trowers & hamlins

HM Revenue & Customs

By email only: capitalgains.taxteam@hmrc.gsi.gov.uk

your ref
our ref NXC
direct dial
email
date

Dear Sirs,

Consultation on non-residents

We welcome the opportunity to respond to the consultation document *Implementing a capital gains tax charge on non-residents* (the **Condoc**) published on 28 March 2014.

By way of background, we are an international firm of City lawyers with offices in the UK and the Middle East. As such we act for numerous corporate and individual clients wishing to invest in the UK real estate market, both residential and commercial.

Therefore, we take a keen interest in any proposals in relation to inward UK real estate investment.

We should also mention that this firm has attended the HMRC Capital gains tax charge on non-residents working groups *International rules (off shore companies and trusts; temporary non-residents, etc.)* and *Defining residential property*; and this firm attended the group discussion on *PPR*. Accordingly, some of the comments below reflect the discussions at those meetings.

We set out our comments below.

1 **Policy aim of the proposals**

1.1 It is important that the legislation in its final form should clearly reflect and implement the government's policy aim of these proposals.

1.2 As we understand it, the policy is to achieve fairness as between the capital gains tax (**CGT**) treatment of resident and non-resident owners of UK residential real estate. This is not the same policy aim regarding "enveloped" properties where, as we understood it, the aim was to impose new tax costs (i.e. ATED and ATED-related CGT) on such structures which in some cases were created with a view to securing a UK tax advantage e.g. elimination of a SDLT charge on sale of the envelope.

Although paragraph 1.6 of the Consultation Document *Ensuring the fair taxation of residential property transactions* published on 31 May 2012 also mentions, as a policy aim in the context of ATED-related CGT, the creation of more equal tax treatment

Trowers & Hamlins LLP
3 Bunhill Row
London
EC1Y 8YZ

DX 774 Lon/City
t +44 (0)20 7423 8000
f +44 (0)20 7423 8001

www.trowers.com

between residents and non-residents, we see this at an inevitable outcome of the legislation which emerged rather than a principle policy aim. In particular, paragraph 1.6 also states that ATED-related CGT is also designed to support ATED.

1.3 As a general point therefore, it seems to us that the eventual legislation should not be cast so widely that the original policy aim is forgotten. For example, this exercise should not stray into areas of perceived tax avoidance.

1.4 Finally, in this section, it is also worth bearing in mind that there is likely to be a significant collateral economic/fiscal effect if overseas investors choose to invest their funds elsewhere as a result of these proposals.

1.5 Consider, for example, the irrecoverable VAT on improvement/maintenance expenditure on the properties in question, and also VAT on other expenditure of individuals whilst they are in the UK. Additionally, there is spending on professionals such as designers and architects, estate agents and lawyers, producing income tax, corporation tax and NIC's.

Such expenditure assists the UK economy and HM Treasury's tax take.

We wonder what the net economic/fiscal effect of these proposals might be.

Consultation questions

Our comments are as follows:

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

2.1 We agree that, in principle, communal property should be excluded from the scope of the new regime.

2.2 Given that, as appears to be the case, the new CGT charge (**New CGT**) is in some ways an extension of the 15% SDLT, ATED and ATED-related CGT regimes, we are pleased to see that the Condoc specifically mentions property, also relieved from 15% SDLT etc, that is primarily for communal use, such as boarding schools and nursing homes.

2.3 However, we are disappointed to see that New CGT is proposed to cover residential accommodation for students except as part of a hall of residence *attached to an institution* (our emphasis). It is understood that the government feels that this formation will better enable excluded properties to be identified. However, in our experience,

much inward investment into student accommodation would be caught by New CGT under this definition. For example, investors who do not invest in university halls of residence but rather in blocks of flats which are rented direct to students or to another company which lets to the students.

2.4 In light of the above, a possibility might be to exclude properties which are *either specifically designed or adapted as, or used for* student accommodation, irrespective of whether the property in question is attached to an institution.

2.5 Planning use classes – it has been suggested that exclusion from New CGT might be based on the property having obtained planning permission under use class C3.

2.6 In our experience this will be problematic in relation to student accommodation, as follows:

2.6.1 Investors often do not invest in residential colleges (class C2), they invest in properties which are rented to a college/university or, more likely, direct to students or to another company which lets to the students. Currently, these properties are designed and built as cluster flats.

2.6.2 There is little consistency in the planning permissions or restrictions on use.

We have seen, for example, a planning application for a multi-use development including student accommodation. In relation to the student accommodation the application states that the property cannot be used as residential accommodation (other than for students) but no mention of which class into which the planning permission falls.

2.6.3 Some blocks are built as cluster flats which may not be restricted to use for students (and could presumably have got planning for use as dwellings) but in reality are leased to a university. For others there is a restriction on use. It is not clear to us that these restrictions on use will derive from the class of the planning permission.

2.6.4 We have seen an application which was expressly for a "student village" (including pub and car parking) and the use given was C3.

2.6.5 In relation to existing properties it could be that applications for C3 or C4 have been made and/or received, simply because that was the easiest approval to obtain. It would be capricious for the tax treatment to be determined, in effect retrospectively, by previous choices.

2.6.6 For VAT purposes it may be preferable for the building to be dwellings rather than a "relevant residential purpose" building. There could therefore be a tension between the position for VAT and New CGT. We think this should be taken into account in the legislation for New CGT.

2.7 An alternative approach may be to use as a starting off point the *wording* in C3, but without requiring that the building has *received* planning permission under C3:

Class C3. Dwellinghouses

Use as a dwellinghouse (whether or not as a sole or main residence) —

(a) by a single person or by people living together as a family, or

(b) by not more than 6 residents living together as a single household (including a household where care is provided for residents).

For example, it is understood that the government wishes to include within the scope of New CGT street properties which happen to be let to students. This would invariably be achieved by using the above formulation to define dwellings (as distinct from excluded student accommodation).

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

In general terms, we believe the exclusion for communal residential property should replicate, so far as possible, the 15% SDLT and ATED categories.

This will help to keep matters as simple as possible.

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

On the face of it, no, if the non-resident partner pays New CGT at the same rate as traditional CGT. Otherwise, commercial issues may arise, albeit that the tax position will presumably be straightforward.

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

5.1 There is potential for a double CGT/New CGT charge in circumstances where the offshore trustees are within section 86 etc TCGA 1992 and/or section 13 TCGA 1992.

5.2 Accordingly, it will need to be decided which tax regime takes precedence in relation to offshore trusts: those mentioned above or New CGT.

6 **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?**

We believe in principle that there should be a GDO exclusion; in particular this may assist in identifying excluded properties which would otherwise be in grey areas.

For example, an offshore fund which satisfies the GDO test invests in modern student accommodation designed as self-contained flats or clusters of flats. The safe haven of a GDO exclusion would avoid the need to establish whether the property is excluded from New CGT based on, for example, the tests mentioned in Question 1 above.

A GDO test would, however, leave individual investors in student accommodation potentially subject to New CGT.

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

It will be important to tailor the test to fund structures commonly used to invest in the UK residential sector.

8 **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?**

No comment.

9 **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?**

9.1 It is possible that the imposition of New CGT may deter potential inward investment in the UK residential sector.

As mentioned above:

1.5 Consider, for example, the irrecoverable VAT on improvement/maintenance expenditure on the properties in question, and also VAT on other expenditure of individuals whilst they are in the UK. Additionally, there is spending on professionals such as designers and architects, estate agents and lawyers, producing income tax, corporation tax and NIC's.

Such expenditure assists the UK economy and HM Treasury's tax take.

We wonder what the net economic/fiscal effect of these proposals might be.

The result of the above may, for example, be a reduction in the supply of residential accommodation for rent.

10 **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?**

No comment.

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

This may deter potential investment in the UK residential sector from both UK-resident *and* non-resident investors.

At the very least, the current election procedure is straightforward. Further complication may, quite apart from New CGT, deter investment.

12 **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?**

12.1 We think the second test is preferable because it is simpler. However, we fear it will have a knock-on effect on the investor's tax residence status, in which case it will become moribund we think for non-resident investors. In that case, the first approach would be preferable.

12.2 As a more general point, the proposals in the Condoc may have a serious impact on those who, for example, live in London during the working week and join their families at home elsewhere in the UK at weekends, and who might previously have elected to

treat the London home as their main residence simply because this was likely to be showing the bigger gain.

The same issue would arise for those who work abroad, spend most of their time abroad, but maintain a family home in the UK.

Similarly, for a non-resident who might one day become resident again, if a UK family home is sold and the proceeds reinvested in a replacement home for use on the eventual return here.

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

We would suggest retaining PRR in its current form if the non-resident or resident taxpayer has no main residence outside the UK.

This would replicate the current position for resident taxpayers.

14 **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.**

14.1 No, not least because this would almost certainly be beyond the scope and ability of most non-tax specialists. It would also potentially interfere with the conveyancing procedure, for example, the redemption of an outstanding mortgage on completion of the sale.

14.2 It is understood HMRC now prefers a payment on account mechanism. This appears to a promising development and we would be interested to hear more about it.

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

We believe not.

16 **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?**

No.

17 **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?**

17.1 As an initial point, we feel that 30 days is too short to submit a final computation. Instead, we think that non-residents should be subject to the same timescales, based on fiscal periods, as resident taxpayers.

17.2 In our view, a variant form is the better way forward, since many non-resident taxpayers will have no other UK tax exposure apart from New CGT.

Other comments

18 **ATED-related CGT** – it seems to us that ATED-related CGT should be abolished for property acquisitions after New CGT is introduced. Otherwise the tax regime for such properties will be in danger we think of collapsing under the weight of its complexity, with the possibility of multiple taxes on the same gain.

19 **Transitional period for New CGT** – this will need to be carefully considered, again with the aim of reducing complexity and unfairness so far as possible. As with the introduction of ATED-related CGT, gains accruing prior to the introduction of New CGT should not be taxed.

20 **Section 10A TCGA 1992** – this will also need to be carefully considered, particularly with regard to transitional provisions for New CGT.

It would be helpful to have some published guidance including worked examples on the interaction of New CGT and section 10A.

21 **Schedule 4B TCGA 1992** – once again, the interaction of this legislation with New CGT needs to be carefully considered.

For example, perhaps exclude properties potentially subject to New CGT from Schedule 4B, although properties going in and out of both regimes my result in undue complexity.

22 **Mixed use properties and properties moving in and out of use as dwelling subject to New CGT** - this will no doubt be a fairly complex part of the New CGT legislation.

Suffice to say that care will need to be taken to achieve as fair a result as possible for all taxpayers. It seems to us that a combination of say, floor area and/or industry

standard apportionment (e.g. a fat above a pub is generally taken to be 10% of the whole property) (mixed use properties) and time apportionment and/or rebasing (properties moving in and out of use as dwelling subject to New CGT) whilst avoiding "dry" tax charges, will probably be the way forward.

23 **Extra care villages and sheltered accommodation etc** – that is, residential properties, often communal in nature (in the non-technical sense), which include an element of care/attention.

A decision needs to be made as to the point at which the above categories of properties perhaps become communal in nature and therefore outside the scope of New CGT.

24 **Charities** - the Condoc does not specifically mention charities but as they are currently exempt from the ATED regime, we would presume that they would also be exempt from the New CGT regime subject to the same conditions.

25 **Social housing** – we would propose a parallel relief, as for ATED, for social housing, if the purchase is assisted by public subsidy.

Additionally, we would propose a relief for social housing activities carried on on a not-for-profit basis, with no public subsidy.

26 **Next steps** – it is understood and appreciated that following this consultation there needs to be a period of reflection for the government to consider the responses to the Condoc and the government's own response.

Having said that, however, it would be helpful if:

26.1 lines of communication could please be left open beyond the consultation period, including further informal consultation on discrete issues if necessary and/or requested.

26.2 the government's response could please published as soon as reasonably practical.

26.3 draft legislation could please be published as soon as reasonably practical.

We hope that our above comments are clear and helpful. We would be pleased to discuss any issue arising out of our comments should you feel it would be helpful to do so. In that case,

Yours faithfully