MAURICE | TURNOR | GARDNER

Maurice Turnor Gardner LLP 15th Floor Milton House Milton Street London EC2Y 9BH

BY EMAIL ONLY

capitalgains.taxteam@hmrc.gsi.gov.uk

Our ref ELP/FP/10288/177/1935334

19 June 2014

Dear Sirs

Response to Consultation Document:
Implementing a Capital Gains Tax Charge on Non-Residents

1. INTRODUCTION

Maurice Turnor Gardner LLP is a specialist private client firm advising UK and non-UK resident, domiciled and non-UK domiciled individuals on all aspects of their business and personal affairs.

As professional advisers, we welcome the opportunity to comment on HM Treasury and HM Revenue & Custom's proposals in relation to implementing a capital gains tax charge on non-UK residents as set out in the Consultation Document published on 28 March.

We understand the overarching objectives to be fairness, sustainability and simplicity, and hope that our comments and specific responses to the questions raised in the Consultation Document are of assistance in the Government's formation, and introduction, of the proposals, whilst at the same time meeting these objectives.

2. GENERAL REMARKS

We note that the Government views Britain as an open country and that investment is welcomed from all over the world, including investment in residential property. We find the timing of these proposals to be ill-considered, occurring so soon after the introduction of the ATED regime, and particularly in times of economic and political instability when non-UK residents are actively looking to relocate wealth to the UK by investing in high value real estate.

While the current CGT regime, insofar as it applies to non-UK residents, is anomalous, we strongly believe that if changes are not effectively managed there will be adverse and unintended consequences, which do nothing to meet the objective of improving "fairness" or to correct the imbalance between the treatment of UK-residents and non-UK residents. Instead, it is likely that the measures would be disproportionately detrimental to both.

We urge the Government to consider, very carefully, the possibility of delaying implementation of the proposed extension to the current UK CGT regime to allow the industry time to comment on and assist with formulating and drafting the legislation required to enact the proposals. We understand that draft legislation is expected to be published with the Autumn Statement. That leaves very little time to consider, address and advise on the intricacies of the rules in advance of them coming into effect from 6 April 2015. Given that the scope is widening to non-UK residents who may not be immediately aware of the changes, further time would also be beneficial in order to deliver the message to those affected, ultimately helping to avoid situations of non-compliance.

Our main area of concern is how the extension of the CGT regime to non-UK residents will sit alongside the recently introduced ATED-related CGT on post-6 April 2013 gains realised on disposals of UK residential property (over a certain value). It is our view that the better way to proceed would be to replace ATED-related CGT so that the tax on gains is dealt with under the broadened scope of CGT applying to non-UK residents disposing of residential property generally and/or by taxing disposals by companies under the corporation tax regime.

Clear guidance will be needed to set out how existing double tax treaties will operate in respect of those falling within the scope of UK CGT from 6 April 2015, under the Government's current proposals, as set out in the Consultation Document.

Will there be unilateral treaty relief for tax withheld at source? Gains on the disposal of immoveable property (e.g. land and buildings) are generally taxable in the territory in which the property is situated (article 5 OECD model treaty). The OECD model treaty nondiscrimination clause ensures that foreign nationals taxable in another country shall not be charged to any more tax than individuals native to that country on income received form similar sources.

3. SUMMARY OF OUR VIEWS

3.1 We fully support the Government's primary objective to introduce a fair system of taxation for residents and non-residents alike in respect of disposals of UK situated immoveable property in the form of UK residential property. We also support having in place a sustainable system which is designed at the outset to prevent avoidance.

3.2 We are, however, doubtful that the third objective of simplicity can be met by undertaking the current approach as set out in the Consultation Document.

3.3 We agree and support the exclusions of dwellings provided for education, care, armed forces and encourage investment by resident and non-resident investors alike, in this way.

3.4 Clarity is needed on how the suggested approaches would operate in terms of:

(a) The proportion of a gain realised on disposal that would become chargeable.[1]

(b) Interaction with the ATED-related CGT regime.

(c) Application of the GDO test.

(d) Interaction with existing anti-avoidance rules relating to foreign companies and trusts.

(e) Application and operation of double tax treaties.

3.5 It is our strong view that the ability for a taxpayer to elect to treat a particular residence as his main residence for the purposes of Principal Residence Relief should remain.

[1] The new charge is to apply from April 2015 and only to gains arising from that date. However, the method of excluding gains which arise prior to April 2015, is not clear in terms of whether there would be a straightforward rebasing mechanism (as has been successfully implemented in both 2008 and 2013) or whether, rather, a straight line apportionment may be favoured.

3.6 It is our view that the better way to proceed would be to replace ATED related CGT so that disposals are dealt under the broadened scope of CGT applying to non-UK residents disposing of residential property generally and/or by taxing disposals by companies under the corporation tax regime.

3.7 A 30 day timescale for reporting and paying a flat rate of CGT seems sensible but where a computation is required those without an existing UTR should not be discriminated against.

3.8 There is a risk that the suggested proposals could damage to the commercial attractiveness of the UK to foreign investors and therefore great care should be taken when considering measures which could deter such investment.

3.9 Finally, we implore the Government to consider delaying implementation so that there is sufficient time in which practitioners may consider, analyse, provide feedback and input on the draft legislation to ensure that it is fit for purpose. A delay in implementation will also allow more time for non-UK residents to understand and become aware of their new responsibilities, thus avoiding non-compliance through ignorance.

4. RESPONSES TO QUESTIONS POSED

The following specific questions have been posed.

Question 1

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

We do not consider that it would.

Question 2

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

No, provided there is consistency with the existing SDLT regime which we believe will be the paramount consideration in most circumstances.

Question 3

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

As a matter of principle, we can see no objection to extending the charge to non-UK resident partners. Great care however needs to be taken in implementation.

The taxation of partnerships gives rise to different (and additional) considerations to the taxation of individuals. The current application of CGT to partnerships is based on a mixture of extra statutory concessions and guidance in HMRC manuals. Consideration would need to be given (for example) to CGT considerations associated with contribution of assets to partnerships; base cost of assets in partnerships; treatment of capital ratios during the lifetime of a partnership; and changing the book value of partnership assets for accounting purposes.

It will be necessary to take into account commercial and accounting practice associated with partnerships. It should also be noted that applying partnership tax rules to Limited Liability Partnerships (**LLPs**), i.e., corporate entities with tax transparency, can give rise to serious discrepancies and anomalies (e.g., the application of inheritance tax to LLPs). Particular care would need to be taken to ensure that the proposed extension of CGT did not give rise to such anomalies.

Question 4

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

We see no conceptual difficulty with bringing non-UK resident trustees in the scope of charge. Care must be taken with the application of PRR, and the enforcement of liabilities.

We note, however, that the anti-avoidance rules relating to foreign trusts (principally ss.86, 87 TCGA and related schedules) are extremely complex. Experience following the introduction of the Finance Act 2008 shows that attempting to modify the scope of these provisions is difficult. It would be important to give very careful thought as to the interrelationship between these provisions and any new charging regime.

For the avoidance of doubt, please confirm that disposals of residential property by charitable trusts would be excluded.

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?

The GDO condition (borrowed from the Offshore Fund Regulations) is intended to prevent close groups of investors from taking advantage of the 'white list' provisions which are aimed at investors in widely-pooled schemes, rather than those using closely-held arrangements that may in reality be for the benefit of a tightly restricted group (for example a group of family members or a group of companies in common ownership).

Under the existing GDO test, an offshore fund will satisfy the test if the fund meets three conditions, which, broadly, demonstrate that the fund is a commercial arrangement.

Condition A is that the fund must produce documents (available to HMRC and Investors) which contain:

- A statement specifying the intended categories of investor.
- An undertaking that the shares will be widely available.
- An undertaking that interests in the fund will be marketed and made available sufficiently widely to reach and attract the intended categories of investors.

Condition B is that neither the specification of the intended categories of investor nor any other terms governing participation in the fund has a limiting or deterrent effect.

Condition C is that the interests in the fund are marketed and made available:

- Sufficiently widely to reach the intended categories of investors.
- In a manner appropriate to attract those categories of investors.
- That a person who falls within the intended categories of investor can, upon request, obtain information about the fund and acquire units in it.

The Corporation Tax Manual guidance on the GDO test states: *"If there is no doubt that a fund has or is intended to have a wide range of unconnected investors then it will clearly have no difficulty in meeting the GDO and advance clearance will not be necessary."*

Taking the above into account, and based on our understanding of the GDO test, it would appear to us to be a sensible and 'off the shelf' way in which to determine whether a closely connected group of investors are seeking to avoid tax by structuring investment in UK residential real estate in a certain way.

However, as specialist private client lawyers we do not regularly advise on the Offshore Fund Regulations and so, whereas in our view the GDO test appears to be a sensible and ready-formulated test, we would defer to our funds colleagues in the industry to provide deeper insight on the working practicalities of this test and the challenges that are faced in its application.

We would hope that HMRC would give weight to the representations and responses from experts practicing in the offshore funds field and to take careful note of such practical challenges that they may raise.

It is our understanding that (under the Offshore Funds Regulations) as part of the process of applying the GDO test it is possible to seek advance clearance from HMRC. We believe that the ability to obtain advance clearance would be vital in introducing such a test in respect of residential real estate investment.

Question 6

Are there any practical difficulties in implementing a GDO test?

One practical difficulty that is foreseen is in respect of the extent to which it must be shown that investing parties are unconnected. This point goes to the level of disclosure of ultimate beneficial owners of investing entities. In order for the GDO to be complied with consistently, and with the GAAR provisions in mind, greater clarity and guidance will be needed so that advisers who are not offshore funds specialists will be able to apply the GDO test with confidence.

However, and as set out in our response to question 6 above, as specialist private client lawyers we defer to our funds colleagues in the industry to provide deeper insight on the working practicalities of the GDO test and the challenges that are faced in its application.

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?

In principle, provided that the GDO test and the guidance as to its application is clear we see no need for an additional test. However, again, we defer to our funds colleagues in the industry to provide insight on whether the GDO test requires either further qualification or whether a, separate, additional test might also be required.

What we believe would be helpful is to retain (as is available in under the Offshore Funds Regulations) the ability for advance clearance application as this provides an element of certainty and clarity in the industry and for taxpayers.

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 introduction of the new charge will lead to increased complexity within the UK's taxation system.

- It will be difficult to implement the new charge in such a way as to create a comparable tax position for residents and non-residents (for example in terms of allowances and reliefs) without introducing unacceptable complexities in terms of anti-avoidance legislation or opportunities for avoidance.
- The interaction of the new charge with the ATED-related CGT provisions will create a two tier system with considerable complexities. In some cases, a sale of UK residential property by a non-UK non-natural person will generate a gain that is subject in part to ATED-related CGT and subject in part to the new charge.

- Particular care will be needed to ensure (as appears to be intended) that the introduction of the new charge does not to give rise to the double taxation of any gains under the ATED-related CGT regime and the new charge.
- Clarification is required in relation to how the new charge will interact with existing anti-avoidance legislation (particularly ss13 and 87 Taxation of Chargeable Gains Act 1992) in respect of disposals by closely-held non-UK resident companies and non-UK resident trustees.
- Clarification is also required in relation to which losses will be allowable in relation to gains realised on the sale of UK residential property by a non-UK resident company, a non-UK resident trustee and a non-UK resident individual.
- Confirmation is required that the new charge will only apply to gains which have accrued post-6 April 2015 realised by any non-UK resident (be it a company, individual, trustee or other person) and not simply to gains realised post 6 April, without an adjusted or re-based base cost.

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?

It would be preferable to have a single tier approach to charge gains realised on the disposal of all UK residential property by non-natural owners, whether UK resident or non-UK resident. This would achieve the simplicity objective. Our suggested approaches are as follows.

The first, and preferable, approach would be to examine whether a non-UK resident company owning UK residential property (including rental property or investment property) has a permanent establishment in the UK, and in such cases provide that any profit made on a disposal would be subject to UK corporation tax. This would bring the tax regime extended to non-UK residents more in line with the UK's existing regime to tax companies (ss.1(2) and 8 TCGA) rather than extending a regime currently applicable to UK individuals and trustees to companies.

In summary, rather than have the position that UK corporation tax applies *unless* ATED related CGT applies, instead extend corporation tax – which is, after all, a tax on the income and gains of companies.

The second suggested approach would also be to discontinue ATED-related CGT and, instead (rather than subject gains to corporation tax as in the first approach), tax gains made by non-UK resident non-natural persons on disposals of UK residential property under the proposed, extended CGT regime.

A further approach, if ATED-related CGT is to remain, is to carve out those who fall within the ATED-related CGT regime from the broadening scope of CGT to non-UK residents generally.

The ATED regime could be (i) extended so that ATED-related CGT is charged on all gains made by non-UK resident companies on the sale of UK residential property regardless of the value of that property and (ii) amended to remove the current exemption for property rental businesses (in effect this is what will be achieved through the implementation of the new charge).

These approaches would also meet the Government's fairness and sustainability objectives.

Question 10

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

In our view, there are a number of potential practical difficulties with the proposed changes to the PRR election rules.

The first is a question of proportionality: given that, according to HMRC figures released in December 2013, there were approximately 97,000 residential property transactions in November 2013, one might assume an annual average of over a million property transactions. The vast majority of these transactions are likely to be by UK resident individuals. Most will own only one home, but a material number may own, rent or use another property at some time (even if only briefly). To require any degree of (new) record-keeping by a significant sector of the UK taxpaying public, in order to capture new amounts of tax (however welcome) from those who are not resident, invites the kind of error or unfairness which would weigh disproportionately on UK taxpayers. It may also lead to avoidance by those who have failed to keep records.

If the Government adopted option 1 (the removal of the ability to elect) this would potentially require all property owners to keep records of where they spend most time, and other factual/circumstantial evidence.

Option 2 (the replacement of the election with a fixed test based on actual presence) would also potentially require the entirety of the UK's homeowner tax base to keep records to some degree, and may also require HMRC to assess each claim, depending upon the test adopted.

Either option (but particularly option 1) would place a considerable burden on HMRC to assess each claim, and since a material proportion of those property sales may involve those who have had access (as owners or renters) to more than one home, if a seller's pattern of use changes during a year, or from one year to the next, HMRC may not have the resources to deal with complex apportionment of gains over a long period of ownership with variable use.

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?

For the reasons given in our response to Question 10, neither option 1 nor option 2 represents, in our view, a suitable approach. Our preference would be to maintain the ability for taxpayers to make an election (and only in default of election to be assessed on the facts and circumstances specific to them).

Question 12

Are there any other approaches that you would recommend?

We appreciate that the purpose of the proposed change is to bring non-UK residents within the charge to tax on sale of a property which is not their main home, in the same way as that rule applies to those who are UK resident. However, if the price of such a change is to impose a significant administrative burden on existing taxpayers – or, worse, to deprive them of a relief (in the form of the right to elect without question) which they have traditionally enjoyed – then this simply creates a new unfairness.

Clearly, the obvious preference would be to restrict the relief to those who are resident in the UK when they make the claim, or make it within 18 months after it ceases to be their main home (and relief should be allowed only for years that they are resident in the UK). However, we also appreciate that current EU legislation means that a relief afforded to UK residents must generally also be afforded to EU residents. If that is the case here, then on balance, it seems to us preferable that the current PRR election rules should be extended to EU residents. If this means that some hoped-for tax is lost from EU residents, it will presumably be balanced to some degree by the recovery of tax from others who are currently not liable to pay, and without a great increase in the overall cost of administering the tax.

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.

We understand that following announcements made at the 22 May joint HM Treasury and HMRC working party meeting the original proposal to place a legal obligation on an agent to withhold tax, as set out in the Consultation Document, has now been withdrawn and that the new proposal is for a 'payment on account' (**PoA**) system to be introduced. It is our understanding that the revised proposal is that, following a disposal, a non-resident individual or company will have 30 days to submit a form which provides the taxpayer with three options:

1. Make a PoA (at a rate to be decided).
2. Submit a computation of the actual amount due.
3. Indicate that they will report the gain on their tax return in the usual way (for taxpayers able to provide a current individual or company unique taxpayer reference (**UTR**)).

Clarification is required as to how the PoA will be calculated and whether it will be a flat percentage of proceeds, or one of a number of other possibilities, and what further liability (if any) to tax will remain once a PoA has been made.

We agree that it is sensible and flexible to offer a range of options to the tax payer. If there is a flat rate (akin to an SDLT rate) of CGT which can be reported and paid within 30 days of the effective date of completion of a disposal then that seems to us to be a sensible approach and we can see the benefit of dove-tailing the timescale for reporting and payment.

However, it would not be fair to impose the same 30 day timescale for payment and reporting on taxpayers opting to submit a computation. Such an imposition would be discriminatory towards those taxpayers who do not already have a UTR, i.e. the majority non-UK residents.

Question 14

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

No longer applicable. Please see our response to question 13. In any event, requiring solicitors to manage a withholding tax would add to the cost of a sale and the administrative burden involved in the sale of residential property as at present completion of the sale and payment of the proceeds of sale to the client is the last stage in a transaction.

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?

We understand that the Government is already doing this by amending the proposals (as set out in our response to question 13).

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

It seems sensible, provided there is a flat rate of tax to be paid, that the time period for the submission of an SDLT return (by the purchaser) and submission of CGT return (by the seller) should be the same in the circumstances where the taxpayer does not already have a UTR enabling him to report and pay tax in the usual way.

Where a computation is required the time frame should be in line with the timeframe permitted for those with a UTR (see our response to question 13).

5. CONCLUSION

We hope that this is of assistance. If anything is not clear, or if we can be of any further assistance, please do not hesitate to contact any of whose contact details are all on our website www.mauriceturnorgardner.com.

Yours faithfully

Maurice Turnor Gardner LLP.

Maurice Turnor Gardner LLP