MOORE STEPHENS

Implementing a capital gains tax charge on non-residents

A response by Moore Stephens LLP to the HMRC

consultation document of 28 March 2014

June 2014

Introduction

This paper is a response by Moore Stephens LLP to the HMRC consultation document of 28 March 2014, 'Implementing a capital gains tax charge on non-residents'.

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This paper responds to each of the questions posed in the consultation document. We have only one point to raise that is not covered by our responses to those questions. This relates to the rebasing of affected properties to April 2015, when the charge commences.

Comments from Moore Stephens LLP

Rebasing

The Foreword to the document, and para 1.1 in the introduction, both state that 'The charge will come into effect in April 2015 and apply only to gains arising from that date'. This is somewhat ambiguous. The reference to 'gains arising' may mean gains 'accruing to a person on the disposal of assets' within s1 TCGA 1992, in which case increases in the value of residential property between acquisition and April 2015 will be brought into charge on a disposal after that date (and it follows that there is a one-year 'window' for affected taxpayers to avoid such a charge by disposing of property under the current regime). Alternatively, it may mean that affected properties will be 'rebased' to April 2015, so that increases in value before that date escape the charge.

We assume that the latter is the intention, because of:

(a) the manifest unfairness of any other approach;
(b) the absence of any mention in the document of 'forestalling' provisions; and
(c) the parallel with the introduction of the ATED-related capital gains charge where properties were rebased to April 2013 (but where, as in the present case, that intention was not made clear in the initial consultative document).

We would certainly recommend strongly that pre-April 2015 increases in value should be left out of account by rebasing properties to that date, as any other approach would amount to retrospective taxation. There should also be a facility to elect for the gain to be calculated by reference to the whole period of ownership (as for ATED-related chargeable gains in para 5 Sch 4ZZA TCGA 1992) in order to avoid the situation where a taxpayer is charged on a post-April 2015 gain greater than that which has arisen over the total period of ownership.

We would also recommend that the Government's intentions on this point be made clear as soon as possible, without waiting until the issue of the response document for the present consultation, in view of the importance of this point to affected taxpayers. Different commentators have understood the Government's intentions in this area in different ways, which has led to uncertainty and confusion. It is highly undesirable that taxpayers' actions should be constrained by uncertainty as to the tax consequences.

Chapter 2. Key design features: who and what is in scope?

What is meant by residential property?

Q1. Would an exclusion of communal property from the scope of the new regime result in any unintended consequences?

No.

Q2. Are there any other types of communal residential property that should be excluded from scope?

No.

Different forms of residential property ownership

Q3. Are there any particular circumstances where including non-resident partners in scope of the charge might lead to unintended consequences?

No.

Q4. Are there any particular circumstances where including non-resident trustees in scope of the charge might lead to unintended consequences?

Care will be needed, as recognised in para 2.10 of the document, to avoid any double charge as a result of the interaction between the new rules and existing anti-avoidance provisions relating to overseas trusts.

Section 225 TCGA 1992 gives relief to trustees on the disposal of a dwelling house that has been the only or main residence of a person entitled to occupy it under the terms of the settlement. Currently this only applies to UK-resident trustees, because non-resident trustees are outside the scope of the capital gains tax charge in any case. We suggest that this relief should apply equally to non-resident trustees, subject to any restrictions on the extent to which a UK dwelling may be treated as the only or main residence of a non-resident individual, as discussed in reply to Question 12 below.

Q5. 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?

Yes.

Q6. Are there any practical difficulties in implementing a GDO test?

Such a test would need to be based on ultimate ownership, so that the existence of a major institutional holder in a fund did not result in the test being failed.

The intention of the legislation is to prevent tax avoidance where residential property is owned by a small number of individuals through closely held structures. We foresee problems if the test were to be framed by reference to connections between investors, because of the practical difficulty for a fund in obtaining the necessary information where investors would not necessarily be aware of its relevance. However, it appears that the intention is to use a test such as that in reg 75 of the Offshore Funds (Tax) Regulations 2009, SI 2009 No 3001, which concentrates more on the way the fund is marketed and conducted. We agree that this provides a practical solution. We would recommend also that there should be a procedure for a fund to apply for clearance that the GDO test is met, as in regs 77 and 78 of the Offshore Funds (Tax) Regulations.

Q7. 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?

We support the suggestion in para 2.17 of the document that a further, second-stage, test be included in the legislation to ensure that where the vast majority of a fund's portfolio is not in residential property it is not affected by the charge.

Q8. 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?

We answer this question in conjunction with Question 9 below.

Q9. 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 ATED regime and associated changes were introduced with the stated aim of discouraging 'enveloping' arrangements under which individuals owned UK residential properties through the medium of companies, giving the opportunity to save SDLT by selling the company rather than the property. Somewhat perversely, the current proposals could in certain circumstances provide an incentive to move back towards those arrangements. A non-resident individual owning a UK residential property may have an incentive to transfer it to a non-resident company. An initial capital gains charge may arise (which will be minimal if rebasing applies) and thereafter it will be possible to avoid any further capital gains charges by selling the shares rather than the property. There will of course be an SDLT charge on the transfer, which may be prohibitive.

We are unconvinced of the rationale for taxing capital gains made by non-resident corporate landlords; ie, for not including a relief for let property, as in the regime for ATED-related gains. There does not appear to be any policy reason to distinguish between residential property that is let commercially, and let commercial property - or indeed between let residential property and any other UK asset that produces investment income. The segregation of residential property as a particular category of asset to be brought into charge in the hands of non-residents can only (it seems) be justified on the ground that the owners are competing with UK residents for a scarce resource (and are often leaving it unoccupied for at least part of the time). This does not apply to let property, which continues to be occupied, normally by UK residents.

Even if the inclusion of let property within the charge can be justified, we consider that the method proposed introduces undue complexity which will cause additional administration and uncertainty for taxpayers and professional advisers without affording any benefit to the Exchequer. A non-resident landlord with a property valued at over £2 million (reducing in due course to £500,000) will notionally be within the scope of the ATED-related CGT charge, but will be taken out of charge by the relief for let property, only to be brought back into the scope of tax by the proposed 'tailored charge'.

The rate of that charge has not yet been announced but, clearly, if it were to be the same as (or very close to) the rate of the ATED-related charge it would be simpler to abolish the relief given under the ATED-related charge and leave the gain to be taxed under that regime.

If the rate is significantly different, an overseas landlord company will potentially be placed in the same position as UK companies, for which under current rules the increase in value of a property over many years may be made up of a number of 'slices' taxable at either the ATED-related rate of 28% or at a different rate (in the case of UK companies, the normal corporation tax rate). This involves an element of 'rough justice' because the slices are determined on a time apportionment basis rather than by reference to valuations. We do not recommend the substitution of valuations (either as regards the existing system for UK companies or the proposed system for overseas companies) because of the cost involved, but we do suggest that the potential for fluctuation between two rates is an unsatisfactory feature of both systems.

The current complex position of UK companies presumably results only from the necessity to ensure that such companies are not treated more advantageously than companies based in other EEA states as regards ATED-related gains. We suggest that consideration be given to abolishing the ATED-related capital gains charge altogether, leaving UK companies to pay tax on all capital gains in the normal way, and overseas companies to pay tax on all UK residential property gains under a single new regime. We acknowledge, however, that if EU constraints meant that the rate of tax under the new regime could not be more than the UK corporation tax rate, this would give scope for individuals to reduce their tax liability by enveloping arrangements. It is difficult to make detailed suggestions without knowing the rate of tax that the Government has in mind for the new 'tailored charge'.

Chapter 3. Key design features: how the charge will be implemented

Private residence relief

Q10. Are there any particular circumstances where changing the PRR election rules might lead to unintended consequences?

We would strongly urge that any perceived problems with the current principal private residence relief for UK-resident taxpayers should be addressed as a separate matter, and not as 'knock-on' effects of extending the capital gains regime to non-residents. The relief is a fundamental part of the capital gains regime, recognising as it does that increases in the value of a taxpayer's home do not represent any increase in his real wealth unless he is in a position to 'downsize' or to move to a part of the country where properties are less expensive. To tax gains on an individual's home is an arbitrary tax on mobility, discouraging sales and forcing those for whom a sale is unavoidable to move to ever smaller homes as their capital is depleted by tax charges.

Successive governments have sought to ensure that while, in general, relief is not available to an individual for two dwellings at the same time, the regime does take into account the practical difficulties that can be involved in the mechanics of moving house. Clause 54 of the current Finance Bill reduces to 18 months (from 36 months) the time at the end of the period of ownership that can be taken into account automatically, as if the dwelling were the individual's only or main residence during that time. This change may well prove sufficient to address the areas where the Government has concerns, and we suggest that further changes affecting UK residents should not be made until there has been an opportunity to assess the impact of the reduction in this closing period.

We would strongly urge the retention of the present facility to elect which of two or more residences is to be treated as the main one. This acts as a major simplification in the current system in circumstances where it would be difficult for the taxpayer or HMRC to say with any certainty which was the main residence as a matter of fact. If this was true when the facility was introduced (by s29(7) FA 1965) it is even more so now when travelling is easier, mobile lifestyles are much more prevalent, and households where both spouses work are the norm. We do not consider that it creates a significant distortion in the system. A taxpayer is, broadly speaking, most likely to wish to claim the benefit of the exemption for his most valuable residence, and that is most likely to be his main residence. If, on occasion, it is claimed for a less valuable property because that property is more likely to be sold then, broadly, the taxpayer stores up a larger gain to be taxed in the future.

Q11. 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?

If, contrary to our advice, the facility to make the election were abolished, then we would advocate the retention of the existing rule that in the absence of an election the matter is determined on the basis of all the facts. We would advocate this on the grounds of fairness, despite believing that it would bring about a multitude of time-consuming disputes between taxpayers and HMRC, many of which would have to be decided by the First Tier Tribunal. We believe that a 'day-counting' system would be inherently unfair. A taxpayer who lived outside London but kept a London flat for use during the week, where he did little but sleep, could 'clock up' four or five nights a week for that home, and only two or three for a country home where he spent many more waking hours, where his family lived, and where the vast bulk of his belongings were kept.

In addition, the vast majority of taxpayers will not keep day-by-day diaries of their movements, because they will be unaware that this is necessary. To impose a statutory requirement to do so would be ineffective in many cases, and unduly burdensome in the case of those taxpayers who complied. Even where the necessary information was available there would inevitably be 'hard cases' where taxpayers fell just to one side of the line, perhaps because of unforeseen circumstances such as illness.

Q12. Are there any other approaches that you would recommend?

We would recommend making no change to the current system, except to introduce a rule that a UK property could not be the main residence for a year of assessment or split year in which the taxpayer (or the occupier in the case of a property owned by a trust) was not resident in the UK. It would follow that if the taxpayer (or, in the case of a trust-owned property, the occupier) was non-resident for the whole of the period of ownership no relief would be available.

We recommended in our comments on rebasing above that there should be a facility to elect for the gain to be calculated by reference to the whole period of ownership rather than the period since April 2015 (as for ATED-related chargeable gains in para 5 Sch 4ZZA TCGA 1992) in order to avoid the situation where a taxpayer is charged on a post-April 2015 gain greater than that which has arisen over the total period of ownership. This may be particularly relevant in the case where the dwelling has been an individual's only or main residence for a considerable time before April 2015 but not for the whole of the period thereafter.

Delivery mechanism

Q13. 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 believe that these responsibilities should not fall on any professional adviser other than a solicitor or licensed conveyancer through whose hands the proceeds of the sale pass in the course of the transaction, when they are acting for the vendor. In other circumstances the responsibility should lie with the vendor. Thus the vendor alone would be responsible in circumstances where the sale proceeds passed directly to him from the purchaser or the purchaser's agent, or in circumstances where funds found their way directly or indirectly into the hands of an agent for the vendor who had not acted in the sale. Otherwise, for example, a professional adviser receiving funds from a client to hold for investment might find himself liable for withholding tax if it emerged that, unbeknown to him, those funds had derived in some way from the sale of UK residential property.

Identification of the seller as non-resident should be by means of reasonable tests such as those that apply for the purpose of reporting by paying agents under the EU Savings Directive or FATCA, rather than by reference to what may eventually be agreed (after negotiation and possible litigation) to be the vendor's residence status for tax purposes, applying the statutory residence test. In many cases that test cannot be applied correctly until after the end of the tax year in question, once further changes in circumstances are precluded. In addition, specialist professional advice is often needed as regards its application.

The withholding requirement should apply only where the conveyancer has reasonable grounds for suspecting that the vendor is non-resident, and the vendor is unable to provide evidence to rebut this presumption. In particular we consider that requiring all vendors to provide a UTR or a certificate of residence from HMRC would be unduly cumbersome, both for taxpayers and for HMRC.

It will be important to avoid a situation where the retention of withholding tax by the conveyancer becomes the default position. Such a situation would significantly impede the majority of residential property transactions, where the proceeds are required in order to meet the costs of a new dwelling being purchased on the same day. We leave solicitors and licensed conveyancers to comment on the practicalities of this point, but we suggest that HMRC look carefully into the way in which these problems are addressed in other jurisdictions where there is a withholding requirement.

Q14. Are there ways that the withholding tax can be introduced so that it fits easily with other property transactions processes?

We leave comment on this point to lawyers involved in property transaction processes.

Q15. 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 consider it absolutely crucial that there should be a facility to base the tax payment on a calculation of the actual tax liability, because a withholding tax based on proceeds would bear a completely arbitrary relationship to the amount of the gain, and could well exceed it. Taxpayers should be allowed to use reasonable estimates where necessary, subject to later adjustment; for example, where the liability depends on valuations.

Q16. 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 consider a 30-day limit far too short, when valuations and complex calculations may be required. There is no comparison to the position for SDLT where a 30-day limit is reasonable because the calculation of the tax liability is a straightforward percentage of the purchase consideration. A 90-day limit would seem more appropriate. This need not place revenue at risk if solicitors acting for the vendor were required to retain withholding tax based on the full amount of proceeds until they received (or made) a calculation of the actual liability that they reasonably believed to be correct.

We also consider that HMRC should be obliged to provide a response within a further period of 60 days, or to make a reasonable request for further information within 30 days, failing which the taxpayer's computation should be deemed to be agreed.

The time limit for submitting the computation should not run from the exchange of contracts (which is the crystallising event for the CGT liability) but from the date of completion. If it ran from the exchange of contracts there would be circumstances where the tax became due before funds were available to meet it.