STEP
Society of Trust and Estate Practitioners

Implementing a capital gains tax charge on non-residents

STEP response to consultation

24 June 2014

Introduction

1. STEP is the worldwide professional association for practitioners dealing with family inheritance and succession planning. The Society helps to improve public understanding of the issues families face in this area and promotes education and high professional standards among its members. STEP has over 19,400 members across 95 jurisdictions from a broad range of professional backgrounds, including lawyers, accountants, trust specialists and other practitioners in this area. STEP members help families plan for their futures, specialising in a wide range of activities, from drafting a relatively simple will to more complex issues surrounding international families, protection of the vulnerable, family businesses and philanthropic giving.

Summary

2. STEP agrees that, from a policy perspective, non-UK residents should be subject to UK taxation on capital gains made on the disposal of residential property situated in the UK. However, the regime which will apply to non-residents should be clear and coherent and should not be introduced in the piecemeal fashion. Taxpayers must be able to take long term life and investment decisions and arrange their affairs in the light of clear legislation.

3. The imposition of this tax charge on non-residents will clearly discourage some from investing in UK residential property, as anticipated rates of return will have to take account of the tax charge, but the charge per se is less of a disincentive than unclear and uncertain legislation, with the possibility of yet more fundamental changes. It is a great pity that this policy was not formulated at the same time as the ATED. As it is, this proposal not only results in a new cost, but adds to complexity for those contemplating investment in UK property, and confirms fears that fiscal policy is subject to frequent and sudden change.

4. The introduction of the ATED and ATED related gains rules from 2013 (together with the increased SDLT rate for enveloped properties) and the changes to the scope of those rules contained in the current Finance Bill are targeted at discouraging enveloping of residential property. This aim would largely seem to have been achieved.

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5. STEP therefore feels that the opportunity should now be taken to consider whether it would be beneficial to replace the ATED related gains rules and have just one regime applicable to all non-residents owning residential property. The rules need to be carefully thought through so as to avoid the need for changes during the next few years. Any impact that this may have on potential tax yields could be dealt with by setting an appropriate rate of tax.

6. Changes should not be made to Private Residence Relief (PRR) without careful consideration being given as to the implications that this will have on UK resident home-owners and a separate consultation should be carried out and appropriate publicity given to it.

7. It is unfortunate that the issue of rebasing has not been clearly dealt with in the Consultation Document as this is a key issue. Properties should be rebased as at April 2015 (with the option for the taxpayer to use the actual allowable expenditure) and non-residents subject to these rules should only be chargeable on gains accruing and realised after that date.

8. If the proposals are introduced, some private clients will be subject to tax on the disposal of UK residential property, whilst some will not, for example: if the property is owned through certain funds. STEP has left it to other bodies to comment on ownership by fund structures.

ATED related gains and new CGT rules

9. STEP considers that, other than in relation to relevant gains accruing between 2013 and 2015, there is no need to retain the ATED related capital gains charge following the introduction of the proposed direct charge on non-residents, as this will result in further unnecessary complexity within the UK tax system.

10. Under the current proposals, a company will be subject to two different types of CGT charge at different rates and computed with different base costs. The ATED-related CGT charge should be abolished for any disposals made after April 2015. STEP understands that the rate of tax that applies for ATED related gains is higher than the rate that is likely to apply under the proposed new rules. If the ATED related gains rules were to be abolished, this difference in rates could be more than compensated for by increasing the level of the ATED itself.

11. The different types of CGT charge and their staggered introduction will give rise to further complexity. Take for example a company which disposes of a residential property worth between £500,000 and £1 million after 5 April 2016. The gain will be subject to three different types of charge: a charge under section 13 TCGA 1992 on a UK resident participator in the company on gains accruing up to 5 April 2015, a tailored charge on gains accruing between 6 April 2015 and 5 April 2016 and an ATED related capital gains tax charge on gains accruing after 5 April 2016.

12. If the decision is taken that there needs to be two different regimes, it would certainly be helpful if the ATED-related CGT and the non-residents CGT charge could at least be filed on the same form.

13. There is a multiplicity of taxes that need to be considered when deciding on the ownership structure for non-UK residents. The rules have been developed incrementally and *inter alia* there are apparent differences in the following:

- Definition of residential property;
- Applicable date for rebasing;
- Dates for the introduction of the rules depending on the value of the property;
- Rate of taxation;
- Rules in relation to exemptions from charge.

This means that the UK tax system for non-UK residents investing in UK residential property is and will continue to be extremely complex.

Rebasing

14. It is unclear from the Consultation Document whether or not there will be rebasing of the value of the property. It is understood that rebasing or time apportionment of the gain is being considered. Rebasing to 6 April 2015 should be the default with the taxpayer having an option to keep the original base cost. Time apportionment would introduce unnecessary complexity, particularly in relation to enhancement expenditure.

Defining Residential Property

15. There are a number of different definitions of residential property for different taxes, for example: CGT, VAT, ATED, SDLT, pension provisions and capital allowances. There seems to be no reason why the various taxes cannot treat residential property in a rational and coherent way. Consideration should be given to whether it would be possible to have only one definition which would apply for all tax purposes, for example, the Use Classes Order could be incorporated. It is essential that the definition is clear, so that taxpayers are able to identify what is within the charge to tax.

16. The legislation will need to contain provisions for mixed use buildings and changes of use. It needs to be clear for example whether as regards change of use the property there needs to be a rebasing for tax purposes at each change of use or whether the gain needs to be time apportioned over the period of ownership depending upon its use.

17. In relation to residential properties with large gardens, will the rules follow the ATED or the PRR provisions?

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Collection of Tax

18. STEP agrees that collection of tax should fall within the self-assessment regime, with the taxpayers having the option to pay the tax due within 30 days of disposal or within the normal self-assessment time limits. If the option to pay within 30 days of disposal is taken, then no reliefs should be capable of being claimed.

19. The collection of the tax due by withholding tax from the sales proceeds by professional advisers is considered cumbersome and unnecessary and could give rise to practical difficulties, for example establishing whether or not the vendor is non-resident at the time of the disposal and how to resolve competing claims where the mortgage repayable on the disposal of the property exceeds the sale proceeds.

Private Residence Relief (PRR)

20. STEP is strongly of the opinion any change to PRR should be the subject of a freestanding consultation. A change in the rules potentially affects all UK resident homeowners too, and the consultation in this respect should be given wider publicity.

21. STEP is supportive of the introduction of the requirement for a non-UK resident taxpayer to make a claim for PRR ensuring that relief is only available from UK tax where the property is the individual's main residence. However, in order to comply with EU law, a non-UK resident taxpayer will have to be treated no less favourably than a UK resident taxpayer and we assume that any changes will have to apply equally to both. For this reason we consider that this should be the subject of wider consultation.

22. Consideration will need to be given as to how the new rules will interact with the self-assessment regime where there is currently no requirement to report the disposal of a main residence if the gain is relieved by PRR.

23. It has been suggested that the making of a PRR election would be an additional tie to the UK for the purposes of the statutory residence test (SRT). However, STEP feels very strongly that there should be no change to the SRT so soon after it has been introduced.

24. Throughout the detailed and very lengthy consultations on the SRT, it was accepted that one reason for having a statutory test was that individuals would be able to tell fairly easily whether or not they were resident. Adding an additional tie so soon after the introduction of the test would give rise to a lack of confidence in the new rules.

25. STEP recognises the difficulties with the various methods of determining whether PRR should be available to a non-UK resident individual. On balance, STEP considers that there should be a minimum number of days (ie midnights) of presence in the property for every year the individual would like the election to apply to. This will require records to be kept on an annual basis and STEP considers 91 days of presence would be an acceptable number.

26. In order to be effective as regards a particular year, the election would require the individual to have spent the requisite number of midnights at the property during that year. If during a particular year the taxpayer had not actually spent the requisite number of midnights in the

property, the default position should be that PPR may still be available for that year in respect of another UK property but only if the taxpayer can show on the facts that that UK property was his main residence during that year, or to the extent that the permitted periods of absence provided by section 223 applied.

27. If no election is made, it should be necessary to prove on a factual basis that any particular UK property is the individual's main residence.

28. Spouses and civil partners should continue to be able to only have one main residence with qualifying occupation by either of them being sufficient for them both or either to claim PRR. For example: a husband and wife jointly own a UK residential property but the husband is non-UK resident as he is working overseas. The wife remains resident in the UK and occupies the property as her main residence – both spouses should be able to claim PRR on the subsequent disposal of the property. This should also apply if the property is owned by only one spouse but occupied by either spouse at different times.

29. The income tax cases regarding mortgage interest relief may assist in formulating a new rule and defining a main residence.

30. In relation to occupation under the terms of a settlement, careful consideration needs to be given to the impact any changes to PPR have in relation to section 225 TCGA 1992 and this should not be changed without proper consultation. If a beneficiary is non-resident, then the same conditions as to making a PRR election (for example, the minimum day count etc.) would need to be imposed on that beneficiary.

International Rules

31. ***Temporary non-residence***

31.1 Where the property was acquired prior to April 2015, transitional provisions may be required even if the departure is many years later. STEP considers that the new CGT charge for non-residents should have priority and tax gains accruing after 5 April 2015 but that the temporary non-residence rules would apply in the year of return, to the gains accruing prior to that date. This would require a valuation as at April 2015.

31.2 If the property is acquired after 5 April 2015 and sold while an individual is temporarily non-resident, no special rules will be needed. The individual will be taxable anyway under the new CGT charge for non-residents and this should be given priority. The temporary non-residence rule that taxes gains in the year of return would have to be disapplied in relation to this disposal as it will already have been taxed.

31.3 Some consideration needs to be given to loss relief in respect of losses realised while the person is temporarily non-UK resident. These are normally set against the gains realised while temporarily non-resident but would presumably not be available to reduce the gain on disposal of UK residential property which is taxed under separate provisions.

32. ***Section 13 TCGA 1992***

32.1 Section 13 should be disapplied and the new CGT charge for non-residents should be given priority so gains subject to this charge would not be apportioned under section 13, save to the extent that gains accrued prior to 6 April 2015. Again, this would require a rebasing election to be made and a valuation as at April 2015 obtained.

33. ***Section 87 TCGA 1992***

33.1 To the extent the gain is subject to the new CGT charge for non-residents, then it should not be included in the pool of stockpiled gains in relation to properties acquired prior to April 2015. The gain accruing prior to 6 April 2015 would be included in the section 87 pool. Again this would require a rebasing election to be made.

34. ***Schedule 4B TCGA 1992***

34.1 If there is an event within Schedule 4B, there will be a deemed disposal of the settled property held by trustees. This deemed disposal could trigger a Schedule 4C gain on UK residential property which would go into the trust pool of gains.

34.2 Such a gain would also be taxed on an actual disposal of the property by the trustees of residential property. Therefore, deemed disposals resulting from any transfer of value after 5 April 2015 should be excluded from Schedule 4C gains as they will be taxed later anyway directly on the trustees (to the extent PRR is not available).

34.3 Consideration would need to be given to what happens when property changes in nature, ie is residential at the date of the deemed disposal under Schedule 4B but is commercial at the subsequent date of actual sale.

STEP

UK Technical Committee

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