



Response from ICAS

Capital Gains Tax Review – call for evidence Second Stage

9 November 2020

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good.
2. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.
3. ICAS welcomes the opportunity to respond to the 'Capital Gains Tax review – call for evidence', issued by the OTS on 14 July 2020. This response addresses the second stage of the review and incorporates comments from our first stage response where these cover second stage questions.
4. We were pleased to have the opportunity to discuss the review with the OTS at meetings with our Private Client Committee on 3 September and our Tax Board on 29 October.

Structural CGT Issues

5. We support greater certainty and stability in the tax system, with fewer and less frequent changes, to allow taxpayers to plan with confidence; for businesses this encourages and maintains investment in the UK and for individuals it facilitates planning for life events, like retirement.
6. Constant changes to the tax regime also undermine taxpayer understanding and compliance. The anticipated benefits of any proposed changes to CGT need to be balanced against the potential downside of changing aspects of the rules which are longstanding and generally well understood.

Acquisition and disposal

Education and HMRC communications

7. HMRC communications to taxpayers about significant changes to CGT in recent years have not been adequate, as evidenced, for example, by the large number of NRCGT penalty cases coming before the First Tier Tax Tribunal. In general, these taxpayers were aware of the need to report a gain on the disposal of a residential property (and seeking to comply) but unaware of the introduction of the NRCGT requirement to report the disposal within 30 days.
8. Feedback from our members also indicates that many normally compliant taxpayers did not realise that they had an obligation to report (particularly where there was no tax to pay) until they came to complete their normal SA tax return (which included information on NRCGT). More targeted communications should have been provided (HMRC would have been aware of many non-residents who had rental income from UK property); it would also have made sense to include advance information in tax returns the year before implementation.
9. In cases where no tax is due – and the taxpayer was unaware of the filing requirement due to the poor HMRC communications - the penalties also appear disproportionate and intended to raise revenue, rather than intended to act as an incentive to comply.
10. We understand that similar issues are already arising with the extension of 30 day reporting to UK residents. Agents have tried to warn clients of the need to report gains on residential property within 30 days but there appears to have been little effective HMRC communication – particularly to key intermediaries like solicitors and estate agents, who will be immediately aware of relevant transactions. We understand that HMRC wants to prevent taxpayers making errors in the first place, rather than tackling non-compliance after the event. We agree with this objective but improved HMRC communications - both targeted and through high profile media campaigns – will be required.

Separation and divorce

11. Under current rules a married couple, or civil partners, can transfer assets between them on a no gain/no loss basis – but if the couple separate this treatment is only available until the end of the tax year of separation. This causes problems where a couple separate shortly before 5 April because

there is unlikely to be time to reach agreement on the division of assets (including properties) before the end of the tax year.

12. There appears to be no good reason why couples separating on 6 April should have a significant tax advantage over those separating on 4 April. We support an extension of the period in which no gain/no loss transfers of assets between separating spouses/civil partners are available. This could be linked to the date of separation – for example, an extra one or two tax years following the end of the year of separation (or a time limit of two years from the actual date of separation).
13. Alternatively, the availability of the no gain/no loss treatment could be linked to court approval of the financial settlement for divorcing couples in England and Wales. In Scotland, where many cases do not require court approval, the link could be to the Minutes of Agreement or Separation Agreement entered into by the parties which resolves the issues arising from their separation.

Annual exempt amount

14. The AEA has a useful purpose and should be retained in its current form. It removes the necessity to report small gains in a simple, straightforward and understandable way. The administrative costs for HMRC and the taxpayer of reporting such small gains are unlikely to be justified by the tax collected.
15. It is possible that some wealthy individuals with advisers deliberately generate sufficient gains to use their AEA each year, but our experience suggests that such individuals are relatively few in number, so the benefits of the AEA outweigh any disadvantage. We do not believe it would be possible to replace the longstanding, simple AEA with a more targeted way of taking small gains out of tax, without adding unnecessary complexity.
16. Removing the AEA would also be out of line with the direction of travel in other parts of the tax system, where annual exempt amounts (or an equivalent) have been introduced in recent years, for example, the £1,000 trading and property allowances and the savings and dividend allowances.

Rates of CGT

17. As noted in our response to the first stage of the review, the current multiple rates of CGT cause complexity and uncertainty. The extension to UK residents of 30 day reporting and payment for residential property gains, means that the link to the BR and HR income tax thresholds causes additional practical problems for calculations required before the end of the tax year. One obvious way to address this would be to have a single rate of CGT – as was briefly the case in 2008/09 and 2009/10. A single rate of CGT could be accompanied by a reduction in the number of reliefs – which we discuss further below.
18. The lower rates of CGT (linked to the basic rate income tax band) are arguably unnecessary, given the AEA. Having one fixed rate for CGT would also eliminate any scope for manipulation (by shifting income, such as dividends, out of the year in which a gain is realised).
19. The CGT rates (or the single rate) should arguably be lower than income tax rates (or the higher rate of income tax) to take account of the fact that many gains arising on the straightforward disposal of assets are largely the result of inflation, i.e. there is no real increase in wealth.
20. If CGT rates were to be set at the same level as income tax rates there should be a mechanism for removing the inflationary element of gains (as used to be the case before the abolition of indexation allowance). Reintroducing indexation allowance would, however, add complexity; retaining lower CGT rates is a simpler option. Rebasing could also be considered – we discuss this further below.
21. Arguably, there are some gains which currently fall within CGT but could more appropriately be treated as income. This could be addressed by bringing them within income tax, rather than equalising CGT rates with income tax rates for all chargeable gains. Examples where this might be considered include carried interest.
22. Distinguishing between short term and long term gains for CGT purposes would add considerable complexity (as illustrated by taper relief, for example), but could be necessary if CGT and income tax rates were the same. It would be preferable instead to reclassify some very short term gains as income (where that reflects their real nature) – and to continue to compensate for the inflationary element of longer term gains with lower CGT rates.

Issues commonly affecting individual taxpayers

Principal Private Residence Relief

23. Removing PPR entirely would distort behaviour by causing a reluctance to sell homes where this would give rise to large gains (particularly if accompanied by an increase in CGT rates). This could mean, for example, owners not downsizing, or employees being reluctant to move for work. Paying CGT might also restrict the purchase of the next property.
24. However, there is scope for simplification – and potentially for some restriction of the relief (for example, suggestions have been made for some form of lifetime allowance, or a 'rollover' system).
25. One area of difficulty, where the rules should be reformed is the provision for making an election to treat a property as the main residence (where more than one property is owned). This offers scope for manipulation but can also present problems where there are multiple residences, but no election has been made, due to lack of awareness of the election.
26. We suggest that instead of being a matter of choice and the making of an election, the main residence should usually be determined on the facts. We appreciate that in some circumstances – for example, where a taxpayer lives in, say, Scotland but works in London, with residences in both places – it could be difficult to determine the main residence.
27. The [factors used to determine Scottish residency](#) might provide some assistance in considering a CGT main residence test. In circumstances where a taxpayer has more than one place of residence in the UK, Scottish residence/non residence depends on identifying the residence with which the taxpayer has the greatest connection. This will not necessarily be the place where the taxpayer spends most time, nor will it be determined by where the taxpayer works. Factors to be considered include where most of the taxpayer's possessions are or where their family lives.
28. We understand that the OTS is considering recommending that a rental property should not be treated as a main residence – we agree that this would be sensible. Many taxpayers do not realise that there is any possibility that a rental property, rather than a property they own, could be regarded as their main residence for the purposes of PPR.
29. Another area where simplification should be possible is the approach to gardens/the permitted area. Currently, specialist advice tends to be needed for properties with significant grounds above the permitted area. One possibility might be to have a larger permitted area – but to apply this to all cases (with the excess over the permitted area being taxable), removing the scope for arguments and litigation about what is required for the 'reasonable enjoyment' of the dwelling house.

Chattels exemption

30. The exemption for chattels/wasting assets should be retained and generally works well. Like the AEA this removes the need to report small gains – which would otherwise clog up the system and impose administrative burdens on both taxpayers and HMRC. It also, importantly, ensures that losses cannot be claimed on tangible moveable property within the definition. The £6,000 figure has been in place for many years and might need to be revisited and increased at some point.
31. We understand that the OTS is considering whether the rules should be amended to address some anomalies arising from the present rules around wasting assets and the exemption for private cars. It is not clear that this would simplify the system, particularly as there would still need to be a de minimis threshold to achieve the aim of keeping small gains out of scope. The benefits of addressing the anomalies would have to be weighed against the negative effects of changing longstanding and well-understood rules.

Issues commonly affecting business owners and investors

Business lifecycle

32. As a general principle it is useful to have tax reliefs which facilitate passing on businesses to the next generation, but it is important that these do not distort taxpayer behaviour and that they meet the intended objectives.

33. There had been suggestions that Entrepreneurs' Relief (now Business Asset Disposal Relief) was not fulfilling the original objectives and was not providing an incentive to entrepreneurs. Recent changes to the relief have already altered the focus of some business owners. Before, the changes there was a 'fixation' with obtaining the 10% rate on exit. Now, there appears to be a shift towards holding on and planning a long term transfer to the next generation. However, regardless of the tax reliefs available some business owners will hesitate due to an unwillingness to lose control. In terms of incentivising entrepreneurs, or investment in businesses, relief on start up rather than on exit would be more effective.
34. Earnouts: As a result of Covid-19 there may be more claims against sellers under warranties. The window for adjustments is short – a Covid extension would be helpful.
35. Delays in responses from HMRC's share asset valuation team (and an inconsistent approach to valuations) are causing practical difficulties and hold-ups.

Reliefs available to business owners/shareholders

36. It is too early to say whether Investors' Relief will be widely taken up – and whether it will achieve the desired results, relative to the costs. Post Covid-19 many businesses may struggle to raise finance. Consideration could be given to reducing the restrictions surrounding Investors' Relief to encourage take up by investors and to improve access to finance at a difficult time.
37. Similarly, improvements to EIS might assist businesses in accessing finance. The complexities of EIS have always created problems and it seems to be taking longer to obtain EIS approval from HMRC, which can affect cashflow. Simplification and improved administration would help. Additionally, over time, exclusions have been added; a review of the definitions and exclusions and consideration of whether the right sectors can access EIS, in the light of financing needs post-Covid, would be useful.

Specific asset classes

Company issues

38. It is important to be aware of (and take into account) potential unintended consequences arising from changes to the rules on chargeable gains. For example, changes to the indexation rules had knock on consequences for life companies.
39. The 2016 TAAR relating to winding up companies: it is now very difficult for advisers to advise clients with certainty on whether CG treatment will be applicable or not, and there is no clearance mechanism. HMRC's guidance only covers very simplistic scenarios where there is little doubt around the application of the rules. HMRC's view is that this is anti-avoidance legislation, so they have declined to provide more detailed guidance – but this approach ignores the fact that some of the cases where greater clarity is required are complex/fall into grey areas, rather than reflecting artificial avoidance motives.
40. There may also be a case for treating some distributions made by close companies in liquidation as income rather than chargeable gains - where these effectively represent 'rolled up' income (and to the extent that they are not already caught by the 2016 TAAR). However, this is one of a number of issues relating to differences in taxation arising from differing business structures (particularly distinctions between incorporated and unincorporated businesses).
41. There are undoubtedly distortions, due to differing CT and IT rates – and differing CGT and IT rates – but making changes to one aspect, without considering the entire picture, would have wider consequences. We therefore believe this whole area should be subject to a separate review, so that a range of options can be considered – including, for example, the reintroduction of some form of close company apportionment. We do not believe that difficulties/distortions in this area should determine the appropriate CGT rates for more general chargeable gains arising from the disposal of assets.

Administration of CGT (for individuals, investors and unincorporated businesses)

Administration

42. Members are encountering numerous practical problems with HMRC's new IT system for reporting chargeable gains for residential property – particularly with the digital handshake required to appoint

an agent. The system is not easy to use, did not include full functionality when it went live and, in some circumstances, it still does not work at all. The HMRC helpline is not working well. HMRC guidance on using the new reporting system was completely inadequate – some agents have developed their own lengthy guidance for their staff to fill the gap. The poor functionality (and lack of access to adequate HMRC support) increases costs for clients. Additionally, gains now have to be reported twice – once after 30 days and again in the annual return.

43. Extending the reporting deadline to 60 days would be of some assistance but would still leave little time to gather the relevant information. As noted above there is a lack of awareness about the new rules so whilst tax agents have made efforts to alert existing clients to the 30 day requirement, in many cases there may be little or no time left by the time the agent becomes aware of the disposal.
44. Agents are also likely to advise clients with rental properties to keep records of all expenditure, enhancements etc. However, where a property has never been relevant for tax (for example, a holiday home which has never been let) there is likely to be very limited information and the agent may only find out about the property when the client sells it. Gathering the necessary information within 30 days is problematic.
45. We appreciate that realistically the 30 day payment requirement for residential property disposals is unlikely to be reversed, although an extension to 60 days would be helpful. However, the system could potentially be improved by switching to a formal payment on account system. The 'return' filed at 30 (or 60) days would effectively be a limited notification, accompanied by an estimated payment on account. The return, including full details of the transaction, could then be finalised later, with interest due on any underpaid tax. This would avoid the need for agents to advise clients to file a return within 30 days solely to avoid the risk of penalties – even when it is unclear that a return will actually be required.
46. There is a wider issue around the digital handshake process associated with the 30-day reporting system. This is causing significant problems for agents and clients, particularly where clients are digitally excluded or digitally challenged. The system is not fit for purpose for these clients and undermines HMRC's Charter commitment that it will accept that taxpayers have the right to appoint an agent and to have HMRC deal with that agent. Even some clients who do use technology find the process onerous and complicated. Difficulties are compounded by the fact that clients do not understand why they need to re-authorise an agent who has often been acting for some time (and a 64-8 is in place).
47. This problem is not confined to the CGT system – the new TRS also requires a digital handshake, giving rise to similar problems. Going forward HMRC seems to be proceeding on the basis that each new system will require a separate, digital handshake, creating a patchwork of different digital authorisations for agents and clients. This is not acceptable. We would like to see a simple, streamlined digital system, managed via a single agent account and a single taxpayer account – with the functionality to accommodate multiple authorisations (for different taxes, agents etc).
48. It is also essential that taxpayers should not be required to use digital channels to authorise an agent. Many taxpayers appointing an agent do not want to interact with HMRC at all, or do not wish to interact digitally, so we do not believe that requiring the creation of a Government Gateway account (necessary for both CGT and TRS) is acceptable or in line with the HMRC Charter. Not making suitable non-digital alternatives available is likely to lead to insecure workarounds being used.

Administration – lead time for changes

49. If significant changes to CGT are contemplated it is important to allow sufficient lead time for advisers and others to update their systems and carry out adequate testing, to take account of new rules. Rushed implementation can cause significant issues with digital systems – and lead to incorrect results. For example, investment platforms provide tax information for clients and their advisers to enable them to complete returns – if CGT rules change it will take time to update and test the platforms before they go live. It is important that adequate information about the new rules is available well in advance to facilitate this.

Payments

50. See our comments above about the 30 day payment system.

Record keeping, valuation and calculation of any tax payable

51. As noted above, changing to a more recent rebasing date could be useful in the context of dealing with inflation (simpler than reintroducing indexation, although the rebasing date would need to be revisited periodically). The other advantage of a change to the rebasing date would be the practical one of not having to try to find historical values (which causes difficulties in practice). The new date would need to be a reasonable one, balancing practicality and the impact on CGT receipts – we suggest it should be linked to increased digitalisation, so probably 2000 or later.

Interaction between CGT and IHT and with other taxes

52. As noted above, consideration should be given to reclassifying some items currently treated as gains, as income. However, there should also be a separate review to cover the much broader area of differences in taxation arising from differing business structures (particularly distinctions between incorporated and unincorporated businesses). We do not believe that problems and distortions in this area should determine the appropriate CGT rates for chargeable gains arising from the straightforward disposal of assets.
53. As the OTS concluded in its report on inheritance tax, the interaction between CGT and IHT is complex and can distort decision making, particularly in the context of deciding when and how to pass assets to the next generation. Where assets qualify for BPR/APR a lifetime gift may be unattractive because retaining the assets until death will obtain the CGT uplift. However, if the CGT uplift on death is removed, an asset with a low base cost (which does not qualify for APR/BPR), would effectively suffer two charges – IHT and a significant CGT charge. There may be a case for not giving the CGT uplift where APR/BPR applies.
54. There are also practical advantages to the CGT uplift on death because records relating to assets held for long periods may be difficult to obtain (and the person who was most likely to know the details is dead); resetting the base cost can therefore be helpful. If the removal of the CGT uplift on death is being considered, a change to the rebasing date would mitigate some of the significant practical difficulties which would otherwise arise.
55. As suggested in the call for evidence there are issues with gifts. The OTS has already considered gifts and IHT (ICAS submitted a response to this review) – and made recommendations. There is a widespread lack of awareness of the CGT consequences of gifts; it is not clear what percentage of gifts (particularly of assets other than land and property) get reported to HMRC.
56. We can see a case for extending gift holdover relief to a wider range of assets – given that tax will be paid when the property is eventually sold. For assets which do not qualify for APR/BPR there is also potential unfairness where CGT is paid on a gift – but IHT also subsequently arises, because the PET becomes chargeable on death.

Other areas of complexity

57. S248A TCGA 1992 (previously ESC D26) allows a roll-over style relief for CGT where joint owners of land exchange their interests so that each owner is left owning one or more parcels of land individually. For the exchange of joint interests to apply, the land must initially be jointly held.
58. This provision is now causing difficulties for Scottish partnerships because HMRC rejected a non-statutory clearance application relating to the availability of relief under s248A, where the land was held in a Scottish partnership. Clearance was apparently refused on the grounds that a Scottish partnership is a legal person and therefore the land was not 'held jointly' under the conditions of s248A.
59. ICAS has requested that s248A TCGA 1992 should be amended to remove this disadvantageous treatment of Scottish partnerships. Full details of the problem and the proposed amendment are included in the [ICAS Budget Representation](#) submitted earlier this year.
60. The problem with s248A arises from different Scottish law – a partnership in England is not a legal person. When making any recommendations for CGT it will be important to take account of any issues arising from differing Scottish law and from devolution. The impact of changes in the devolved jurisdictions may not be the same as in England. For example, income tax is partially devolved;

therefore, the potential behavioural impact of changes to the CGT/income tax base could be greater where devolved income tax rates are higher.

Wider GGT framework

61. We believe there is a strong case for implementing a system for reviewing CGT reliefs regularly, to assess the costs, value for money and whether they continue to achieve their objectives – or whether they distort behaviour in a detrimental way. This would be in line with suggestions from the NAO and the OTS.
62. Even where reliefs are still meeting their original objectives it would also be worth considering whether those objectives remain desirable – or whether circumstances have changed.
63. Reliefs which are not value for money, are no longer in line with government objectives, or produce unacceptable distortions should be removed. Reliefs which remain should be simplified wherever possible. Simpler rules would create less uncertainty and reduce litigation.