IMPLEMENTING A CAPITAL GAINS TAX CHARGE ON NON-RESIDENTS

Comments submitted on 20 June 2014 by Rawlinson & Hunter Chartered Accountants in response to the draft legislation published on 28 March 2014

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INTRODUCTION

1. In the 2013 Autumn Statement the Chancellor announced that capital gains tax (CGT) would be extended such that from 6 April 2015 it would be chargeable on future gains made by non-residents who sell UK residential property. Very few details were released beyond the policy intent and the "fairness" rationale behind it. A consultation document providing further details was promised in early 2014.

2. The promised consultation document (entitled *Implementing a Capital Gains Tax charge on non-residents)* was published on 28 March 2014. This set out the initial HM Treasury (HMT) / HM Revenue & Customs (HMRC) thinking on how the proposed extension of CGT to non-residents disposing of residential property would work.

3. HMT/HMRC have held a number of working groups (both high level and more detailed) during the consultation period at which various aspects of the proposals set down in the consultation document have been discussed; we have had the benefit of being party to those meetings through our involvement with STEP and the ICAEW Tax Faculty.

4. We have contributed extensively to the ICAEW Tax Faculty response and endorse the comments therein. As such, our response below considers the key issues and any additional points we feel are of importance that are not included within the ICAEW Tax Faculty response.

5. We hope that our comments are clear but, if there are any queries, we should be happy to discuss anything set down herein in greater detail.

6. We will be happy to take part in any future consultations.

WHO WE ARE

7. Rawlinson & Hunter is an international grouping of professional firms, specialising in financial and taxation advice. The UK firm is a practice of Chartered Accountants and tax advisers. Our response is made as a firm with considerable experience in dealing with private individuals with international interests.

8. Further information concerning Rawlinson & Hunter is available on the firm's website at http://www.rawlinson-hunter.com/.

OUR COMMENTS

The extension of CGT to non-resident individuals disposing of UK residential property

9. One of the fundamental principles of CGT was that it only applied to persons resident in the UK (prior to 6 April 2013 this was resident or ordinarily resident in the UK). This principle was undermined by the ATED-related CGT charge that was introduced from 6 April 2013 (applying to high value residential property subject to the Annual Tax on Enveloped Dwellings (ATED)). The announcement by the Chancellor that *"from April 2015, we will introduce capital gains tax on future gains made by non-residents who sell residential property here in the UK"* further eroded that principle.

10. The policy to extend CGT to non-residents disposing of UK residential property is regrettable, not so much because of any fundamental principle (for, as the Chancellor said, the taxation of foreign owned real estate is a widespread feature of many tax systems), so much as because of:
    - the piecemeal way that changes to property taxation have been put through in the past few years; and
    - the absence of any public consultation on the economic ramifications of the proposal.

    Had this policy been introduced (as we advocated) at the time when the ATED was being implemented, this would have been understandable, but such a rapid change in policy, adding to the complexity of a system already extremely difficult for foreign investors to appreciate, will be a cause of great concern.

11. The change proposed is so fundamental that we feel that it would be a significant mistake for it to be hurried. Rather, the proposal should be deferred and there should be a wider consultation on property taxation issues. This is particularly the case since changes to the main residence relief provisions (TCGA 1992, s 222 to s 226B) are required and main residence relief is of such importance to UK residents that it is not appropriate for changes to that relief to happen as a result of a narrow consultation considering non-UK residents.

The need for a consistent policy for the taxation of UK real estate

12. During the representations on high value residential property taxation in 2012/13, a case was made for a general extension of CGT, in place of the complicated structure of the ATED related proposals, but this was not taken up at the time. Foreign investors assumed that after the 2012 and 2013 changes there would be a period of calm and that a general charge had been rejected.

13. The announcement of a general charge less than a year after ATED-related CGT became effective and the current proposal that ATED-related CGT will continue has undermined the credibility of UK tax system as there is an impression of incoherence and undue complexity.

14. A consistent, dependable and comprehensible fiscal framework is vital to the credibility of a tax system. Constant changes to the underlying rules and/or undue complexity undermines trust. This is not just a tax compliance problem as there is significant evidence that foreign investors will not invest in jurisdictions if they have concerns with the stability and comprehensibility of the tax provisions.

Concerns around coherence, simplicity and competitiveness

15. Extending CGT to non-residents just for disposals of UK residential property is more complicated than a general extension to UK real estate. There are problems with definitions and the need for provisions to cover changes of use and mixed use. There are also various arguments for exclusions on economic and/or social grounds. Unfortunately, the more exclusions one has from the regime the more complex and incoherent it will become. As such, there is a fundamental tension between having a coherent and simple policy (which would be to tax non-UK residents on all disposals of UK real estate) and avoiding damaging the UK property market and inward investment into the UK.

16. We appreciate that the Chancellor's rationale for the policy is "fairness". We agree that "fairness" is important. However, we think that in this case simplicity and competitiveness are more important and that sometimes economic considerations require tax policy to be pragmatic. It seems to be accepted that extending the charge on non-residents to UK commercial property would be bad for the economy. Given the complexity of introducing this partial charge, and the concerns expressed about the negative impact it could have on the UK residential property market at a time when foreign investment is required, we feel that there should at least be a public consultation as to whether the anticipated tax revenue from the new CGT charge will outweigh the complexity and the potentially negative impact on the property market and inward investment into the UK.

ATED-related CGT should be abolished

17. At the time of the 2012/13 consultation on the changes to the taxation of high value residential property we stated that we supported the Government's objective of preventing artificial avoidance of SDLT but not the proposals. We were particularly concerned by the CGT proposals stating that *"CGT should not be used as a fall back for deficiencies in the SDLT legislation"*. We are still of this view and are even more concerned for the coherence of the CGT regime should a general CGT charge on non-residents disposing of UK residential property be introduced and the current ATED-related CGT regime be retained.

18. Furthermore, the potential complexity of having two potentially interacting regimes will make the tax provisions sufficiently complex that foreign investors will be deterred by that alone and look to invest in other jurisdictions with comprehensible tax rules.

19. We appreciate that the Government views ATED-related CGT as being an additional measure to penalise those who have "enveloped" UK residential property for reasons it does not consider to be acceptable. However, the introduction of a general CGT charge will make the retention of ATED-related CGT far more problematic. If the tax penalties applicable to "bad enveloping" must be retained then this should be done either by increasing the SDLT rate and/or by increasing the ATED charges so that there is overall tax neutrality.

20. Our preferred approach, because it is simplest, would be to abolish ATED-related CGT effective for all disposals effected on or after 6 April 2015. We appreciate that there would be some loss of tax as gains between 6 April 2013 and 5 April 2015 that would have been caught by ATED will fall out of charge. However, given the long-term nature of property ownership, it seems possible that the short-term impact on the Exchequer will be modest such that overall the simplicity benefit may outweigh the tax loss. If the tax loss of removing ATED-related CGT completely from 6 April 2015 is unacceptable then ATED-related CGT should be abolished for all gains accruing after 6 April 2015 (that is ATED-related CGT will only apply on the portion of the gain between 6 April 2013 and 5 April 2015). The ICAEW Tax Faculty response provides details as to how this would work.

Rebasing

21. We welcome the commitment to tax only gains arising after 5 April 2015. To ensure this is in fact the case it will be necessary to have rebasing (with an option to elect out), as time apportionment will not necessarily achieve the same result (house prices do not increase in even increments). The election should be specific to the chargeable interest so that a taxpayer with a number of UK properties can decide what is best for each property rather than having to make one election to cover all UK residential properties held at 5 April 2015.

In addition, so the taxpayer can make an informed choice the election should be made on the first CGT return (or amendment to the first return) that the taxpayer has to file with respect to a disposal (or part disposal) of a chargeable interest.

22. Whilst we welcome the desire to not make the new rules onerous for unsophisticated taxpayers we do not consider rebasing to be something unsophisticated taxpayers would object to. In our experience owners of UK residential property have a good idea of the value of these properties and are likely to be far more upset if apportionment results in pre 6 April 2015 gains being taxed than they will be by the need to obtain a 5 April 2015 valuation.

23. There are, in addition, practical problems with apportionment:
    - Land registry information will only provide information about the last recorded sale. Where a non-resident did not acquire the property through a sale and/or there has been significant enhancement expenditure (which in our experience is very common) the taxpayer may not have accurate base cost and/or enhancement expenditure records. This will mean that apportionment will not work as the taxpayer will not be able to determine the overall gain accurately.
    - If ATED-related CGT does continue after 5 April 2015 (either on an on-going basis or just to capture gains in the two year period to 6 April 2015) the new regime will need to interact with ATED-related CGT and since ATED has actual rebasing adopting time apportionment for this new charge will result in problematic interactions.

24. We would not object to allowing taxpayers to choose between: (i) rebasing to 5 April 2015; and (ii) apportionment of the entire gain. However, we believe it would be fairer and simpler to offer simply a choice between actual cost and enhancement expenditure or 5 April 2015 valuation.

Following the existing CGT provisions as closely as possible

25. It is important that the new CGT charge is as fully integrated into the existing CGT regime as possible and in as simple a manner as possible. We appreciate that some modifications will be required but there should be alignment wherever possible.

26. EU law considerations will come into play when considering the tax treatment of corporate entities. To avoid contravening EU law it we presume the relevant favourable features of the corporate CGT regime (such as indexation allowance, the various beneficial rules for CGT groups and the lower tax rate) will need to apply to disposals by non-UK resident corporate entities.

27. There should not be any specific anti-avoidance provisions just for this extension of the CGT charge. Provided there is sufficient time for the new provisions to be drafted properly, the existing CGT legislation when combined with the general anti-abuse rule should provide all the anti-avoidance legislation that is required.

The new CGT charge and the anti-avoidance provisions

28. The proposed extension of CGT to non-residents disposing of UK residential property will result in double taxation unless adjustments are made with respect to the interaction with the anti-avoidance provisions. We recommend there is a consistent approach across all the taxes and this should be based around the primacy of the new CGT charge. Credit

mechanisms where there is scope for double charging would at best be unduly complex and at worst practically impossible without adding pages of additional anti-avoidance legislation.

29. The ICAEW Tax Faculty response considers the various anti-avoidance provisions and the necessary modifications so the new charge takes priority and double charging is avoided.

30. The drafting of the general definitions provisions and the sections dealing with change of use and mixed use will be crucial as these will need to feed through effectively so that it is only gains taxed under the new CGT regime that are excluded for the anti-avoidance provisions.

Main residence relief

31. We understand why changes to the TCGA 1992, s 222(5) main residence election need to be considered and also that, for EU law reasons, any changes cannot just apply to non-residents. The election is, however, integral to how the current main residence relief provisions work and we are concerned that any change could have a wider impact than is desirable. Since this relief is so important to UK residents we do not think any change should be made as part of a consultation into CGT and non-residents. We think that a specific consultation on main residence relief is necessary with sufficient time to enable a proper consideration of the relief (also taking into account the comments made by the Office of Tax Simplification).

32. We do not support either of the proposals set out in paragraph 3.5 of the consultation document. For a host of practical reasons we think it is important to retain the ability to make an election.

33. If this issue had been considered prior to the introduction of the statutory residence test (SRT) it might have been appropriate for the making of a main residence election in favour of a UK property to impact on an individual's residence status (by constituting a UK tie). However, the SRT was enacted in the 2013 Finance Act and we do not think it would be appropriate to make amendments to the test so early in its life. There may also be EU law issues why this approach would not work.

34. Taking the above into account the only viable solution would seem to be to restrict the circumstances in which an election is made.

35. If this is done, to avoid unfairness, there needs to be a change in the interests that are taken into account when considering whether an individual has multiple residences for main residence relief purposes. It will be necessary to change the legislation such that only interests in property owned by the individual are taken into account when considering eligibility for main residence relief. This will mean that where an individual has two residences, only one of which they own, the property they own should automatically qualify for relief with no need for an election to be made. Provided this is done, elections could be retained subject to an annual minimum occupancy level restriction (with apportionment if occupation starts or ceases part way through the tax year). This should not, however, disadvantage individuals where the lack of occupation is work related or due to illness so there would need to be special provisions to cater for these situations.

36. Where an individual owns more than one residence, for an election in favour of one of the properties to be valid for a tax year, we would suggest that the property that is the subject of the election would need to have been occupied by the taxpayer and/or their spouse/civil

partners for a minimum of 91 days in the tax year. If this condition is not met then for that tax year the main residence would fall to be determined under the current rules for the factual main residence (that is the position would be as it is now if no election has been made). We think that 91 days is sufficient time to demonstrate a significant level of occupation without being unduly onerous.

37. There is no reason why non-UK resident trusts should be in a worse position than UK resident trusts. As such, non-UK resident trusts should be able to benefit from TCGA 1992, s 225 (private residence occupied under terms of settlement) where a UK residence is occupied under the terms of a settlement by a beneficiary for whom the residence is his or her only or main residence. Incidental changes should be made to TCGA 1992,s 225 so that the changes made to the TCGA 1992, s 222(5) main residence relief election flow through.

38. Whatever changes to the TCGA 1992, s 222(5) main residence relief election are enacted there need to be transitional rules so existing relief entitlements are not lost.

The collection mechanism

The problems with a withholding tax mechanism

39. Collecting this new tax poses a significant practical challenge. A withholding tax system would seem the safest route but we understand that this will not work in the UK. The UK has a different legal framework when selling property to jurisdictions with a withholding tax. For example, in France and Spain (where we understand a withholding tax mechanism is used) there is a mandatory requirement to use a notaire when selling a property and the notaire is responsible for withholding the tax. This would not work in the UK, as there is no such mandatory requirement where property is transferred. It is possible for UK property to change ownership without the buyer or seller having any recourse to a UK professional adviser.

40. From a technical prospective we cannot see how it would be possible to design a withholding tax mechanism that would result in a good approximation of the tax due. A withholding tax based on sales proceeds is unlikely to be a good approximation of the gain due as the charge will only apply to gains arising from 6 April 2015.

41. There will also be issues in determining who should pay the withholding tax since at a given point in a tax year it will not necessarily be possible to say with certainty whether an individual is UK resident or not. The default option could be withholding tax unless the individual can obtain a certificate of UK tax residence from HMRC but this might be problematic for HMRC at a given point in a tax year and will be onerous for everyone involved in the process

42. Finally, the UK housing market is not used to factoring in a withholding tax charge on gains. Where main residence relief does not apply in whole or in part to residential gains realised by UK residents they have until 31 January following the tax year to pay the CGT due.

Alternatives

43. Non-resident taxpayers who are in the UK self-assessment system already should be able to report gains and losses on the disposal of UK residential property through the self-assessment system rather than having to contend with two different reporting systems.

44. We understand that HMRC does not want an influx of new entrants into the self-assessment system as a result of this CGT extension. We also accept that it would not be appropriate for everyone who has to pay this new CGT charge to be included in self-assessment as the system is not flexible enough for persons who only have occasional UK tax liabilities. However, where there is one or more disposal there should be annual reporting so appropriate relief can be obtained for losses and there is sufficient time for the submission of accurate CGT computations.

45. We understand that where there is no existing relationship with HMRC there is a desire for initial information within 30 days of the conveyance. Any computation produced at this stage should, however, just be seen as an estimation with the annual return providing the final computation(s). In addition to providing the computation basic information such as the taxpayer's name, address and tax reference number in the residence jurisdiction should be provided. Where the taxpayer is resident in a jurisdiction that has a double tax treaty with the UK (or in the case of EU states a multinational convention) with appropriate exchange of information and mutual assistance in the collection of tax provisions the deadlines for the payment of the tax should be aligned with UK residents. In all other cases we would accept that requiring payment of the estimated tax due within 30 days is reasonable.

46. The annual return should be the main reporting document. The default position should be that all disposals of UK residential property within the tax year should be shown on it with full tax computations and all relief claims. However, where companies (or partnerships) produce statutory accounts, they should have the option of preparing the annual return for the accounting period ending in the tax year. The submission, amendment and HMRC enquiry time limits applying to this annual return should be aligned with self-assessment.

Rawlinson & Hunter
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