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OTS CAPITAL GAINS TAX REVIEW – CALL FOR EVIDENCE

Response by Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to comment on the first stage of the Office of Tax Simplification's Capital Gains Tax Review – call for evidence[1] issued on 14 July.

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 The review asks on a number of occasions for respondents to identify potential distortions. As tax advisers, familiar with the existing structures and used to advising on how to avoid pitfalls, it can be hard to identify such features of the system as distortions (even if that is what they are). Rather than distortions per se, we think the most useful approach in terms of achieving simplification in the second part of the review would be to look for common situations where an individual without an adviser might be put at a disadvantage because they lacked detailed knowledge of the rules. For example, situations where the order of disposals matters to get the best outcome, or timing is important.

1.4 We look forward to commenting in more detail on the technical areas being considered in the second part of the review.

2 Allowances, including the annual exempt amount, its level and the extent to which it distorts decision making.

2.1 *Use and impact on decision making*

Members reported limited options for manipulating the annual exempt amount (AEA). Where possible, taxpayers will use it to their maximum advantage, but generally, there is a gain and the AEA is available or it is not. With the exception of investment portfolios - where there is generally more flexibility in planning

[1] https://www.gov.uk/government/consultations/ots-capital-gains-tax-review-call-for-evidence-and-survey

because there is a more liquid market- the decision to sell is not usually influenced by the availability of the AEA but commercial or practical reasons such as the need for cash.

2.2 There are though occasions where the benefit of multiple AEAs can be obtained by completing transactions in stages. These include:

- Disposing of property into trust in instalments either side of the 5 April boundary
- Structuring share buy-backs over a number of years
- Drip-feeding shares in a family company down the generations over a number of years

However, savings from use of multiple AEAs can be limited once any additional transaction fees or legal costs which result are factored in. Furthermore, it is not always practically or commercially possible to stagger transactions over tax years when a third party is involved so planning of this nature tends to be more common between connected parties.

2.3 For larger transactions in particular, members report that the savings from structuring to benefit from more than one AEA are outweighed by additional complexity – it is generally at the smaller end of the scale that the savings are considered significant enough by the client to justify any extra work.

2.4 There is sometimes scope to transfer assets between spouses/civil partners to ensure both parties' AEAs are used but, despite a general understanding this is accepted by HMRC, we have had reports that some solicitors are, in the light of ongoing concerns about anti-avoidance, increasingly reluctant to transfer assets in this manner prior to sale. Again, for larger transactions, any benefits can be outweighed by additional complexities.

2.5 Members reported that the AEA is used most regularly by those with investment portfolios who may, towards the end of the tax year, opt to realise gains within the AEA to rebase elements of a portfolio without a CGT cost. In these cases, it is typically the broker that drives the use of the AEA.

2.6 *Level of AEA*

For 2020/21 the AEA has been set at £12,300, resulting in tax savings of between £1,230 and £3,444 depending on the nature of the gain and the rate of tax paid by the individual.

2.7 We consider that having an allowance for CGT for individuals, trustees and executors is consistent with the allowances in other personal taxes including income tax, national insurance and even inheritance tax and that to remove the limit could be perceived as unfair.

2.8 We discussed the potential for reducing this limit but we are concerned that this would bring more people into reporting, which would increase the administrative burden for potentially trivial amounts.

2.9 It is of course difficult to know who might be impacted if the AEA is reduced and we presume that it will be difficult to gather evidence on who is using the AEA at present because if gains are under the AEA - and the proceeds are less than four times the AEA – there is no obligation to report.

2.10 One argument for reducing the AEA which was raised is that ISA allowances have been increased in recent years, meaning that individuals can now accumulate substantial shareholdings within an ISA wrapper and so CGT is no longer a concern for them. However, it is not possible to transfer existing shareholdings in (unless in respect of certain employee share schemes) and the ISA benefits are confined to shareholdings when CGT

applies to a much greater range of assets including property. The increased ISA allowances do not therefore, on their own, justify a reduction in the AEA.

2.11 *Conclusion*

Fundamentally, even if the AEA has its limitations, it has a number of practical advantages. It is demonstrably simple, straightforward and widely understood. Having an initial tax-free allowance is also consistent with the personal allowance in income tax. On this basis, we suggest that the OTS focus their efforts on the simplification of other aspects of CGT, or that any changes to the AEA should be considered only as part of a package of recommendations (in line with the approach taken in recent OTS IHT reports) where adjustment to the AEA might be compensated for by other changes.

3 Exemptions and reliefs, including how they fit together and the extent to which they incentivise some decisions over others

3.1 We have focused our comments here on private residence relief and divorce/separation issues as the areas where we consider that simplification would benefit the largest number of people, particularly those who may not have a tax adviser.

3.2 *Private residence relief (PRR)*

In general, members reported that PRR operates as intended. Most people's circumstances are clear cut, and the relief benefits a large number of people. Given that removing PRR without some other compensatory mechanism would put owner-occupiers on the same footing as property investors we consider it highly unlikely that this relief will be scrapped.

3.3 In terms of the review, what we would like to see the OTS address at the second stage are some of the areas where PRR could be usefully simplified to make it more comprehensible to the general public as this is an area where people do not always realise that they need to seek advice. Suggestions for areas to review included:

- The potential impact of homeworking on PRR, which will be more common in the light of COVID-19.
- How to determine whether a property is a main residence or not. This is currently assessed on the facts, looking at the quality, not quantity of occupation. While the current system has its merits because there are no fixed requirements such as minimum periods of occupation, the result is that there is uncertainty and there have been several tribunal cases where claims have been made with little supporting evidence. This suggests it is an area that is open to abuse (or at least misunderstanding), and tackling the problem must take up HMRC's resources. One approach might be to fix a minimum period of occupation before a property qualifies as a residence. However, such a hard line could have unintended consequences and exclude people from benefit who were intended to be in scope of the relief, but whose plans were changed at short notice in response to extraneous factors and thus fell out of it. We think this is an area which could usefully be explored in more detail in the later stages of the review.
- The various periods of absence in which the individual is deemed to be in occupation. We think these should be looked at to see whether these still relevant and appropriate to modern working practices.

- Similarly, statement of practice 14/80 which extends PRR to those who let to lodgers is now 40 years old and no longer reflects the modern lodgings market. In the light of the recent restrictions to letting relief in Finance Act 2020, this could usefully be revised and updated.
- The ability to 'flip' nominations between properties where the individual has two or more homes is an area which could also be reviewed. While much of the benefit of transferring elections has been removed by recent reductions to the final period of exemption and restrictions to letting relief, this has come at a cost to those who are, for whatever reason, unable to sell within nine months of moving out. A more targeted measure to counter flipping might enable consideration of a more flexible rule in relation to the final period of occupation.
- Sales of garden for development - this is another area where uncertainty can arise and members have reported difficulties.

3.4 *Divorce/separation*

The CGT aspects of divorce are complex, and married couples/civil partners only have the tax year of separation in which to transfer assets while still benefiting from the favourable transfer rules. This means that couples are supposed to somehow time their separation to ensure that it happens as early in the tax year as possible, since any couple separating on 31 March would only have five days to arrange their tax affairs.

3.5 We think that couples should have a window of 12 or perhaps 18 months following the date of their separation to make transfers under the no-gain, no-loss provisions, rather than have the period tied to tax years. If it must be tied to tax years, then the no-gain, no-loss rules should apply until the end of the tax year following the tax year of separation.

4 The treatment of losses within CGT, including the extent to which they can be used and whether the loss regime distorts decisions about when to buy or sell assets.

4.1 *Use of losses*

Since so few people dispose of chargeable capital assets more than once in their lifetime, members reported to us that many clients who realise a capital loss never have the opportunity to offset it - with the result that that losses are just carried forward indefinitely with little or no prospect of relief. Taxpayers can struggle to see the fairness in this. Given that it can be hard to time disposals of assets, we wondered whether some, limited, form of carry back for capital losses would go some way to addressing this. Going further, some form of tax reducer (at CGT rates) against income tax, might also assist.

4.2 Another situation where unfairness can arise is the different treatment of current year losses and brought forward losses. Current year losses must be offset in full against current year gains, even if as a result the AEA is wasted. By contrast, taxpayers can restrict the amount of brought forward losses which they set against current year gains in order to preserve their AEA. This is inconsistent and adds complexity.

4.3 *Timing*

Members largely reported that, with the exception of investment assets, clients had limited control over the timing of sales to third parties.

4.4 For the few that do make multiple disposals in the same year, we wonder if the requirements of 30-day reporting in respect of UK residential property might encourage people to make loss making disposals prior to the sale of such residential property to help with the cash-flow implications of the payment on account. Again, it is more likely for this to arise where the individual is selling listed shares at a loss.

4.5 From a practical perspective, many people (especially those outside self-assessment and without an adviser) do not realise that losses have to be 'claimed' or reported to HMRC in order to be carried forward and used in the future. We wonder whether the Personal Tax Account (PTA) could be usefully developed to encourage people to report losses and also help to keep track of their accumulated losses which are carried forward.

5 The interactions of how gains are taxed compared to other types of income, including how the boundary between what is taxed as gains rather than income works. Should there be different regimes for short-term gains, compared to long-term gains?

5.1 We were surprised to see capital gains referred to here as if they were themselves 'types of income'. In our view, for most people, capital gains are not alternative sources of income but an entirely different beast.

5.2 In respect of rates, separating the rate from the individual's income tax rate would be a simplification and allow people to more accurately estimate the amount of tax that they need to set aside at the point of transaction. A number of members would be keen to see a simpler rate system rather than the four rates we have at present.

5.3 We would need more detail of the proposals and the policy intent to comment on the merits of different regimes for long and short term gains. Our immediate concern here is whether individuals would have retained the necessary information to determine with sufficient precision how long an asset has been held.

5.4 *Boundary issues*

We appreciate that there are areas where the boundary between income and gains can be uncertain, with the most common example reported to us being where an individual seeks to benefit from private residence relief by repeatedly purchasing, renovating and selling properties which they also occupy rather than treating the activity as a trade. Our comments above about a possible minimum holding period could be of relevance here.

5.5 Other examples where there is blurring of the boundary include where dividend withdrawals are reduced from a company in order to accumulate cash in the company which is then extracted during liquidation/sale at a more favourable tax thanks to Entrepreneurs' Relief.

5.6 In both cases, there is an incentive to access a relief, but while the former could be argued to be an abuse of a valuable relief, the second is probably more of a side benefit of a wider transaction that depends on the owners' ability to live on reduced drawings for a period in the run-up to sale. The former could be tackled by addressing more firmly the issue of what is a residence, and the second is a problem that can be identified in theory, but has no easy solution in practice.

6 Other concerns

6.1 Members raised a number of other concerns during our discussions which we think could also be usefully considered by the OTS.

6.2 ***Rebasing***

As a general rule, under the system of rebasing, gains realised before 31 March 1982 are not subject to CGT. The last rebasing took place in 1988, replacing the previous base cost for taxing gains as the value in 1965. A decision to rebase was therefore taken 23 years after the introduction of the tax, with an effective roll forward of 17 years.

6.3 We are now 38 years since the last rebasing and we think that this is another area which the review could consider.

6.4 While there would potentially be some significant winners from moving rebasing to a later date, the practical benefits to bringing forward rebasing would be that it would eliminate some record keeping and also make it easier to deal with assets which have been held for some time and where records are patchy.

6.5 While it is practically possible to obtain 1982 values for land and property, and surveyors are used to this, there can be challenges working out the extent or precise nature of the land and property to be valued at that date, as much work can have been done to a property and memories fade over what was done and when. There are also challenges for old shareholdings where it can be difficult to trace back through over three decades of reconstructions, take overs and accumulated units to establish a fair assessment of the base cost.

6.6 There is also an argument that rebasing aids fairness in the absence of any indexation allowance, as it reduces the amount of inflationary gains on which individuals are taxed.

6.7 ***Digital***

There are a large number of areas where useful simplification could be achieved by recording information within a taxpayer's PTA so it is easily accessible to both the taxpayer and HMRC, including:

- Records of nominations for PRR
- Records of holdover claims
- Brought forward losses

6.8 ***Concerns over 30-day reporting for UK residents of residential property disposals***

We have a number of concerns about the new 30-day reporting rules and look forward to discussing the details of our concern in the second round of the review.

6.9 *Policy*

The measure imposes additional reporting requirements and costs on taxpayers who were already obligated to report their CGT obligations on property disposals as part of self-assessment. We presume that HMRC has evidence that this is an area in which a significant amount of tax is being lost or only recovered with difficulty but this evidence was not made available during consultation.

6.10 We note that the original proposal in the Spending Review and Autumn Statement 2015 observed that CGT is out of step with PAYE. Our concern with this argument is that many items are dealt with under self-

assessment could be said to 'out of step with PAYE', on the basis that self-assessment allows the final bill to be calculated and paid after the end of the tax year when all the facts are known.

6.11 From a policy perspective, we are not clear what this policy is trying to achieve, other than a slippery slope in to more in-year reporting. If Government has a broader desire to accelerate the timing of tax payments to minimise loss to the Exchequer, there should be wider debate on the timing of payment of tax rather than changes to payments on account being introduced in a piecemeal fashion over a number of different assets or income sources. A broader debate would enable HMRC to identify clearly the specific areas of concern and the risks to tax collection, and thereby enable discussion of possible solutions.

6.12 We consider that, while CGT remains assessable on a tax year basis, a wider move to in-year reporting is undesirable as this simply results in duplication of work and costs for taxpayers. If there is a desire for more in-year reporting, then CGT would need to be restructured so it could be assessed on a transaction by transaction basis.

6.13 *Practical aspects*

We are also concerned about the general lack of awareness of this new policy– not just amongst taxpayers, but amongst their estate agents and solicitors, the people who most likely to know about a disposal at its earliest stages and be in a position to alert the taxpayer to take action or seek advice early enough in the proceedings that they can be in a position to report within 30 days of completion.

6.14 The system is also digital by default, with limited guidance available on how the digitally incapable should access paper reporting routes. This has caused members and their clients a great deal of concern, especially at a time when it is difficult for agents and clients to meet in person to resolve issues.

7 Contact details

7.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Helen Thornley on 07773 087125 or hthornley@att.org.uk.

The Association of Taxation Technicians

8 Note

8.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,000 members and Fellows together with over 5,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.