TAXREP 13/15 (ICAEW REPRESENTATION 32/15)

DRAFT LEGISLATION FINANCE BILL 2015

ICAEW welcomes the opportunity to comment on the draft legislation on Capital gains tax: non-UK residents and UK residential property published by HM Revenue & Customs and HM Treasury on 10 December 2014. The comments in this representation relate to the draft clauses on:

- Disposals of UK residential property interests by non-residents etc;
- Private residence relief
- Relevant high value disposals: gains and losses

This response of 4 February 2015 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.

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MAJOR POINTS

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. A Consultation Paper Implementing a capital gains tax charge on non-residents (published 28 March 2014) set out the initial thinking on the proposed extension of CGT and a number of working groups (both high level and more detailed) were held during the consultation period.

3. We raised some immediate concerns with the proposals in a letter of 29 April with our detailed comments on the Consultation Paper and the further clarifications provided in the working groups being set out in TAXREP 35/14.

4. The summary of responses was published on 27 November and draft legislation was published on 10 December 2014 (though as made clear at the time the draft legislation was incomplete). Whilst some of our points were addressed we were overall very disappointed with two key decisions:

- To enact the legislation in the 2015 Finance Act rather than deferring the legislation for a year to provide sufficient time to get the legislation right; and
- To introduce this new CGT regime for non-UK residents whilst retaining annual tax o enveloped dwellings (ATED)-related CGT.

5. Since the draft legislation was published on 10 December 2014 a number of working groups (both high level and detailed) have been held to discuss the legislation; we attended meetings on 16 December 2014, 12 and 20 January 2015. As a result of the discussions at these meetings and related correspondence we know that, in addition to working on the legislation that was not ready for publication on 10 December 2014, revisions have been made (and work is on-going) with respect to the legislation that was published. Our comments below take account of the position following the 20 January 2015 meeting.

6. We are happy to discuss any aspect of our comments and to take part in further working groups and discussions.

Key point summary

7. It is a widespread feature of many tax systems to tax a non-resident on disposals of property in their jurisdiction. Whilst we would have preferred a proper consultation on whether to do so was right for the UK economy (given that for so long it was felt more advantageous not to) the decision was a policy matter for the Government to decide.

8. Our concern is with the management of the change and, as stated below, we feel that certain key decisions made by Ministers should be reconsidered urgently.

9. Ideally rather than more piecemeal changes we would like to see a far wider review of the taxation of UK real estate that considers all the taxes (both direct and indirect) with the intention of creating a new coherent regime for the taxation of real estate across all the taxes. We have requested this holistic approach be adopted on several occasions in previous representations. In the absence of this wider review and the formulation of a coherent strategy we have the following key concerns with the proposed change to the legislation.

This is a major change to the tax system and the current timetable provides insufficient time to get the legislation right

10. The 1965 Finance Act enacted CGT, so 2015 marks its 50th anniversary. For 50 years, therefore, the UK has not taxed non-UK residents disposing of UK residential property. We do

not understand why the legislation needs to be rushed through in 2015 when a delay for a year would allow the necessary time for the detailed thought and scrutiny that such a major change to CGT requires. Getting the definitions right and considering all the various interactions is complex and no matter how hard Parliamentary Counsel, HM Treasury and HMRC officials work keeping to the current timetable will mean that mistakes are made. Together with our volunteers we will do what we can to assist but again the timetable is not realistic.

11. As 2015 is an election year and we understand that there is consideration of passing this legislation in the Finance Bill prior to the election there is an enforced early cut-off date. Given the fixed dates for Parliament to be dissolved that would seem to us to give less than a day for the entire Finance Bill to be scrutinised. As such, we hope that the only measures that are passed will be those necessary for the continuation of the collection of tax with everything else deferred and given adequate scrutiny after the election. In addition to being important for the democratic process adequate Parliamentary scrutiny of the Finance Bill gives additional time for technical issues to be identified and dealt with. If our plea for deferment is not heeded then this legislation will almost certainly need reviewing after the election for technical errors.

12. If our concerns are dismissed and our request for a delay disregarded we at least hope that there will be a Ministerial announcement that there will be further scrutiny of the legislation and changes if errors and omissions are found.

ATED-related CGT should be abolished

13. In our view ATED-related CGT should never have been introduced. CGT is a long established tax in its own right and should never have been used to solve a perceived stamp duty land tax (SDLT) problem. A specific CGT charge is now being introduced to tax gains on residential property and so to keep the ATED-related CGT as well is perverse, it is not in the interest of a coherent tax system and it flies in the face of simplicity.

14. Retention of ATED-related CGT adds an extra layer to already complex legislation making it far more complex and adding unnecessary incoherence. The additional complexity is likely to deter foreign investors who will be put off by the lengthy explanations (and calculations) and go to other jurisdictions with comprehensible tax rules and this will ultimately damage the UK economy.

15. The decision to retain ATED-related CGT should be reconsidered. We appreciate the Government wants to penalise non-natural persons who envelope residential property but that penalty is provided by the ATED tax (which it has raised very significantly) and the higher rate of SDLT.

Problems caused by the 6 April 2016 extension of ATED-related CGT to properties worth in excess of £500,000

16. The draft clauses on relevant high value disposals gains and losses are complex, but we do not think that this can be avoided unless one or more of the key policy decisions is changed (that is retaining ATED-related CGT, extending ATED to property worth in excess of £500,000 from 1 April 2016 and introducing the new CGT regime for non-residents from 6 April 2015).

17. As previously mentioned we do not see properties in the £500,001 to £999,999 bracket as high value and have concerns about the extension of ATED to such properties from 1 April 2016. This legislation is, however, already on the statute book, so whilst we would support a change of position on this, it seems unlikely.

18. As mentioned above we still hope that the Government will reconsider its position on ATED-related CGT. If it does re-consider and ATED-related CGT is abolished then the current complexity with respect to the interaction of the new charge and the properties that will come into ATED-related CGT from 6 April 2016 will fall away.

19. If ATED-related CGT stays then there would be one more reason for wanting a deferral of the general CGT charge for a year, as this complication at least would then fall away.

COMMENTS ON THE DRAFT LEGISLATION

Disposals of UK residential property interests by non-residents etc: amendments to TCGA 1992

20. The published amendments and revisions to date were discussed at the working group meetings and we know that HMRC has a schedule of the various concerns raised by the group and that further work will be carried out both by HMRC and group members. As such, we will not comment on the detailed technical discussions herein.

21. The position of foreign partnerships that are not seen as transparent is of particular concern to us as we can see anomalous results being produced both here (where it could be beneficial) and when considering the provisions in Schedule C1. For SDLT purposes all partnerships are deemed to be look through. CGT does not do this. For this legislation (and also for ATED-related CGT so there is consistency) the better solution might be to have the same deeming provision as for SDLT.

22. The requirement for non-UK resident companies that are outside of the CGT charge to make a claim is unduly onerous. We understand HMRC would like information to verify that the company is outside of the charge and would suggest that requiring details to be provided on the first disposal only (unless there is a change in circumstance such that the company is no longer outside of the charge) would be a pragmatic compromise.

23. We are concerned the provisions disallowing all carried forward non-residential property losses could contravene EU law on the grounds of proportionality. This was discussed during one of the working groups and we understand it will be looked at further. On the basis that carried forward losses on UK residential property will be allowed then the legislation should make it clear that for these purposes non-UK residential losses are deemed to be utilised first in the tax year. In our view the legislation should work in the way set down in the following example:

Sarah is UK resident in tax years 2010/11 to 2013/14 and non-resident in 2014/15. From 2010/11 to 2013/14 she realises the following gains and losses:

Tax Year	Gains	Current year losses on non-UK residential property	Current year losses on UK residential property
2010/11	£100,000	£50,000	£175,000
2011/12	£25,000	£35,000	£NIL
2012/13	£10,000	£NIL	£NIL
2013/14	£200,000	£200,000	£175,000

Sarah should be seen as having used her non-residential property losses in priority to her residential property losses meaning that she carried forward UK residential property losses of £300,000 to set against any gains on UK residential property that she realises in the non-UK resident period.

24. The legislation amending TCGA 1992, s13, s86 s87 and s88 appear to work as required. The changes to Sch 4B and Sch 4C are the most complex given the extreme complexity of that legislation. As set down in our TAXREP 35/14 there should be 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 to trustee borrowing) the property meets the definition of UK residential property.

25. We appreciate that the legislation shared at the latest working group meeting was a work in progress; however we want to make clear our objection to the use of a group definition that

draws on accounting concepts. We need consistency and for this legislation the way to do that is to use the definition that applies for the purposes of TCGA 1992, s13 (that is the TCGA 1992, s14 definition of a non-resident group of companies).

New TCGA 1992, Schedule B1

26. The definition of dwelling included the words "suitable for use as a dwelling". There is concern that this wording is wide enough to catch property that was originally residential that has been converted to offices (with building regulations specifying it cannot be used for residential property) but where the conversion is not dramatic enough that the building is not "suitable for use as a dwelling". The issue seems to be resolved in the pension scheme legislation by guidance (see RPSM0710960). We do not support the use of guidance to clarify legislation preferring the legislation to stand-alone. As such, the legislation should be adjusted to make it clear that a dwelling does not include any building specified in Regulations as not to be treated as residential property.

27. There are some words missed out of the paragraph (para 3(4) in the published legislation) excluding institutions (such as monasteries and nunneries) it should read "….as a dwelling if it is *used as* an institution…"

28. The student accommodation clauses need to include converted as well as purpose built accommodation Sch B1 3(8). The half the days in the tax year requirement could be too high; some UK universities may have term times that mean this condition will not be met.

29. The clauses on the disposal of a building that has undergone work Sch B1 7 are very prescriptive. There should be a softening such that the conditions for non-residential property treatment are deemed to be met provided planning consent is achieved after the work is completed (that is the taxpayer is allowed to rectify any errors).

New TCGA 1992, Schedule C1

30. The definition of a closely held company is convoluted; the approach adopted, starting from the close company definition and adjusting to get the closely held company definition could inadvertently produce difficulties due to the complexity of the close company definition. Whilst we appreciate that the time constraints make it difficult to produce a bespoke definition it would be the safest approach, particularly in this context where it is necessary to look up and down a chain so the definition works for complex groups (including partnerships).

31. We would like further time to consider the provisions to reassure ourselves that they do allow the looking up and down the chain that is required such that the legislation works for complex groups. As mentioned in paragraph 18 we are concerned about the position where partnerships are also involved (particularly where there is a General Partner who receives all the income as its fee).

32. The charity exemption only applies to charities in the UK, other EU states, Iceland or Norway. It seems unfair that charities that do not meet the jurisdictional condition to be regarded for UK tax purposes as a charity cannot fall within the qualifying institutional investor definition. Some US charities (for example) have funds under management as significant as a diversely held company so the same economic arguments could be made for excluding them for the new regime as excluding diversely held companies.

Amendments to TCGGA 1992, Schedule 4ZZA and new Schedule 4ZZB

33. As discussed during the working group sessions the computations are intensely mechanical. In common with other members of the working group we would like to spend further time running through different example calculations to ensure the provisions work for the different

permutations. As HMRC knows an adjustment is required to new Schedule 4C, para 17(2) so the calculations work out as required.

Interaction issues

34. As touched on during the working group meetings there are various interaction issues with other parts of the TCGA code that need to be considered such as holdover relief, being able to make an ER claim where the property qualifies as a furnished holding let (FHL) and rollover relief.

35. The rollover relief issue raises a problematic EU law point. We assume that there would be no objection to a non-resident rolling over the gain on an FHL in Aviemore into the acquisition of a FHL in Fort William. However, we can see that rolling the gain into an FHL in Cyprus would not be what the Government would want since the profit on the property would be outside the scope of UK CGT. Perhaps to be proportionate in such circumstances rollover relief could be allowed but on the disposal of the non-UK property it is specified that the rolled over gain comes into charge in the UK (unless rolled over again).

The main residence relief provisions

36. Given the dilemma posed with respect to main residence relief we think that overall the solution proposed is a good one. We do, however, have some concerns.

37. We appreciate that new s 222B(4) will be changed so the result is rounded not the fraction and we also appreciate that the legislation will be changed to introduce a deeming rule so trustees and personal representatives are deemed to have a "qualifying interest".

38. We are concerned that the provisions do not work adequately for spouses/civil partners and in particular where one is UK resident and one is not UK resident. The following example illustrates our concern:

Ethan and Serena are husband and wife. Ethan is posted overseas for 18 months to Zurich. Serena's mother is ill so she remains behind in the UK. Whilst he is away Ethan takes out an 18-month lease on a property in Zurich.

For 2016/17 Ethan is not UK resident and Serena is UK resident. Ethan spends 65 midnights in the UK property with Serena. Serena has to spend so much time with her mother that she only spends another 15 nights in the UK home. As such in aggregate Ethan and Serena only spend 80 midnights in the UK property in the tax year. This is not sufficient to meet the 90-day test.

Since she is UK resident the UK property remains Serena's residence but the legislation does not allow a husband and wife to have more than one residence and it cannot be Ethan's residence because he is non-UK resident and the 90 day test is not met.

We think that because Serena is UK resident throughout the tax year and the house remains her main residence it should qualify as the main residence for both spouses. However, we know from discussions that this is not felt to be the position. In such situations we think it would be very unfair for no main residence relief to be allowed. The legislation should be amended so that, where there is a UK resident spouse/civil partner, the 90-day test does not apply.

39. Where there are spouses/civil partners with different residential status the non-resident should not be able to act unilaterally with respect to making or revoking elections and to avoid an issue for the UK resident spouse/civil partner missing the election deadline it should be possible to make an election earlier than on the tax return when the disposal is reported.

40. Whilst we understand why HMRC have used the midnight concept for the 90 day test we do not think it appropriate here as people go out and are not necessarily at home at midnight. Whilst the midnight concept works for the purposes of day counting for the statutory residence test that relates to the UK as a whole applying midnights to time spent in a property can get rather absurd, Cinderella like. A day should count if the individual is in the jurisdiction at midnight and uses a qualifying unit at some point during the day.

41. It would significantly simplify the main residence relief legislation and give greater certainty when considering the drafting changes made to TCFA 1992, s223 if the definition of “interest” in a dwelling is amended so it does not include interests in property that are of nominal value only.

APPENDIX 1

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)