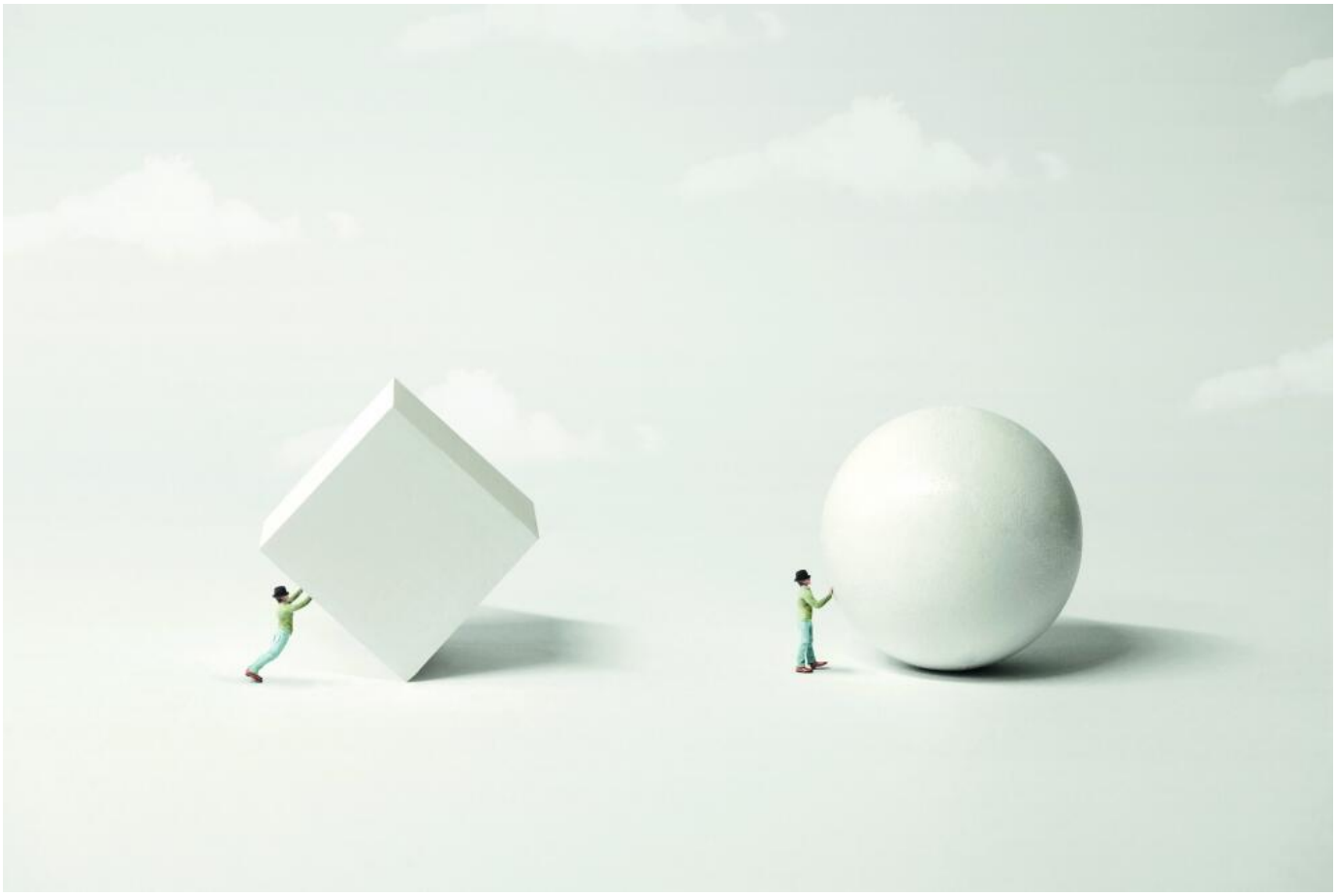
Capital gains tax made easier?

OMB Personal tax



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Bill Dodwell considers the OTS's report on how to simplify capital gains tax by focusing on a range of practical, technical and administrative issues

In July 2020, Chancellor Rishi Sunak requested that the Office of Tax Simplification review capital gains tax:

> 'This review should identify opportunities relating to administrative and technical issues, as well as areas where the present rules can distort behaviour or do not meet their policy intent. In particular, I would be interested in any proposals from the OTS on the regime of allowances,

exemptions, reliefs and the treatment of losses within CGT, and the interactions of how gains are taxed compared to other types of income.'

The first report, which covered policy principles, was published on 11 November. That report especially answered the chancellor's request to consider distorti ons and whether current rules meet their policy purpose.

The second report, 'OTS capital gains review: Simplifying practical, technical and administrative issues', was published on 20 May 2021, and answers the second part of the chancellor's request by covering technical and administrative simplification (see bit.ly/3bWxQSj).

The review is wide-ranging and recommendations cover issues relevant to individuals and to business. However, it did not consider partnerships, trusts, estates in administration, non-UK residence, non-UK domicile or complex international issues – or issues especially relevant to corporate groups. Many of these issues are worthy of a review in their own right.

The published report contains 14 recommendations for the chancellor, HM Treasury and HMRC to consider.

The chancellor is required by the OTS legislation to respond to reports he has commissioned; typically, responses are given at fiscal events (mainly Budgets!).

Tax returns, administration and awareness

The report starts by looking at administration and awareness of the tax and filing requirements. In a typical tax year, about 250,000 individuals pay capital gains tax, but about 500,000 people are required to complete the capital gains part of the self assessment return. The reason for the difference is that some have losses to off set against gains, some make losses on disposals and others have gains below the annual exempt amount. Of those paying the tax, 70% do so only once in 11 years (or perhaps longer). This is partly why awareness is low, as most people pay the tax so infrequently – and, of course, the vast majority of adults never see a capital gain at all. However, it also means that each decade about 1.5 million people do pay the tax – so it is much more significant in numbers than, say, inheritance tax.

The report makes recommendations for integrating capital gains tax into the forthcoming Single Customer Account – which is part of HMRC's ten-year tax

administration strategy and will take over from the current personal tax and business tax accounts. The Single Customer Account is an ambitious project and, in the view of the OTS, is a critical part of the future relationship between taxpayers and HMRC. It needs to become the capital gains tax hub, where data such as losses and main residence nominations are stored. It could also become the best way for many to report to HMRC, without needing to complete a full-blown self assessment return. Potentially as an interim measure, the OTS recommends that the current real time capital gains reporting service should become a proper return – and be opened up to tax agents. Currently, minimal use is made of this reporting service (just 1,670 people used it in 2018/19) and many more have to prepare the much longer self assessment return simply to report a capital gain.

The importance of data

One of the important benefits of an OTS review is that much more data on tax issues is published for the first time. This report has an entire appendix covering data sources used in the report. The report also recommends that HMRC should collect more data on capital gains, with less reliance on ’white space’ entries.

Collecting better data would help with both better compliance analysis and better understanding of capital gains policy. This theme applies across many taxes. One current example is that HMRC has no information on dividends taken by a company owner from that company.

The UK property return

One of the areas where new data has been published covers the new 30 day reporting and the payment required on the sale of residential property where there is a taxable disposal. In a typical year, about 150,000 people sell taxable residential property and about 85,000 have a tax liability. We do not know whether 2020/21 will be a typical year, of course, but during the first nine months just over 50,000 individuals have reported disposals, with a third failing to make the 30 day deadline.

Evidence to the OTS from a wide range of bodies was clear that there is a general lack of awareness. There is also an important questi on on whether 30 days is long enough to prepare the necessary information. Responses to the OTS survey suggests that gathering information and calculating the base costs takes nearly 60% of the time needed to report a capital gain. Property disposals are likely to be

complicated partly due to the length of ownership and partly due to enhancement expenditure.

These complexities led the OTS to recommend these alternatives: ‘The government should consider extending the reporting and payment deadline for the UK property tax return to 60 days, or mandate estate agents or conveyancers to distribute HMRC provided information to clients about these requirements.’ The 30 day policy brought in over £1 billion; increasing the reporting period to 60 days would cost about £105 million.

Main residence relief

The review did not examine the principle of main residence relief – which ‘costs’ about three times as much as capital gains tax raises – and is thought to benefit between 1.5 million and 2 million people every year.

It is estimated that just over 9,000 people paid capital gains tax on a property disposal that received only partial private residence relief in 2018/19. This is small in comparison with the 1.2 million property sales completed in that tax year. Some may consider that there could be under-reporting, aided no doubt by the complicated rules covering multiple residences and periods of absence.

The OTS put forward two recommendations, as well as calling for improved guidance in certain areas:

- The government should consider adjusting private residence relief to cover developments in a taxpayer’s garden which the taxpayer subsequently occupies.
- The government should review the practical operation of private residence relief nominations, raise awareness of how the rules operate, and in time enable nominations to be captured through the Single Customer Account.

The system of nominations where an individual or married couple own two or more residences creates complexity, as a nomination must be filed within two years of first acquiring multiple residences (or can only take effect up to two years before the election is made).

There is insufficient awareness of the rules and HMRC does not provide a standard template for making a nomination. One of the areas where better guidance would be

useful concerns lodgers, where the guidance revolves around the lodger eating meals with the owners.

The final recommendation for residential property concerns leases where the leaseholder owns a share of the freehold, typically through a fl at management company. Current rules lead to capital gains arising in the company where the leaseholder extends their lease, even though there is no overall economic gain.

‘The government should consider exploring ways of removing inappropriate corporati on tax or capital gains tax charges where a freeholder is in eff ect only extending their own lease.’

Divorce and separation

As many will no doubt know, disposals between spouses and civil partners take place on a no gain, no loss basis. Where a couple separates, this rule extends to disposals in the year of separation. However, this period is too short to allow a couple to rearrange asset ownership fairly. Accordingly, the OTS recommends that:

‘The government should extend the “no gains, no loss” window on separation to the later of:

- the end of the tax year at least two years after the separation event; or
- any reasonable time set for the transfer of assets in accordance with a financial agreement approved by a court or equivalent processes in Scotland.’

Business issues

The review put forward two specific business recommendations, intended to simplify tax issues on business sales by individuals. Firstly, the government should consider whether capital gains tax should be paid at the time the cash is received in situations where proceeds are deferred, such as on the sale of a business or land, while preserving eligibility to existing reliefs. The current situation where, in some cases, the right to receive future profits needs to be valued is confusing and adds administration for both taxpayers and HMRC.

Advisers will be aware that a taxable company bond – which enables deferral for a seller – must include a currency conversion clause (usually with a collar and cap to limit the economic effect), or the need to allow for additional bonds to be issued. These clauses typically have very limited commercial effect and are confusing.

Accordingly, the OTS recommends that: ‘The government should consider enabling an irrevocable provision in the documentation for a corporate bond to specify that it is subject to capital gains tax, and for the absence of such a provision to mean that it is exempt.’ Simple!

The final business issue concerns rollover relief where land and buildings are acquired under compulsory purchase orders. The report recommends that the government should expand the specific rollover relief rules in this area.

Investor issues

The Enterprise Investment Scheme is a highly regarded relief to support equity investment in small trading companies. It is generous and inevitably there are a number of conditions to ensure the relief is properly targeted. However, there is evidence that companies which meet the policy intent sometimes fail due to procedural or administrative issues. The OTS recommends that the government should review the rules with a view to ensuring that such issues do not prevent their practical operation.

Finally, as more individuals own assets outside the UK the report recommends that: ‘The government should consider whether gains or losses on foreign assets should be calculated in the relevant foreign currency and then converted into sterling.’