STEP’s response to the first part of the Office of Tax Simplification’s call for evidence in its review of Capital Gains Tax published on 14th July 2020

About Us

STEP is the worldwide professional association for those advising families across generations. We help people understand the issues families face in this area and promote best practice, professional integrity and education to our members.

Today we have over 22,000 members in over 100 countries and over 8,000 members in the UK. Our membership is drawn from a range of professions, including lawyers, accountants and other specialists. Our members help families plan for their futures: from drafting a will or advising family businesses, to helping international families and protecting vulnerable family members.

We take a leading role in explaining our members’ views and expertise to governments, tax authorities, regulators and the public. We work with governments and regulatory authorities to examine the likely impact of any proposed changes, providing technical advice and support and responding to consultations.

STEP welcomes the opportunity to comment on this call for evidence for the Office of Tax Simplification’s review of Capital Gains Tax published on 14th July 2020

Purpose of the Paper

1.1.1 In this Paper the Society of Trust and Estate Practitioners (the ‘STEP’) makes a submission in response to the first part (the ‘First Part of the Call’) of the Office of Tax Simplification’s call for evidence in respect of its Capital Gains Tax (‘CGT’) review (the ‘Review’).

Uncertainty as to the submissions which the call invites

1.2.1 Although the Call asks for submissions of responses ‘on the principles of capital gains tax’ and includes a section entitled ‘Section 1: Principles of CGT’ it neither explains what it means by such principles nor gives any examples of them. Section 1 states that:-

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1 That concerning the principles of CGT. Capital Gains Tax review – call for evidence published by the Office of Tax Simplification on 14th July 2020 (the ‘Call’).
2 In this Paper we refer to the Office of Tax Simplification as the ‘OTS’
3 Call page 1
‘The OTS would like to invite views on the principles of CGT including whether its scope and reach in the context of the wider tax system continue to be appropriate.

Respondents are encouraged to think broadly ….’

1.2.2 The Call does not, however, define how fundamental is to be the examination of whatever are the principles of CGT. Immediately after the passage cited above it directs the reader’s attention to four areas of some generality but which are neither principles nor are they concerned with the fundamental design of the tax. One of those areas is:-

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

1.2.3 It is rather odd to consider in a section concerning principles an allowance whose effect, the Call later explains, is to exclude, for administrative convenience, minor disposals from charge by reducing ‘the number of individuals who might need to report relatively small total amounts of taxable gains that accrue over a tax year’.

1.2.4 Further, it is only at the very end of the supposedly more specific Second Part of the Call, that the Call asks:-

‘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?’

1.2.5 We are concerned that this uncertainty as to the level of generality at which the review is to operate could mean that it is less likely to arrive at useful conclusions.

Is a large scale review of the principles of CGT an appropriate subject for the OTS?

1.3.1 A large scale review of any tax with a view to simplification should distinguish between:

1.3.1.1 reviewing questions of fundamental principle so as to achieve simplification though radical change to the tax and to its interaction with other taxes;

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4 Call page 3
5 Call page 3
6 Call page 5
7 Call page 11 para 41
1.3.1.2 questions as to the major elements of the existing form of the tax which might provide suitable opportunities for simplification without fundamental change to the form and nature of the tax; and

1.3.1.3 matters of administration and more minor areas of technical detail which might also provide such opportunities.

1.3.2 Any review which covered all three of these areas, however, would take a considerable investment of time and require major resources. The first and second areas would require a package of proposals which would work as a whole rather than a menu of individual changes some of which could be implemented without others being so. It would need to take account of the whole ambit of the tax covered as well as its interaction with other taxes (in this context, see STEP’s recent response to the Treasury Select Committee call for evidence in relation to tax after coronavirus).  

1.3.3 The review now started by the OTS, however, does not deal with the whole ambit of CGT, excluding a consideration of the taxation of the gains of large companies and trusts.  

1.3.4 Although the purpose of the OTS is to provide advice on the ‘Simplification of the Tax System’ we do not believe that its purpose extends to major considerations of tax policy as it is clear, under its governing legislation, that the focus of its reviews is to be on smaller scale technical and administrative changes. The OTS’ membership, and those of its resources which are independent of Government, are too restricted to allow it to make an independent review of such extensive matters.

1.4.1 To radically change any one feature of the current form of CGT is likely to require adjustments elsewhere in it (and possibly, in relation to other taxes), the exact nature of which can, currently, only be guessed at. Determining the changes which would be required and their effect requires the application of considerable resources; an application which is not a suitable use of the OTS’ resources and for which it does not appear to be adequately equipped.

1.5.1 We believe therefore that the Review should be concentrated on smaller scale changes to the substantive provisions of CGT and changes to its administration which allow a measure of simplification within the broad existing
structure of the tax. We shall comment in detail on such matters in our response to the Second Part of the Call.

1.5.2

**The principles of CGT**

2.1.1 Although we have said that the Review should concentrate on small scale and administrative changes within the broad, current structure of the tax, in accordance with the request in the Call,\(^{12}\) we offer some thoughts on the principles which ought to govern CGT.

**The need to understand the nature of what is being taxed**

2.2.1 If one is to consider the broad principles of a tax and its interactions with the other parts of the tax system, one needs to understand the fundamental nature of the thing on which the tax is designed to impose a charge to tax. The Call displays a fundamental misconception as to the nature of capital gains. Page 3 of The Call conflates capital gains with income referring to ‘The interactions of how gains are taxed compared to other types of income …’

2.2.2 This is not an isolated mistake. In his letter of 13\(^{th}\) July 2020 the Chancellor made a similar reference to:

‘…. the interactions of how gains are taxed compared to other types of income.’

**The distinction between capital and income**

2.3.1 The fundamental difference between income and capital has been a core concept of CGT throughout its history.\(^ {13}\)

2.3.2 There may be areas (for example the treatment of money or assets transferred from a company to its shareholders) at the borderline between capital and income transactions which are difficult to characterise but, in general, the distinction between the two is clear. In the 1921 case of *IRC v Blott*\(^ {14}\) Viscount Finley quoted with approval the words of Justice Pitney in the US Supreme Court case of *Eisner v Macomber* (1919) 252 US 189 in which he set out how income may be distinguished from capital gains:

‘Here we have the essential matter; not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed

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\(^{12}\) Call page 1
\(^{13}\) Call page 5
\(^{14}\) CIR v. Blott; CIR v. Greenwood HL 1921 8 TC 101
from the capital however invested or employed, and coming in, being “derived”, that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal; that is income derived from property; nothing else answers the description.’

2.3.3 In its most common form the distinction between capital and income, between owning land and the rent which the landowner is paid for its use, between owning shares and the dividend which the shareholder receives from the company and between the bank deposit and the interest paid in respect of it, is clear.

What is CGT charged upon?

2.4.1 The Call says:-
‘CGT is broadly a tax on the difference between an asset’s value when it is acquired and its value at disposal, less any allowable expenses.’

Consideration

2.4.2 This is adequate, as far as it goes, but it is not sufficient. The starting point for a CGT computation of the gain arising on a disposal is the consideration received for the disposal or, in respect of certain disposals, treated as having been received for it. The most important category of the latter is disposals ‘otherwise than by way of a bargain made at arms’ length’. Thus the value which, in general, is taken into account in determining capital gains is, in most cases, either the consideration actually received for an asset or the consideration which could have been received for it if it had been disposed of at its market value. In a bargain at arms’ length, the former value will only differ from the latter where the disponer has made an inadvertent bad bargain. CGT is, therefore, levied on gains calculated by reference to the consideration received, or treated as received, for a disposal.

Consideration is paid for the future benefit of a capital asset

2.4.3 The amount of consideration which an acquirer of a capital asset is willing to pay for it will, in many cases, be determined by the benefit which ownership of that capital asset will confer in the future. That benefit will either be the income which it will generate or, in the case of chattels and land, the

15 CIR v. Blott; CIR v. Greenwood HL 1921 8 TC 101 page 132
16 The Call page 5
17 TCGA 1992 ss.17 and 37
18 TCGA 1992 s.17(1)(a)
19 TCGA 1992 s.17
The potential for double taxation

2.4.4 Clearly taxing capital gains which may be determined by reference to the receipt of consideration which reflects the future benefit of an asset and also subjecting the income subsequently arising on that asset to Income Tax results in a form of double taxation.

Points emerging from considering the nature of CGT

2.5.1 Bearing in mind the points we have just made, the following areas for consideration emerge. Some of these are suitable for the Review. Given what we have said above, others will not be.

Should CGT be charged only by reference to actual consideration?

2.5.2 There is in our view a strong argument that tax ought to be charged only on disposals which result in the benefit of capital assets being realised by the receipt of consideration. Many of the distortions of the current form of CGT arise from its imposition on disposals which do not lead to a receipt of consideration or lead to the receipt of consideration which is less than the amount by reference to which tax is charged. CGT should arguably only to be imposed on real gains which should be calculated only by reference to actual consideration.

2.5.3 For example, the restriction of the previous general hold-over relief on disposals made at less than market value\(^{21}\) has led to the imposition of CGT on unrealised gains and to the distortion of decisions as to whether to retain assets or to transfer them. This would be resolved by restricting the consideration taken into account in calculating capital gains and losses to the actual consideration received\(^{22}\).

2.5.4 However, any debate in relation to this aspect would need to consider the impact on trusts, which is an area outside the scope of the Review. It would also need to go hand in hand with a review of the inheritance tax treatment of

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\(^{20}\) Although speculative buyers may be influenced in the price which they pay for a capital asset by their assessment of likely future movements in the market price of an asset.

\(^{21}\) FA 1989 s.124 repealing FA 1980 s.79

\(^{22}\) By repealing provisions such as Taxation of Chargeable Gains Act 1992 (‘TCGA 1992’) s.17
lifetime gifts as well as the treatment of assets passing on death both for inheritance tax and CGT purposes.

2.5.5 In the OTS review of Inheritance Tax it was suggested that the uplift to market value of the acquisition cost of an asset on death should be abolished. The OTS acknowledged that ‘at a theoretical level, Inheritance Tax and Capital Gains Tax are quite different’. The differences between Inheritance Tax and CGT is not a mere theory. It is a simple fact that they are designed to tax different economic phenomena.

2.5.6 The Call referred to the proposal to remove the uplift in the acquisition cost of an asset to its market value on death asking whether ‘… the absence of a CGT charge on death and transferring those assets at market value distort and complicate the decision-making process’, particularly when the decision involves when and how to pass on assets to the next generation.

2.5.7 This fails to identify the real source of distortion in this area. The distortion of decisions on whether and when to pass assets to another generation does not arise from failing to impose a charge to CGT on death, an occasion on which no realised gain arises, but from imposing a charge on gifts, another occasion on which no realised gain arises as there no consideration is received on the disposal.

2.5.8 There are good practical reasons for uplifting an asset’s acquisition cost on death. Far from complicating ‘the decision-making process’, it is simple both conceptually and administratively. It relieves personal representatives and heirs of the necessity of conducting onerous investigations into the deceased’s affairs which often requires an investigation of events which took place decades before the death of the deceased long after the relevant records have ceased to exist.

2.5.9 We acknowledge that a CGT uplift on death in circumstances where no inheritance tax is payable could be said in certain circumstances to be anomalous. However, the current form of CGT and its relationship to other taxes is the result of change over more than half a century; change which has not always been conceptually clear and consistent but which represents a long developed, rough and ready consensus as to the overall effect which the system should have.

23 Office of Tax Simplification Inheritance Tax Review – second report; Simplifying the design of Inheritance Tax pages 9 and 13 and Chapter 4
24 Office of Tax Simplification Inheritance Tax Review – second report; Simplifying the design of Inheritance Tax pages 9 and 13 and Chapter 4 para 4.1
25 Call page 11 para 34
26 See para. 2.5.6 above
2.5.10 To change one element of CGT by abolishing the uplift in the acquisition cost of an asset on death, would be a radical change driven by policy rather than simplification considerations. It would require adjustments elsewhere in the tax system in ways which could be determined only by the application of considerable resources. We do not think that such an exercise is a suitable use of the OTS’ resources in respect of a feature of the tax system which is accepted by taxpayers, works well and which, if it were changed, would result, not in simplification, but in much greater complexity.

**Full relief for losses**

2.5.11 In general, the rules relating to the offset of capital losses are unduly restrictive. If CGT is to fulfil its function capital losses should be relieved to the same extent that capital gains are assessable. The lack of a comprehensive regime for the carry back of capital losses and restrictions on the allowability of capital losses\(^{27}\) have the result that they are not.

2.5.12 If the taxation of capital gains is aligned with the taxation of income by the alignment of tax rates that would require full relief of capital and income losses (without any distinction between the two) against both capital gains and income.

2.5.13 There is also a need for a more comprehensive relief for real losses, that is after allowance for inflation, even where, without such an allowance, a ‘gain’ would arise. This is particularly necessary in respect of interest bearing forms of investments which are mainly outside the current scope of CGT and where the return on investment in the form of interest will often be less than the reduction over time of the value of the capital asset on which it arises by reason of inflation.

**Defining the boundary of capital and income**

2.5.14 The boundary between capital and income must be defined with precision. As we have said, in general that boundary is clear. Where it is not, the right approach in our view is to make clear in the income tax legislation what should be subject to income tax, an approach which has already been adopted in many situations (for example, profits from deeply discounted securities and non-reporting status offshore funds and distributions from UK companies).

2.5.15 Other areas for review might include opportunities to make capital profits conferred by reason of a person’s employment and structured investment

\(^{27}\) For example gains chargeable under TCGA 1992 s.87 cannot be relieved by capital losses whereas gains chargeable under s.86 ibid can. See also s.16ZA and s.18(3) and (4) ibid
products designed to provide a return which reflects the income which arises within the structured investment but is in a capital form.

**Rates of Tax**

2.5.16 For most of its life, the rate of capital gains tax has been lower than the rate of income tax. In our view there are good reasons for this:

2.5.16.1 Assets giving rise to capital gains will in many cases have been acquired using funds on which income tax has been paid.

2.5.16.2 The valuation of an asset will often reflect future income streams which will themselves be subject to income tax (see 2.4.4 above) so giving rise to an element of double taxation.

2.5.16.3 The value of shares in a company will be affected by past and future profits of the company which will themselves be subject to corporation tax.

2.5.16.4 The lack of any adjustment for inflation results in purely artificial gains, which do not correspond to the economic benefit received from an asset, being brought into charge.

2.5.17 Again, a consideration of rates of capital gains tax is more an issue of policy than simplification and it cannot be considered in isolation but only as part of a review of the overall tax system and with a proper understanding of the principles and policy aims underlying capital gains tax.

**Main Residence Relief**

2.5.18 As the volume of cases on Main Residence Relief reaching the Courts indicates, it is often difficult for a taxpayer, especially one who cannot afford high level professional advice, to determine whether a particular dwelling is his residence or not, if it is, whether it is his main residence and the extent of any surrounding land which might qualify for relief.

2.5.19 The rules in respect of Main Residence Elections\(^{28}\) are unduly restrictive particularly in the requirement that elections be made within a two year time limit. That will often require an election to be made long before any disposal is contemplated or made. It is particularly important that the operation of the election should be reviewed and that consideration should be given to the election being made at the time of reporting the disposal.

\(^{28}\) TCGA 1992 s.222(5)
Divorce and separation

2.5.20 On divorce and separation, liability to CGT often arises on transactions which are mere divisions of assets on which no real gain is realised. This is inappropriate at a time when the separating parties are likely to be under financial pressure.

Partnerships and capital gains

2.5.21 The application of CGT to a partnership is a particularly bad instance of the imposition of taxation by HMRC practice rather than by clearly defined statutory rules. A comprehensive statutory code for the application of CGT to partnerships is required.

Unnecessary short period for reporting gains on residential property

2.5.22 The introduction of a thirty day limit for making returns of gains on residential property disposed of by UK residents has created immense practical difficulties for taxpayers, particularly in respect of valuation, difficulties which are disproportionate to the benefit conferred on the Exchequer by accelerating the receipt of tax revenues by some nine to twenty months. This departure from the system of annual reporting should be reversed.

Submitted by STEP dated 2 September 2020

29 FA 2019 s.14 and Sch 2 para 3
STEP Call for Evidence Response: To the Second Part of the Office of Tax Simplification’s Call for Evidence in Its Review of CGT, Published on 14 July 2020

About Us

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STEP welcomes the opportunity to comment on this call for evidence from the Office of Tax Simplification (OTS) on CGT, published on 14 July 2020.

Purpose of the paper

1. In this Paper the Society of Trust and Estate Practitioners (the ‘STEP’) makes a submission in response to the second part (the ‘Second Part of the Call’¹) of the Office of Tax Simplification’s call for evidence in respect of its Capital Gains Tax (‘CGT’) review (the ‘Review’).

2. This paper follows on from the first part of the call.² STEP sent its high level comments to the OTS on 2 September.³

Use of losses

¹ That concerning detailed comments on the technical detail and practical operation of CGT. Capital Gains Tax review – call for evidence published by the Office of Tax Simplification on 14th July 2020 (the ‘Call’).
² In this Paper we refer to the Office of Tax Simplification as the ‘OTS’
³ That concerning the principles of CGT. Capital Gains Tax review – call for evidence published by the Office of Tax Simplification on 14th July 2020.
⁴ https://www.step.org/sites/default/files/2020-09/STEP%20high%20level%20comments%20on%20OTS%20CGT%20review.pdf
3. The current position is that all capital losses must be formally claimed which means that for a taxpayer to be able to use a capital loss, the disposal must be reported to HMRC and the loss quantified. In most cases this does not give rise to an issue where the loss is reported by completing a tax return. However, where the taxpayer does not need to complete a tax return, the taxpayer will need to make a separate repayment claim to report the loss.

4. The taxpayer must make a claim within four years from the end of the year of disposal. For example, if a capital loss arises in 2019/20, the taxpayer must make a claim by 5 April 2024.

5. For taxpayers who do not regularly file tax returns, the requirement to make such a claim can be overlooked and the taxpayer’s ability to carry forward the loss may be lost. There appears to be no justification for the requirement to make such a claim within a fixed time frame. It should be possible for the taxpayer to claim the benefit of the loss in the tax return in which the gain is reported against which the loss is to be offset.

**Divorce**

**Spouse/civil partner exemption**

6. As per question 6 of the call for evidence the main issue is with the spouse/civil partner exemption and transfers after the tax year of separation. Matters could be simplified greatly if transfers on a no gain no loss basis continued to apply to transfers of assets between spouses/civil partners for a minimum period of two tax years after the tax year of separation and to transfers pursuant to any court order approving the financial arrangements, if later.

7. The conditions for the stamp duty land tax exemption in paragraph 3 of schedule 3 to Finance Act 2003 could form the basis for this. This would not wash the gains out on the assets but simply remove the dry tax charge that arises in these situations where couples do not divorce for tax planning reasons and where they are often significantly worse off.

**Mesher orders etc.**

8. Another point is the difficulty created on moving the family home between parties as part of a settlement while one party seeks to retain an interest in the future sale proceeds.

9. This is an increasingly common problem as divorce/dissolution may occur when young children have to be provided with a home and there is insufficient to allow for the matrimonial home to be passed over to one party.

10. While Mesher orders help alleviate CGT risks by creating a settlement benefiting under s225 TCGA 1992, there are IHT penalties as the property will be a relevant property (although there may be no charge on entry.)

11. The alternative is deferred charges where a departing spouse/civil partner is given a right to future proceeds. This right is treated as an asset itself. If it is for a fixed amount, then there is probably no CGT. However, if a variable amount i.e. a percentage of sale
proceeds, there would be a potential CGT charge. Allowing for PRR to be extended on election would deal with that - or exempting the trust from the relevant property regime if it is for a term limited by reference to a court order for the benefit of children.


Annual exempt amount (AEA)

13. The current CGT annual exempt amount is £12,300 for individuals. This is available in addition to the £12,500 personal allowance which applies for income tax purposes.

14. One purpose of the annual exemption is to ensure that those individuals whose gains are relatively small do not have to report and pay tax on their gains. The OTS call for evidence suggests that the annual exemption is successful in achieving this objective in the sense that “most of those with gains are taken out of tax entirely by the tax free allowance”. It does this in a simple and straightforward way.

15. There are however two possible objections to the annual exemption:

15.1. It distorts decision making so that individuals will dispose of assets in order to realise gains to make use of their annual exemption each year in circumstances where they would not otherwise have disposed of the relevant assets.

15.2. It disproportionately benefits wealthy individuals who realise larger gains on a more regular basis as the same allowance is available to all individuals whatever the amount of their gains and whatever the size of their income. This is in contrast to the income tax personal allowance which reduces for individuals who have income over £100,000 and is eliminated completely once the income is over £125,000.

16. In relation to the first point, our experience is that it is only those individuals with relatively liquid portfolios of stock exchange investments who can time disposals with the aim of using their annual exemption each year. Given the liquidity of these sorts of investments and the fact that investments will in any event be bought and sold on a regular basis, we do not see this as giving rise to any significant distortion in behaviour or in the markets for liquid investments.

17. Turning to the second point, it seems likely that the annual exemption provides greater benefits to wealthier individuals. They are more likely to have gains which, as a result of the annual exemption will escape tax. The benefit of not paying CGT on the first £12,300 of gains is also greater for a higher rate taxpayer who is effectively saving 20%/28% tax rather than a basic rate taxpayer who is saving 10%/18%.

18. If, as a matter of policy, it is thought right that those with significant gains or high income should not benefit from the annual exemption, it would be possible to remove it in a similar way to that which applies for income tax. However, it must be borne in mind that CGT is paid on one off events whereas income tax is paid on annual basis. Removing the CGT
annual allowance for individuals who have capital gains over a certain level could lead to perceived unfairness.

19. For example, say it is decided that the CGT annual exemption should not be available to an individual whose gains in a particular year exceed £50,000. Mr A inherited his parents' house 20 years ago when it was worth £100,000. He rents it out. His income is £20,000 a year. He sells the house for £180,000 realising a gain of £80,000. Averaged over the holding period, his profit is only £4,000 a year. Is it right that because the gain is all realised in a single year, he should not benefit from the annual exemption at all?

20. An alternative would be to remove the CGT annual exemption based on an individual's level of income rather than on their level of gains. So, for example, if an individual has income over £100,000, both the income tax personal allowance and the CGT annual exemption could be reduced by £1 for every £2 of income above that amount. In those circumstances, Mr A would still benefit from the annual exemption. This solution however runs the risk that an individual with income over £100,000 who realises a small capital gain will still have to report and pay tax on that gain, thus frustrating the purpose of the annual exemption in the first place.

21. The removal of the annual exemption over certain thresholds also creates potential unfairness for those whose income/gains are only just over the threshold amount.

22. For these reasons and, given the added complexity of removing the exemption above certain thresholds, if any change is to be made, we would favour simply reducing the absolute amount of the annual exemption. This would still achieve the objective of preventing those who realise small gains from having to make returns and pay tax whilst at the same time reducing any benefit to those individuals who are wealthier and who realise larger gains.

23. One other point which is worth considering in relation to the annual exemption is that protection for small gains in relation to portfolio investments is now available by investing through an ISA. It might be argued on this basis that the annual exemption is no longer needed. However, ISA's are of course only available in relation to a limited class of assets and so removing the exemption would leave small gains on other assets still needing to be reported.

24. In addition, we suspect that there are many less wealthy individuals (who may not take financial advice and may not therefore be aware of the use of ISAs for investments) who invest through online share trading platforms and who would have to report small gains if the exemption were removed.

**Different rates of CGT (10/20/18/28 per cent)**

25. There are two issues in relation to the rates of CGT:

25.1. Too many different rates - Whilst most gains are taxed at 10%/20%, gains on residential property/carried interest are taxed at 18%/28%.
25.2. Perceived unfairness - There is a significant differential between rates of CGT and rates of income tax.

26. In our experience, the different rates of CGT do not cause any problems or complexity. It is a policy matter how these rates should be set and there seems no reason in principle why different rates should not apply to different assets as long as it is clear which gains are taxed at which rate. We are not aware of any material problems arising in determining which rate applies.

27. Turning to the differential between income tax rates and CGT rates, for most of its life, the rate of CGT has been lower than the rate of income tax. In our view there are good reasons for this:

27.1. The valuation of an asset will often reflect future income streams which will themselves be subject to income tax, so giving rise to an element of double taxation. For example the value of real estate will, to some extent, be based on the amount of rental income which can be generated. Similarly, the value of a corporate bond will, in part, depend on the interest rate.

27.2. The value of shares in a company will depend on past and projected future profits of the company which will themselves be subject to corporation tax as well as its ability to pay dividends which will be subject to income tax.

27.3. The lack of any adjustment for inflation results in purely artificial gains which do not correspond to the economic benefit received from an asset being brought into charge.

28. In our view, any differentiation between rates of income tax and rates of CGT are matters of policy, not simplification. From a policy point of view it could for example be argued that rates of CGT are too low relative to rates of income tax although, for the reasons set out above, it would not seem appropriate simply to align rates of income tax and CGT.

29. If CGT rates were aligned with income tax rates, at the very least it would be necessary to provide some sort of relief in relation to inflation such as the indexation or taper relief regimes which have existed in the past. These were however complicated. Having a lower rate of CGT is significantly simpler although does not of course distinguish between gains on assets held for a short period of time and gains where assets have been held for longer periods of time. Based on past experience of the previous regimes, we believe that the simplicity of having a lower CGT rate outweighs any unfairness in not distinguishing between long-term and short-term gains.

30. In addition, if the rate of capital gains tax is aligned with the rate of income tax, some thought would need to be given to those situations where gains have been deferred for example as a result of holdover relief or rollover relief. It is potentially unfair for those gains to be taxed at a much higher rate when they eventually come back into charge as decisions would have been made on one basis and tax will eventually be levied on another. There is a case for providing some limited relief for such gains. This could be done by providing that the deferred gain remains taxable at existing rates. Equally we
recognise that to some extent it is inherent in the decision taken to claim hold over relief in the first place that the gain may eventually be taxed at different rates when it comes back into charge.

31. Further if the rate of capital gains tax is aligned with the rate of income tax, it should be possible to offset capital losses against both income and capital gains.

32. Finally aligning CGT rates with income tax rates will have an effect on the supplemental charge for non-UK resident trusts which could mean that trust gains are taxed at up to 72% when paid to UK resident beneficiaries. Previous experience suggests that such a penal rate means that in practice stockpiled gains are never paid out to UK resident beneficiaries, thus reducing tax yield. The reduction of rates in 2008 saw a big repatriation of foreign trust gains to the UK. This would have the opposite effect.

Reliefs and exemptions

Principal Private Residence Relief (PPR)

Definition of garden and grounds

33. There continues to be regular litigation before the tax tribunal regarding the amount of land which will qualify for relief as the garden or grounds of a main residence (s222 (1)(b) TCGA 1992).

34. Where this is in excess of the permitted area of 0.5 of a hectare (including the site of the dwelling house), s222(3) TCGA 1992 allows a larger area to be the permitted area where the area is required for the reasonable enjoyment of the dwelling-house (or of the part in question) as a residence, having regard to the size and character of the dwelling house.

35. HMRC guidance CG64803 itself states that the extent of the permitted area is a common area of disagreement between HMRC and taxpayers. The test is an objective one but the outcome depends on an assessment of what is ‘required’ being made by the DVO.

36. It seems that HMRC have recently been challenging more taxpayers on this issue. In light of this, consideration should be given to changing the rules so the number of properties in relation to which there is a dispute is reduced and there is less need for litigation.

37. The current fixed permitted area of 0.5 of a hectare is suitable in many circumstances (particularly in relation to smaller suburban properties or properties which are newer), but it will often not be large enough in relation to more rural properties or older suburban properties where gardens have traditionally been larger.

38. However in order to avoid introducing further complexity, we consider that either:

38.1. the current rule should be retained so that in relation to properties where the permitted area is larger than 0.5 of a hectare the matter is resolved between HMRC and the taxpayer as it is now; or
38.2. the permitted area should be set at a fixed area larger than 0.5 of a hectare and the provisions of s222 (3) TCGA 1992 repealed so that it would not be possible to argue that a larger area should be the permitted area on the basis that it is required for the reasonable enjoyment of the dwelling in relation to a particular property.

Elections

39. Section 222(5) TCGA 1992 allows a taxpayer to make an election which concludes which of 2 or more residences is the individual's main residence. If no election is made then it is a question of fact whether the residence disposed of was the individual's main residence.

40. Each time the individual has a new combination of residences, a new election needs to be made within two years as the original election ceases to have effect. This is the case even if the new election confirms that the same residence remains the individual's main residence. Late elections are only permitted in certain limited circumstances (s222(5A) TCGA 1992) where all but one of the residences has a negligible capital value.

41. Individuals who are non-resident in the year in which the disposal of a property takes place may make the election that the property was the individual's main residence at the time of the disposal (s222A TCGA 1992).

42. However, this does not apply where, although the individual was non-resident for a number of years whilst the property was owned, the individual has become UK resident before the disposal occurs.

43. In cases where individuals have acquired a combination of residences whilst non-resident, they are unlikely to have made the necessary election. If an individual becomes UK resident before disposing of their main residence, it is not possible for them to make an election at the time of that disposal (unless the two year period since that combination of residences began has not yet expired).

44. In our view the need to make an election within two years of every change in the combination of residences adds unnecessary complexity to the rules and we cannot see why it should not be possible for UK resident taxpayers to be able to make an election at the time of the disposal in the same way as non-residents can.

Extension of nine-month period (s223 TCGA)

45. The final period exemption has been reduced to 9 months for disposals after 5 April 2020. This exemption applies in every case although it is aimed at assisting taxpayers who cannot find a buyer for a property.

46. Nine months is a short period particularly during the current COVID-19 crisis when many individuals have had to change their living arrangements at fairly short notice. Individuals may have moved out of a residence but not be able to put it on the market for health reasons or may not be able to find a buyer as currently the market for more rural properties seems to be more buoyant than that for city centre properties.

47. Where, on the facts, it can be established that the seller has not actively used the property and it has been actively marketed for sale during the final period of ownership, we would
welcome the introduction of an additional 9 months to the final period exemption. This would assist those who have been unable to sell their property in the current circumstances.

48. We would also welcome the introduction of an additional 9 months to the final period exemption where one spouse or civil partner moved out of the family home at the time the relationship broke down but the other spouse/civil partner remained living in the property until it is sold to a third party. See divorce issues above.

**Chattels exemption**

49. In 1979, the chattels exemption was £2,000. It is currently £6,000. The purpose of the chattels exemption is to avoid the need for disposals of everyday items of property which are unlikely to give rise to significant gains to be reported. It is important to note that the exemption is based on the amount of the consideration for the disposal, not the amount of the gain. In most cases, the amount of the gain which is exempted will be relatively small even if the consideration is at the upper end of the £6,000 limit.

50. Clearly it makes sense to have some sort of exemption for small disposals of these sorts of assets. The reason a separate exemption is needed is that, if the annual exempt amount has been used up by gains on other disposals, it would still be necessary to try and work out whether any gain had arisen on the disposal of even very low value items of personal property which would be both time consuming and complex for taxpayers and for HMRC.

51. In our view, the chattels exemption should therefore be retained in its current form and there is no need for any increase.

**Wasting assets**

52. A wasting asset is an asset which has a predictable life of no more than 50 years. Gains on such assets are exempt from CGT unless the asset qualifies for capital allowances or is used for the purposes of a trade.

53. The real purpose of the relief is not to exempt gains but is to ensure instead that allowable losses do not arise in relation to assets which, by their nature, are likely only to go down in value over time.

54. Like many tax-related provisions, there are however anomalies. For example classic cars, watches and clocks all qualify as machinery (and are deemed to be wasting assets even if they have a predictable life of more than 50 years). Such items are often purchased as investments or by collectors and can increase significantly in value. Classic cars in particular can be worth millions of pounds.

55. It is fair to ask whether such assets should be outside the scope of capital gains tax when other assets which might be bought by collectors or investors (such as works of art) are taxable.

56. However, defining the boundary between those assets which are purchased for their functionality and those which are purchased as an investment would create uncertainty
and complexity. In many cases, it will be very difficult to tell what the motives for any acquisition may have been. In addition, it would be very difficult to distinguish between assets of a similar type (say vintage cars or antique watches) which are likely to increase in value and those more standard cars or watches which are more likely to go down in value over time.

57. Clearly the rationale for the relief still stands. Most wasting assets would give rise to losses rather than gains and it is therefore understandable that it is thought right that they should be outside the scope of CGT. Trying to distinguish between wasting assets which might go up in value and those which are likely to go down in value will add significant complexity to the legislation. We would therefore suggest that the relief should remain as it stands. Whilst we cannot offer any facts or figures, we would be surprised if any changes to these provisions would be justified by reference to any additional tax collected particularly bearing in mind that, although gains would be taxable, losses would become allowable.

Reliefs available to business owners/shareholders

General

58. As a general point we would say that it is important to identify carefully what each relief is designed to achieve and then work out whether it does so. Too often the stated policy behind a relief is unclear or inconsistent.

59. There is a useful project to be done on the examination of the various CGT reliefs and whether they could be simplified or targeted better; this is particularly true of reliefs like EIS income tax relief and CGT exemption as opposed to CGT deferral. The conditions are quite different for each. It is doubtful whether the very stringent conditions for EIS are in all cases justified in terms of policy objectives. The tax tribunals on some occasions have commented on this particularly given the very literal interpretation that HMRC insist on. See for example *R Ames v HMRC* [2015] TC04523, where an Enterprise Investment Scheme (EIS) investor initially failed to secure Capital Gains Tax (CGT) exemption because he had not made an Income Tax relief claim, having no taxable income in the year in which he had made his investment.

60. This is in contrast to *Oxbotica* where four individuals and Oxford University subscribed £1,000 for shares in the company and the university made a loan to the company of £110,000. The company sought authority to issue an SEIS compliance certificate to three individuals, who had subscribed £316 for shares. HMRC rejected the application, asserting that Parliament did not intend to grant relief where the share subscription was just £316. HMRC also said that "in circumstances where the company had already secured funding from the University, HMRC considered that the purpose of the share issue was an attempt to secure capital gains tax relief." The answer to this might be so what? Why should not claiming one relief disqualify you from claiming another? And is it reasonable to make the relief so technically complex anyway?
61. In *Gregory Finn, Averil Finn, Andrew Cornish and Robin Morris v HMRC* [2015] TC 04347, a group of Enterprise Investment Scheme (EIS) investors lost their relief when their company PhotonStar LED Limited was acquired by another company in a reverse takeover. Advance clearance had been applied for by the acquiring company’s advisers for itself (it was also an EIS company) but no one had considered doing the same for PhotonStar. The fact that the need for clearance had not crossed any tax adviser’s minds suggest there is something wrong with the current relief. If the aim is to encourage investment in risky undertakings let us make it easier for entrepreneurs to do so.

62. Even the priority of such reliefs inter se remains complex. For example roll--over relief and incorporation relief take priority over what was entrepreneurs’ relief. However, if a capital gain is left assessable after the incorporation (e.g. where some of the consideration is in cash rather than shares), entrepreneurs’ relief can be claimed. Entrepreneurs’ relief took priority over EIS relief for disposals before June 23, 2010. The gain deferred under EIS relief was the gain after being reduced by entrepreneurs’ relief. From June 23, 2010 the taxpayer must choose whether to claim EIS deferral relief and pay no tax on the gain deferred or not claim EIS deferral but instead reduce the rate of tax by claiming entrepreneurs’ relief. It is not possible to claim EIS deferral on the balance of the gain chargeable after what was entrepreneurs’ relief is given. By contrast, unlike EIS relief it was possible to claim both SEIS relief and entrepreneurs’ relief but with certain complications.

63. A long hard look is needed at the various conditions and interactions of each relief to ascertain whether they are really necessary.

**Investors’ Relief**

64. Unlike entrepreneurs' relief (now business assets disposal relief), no significant changes have been made to investors’ relief since it was introduced in 2016. In particular, gains of up to £10m can qualify for relief.

65. The policy intention behind the legislation is presumably to encourage individuals to put money at risk by investing in private trading companies with which they are not otherwise involved.

66. There are of course other reliefs which are designed to encourage investment in certain unquoted trading companies such as EIS relief and inheritance tax business property relief. There are policy questions as to whether these reliefs either individually or in combination provide the right incentives or whether public funds could be better deployed in other ways to support entrepreneurial activity and investment in riskier unquoted businesses. However, that is beyond the scope of this review.

67. Anecdotally, the take-up of investors' relief is low. However, we suspect that this may partly be explained by a lack of information due to the fact that an investment can only qualify for relief if it was made on or after 17 March 2016 and is held for at least three years before disposal.
68. This means that the first tax year in which a claim for relief could be made would be the 2018/19 tax year (if an investment were made say on 17 March 2016 and disposed of between 17 March – 5 April 2019. In reality, it is more likely that the first claims will be made in the 2019/20 tax year in respect of which returns may well not yet have been submitted.

69. Unlike other reliefs (for example EIS relief), the qualifying conditions for investors’ relief are relatively straightforward and no simplification is needed. It is too early to tell whether the relief will achieve the intended policy objectives but no doubt this is something which should be monitored carefully over the next few years. In the meantime, there is no case for making any changes.

**Gifts**

**General**

70. As we said in our previous response, any consideration of possible CGT changes cannot be conducted in a vacuum; the effect of other taxes must also be taken into account, in particular, inheritance tax. In this context, there seems no justification for the different treatment of lifetime gifts and gifts on death.

71. In the case of lifetime gifts to an individual, CGT is payable (unless the asset is a business/agricultural asset) but no IHT is paid if the donor survives for 7 years. On death, there is no CGT but IHT is payable unless there is an exemption (such as the spouse exemption or business/agricultural property relief).

72. Simply removing the CGT uplift on death and/or having a general holdover relief on lifetime gifts still leaves a significant difference between the tax treatment of lifetime gifts and gifts on death when the inheritance tax position is considered as lifetime gifts will not generally be subject to inheritance tax if the donor survives for 7 years.

73. In our view, any CGT changes of the sort we discuss in this section should only be undertaken in conjunction with a proper consideration of the IHT aspects. There is otherwise a risk of creating greater distortions in people’s behaviour than exists at the moment. This is not a question of simplification. It involves policy issues and potential complexities which the OTS is not properly resourced or mandated to explore.

74. Having said this, we comment below on some issues which would need to be considered were a general holdover relief for gifts and/or no gain/no loss transfer on death to be introduced.

**Holdover relief for lifetime gifts**

75. The transfer of assets by way of a gift from an individual to another individual, or occasionally to a company or trust, is a disposal for Capital Gains Tax purposes. Generally, being gifts, there is no consideration received. Instead, the consideration is deemed to be the market value of the asset at the time of the gift.

76. Whether or not Capital Gains Tax is payable depends on

76.1. The Inheritance Tax treatment of the gift, and
76.2. The CGT categorisation of the asset gifted.

77. For Inheritance Tax purposes transfers of assets are classed as either Potentially Exempt Transfers (PETs) – primarily to individuals, or chargeable lifetime transfers (CLTs) – to any other entity – trusts generally but occasionally a company.

78. CLTs being subject to IHT, even if no IHT is actually payable because for example the value of the transfer is below the IHT nil rate band, qualify for CGT holdover relief under s260 TCGA 1992.

79. Transfers which are classed as PETs for Inheritance Tax are generally subject to CGT unless the asset gifted qualifies for CGT holdover relief as a result of the nature of the asset. This includes assets which are qualifying business assets as defined in s165 TCGA 1992.

80. The definitions of what qualifies as a business asset for Inheritance Tax and Capital Gains Tax are different. The main difference revolves around the level of assets owned by the business which are trading as opposed to non-trading. For Inheritance Tax purposes there is a “wholly or mainly” (51/49) test whereas for Capital Gains Tax purposes it is a “wholly or substantial” (80/20) test. Therefore a business which might qualify for Business Property Relief for Inheritance Tax purposes being wholly or substantially trading may not qualify for holdover relief for Capital Gains Tax because its mix of assets does not pass the 80/20 rule.

81. In addition not all business assets which qualify for Capital Gains Tax relief qualify for Inheritance Tax relief under Business Property Relief. The obvious example is furnished holiday lets which qualify as a business for Capital Gains Tax purposes but do not generally for Inheritance Tax purposes. Certainly HMRC will generally deny Business Property Relief on furnished holiday lets for Inheritance Tax purposes unless there are substantial additional services provided – see Graham -v- HMRC and contrast Cox v HMRC. Moreover in the case of gifts of let agricultural property, the entire value including hope value can qualify for hold over relief but the hope value will not qualify for IHT reliefs. These anomalies unnecessarily complicate the system and it is hard to discern much policy rationale.

82. In theory therefore a taxpayer who owns an asset which qualifies for IHT business property relief but not holdover for CGT purposes (because the asset fails the 80/20 test) could:-

82.1. transfer it to a Discretionary Trust (a CLT on which CGT holdover relief is available) and pay no IHT nor CGT as holdover relief is available,

82.2. transfer it to an individual and pay no IHT, at least initially, but have to pay CGT as the asset does not qualify for CGT holdover relief, although perhaps Entrepreneurs’ Relief (now renamed Business Asset Disposal Relief) may apply but nevertheless there will be a CGT liability to pay (which can be paid in instalments).
83. There is no obvious reason for these different outcomes apart from the fact that one would be subject to IHT immediately and the other subject to IHT if the donor died within seven years of the gift.

84. Conceptually it makes sense if no consideration is received for a gift that no Capital Gains Tax is paid, particularly if no gain/no loss treatment applies on death rather than the current CGT uplift (as to which, see below). However, in order to achieve this there would have to be a proper consideration of the tax treatment of gifts both for IHT and CGT purposes both on death and during lifetime. If it were decided to proceed with a general holdover relief for lifetime gifts, failure to align the rules for CGT and IHT and continuing to have differences between the treatment of lifetime gifts and gifts on death will lead to further confusion, anomalies and distortion.

85. A general holdover relief for gifts would mean that the acquisition cost, plus enhancement expenditure expended by the donor would transfer to the donee. The longer that an asset is owned, the more difficult it is generally to find that information. A general rebasing of an asset’s base cost would address this issue to some extent (see further below for our thoughts on the possibility of rebasing) but would also lead to other anomalies and complicated transitional issues.

Clogged losses – holdover relief

86. There are specific Capital Gains Tax rules which apply to gifts to connected persons where losses are created. Generally these are known as “clogged losses”.

87. Such losses can only be offset against future gains made on transfers – gifts or sales - between the same donee and donor.

88. If a general holdover relief was to apply to all transfers for no consideration then consideration would have to be given to how historic clogged losses can be dealt with.

88.1. Possibilities are:

88.1.1. Clogged losses become generally available against all future disposals at a gain, similar to losses under the existing rules,

88.1.2. No change, in which case, the clogged losses could only be offset against future sales to the donee.

89. Arguably there would be no need for the clogged losses regime if there was a general holdover on gifts or other transfers made without consideration.

Conditional exemption – holdover relief

90. Conditional exemption is available for assets which are historically significant, whether that be land or chattels. If there is to be an automatic holdover for gifts then there would be no requirement for this exemption to continue.
91. However consideration will have to be given to gifts/transfers of assets which had previously benefitted from conditional exemption. Is a subsequent gift/transfer going to mean a deemed disposal by the donor of the conditionally exempt asset?

92. It would seem sensible if conditional exemption continued for those assets which had previously qualified for conditional exemption to avoid any deemed disposal, subject to the applicable conditions continuing to apply to the assets.

**Uplift on Death**

93. One advantage of the CGT uplift on death is that the record keeping of the asset owner becomes less onerous as generally where Inheritance Tax is payable, the value of an asset has to be agreed with HMRC unless it qualifies for relief from Inheritance Tax such as Business Property Relief or Agricultural Property Relief.

94. Ascertaining an asset’s historic base cost if there is no rebasing to date of death may be difficult for a beneficiary, or indeed Executors, who may have to sell assets during the administration period to pay Inheritance Tax. In the case of assets other than listed securities (for example in relation to farmland or other real estate where there may have been capital improvements over the years) it can be difficult to ascertain the historic base cost.

95. In these cases significant time may have to be spent by the executors ascertaining when an asset was acquired and what money has been spent in relation to the asset which can be taken into account for CGT purposes. Executors, unless they are acting in a professional capacity, are generally not paid so this will add more pressure to an already burdensome role. The base costs of some assets such as quoted shares, are obviously easier to ascertain but private company shares where no agreement of value was reached with HMRC on a prior disposal will be particularly problematic to deal with.

96. In addition, in the rare cases where an asset has been inherited by the deceased from another estate, or perhaps via several estates, without rebasing to date of death, it could become more difficult for the Executors to ascertain the asset’s original base cost.

97. Some of these difficulties may be addressed by a rebasing to a specific date such as that which took place in March 1982. The March 1982 rebasing was initially available by election but the tax computations required to decide whether the election was worthwhile – not all assets rise in value – were onerous to all but professionally advised taxpayers. The complications created for taxpayers at a time when for example share ownership was a lot less common than it is now were eventually settled by there being an automatic rebasing to March 1982.

98. It might also be said that removing the CGT uplift on death will result in double taxation. We accept it can be argued that this is not necessarily a fair criticism as IHT is taxing the entire asset and CGT is taxing the gain. Nor (as we understand the proposal generally put forward in this context) is the gain as such being taxed on death as it is simply a no gain/no loss disposal. Nor is there any intrinsic reason why the two taxes should not operate on the same asset given that they are doing different things.
99. However, there is no doubt that removal of the CGT uplift on death will be widely seen as
double taxation in circumstances where IHT is payable. This will be felt most acutely in
cases where assets have to be sold by the personal representatives (as is often the case)
in order to meet expenses/tax liabilities.

100. In these circumstances, a comparison might be made between a disposal prior to death
and a disposal after death. If the disposal takes place before death, any CGT paid
reduces the estate of the deceased and so reduces any IHT due on death. However, in
the absence of any relief being granted, where there is a sale shortly after death, IHT is
payable on the full value of the asset as well as CGT on the full amount of the gain.

101. These objections do not of course apply if no gain/no loss treatment is limited to those
assets which are not subject to IHT as a result of a relief or exemption.

102. The administrative burden of removing the uplift on death would also be lessened if there
continues to be automatic rebasing to date of death for assets which do not qualify for
any specific Inheritance Tax reliefs or exemptions but that in itself presents intrinsic
difficulties.

103. In particular, some IHT reliefs are not at 100%, such as agricultural property relief for
farmland let before 1 September/October 1995 and business assets owned by a taxpayer
but used in their business. If rebasing to the date of death no longer applies, at the very
least, this IHT liability should be allowed as a cost of acquisition so increasing the base
cost of the asset in the beneficiaries' hands.

104. It must however be recognised that removing the uplift on death, even if only for assets
which are not subject to IHT, would not be a simplification but would rather make matters
more complicated for PRs and beneficiaries as a result of having to ascertain the
deceased's base cost in the relevant assets. We accept that some of the difficulties in
doing this may be exaggerated, but there is no doubt that it would be an additional burden,
in some cases a significant one.

105. Another complexity which would need to be considered if the uplift on death were
removed for all assets, even where IHT is payable, is the extent to which relief should be
given CGT purposes on a future disposal for any IHT paid on death. This can be illustrated
by looking at the current position for immediately chargeable lifetime gifts

106. Currently where a settlor transfers assets into a settlor-interested trust there is a potential
double IHT/CGT charge. He cannot claim hold-over relief and he will be liable for IHT if
the settled assets exceed his unused IHT nil rate band.

107. HMRC have commented as follows:

“[we] agree that in theory there can be a double charge to IHT and CGT on a transfer into
a settlor-interested trust—assuming IHT business property or agricultural relief does not
apply and the transfer is over the [nil rate band] limit. However, where the transfer is a
chargeable transfer for IHT the IHT is allowed as a deduction in computing the chargeable
gain on the [subsequent] disposal by the transferee (s.260(7) TCGA). Also under s.165
IHTA if the donee pays the CGT on the transfer the tax reduces the value of the transfer
for IHT. So in practice there is no double charge.”
108. This ignores the possibility that if the settlor pays the CGT and IHT on the original transfer into trust, one tax cannot be deducted by the settlor against the other. If the settlor does not pay the CGT on the gift, it is true that any such tax borne by the donee (and not recovered from the settlor) as a result of an assessment by HMRC under TCGA 1992 s.282 can reduce the value transferred by the settlor for IHT purposes.

109. Example:

Robin settles an office block (value £1 million) on trusts for his adult children and grandchildren. The CGT amounts to £100,000.

(1) If it is paid by Robin, the transfer of value for IHT purposes is £1 million.

(2) If it is paid by the trustees, the transfer of value for IHT purposes is reduced by the CGT to £900,000.

110. If there is a hold-over relief claim on a disposal by an individual to a non-settlor interested trust (ie similar to no gain/no loss treatment on death) and the trustees subsequently dispose of the asset, the gain includes both the held-over gain and any subsequent gain. In computing the gain the trustees can deduct any IHT charged on the original disposal into trust (s260(7) TCGA 1992). If this IHT only becomes chargeable or is increased because the donor fails to survive seven years, the CGT deduction is accordingly adjusted.

111. However, there are two limits on the amount of IHT that can be added to the donee’s CGT base cost. Firstly, the maximum permitted amount is the IHT “attributable to the value of the asset”, which means that if IHT had been paid by the donor on a chargeable lifetime transfer so that grossing-up applied, it is only the tax attributable to the gift which can be used.

112. Secondly, IHT which is added to the donee’s base cost cannot be used to create a loss on a later disposal by that person.

113. Example:

Robin settles shares in his investment company worth £500,000 on trust for his siblings. He elects to hold-over the gain so that the trustees acquire the shares at a base cost of £200,000. Robin has already used up his IHT nil rate band and so the IHT payable on creation of the trust is £125,000. This is calculated on the basis of grossing-up which involves the following formula:

\[
\text{\£500,000} \times \frac{100}{(100-20)} = \text{\£125,000}
\]

Tax on \£625,000 at 20% = \£125,000.

IHT attributable to the value of the shares is \£100,000 (20% \times \£500,000).

This is added to the trustees’ base cost which therefore becomes \£300,000.
If Robin dies within seven years so that additional IHT is payable, this is also added to the trustees’ base cost.

If the trustees sell the shares during Robin’s lifetime for £275,000, the IHT addition to the base cost is limited (to £75,000) to prevent a loss arising. By contrast, if they sell for £400,000, the IHT (of £100,000) is allowed in full and if Robin died within seven years of setting up the trust the additional IHT is added to the base cost and the CGT liability adjusted accordingly.

114. On a slightly separate point, we note that there is an anomaly in relation to the operation of s260(7) TCGA 1992. This is that the allowance of any IHT as an addition to the CGT base cost is not available in respect of a failed PET.

115. If a donor dies within seven years of making a gift and the asset concerned does not qualify for Business Property or Agricultural Property Relief then Inheritance Tax may have to be paid on the failed PET.

116. The Inheritance Tax liability is generally paid by the donee but if the donee fails to pay the IHT liability HMRC can look to the deceased’s estate to pay the IHT liability and leave the Executors to recover it from the donee.

117. It is suggested that any Inheritance Tax payable in relation to the gift should be an allowable deduction in any Capital Gains Tax calculation by the donee on the subsequent sale of an asset in the same way as it is where the gift is an immediately chargeable transfer. There seems no policy justification for the difference in treatment.

118. The above illustrate some of the complexities in abolishing the death uplift for CGT purposes if IHT is also payable. They would need to be thought through carefully.

Conclusions

119. Taking all of this into account, our view is as follows:

119.1. There is a case for removing the CGT uplift on death where no IHT is payable and applying no gain/no loss treatment instead;

119.2. It is more difficult to justify this in respect of assets which are subject to IHT;

119.3. There is a case for general holdover relief for lifetime gifts;

119.4. If no gain/no loss treatment applies on death, the case for holdover relief for lifetime gifts is stronger;

119.5. All of these options create more complexity both in terms of tracking base cost but more importantly in considering related changes which may need to be made to the CGT rules and in respect of the interaction of the CGT and IHT rules;

119.6. It is not desirable to make piecemeal changes. The wider picture of the relationship between lifetime gifts and gifts on death must be carefully thought through based on clear policy objectives, as must the interaction between CGT and
IHT charges on both of these events. Until this is done, it would in our view be wrong to make any changes to the current rules.

120. If it is nevertheless decided to abolish the rebasing to date of death it is recommended that:

120.1. There is a general rebasing to a date after which a taxpayer should be keeping their tax records – ie if rebasing is to be implemented from 5th April 2021 then the rebasing date should be on or after 31st March 2015 which would broadly align to the position for non-residents on residential property.

120.2. Taxpayers should be warned about the implications of any new rules and the requirements to retain records.

121. If making tax digital is to proceed, then a section in the taxpayer’s records could be created allowing those who choose to do so to record the acquisition of assets, enhancement expenditure and other allowable expenditure such as IHT, so they have a record of all expenditure so allowing them or their executors access to information necessary to accurately calculate a potential tax liability. This would also allow Executors to pass accurate information to beneficiaries to allow them to comply with their future taxpaying obligations.

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

Rebasing

122. We have heard suggestions from other professional bodies that a possible one-off rebasing might be considered. We are not sure why this possibility has been suggested but reasons might include the following:

122.1. One objection to removing the tax-free uplift on death is the difficulty in obtaining reliable base cost information. Whilst we think these difficulties may be overstated, having a general rebasing of assets would do much to remove any such objections, at least for the time being;

122.2. Should it be decided to align income tax rates and capital gains tax rates, having a rebasing to current market value would remove past inflationary gains.

123. We do not however consider these reasons to be sound justifications for a general rebasing.

124. Looking first at the uplift on death, it is true that rebasing assets to current market value will make it easier to determine base cost for the future. However, unless there is to be a regular rebasing, the same problems as currently exist (to the extent that there really are problems) will reappear. This could only be solved by having a regular rebasing which would of course distort behaviour and provide opportunities for avoidance should taxpayers be aware that a rebasing will occur at regular intervals.
125. Whilst rebasing would remove past inflationary gains, it would also remove real gains over and above inflation and therefore provide a rather arbitrary windfall for those likely to be at the wealthier end of the scale. It would also potentially disadvantage taxpayers who have acquired assets which have gone down in value since they were acquired. Having a one-off rebasing would not in any event justify alignment of capital gains tax rates with income tax rates unless there were some mechanism to exclude future inflationary gains which, as set out above, would create significant complexity.

126. Rebasing is not a straightforward exercise. Whilst, in principle, it appears simple, the interaction with holdover and rollover reliefs as well as situations where gains are deferred throw up significant difficulties which would need to be overcome. Whilst the experience of rebasing to 1982 values is available to assist with this, some of the previous solutions produced somewhat arbitrary results (see for example the kink test and halving relief).

127. If there is to be another rebasing to 31 March 2015 (this being six years before 31 March 2021 and at least in line with the rebasing option offered to non-residents on residential property) it is recommended that the alternative calculations which are required (which were a feature of the previous 1982 rebasing) be kept to a minimum. This may lead to some unfairness but against a general easing of compliance costs for the taxpayer.

128. Where assets have fallen in value a taxpayer should be allowed to opt out of the rebasing by an election in which the original base cost is agreed, and recorded for the future. Although this may present some compliance costs for HMRC, it does mean that there is an agreed base cost for the future.

129. It would appear to us to be a policy decision whether or not assets held by a taxpayer, which had previously benefitted from some form of Capital Gains Tax holdover relief or rollover relief, should automatically be rebased to a new rebasing date.

130. Any simplification resulting from rebasing can only be the removal of a requirement to ascertain historic base cost information. However, this is likely to be more than outweighed by the need to obtain valuations of illiquid assets at the relevant rebasing dates and the resulting scope for disagreement between taxpayers and HMRC as to the appropriate valuations.

131. Overall, we do not see any compelling justification for a general rebasing. It would certainly not provide a rational reason for proceeding with other possible changes such as removing the uplift on death or aligning capital gains tax rates with income tax rates.

Residential property gains and 30-day reporting requirement

132. HMRC have recently changed their processes. In order to allow an agent to lodge a non-resident CGT Return on behalf of the taxpayer, they have to create a Government gateway account. In order to create a Government gateway account a taxpayer has to have a UK address or UK passport or a UK bank account. If, and this is often the case, a non-resident has none of these it is not possible to open a Government gateway account. This then means that a paper Tax Return has to be obtained from HMRC and experience recently is that notwithstanding the Returns being lodged timeously no response has been received from HMRC acknowledging receipt of the Return, nor giving
a UTR which is required to make a tax payment so HMRC can allocate the payment correctly.

133. Consideration should therefore be given as to how to simplify the process for non-resident taxpayers by allowing them to create a government gateway account.

**Estates in administration**

134. In response to question 33, HMRC’s guidance differentiates between ‘simple’ and ‘complex estates’. A self-assessment tax return is needed if any of the following applies:

134.1. The total Income Tax and Capital Gains Tax due for the administration period was more than £10,000.

134.2. In any tax year that ended before 6 April 2016, more than £250,000 came from the sale of the estate’s assets by administrators or executors.

134.3. In the current tax year, more than £500,000 came from the sale of the estate’s assets by administrators or executors.

134.4. The estate was worth more than £2.5 million at the date of death.

135. In many modest estates there is little interest and the estate can be administered on a ‘no notification basis’ for income tax (if the total tax is below £100 for the estate administration period as a whole); or, on the ‘informal procedures’ basis, if the income tax due is over the de minimis limit. The problem comes where an otherwise ‘informal procedures’ estate is caught by the complex estate rules because of a property worth more than £500,000 which is sold during the administration period.

136. It does not come up too often, as where possible the PRs will appropriate the property to the beneficiaries prior to the sale so that any chargeable gain which might arise on the disposal will be personal to the beneficiaries. But if the chargeable gain is realised by the PRs then they must meet the CGT liability. For a residential property this must be reported to HMRC and any tax paid must be done within 30 days of the transaction.

137. If you have a complex estate, you must register it on the Trust Registration Service (TRS). This means the PRs will get a Unique Taxpayer’s Reference (UTR) for the estate and will have to submit an SA 900 Trusts & Estates Tax return. Is this really necessary for the income tax and maybe a small amount of CGT?

138. In HMRC’s newsletter for August 2020\(^5\) says: “If a PR has disposed of UK residential property which gives rise to a CGT liability they must report and pay the tax due within 30 days of the completion date. This can be reported through the new CGT payment on property disposals service if this disposal occurs before they are ready to finalise the estate’s tax affairs. Or, if following the disposal of UK residential property which gives rise to a CGT liability, the PR is also ready to finalise the estate’s tax affairs in their entirety

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and pay any tax due, they can report and pay through the existing processes as set out on GOV.UK but still within the CGT payment on property disposals 30 day window. This may be done by:

- Completing a Self-assessment return for the administration period if the estate meets the ‘complex estate’ criteria.
- Advising HMRC of the CGT due for the administration period through the ‘informal arrangements’ if it does not meet the complex estate criteria.

Estates do not have to have registered via the Trust Registration Service to be able to use the new CGT payment on property disposals service. However, if the PR already has a UTR for the estate, this can be used when filing on the CGT payment on property disposals service. Where a ‘complex estate’ does not have a UTR the PR will need to get one by registering on the TRS.”

139. So as soon as a property is worth £500,000 in an estate you have a complex estate and can no longer use the informal procedures. This seems unduly harsh if the income of the estate is below £100 and the gain is modest as is likely to be the case as it will only be the gain arising since death. It means the PR has to register the estate on the TRS; complete a SA 900 and report to the CGT payment on property disposals service if there is a chargeable gain realised by the PR on the disposal of a residential property. You still have to complete the CGT page of the SA 900 too when submitted later. Could we not have a de minimis for CGT as well as income tax? Could the informal procedures still apply if the CGT was less than, say, £1,000?

140. The payment of CGT when it is unnecessary is a particular problem with lay PRs who do not seek advice. These PRs may not be aware of the benefit of appropriating the property to the beneficiaries before sale and so incur unnecessary tax. In order to alleviate this problem, a system which allowed PRs and beneficiaries to elect who should be treated as making a disposal of estate assets where there has been no formal appropriation would be helpful.

141. A similar problem arises in trusts which is worse. This is because you may be making a gift and have no sale proceeds to meet the tax within the 30 day window and the valuation of the property for the purposes of the disposal will not be agreed by HMRC in time to meet the 30 day window – the CG34 procedure can take many months. This means you are presumably making your payment against a valuation which subsequently may be rejected and have to submit a further payment perhaps with penalties when the values are agreed.

142. The system also is currently inflexible if someone has made a mistake e.g. if they have registered the estate as a complex estate on the TRS but subsequently realise this is incorrect. HMRC still insist on the completion of the SA900s when had the taxpayer realised it was not a complex estate initially there would be no need to file SA900s. The computer system simply generates penalty notices if the SA900s are not filed. Is it possible for there to be a system override to avoid unnecessary paperwork for all concerned?

143. There appears to be uncertainty still as to who needs to file within the 30 day window. Some professionals tell clients they need to file when they do not (e.g. it is exempt due to
main residence relief or it is within the annual CGT allowance). Other professionals do not
tell their clients at all about the 30 day reporting window so the client thinks they just put
it in their tax return as before and do not report the transaction on the property disposals
service. Further publicity/education in relation to this would be helpful, bearing in mind that
the professionals who may be advising the client are often property rather than tax
specialists.

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