ICAEW
REPRESENTATION 52/20

OTS CAPITAL GAINS TAX REVIEW CALL FOR EVIDENCE - PRINCIPLES

Issued 10 August 2020

ICAEW welcomes the opportunity to comment on the principles section of the OTS Capital gains tax review call for evidence published by the Office for Tax Simplification (OTS) on 14 July 2020, a copy of which is available from this link.

The Chancellor has asked the OTS to carry out a review into capital gains tax (CGT). The scope of the review is explained in a scoping document and the call for evidence. This response is on the principles of CGT, in advance of the main phase of the review. ICAEW is concerned that the scope of the review extends beyond simplification, into policy areas that are outside of the remit of the OTS and are the preserve of Government and Parliament. ICAEW's view is that CGT largely meets the policy intent as we understand it and the present rules do not distort behaviour to any significant extent. We suggest that the policy objective be carefully considered and that any significant changes would need very careful consideration before being implemented, over a longer period than this review allows.

This response of 10 August 2020 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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SCOPE OF THE REVIEW

We are not clear about the purpose of the review and would welcome clarification of its objectives.

The scoping document states '*The review will identify, and offer advice to the Chancellor about, simplification opportunities relating to administrative and technical issues affecting individuals, partnerships, and unincorporated or single entity owner managed companies, as well as areas where the present rules can distort behaviour or do not meet their policy intent.*'

The remit of the OTS as codified in Part 12 of the Finance Act 2016 is set out purely in terms of simplifying the tax system. We are concerned that the scope of this review, with the references to distortions to behaviour and meeting the policy intent, appears to extend into making recommendations on policy areas which are outside of the statutory remit of the OTS and which are the preserve of Government and Parliament.

The scope assumes that the intent of the current policy on CGT is clear, at a time when the Government may be considering significant changes to that policy. Measuring a distortion means you have to identify a baseline of what is the 'normal' behaviour, a subjective matter which is not necessarily linked to simplification.

Some of the language used in the documents also causes concern, for example it conflates income and capital gains, referring to '*income from capital gains*' which suggests that the two are the same which is not the case.

TIMEFRAME

Responses on the principles of CGT are requested by 10 August 2020. This request for views on the principles of CGT including '*whether its scope and reach in the context of the wider tax system continue to be appropriate*' in a very short timeframe, along with the suggestion that the OTS may '*provide an update on those bigger picture issues*' in advance of the main report. This suggests that the Chancellor may be considering policy announcements in the Autumn Budget and has requested the review with that in mind rather than simplification.

Given the very short period in which to respond we have been very limited in the extent to which we have been able to engage with members or able to consider the complex and wide-ranging issues involved.

We suggest that any significant changes would need much more careful consideration than the very limited timeframe for this review allows and the request for comments on the principles in particular.

GENERAL COMMENTS

CGT raises less than £9bn per annum and any changes are unlikely to raise significant revenue for the exchequer without a major structural change to reliefs such as only or main residence relief.

We suggest that the policy objective be carefully considered. One of the main objectives for taxing capital gains has always been that it significantly reduces the incentive to develop schemes that seek to convert income into a capital gain. With the significant amount of anti-avoidance legislation that is in place, the current system largely achieves that objective and, to the extent that it does not, targeted measures could be considered.

Our general view is that capital gains tax largely meets the policy intent as we understand it and the present rules do not distort behaviour to any significant extent and, if they do, they are probably no worse now than they have been since CGT was first introduced in 1965.

We will comment on administrative issues in our response to the main phase of the review, but at this stage would highlight that the newly introduced 30-day reporting and payment of CGT on UK residential property, effective from 6 April 2020, is proving extremely problematic to apply in practice and a very significant administration burden. HMRC's systems supporting this statutory

change are not satisfactory and if any statutory changes to CGT are to be introduced a much longer lead time is needed, to allow robust systems development.

We suggest that the OTS considers the role of HMRC clearances which can offer simplification by giving the taxpayer certainty and reducing the number of disputes and appeals. In recent years HMRC has been reluctant to consider clearance procedures on new policies even though they are a form of real time reporting.

SPECIFIC QUESTIONS ON PRINCIPLES

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

The annual exempt amount is a major simplification measure. It avoids the need for significant numbers of taxpayers to report and pay CGT on relatively small amounts of gains. If simplification is the overriding objective, then it should be retained at about its current level or even increased.

Some taxpayers may arrange their affairs to ensure that they utilise the annual exempt amount but to do so they have to make a genuine disposal. Anti-avoidance rules have stopped practices such as bed and breakfasting of shares. Assets other than shares cannot usually be managed in a way that specifically uses the annual exempt amount without tax being due. The annual exempt amount avoids the need to calculate and report small gains that might arise on a disposal that is otherwise exempt eg, a principal private residence which does not completely qualify for relief. The allowance allows small changes to be made in investment portfolios without incurring a tax charge.

We have not identified any other allowances at this stage.

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

- **Investors' relief.** The first tax returns on which claims for investors' relief will be made are for 2019/20 and it seems too early to assess the effectiveness of this relief.
- **Business Assets Disposal relief.** Significant changes to this relief (formerly entrepreneurs' relief) were made in Finance Act 2020. We suggest that the impact of this change be assessed before any further changes are made. Taxpayers will act to ensure that they meet the conditions for the relief, but unless the taxpayers adopt arrangements to try and use the relief in circumstances where they should not be entitled to it, we do not consider this to be distortionary. Opinion is, however, more divided on whether the relief encourages investment.
- **Chattels and wasting assets.** These rules have not changed for many years and might be worth considering further.
- **Only or main residence relief.** The relief for an only or main residence has been a feature of CGT since it was introduced and is a major simplification measure for the majority of taxpayers when they move. It has been amended and made more restrictive in recent years but for most taxpayers it works well and continues to perform a valuable role. Its removal would have profound implications and increase the complexity of the tax system for most taxpayers. If such a change were to be made, it would need to allow for rebasing, or the measure would be retroactive. Stamp Duty Land Tax (SDLT) is already a disincentive to people moving home. The removal of only or main residence relief has potentially undesirable policy consequences including on social mobility, providing a significant disincentive to moving and causing major disruption to the property market.
  A system that taxes gains but allows them to be rolled over into a new property might be another possible approach in policy terms, but would add significant complexity, distort behaviour and the yield for the exchequer would be long rather than short term. Such a proposal would again appear at odds with the overall policy aim of this project which is to simplify the tax system.
  There is scope to make changes to simplify the rules for only or main residence relief. We will expand on this in our response to the main phase of the review but two specific issues worth considering are:

  - Nominating a property where more than one is available.
  - Lettings relief is now available in very few cases and removing it might be considered, particularly if the rule for the number of lodgers allowed without affecting entitlement to only or main residence relief were relaxed from the current one.
- **Base cost uplift on death.** The availability of the uplift may encourage taxpayers to retain assets towards the end of their lives, so could be seen as potentially distortionary. However, any change would need to be considered in the context of its interaction with inheritance tax (IHT) and so is probably outside the scope of this review. In principle, acquiring assets at their probate value is much simpler and reduces the record-keeping burdens; identifying the base cost of an asset after the death of the owner is likely to be problematic in practice.
- **Separation and divorce.** The rules for transfers between spouses and civil partners are a simplification measure and play a valuable role in the system but matters often become very complex on separation and cause difficulty during negotiations over the financial settlement. At present transfers between separating spouses can only be made on a no gain no loss basis until 5 April following separation (so between one day and one year after separation, depending on when in the tax year this occurs). We suggest that any transfers in connection with divorce should be made on a no gain no loss basis, regardless of timescale. This would be more in line with SDLT (no time limit) and IHT (spouse exemption until decree absolute and subsequently other exemptions may apply).
- **Rollover relief.** Rollover relief plays a valuable role when disposals do not generate cash. We suggest that the OTS considers whether rollover over relief might be extended to a wider range of transactions.

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

The treatment of losses does not generally distort decision making. The existing legislation mostly prevents the creation of artificial losses, which was a problem in the past. If the rates of tax on income and on capital gains were to be aligned there would be an argument that it should be possible to offset capital losses against income.

One group who do need to manage their affairs and the timing of disposals carefully to ensure that losses can be used are taxpayers who are internationally mobile or non-UK domiciled.

The fact that it is not possible to carry back losses means that some taxpayers may seek to realise losses if they have realised a gain in the tax year. This is particularly relevant to taxpayers who rarely realise chargeable gains, and so may not be able to utilise a brought forward capital loss at a later date.

Some practical issues do arise with losses such as:

- Taxpayers being unable to offset capital losses because they omitted to crystallise them by reporting them on a tax return within the four-year time limit.
- The difficulty of keeping track of losses on disposals to connected parties, the use of which is restricted. No tax software product that we are aware of allows these records to be maintained digitally, necessitating manual records.

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?

The structure of tax rates is important, particularly for CGT as the taxpayer will often be able to choose when to make disposals. The current rates are intended to reflect the fact that following the removal of indexation relief for individuals and taper relief the calculation of gains does not take into account the length of time an asset has been held or inflation; this is the basis for CGT rates being lower than income tax rates. Differential rates for short-term and long-term gains would introduce a distortion, providing an incentive to retain assets until such time as they would be treated as being long term. Whether such a distortion would be justified on policy grounds is a question for Government.