Implementing a capital gains tax charge on non-residents

Response to Consultation issued on 28 March 2014

Gabelle
Expert Tax Support

Introduction

1. Gabelle LLP welcome the opportunity to comment on the consultation document in respect of implementing a capital gains tax charge on non-residents published by HM Treasury and HM Revenue & Customs ('HMRC') respectively on 28 March 2014.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

Who we are

3. Gabelle LLP, founded in February 2011, is an independent tax business. We work in partnership with accountancy firms and other professionals in servicing, keeping and winning clients through technical tax know-how and practical experience. The team at Gabelle is made up of senior professionals with years of practical experience in advising accountants and their clients on tax matters.

4. At the recent Lexis-Nexis's Taxation awards, we were awarded the title of Tax Consultancy Firm of the Year, 2014.

5. For more details regarding our firm, please refer to our website, www. Gabelletax.com.

General Comments

6. Thank you for the opportunity to respond to the consultation on 'implementing a capital gains tax charge on non- residents in respect of UK residential properties'. We agree with the sentiments set out in the foreword that any change made in respect of the legislation must be made in order to improve the fairness of the tax regime for those holding UK residential property and that it is vital that we continue to attract foreign investment.

7. However, the concept of bringing non-residents within the scope of UK capital gains tax charge is a fundamental variation from the current tax legislation and will need careful implementation, if it is to achieve the objective of being fair, sustainable and simple.

8. In particular, we are concerned that any tax regime that is introduced must be simple to understand and administer. Our main concern is that the implementation of this capital gains regime shortly after the introduction of the Annual Tax on Enveloped Dwellings ('ATED') capital gains regime has the potential to cause complex compliance for non-natural entities holding UK residential property, with the risk of transitioning between two sets of rules on the same asset.

9. For example, if an overseas company purchased a residential property for £2m in April 2011 and the property was rented out from April 2011 to April 2016. From April 2016, the directors sought new tenants but were unable to find any suitable tenants and in April 2017 a non-qualifying individual occupied the property until it was sold by the company in April 2018. Based on the current legislation, the gain attributable to the period April 2013- 2016 should fall within the ATED exemptions, but the gain attributable to period from April 2016-April 2018 would be liable to the ATED capital gains charge, taking in account the look-back provisions that can apply on occupation by a non-qualifying individual. However, on implementation of the new legislation, the period from April 2015-April 2016 will now fall within the scope of the

new capital gains tax charge. Undertaking the capital gains calculation arising will be far from simple to comply with, particularly if the two regimes have differing rates, rebasing methods and filing requirements.

10. The consultation document clearly states that the legislation will only arise in respect of "gains arising from" April 2015. It is therefore implicit within the consultation document that there will effectively be a 'rebasing' to the market value as at April 2015 for capital gains purposes of any UK residential assets currently held by non-resident. It is assumed that this rebasing would be achieved on a similar basis to that implemented in respect of the ATED capital gains accruing before 6 April 2013. We would, however, be grateful if HMRC could confirm explicitly that in relation to pre-owned assets, it will only be the gains attributable to the period after April 2015 that will be brought into charge and how it is proposed to identify the pre-April 2015 element of the gain. The calculation method of this pre-April 2015 gain is also considered in further detail below.

Specific comments on the draft legislation

11. In addition to our general comments, our comments on specific questions set out in the consultation document are set out below.

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

12. We do not consider that the exclusion of the communal property as proposed should result in any unintended consequences. However, we do note that the use of slightly different definitions of communal property under ATED regime and under this capital gains regime will lead to further confusion and complication, rather than simplification.

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

13. We are not aware of any other types of communal residential property that should be excluded from the scope.

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

14. Maintaining the tax transparency of partnerships and attributing the capital gains to each partner would seem appropriate. However, in accordance with existing legislation and Statement of Practice D12, there would be a capital gains disposal event for each of the partners in the event that there is a change in the profit sharing ratio of a property owning partnership following a revaluation of the property within the partnership. Under such circumstances, it is not clear how any withholding tax would be applied to the non-resident investors as the partnership itself has not disposed of its property interest. Further clarification is therefore requested from HMRC as to how it is envisaged to deal with such circumstances.

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

15. Section 2.10 states that "if [non-resident trusts] were not included in the scope of the charge this would create tax avoidance opportunities." Adequate anti-avoidance rules already exist to

tax such gains in the UK on the UK resident beneficiary. Care needs to be taken so that the same gain is not charged twice, once on the trust and then again on the beneficiary.

16. Our understanding is that there is nothing in section 225 TCGA to prohibit non-UK resident trustees from claiming Principal Private Residence ('PPR') relief and welcome HMRC guidance in this regard.

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 charges?

17. We agree with HMRC's assertion that it would be administratively extremely difficult to track and target the gains arising residential disposals within a fund that are attributable to non-residents. It also appears equitable to allow all funds, regardless of their legal form, that are widely held, to be excluded from the regime. The genuine diversity of ownership test therefore would seem an appropriate way to identify funds that should be excluded from the extended CGT regime.

18. We also note that the Government is considering a second-stage test, which could exclude funds which do not pass a GDO test, if the vast majority of a fund's portfolio is not in residential property. We would welcome further detail from HMRC on the particular circumstances that would need to apply to fall within these rules and their views on what constitutes the "vast majority".

19. We note that in the event that a Fund does not qualify for the exemption (see further comments below), it is currently envisaged that a charge may be made at the Fund level. The application of the charge to the Fund would mean that a UK resident taxpayer suffer additional tax, firstly as the Fund would be taxed and secondly the on the individual any distribution from the Fund or on disposal of their interest. Clarification is sought from HMRC as to whether it is envisaged that a credit will be available for UK investors in such circumstances.

20. We noted as well that it is the government's intention to exclude from scope of the regime, both UK and foreign pension funds. Further detail is requested from HMRC as to how this exemption will apply, particularly in the situation where a Pension Fund is a co-investor with non-residents.

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

21. In order for the Fund to have certainty for its investors as to its position in relation to this tax, it would seem necessary to have a clearance procedure on a similar basis to the offshore fund rules. Clarification is sought from HMRC whether such a clearance procedure would be available and whether annual returns to demonstrate fulfilment with these requirements will be necessary.

22. It should be noted in the event that it is necessary for such Funds to submit ongoing annual returns, this administrative burden would also seem to place REITs and Foreign REITs at a distinct advantage as they will not need to fulfil this requirement.

23. For commercial reasons, the actual residential property interests are typically held in underlying subsidiaries or unit trusts beneath the Fund, rather than by the Fund itself. Clarification is requested from HMRC as to how the exemption will apply to such entities. For instance, what evidence would the subsidiary need to provide to demonstrate exemption from the charge and how would it claim the exemption, in particular to avoid any withholding tax

being applied on the sale proceeds?

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?

24. We do not consider that it would be necessary to have a further test in addition to a GDO. However as noted above, in order to have certainty as to the Fund's position, it would be necessary to have an advance clearance procedure in place.

Question 8: what are the likely impacts of charging gains (and allowing losses) incurred on disposal of residential property in non-residential property companies that are not already operating a trade in the UK?

25. Within the Consultation Box 1.A we are told that the "overreaching objectives of the capital gains tax charge on non-residents disposing of UK residential property is:

   - Fairness...
   - Sustainability...
   - Simplicity..."

26. The proposals set out in the consultation paper dated March 2014 are not fair, and in some cases discriminatory, because:

Fairness

- Subjecting non-UK companies to a tailored capital gains tax and not corporation tax may well mean that non-UK companies will pay more tax than their UK resident counterparts. This cannot be acceptable, and is in direct conflict with the freedoms established under the European Treaty.
- Allowing an exemption for large funds but not for companies discriminates against smaller investors.
- The rules are unduly complicated (see below) and in the absence of any de minimis rules place a disproportional administrative burden on less well-off taxpayers that do not have access to expensive advisors.

Sustainability

- As stated above the proposed rules (together with existing CGT rules) are too complex for ordinary taxpayers to administer without expensive advice.
- It is noted if HMRC are looking to place non-resident corporates on a similar basis to a UK company, this would imply a tax charge of approximately 20%. This would therefore seem to encourage further incorporation of properties within company wrappers, as the tax rate may well be lower than if held directly by the non-resident individual. This consequence seems to be slightly at odds with government's comment under 2.25 of the consultation document.

Simplicity

- Capital gains made by non-resident companies on the disposal of UK residential property are currently subject to UK tax under:
    - The ATED related CGT charge
    - The anti-avoidance provisions of s 13 et al of TCGA 1992
    - The anti-avoidance provisions of s 86 et al of TCGA 1992
    - The anti-avoidance provisions of s 87 and 97 et al of TCGA 1992

Adding another layer of taxation, be it with complex reliefs will create overly complex rules that affect ordinary companies and not just those perceived as enjoying some sort of tax advantage.

27. This complicated regime would seem far from simple for investors to understand, particularly if there is a different rate of charge between the various taxes, and therefore to take into account correctly in their business plans. This matter may also be further complicated if the property values have fluctuated during this period, for instance a capital loss may be created during the period that the ATED capital gains rules applied and a capital gains arises in respect of the period that the new tailored tax charge arises. Based on current legislation, the ATED capital losses and gains are ring-fenced. Clarification is sought from HMRC as to whether any relief under the tailored charge regime will be available for any ATED loss in such circumstances. In our view, consideration should be made to consolidating the ATED capital gains within the new proposals.

28. In the event a separate tailored charge remains, clarification is also sought from HMRC that on a similar basis to the ATED charge, that there will be an exemption from s 13 TCGA 1992 for UK residents, where the gain arising in the non-resident company has already been taxed in accordance with the new tailored tax charge.

Question 9: Are there any 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?

29. The capital gains rules would be greatly simplified if the ATED rules were abolished or at least integrated into the new proposed legislation.

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

30. Any withdrawal of the PPR election will significantly affect UK resident taxpayers and must be considered under a separate consultation. The aim of the current consultation is to tax non-residents in a fair manner and not to amend the PPR rules.

31. In order for the rules to be fair and not to discriminate against non-UK persons, the PPR rules must be the same for all UK and non-UK residents.

32. The current election regime was introduced with good reason. It is an important tool for UK tax-payers, who have more than property at their disposal, for instance due to work requirements, in allowing them to have certainty as to which property should be considered their PPR. For instance, consider the following situation of a married couple, where one spouse has a pied à terre in town (so resides there say 4 nights a week) whilst the other spouse resides in the family home maintained elsewhere. The use of a PPR election prevents any confusion as to which property should be considered the couple's PPR.

Question 11: Which approach out of those set out in paragraph 3.5 do you believe is most suitable to ensure that PPR effectively provides tax relief on a person's main residence only?

33. As stated above, both approached are flawed and the current election rules should remain. If the first proposal (limit PPR to the person's main residence) is enacted, the facts and circumstances to be considered are open to different interpretation and would remove a sense of certainty from the PPR rules.

34. Although second proposal does have the attraction that would provide clear certainty as a person's position, a fixed rule that looks at where a person is present most of any given year would be unworkable as time spent in a property is often not the best indicator of where a person's principal residence is, and few people count the nights they spend in their home(s).

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

35. We would recommend that the current election rules remain (see above).

36. However, in the event that the election is removed, we would recommend that a hybrid between the two proposals should be put in place, which sets out the key factors that will be taken into account in determining a person's principal residence and gives a points or weighting system to each factor (for instance a higher weighting may be given for electoral roll registration, residence of spouse, partner). This would then allow particular facts and circumstances to be taken into account but also would provide certainty as to a person's position.

37. We would welcome further clarification from HMRC regarding the method proposed for excluding gains prior to April 2015. Based on recent press publications, it is noted that HMRC may be not be looking at a straightforward value rebasing; instead a straight line apportionment may be favoured. If this is the case, as property valuations fluctuate heavily with time, we consider that there should be also be an option to elect to:
    1. use the actual base cost of the property, and
    2. rebase using the market value of the property at April 2015,

    where this results in a lower gain.

38. We also note that in the event that a straight line apportionment is adopted for calculating the attributable gains then this is another compliance difference to the calculation of the ATED capital gains charge, which can only add to further confusion by tax-payers.

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.

39. We do not consider that it would be appropriate for accountants to be responsible for the identification and collection of the withholding tax, as often accountants are not involved in the selling process of residential property and are unlikely to be involved in handling the money associated with the sale.

40. It would therefore be more appropriate for the withholding tax obligation to be administered by the solicitors, who undertake the conveyancing.

41. Further guidance is sought from HMRC on what level of due diligence a professional with responsibility will be required to undertake to satisfy themselves that the seller is either UK or non-UK resident, and whether the seller falls within the scope of the capital gains tax charge. For example, provision of a passport by an individual is not going to provide sufficient evidence to determine if that person is UK tax resident. In addition, even if the person is non-resident, they may or may not fall within the scope these rules for example, an overseas company could fall within any of the following categories:
    - All of the capital gains subject to ATED capital gains charge and therefore not within the scope of the withholding tax.
    - Company resident in the UK by virtue of central management and control and therefore

the gains arising will be outside the scope of the withholding tax.
- Trading in UK properties and therefore the gain will be outside the scope of the withholding tax.
- The capital gains within the scope of new tailored tax charge.

42. A solicitor who has been appointed to undertake the conveyancing in relation the property may well not be aware of the factors that they would need to look at to identify which of the above categories the vendor falls within. Will HMRC be providing a clearance procedure under which a professional can obtain certainty as to which category such an entity will fall within?

43. Given the complexity for professionals in identifying whether the seller is non-resident, in our view, consideration should be given to a far simpler system which applies a withholding tax on the sale of all residential property in the UK, unless the seller is able to provide evidence to verify that they are UK resident. This would be on similar basis for example to the obligation to withhold tax on interest payments. Under such a system, we would envisage that a taxpayer should be able to apply, preferably on-line, for a certificate from HMRC, under which the taxpayer confirms that there have been no material changes to their circumstances since their last tax return and then HMRC are able to issue a certificate confirming their UK tax residence.

44. Having said the above, again we understand based on recent Press covering that HMRC may now be reconsidering this option and looking at replacing the withholding tax with a payment on account mechanism. We welcome this change and look forward to further details in due course.

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

45. As the tax charge is distinct from any other property transaction processes, we do not consider that it is necessary that the withholding tax fits in with any other property transaction processes.

46. As noted, we understand that the withholding tax is likely to be replaced with a payment on account mechanism. We welcome this change and look forward to further details in due course.

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?

47. We agree that it would be appropriate to offer the options of either paying the withholding tax or paying the actual tax due. However, we consider that the time frame of 30 days is too tight to finalise the calculation of the resultant capital gain, particularly when the supporting documentation is likely to be retained overseas.

48. As noted, we understand that the withholding tax is likely to be replaced with a payment on account mechanism. We welcome this change and look forward to further details in due course.

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?

49. As noted above, we think that the timeframe of 30 days to use self-assessment or a variant of this is too tight to finalise computations. A CGT calculation is more complex than, say for example a SDLT liability. In addition, it is rarely possible to determine an individual's residence status under the statutory residence test before the end of the tax year in question.

50. We would also welcome clarification of the commencement of the period from which the 30 days will start, as it would seem more sensible if the period commenced with completion (i.e. once the proceeds of the sale have been received) rather than on exchange.

51. Adding another new filing date and payment date will not in our view simplify the administration of this tax, particularly in the circumstances where maybe part of the gains falls within the scope of the ATED charge and part within the scope of this new tax. We therefore consider that it would be more appropriate to align the filing requirements of this tax with the ordinary self-assessment rules, on a similar basis to UK individuals and those within the ATED charge.

52. Having said the above, we understand that a payment on account mechanism may now be being considered. However the same principles noted above in respect of payment and filing requirements would apply to either a withholding tax or payment on account.

Contact Details

53. If you have any questions in respect of these comments, :