Frank Hirth

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Alan McGuinness
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H M Revenue and Customs
100 Parliament Street
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Dear Mr McGuiness

RESPONSE TO CONSULTATION ON IMPLEMENTING A CAPITAL GAINS TAX CHARGE ON NON-RESIDENTS

Frank Hirth plc is a medium size accountancy firm based in London with over 35 years' experience and expertise in advising US citizens and other international individuals resident in the UK and their associated business enterprises. Since then, we have developed into one of the most respected practices in the field of international taxation and are recognised as a leader in the specialist area of US and UK personal, trust and corporate taxation. Our personal taxation client base contains a significant number of non-resident individuals who own residential property in the UK. That ownership group comprises a mix of Britons working abroad and foreign nationals who have retained UK properties despite their working assignments here having been completed

Our responses are set out using the same numbers as were attached to the specific questions raised in the consultation document:

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

In principle there should not be any. However, close attention will need to be given to the statutory definition of communal property. The case of student accommodation illustrates this well, although the point is also valid in relation to a range of communal facilities. In recent years, there have been various innovations in the financing of projects such as the construction of university halls of residence. Something that the lay person will clearly recognise as a university hall of residence may no longer be sited on the university campus or "owned" by the university even if so located. Nevertheless, we assume that it is the government's intention that any student accommodation that is the result of a formal partnership between a university and a private sector provider should be communal property that is excluded from the charge. On page 8, the consultation document refers to the exclusion in terms of "a hall of residence **attached** to an institution" (*emphasis added*) The new legislation will require a definition which caters for all the different ways in which the requisite attachment may be manifested.

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Question 2:

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

The consultation document covers accommodation for those needing care due to old age, poor health or dependencies of alcohol or drugs. However, it is not clear whether the intention is to include shelters for the homeless. The latter are clearly within the spirit of what is suggested in the consultation document. However, there is a risk that a shelter for the homeless might not be included. Finding oneself to be homeless may, for example, be a consequence of having a drug or alcohol dependency. However, it can just as easily result from a case of bad luck. If exemption is worded so as to require provision of specifically targeted care within the accommodation, then a shelter for the homeless may only satisfy that requirement for some of the people it takes in.

Question 3:

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

No comments.

Question 4:

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

Dealing with s87 is not straightforward. The design imperative should be to make sure that the trustees' UK gains which have been subjected to CGT are not charged again to CGT on distribution to a beneficiary. However, delivering that outcome is not simple. The s87 charge is based on matching the s2(2) TCGA1992 amount for a trust for each year to capital payments made to beneficiaries. So ideally the residential property gain should be matched but not taxable (similar to pre 2008 gains for non-doms), with rules on how it is allocated where only part of the trust's s2(2) amount for a year is matched. This would allow the trustees to distribute the gain without it being taxed again or causing a different gain to be taxed either at the time or later.

The legislation should also ensure that a distribution of such a gain from an offshore trust will not be ignored, thereby creating an excess capital payment which could become taxable later when income or gains are generated in the trust.

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 funds structures to avoid the charge?

A GDO test would appear to be an appropriate method.

We strongly recommend that the wording of this test is kept simple. Existing legislation is already able to deal with any worries the government may have about potential abuse. Consequently, there is no need to burden this GDO test with anti-avoidance measures.

Much time and effort went into the framing and subsequent legislation of the GAAR. Fundamental to the GAAR is the ability to neutralise arrangements which achieve results at variance with the policy objectives of a particular provision.

In particular, s211(3) FA 2013 provides extremely wide scope in terms of what "guidance, statements or other material" may be used in a purposive interpretation of a statutory provision. HMRC's own GAAR Guidance (at C5.7.3) stresses this point. In applying this aspect of the GAAR, s211(3) FA 2013 allows material to be taken into account "which would not otherwise be permissible under the normal rules of evidence." Accordingly, all that is required is a straightforward GDO test, accompanied by a clear ministerial statement concerning the intended purpose of that GDO test.

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

No. See the comments in the answer to Question 5 about use of the GAAR.

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. See the comments in the answer to Question 5 about use of the GAAR.

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?

It is almost impossible to comment on the likely impacts without knowledge of the rates that will apply to gains realised by non-residential companies. For example, how the CGT rates will compare with the rates of corporation tax that apply to resident companies or those foreign companies with a UK trade.

Another key question that will need to be addressed is whether indexation will be allowable on the sale of residential property by non-resident companies not already operating a trade in the UK. If not, there could be a mismatch between the treatment for non-resident and resident companies selling similar property.

Other points that will need clarification relate to loan relief and group relief.

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 CGT charge within the ATED regime should be abolished. Failure to do so will result in needlessly complicated layers of legislation, the only achievement of which will be to deliver confusion to the bulk of taxpayers. ATED related CGT was introduced as a form of anti-avoidance targeted at stamp duty avoidance. Now that all residential property owned is to come within CGT, it would be farcical to have one branch of that tax aimed at enveloped properties and a different set of rules for all other residential property. Although ATED related CGT is a relatively new tax, that fact should not make it immune to abolition.

The major change now being incorporated in CGT was not envisaged when ATED related CGT was legislated. To determine if there is any case for retaining ATED related CGT, the simple test is to ask what policy on stamp duty avoidance will not be served by a universal application of the revised CGT regime on residential property.

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

Historically, the PRR election rule has performed a useful role and generally functions well. Our concern is that in trying to prevent non-residents having an obvious way to avoid capital gains tax on their disposal of a UK residential property, UK resident vendors of similar residential property might be adversely affected. So it is important to avoid the "wrong" approach in closing any avoidance window for non-residents. From a policy perspective, it is particularly important that new complexity is not introduced in the type of situation that the PRR election is intended to simplify.

The current PRR election rule was introduced for use where, in the matter of hard fact, it is unclear which of two properties constitutes the taxpayer's main residence. The most often quoted example is where one property is lived in during the week because of work, while another is occupied at weekends with the family. The election was not intended to be used as a mechanism for taxpayers to simply choose, regardless of other factors, which one out of two or more properties would be exempt from CGT.

Thus:

a) The taxpayer is presently able to elect which of properties competing for the status of main residences will receive PRR relief.
b) The fact patterns need to be such that the elected property has the prima facie attributes of a fide main residence.
c) HMRC has the option to query the factual basis that underpins the taxpayer's election.
d) If unsatisfied that, prima facie, the underlying facts suggest a main residence, HMRC are able to ignore the election. (*Also in cases where an election is not made within statutory time limit, HMRC is able to decide on a facts and circumstances basis which of competing properties is the main residence.*)

Consequently, were a non-resident to seek to elect for their UK property to be their main residence, HMRC would still have the ability to review the facts and reject any claim where the property failed prima facie case categorisation. Given that we are concerned with individuals who are not resident in the UK under the statutory residence test ("SRT"), only in relatively few cases will it not be apparent that, as a question of fact, the non-resident's main home is somewhere other than in the UK. Obviously there will be some "difficult" cases such as individuals whose work involves them in constantly moving between countries throughout the year.

Removing the election completely as an anti-abuse measure targeted at non-residents will needlessly complicate the lives of UK resident taxpayers who dispose of residential property. In addition to creating an atmosphere of uncertainty for a number of taxpayer, abolishing the election would also place an increased burden on HMRC's resources. If all cases have to be resolved on a strict factual basis, HMRC will be drawn into the resolution of borderline cases unless there is a policy of accepting without question how the taxpayer reports for self-assessment purposes. As noted above, avoiding the need to commit such resources was presumably one of the reasons why the PRR election was originally introduced.

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?

Of the two approaches mooted in paragraph 3.5, the first approach (balance of factors) is the more suitable, as it is effectively what should already be used in a variety of cases. As mentioned in our response to question 10 above, removing the PRR election element is likely to introduce an unnecessary element of confusion for taxpayers.

Although it has the appearance of being the simpler approach, we strongly believe that the second suggestion in paragraph 3.5 (a fixed rule) would lead to significant complications. Taxpayers would need to maintain detailed records of the amount of time spent at each residence. This is in addition to the copious travel day and workday records they may already be keeping for purposes of the SRT.

The problem with adequate record-keeping could be a major problem if the taxpayer's situation changed unexpectedly. For example, individual is sent abroad by their employer for an assignment of only a few years, but is unexpectedly reassigned to another country on terms which result in the UK home never being reoccupied. It is unlikely the individual would have been keeping the necessary records whilst away. At the time, the need for detailed records would have seemed superfluous of the expectation of returning to the UK and reoccupying the home as their main residence.

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

One approach that we think may work is to introduce an additional tie within the sufficient ties test of the SRT for any person electing a UK property as their main residence. This has the benefit of being simple, consistent with the philosophy of the SRT, and likely to deter the sort of avoidance the consulting document states is to be discouraged. Taxpayers with this additional tie would be more likely to be UK resident under the SRT and UK taxable on their worldwide gains, not just those arising on the disposal of UK real property.

This approach would seem to us to be favourable as it allows the domestic PRR rules to remain in place largely unchanged, but provides a means to deter anti-avoidance by non-residents through extended use of the SRT. The SRT would only require a minimal change to include an extra UK tie.

PRR is one of the few parts of the UK tax system where both spouses are treated the same, despite the UK taxing the two individuals separately. There may be an argument to allow each spouse to apply the PRR rules independently of the other. This could resolve those tricky situations where one spouse spends a large amount of time in one property which is convenient for work whilst the other lives with the children in the family home at another location.

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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.

The UK tax system is based on the concept of self-assessment, as such we do not believe a solicitor or accountant should be responsible for identifying which sellers are non-residents. In some cases an individual's UK residence position may not be determinable until the end of the tax year, and the tax return not due until the following 31 January.

We understand that the initial idea of a withholding tax has been replaced with the concept of the seller making a payment on account within 30 days of the sale. This payment would be based on the estimated tax due.

It would be desirable to include some sort of information pack with sales of property so that the seller is aware of their responsibilities to pay UK tax and in particular to estimate the tax due and make a payment on account within 30 days of the sale.

Question 14:

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

We understand that the intention is now to have a payment on account made within 30 days of sale, rather than a withholding tax at the point of sale. However, we feel that an answer to this question is still warranted in case the idea of a withholding tax is revived.

In principle a withholding tax could fit easily with other elements of the property transactions process. That statement is subject to one caveat. If, as in the USA, withholding was based on a fixed percentage of sales proceeds, there would need to be a quick way to obtain a certificate authorising reduced or NIL withholding.

The only conflict between a withholding tax and other aspects of the property transaction would be in the event of there being insufficient net proceeds (after withholding) to clear any mortgage on the property. Such a shortfall could only occur in two specific scenarios.

1. The classic case of negative equity, where the property's value has fallen since purchase. There is a potential deal stopper in this scenario. Sales proceeds will already be insufficient to clear the mortgage. The existence of a withholding tax regime should add no further complications. The property is being sold at a loss, so there should be an exemption from withholding in such circumstances.
2. A variation on negative equity. This would be when the property is sold at a gain, but at some stage the mortgage has been refinanced in a larger amount than was borrowed at the time of purchase. In some, but not all such situations it could be that the amount of tax required to be withheld made the difference between there being sufficient or insufficient funds to clear the mortgage.
    - The difficulties presented by such situations do not provide a rationale for not having a true withholding tax.
    - The transaction process would really be in difficulties due to an imprudent level of refinancing rather that the existence of a withholding tax.

- Once a withholding tax was introduced, prudent lenders would take that cash drain into account when determining the level of refinancing that would be granted in excess of the original cost of the property.

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 scales as SDLT?

No comments.

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 the revised intention is for the seller to submit a draft calculation estimating the CGT due within 30 days of sale, and pay this tax within the same time period as a payment on account. Any adjustments are then to be made with the final self-assessment return.

We believe it should be reasonable for non-residents to prepare a preliminary CGT calculation on a property sale within 30 days of the sale. The vast majority of taxpayers should have a clear idea of the cost basis and obviously will know the proceeds once a sale has been completed.

There may be a few instances where the seller may not know the cost basis, for example where the property was inherited and the probate value is not readily available. This may be problematic where they are working abroad, say, but all documents are in the UK. In such cases where the gain is unknown, it may be desirable to have a set rule whereby the payment on account is a percentage of the proceeds.

The other issue that needs to be addressed is how HMRC will allocate the payment on account and ensure it is matched to the relevant property sale. We believe that two distinct forms are required. The first form should be filed within 30 days of sale to both report the sale and show an estimated gains tax calculation in support of the initial payment on account. The second form (filed by the following 31 January) to show the final gains calculation and the balancing payment/refund required. Where the taxpayer is already within the self-assessment system this second form would form part of the tax return.

The first form will need to include details of the property address and a means of generating a reference number unique to the reported transaction. This transaction reference number would be for those individuals who are not already within the self-assessment system. With such a reference number, HMRC can create a record against which to allocate the payment on account and later the formal reporting of gain. Those taxpayers who already file self-assessment returns can use their UTR.

Other Matters

Definitions:

In contrast with SDLT, where definitions are forward looking, CGT definitions essentially look at what has happened to date. For example whether a particular property constitutes a taxpayer's main residence at a particular point in time will depend on how the taxpayer has been using the property. That clear definitional historical link within CGT jars with the suggestion in the consultative document that the "potential to be used as a residence" has relevance.

The issue of which property might be included in or excluded from the scope of CGT is clearly a matter for the definition of what constitutes residential property. Clear legislation/guidance is essential. This will be particularly so if the concept of "potential to be used as a residence" is incorporated in the legislation. For example:

- Is intent factored into such a test? One owner might intend to use property as a dwelling, whereas another may not.
- A property without plumbing could be said to be unsuitable for habitation, but it will often be possible to install this. Thus even in its unplumbed state, such a property has potential to be used as a residence.
- Will a distinction made between property with such potential but no current planning permission for residential use and a similarly uninhabitable structure which has already received detailed planning permission for residential use?

Particular attention will need to be given to how the new charge applies to the following:

- Residences situated in grounds which for PRR purposes are deemed to be excessive for enjoyment of the property.
    - Consistency would suggest that the excess grounds should not be considered residential property.
- Houses either used in their entirety as offices or containing particular rooms which are dedicated to business use.
- Farmhouses.

If you have any questions, please contact me.

Yours sincerely