Chartered Institute of Taxation
Excellence in Taxation

Finance Bill 2018-19
Draft legislation for consultation
Clause 6 and Schedules 1 and 2
Response by the Chartered Institute of Taxation

1 Introduction

1.1 In this document, the CIOT comments on the draft provisions for Finance Bill 2018-19 issued for consultation on 6 July 2018 as Clause 6: Disposals of assets by non-UK residents and payments on account etc. introducing Schedule 1 Chargeable gains accruing to non-residents etc and Schedule 2 Returns for disposals of land etc.

1.2 In addition, the CIOT comments on some aspects of the summary of responses to the Taxing gains made by non-residents on UK immovable property consultation:

- On-shoring and SDLT group relief under FA 2003 Schedule (see para 9 below)
- Our concerns in relation to the implementation date given that core provisions only have been published with substantive elements still to be consulted upon. (see para 11 below)
- Timely guidance and raising awareness (see para 10 below)

1.3 The CIOT's stated objectives for the tax system include

- a legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences;
- greater certainty so businesses and individuals can plan ahead with confidence; and
- a responsive and competent tax administration, with a minimum of bureaucracy.

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It is with these particular objectives in mind that the CIOT responds to the consultation on the draft legislation.

2 Rewrite of Chapter one of the Taxation of Chargeable Gains Act 1992

2.1 The published draft legislation includes a re-write of Part 1 of the Taxation of Chargeable Gains Act 1992 (TCGA). Paragraph 2.15 of the Summary of Responses[1] states that :

'Apart from the changes to implement this measure and changes required to bring the existing Non-Resident CGT (NRCGT) rules on certain residential property within the scope of CT from the measure on 'Non-resident companies chargeable to income tax and non-resident CGT', the draft is a re-statement of the existing law and makes no change to the way the existing provisions work.'

And further at paragraph 2.16:

Approaching the implementation of this measure in this way modernises and simplifies the UK capital gains rules, and addresses structural issues identified by the advisory profession by re-stating the core charging rules positively and in alignment with the new measure.

2.2 In addition, HMRC sent the following message to representative members of the HMRC 's forum, the Capital Taxes Liaison Group on 6 July 2018:

'…*the context for the rewrite of chapter one of TCGA is described as follows for the benefit of your colleagues and members:*

Part 1, and Chapters 5, 6, and 7 of Part 2, of TCGA will be re-written to accommodate the taxation of non-UK resident persons making disposals of interest in UK land, and simplify the alignment of the new and existing rules. Apart from the changes to implement the new charging provisions applying to non-UK residents, the draft is a re-statement of the existing law and makes no change to the way the existing provisions work. Appropriate changes will be made to other Acts in parallel. The L-day draft[2] does not include the full detail of the consequential amendments nor a table of destinations, which will be published at Budget'

2.3 We note that the rewrite is intended to modernise and simplify the structure of the UK capital gains rules rather than change existing laws. However, there is an opportunity to correct anomalies and remove current uncertainties identified below.

2.4 One such anomaly is that new section 1N excludes an asset acquired by an individual in a temporary period of non-residence. However, the exclusion does not apply to attributed gains to a temporary non-resident settlor on an asset acquired by trustees where TCGA 1992 section 86 would have applied, a gain on which is caught by section 1M(3). The same applies to deemed gains under section 87 and new section 3 (replacing existing section 13).

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/722418/Taxing_gains_made_by_non-residents_on_UK_immovable_property_summary_of_responses.pdf

[2] 6 July 2018

2.5 An existing uncertainty present in section 13 appears to have been carried over to the new sections 3-3G. At present, it is clear that the substantial shareholdings exemption (SSE) can be claimed under TCGA 1992 Sch 7AC para 1 on a section 13 gain, where the conditions are met. Where the main exemption in para 1 is not available it is understood that it is also possible to claim SSE on a section 13 gain under the subsidiary exemption in Sch 7AC para 3. However, in the latter case there is some inherent ambiguity in the legislation.

2.6 Para 3 includes a requirement for the disposing company to be UK resident. The HMRC manuals state, at CG57275, that in applying section 13 a taxpayer should 'Calculate the chargeable gain that would have arisen to the non-resident company if it had been resident in the UK.' This would seem to allow SSE to potentially apply under para 3. However, the actual wording in section 13 is ambiguous, simply stating (at section 13(11A) that the gain should be computed as if that company were within the charge to corporation tax. This ambiguity appears to have been carried over into new section 3G(3). There would appear to be no policy reason why the main, but not the subsidiary, SSE exemption should be available on a section 13 gain.

2.7 We suggest that the rewrite of this section could be used to remove this unnecessary ambiguity by rewriting section 3G(3) to state that any gain should be calculated as though the company were UK resident.

3 Schedule 1 substituting new section 1 et seq. regarding general charge and territorial scope of capital gains tax

3.1 Section 1 TCGA has been rewritten and new sections 1A to 1O added. We are concerned that this re-write has introduced an ambiguity in respect of non-resident companies that become UK resident part way through a tax year and whether any gains arising as a result of such a company disposing of assets (which do not meet the conditions for SSE to apply and is not UK land; for example, foreign real estate) in that tax year, but before they became UK resident, are brought within the charge to capital gains tax. The new legislation deals expressly with split years for individuals at new section 1G, but there are no explicit provisions for companies.

3.2 The concern arises as a result of new section 1A (1) which says that a 'person' (which would include a company) who is resident 'for a tax year' is chargeable to CGT on disposals in that tax year and new section 1A(4) which says that a person is a UK resident 'for a tax year' if he/she/it is resident in the UK 'during any part of the tax year~'.

3.3 Thus, it appears that a company which becomes UK tax resident in, say, August 2020 would be liable to capital gains tax for the tax year beginning on 6 April 2020 in respect of a disposal of foreign real estate on, say, 15 July 2020.

3.4 This ambiguity arises as a result of the language in new section 1(2). This sub-section says '<u>As a as a result of section 4 of CTA 2009</u>, capital gains tax is not charged on gains accruing to a company, but corporation tax is chargeable instead …..' (emphasis added). We would like to assume that the intention of this provision is to ensure that companies can never pay capital gains tax and pay, instead, corporation tax on appropriate gains as a result of the provisions referred to. However, what section 4 CTA 2009 actually says is that capital gains tax is not charged on gains if those gains are charged to corporation tax or would be charged to corporation tax but for an exemption. This section does not, therefore, apply to a non-resident company which makes a disposal of foreign real estate. Not being UK resident is not an exemption from corporation tax; rather, the non-resident company is simply outside the scope of the corporation tax charging provisions.

3.5 As a result, it appears that new section 1(2) does not preclude a non-resident company from being within the charge to capital gains tax in circumstances where a gain is made in a split year.

3.6 We note that the drafting of the new section 1(2) has changed. Currently section 1(2) TCGA simply states that 'Companies shall be chargeable to corporation tax in respect of chargeable gains accruing to them … subject to the exception [*for certain NRCGT gains*]'. We suggest that the new re-written section 1(2) is amended to similarly clarify that companies can never pay capital gains tax, which, we believe will now be the position following the subsuming of the rules relating to NRCGT for certain residential property within the new rules applying to all disposals of UK land.

4 Schedule 1 substituting new section 3 et seq. for section 13: Gains attributed to UK resident individuals etc

4.1 Section 13 has been rewritten as new section 3. However, is not clear whether the new section 3 continues to charge pre-April 2019 gains as is understood to be the intent. New section 3(1)(d) states that this section applies if 'apart from this section, the gain would not be chargeable to corporation tax or capital gains tax'.

4.2 A gain of a non-resident company (even where owned by UK resident individuals) would be chargeable under the new rules (new section 2B(4)), and new Schedule 4AA (April 2019 rebasing provisions) apply to calculate the gain chargeable under section 2B(4). Hence the non-resident company is chargeable to CT in respect of the gain under the new rules, but only in respect of the post April 2019 element.

4.3 However, new section 3(1)(d) simply asks if the gain is chargeable or not. If it is chargeable (under section 2B(4)) then section 3 may not apply. We understand that this result is not the intention.

5 Schedule 1 inserting Schedule 1A (Assets deriving 75% of value from UK land etc.) Part 2 Paragraph 4: Exception in relation to interests in UK land used for trading purposes

5.1 The exception for land used for trading purposes is narrowly drawn and appears to give rise to some inconsistencies. In order for the disposal of a right or interest in a company to be not regarded as a disposal deriving at least 75% of its value from UK land, it is necessary for all of the interests in UK land to be used for trading purposes, or at least all other than those of an insignificant value (Sch 1A, para 4(1)(b)). It is noted that this test is a much more stringent test than applies to the substantial shareholdings exemption in TCGA 1992 Sch 7AC. In order to meet the latter definition a company may have non-trading activities, provided they are not 'substantial'; a far more generous test than the 'insignificant value' test in proposed Schedule 1A para 4. This distinction will lead to a disparity in the way that companies and individuals are taxed when making a disposal of a company holding UK land. The disparity could, in turn, have a distortionary effect on taxpayers' behaviour, for instance individuals may consider setting up foreign holding companies in order to benefit from the SSE exemption if it is perceived that this route might offer more relief than would be available on a direct disposal of UK property rich entities. Is this consequence intended?

5.2 In addition to the disparity between the treatment under these rules and the SSE legislation, there is a disparity in treatment between companies, depending on the nature of their trade. For example, a UK company with a trade of house building, that holds 80% of its UK land as trading stock, but 20% as an investment that is let out, would fail the test in the exception and therefore a disposal of its shares would be an indirect disposal of land. By contrast, a company that trades in making widgets but 70% of its value is nevertheless represented by UK land that it holds as an investment would fall outside the charge. Is this inconsistency of approach intended?

5.3 Alternative approaches could be

- to exclude any land used for the purpose of trade when considering the value of UK land as part of the value of the company (the value of such land would be included in the value of other assets for this purpose).

- A second alternative could be an exception where the company as a whole is trading, regardless of the value of any UK land (with the definition of trading for this purpose following the SSE definition).

The first alternative is preferred as it appears to accord more closely with the policy intent. The second alternative may not operate effectively as the value of the land could affect whether the company is trading as a whole.

6 Schedule 1 inserting Schedule 1A (Assets deriving 75% of value from UK land etc.) Paragraph 6: Whether person has substantial indirect interest in UK land

6.1 Paragraph 6(1) provides the ‘basic rule’ that a person has a substantial indirect interest in UK land if, at any time in the period of two years ending with the time of disposal, the person has a 25% investment in the company. Paragraph 6(2) ameliorates that test where, having regard to the length of the person’s ‘qualifying ownership period’ (as defined in paragraph 6(3)), the times at which a 25% investment is held (taken as a whole) constitute an ‘insignificant proportion of that period’.

6.2 Guidance will be required to clarify HMRC’s view of what is meant by an ‘insignificant’ in this context. In addition, it is not clear how this test will operate in relation to a ‘person's qualifying ownership period’ and the two-year period in paragraph 6(1), to the extent that these two periods do not correspond.

7 Schedule 1 inserting Schedule 1A (Assets deriving 75% of value from UK land etc.) Paragraph 9: Anti- avoidance

7.1 Part 4 of Schedule 1A is headed ‘Anti-Avoidance’. This paragraph applies to arrangements the main purpose, or one of the main purposes, of which is to obtain a tax advantage for the person as a result (wholly or partly) of –

a) A provision of this Schedule (assumed to be Schedule 1A*)* applying or not applying *(*for arrangements entered into on or after 6 July 2018*)* or

b) double taxation arrangements… where the advantage is contrary to the object and purpose of the double taxation arrangements (for arrangements entered into on or after 22 November 2017).

7.2 One of the drivers for the Aaronson recommendation of a GAAR was for a long-term improvement in the UK's tax system and simplification of current and future legislation. Although it is recognised that there will still be a need for specific anti-avoidance rules in new provisions the introduction of a new widely drafted TAAR in relation to a provision of the Schedule 'applying or not applying' seems to be out of step with that recommendation and will potentially catch non-abusive arrangements.

7.3 By way of example, given the width of the drafting, it applies to any arrangements the main purpose of which is to obtain a tax advantage as a result of a provision applying including an election under Schedule 4AA paragraph 8. Arrangements are defined to include any agreement, understanding, scheme etc and this could arguably include the making of an election. A tax advantage is defined to include any relief from tax and electing to use a historic base cost to reduce the chargeable gain would appear to fall into scope. Perhaps it would be argued that no counteraction would be just and reasonable in these circumstances but as a matter of principle the scope of anti-avoidance legislation should not cover any claim for relief made under the legislation itself.

7.4 It is also recognised that the anti-avoidance rule has allowed for the simplification of the 25% ownership exemption threshold, and that approach is to be welcomed.

8 Clause 6 Schedule 2 (Returns for disposals of land etc) Part 1 Paragraph 2

8.1 A payment on account is required on or before the 30th day following the day of the completion of the disposal. How will the 'Post-transaction valuation checks for capital gains' interact with the shortened payment period?

8.2 The post transaction service requires completion of the form CG34 at least 2 months before the filing date. As the filing date is within 30 days of completion, a post transaction check can only be carried out in the 30 days following completion, not the two-month period that extends before the transaction has taken place.

9 Stamp Duty Land Tax and 'on-shoring'

9.1 The summary of responses at 2.22 states that it is not the intention of this measure to encourage on-shoring (that is, moving property out of offshore structures and into the UK) rather it is to create a 'level playing field' for offshore and UK investors. Therefore, there are no plans to allow an SDLT relief for the initial transfer of a property to a UK company (referred to as 'seeding relief') as part of this measure.

9.2 However, investors may wish to transfer UK properties to a UK group company as the portfolio will be easier to manage from the UK. They may wish to do so in advance of April 2019 when market values are more predictable given that the rebasing date of April 2019 is close to the timing of the UK's exit from the European Union.

9.3 SDLT group relief under FA 2003 Schedule 7 should be available for such a transfer assuming that the qualifying conditions are met. Group relief is not available if the transaction:

a) Is not effected for bona fide commercial reasons, or
b) forms part of arrangements of which the main purpose, or one of the main purposes, is the avoidance of liability to tax. (FA 2003 Sch 7 para 2(4A))

'Tax' for these purposes includes capital gains tax.

The 'white list' at SDLTM23040 sets out some examples of transactions where it is accepted that group relief is not denied by para 2(4A) including the transfer of property to a non-resident group company in the knowledge that future appreciation or depreciation in value will be outside the scope of corporation tax on chargeable gains.

9.4 In the interests of certainty, it would be helpful if the transfer of a UK property to a UK group company, the timing of which is driven by a commercial assessment of property values, could be added to the list of examples where SDLT group relief is not denied by virtue of para 2(4A).

10 Guidance and raising awareness

10.1 The summary of responses recognises that there will be aspects where timely guidance is required well in advance of April 2019 particularly in respect of the property richness test, for example, what is meant by 'an insignificant proportion of that period' for the purposes of a 25% investment (Schedule 1A para 6(2) and definitions of land and buildings.

10.2 In terms of the property richness test, paragraph 3.53 indicates that '*in many cases it will be sufficient to look at a balance sheet or similar statement that represent recent valuations of the assets'*. While that may be the case for disposal of property owning SPVs, where there are other activities carried on by the company or by its underlying subsidiaries, the valuation exercise could be very complex. Guidance will need to be in place well before April 2019 to allow the valuation exercise to be conducted in respect of potential disposals in that month.

10.3 We reiterate the importance of raising awareness of the new regime and reporting requirements well in advance of April 2019.

11 Implementation date

11.1 The government has explicitly recognised the need for an extended period of familiarisation to April 2020 for non-UK resident companies entering the CT regime for property income. Implementing the very significant changes proposed for CGT by April 2019 will also be challenging for taxpayers and for HMRC. As the government notes[3], it is expected that the impact on businesses, individuals and trustees brought

[3] https://www.gov.uk/government/publications/capital-gains-tax-and-corporation-tax-on-uk-property-gains/capital-gains-tax-and-corporation-tax-on-gains-for-non-residents-on-uk-property

within the scope of corporation tax or CGT for the first time following introduction of this measure will be significant. Furthermore, the IT and operational impacts for HMRC are estimated to be in the region of £2.5 million per annum. The need for reporting mechanisms for offshore funds is likely to increase this cost.

11.2 The current published draft legislation constitutes core provisions only. The proposals for the treatment of offshore collective investment vehicles are currently 'high level' and subject to further consultation with the industry over the summer (holiday) period. Further significant tranches of legislation will be required before April 2019.

11.3 These changes will be required alongside major IT changes for and the UK's exit from the EU and Making Tax Digital for VAT. Delaying implementation until 6 April 2020 would have the benefits of a period of familiarisation, more time to implement the significant operational changes for taxpayers and HMRC and an effective period of further consultation with industry on the treatment of collective investment vehicles and exempt investors. Sufficient time to address the complexities inherent in the treatment of collective investment schemes and arrive at a robust and sustainable regime may outweigh a slightly longer period of uncertainty for investors particularly given other changes, and the potential for volatility as the UK exits the EU.

11.4 The need for further consultation with stakeholders, and the complexity and the scale of the change is recognised in the summary of responses. However, both UK resident and non-UK resident investors will need to review existing structures in advance of the implementation date. In particular, the removal of the 25% investment threshold for those who invest in UK property funds brings investors into the new regime but who were not expecting to be so included based on the consultation. The review of current structures will need to be conducted by reference to firm proposals and draft legislation issued following the further consultation. An implementation date of 6 April 2019 allows very little time for this consultative process and review to occur.

11.5 We suggest that the current implementation date is therefore re-evaluated as part of the further consultation process. We note that projected tax revenues are low in the early years of the change[4] and therefore the revenue foregone by delaying implementation is relatively less significant.

12 Acknowledgement of submission

12.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

'*It is expected that the impact on businesses will be significant and the overall impact will depend on how many businesses are brought within the scope of Corporation Tax and Capital Gains Tax for the first time following introduction of this measure*.'

[4] See the Impact Assessment Table 2.1 Autumn Budget 2017 (m) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661428/Autumn_Budget_Policy_costings_document_web.pdf*
p.43

13 The Chartered Institute of Taxation

13.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
31 August 2018