HMT/HMRC: Implementing a capital gains tax charge on non-residents

Response by Wellcome Trust

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Key Points

- Charities should be granted a specific exemption from the application of the new regime.
- Gains subject to the new regime, whether or not taxed under the new regime, must be excluded from section 13 TCGA 1992
- Where charities invest in a non-resident fund the fund's tax liability should be calculated on the basis that the proportion of the capital gains that is attributable to the charity investors is exempt from the tax charge.
- Where anti-avoidance provisions are required the legislation should include a motive or purpose test rather than a wholesale denial of the charities exemption.

INTRODUCTION

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GENERAL COMMENTS

3. It is common for UK charities to invest a significant part of their investment portfolio in residential property. Where the charity seeks to diversify its exposure by means of indirect investment through a fund, the fund will not necessarily invest exclusively in UK property. Funds which have a broader geographical focus are likely to be marketed to investors outside the UK as well as to UK residents, in which case the fund will commonly reside in a foreign jurisdiction. The fund manager will generally have broad discretion to select particular properties for acquisition within limited pre-

set parameters (e.g. as to the maximum capital that can be committed to a single country). Aside from these parameters the investors do not generally have any ability to control the individual investment decisions made by the fund's board.

4. The summary of the current tax treatment of UK property ownership in Table 2.A on page 13 of the consultation paper is incomplete. In particular it does not explain that the anti-avoidance rules that attribute capital gains of non-resident companies to UK resident participators - i.e. the rules in section 13 Taxation of Chargeable Gains Act 1992 (TCGA) – also extend to UK resident participators in non-resident unit trusts as a result of section 99 TCGA which treats units in a unit trust scheme as if they were shares in a company.

5. The provisions of section 13 TCGA are a concern to UK charities in this context because HMRC have taken the position that the exemption of charities' capital gains under section 256 TCGA does not extend to gains that are attributed under section 13. Consequently, where a UK charity invests in UK property that is owned by a non-resident entity the application of current tax law to the ownership structure could result in the charity becoming subject to UK tax on its share of any capital gains arising on a disposal of the UK property by the non-resident entity notwithstanding all other gains made by a charity are exempt. The reduction in the scope of section 13 as a result of the amendments made in the Finance Act 2013 will not necessarily remove this problem where investment in UK property is involved.

6. The consultation paper does not clearly explain the Government's intentions regarding the application of the new regime to UK charities. Given HMRC's position on the application of section 13 TCGA to charities, the Trust would be strongly opposed to the additional inclusion of charities in the new regime which could result in a double charge on gains which should not be taxed at all. We therefore believe that there should be a specific exemption for charities.

7. The benefit of an exemption for charities would be lost if the new regime imposed a tax charge at the fund level that could not be reclaimed by the charity. The Trust therefore considers that the fund's tax liability should be calculated on the basis that the proportion of the capital gains that is attributable to the charity investors is exempt from the tax charge.

RESPONSES TO CONSULTATION QUESTIONS

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

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

The Government proposes that residential accommodation for students should not be excluded from the scope of the new regime - unless it forms part of a hall of residence attached to a further or higher education institution (HEIs). Although this would be a more restrictive approach than has been adopted for ATED purposes, the consultation paper does not explain the reasons for this proposal. The forecast demand for communal student accommodation in the UK is unlikely to be met solely by the supply of buildings that are attached to HEIs, and it is unclear why an investor in one form of student accommodation should be favoured as against an investor in another. There is an established role for institutional investors to play in funding the construction of student accommodation, whether it is purpose built or adapted from an existing alternative use. The Trust believes that larger scale student accommodation buildings should be eligible for the same exclusion as traditional halls of residence.

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

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

Under current law capital gains accruing to a non-resident unit trust in which all the unitholders are exempt funds are exempt under s100(2) Taxation of Chargeable Gains Act 1992 (TCGA). These unit trusts should therefore be excluded from the scope of the new regime.

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?

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

The GDO test is one way to identify funds that should be excluded from the new regime, but it is not necessarily the best way to do so. There have been instances where an investor in what was originally a GDO fund became an investor in a closely controlled fund solely as a result of other unconnected investors leaving the fund.

The application of the test in practice can lead to inconsistent results as between the different legal forms used by funds or where the fund structure combines different legal forms (e.g. a feeder unit trust with a master limited partnership). In the case of fund entities that are treated as partnerships for UK tax purposes there is the added complication that under current law all partners are deemed to be connected with one another (e.g. under section 1122 Corporation Tax Act 2010), regardless of whether any real connection exists outside the partnership.

The Trust favours the approach that is already in use for the purposes of determining whether a Real Estate Investment Trust (REIT) is closely held. The test in section 528 CTA 2010 provides that a REIT will not be considered to be close solely by reason of one or more of the five or fewer participators being an "institutional investor". For this purpose institutional investors comprise pension funds, charities, insurance companies, registered social landlords, sovereign funds and collective investment schemes.

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?

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?

The avoidance of UK tax on capital gains that involves the ownership of UK property by a closely controlled non-resident company is already addressed by a specific measure (section 13 TCGA) which taxes a UK resident participator on its share of the capital gains arising in the non-resident company, regardless of whether the gains are distributed to the participator. This legislation is extended to non-resident unit·trusts by means of section 99 TCGA which treats units in a unit trust scheme as if they were shares in a company. A double charge to tax must not arise where this legislation applies to gains which will also be subject to the new regime .

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

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?

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

Questions 10 to 12 are not relevant to the tax treatment of charitable investors and we have no comments.

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.

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

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?

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 understand that since the consultation was launched the Government has decided (without any formal announcement of its intention) to replace the withholding tax proposal with a requirement for non-resident owners of UK residential property to file an election within 30 days after a sale of the property for one of three options:

- to make a payment on account (at a rate to be decided);
- to submit a computation of the tax due on the sale and pay the due amount;
- to confirm that the gain will be reported in the taxpayer's tax return when this is due to be filed.

The third option will only be available to taxpayers that have registered with HMRC and been allocated a unique tax reference (UTR) number.

While we appreciate that the details of this new proposal have not yet been worked out, the Trust would be concerned if the tax payable by the non-resident entity does not reflect the tax position of its UK resident participants, particularly where an exempt investor such as a charity is concerned. Even if a UK charity is able to reclaim its share of the tax paid on account by a non-resident fund a significant delay in obtaining the refund could have an adverse effect on the charity's cash flow position.

CONCLUDING REMARKS

We understand that the proposals for the introduction of the new regime are driven by concerns about the risk of revenue loss arising from sales of UK residential properties that ultimately owned by non-resident individuals and that the Government is not targeting institutional owners of residential property. However, the consultation paper does not clearly articulate how charities are to be relieved from the burdens of the new tax charge. The Trust believes that it is imperative that the position of charity investors is protected by the provision of a specific exemption from the new regime.

We propose that charities be excluded from this new regime in the same way pension funds are to be excluded. With regard to the potential for a a double charge to tax under as a result of the operation section 13 TCGA 1992 we suggest that transactions within the new regime, whether taxed or not, should be excluded from a charge to section 13.

Should you require any further information concerning this submission please contact