Office of Tax Simplification Capital Gains Tax Review: CIOT, ATT and LITRG responses to stage two

OMB Personal tax

07 January 2021

The CIOT, ATT and LITRG have responded to the second stage of the Office of Tax Simplification's call for evidence into its Capital Gains Tax Review. This second stage of the review covered the technical details and practical aspects of capital gains tax.

CIOT

CIOT technical committee members met the Office of Tax Simplification (OTS) on 26 October 2020 to discuss the second tranche of its review of capital gains tax (CGT). Following this meeting, we provided a detailed follow-up note on specific areas identified in those discussions. Below is a summary of some of the key points discussed with the OTS. These are reflected in more detail, and additional points are made, in the CIOT's note which can be found at www.tax.org.uk/ref693.

Private Residence Relief (PRR): Essentially what should be a simple relief has become overcomplicated, with scope for taxpayers to go wrong, so that they need professional help to establish their liability, exacerbated by the different rates and the difficulty of calculating CGT liability mid-tax year for the 30 day return. The number of cases taken to the First-tier Tribunal is a good indication of an area that needs attention. In our note, we consider in detail a number of fairly commonplace situations where the availability of PRR and/or the application of lettings relief is not straightforward. The periods of absence rules in TCGA 1992 s 223(3) are difficult to follow and over-restrictive. Nominations are a further area in need of simplification; our strong preference is to exclude the need to consider interests that have no capital value (and therefore potential for a gain) when deciding which of two properties is a main residence for PRR. Consideration could be given to abolishing

the two-year time limit for a PRR nomination more widely, and simply enabling PRR nominations to be made following a disposal.

Divorce: It is often challenging to effect transfers of chargeable assets within the year of separation to ensure the transfers take place on a no gain/no loss basis. Further complexities arise in the interaction with PRR, holdover of business assets, ‘clogged’ losses and inconsistency across the tax code. Providing for any transfers made in connection with divorce to be on a no gain/ no loss basis could offer a solution.

The operation of the rule in Marren v Ingles: Under Marren v Ingles, a right to deferred consideration is treated for tax purposes as an asset (a chose in action) itself. When the right is satisfied, there is a disposal for CGT purposes. We suggested that a key simplification to mitigate the current complexity would be a simple rule whereby unascertainable consideration is taxed on receipt as deferred consideration referable to the disposal of the original asset (not as a chose in action).

Distortions in Business Asset Disposals Relief (formerly Entrepreneur’s Relief): We consider some of the distorting elements of the 5% test in the ‘personal company’ definition and some of the difficulties around the two-year holding period (views on this latter point were mixed).

Land assembly for housing developments: We noted that the CGT code (and the wider tax system) militates against using a land pooling mechanism (to promote more sustainable developments and patient investment over short term return) as opposed to the ‘traditional’ route where a landowner pursues an option and sale arrangement with a developer or a promotion agreement and sells the land upfront. Possible solutions could lie in adopting principles-based legislative drafting or a ‘land-pooling’ vehicle specifically designed to provide a neutral tax treatment without affecting the wider tax code, or a series of dedicated reliefs for CGT, inheritance tax and possibly other taxes or amendment to existing reliefs or provisions. Our note considers the pros and cons in each case.

The Crowe v Appleby trap: The Crowe v Appleby case is problematic in two ways: firstly, the trap caused by its application; and secondly, the scope for errors that occur across potentially many years of returns if the rule is not recognised and therefore not applied correctly. The trap applies if the settled property is an undivided share in land in England or Wales; for example, a joint interest in a field.

The note includes case studies and the suggestion of a statutory override.

Lease extensions and tenant-owned flat management companies: We noted the lack of awareness of the CGT and wider tax issues arising where the freehold is an asset of the freehold company (other than as bare trustee) and a lack of HMRC guidance on the specific issues which needs to be addressed.

Estates in administration/position on death: Our note considers extending the Statement of Practice (02/04) allowance for the costs of establishing title to legatees. We point out the widely misunderstood position around asset values on death where estimates or incorrect low values have been entered onto the inheritance tax forms that produce an unanticipated chargeable gain. The CIOT's previous response in relation to stage one of the OTS's review (reported in October's Technical Newsdesk) considered more generally CGT uplift on death and the interaction with a general gifts holdover.

30-day reporting and payment: The design of the new system as an 'add-on' micro system meant there were a number of teething problems when it first went live, and problems remain with functionality and guidance that incur extensive professional time. These issues are discussed further below in the article on Capital gains tax: 30-day reporting and payment. In our response to the OTS, we questioned the benefit of developing standalone systems that operate independently of mainstream systems, such as the personal tax account and the agent services account, especially where they require their own separate agent authorisation process. In addition, there remains the fundamental issue of a general lack of awareness by the public of the obligation to report and pay within 30 days.

Record keeping: A common problem for property disposals is lack of information about holdover claims, details of enhancement expenditure and deferred EIS and SEIS gains. The facility for individuals and their agents to record these details when made or incurred in the personal tax account would have clear direct benefits.

ATT

The ATT's comments to the OTS focused on UK residential property reporting rules, PRR, divorce, Scottish partnerships and potential uses of the personal tax account.

We also discussed at length members' concerns about the new 30-day reporting requirements which have been universally unpopular. We provided the OTS with

screen shots of the process and highlighted our key concerns including:

- the lack of communications and guidance from HMRC;
- practical issues with the process, particularly agent authorisation; and
- the wider lack of awareness of the requirements by the general public.

In respect of CGT on divorce, we highlighted a number of areas which could usefully be addressed, including the short window in which couples can make no gain/ no loss transfers and recent, and unexpected changes to HMRC's position on the availability of hold-over when couples are transferring business assets on divorce.

The ATT also highlighted that Scottish partnerships are currently unable to access the ability to partition land between joint holders on the same basis as partnerships in England and Wales. This is a distortion which needs to be addressed.

Finally, the ATT suggested a return to a 12-month final exemption period and an update to Statement of Practice 14/80 (which allows those who let to a single lodger to continue to claim PRR rather than rely on letting relief) so that it better reflects the modern lodgings market.

LITRG

LITRG's response highlights the fact that the majority of CGT taxpayers pay either no income tax or only pay it at the basic rate. For this population, the main reason for interaction with the CGT system is the disposal of real property. Properties which have been the taxpayer's only or main residence at some point throughout the period of ownership – but not the entire period – present a particular challenge in calculating and reporting the CGT payable.

Drawing upon queries received through the LITRG website, the submission explores how this is an issue which brings complexity and challenge in terms across almost all of the main stages of compliance, including: awareness that a chargeable disposal has been made; calculating the gain; calculating the tax; reporting the disposal; and making the payment. LITRG suggests a number of easements to make it less likely for unrepresented taxpayers to fall into non-compliance unwittingly. These include:

- consideration of how to make taxpayers more aware of their potential CGT obligations on the sale of property;

- a possible additional CGT allowance which applies to the disposal of a main residence where full PRR is not available;
- relaxations for separating couples to allow them more time to make no gain/no loss transfers, and extended private residence relief for former spouses and civil partners who leave the family home;
- clarifications and improvements to the process of nominating a property as a main residence;
- various possible exclusions from the obligation to make a 30-day report on the disposal of UK residential property, as well as an extension of the period allowed to 90 days; and
- improved guidance on GOV.UK on various CGT issues.

The LITRG response can be found here: www.litrg.org.uk/ref2353.