will lead to an extra layer of compliance costs being incurred by the would-be taxpayer.

2 RESPONSES TO CONSULTATION QUESTIONS

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

2.1 There is a possibility that such an exclusion could lead to a behavioural change that might make investing in communal property relatively more attractive, in that non-residents might make the switch from investing in ordinary residential property to avoid the proposed new charge. If this was to happen then a change in tax legislation might lead to a distortion in the property market.

2.2 Taking into account past changes in UK tax legislation there is a possibility that any worries might prove to be unfounded as evidenced by what happened when the VAT option to tax (OTT) was introduced. Initially there was a fear that the introduction of an OTT would lead to the establishment of

a two-speed property market in the UK. Ultimately, this fear proved to be unfounded.

2.3 We are concerned that if commercial and industrial properties are excluded from the charge it is likely that non-residents looking for capital appreciation in their UK property portfolio will consider diversifying into such property solely on the basis that on liquidation of a UK-based portfolio it will not be taxed in the UK. Alternatively, non-resident investors could choose to invest in REITs which are not currently within the proposed scope of the extended CGT charge.

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

2.4 The Condoc reveals that the new charge should cover student accommodation except where it comprises a hall of residence which will be exempt.

2.5 Boarding school accommodation is also excluded under the current proposals.

2.6 It is hard to see the immediate logic behind this split. Take for example the position faced by on overseas investor considering investing in student accommodation situated on a campus, the investor will face the potential of two tax treatments depending on whether it is within the scope of the exemption or not.

2.7 We consider that any ensuing legislation will need to clarify how houses in multiple occupation (HMOs) will fall to be treated for CGT purposes and what difference would it make if the HMO property is situated within a university campus.

2.8 We also consider that there are other forms of residential accommodation which will need to be examined such as monasteries and other faith-based communes to ensure that their capital gains tax treatment under any proposed legislation is clear.

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

2.9 AAT declines to comment in respect of the above question.

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

2.10. AAT declines to comment in respect of the above question other than to observe that any legislative change arising from this consultation should consider the provisions of ss86 and 87 of the Tax of Chargeable Gains Act 1992 (TCGA) and the trustee relief provisions in s225, of the same act.

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?

2.11 It is axiomatic that when further rules are added to the UK's tax legislation, people will look to ways of avoiding it.

2.12 AAT considers that the GDO will probably work, but at the same time is concerned that policing the test may prove challenging and costly.

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

2.13 The main difficulty with respect to the design of a GDO test is ensuring that the wording of the definitions are sufficiently tight and all encompassing to ensure the policy objective is met.

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?

2.14 AAT declines to comment in respect of the above question.

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?

2.15 AAT declines to comment in respect of the above question.

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?

2.16 AAT has no comments on this question beyond hoping that the relationship between the proposal outlined in the Condoc and the ATED-related CGT provisions are given careful consideration.

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

2.17 The Condoc proposes removing the ability to make a main residence election with HMRC, for the purposes of the CGT main residence exemption. We acknowledge that this is to prevent non-residents avoiding the new CGT charge on their only UK property by making a main residence election.

2.18 Instead, HMRC would determine an individual's main residence by looking at the facts or by a day counting rule.

2.19 Changing the main residence election regime for everyone would also prevent UK residents from making an election and although this would lead to the end of the 'flipping' process, it is a fundamental change to a long-established procedure, which although open to abuse, has a useful and helpful base in people's lives where say they live in the city during the week (4 nights), but have a home in the country at weekends (3 nights). The PPR election allows them to determine their PPR on the basis of their own circumstances and choice, rather than having HMRC determine it on a day count basis.

2.20 Taking into account that HMRC can already look through an election if it believes it to be a sham, then it may be that this area is best left alone. We suggest that existing mechanisms already work and that there is actually no requirement for extra layers of legislation to be introduced.

2.21 If PPR rules are to be changed we consider that subsidiary lettings relief would need to be reviewed in the light of the proposed changes.

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?

2.22 The first proposal requires the non-resident taxpayer to provide "proof" that the residence is his or her PPR which is the current position in instances where there is an absence of a PPR election, or if HMRC believes the PPR election to be a sham.

2.23 As the proposal would impose extra burdens on the taxpayer and HMRC alike, it is not our favoured option.

2.24 In contrast a fixed rule ought to be simpler, but a person's main residence may change from year to year so, if this approach were to be adopted, there will of necessity be a requirement for more complicated rules to cope with this fact.

2.25 Matters could be further complicated in instances such as if a non-resident taxpayer, knowing that a sale is imminent, spent time in the UK in the year of sale to establish occupation in the year.

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

2.26 Given that both of the proposed bases suffer from problems, it could be that simply denying the relief to non-residents would be a simpler option.

2.27 Although, at first consideration, our proposal may seem unfair there are other areas in the existing tax legislation where overseas entities are denied advantages available to resident entities; for example the VAT registration threshold available to UK resident entities is not available to non-established taxable persons.

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.

2.28 AAT considers that an unacceptable burden on those outlined in Question 13 by requiring them to ask searching questions of non-resident clients, without any certainty that the answers given in respect to their questions are right.

2.29 We are particularly concerned that this aspect of the proposal could lead to the professional involved being personally and professionally at risk if the answers given subsequently prove to be incorrect.

2.30 Notwithstanding our above comments we consider that the real and practical choice is only between Self Assessment and the introduction of a collection mechanism akin to that operated under the SDLT regime (i.e. the solicitors collect the money and pay it over within 30 days of the relevant date together with the return).

2.31 Taking the above into account we consider that a SDLT clone would appear to be the most practical solution.

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

2.32 It is hard to see any alternative other than a straight choice between an SDLT type collection mechanism and collection through SA. The SDLT route would appear to be the better, cleaner route on the basis that solicitors and conveyancers already understand the system.

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?

2.33 As a principle of equity this would appear to be reasonable.

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?

2.34 AAT considers that non-residents could use the current self-assessment regime and its existing filing rules as-is to submit their final computations. We do not consider that it would be reasonable to expect non-residents to file final-returns within a 30 days window for a whole variety of reasons. For example, in many instances professional valuations have to be sought and agreed with HMRC.

3 CONCLUSION

3.1 AAT noted (para 1.3) that the overarching objectives for the CGT charge on non-residents disposing of UK residential property are fairness, sustainability and simplicity. However, we are concerned that the objective of fairness in bringing non-residents into a tax charge already incumbent on residents, is taking priority over simplicity.

3.2 Our view overall is that these proposals will require much further thought and discussion with the professional bodies, with possible further consultation once the results of this consultation have been digested.

4 ABOUT AAT

4.1 AAT has over 50,000 full and fellow members and 75,000 student and affiliate members worldwide. Of the full and fellow members, there are 4,000 Members in Practice (MIPs) who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types (figures correct as at 31 March 2014).

4.2 AAT is a registered charity whose objects are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

4.3 In pursuance of those objects AAT provides a membership body. We have drafted our response on behalf of our membership.

5 FURTHER ENGAGEMENT

If you have any questions or would like to consult further on this issue then please contact AAT at:

Association of Accounting Technicians
140 Aldersgate Street
London
EC1A 4HY