TAXREP 35/14 (ICAEW REPRESENTATION 83/14)

IMPLEMENTING A CAPITAL GAINS TAX CHARGE ON NON-RESIDENTS

ICAEW welcomes the opportunity to comment on the consultation paper *Implementing a capital gains tax charge on non-residents* published by HM Treasury and HM Revenue & Customs on 28 March 2014.

This response of 20 June 2014 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

Contents	**Paragraphs**

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 0547
E taxfac@icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 142,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

INTRODUCTION

1. In the 2013 Autumn Statement (5 December 2013) the Chancellor announced the extension of capital gains tax (CGT) to non-residents disposing of UK residential property and a consultation in 2014 on how the policy would be implemented.

2. Consultation Paper *Implementing a capital gains tax charge on non-residents* (published on 28 March 2014) sets out the initial HM Treasury (HMT)/HM Revenue & Customs (HMRC) thinking on the proposed extension of CGT.

3. We raised some immediate concerns with the proposals in the consultation in our letter of 29 April 2014 addressed to Mr M Crabtree, Deputy Director - Assets and Residence Policy Specialist Personal Tax, Appendix 1.

4. HMT/HMRC have held a number of working groups (both high level and more detailed) during the consultation period at which various aspects of the proposals set down in the consultation document have been discussed; ICAEW Tax Faculty volunteers have attended these meetings.

5. In the response below we address both the proposals in the consultation document and the suggestions considered during the various working group discussions about those proposals. Our response comprises a summary of our key concerns, comments on the areas not covered specifically in the consultation questions and finally, replies to the 14 consultation questions.

6. We are happy to discuss any aspect of our comments and to take part in all further consultations. We appreciate that enacting this legislation will be far from straightforward and that the drafting process will throw up various additional unforeseen technical difficulties; we are happy to participate in technical discussions and correspondence in this connection.

KEY POINTS

7. Extending CGT to non-residents disposing of UK residential property is a major change to the UK tax system. We agree that that the taxation of foreign owned real estate is a widespread feature of many tax systems, so the fundamental principle is not objectionable. However, we are concerned about the management of this change, the complexity that the current proposals threaten to introduce into the CGT system, and the proposals run counter to our *Ten Tenets for a Better Tax System* (summarised in Appendix 2), especially simplification, ease of tax collection and competitiveness. It is essential that there is consistency in the way all the property taxes apply and interact including ATED.

8. Various piecemeal changes have been made to the taxation of residential property over the past few years. Rather than going ahead with the proposed CGT extension in the 2015 Finance Act we suggest that there is a far wider public consultation into the taxation of UK real estate that considers all the taxes (both direct and indirect) with the intention of implementing coherent policies relating to real estate across the taxes.

9. In the absence of a wider review of the taxation of UK real estate, we are particularly concerned that the consultation document is drafted on the assumption that ATED-related CGT will continue and, where it taxes a gain, take priority over the new general CGT charge. In our view this will undermine the new general charge and result in unacceptable complexity that is likely to damage the UK economy as foreign investors will be baffled by the presence of two different regimes and look to other jurisdictions with comprehensible tax rules.

10. There should be just one CGT regime for non-residents (though with appropriate modifications so the rules work for all the different categories of taxable non-resident person) and this should be as closely integrated as possible with the general CGT provisions. ATED-related CGT should be abolished for all gains accruing after 5 April 2015. Any tax lost as a result of this could be recouped either by increasing the SDLT rate and/or by increasing the ATED rate so that there is overall tax neutrality.

11. To ensure a consistent interaction with other charging provisions (particularly the offshore CGT anti-avoidance legislation) this new tax charge should be given primacy such that it will apply to all gains on UK residential property accruing after 5 April 2015. Transitional provisions will be needed for property held prior to 6 April 2015 and we discuss these below.

12. We welcome the commitment to only tax gains arising after 5 April 2015. To ensure this is in fact the case it will be necessary to have rebasing (with an option to elect out), as time apportionment will not necessarily achieve the same result.

13. We understand why changes are necessary to the TCGA 1992, s 222(5) main residence election. However, we do not think it is appropriate to remove the ability to make an election as this will impact adversely on UK residents and would make the operation of the provisions much more complicated in situations where determining the main residence of an individual or couple is not straightforward.

14. We have considered adjustments to the statutory residence test but on balance think there could be a conflict with EU law and also we are not particularly in favour of changing the statutory residence test so early in its life. As such, we would suggest that the election is retained but that it should be restricted. We know doing this appropriately will be problematic, as there are various considerations that need to be considered (such as the interaction with the “absence rules”).

15. Our preferred approach is to have a general consultation on main residence relief where the various issues could be considered in depth. However, if the current timetable, with the new charge coming in from 6 April 2015 is adhered to there will be no time for this.

16. To avoid unfairness, if restrictions in the ability to make an election are introduced, there needs to be a change in the interests that are taken into account when considering whether an individual has multiple residences for main residence relief purposes. It will be necessary to change the legislation such that only interests in property owned by the individual are taken into account when considering eligibility for main residence relief. As a result where an individual has two residences, only one of which they own, the property they own will automatically qualify for relief with no need for an election to be made. Provided this is done, elections could be retained subject to restrictions. For example, the restriction could relate to a minimum occupancy period in order for an election to be valid with apportionment if occupation starts or ceases part way through the tax year. This should not, however, disadvantage individuals where the lack of occupation is work related or due to illness so there would need to be special provisions to cater for these situations.

17. Whatever changes to the TCGA 1992, s 222(5) main residence relief election are enacted there need to be transitional rules so existing relief entitlements are not lost.

18. Drafting the legislation for this new CGT charge will not be straightforward. The definitions legislation alone (with the necessary exclusions and provisions for changing use etc) will be very difficult. In addition, as discussed above, the changes to TCGA 1992, s222(5) main residence relief impact on UK and non-UK residents and more time than the current timetable allows is required for all the issues to be thought through. Enacting the legislation in 2015 will give insufficient time for review and amendment. In the same way that the statutory residence test proposals were deferred by a year to give time to get the legislation right we think that this legislation should be deferred. Given that the policy has already been announced this could be done whilst still keeping the 5 April 2015 rebasing date.

GENERAL COMMENTS

Avoiding piecemeal changes to the taxation of UK real estate

19. A consistent and dependable fiscal framework is vital to the credibility of a tax system. Constant changes to the underlying rules undermine trust in the tax system and there is significant evidence that this translates into less foreign investment and is therefore, bad for the economy as a whole.

20. During the representations on high value residential property taxation in 2012/13, there were calls for a more fundamental consideration of the territorial scope of CGT and the taxation of UK real estate. We said the following in our response (Taxrep 41/12 Residential Property Transactions, paragraph 15):

"The proposed CGT measures should be dropped entirely. Government could consider whether the policy of not subjecting non-residents to CGT is still appropriate. This would be a radical move which would need transitional rules and separate meaningful and open consultation."

21. Others made the case for a general extension of CGT, in place of the complicated structure of the ATED-related proposals. Responses on the scope of the charge were summarised in paragraph 4.5 of HMT's December 2012 document "Ensuring the fair taxation of residential property transactions: summary of responses" (published on 11 December 2012):

"Many respondents argued that CGT should only be applied to NNPs subject to ARPT and the 15 per cent SDLT rate. Several respondents also suggested that a narrower group of entities should be covered, with some specific comments that genuine businesses, personal representatives and trustees needed to be excluded. On the other hand, a minority of respondents suggested that the CGT charge should be applied more widely, to align treatment more closely between residents and non-residents disposing of high value residential property."

22. These calls for a wider review and consideration of the territorial scope of CGT and the taxation of UK real estate were all rejected in favour of introducing a narrow ATED-related CGT charge. Whilst we appreciate that the Chancellor's 2013 Autumn Statement announcement was the result of a new "fairness" policy it is unfortunate that, less than one year into the new ATED-related CGT charge another far wider extension of CGT was announced. Even worse, the consultation document is drafted on the basis that we will have two different CGT regimes applying to non-UK residents from 6 April 2015 **(as discussed below we think that such complexity is unjustifiable and that for gains accruing after 5 April 2015 ATED-related CGT must be abolished).**

23. The piecemeal changes to the taxation of UK real estate we have seen over the past few years are regrettable. This is particularly the case as there has been no consultation on the actual policy of extending CGT to non-residents disposing of UK residential property. Given the past history foreign investors must be concerned this latest announcement is not the end of the matter.

24. The Chancellor's comments in the Autumn Statement and the rationale set down in the consultation document attribute the change to the grounds of fairness. We have a conceptual problem with this rationale.

25. There are problems with definitions and the need for provisions to cover changes of use and mixed use. Whilst "fairness" is important a tax system also needs to be pragmatic. As such, whilst the proposal to charge non-residents CGT on residential property gains might be "fair" there should be some public discussion as to whether it is an economically sound policy when taking into account the potential negative impact on the property market and inward investment into the UK and the anticipated tax revenue.

26. The consultation document recognises that the change will not be straightforward to introduce and as such a start date of April 2015 seems over ambitious. A year is insufficient time to consult on the proposals and produce the required legislation. There are a number of technical aspects that need to be addressed and we are concerned there will be insufficient time to consider the various interactions with other parts of the CGT code to ensure that inadvertent errors are not made.

27. At a minimum the legislation should not be included in the 2015 Finance Bill that will be enacted prior to the May 2015 election. We understand that draft legislation is expected in December 2014, but to include it in the 2015 Finance Bill will not give enough time for adequate scrutiny and discussions of the proposals. This is particularly the case since January is the busiest time for many of the practitioners best suited to comment on this legislation. For many client workloads will make it impossible to give sufficient attention to draft legislation produced in December in order to make comments that can be picked up on for the first 2015 Finance Bill. In any event, given the impact and complexity of the legislation it should be subject to proper scrutiny by elected members and not pass onto the statute book under the guillotine process without further amendment or discussion.

28. From past experience we know that despite the best efforts of technical specialists from inside and outside HMRC any legislation as complex as this will have flaws. It is just not possible to consider in the abstract all the various practical ramifications of legislation. If the legislation is passed in 2015 we should like the Government elected in May 2015 to commit to:

(i) retain the high level working group for at least one additional year to monitor how the legislation is working in practice and identify areas where legislative change is required; and

(ii) set aside space in the 2016 Finance Bill to make the required changes to the legislation.

The need for just one CGT regime for non-UK residents

29. On the basis that the Government is committed to going ahead with the extension of CGT to non-residents disposing of UK residential property our key concern is there should be just one CGT regime for non-residents (though with appropriate modifications so the rules work for all the different categories of taxable non-resident person). ATED-related CGT should be abolished for all gains accruing after 5 April 2015.

30. We know the policy reasons behind ATED-related CGT and the current wider proposal to extend CGT to non-residents disposing of UK residential property are different:

- ATED-related CGT was designed to penalise those who had "enveloped" UK residential property for reasons the Government did not consider to be acceptable (that is where the ATED reliefs did not apply).
- The current proposal to extend CGT to non-residents disposing of UK residential property is prompted by the "fairness" agenda.

31. We do not, however, accept that these different policy rationales are sufficient to justify the complexity of having two different CGT regimes. If the Government does not consider the 15% SDLT charge and the ATED charge are sufficient to penalise "bad" enveloping of UK residential property then:

(i) it should consider how great an additional financial penalty it wants to impose; and
(ii) impose this additional penalty through increasing the SDLT charge and/or increasing the annual ATED charge.

32. We have always been of the view that using CGT to address the Government's concerns over "enveloping" was the wrong approach. To continue with ATED-related CGT when there is a general CGT charge on non-residents will add unacceptable complexity. The dual CGT provisions for non-natural persons will be incomprehensible to all but tax specialists; foreign investors will be bemused and the complexity is likely to put them off investing in the UK generally and to have a negative impact on the way that the UK tax system is viewed internationally.

33. We appreciate the Government is unlikely to find it acceptable to abolish ATED-related CGT for all disposals after 5 April 2015 without transitional provisions to catch gains between 6 April 2013 and 5 April 2015 that would have been within the ATED-related CGT provisions. The actual CGT at stake may be relatively low but backtracking may be unacceptable. If this is the case ATED-related CGT should still be abolished but with the introduction of transitional provisions for properties within ATED between 6 April 2013 and 5 April 2015. Transitional provisions add complexity and we hope this issue can be looked at pragmatically and complex provisions will not be introduced if the tax loss is modest.

34. If there have to be transitional provisions the example below shows how these might work:

Example 1

Strawberry Mansion (a UK residential property) was acquired on 15 April 2013 by Berry International Ltd (a Jersey resident company) for £4.65 million. Berry International Ltd is wholly owned by a UK resident foreign domiciliary

None of the ATED reliefs apply so ATED applies for 2013/14 (though time apportioned since the property was acquired during the tax year) and 2014/15.

The property is sold on 17 November 2017.

Abolishing ATED-related CGT for gains accruing after 6 April 2015 would (assuming one has a rebasing rather than apportionment) result in the gain being allocated as following:

- *The gain for the period between 15 April 2013 (the acquisition date) and 5 April 2015 being subject to ATED-related CGT.*
- *The gains for the period between 6 April 2015 and 17 November 2017 being subject to the new general CGT charge on non-residents disposing of UK residential property.*

35. We accept the above is complex but it is not as complex as the potential calculations if ATED-related CGT continues alongside the new general CGT charge.

Rebasing

36. We welcome the commitment to only tax gains arising from 6 April 2015. This should be achieved by automatic 5 April 2015 rebasing provisions such that for the purposes of the new charge the taxpayer is deemed to have acquired the residential property on 5 April 2015.

37. There should be the facility to opt out of the automatic rebasing and use the actual cost and acquisition date. The election should be irrevocable and available on each chargeable interest owned rather than one election applying to all interests in UK residential property owned by the taxpayer on 5 April 2014 and the election should be made on the return (or amendment to the return) the taxpayer has to file with respect to the first disposal of that chargeable interest.

38. We understand that consideration is being given to adopting time apportionment provisions rather than rebasing; we support rebasing rather than apportionment. This is because house prices do not increase in even increments so apportionment is unlikely to accurately achieve the Government objective of only taxing gains arising from 5 April 2015.

Example 2

Miss Pink has always been a non-UK resident. She acquired a flat in London on 5 April 2008 for £1 million. On 5 April 2015 the flat was worth £4.75 million. She sold the flat on 5 April 2018 for £5.5 million.

Her actual gain arising after 5 April 2015 is £750,000. However, if time apportionment provisions were introduced she would have to pay CGT on a gain of £1.35 million (3/10 x (£5.5 million - £1 million)).

39. There is a general concern that the new tax will depress the price of residential property (particularly high value residential property). If there is a price reduction and the time apportionment route is adopted rather than actual rebasing we are concerned that taxpayers will enter into transactions to rebase the cost of their properties, as they will be of the opinion that apportionment will not provide a “fair” result for them and they are likely to feel resentful that they have to do this.

40. We appreciate that it has been suggested that rebasing could be onerous for unsophisticated taxpayers, as valuations will need to be obtained. We are not sure that this really is that onerous as our general experience is that, apart from where the investor is a high net worth individual and UK property makes up just a small proportion of his or her investments (in which case there will be sufficient funds to obtain a valuation without it being seen as onerous), investors have a very good idea of the value of their properties and are likely to be far more upset if apportionment results in pre 6 April 2015 gains being taxed than they will be by the need to obtain a 5 April 2015 valuation.

41. Time apportionment could also give rise to practical issues for older properties as records may not exist to accurately determine the chargeable gain. Details of the original cost could be obtained from the Land Registry in many cases but where the person did not acquire the property through a sale and/or where there has been significant enhancement expenditure these details will not be available publicly.

42. In addition, if ATED-related CGT does continue after 5 April 2015 (either on an on-going basis or just to capture gains in the two year period to 6 April 2015) the new regime will need to interact with ATED-related CGT and since ATED has actual rebasing adopting time apportionment for this new charge will result in problematic interactions.

Following the existing CGT provisions as closely as possible

43. It is important that the new CGT charge is as fully integrated into the existing CGT regime as possible and in as simple a manner as possible.

44. EU law considerations will come into play when considering the tax treatment of corporate entities. When ATED-related CGT was introduced the EU law issues were circumvented through the subjection of UK companies to ATED-related CGT. This was considered to be a pragmatic solution as the reliefs would mean very few UK companies would be within ATED-related CGT.

45. The new CGT charge will apply to all disposals of UK residential property (with only limited exclusions). As such, following the ATED-related CGT strategy and subjecting all UK companies who dispose of UK resident property to the new CGT charge rather than corporation tax will be far more disruptive. As such, we assume this will not happen (there is no mention of it in the consultation document). To avoid contravening EU law it we presume the relevant favourable features of the corporate CGT regime (such as indexation allowance, the various beneficial rules for CGT groups and the lower tax rate) will need to apply to disposals by non-UK resident corporate entities.

46. We appreciate that for individuals, trustees and personal representatives the Government is concerned that main residence relief could be used to undermine the new charge. We consider these issues in our answers to consultation questions 10 to 12 (paragraphs 110-124). We assume, however, that there would be no objection to non-UK residents (either individuals or the trustees of an interest in possession trust where there was a joint claim with the life tenant) claiming entrepreneurs' relief if the disposal was of a qualifying asset (such as a disposal of a property that met the furnished holiday letting criteria).

47. We do not think that there is any need to introduce specific anti-avoidance provisions for this new CGT charge. Provided there is sufficient time for the new provisions to be drafted properly, the existing CGT legislation when combined with the general anti-abuse rule should provide all the anti-avoidance legislation that is required.

The definition of residential property and issues such as change of use
Overview

48. We are concerned there is no one aligned definition of residential property across all the taxes and the introduction of this new charge will make the situation worse by adding a further definition. Multiple definitions of residential property add to the complexity and lead to confusion; one aligned definition would be simpler for all concerned. We have outlined above a case for a wide-ranging consultation on property taxation; one of the aims of such a consultation should be to introduce aligned definitions.

49. When considering the definition of residential property regard should be given to the definitions used for planning and property law and also Council Tax/Business Rates.

50. If there are particular policy reasons for not wanting a certain proposal to apply to certain types of residential property an exclusion/relief should be introduced for that exception rather than having multiple definitions

51. For CGT purposes it will be necessary to specifically define what is meant by property that is "suitable for use as a dwelling". This might be linked to the category that the property is included in for the purposes of The Town and Country Planning (Uses) Order 1987. We are assuming the Government would not class hotels as "residential property" and would accept that "boarding" and "guest houses" are mixed use if the owner/manager has their own residential accommodation within the property.

52. The definition for the garden and grounds of a residential property should be taken from the main residence legislation; this would be consistent and where main residence relief does apply to the whole or part of a gain it will avoid mismatches.

Exclusions and reliefs

53. Exclusions/reliefs always add complexity to a tax regime, as it is necessary to define who/what is excluded and/or who/what can benefit from the relief. In addition for a tax such as CGT (which seeks to tax a gain that accrues over a period of time) there can be additional complexity as property may drift in and out of the exclusions meaning apportionment provisions are necessary. As such, whilst exclusions/reliefs will often be necessary to ensure fairness they should only be introduced if the economic and/or social case for the exclusion outweighs the additional complexity.

54. There have been various discussions about whether property should or should not be within the scope of the charge. Economic and social arguments can be made for various types of property to be excluded. We expect there will be various representations to exclude amongst others:

- let property because it is operated commercially and there is an argument that the UK economy needs investment in letting stock;
- all accommodation used by students because of the social good case;
- any accommodation for elderly individuals where there is warden assistance because of the social good case.

55. A fundamental policy decision has to be made as to whether the new charge is to be:

- a general charge on UK residential property with very limited exclusions; or
- where justifiable economic and/or social cases are made the Government will consider wider exclusions and/or reliefs.

56. Our impression from the consultation document is that the Government wants to introduce a general charge on non-UK residents with very limited exclusions (in contrast to the ATED model where there are several reliefs) and presumably this is why exclusions to communal accommodation are restricted. We can see that allowing an exclusion for all residential accommodation for students would undermine the general policy as, if there can be an exclusion for all students, it would be difficult to argue against an exclusion for all accommodation for elderly individuals were there is the potential for a care component and so on. We consider the specific issues with respect to the proposed exclusions for communal property in our answers to consultation questions 1 and 2 below (see paragraphs 84-88).

57. As discussed above since the new charge will only apply to UK residential property it will be necessary to introduce provisions to deal with change of use situations. For simplicity we think the provisions for this new charge should follow the ATED provisions as closely as possible. However, it is important that “dry tax” charges are not created; a change of use should not result in a tax charge where there is no actual disposal.

58. When an actual disposal occurs the taxpayer should be able to make an election as to how to calculate the chargeable gain where there is either a change of use or an exclusion starts or ceases to apply. The alternatives should be as follows:

- computing actual gains for each period (meaning that valuations will be required where there is a change); or
- time apportionment.

59. A choice is appropriate as time apportionment may be easier where there are frequent changes but it could result in a quite unfair result particularly where the changes are infrequent.

60. Where a property has mixed use (such as a building with a shop below and flats above) the chargeable gain will need to be computed on a just and reasonable basis. Industry standards could be used to assist taxpayers but there should be flexibility to accommodate cases outside of the norm.

61. Where an exemption applies there should be de minimis limits such that temporary periods of non-use can be disregarded. This is particularly necessary for student accommodation, as such accommodation will not be used all year round by the students.

The new CGT charge and anti-avoidance provisions

62. It is important the new CGT charge is fully integrated into the existing CGT regime and in as simple a manner as possible. Credit mechanisms where there is scope for double charging would at best be unduly complex and at worst practically impossible without adding pages of additional anti-avoidance legislation. We recommend there is a consistent approach across all the taxes and this should be based around the primacy of the new CGT charge. This means the new CGT charge should be the sole applicable taxing provisions for gains accruing after 5 April 2015 on disposals by non-residents of UK residential property.

63. The drafting of the general definitions provisions and the sections dealing with change of use and mixed use will be crucial as these will need to feed through effectively so that it is only gains taxed under the new CGT regime that are excluded for the anti-avoidance provisions.

TCGA 1992, s 10A (Temporary non-residents)

64. UK residential property acquired after 5 April 2015 should be excluded from the TCGA 1992, s 10A charge completely (assuming there are no change of use or mixed property complications). Transitional provisions will be required for property acquired prior to 6 April 2015. For disposals of such property the default position would be:

- pre 6 April 2015 gains taxed on the individual under TCGA 1992, s 10A; and
- post 5 April 2015 gains taxed on the individual under the new CGT charging provisions.

As proposed in paragraph 37 above taxpayers should be able to elect out of rebasing and if they did the entire gain would be taxable on the individual under the new CGT charging provisions.

65. As illustrated by the following example the ring-fencing of gains and losses under the new CGT charging regime will mean some temporary non-residents will be worse off under the new regime than under TCGA 1992, s 10A.

Example 3

On 25 June 2015 Mr Purple (who had prior to this been UK resident all his life) was sent on a three-year secondment to Dubai. He made a number of chargeable disposals in 2016/17:

- *A UK residential property he had acquired as an investment (so no main residence relief as he had never used the property as a residence). A gain of £300,000 was realised on this disposal.*
- *Various disposals of investments realising aggregate loses of £175,000.*

No other chargeable disposals were made in the non-UK resident period.

Under the TCGA 1992, s 10A provisions the losses on the investments could be set off against the gain on the residential property meaning that on his return to the UK Mr Purple would only be taxed on gains of £125,000.

However, under the proposals for the new regime Mr Purple will be taxed on the £300,000 gain and the losses on the investments will effectively be stranded.

66. An obvious way to avoid the problem above is for Mr Purple to have either made the disposals before leaving the UK or to make the disposals when he returns to the UK. Sometimes though this may result in commercial problems as changes in the market may mean that sales during the temporary non-resident period are desirable.

67. We appreciate that with a new regime there will always be rough edges and pragmatism is required. However consideration should be given to allowing individuals, who meet the "at least four out of the seven tax years immediately prior to their departure from the UK" criteria set down in FA 2013, Sch 45, para 110, to make an irrevocable election to be taxed as a UK resident during their current period of non-UK residence (the election being made on the return they file to report the chargeable gain on the UK residential property). Whilst the timing may be such that this will not assist individuals who come back to the UK unexpectedly it will assist those who know that their period of non-UK residence is only temporary and have a similar gains and losses issue to the one facing Mr Purple in the above example.

TCGA 1992, s 13 (attribution of gains to members of non-resident companies)

68. The TCGA 1992, s 13(5)(cb) motive defence means it is very unlikely TCGA 1992, s 13 will apply to the disposal of UK residential property. We struggle to think of any actual case where UK residential property would have been acquired through an offshore company for the purpose of avoiding liability to CGT or corporation tax.

69. Even so, we still think it is important that the interaction of the new CGT charging regime with TCGA 1992, s 13 is addressed and this should be done on a consistent basis so the new CGT charging regime should have primacy for gains accruing after 5 April 2015.

70. UK residential property acquired after 5 April 2015 should be excluded from the TCGA 1992, s 13 charge completely assuming there are no change of use or mixed property complications).

71. Transitional provisions will be required for property acquired prior to 6 April 2015 and these will need to also consider that ATED-related CGT might be in point for the period between 6 April 2013 and 5 April 2013. For disposals of such property the default position would be:

- where the motive defence does not apply, pre 6 April 2013 gains would be taxed on the individual under TCGA 1992, s 13;
- gains between 6 April 2013 and 5 April 2015 would be taxed on the company under the ATED related CGT provisions; and
- the gain post 5 April 2015 will be taxable on the company under the new CGT charging provisions.

72. Where the election has been made to opt out of ATED-related CGT rebasing, the position would be:

- pre 5 April 2015 gains taxed on the company under the ATED related CGT provisions; and
- post 5 April 2015 taxed on the company under the new CGT charging provisions.

TCGA 1992, s 86 (Attribution of gains to settlors with interest in non-resident or dual resident settlements)

73. Whilst the rates of tax have not been determined yet we assume that non-UK resident trusts will not be subject to tax at a lower rate than non-resident individuals. Provided this is the case (and assuming there are no change of use or mixed property complications) there will be no reason to have an anti-avoidance rule where UK residential property is acquired after 5 April 2015 and there is a settlor interested trust. As such TCGA 1992, s 86 should not apply to any UK residential property acquired after 5 April 2015.

74. We appreciate that, where there is a UK resident settlor of an offshore settlor interested trust, there will need to be transitional provisions for property acquired prior to 6 April 2015. For disposals of such property the default position would be:

- pre 6 April 2015 gains attributed to the UK resident settlor; and
- post 5 April 2015 gains taxed on the trustees under the new CGT charging provisions.

75. As discussed in paragraph 37 above there should be the option for taxpayers to elect out of rebasing. This would need to be a joint election made by the settlor and the trustees. If this were done the entire gain would be taxable under the new CGT charging provisions with the tax suffered by the settlor (since it would be an issue for trustees to make an election that would increase their tax liability).

TCGA 1992, s 87 (Non-UK resident settlements: attribution of gains to beneficiaries)

76. The new CGT charge should have priority and gains taxed under the new provisions should not form part of the TCGA 1992, s 87 gains pools.

77. This means that (assuming there are no change of use or mixed property complications) UK residential property acquired after 5 April 2015 should be excluded from the TCGA 1992, s 10A charge completely.

78. Transitional provisions will be required for property acquired prior to 6 April 2015. For disposals of such property the default position would be:

- pre 6 April 2015 gains included within the TCGA 1992, s 87 pool; and
- post 5 April 2015 gains taxed on the trustees under the new CGT charging provisions.

79. As discussed in paragraph 37 above there should be the option for taxpayers to elect out of rebasing. If this were done then the entire gain is taxed on the trustees under the new CGT charging provisions.

Example 4

The Rose Offshore Settlement acquires Petal Cottage on 15 July 2015. Income is distributed annually so there is no relevant income within the settlement. The cottage is sold on 15 July 2025 and a £475,000 gain is realised. The trustees pay tax on the gain. The trust has no other assets and no other chargeable gains have been realised.

The entire £3 million sales proceeds are distributed to UK resident beneficiaries. The beneficiaries have no tax to pay as the trustees have been taxed in full on the gain.

Example 5

The Honeypot Offshore Settlement acquires Manuka Cottage on 15 July 2015. Income is distributed annually so there is no relevant income within the settlement. The cottage is sold on 15 July 2025 and a £525,000 gain is realised. The trustees pay tax on the gain.

On 25 October 2025 the £525,000 gain is distributed equally to three UK resident beneficiaries (each receiving £175,000).

The trust had various other assets and as at 6 April 2025 unmatched s 87 gains of £750,000 with additional gains of £50,000 being added to the pool in 2025/26. The capital payments made are matched to s 87 gains (with the possibility of supplementary charge depending on when the earlier gains were realised).

80. We appreciate that the analysis in Example 5 appears unfair and it could be argued that there should be no further tax to pay where a capital payment is paid out the proceeds from the sale of UK residential property as it has been fully subject to CGT in the hands of the trustees. However, in our view legislating for this type of situation would be unjustifiably complex. In many instances trusts holding UK residential property will have been created for the sole purpose of holding that property and consequently the “double charge” is unlikely to present itself often.

TCGA 1992, Sch 4B (transfers of value by trustees linked with trustee borrowing) and TCGA 1992, Sch 4C (transfer of value: attribution of gains to beneficiaries)

81. Given the complexity of the TCGA 1992, Sch 4B and Sch 4C legislation it is not surprising that these provisions potentially throw up the greatest challenges when considering the interaction of the new regime with the existing legislative charging provisions.

82. Various practical problems would be thrown up by an attempt to create an effective credit mechanism to try to balance out the various double charge situations that could result where a UK residential property was owned by an offshore trust caught by TCGA 1992, Sch 4B and Sch 4C. Given that the legislation is far too complex already we really do not think that adding another layer of complexity is desirable.

83. We suggest there is a basic rule that no gains are crystallised under the Sch 4B legislation where at the time of the Sch 4B event (that is, when there is a transfer of value that is deemed to be linked with trustee borrowing) the property meets the definition of UK residential property used for the purposes of the new charge.

RESPONSES TO CONSULTATION QUESTIONS

Exclusions

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

84. For a general discussion of the definition of residential property and the issues with introducing exclusions from a general tax charge please see paragraphs 53-61 above.

85. It is not clear how the proposed exclusion for communal property will be effected, will the definition of residential property used for the purposes of the new CGT charge include communal property with a specific exclusion or will communal property be outside of the definition.

86. The consultation document makes it clear that the Government wants to ensure residential property used primarily for communal purposes, such as boarding schools and nursing homes, is not affected by the extension of CGT. The best way to legislate for this is to define what is meant by “communal accommodation” in the context of the new CGT charge. This will not be straightforward but from the comments in the consultation paper it seems the key test will be whether the accommodation is “institutional” in nature such that the residents are not free to come and go as and when they wish but have restrictions imposed by the connected institution(s).

87. Once there is a basic legislative definition of “communal property” there could then be various examples given of types of accommodation that will automatically be accepted as being communal accommodation. For these purposes it will be necessary to update the definition of “halls of residence” so it includes cluster flats.

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

88. As discussed above (paragraphs 53-61) arguments can be made for various exclusions to the new CGT charge. If the Government wants to have a general charge exclusions need to be kept to a minimum; there is a consistency and logic to limiting the exclusion to communal property with an institutional connection.

Partnership issues

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

89. Unlike the stamp duty land tax provisions, for CGT purposes foreign partnerships are not automatically treated as transparent and thus the treatment of a foreign partnership will depend on whether it is closer to a corporate or a non-corporate entity.

90. Foreign entity classification is considered in the HMRC International Manual with INTM180030 providing a list of the foreign entities HMRC has opined on the status of. For example, a Jersey limited liability partnership is considered to be opaque, whilst a Jersey limited partnership is seen as transparent.

91. From this is follows that non-resident partners will only be within the scope of the charge if the partnership is transparent. An opaque foreign partnership and not its partners will be within the scope of the charge and will be subject to the special rules for foreign corporates.

92. There are many different types of foreign partnership and most of these will not have been considered by HMRC. The new CGT charge may mean that non-resident partners who never previously concerned themselves with whether the partnership would be seen as opaque or transparent for UK tax purposes will now have to consider the question so as to establish who the correct chargeable person is. It is possible HMRC will see a significant increase in CAP 1 (Approvals and Clearances) applications.

Trusts

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

93. We accept the rationale for including non-resident trusts within the scope of the new charge. The interactions with the various existing anti-avoidance provisions have been considered in paragraphs 68-83 above.

94. It is important the new regime aligns the tax treatment of non-UK resident trusts as closely as possible with the tax treatment of UK resident trusts. As such, the reliefs open to UK resident trusts (such as main residence relief and, for interest in possession settlements, entrepreneurs' relief) should also apply to non-UK resident trusts.

95. Any changes that have to be made to the main residence provisions (discussed in paragraphs 110-116 below) should be to the main legislative provisions and flow through to the specific trust provision rather than making changes to TCGA 1992, s 225 (private residence occupied under terms of settlement). There is no reason why the new CGT charge should result in non-UK resident trusts being in a worse position than UK resident trusts.

Funds

Q 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?

96. A definition of fund will be required for the purposes of the legislation and we recommend consideration is given to using the definition provided in the Alternative Investment Fund Management Directive.

97. We appreciate the Government's concerns that small groups of connected non-resident people might try to use a fund as a wrapper structure to avoid the extended CGT charge. We do not however, think the GDO test is appropriate; it should be modified to include the broader institutional investor definition within the REIT legislation. Refinements so that appropriate tests are in place for open and closed ended investment vehicles will also be necessary.

98. If there are concerns that taxpayers may change the operation of a fund close to the sale to try to come within the exclusion there could be apportionment legislation such that where the test is not met throughout the entire period that a fund has held a UK residential property only the gain relating to the period (or periods) when the test was met will be exempt.

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

99. Where there are various entities in a structure careful consideration will need to be given to the level at which it is appropriate to apply the test. There may be a Topco, which invests in various companies that acquire UK residential property. In such cases the test should be applied to Topco and if that passes then the entire structure should we excluded from the extended CGT charge.

100. We understand HMT and HMRC have had various discussions with institutional investors and these issues are being considered with practical examples of the different types of investment structures provided to them. From the discussions we have been party to one area causing concern is the creation of structures through which a UK residential property is held and the structure is ultimately owned by a diverse fund and non-qualifying individuals; it seems resolving these issues is very important economically as foreign institutional fund investment in the UK residential housing market is needed.

101. A pragmatic solution is to say that: (i) where at least 80% of the ultimate ownership is with one or more qualifying funds the entire structure should qualify; and (ii) where this test is not met (or if there is concern that the 80/20 test could open up avoidance opportunities) there should be a targeted relief such that the proportion of the gain equivalent to the ultimate ownership of the structure by qualifying investors is exempt. For example, if Topco is owned 65% by funds meeting the diversity requirement then 65% of the gain is exempt.

102. Particular issues may be thrown up where partnerships are involved in fund structures and these need to be thought through to ensure where a partnership is used in the role of a Topco the exclusion from the charge will not be lost if for UK CGT purposes the partnership is seen as transparent such that the gains are attributed to the individual partners.

Q 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?

103. As discussed above, we do not think that the GDO test on its own will be sufficient to ensure the funds the Government wants to exclude from the charge are excluded. Rather than having the GDO test and additional tests, appropriate modifications should be made to the GDO test (following the REIT model). Different tests may, however, be required for open and close ended funds or it might be that one multi-faceted test will work better. Provided all the necessary elements are there it may come down to how best to draft the legislation.

104. We note that pension funds are to be excluded from the charge. We welcome this but are concerned that the exclusion is not limited to foreign pension schemes that would be equivalent to UK approved pension schemes.

105. From the discussions we have been party to, getting the test(s) for funds right so that inadvertent damage to the UK economy is avoided with be challenging. There are various complex issues that need to be thought through and with the current timetable this will be difficult. As such, consideration could be given to providing HMT with the power to amend the definitions/tests through regulations.

Companies

Q 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?

106. We agree that if CGT is to be extended to all non-UK resident individuals, trusts and personal representatives it should also be extended to non-UK resident corporate entities; not doing so would be inconsistent with the “fairness” policy rationale for introducing the charge.

107. The consultation document is quite tentative with respect to the comments on extending the charge to non-UK resident corporates. From the discussions we have attended we understand some readers are unclear as to whether the Government is minded to extend the charge to all non-UK resident corporate entities or just to non-UK resident corporate entities that would be close companies if they were UK resident.

108. If the charge is restricted to non-UK resident corporate entities that would be close companies if they were UK resident it will be clear that it is really only aimed at private individuals and their families. We appreciate that an economic argument could be made for not subjecting all non-UK resident companies that invest in UK real estate to tax on gains realised. This is, however, problematic as it does not fit with the “fairness” agenda and too many exclusions on economic grounds could undermine the charge. There is a need to review the economic impact of the change and what damage could be done to necessary foreign investment in the UK property market if foreign multinationals are subject to the charge.

Q 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?

109. It is important the new charging regime is as aligned and coherent as possible. It would be inappropriate to have special provisions applying to non-resident property investment and rental companies. However, as discussed in paragraph 44-46, unless changes are made to the tax provisions applying to UK resident companies disposing of UK residential property, the differences in the way CGT applies to corporate and non-corporate entities will mean EU law considerations are brought into play. This will mean the provisions applying to all non-UK resident corporate entities will have to be different to those applying to other non-resident persons.

Main residence relief

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

110. Without a change to the operation of the TCGA 1992, s 222(5) main residence election the CGT charge on non-residents on disposal of a UK residential property could be very simply avoided and we also understand that UK and EU residents have to be treated equally meaning any change has to apply to UK residents. However, the fact that UK residents will be affected by the changes to the main residence relief provisions makes this very problematic.

111. The difficulty is, as discussed during the working groups, the ability to make elections is of great practical value for UK residents with second homes. This is particularly the case for spouses/civil partners (who are only allowed one main residence between them), as in some cases without the election there would be a practical stalemate when trying to determine which property was the main residence as they each could have a different factual main residence.

112. The election cuts through these practical issues and by so doing significantly reduces the compliance burden on taxpayers and HMRC.

113. Given the EU law constraints we recognise the near impossibility of reconciling the conflicting aims of:

- avoiding making changes to the existing rules that will adversely impact on UK resident taxpayers, and
- changing the current rules to prevent well advised non-resident taxpayers being able to largely avoid the new CGT charge on UK residential property.

114. Whatever approach is adopted there needs to be a change in the definitions such that only interests in property **owned** by the individual are taken into account when considering the property with respect to which main residence relief can be claimed. This would mean that no election would be necessary when the individual has a number of residences but only owns one of these.

115. The current wide definition of "interest in a dwelling house means that rented property and employer provided accommodation under tenancy agreements are considered to be residences for the purposes of the relief. This is considered in the HMRC guidance at CG64470, where the following paragraphs demonstrate the width of the current definition:

"An interest in a dwelling house means a legal or equitable interest. It includes all possible forms of ownership from owning the freehold to being the co-owner of a minimal tenancy. In most cases, where a residence is rented a tenancy exists, and such residences therefore remain within Section 222.

The only circumstance in which an individual can reside in a dwelling house in which he or she has no legal or equitable interest is where the property is occupied under licence. A licence is a permission to reside in a property which may be contractual or gratuitous. For instance, staying in a hotel or in lodgings are examples of residence under contractual licence. And staying with family or friends is an example of residence under gratuitous licence."

116. If the definition is not limited to owned properties, imposing restrictions on the ability to make an election will result in the ability of some individuals to benefit from main residence relief being severely restricted, as the property they actually own does not qualify as their main residence. In our view that is unjust and UK residents will consider it to be very unfair. It is also contrary to the comments in paragraph 3.7 of the Consultation Document as, if the definition is not amended, it seems likely that the changes made to the ability to make an election will make claiming TCGA 1992, s 222(8) relief for living in accommodation which is job related impossible where that accommodation is provided under a tenancy agreement.

Q 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?

117. We do not support either of the proposals set out in paragraph 3.5. Neither proposal will deal adequately with the situation where spouses/civil partners have different factual main residences. It is important to retain the ability to make a main residence election.

118. On balance, if one of the approaches set down in 3.5 had to be chosen we would prefer the first as the determination of a factual main residence does at least look at a variety of factors. A fixed rule turning on which property the individual has stayed in most during the given tax year could complicate calculations by resulting in a greater number of changes in the main residence.

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

119. It is important to retain the ability to make a main residence election. We agree a change is required otherwise the ability to make an election will undermine the new tax charge. Two approaches need to be considered:

- restrict the circumstances in which an election is made so it will be of limited use to non-UK residents
- adjust the statutory residence test provisions so making a main residence election for a UK residential would impact on the individual's residence status.

120. Regardless of the approach adopted incidental changes will need to be made to TCGA 1992, s 225 (private residence occupied under terms of settlement) so the conditions/test will be applied to the beneficiary who is occupying the residence under the terms of the trust.

121. Whatever changes to the TCGA 1992, s 222(5) main residence relief election are enacted there need to be transitional rules so that existing relief entitlements are not lost.

Restricting the circumstances in which an election is made

122. Whilst the minimum change necessary is to be made to the main residence relief rules any change has the potential to result in unintended consequences given the interactions with other parts of the legislation. As discussed above, given the importance of main residence relief legislation and that the election plays an important role in simplifying the compliance for individuals with multiple residences we would prefer that a separate consultation on these changes were held so that the issues could be considered in depth. The current timetable does not allow sufficient time for such a consultation so should be extended.

123. Provided the change to the definitions (discussed at paragraph 116 above) is made so that only residences an individual owns are taken into account when considering if the individual has more than one residence, the restriction on making an election could relate to a minimum occupancy period (with apportionment if occupation starts or ceases part way through the tax year). This should not, however, disadvantage individuals where the lack of occupation is work related or due to illness so there would need to be special provisions to cater for these situations. The minimum period could be say 120 days (or if this is felt to be too onerous 91 days). As a further refinement once the election is made it could be specified that it cannot be varied until there is a change in the properties used by the individual as residences.

Adjusting the statutory residence test

124. Adjusting the statutory residence test such that there is a significant disincentive for non-residents to make the election would mean UK residents would not be adversely impacted. However, there are potential EU law issues why this would not work and we are not particularly in favour of changing the statutory residence test so early in its life.

Administering the new tax

Q 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.

125. Residence is determined on a tax year basis. Identifying a seller as non-resident at a given point during a tax year may not be possible even for a specialist. This is because later actions can impact on the residence status for the tax year particularly with the new statutory residence test for individuals.

126. Making professional advisers involved in the conveyance responsible for the identification of the seller as non-resident is not fair or practical. This is particularly the case because those involved with the conveyance will not necessarily have a detailed knowledge of the UK tax provisions on residence.

127. We understand that HMRC thinking on this issue has progressed and that the following alternative options are also being considered:

- Non-resident persons who are within the self-assessment system already will report gains and losses on the disposal of UK residential property through their self-assessment return with the same filing and payment deadline applying to them as apply to UK resident individuals.
- Other individuals can either: (i) make a payment on account within 30 days of conveyance; or (ii) within 30 days of conveyance put in a CGT computation and pay the amount shown to be due. There would then be a period of time within which amendments could be made.

128. We welcome these developments in HMRC thinking. We agree non-UK residents who are already within the self-assessment system should be able to report gains and losses on the disposal of UK residential property through the self-assessment system rather than having to contend with two different reporting systems. We also accept that it would not be appropriate for everyone who has to pay this new CGT charge to be included in self-assessment as that system would not be flexible enough for persons who only have occasional UK tax liabilities.

129. We have concerns with the options put forward for persons who are not within self-assessment. We are not sure what basis a taxpayer would use to calculate the payment on account and this option should be dropped in favour of the submission of a CGT computation. The initial CGT computation should be treated as an estimate of the tax due. There should be an annual form (covering the tax year or for companies that produce statutory accounts, for the year end falling within the tax year) on which all disposals are shown so loss relief etc can be claimed. The submission, amendment and HMRC enquiry time limits applying to this annual form should be aligned with self-assessment.

130. We appreciate why there is a desire for non-UK residents who are not covered by self-assessment to make a tax payment within 30 days but are concerned there could be EU issues with this. As an alternative, as part of the CGT computation submission process it should be necessary to provide details such as name, address and tax reference number in the jurisdiction where the individual is residence. Where the individual is resident in a jurisdiction with which the UK has a double tax treaty (or in the case of EU states a multinational convention) with appropriate exchange of information and mutual assistance in the collection of tax provisions we do not think the 30 day tax payment should be necessary. In such cases the deadlines for the payment of the tax should be aligned with UK residents.

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

131. As discussed above, we understand that the withholding tax proposal is not now the only collection mechanism being considered. We welcome this as we think that it would be problematic to introduce a withholding tax in the UK for both practical and technical reasons.

132. The UK has a different legal framework when selling property to jurisdictions with a withholding tax. In France and Spain (where we understand a withholding tax mechanism is used) there is a mandatory requirement to use a notaire when selling a property and the notaire is responsible for withholding the tax. This would not work in the UK, as there is no such mandatory requirement where property is transferred. It is possible for UK property to change ownership without the buyer or seller having any recourse to a UK professional adviser.

133. In addition there are technical difficulties when considering the enactment of a withholding tax mechanism in the UK. A withholding tax based on sales proceeds is unlikely to be a good approximation of the gain due as the charge will only apply to gains arising from 6 April 2015 and, as discussed above, it may be impossible for even a UK tax specialist to identify a seller as non-UK resident part way through the tax year.

134. In addition to the various issues in creating a viable withholding tax mechanism there could be difficulties fitting withholding tax into the property transaction process. The UK housing market is not used to having to take account of a withholding tax deduction at the point of sale. UK residents who sell second homes or investment properties (such that main residence relief does not reduce any chargeable gain to nil) do not have to pay tax on the gain until 31 January following the end of the tax year that the gain is realised.

135. Practically a withholding tax mechanism would be a problem where the proceeds of a sale are required to pay off the mortgage and/or be rolled over into the purchase of another property. This is especially likely to be an issue for properties acquired prior to the announcement of the general tax on the sale of non-UK residential property as the financing arrangements etc on the acquisition of the property would not have taken into account the fact that a significant amount of the sale proceeds would be taken as withholding tax rather than being available to pay off the loan.

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?

136. See our response to questions 13 and 14.

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?

137. See our response to questions 13 and 14.

APPENDIX 1

29 April 2014

Mr M Crabtree
Deputy Director - Assets and Residence Policy
Specialist Personal Tax

Dear Mike

Implementing a capital gains tax charge on non-residents: consultation

We are writing in advance of submitting our formal response on the above consultation document as we are so concerned about the major shift in policy for UK residents proposed in the consultation.

The announcement in the Autumn Statement and the title of the consultation document give no indication that UK residents will be affected by the matters under consultation which in our view is disingenuous. We can see that without a change to the operation of the election as to which of two or more residences is to be treated as the principal private residence (PPR) that the capital gains tax (CGT) charge on non UK residents on disposal of a UK residential property could be very simply avoided. We understand that UK and EU residents have to be treated equally and hence any change has to apply to UK residents, but the fact that UK residents could be affected by the proposals should have been highlighted in the title of the consultation document.

Current Proposal

In order to avoid the anticipated abuse by non-residents of the ability to elect which of their properties is to be treated as their main residence for PPR relief purposes, it is proposed that the election is to be abolished. Instead, of an election an individual's main residence will be determined by way of an analysis of the facts, such as the period of time they spend in the property or considering other factors including where their mail is delivered and their family resides.

Implications of proposal

Although abolishing the election is to avoid abuse by non-residents, it is also going to have a significant effect on UK resident taxpayers. We are particularly concerned about how a main residence can be determined on fact, there are many practical difficulties. Although it will be quite easy in the majority of cases to determine which residence is the main residence there are several very common scenarios where it will be impossible. For example there are many "split families" where husband lives and works in one part of the country and wife lives and works in another part and they meet up at the weekend, sometimes the wife travels for the weekend together and sometimes the husband. How will the main residence be determined?

Alternative solutions

1. The election could be restricted to those individuals who actually spend 120 days in the residence and once the election is made it cannot be changed until there is a change in the properties available as a main residence.

2. It may be possible to deter non-residents from abusing the ability to elect their UK property as being their main residence. This would enable the election to remain in force for the benefit of the UK taxpayer. A solution may be to review the interaction between an individual's residence and where a non-resident individual has elected that their UK property is their main residence. The current statutory residence test includes a sufficient ties test which essentially reduces the

number of days an individual may stay in the UK before they are deemed to be UK resident based on their various ties with the country.

The fact that an individual elects that their UK property is their ‘main’ residence, should be treated as a significant tie to the country. Therefore such an election could be given additional weight compared to where an individual simply has a property in the UK available for their occupation. This additional weighting would mean that by making the election the individual is increasing their risk of becoming UK resident, which can have significant tax implications. Thus it would be expected that in a lot of cases the individual may be deterred from making the election given that it may affect their tax residence year on year.

That said we are not particularly in favour of changing the statutory residence test so early in its life.

We will be making a fuller response with suggestions in due course but wished to make an early response to record our immediate concerns. In the meantime, would it be helpful for us to meet with you to discuss the practical difficulties of determining a main residence?

Yours sincerely

Lisa Spearman
Chairman Private Client Committee
Tax Faculty

APPENDIX 2

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)