



Law Society
of Scotland

Consultation response

Review of capital gains tax – part 2

November 2020



Introduction

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We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Tax Law Sub-committee welcomes the opportunity to respond to the Office of Tax Simplification's review of capital gains tax¹. We have the following comments to put forward for consideration.

Consultation

Acquisition and disposal

1. Is the scope and boundary of CGT clear? Is it always obvious when an event is chargeable?

We consider that the CGT regime is complex and it is likely not well understood by a number of taxpayers, however we consider the scope and boundary of CGT are generally clear. Please see our comments at Q26 regarding the 30-day reporting deadline for disposals.

2. How generally aware are taxpayers of their (potential) CGT liabilities following a disposal? Could/should they be made more aware, and if so how?

Taxpayers remain unclear on the application of section 17 TCGA (Taxation of Chargeable Gains Act 1992, Disposals and acquisitions treated as made at market value) and section 18 TCGA (Transaction between connected persons) to transfers otherwise than at arm's length and gifts to family members. Taxpayers are generally reliant on professional advice to keep them right on their reporting responsibilities and tax position in these circumstances.

In addition, taxpayers are still not generally aware of the new 30-day reporting requirement for disposals of residential property and are unlikely to look for guidance on the potential CGT charges which could arise on the disposal of their principal private residence in certain circumstances.

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

There is a need to raise taxpayer awareness about both of these points. Although in many cases conveyancing solicitors will not be involved in or responsible for advising on tax liabilities, it may be possible for solicitors involved in property sales to assist with this if appropriate guidance material could be made available which could be passed on to clients at an early stage of a property disposal.

3. To what extent do the current CGT rules influence decisions around whether, how or when taxpayers acquire or dispose of assets? And to what extent and how do taxpayers adjust their activity to reflect this?

The availability of the CGT annual exemption and the timing of payment of CGT (excluding the 30 day reporting regime for capital gains arising on the disposals of residential properties for non-UK residents from 6 April 2015 and UK residents from 6 April 2020) does influence some taxpayers on the disposal of assets.

The qualifying conditions for certain CGT reliefs include a minimum ownership period (e.g. business asset disposal relief, EIS reliefs) which could be a material factor when taxpayers are considering when to dispose of those assets.

4. Are there any specific practical challenges for taxpayers in dealing with the CGT aspects of acquiring and disposing of assets?

A challenge for taxpayers is awareness of the details of the tax regime. The need to keep appropriate records including details of original acquisition of assets is also a practical challenge.

5. Is it always clear and easy to understand which expenses (including capital improvement, acquisition or disposal expenses) qualify for CGT purposes? Are the rules on qualifying enhancement expenditure clear and reasonably straightforward to operate in practice?

No comment.

6. Are there particular practical challenges or issues arising from the CGT rules about acquiring, disposing of or transferring assets on marriage (or civil partnership), separation or divorce?

The CGT treatment applied for transfers between spouses changes following the date of separation. The treatment currently depends on whether a disposal takes place in:

- (i) Tax year of separation (remain married in the tax year);
- (ii) Tax year of separation (divorce in the same tax year);
- (iii) Tax years post separation (remain married in the tax year of disposal); or
- (iv) Tax years after separation (divorce after tax year of separation)

We note that at present, CGT disposals within the year of matrimonial separation are still within the spousal exemption but one day later, they are not. We suggest that this should be dealt with on a 'no gain/no loss' basis regardless of timing. We understand that the OTS are considering how this might be linked to a court

approval of a financial settlement. In Scotland, the procedural steps for financial separation and divorce are different, and it is common for there not to be court approval of a financial agreement between separating parties.

A separation towards the end of a tax year can result in the parties only having a very small window of opportunity to consider their CGT position when other non-tax issues may be more of a priority. The different tax treatments can result in taxpayers being forced into making time pressured decisions to save CGT.

7. Are there particular issues around the boundary with income tax e.g. shares or share rights received by employees or the boundary between trading and investment?

No comment.

Annual exempt amount (AEA)

8. In your experience, to what extent do individuals or their agents arrange to time disposals of assets in such a way as to maximise use of their AEA to manage down their tax liabilities?

In our experience, the utilisation of available AEA is a general strategy adopted by financially/tax sophisticated taxpayers and those taxpayers taking professional financial and/or tax advice.

9. Could there be a simpler or more targeted way of taking small gains out of tax?

We regard the AEA, or something of this nature, as crucial to capital gains tax. It is common for small gains and losses to be incurred by individuals to whom the tax is not primarily targeted. Such a measure allows for these individuals to fall out-with scope of the tax in a fairly simply manner. This helps to reduce the compliance burden. We suggest that the AEA be retained.

Different rates of CGT (10%/20%/18%/28%)

10. To what extent do the different rates of CGT cause complexity? Is it always clear which tax rate should apply? Which situations present specific problems? Does the dependence on the income tax higher rate threshold make this inevitable? Do you think the rates position could be made simpler, and if so how?

In relation to the different rates for basic and higher rate taxpayers, we note that taxpayers who are paying CGT on assets other than a property are likely to be higher rate taxpayers. We note that there can be anomalies with the current banding, for example, it is common for pensioners to be basic rate income taxpayers, but they may have built up significant investment portfolios during their lifetime which are liable to CGT.

We consider that the current multiple rates are a source of complexity. While, we would not favour simply aligning CGT with income tax rates, we consider that there are opportunities to simplify matters by having fewer different rates than at present. We note that there is a particular Scottish angle in relation to the different rates of CGT due to the additional complication about which income tax higher rate means that a taxpayer pays higher rate CGT. Scottish taxpayers therefore currently require to be familiar with both Scottish and rest of the UK income tax thresholds when establishing their CGT position. It is difficult to see how this might be resolved. In addition, property disposals must be reported and the tax paid within 30 days of disposal but taxpayers might not know their final rate of income tax for the year or their remaining annual exemption at that point, so will need to make an estimate.

We note that CGT no longer has any actual or substitute allowance for inflation for non-corporate taxpayers which seems fundamentally wrong if replacement provisions are to continue. We note that many gains arising on the disposal of assets will be as a result, or largely as a result, of inflation, resulting in little or no increase in wealth for the taxpayers. This should be borne in mind in fixing CGT rates and may support the CGT rate(s) being lower than income tax rates. We consider that reintroducing indexation allowance would add complexity.

We recognise that there may be a general attraction for some taxpayers to create gains through artificial means, such as schemes to divert would-be income into gains, or via complex investment products, and taking advantage of reliefs available².

In relation to short-term and long-term gains, we consider that differential rates would add complexity and could create a distortion.

Reliefs and exemptions

Principal Private Residence Relief (PPR)

11. Are you aware of situations where the current rules are not easy to operate perhaps because of changes in society or patterns of work (such as home - working, taking in a lodger, letting out a bedroom to tourists, or the use of gardens or grounds)?

We note that principal private residence relief takes most potential taxpayers out of scope for CGT by virtue of taking their main asset out of scope of the tax. We support the relief in principle and suggest that only minor changes are needed to PPR.

Time apportionment can be unfair and very complex. This has developed in a piecemeal fashion over time and there may be a benefit in a comprehensive review of the rules relating to this in the context of PPR relief.

² For example, the case of *UBS AG v HMRC; DB Group Services (UK) Ltd v HMRC* [2016] UKSC 13 which involved an attempt to benefit from employee share scheme relief.

We would welcome unified definitions across the different taxes although appreciate that this may have both positive and negative impacts on tax take.

We believe that many taxpayers are not aware of the recent reduction of the final exempt period for PPR to 9 months, nor the significant restrictions on letting relief introduced from 6 April 2020. There has not been sufficient awareness raising about these points, and taxpayers generally get no further than the general belief that the sale of your principal private residence is exempt from CGT. The rules relating to the periods of absence which can be ignored in arriving at the exempt gain are labyrinthine, but most taxpayers are probably blissfully unaware of them, and so do not seek advice about any potential tax charge.

The question of what is included in the garden and grounds of a house can be problematic in more rural areas, and either clearer guidance or perhaps an increased permitted area could be helpful.

12. Are the ancillary reliefs and occupation rules consistent with what you consider PPR is aiming to achieve? If not, what would make them simpler to apply or better achieve these aims?

We note that there are a number of combined reliefs for different purposes, for example, army personnel, and there may be merit in simplifying these. We suggest that someone who rents a house should not have this treated as a main residence. In relation to use and area constraints (for example, is half a hectare appropriate for a garden?), we suggest that this should be subject to review. In relation to lettings relief and lodgers' exceptions, modernisation would be merited and we suggest these be considered in light of the overlap with 'rent a room' relief.

13. How do you find the principle and practice of making a nomination? Are there better ways of achieving the same ends?

We suggest that consideration is given to the provisions for nomination. While we agree with the need for one property to be identified as the principal residence, difficulties can arise where no election has been made (for example, as the taxpayer is unaware of the need or process to do so). Consideration should be given to the PPR nomination being able to be made on taxpayer's self-assessment tax returns.

An alternative would be to determine a main residence on the facts and circumstances of the case. The tests used to determine Scottish tax residency may provide some assistance in this regard.

The current 2-year limit for making a nomination on the acquisition of a new 'only or main residence' should be reviewed in light of the recent restrictions in the 'final period exemption' from 3 years to 18 months to now 9 months. This may be of particular relevance given the impacts on the property market of COVID-19.

Chattels exemption

14. Are there any aspects of the taxation of gains arising from the disposal of chattels that you consider would benefit from being simplified?

We note that in Scotland, 'chattels' is not a recognised title for moveable property. We suggest that a more appropriate name may be 'taxable moveable property'. We suggest that the exemption should be retained, but be increased to reflect inflation since it was introduced in 1989, and the sliding scale removed in order to simply matters.

15. Is it clear to taxpayers that gains on significant chattels are potentially taxable? Or is there a general lack of awareness?

There remains a degree of confusion over how the deemed market value rule can apply to gifts of chattels to family members (please see Q2).

Issues commonly affecting business owners and investors

16. Are there features of CGT that present barriers or distortions at any of these stages? Are the rules simple to understand and apply correctly? Please provide examples along with any suggestions on how the rules could be made simpler.

Please see our comments at Q19.

17. Do you know of occasions when CGT rules have affected business decision making more generally, including decisions regarding the structure of a business or the choice of business vehicle (for example a corporate entity, partnership, unincorporated business)?

CGT is not generally the main concern when choosing business structures, though the desire to obtain the EIS exemption from CGT or CGT deferral is obviously a key consideration in structuring EIS investments.

18. Please tell us about any complications or rules which unduly affect the way businesses operate if payment for the sale of a business is not made in cash but in some other way (such as qualifying and non - qualifying corporate bonds, deferred consideration and earn outs). To what extent is there a business tension between claiming a tax relief at the point of sale as opposed to deferring the tax charge until cash is received?

A great deal of professional time is spent when companies are being sold where there is an earnout or deferred consideration to try and both ensure that CGT is minimised, and to try and avoid a tax charge in advance of the receipt of consideration. There is frequently a tension between the two, for example where an election is made to disapply the share for share exchange rules so as to preserve Entrepreneur's Relief on the gain, which accelerates the payment of tax. It would be preferable if the tax treatment of consideration for the sale of shares could be simplified so that tax charges only arise when/to the extent that consideration is received.

In most cases it makes more sense for consideration loan notes to be non-qualifying corporate bonds (NQCBs), but it is questionable whether inserting specific wording into a loan note purely to ensure NQCB treatment where the inserted wording arguably has very little commercial impact is a sensible way to have to structure consideration for the sale of a company.

Reliefs available to business owners/shareholders

19. Is the scope of each of these reliefs intuitive or are there unexpected differences between them that create practical problems for businesses? Are there aspects of any of these reliefs that you consider are unclear or particularly difficult to utilise in practice?

In relation to business hold over relief and hold over reliefs more generally, we consider that there may be scope for unifying some of the points. We note that rollover relief is, in its concept, fairer (by reducing the base cost of the thing one acquires) whereas holdover relief perhaps does not work as fairly.

The introduction of a disincorporation relief would be welcome.

We consider that the reduction in the level of business asset disposal relief ('BADR') from £10 million to £1 million could lead to extreme avoidance behaviour with taxpayers structuring transactions in such a way as to obtain maximum benefit from the relief.

The 5% 'personal company' ownership test for BADR to be available on the disposal of company shares does not appear to be aligned with the availability of the relief for interests in partnerships or shares granted under EMI schemes. There is also no minimum interest condition for CGT reliefs on qualifying EIS investments.

The CGT deferral relief available for qualifying investments (e.g. EIS, SEIS) can result in investments continuing to be held purely to avoid the crystallisation of capital gains being held.

EIS is a highly challenging area for ongoing advice. While EIS does appear to encourage investment, it is commonly the same businesses who benefit from this and other forms of reliefs. Typically, such businesses can benefit from significant gains but also absorb significant losses.

20. Are there aspects of these reliefs which distort business decision making (for example in respect of such areas as the timing of the disposal of an asset, or how much cash to accumulate on a company balance sheet) or are inconsistent with your understanding of what the relief is aiming to achieve? Are there any ways in which they could be made less distortive?

See our comments at Q19.

There is a constant concern that accumulating too much cash can prevent a company being treated as a trading company for Entrepreneur's Relief, for example, but for many companies retaining a large amount of cash is necessary to allow the business to deal with business pressures. It seems unfair that companies

should be prejudiced for what the experience of COVID-19 has demonstrated is actually a sensible business approach.

21. Should gift relief be extended to cover a greater range of business and investment assets as it was until 1989? What would the effect of this be? And would any extension open up unintended avoidance opportunities? Please refer to specific reliefs in your answer and provide illustrative practical examples.

In relation to gift hold-over relief, we note that this is restricted and linked to IHT chargeable events. We consider that the principle of the relief is clear. It would be simpler if the relief was more widely available, but we recognise that this could have an impact on tax take.

The extension of gift relief may reduce the use of the CGT holdover relief under section 260 TCGA on the transfer of assets into trust.

Specific asset classes

22. Are there any aspects of the rules relating to the taxation of gains or losses realised on the disposal of shares and securities that are particularly complex to understand or apply? Are you aware of any difficulties in ascertaining the base cost of such assets, such as the share matching rules?

No comment.

23. Are there any aspects of the taxation of gains arising from the disposal of investment properties, leases, land or buildings that you feel would benefit from being simplified?

We note that existing CGT rules can result in difficulties for land pooling arrangements.

24. Are there other asset classes (such as for example crypto assets) which present challenges or complexity for individuals on disposal?

No comment.

Company issues

25. Are there particular areas of complexity that relate exclusively to companies? And if so, should these be simplified or made more consistent?

No comment.

Administration of CGT

26. Please describe any problems you have had (or anticipate having) in navigating the online systems or forms and provide any suggestions you have on how the forms or related guidance could usefully be simplified, made clearer or made easier to complete. Please specify which method(s) of reporting your experience relates to.

We note that taxpayers are struggling with the 30-day reporting deadline for disposals of UK residential property (i) by UK residents that is not covered by PPR relief; and (ii) by non-UK residents disposing of UK land and buildings. The awareness of taxpayers of the deadline is normally very limited, particularly as a number of taxpayers who are caught by this are not otherwise in the self-assessment system. Greater awareness raising among taxpayers is required. This should involve clearly setting out the information which is required. It would be of assistance if a taxpayer could complete an information sheet or similar with the relevant details, showing the items that could be deducted, and provide this to their agent.

There are practical difficulties of assembling the information within the deadline, which seems particularly challenging in relation to second homes. It is particularly challenging to meet the 30-day deadline in executries that involve the appropriation of property to beneficiaries.

We suggest that either the deadline should be extended or HMRC systems need to be improved. It is common for other matters to require resolution, such as partial disposals and valuation fees, before the full information can be provided to HMRC. This means that in practice, a return often has to be made quickly without having the full picture and then the taxpayer or their agent have to keep going back to HMRC to add further pieces of information. This requires considerable time and effort and is not cost effective for everyone involved

A number of agents report difficulties with agent authorisation for HMRC online systems which causes or adds to delays and potentially prejudices digitally excluded taxpayers. We are aware of problems with the digital handshake process, associated with the 30-day reporting system and other matters, which has caused difficulties for taxpayers and agents. Suitable non-digital alternatives are required.

27. Do you have any suggestions about how HMRC could use information it currently has or has access to, in order to reduce administrative burdens, improve customer experience and ensure compliance in respect of individuals' and businesses' CGT obligations? Does HMRC get the balance right between asking for information to avoid unnecessary enquiries and streamlining the experience for those with simple affairs?

No comment.

Payments

28. Please comment on any complexities or practical problems that you have experienced (or anticipate) in relation to the process of paying CGT. Please specify which reporting system(s) your payment(s) relate to.

No comment.

Claims

29. Are you aware of any particular practical or technical issues (relating to for example record keeping, awareness, use of ringfencing rules, timing deadlines or other challenges) for losses, other claims, or clearances that you feel should be highlighted as part of this CGT review?

No comment.

Record keeping, valuation and calculation of any tax payable

30. What, if anything, could be done to help taxpayers to more easily fulfil their record keeping obligations and calculate any tax payable in relation to their capital gains?

HMRC could consider introducing an option in personal tax accounts to help taxpayers keep records of acquisitions and enhancement expenditure.

We consider that there are opportunities for targeted advertisement and public education by HMRC around CGT. For example, this may include at places such as auction houses and in investment media which may be beneficial in bringing CGT to the attention of those who might need to pay the tax but who may not regularly do self-assessment returns.

31. Have you encountered any difficulty with valuing assets either at acquisition or disposal? What, if anything, could HMRC do to simplify the valuation requirements or processes without opening up unintended avoidance opportunities?

No comment.

32. Would changing to a more recent rebasing date than 1982 make finding the base cost of a disposal easier or would any such benefit be outweighed by an increase in the number of valuations that would then be required?

1982 is now a long time ago and it can be difficult to obtain relevant information to support valuation. It is also confusing for taxpayers as there are currently a number of different dates for rebasing, including disposals of residential property by non-residents (2015) and disposals of non-residential property (2019), which can lead to complex apportionment calculations.

Estates in administration

33. Are there particular aspects of the taxation of capital gains made by those administering an estate that could be simplified?

No comment.

Interaction between CGT and IHT and with other taxes

34. To what extent does the absence of a CGT charge on death and transferring those assets at market value on death distort and complicate the decision-making process around passing on assets to the next generation?

We note the overlap between CGT and IHT in respect of death. We consider that making death a chargeable event would be very difficult to do properly and would result in a significant administrative burden, at least without recent re-basing. We favour the retention of the tax-free uplift or at least a 'no gain/no loss' approach for certain assets. We note that the OTS suggested in its earlier IHT report that where an individual benefits from spousal exemption or APR/BPR for IHT, CGT should operate on a 'no gains/no loss' basis.

If a broader 'no gain/no loss' approach was to be taken for lifetime gifts or on death, we consider that while this would make things simpler in one regard, complexities would result. The interaction with annual exemption would need careful consideration. CGT is currently a tax on disposals, not on gains themselves, and if there was to be a change to this, there would need to be considerable promotion to taxpayers and advisors.

If the tax-free uplift was removed, we note that this might make the situation for surviving cohabitants difficult, where they could be forced to sell the property to cover CGT liabilities.

35. Are there any aspects of the taxation of gifts or other disposals that are not made at market value, that you feel would benefit from being simplified? Should the range of assets eligible for a tax deferral when they are gifted be broadened to include a greater range of assets? And would any extension open up unintended avoidance opportunities?

We believe an expansion of gifts relief would be helpful so that taxpayers can make lifetime gifts without dry tax charges.

36. Are there instances where you feel the interaction of CGT with other areas of tax results in particular complexity or difficulty in applying the rules correctly? Are there definitions within CGT that would benefit from closer alignment with the definitions found in other taxes? Please provide examples, as well as any suggestions for ways to simplify the system.

No comment.

37. Are there instances where you feel the interaction of CGT and capital allowances (in respect to income or corporation tax) results in particular complexity, difficulty in applying the rules correctly, or unexpected tax outcomes?

No comment.

Other areas of complexity

38. Are there any particular areas of complexity that are unique to partnerships?

HMRC's statement of practice D12 sets down the CGT rules for partnerships and LLP subject to section 59 and section 59A TCGA respectively. Partnership event including changes in partnership sharing ratios, revaluations of partnership assets, contributions of assets to a partnership can all trigger potentially unexpected CGT charges for partners. The rules can be complex to apply and difficult to follow for taxpayers.

We have previously supported calls by ICAS for amendment of section 248A TCGA³. We strongly support ICAS' representations on this matter. We consider that Scottish partnerships should not be disadvantaged by being unable to claim the relief which would otherwise be available under section 248A as a result of the underlying Scots law concerning the legal personality of a partnership.

³ <https://www.lawscot.org.uk/media/368358/20-02-07-tax-uk-budget-representations-2020.pdf>

39. Please tell us about any other areas of complexity not covered above in applying any CGT reliefs, thresholds, or administration not already mentioned in your response, along with any suggested improvements to the CGT rules or legislation.

No comment.

40. Are there any areas of complexity that are specific to England, Scotland, Wales or Northern Ireland?

See our comment on section 248A TCGA at question 38.

Wider CGT framework

41. Do you think that there are ways in which the taxation of capital gains should be reformed more widely to simplify the regime for the benefit of taxpayers? If so, how?

In relation to re-basing, we note that there has been a number of re-basing points over the years which has simplified matters to some extent, but complications have arisen due to the re-basing of different types of assets at different times. For example, rebasing is particularly complex in private family company reconstructions where the company has passed through multiple generations. While the re-basing in 1982 helps such transactions to some extent, there may be transitional transactions involved.

We note and welcome the abolition of ATED related CGT charges with effect from 6 April 2019. Given the devolved LBTT system in Scotland, we consider it would be appropriate for the remaining ATED regime to no longer apply in Scotland

Turning to the income/capital distinction, while this is generally simple, there can be difficulties around the edges, particularly in respect of transactions in land and transactions in securities. Transactions in land (for example, corporate SPV holding a property or a let investment property) are particularly challenging due to the breadth of the legislation. It is difficult for advisors to give comfort as to the tax position. Transactions in securities are probably less challenging as consideration can involve whether there is an income tax advantage and whether there is a significant disposal. In the experience of our members, clearance is generally granted fairly quickly.

The wording of the legislation on these matters is very wide and ties directly with rates. A simple approach would be to treat these transactions as income, although perhaps not the highest chunk of income. We consider that a motive-based test would be difficult to assess. Clearer guidance from HMRC would be welcome, giving a clearer steer on what they regard as being in or out of scope.

In relation to company purchases of owned shares, information from HMRC is contradictory, for example, in cases where a company does not have sufficient cash in the bank or distributable reserves to complete the purchase all at once. For company law purposes, there has to be a buy-back all at once, although sometimes

there are buy-backs with multiple completion dates. Greater clarity is needed as to how this is to be treated for CGT purposes.

42. Do you think it would be reasonable for some reliefs or exemptions to be removed if they fail to meet what you regard as their policy objective or are infrequently used? If so, which ones?

In relation to losses, we suggest that the current arrangements could be simplified by removing the complexities relating to the interaction of the utilisation of brought forward capital losses and the AEA.

43. Are there any useful lessons that can be learned from the UK's historic CGT regime or other countries that would be relevant to the UK today? If so what, and from which countries?

No comment.

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