Response from ICAS

Capital Gains Tax:
Payment window for residential property gains (payment on account)

6 June 2018

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to respond to the HMRC consultation on Capital Gains Tax: Payment window for residential property gains (payment on account) published on 11 April 2018.

3. This consultation is a technical consultation at Stage 2 of the consultation process. This is unfortunate as it means that there has been no consultation on the objectives of the policy or on options to achieve those objectives – ie a Stage 1 consultation. There is a risk that this will lead to problems because the likely impacts of the policy have not been properly considered. We have highlighted some issues in our responses to the specific questions below, together with some suggestions for dealing with them.

4. If there had been a Stage 1 consultation we would have strongly objected to the proposal; it introduces an in-year requirement into a regime designed to work on an annual basis. This will result in unnecessary additional complexity and administrative burdens, solely for a temporary cash flow benefit.

5. The announcement of the 30-day payment window in the Autumn Statement 2015 (paragraph 1.290) states that the payment timetable for CGT due on residential property is out of step with the position for other taxpayers, such as those paying income tax through PAYE. However, it is difficult to see any justification for aligning payment of a CGT liability arising from one type of chargeable asset (but not others) - with PAYE which deals with employment income and involves a completely different set of rules. PAYE also involves deduction at source by employers – an option not available for CGT.

6. Calculating a CGT liability can be a complex and lengthy process, particularly where valuations are required. A CGT liability can also arise where no money has been received, for example where a gift has been made. Furthermore, the CGT rate to be applied to a disposal will depend on the level of income for the tax year – which may not be known at the time of the disposal.

7. Making a 'payment on account' within 30 days will present significant practical problems in some cases and could give rise to unfairness. The consultation document does not address other complications which will arise from trying to deal with a gain in-year when the CGT rules and reliefs are designed to work on the basis of the whole tax year; these are discussed below.

8. Experience with the NRCGT regime indicates that lack of awareness of the need to make a return within 30 days will be a significant problem. HMRC will need to undertake an extensive communications campaign to raise awareness of the new regime amongst taxpayers likely to be affected, tax agents and other relevant advisers (including solicitors and licensed conveyancers).

9. It is essential that before this new regime is introduced, the IT system for dealing with the reporting requirements is in place and has been properly tested by both taxpayers and agents. The very poor experience of the introduction of the Trust Registration Service should not be repeated. It is vital that the system works from the beginning and that agents are given access at the same time as taxpayers. In the short term the focus should be on a functioning (standalone) system but in the longer term consideration should be given to working with third party software providers to make it possible for agents to report from existing tax return software.

10. We also suggest that HMRC should review the operation of the penalty regime for late returns for both NRCGT and the proposed regime for UK residents. A penalty structure designed largely for annual returns does not appear to be working appropriately for returns due 30 days after the transaction.

Specific questions

Question 1: Are there areas where the proposed scheme for UK residents could be improved to make it easier for taxpayers to comply?

11. It is sensible that no payment on account (or return) will be required where the gain is fully covered by private residence relief or where there is no gain – as set out in paragraph 3.10 of the consultation document. We assume that the wording of paragraph 3.10 means that where there is a loss the taxpayer will need to make a return in the normal timeframe to ensure that either the loss can be carried forward to future years or can be set off against other gains arising in the tax year.

12. We also assume that the interaction between paragraphs 3.8 and 3.10 of the consultation document means that no return or payment on account will be required where reliefs are available or where the annual exempt amount will cover the gain. This is also sensible – experience with the NRCGT regime suggests that the requirement to make 'nil' returns within 30 days causes particular problems. In paragraph 3.8 we assume that it is intended that losses to be taken into account will be treated as arising at the date they crystallise for CGT (so contract date rather than completion date, where relevant). It would be useful to have confirmation on all these points.

13. S131 ITA 2007 allows the taxpayer to claim that capital losses on certain qualifying share disposals should be set against general income rather than chargeable gains. Is it the intention to allow a taxpayer to set losses that could be subject to a s131 claim against a gain on disposal of a residential property, when calculating the payment on account? If so, and where the s131 claim is later made, presumably the taxpayer would potentially be exposed to interest on unpaid CGT – unless other losses or reliefs covered the gain.

14. Where a loss is made on the first disposal of a residential property in the year – but a gain is made on a later disposal of another residential property it appears that in calculating the gain the taxpayer takes account of the first loss (as set out in paragraph 3.13 of the consultation document) even though they will not have made a return of the first transaction because no tax was due.

15. No mention is made of the approach to be adopted where the taxpayer intends to claim EIS deferral relief or SEIS reinvestment relief in relation to the gain on the disposal of a residential property. Guidance needs to be provided to cover this; there could be similar issues to those arising where a loss on an asset other than residential property crystallises in the same tax year – discussed below in our response to Question 2.

16. Guidance also needs to be provided on the treatment of income tax losses which can be set against chargeable gains ie unused trading losses, loss in employment or office and excess post-cessation trade or property relief (under s71 ITA 2007 and s261B – s261E TCGA 1992). Again, there could be similar issues to those arising where a loss on an asset other than residential property crystallises in the same tax year – discussed below in our response to Question 2.

17. Autumn Statement 2015 made a comparison with PAYE. We do not believe this is a valid comparison but even under PAYE the taxpayer can ask for their code to be amended to reflect changes in income. It might also be appropriate to look at the system for income tax payments on account, where the taxpayer can ask for these to be reduced. As discussed further in our response to Question 2 it is unclear why a taxpayer disposing of a residential property should have to make a payment on account, without being allowed to defer or reduce it where they know that some or all of the amount will not ultimately be due.

Date of disposal and date of completion

18. It makes sense for the due date for the payment on account and the return to be 30 days after the date of completion – rather than the date of exchange of contracts – because in many cases the seller should have received the proceeds of the sale. There is likely to be some confusion (particularly for unrepresented taxpayers) where the date of disposal for CGT purposes (normally exchange of contracts) falls in an earlier tax year than the date of completion, as outlined in paragraph 3.16 of the consultation document.

19. It is also possible that if there is a very long delay between exchange and completion, the date for making the payment on account (and return) could be later than the due date for the payment under

the normal self assessment rules (31 January following the year of assessment). This is likely to be unusual but will present problems, particularly for unrepresented taxpayers outside self assessment – and should be covered in guidance.

Rates applicable to the calculation of the 'payment on account'

20. Paragraph 3.9 of the consultation document states that the CGT payable on account is to be calculated 'after applying the applicable rate of tax' – 'normally 18% or 28% or both' for residential property gains. We note that chargeable gains realised on the disposal of other assets are to be ignored in making this calculation. However, as noted in our general comments, the CGT rate to be applied to a disposal will depend on the level of income for the tax year. This may not be known at the time of the disposal of the residential property, particularly if the disposal takes place early in the tax year. The taxpayer will not therefore know which rate of CGT to apply. The final legislation needs to make clear how tax should be calculated in these circumstances, so that taxpayers can avoid late interest charges but also avoid overpaying.

21. We suggest that a sensible approach, given that the consultation describes the payments as 'payments on account', would be to provide that they should all be calculated using the basic rate of 18%, with a 'top up' being due at the normal GCT payment due date for any additional tax arising because the 28% rate turned out to be chargeable on all or part of the gain. No late payment interest should be due on this 'top up' payment until the normal due date has passed. This would be a relatively simple approach, although it still adds complexity to the CGT regime.

Cases where valuations are required

22. Some CGT computations for residential property disposals will require valuations – for example, a March 1982 value, a market value (where the disposal is a gift, a transfer at undervalue or a disposal to a connected person) or a valuation required on the disposal of a property which qualifies for private residence relief but where the disposal still gives rise to a chargeable gain because the land attached to the property exceeds the permitted area.

23. Where a professional valuation is required it is unlikely that this can be obtained within 30 days. It appears that there will be no question of an 'incorrect' return penalty being applied if the valuation used to calculate the payment on account turns out to be incorrect – but the taxpayer will still be exposed to possible late payment interest. If the return is delayed whilst a valuation is obtained there will also potentially be late filing penalties. This will give rise to unfairness compared to taxpayers disposing of other types of assets within the CGT regime who will continue to have adequate time to obtain valuations before any return or payment is due.

24. The 'corrections and adjustments' section of the consultation document refers to a person being able to correct an amount 'paid or payable on account when they have failed to take into account information available at the time the payment on account calculation was made'. How will this be applied where a valuation is required but cannot be produced within 30 days? HMRC would presumably want the taxpayer to make an additional payment if the valuation, when eventually obtained, produced an increased liability – the taxpayer would also probably want to make another payment to reduce any interest due. It would also be unfair if the taxpayer could not claim a repayment and repayment interest where the valuation produced a reduced liability. This needs to be clarified in the final legislation.

25. Taxpayers who have to use a valuation in a capital gains tax computation can use HMRC's post transaction valuation checking service to try to ensure that their valuation will be accepted by HMRC. The guidance for using the service states that the form (CG 34) must be submitted at least 2 months before the filing date for the return. HMRC may need further information and/or may suggest an alternative value. The purpose of the service is to give the taxpayer certainty, where possible, that their valuation will not be challenged – before they make the return and before any payment is due.

26. How will the CG34 process work for residential property gains under the proposed new regime? It appears that taxpayers disposing of a residential property where a valuation is required could be placed at a significant disadvantage, again giving rise to unfairness. At the very least HMRC should provide an accelerated process for checking valuations where the taxpayer is disposing of a residential property – to give the taxpayer the opportunity to increase their 'payment on account' as soon as possible, if HMRC do not accept their valuation.

27. In view of the difficulties arising where a valuation is required we suggest that consideration should be given to excluding such gains from the requirement to make an advance payment and return. Otherwise the process to be applied in these cases needs to be carefully considered – and detailed guidance provided to affected taxpayers.

Overseas residential property

28. Paragraph 3.6 of the consultation document states that a payment on account will need to be calculated when a UK resident disposes of an overseas residential property, unless 'it is expected that' double taxation relief will be available against some or all of the UK CGT that would otherwise be due.

29. The taxpayer might 'expect' that double taxation relief will be available – but what is the position if that expectation is completely unfounded and based on a misunderstanding of the rules? This may only emerge when the taxpayer seeks advice on completing their self assessment return after the end of the tax year. Will late filing penalties and interest on late payment be due? Is the intention that the expectation should be a reasonable one in order for it to remove the need for a payment on account?

30. It appears that there will be no requirement for the double tax relief to completely cover the UK CGT liability in order to remove the need to calculate a payment on account (and presumably to make a return). This needs to be clarified.

Treatment of partners

31. The consultation document makes no mention of the approach to be adopted for disposals of residential property by a partnership. Partners are normally required to return their disposal of an interest in an asset of the partnership on their own tax returns – although disposals of chargeable assets should be disclosed on the partnership return.

32. Will each individual partner in a partnership be required to make a payment on account and associated return, for their share of the gain, within 30 days of the disposal, whenever a partnership disposes of a residential property and CGT is due? It appears that this will be the case. However, at the time of the disposal it may be impossible to determine the share of the gain attributable to each partner. This may only be determined at the end of the year, because of the need to take account of fixed entitlements etc. Small partnerships with uncomplicated profit sharing arrangements and limited numbers of residential property disposals in any one year, might be able to provide information within 30 days, but there will be cost and administrative implications.

33. There would be significant problems for larger partnerships, with complex profit sharing arrangements and with multiple relevant disposals, for example, property investment partnerships. A property investment partnership with 40 investors might dispose of 50 residential properties in one tax year – which would apparently require 2000 returns and payments on account in a single year (with a further report in the partners' SA returns after the year end). This is not an acceptable cost and administrative burden to impose; it is also unlikely that the amount of the gain to be allocated to each partner could be calculated within 30 days (this will often not be determined until the year end) – or that the partners could be notified in time to make the returns. As a minimum an exemption needs to be provided for property investment partnerships.

Gifts and other disposals where the 'seller' receives no (or partial) payment

34. Where a residential property is given away or disposed of to a connected person, the consideration for the disposal (to be used in calculating the gain) will usually be the market value of the property. The 'seller' may receive no money at all – or an amount less than the deemed disposal value (which could also be less than the CGT which will be due). Under the present CGT payment regime, the taxpayer has between 10 and 22 months before CGT is payable – so they may pay the CGT using the proceeds of later disposals of assets or from other sources (for example, a bonus payment arising from an employment or an inheritance which takes time to be paid out by an estate). Alternatively, they may know that they will be making a later disposal of an asset (in the same tax year) giving rise to a loss which will reduce or eliminate the CGT due – or they may intend to claim deferral or reinvestment relief, or to set off income tax losses (as noted above).

35. The proposed payment on account regime will give rise to difficulties where the taxpayer, in these circumstances, will not have sufficient cash available to pay the CGT 30 days after the disposal. It

would still be sensible to make the return to avoid potential late filing penalties – but the taxpayer may be reluctant to do so if they fear that enforcement action will be taken. In order to encourage compliance there should be a formal and well-publicised procedure available for the return to be made but to be accompanied by a request for a postponement of the tax.

Taxpayers outside self assessment

36. Paragraph 3.23 of the consultation document notes that the government is considering how best to avoid requiring a person to register for self assessment where their only interaction with HMRC is in relation to the payment on account. Given the various issues discussed above – and in our response to Question 2 below – we think that registering for self assessment is likely to be essential in many cases. It is also likely to be the simplest way of dealing with the interaction with income tax to determine the correct rate and establishing the final CGT liability after all claims are taken into account.

Penalties for late filing of returns

37. In contrast to the NRCGT regime the proposed regime for UK residents sensibly removes the need to make returns where private residence relief covers the gain or there is no chargeable gain – as noted above we assume this would include gains covered by the annual exempt amount.

38. Experience with the NRCGT regime suggests that lack of awareness of the need to make a return within 30 days will be a problem. As illustrated by recent First Tier Tribunal cases relating to NRCGT penalties for late returns, taxpayers within self assessment will usually assume that they should include the disposal of a residential property (which will often be a rental property) in their normal self assessment tax return – unless they are told otherwise.

39. HMRC will need to undertake an extensive communications campaign to raise awareness of the new rules for gains on disposals of residential property. Posting information on GOV.UK is unlikely to be sufficient – particularly for those within self assessment who believe that they know how to report the gain and will not therefore be carrying out research into their obligations. Any campaign could usefully include targeted communications to taxpayers making returns of rental income – who might be likely to fall within the new reporting regime.

40. Many property transactions will involve solicitors or licensed conveyancers, so ensuring that they are aware of the new regime is essential. For many taxpayers (particularly unrepresented ones who are not within self assessment), being alerted to the requirements by a conveyancer or solicitor – will be critical. Such an alert would also make it more likely that taxpayers within self assessment find out in time that returning the disposal in their usual return is no longer sufficient.

41. Information could also be included in the guidance for completing form TR 1 (for the transfer of property) for the Land Registry – or the Scottish application for registration form. Would it be possible to include a reference to the requirements on the forms themselves, perhaps with a box for the seller to sign to say that they have been made aware of the requirements? The forms would normally be completed by the purchaser, but we understand that in most transactions drafts will be exchanged between the parties, so this should be feasible.

42. Following representations, HMRC agreed to exercise its discretion and stopped imposing daily penalties for late filing of NRCGT returns. Will this approach continue – and will it apply to the proposed regime for UK residents?

43. Consideration should also be given to the penalty position where a taxpayer makes several disposals of residential property in the same tax year. If they only become aware of the 30-day filing obligation, after the end of the tax year when they prepare their self assessment return, substantial penalties may already have arisen – but the taxpayer will not have had the opportunity to learn from their first mistake. In the Welland NRCGT case (TC06265) the Tribunal decided that this amounted to special circumstances and that only the penalties on the first disposal should be applied. This appears to be in line with the five principles HMRC suggested should underpin penalty regimes in its 2015 discussion document – in particular that penalties should be designed to encourage compliance and should not be applied with the objective of raising revenues.

44. The Jackson case (TC 06329) relating to NRCGT penalties raises further questions about the correct approach to 'tax related' penalties under Schedule 55 where no CGT is actually due on the disposal.

45. We suggest that HMRC should review the way it applies the penalty regime for late returns – for both NRCGT and the proposed regime for UK residents. A penalty structure designed largely for annual returns does not appear to be working appropriately for returns due 30 days after the transaction.

Question 2: Does the proposed treatment of losses on disposals of residential property and disposals of other assets strike the right balance between simplicity and fairness? If not, what alternative approach would you propose?

46. No, we do not consider that the proposed treatment is fair - or in some cases practical. As noted above someone making a gift of a residential property may not be able to make a payment on account within 30 days – but knows that they will be making a subsequent disposal which will produce a loss which will eliminate the tax liability. As noted in paragraphs 15 and 16 above they might also intend to claim deferral or reinvestment relief or expect to have the ability to claim to set income tax losses against the gains. It would be unfair if they were exposed to a liability for interest on unpaid tax on account when no CGT will ultimately be due for the tax year – we discuss this further below.

47. Cases where there are no cash proceeds available may be relatively unusual, but even where the taxpayer is able to make a payment on account it would be unfair for them not to have the option of reclaiming tax immediately, when a subsequent disposal of an asset other than residential property produces a loss – rather than having to wait until the end of year reconciliation. It would also be unfair to continue to charge interest on any unpaid payment on account, once a later disposal giving rise to a loss (on an asset other than residential property) has been made.

48. Paragraph 3.21 of the consultation document suggests that the proposal for the treatment of losses is intended 'to avoid undue complexities' – we do not believe that this is adequate justification for the unfair consequences which may arise. Calculating payments on account and filing the returns involves complexity and compliance costs anyway – the taxpayer is likely to feel that they should therefore be able to choose to reclaim tax by making an adjustment when a later loss on an asset other than residential property arises, or potentially where it becomes clear that some other available claim will reduce the tax to nil.

49. This would align the system more closely with the existing system for self assessment payments on account, where the taxpayer can seek a reduction. If the taxpayer cannot (or decides not to) make the CGT payment on account, or claims a repayment, on the basis that there will ultimately be no liability, they would remain at risk of paying interest if tax does ultimately prove to be due.

50. Some of the practical difficulties and unfair consequences identified above could also be mitigated by providing that in cases where no tax ultimately proves to be due on the disposal of a residential property, no interest on any unpaid or late payments on account will be charged. The payments are 'payments on account' so it seems only fair that if no tax is ultimately payable, then no payments on account should be treated as ever being due in the first place.

Question 3: Are there areas where the scheme for non-residents could be improved to make it easier for taxpayers to comply?

51. The consultation refers to alignment of the NRCGT regime with the proposed regime for UK residents. However, this section only specifically refers to some aspects of the regime. It would also make sense to align other aspects of the regime - including the calculation and reporting provisions so that non-residents would not have to make a return where the gain was covered by private residence relief or there was no chargeable gain. As noted above we assume that this would include gains covered by the annual exempt amount.

52. It is clear from recent Tribunal cases considering NRCGT penalties that there is a strong perception of unfairness, particularly where no CGT is due (usually because Private Residence Relief was available, there was no gain, or gains were covered by the AEA) but HMRC seeks to impose substantial penalties for late returns – beyond the initial fixed rate penalty. In some of the cases it is hard to see how the application of the penalty regime to NRCGT reflects the five principles HMRC suggested should underpin penalty regimes in its 2015 discussion document referred to above. In Welland and Jackson, for example, the multiple penalties issued at the same time clearly could not encourage compliance.

53. As noted above we suggest that HMRC should review the way it applies the penalty regime for late returns – both for NRCGT and the proposed regime for UK residents.

Question 4: Do you have comments on the provisional table of impacts?

54. The main impact of the requirement for a payment on account should be on cash flow. It is therefore unclear why the impact assessment appears to suggest a long term sustained increase in receipts.

55. There will be an increased cost and administrative burden for taxpayers – but this will also be the case for HMRC. The impact assessment mentions an IT cost for HMRC but does not mention the impact on resources which will arise from the need to check large numbers of additional returns, check end of year reconciliations, make enquiries and deal with an increased volume of calls from taxpayers seeking support. As a minimum HMRC should provide a dedicated helpline and email address, with adequately trained staff, to deal with queries relating to the regime (which could be combined with the NRCGT service). We question whether HMRC has adequate resources to deal with this additional workload and to provide an adequate service to taxpayers affected by the new regime.

56. As set out in our general comments it is essential that before this new regime is introduced, a fully tested and functional IT system for dealing with returns is put in place. Agents must have access right from the beginning – in the same way as taxpayers. The poorly-implemented introduction of the Trust Registration Service placed unnecessary additional administrative burdens on agents and should not be repeated. Ideally agents should be able to deal with the returns for disposals of residential properties from existing tax return software – rather than through a separate system. Therefore, whilst the immediate priority should be a functioning (standalone) system, in the longer term consideration should be given to working with third party software providers to integrate with tax return software.

57. The impact assessment points out that companies chargeable to CT on chargeable gains are not affected by the proposals. Due to other tax changes affecting residential property this may provide an additional incentive to individual landlords to incorporate. This would not only reduce the expected receipts from the new regime – but would also be likely to reduce other tax receipts, something which is not mentioned in the impact assessment.