Smith & Williamson

Implementing a capital gains tax charge on non-residents

Response to the HM Treasury and HM Revenue & Customs consultation document

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Contents

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[1] According to the latest league tables from Accountancy magazine and Accountancy Age.

[2] FT Money Guide: private client wealth management AUM rankings, Fenchurch: Side-by-Side Analysis of Key Players - AUM, PAM: Top 40 Managers by Assets Under Management.

2. Introduction

We welcome the opportunity to comment on the consultation document published in March 2014 by HM Treasury (HMT) and HM Revenue & Customs (HMRC) entitled 'Implementing a capital gains tax charge on non-residents'.

We confirm that we are happy for this response, including any personal information, to be published or disclosed in accordance with the access to information regimes.

2.1. Overarching objectives and summary

The overarching objectives set out in the consultation document are:

- Fairness: the primary aim of the new regime is to ensure that the tax treatment of non-residents that 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.

Our response has been drafted with these objectives in mind. A summary of our key comments is set out below by objective.

2.1.1. Fairness

Fairness varies with the taxpayer and over time. Changing the tax system and increasing one group's administrative burdens may be seen as unfair, when compared to the situation of other groups. Fairness, while an admirable objective, can be extremely difficult to achieve without complexity. On balance we consider that simplicity should be the overriding objective.

2.1.2. Simplicity

We would urge HMT and HMRC to have particular regard to the third objective of simplicity. To minimise complexity we would suggest avoiding the introduction of an extensive raft of legislation with further rules and definitions. Definitions should, where possible, be consistent with other legislation to minimise complexity and hence aid compliance.

The proposal to introduce a new set of rules for existing residents seems to bring in unnecessary complication. We appreciate that the legislation must be EU treaty compliant but we would urge the Government to reconsider the proposals and look at bringing non-residents into the existing rules rather than complicating the rules for residents.

It appears that some entities or their members could potentially be subject to different taxes in consecutive periods: capital gains tax (CGT) on attributed gains, the annual tax on enveloped dwellings (ATED) related gains provisions and any proposed CGT charge, each with separate rules. This cannot be described as simplicity. Abolishing ATED-related gains would aid simplicity - this is explored below in response to question 8.

In addition, providing a tax neutral method to de-envelope properties and providing, as an alternative, a different legal structure that was tax transparent yet which functioned for probate purposes should be considered as part of a review of this area.

Simplicity can be aided by having common computational rules across the taxes, with the calculated gains subject to the normal rates for the person, eg individuals at their marginal rate and corporates at the appropriate corporation tax (CT) rate.

Collection of the tax from the new population should not result in unnecessary further burdens on existing taxpayers, including buyers, UK resident sellers and HMRC. We do not support a withholding tax, which would increase burdens and give rise to conflicts of obligations.

Reporting should be through the existing self-assessment system rather than the creation of another reporting mechanism.

2.1.3. Fairness and simplicity

The consultation document indicated that the change was to apply only to gains arising from April 2015. However, the consultative document makes no direct mention of a rebasing as at April 2015 of the capital gains tax base cost of residential property owned by non-residents coming within the scope of tax.

We understand that HMRC is now considering some form of time based pro rata charge. This latter method of calculating the amount of gain liable to tax would have some disadvantages:

a. It will not necessarily tax the actual gains arising from April 2015. Depending upon the relative movement in prices before and after that date it is likely to an extent to be retrospective if it potentially taxes gains that have already accrued;
b. It would require details of expenditure incurred (including prior to April 2015) to be determined, which could present significant administrative burdens for any taxpayer affected, particularly if such records had not been retained due to an assumption of exemption under the existing rules; and
c. It would differ from the current ATED charge method, which uses a valuation. For properties that move between regimes, it would require each method in consecutive periods to be followed, with the inherent administrative burdens.

In our view this contravenes the objectives of fairness and simplicity set out above. We would therefore urge the Government to refrain from having a compulsory time based pro rata charge. Using a valuation method, as under ATED, would be simpler and fairer, although would give rise to a cost. However, introducing rebasing at April 2015 as the default method, but with time apportionment at the option of the seller, should they wish to avoid such survey costs, could be considered.

A withholding tax may add significantly to the administrative burdens for general taxpayers in the housing market as it shifts obligations and costs.

Increasing administrative burdens and tax liabilities of taxpayers is likely to have a knock-on effect on the property market, and for withholding agents themselves eg:

- potential buyers (if they had the obligation to deduct tax from the purchase price), particularly those who can least afford additional expense of determining the residence status of the seller, may be deterred from the process, hence reducing demand at the first time buyer end of the market; or

- potential sellers may be deterred from selling a property, if excessive tax was deducted from their proceeds.

2.1.4. General points

It is unfortunate that the consultation was labelled as implementing a CGT charge on non-residents, whereas one of the key issues embedded in the document is a proposal to abolish the right to give notice for private residence relief (PRR) for resident taxpayers. We feel that this should be the subject of a stand-alone consultation getting wide input from UK resident taxpayers and their representatives.

We have used the term PRR throughout this response to be consistent with the term used in the consultation questions, rather than use the increasingly common term 'only or main residence' (OMR).

We also note that the consultation process included a number of workshops. It would have been helpful to have these workshops and the dates of them more widely publicised, to encourage a broad range of contributions, and to have had them at an earlier stage to inform the consultation document. Setting out the problem and inviting possible solutions, rather than moving straight to Stage 2 of the government's consultation process can get to a better solution more swiftly.

3. Responses to consultation questions

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

Response: While the consultation document states that the Government wishes to ensure that residential property that is primarily for communal use is not affected it then goes on to list some very specific proposed exclusions. This is likely to trigger uncertainty and disputes around the borderlines, eg for retirement homes or halls of residence.

A clearer explanation of what is regarded as fair in the context of 'communal property' would assist in drafting any definition. For example would a hall of residence for students be caught if it was designed so that it could be used for hotel/conference facilities in the holiday periods?

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

We assume from the consultation document that the intention is for the exclusion to apply to a building, or part of a building, used for a purpose specified in FA 2003 s.116(2) or (3) (under meaning of 'residential property' for SDLT purposes), this being subject to it not including residential accommodation for students other than as part of a hall of residence attached to an institution.

There are other examples of communal residential property which should be excluded, for which the position should be clarified. Such communal dwellings include retirement homes where no personal or medical care is provided, monasteries and other communal religious institutions.

Response: We consider that retirement homes where no personal or medical care is provided, monasteries and other communal religious institutions should also be excluded. See question 1 - a single exclusion for 'communal property' would be preferable to a list of very specific exclusions.

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

Response: Abolition of the ATED related gains for partnerships within ATED and replacing it with a single CGT charge would be preferable.

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

Private residence relief is extended by TCGA 1992 s.225 to gains accruing to trustees on the disposal of settled property. There are a number of conditions applying, such as during the period of ownership by the trustees the property must be a dwelling house occupied as the only or main residence of a person entitled to occupy it under the terms of the settlement.

If these conditions are fulfilled PRR is due, as it would be on a gain accruing to an individual.

Response: For fairness and simplicity we consider that PRR should continue to be available to trustees on the disposal of settled property where, during the period of ownership by the trustees, the dwelling-house (or part of the dwelling-house) has been the only or main residence of the person entitled to occupy it under the terms of the settlement. In addition, the interaction of the proposed rules and the existing attribution of gains of non-resident settlements need to be fully explored.

3.5. 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?

Response: No comment

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

Response: No comment

3.7. 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 proposal to build on existing approaches used within existing legislation seems to be a reasonable approach. To add a further test would give increased complexity.

Response: We would urge HMRC to resist adding further layers of complexity.

3.8. 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 existing ATED related gains regime already taxes gains arising to both resident and non-resident companies on high value UK residential property, subject to the reliefs as provided. It is important to consider how this will interact with the proposed extension of capital gains tax on UK residential property to non-residents. The consultative document does not explain the Government's intentions on this issue, but we understand that the current thinking is to retain the ATED related gains regime alongside the new regime.

We are concerned by the complexity that would arise from having to consider two different regimes, each with its own rules and features, in relation to a single gain arising from the disposal of a UK residential property. It is quite possible to envisage a property that, during its period of ownership, moves backwards and forwards between the regimes depending on the use to which the property is being put at any one time.

The resultant complexity for capital gains computations should be avoided as this would be in direct contradiction with the simplicity principle. Moreover it seems to us to be unnecessary; we cannot envisage any circumstances in which a gain which currently falls to be taxed under the ATED related gains rules would not be taxed either under the proposed new rules if it accrues to a non-resident or under existing corporation tax rules if it accrues to a UK company.

Response: Given the complexity that will result from retaining the ATED related CGT regime, we would strongly urge the Government to abolish this regime for gains accruing after 5th April 2015 - assuming that the proposed new rules take effect from that date.

In the interests of simplicity, we would also urge the use of an existing definition of 'residential property', for example that contained in FA 2003 s.116, rather than introducing a new one.

3.9. 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?

Response: As above, we propose the abolition of the ATED related gains regime on any introduction of CGT for non-resident owners of residential property.

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

We are particularly concerned about the consequential implications for UK resident taxpayers with two or more residences if the right to give notice of the PRR under TCGA1992 s.222(5) (the 'election' referred to in the question) is removed.

We appreciate that the facility to give a notice may historically have been used to maximise the available relief, due to the way the legislation automatically treats the final months of ownership as a qualifying period. However, we believe that the reduction in that qualifying period from the final 36 months to 18 months will have a significant impact, not only in reducing the Exchequer cost but in changing behaviour.

Changing the rules further will affect a large number of people, especially families where more than one 'residence' is required due to work commitments. The family home may not necessarily be where most of the time is spent by at least one partner.

We have a significant numbers of clients who genuinely have more than one home; it is not obvious on the facts which one is the main residence. One common example is for couples where one spends weekday nights in, say, a London flat while the other lives permanently in a home in a more rural location. On the facts, each has a different main residence. The current simple facility to give a notice provides clarity and certainty, which will not exist if taxpayers have to keep detailed records to meet a new test.

There can often be the added complication that, based on the facts, the main residence would be a relatively temporary place occupied under licence (ie a rolling short-hold tenancy). If the ability to give notice was removed, private residence relief would be unavailable for the owned family home for a period, with no alternative taxable property on which relief would be being applied.

Further, many taxpayers will not have maintained the necessary records over the whole period of ownership. We are concerned that arbitrary decisions may be made and disputes may arise in these circumstances. This will contravene the first stated objective of ensuring fairness. Such a system may not be sustainable if taxpayers find it difficult to comply.

Response: The current regime, with the scope to give notice, to identify which of two or more residences is treated as the main residence for a period, provides for certainty, is simple to operate and avoids time consuming record keeping and disputes.

Family and working dynamics have changed over the years. It is therefore likely that abolishing the right to give notice could give rise to unintended consequences of bringing gains into charge, possibly for short periods, on a greater proportion of family homes than was intended when capital gains tax was introduced. This could increase the numbers required to self assess.

3.11. 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?

The two approaches being considered by the Government are:

- PRR would be limited to that property which is demonstrably the person's main residence; and
- a fixed rule that identifies a person's main residence e.g. that in which the person has been present the most for any given tax year.

We do not consider that either of the alternatives set out in the consultative document would be satisfactory in most cases without the ability to make an overriding right to give a notice for PRR.

The first suggested approach is highly subjective, and the second is arbitrary. Both tests will require significant record keeping, and we would suggest that it will be difficult to verify or audit the records, apart from through the use of intrusive techniques such as checking mobile phone usage.

There is already a steady flow of tribunal cases under the existing regime that use the first of the alternatives suggested. If it were not for the certainty of the position under the available right to give a notice there would be a significant increase in disputed cases.

Although the second approach is less subjective it would require greater record keeping, probably beyond the capability of most people to remember to maintain. Many cases would have to consider the position based on a balance of probabilities of actual presence.

There is the added complication that a married couple or civil partnership can only have one residence or main residence for PPR purposes. We appreciate that where there are currently two homes the main residence has to be ascertained, based on the facts, if no notice has been given, but the option of a notice often eliminates this requirement and hence significantly reduces the uncertainty, for most people it avoids the need to keep records and is simple to administer.

It is unclear how this 'one residence' rule could be applied using a fixed rule for private residence based on which residence a person has been present for most of a given year. Which spouse/partner would the fixed rule be applied to? Would you only count those nights where the couple are together?

Response: Where no notice has been given, determining the main residence under the current system of available evidence and the balance of probabilities is subjective and burdensome. Although a fixed rule might be less subjective it would also be burdensome. In addition, the consultative document gives no indication of how this would be applied to a married couple/civil partnership living together but present in in different residences at the same time.

The current regime, with the scope for giving a notice, to determine the main residence for a period, provides for certainty, is simple to operate and avoids time consuming disputes.

We feel that neither of the alternatives would be practical. We consider that the current right to give notice of PRR should be retained. We appreciate that this leads to an issue around non-residents giving such notice for a single UK property – this is explored in the next response.

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

The ability to right to give a notice under TCGA 1992 s.222(5) should be retained.

It is recognised that there is concern that non-UK residents could avoid the intended extension to the scope of capital gains tax by nominating a single UK residence as their main one for PRR purposes. We also appreciate that the legislation needs to be EU treaty compliant.

Therefore, the proposed retention of the giving of notice could involve either:

- restricting the availability to give a PRR notice (for periods from 6 April 2015) to individuals who own a dwelling-house, or part of, which is the individual's main residence (based on the facts) that is subject to UK CGT, wherever located; or
- only permitting the right to give a notice where it is necessary to determine which of two or more residences subject to UK CGT is to be treated as the individual's main residence.

The first approach would recognise Parliament's historic intention that capital gains tax should not apply to an individual's main residence with an element of personal choice where there are two or more residences. A conditional requirement for the main residence to be subject to UK tax would recognise that PRR is to ensure the main residence is not subject to CGT yet at the same time retain this principle of choice. This would be irrespective of the tax residence of the individual although it is unlikely that a non-UK resident's main residence would be a dwelling in the UK. Equally, it may make the UK more attractive as a place of residence.

The second approach would leave the right to give a notice available irrespective of whether the individual's main residence is in the UK but would only be available where there are two or more residences within the scope of UK capital gains tax. This would be less restrictive than the previous approach and available to anyone with two or more residences subject to UK tax irrespective of the tax position of their main residence.

Each of the above approaches would need a provision to ensure that the notice lapses automatically where the conditions for making the notice cease to apply. This would, for example, prevent a UK resident from emigrating and retaining main residence relief on a UK property.

There is a need to comply with EU treaty obligations:

- Under each approach there will be little inherent difference between a UK resident taxpayer and one resident in another EEA country, although there is an argument that it might be more difficult for a non-UK resident to obtain the relief, but we think that same argument applies to the proposals in the consultation document.
- Under the first approach relief would be available in respect of a single UK residence only if the main residence based on fact would otherwise be subject to CGT, in which case it is likely that the taxpayer will, under the Statutory Residence Test, be UK resident.
- Under the second approach, the location of the main residence would be irrelevant.

There would be no change for UK resident taxpayers with two or more residences, except possibly where a residence was occupied as a main residence under licence. This may need to be explored further, especially for work-related accommodation, if the status quo for UK residents is to be maintained.

We accept that this proposal would shift the scope of the proposed policy change for non-UK residents with two or more UK residences. However, we hope that it will be acceptable to the Government in order to maintain an existing UK residents' relief that has generally stood the test of time.

However, as set out above, this whole area should be subject to a separate consultation as it is such a radical change.

Response: Other approaches might be:

- **retain the status quo;**
- **restricting the availability to give a PRR notice (for periods from 6 April 2015) to individuals who own a dwelling-house, or part of, which is the individual's main residence (based on the facts) that is subject to UK CGT, wherever located; or**
- **only permitting the right to give a notice where it is necessary to determine which of two or more residences subject to UK CGT is to be treated as the individual's main residence.**

3.13. 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.

Response: We disagree with the proposal to apply a withholding tax. Where there is a debt attached to the property, any solicitor dealing with the sale would

have competing obligations – to settle the loan first and to withhold tax. Given lending levels can be up to 100% of the value, this would present irreconcilable issues. Gifts of property would have no proceeds from which to deduct the tax.

It could also impact on the property market in that, even if there was no tax to pay, the vendor would not have access to the full funds to reinvest in the UK.

Determining, within the necessary time to complete a sale, whether the vendor was UK resident is also likely to present problems not only for the parties involved but also for HMRC who would have to be able to issue residence certificates within days, even though they might not have sufficient details about the vendor at that point.

This should be dealt with through self assessment. Given the deterrent factor for the current range of international recovery provisions, it is unclear as to whether payment of debt would now be a significant issue.

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

Response: See response to question 13

3.15. 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?

Response: See response to question 13

3.16. 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?

As set out above, we do not consider that 30 days is workable in practice and we therefore consider that any return must be part of the normal self-assessment process.

In order to meet such a short deadline the seller would need cost histories and possibly a valuation.

Response: We do not consider that 30 days is workable in practice. We therefore consider that any return must be part of the normal self-assessment process.