OTS Capital Gains Tax Review

Date: 9 Nov 2020
To: ots@ots.gov.uk

Introduction and background

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £100bn to the economy in 2018 and supported more than 2 million jobs[1]. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.

2. We welcome this review and recognise the importance of ensuring that the tax rules are straight forward to comply with and do not distort commercial decisions. It is also particularly important that businesses are taxed on their economic profits and gains, to ensure that the tax system is sustainable and does not put undue pressure on business. A number of recent changes, notably the inclusion of gains within the loss restriction rules, and the removal of indexation relief, have resulted in tax payers being subject to tax on an amount which is far in excess of their economic gain – resulting in a fundamentally unfair and unintuitive tax system.

3. Our response is structured as follows:

    Appendix 1: Executive summary and key recommendations

    Appendix 2: Response to question 23

4. Please do not hesitate to get in touch if you require further information.

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[1] https://bpf.org.uk/media/2659/16688-bpf-economic-footprint-report-140819.pdf

Appendix 1: Executive summary and key recommendations

5. We welcome efforts to simplify the tax rules and support measures to better align the tax treatment of income and gains to ensure that the tax rules are fair and do not influence or distort otherwise commercial decisions. It is also imperative that the tax rules result in taxing businesses as closely as possible on their economic profits.

6. Our primary recommendations are set out below:

   1. **Provide full tax relief for capitalised expenses**
      We recommend introducing a simpler eligibility test for capital expenses which removes the need to ensure that the expense is still reflected in the state or nature of the building at the time of disposal. This would result in a huge simplification, and improve the fairness of the tax system, ensuring all expenses are eligible for tax relief at some stage.

   2. **Address areas of complexity in relation to partnerships**
      We would recommend that the SPD 12 rules for partnerships are reviewed and simplified – with a view to ensuring that investors' tax calculations are more closely aligned to their economic gains, and chargeable when they receive their gain. It would also be appropriate to extend the 30 day tax payment deadline for widely held partnership funds to reflect the complexity and logistical challenges with managing this process for widely held funds.

   3. **Reduce restrictions on utilisation of losses**
      The loss restriction rules have added significant complexity to the tax rules, and result in tax payers not being taxed on their true economic profits. We recommend increasing the timeframe that losses can be carried back in full to 3 years, and allowing losses to be carried forward indefinitely to offset against gains in full.

   4. **Re-introduce indexation relief**
      We recommend that the indexation relief that was removed in 2018 is reinstated to ensure that businesses are taxed on true economic gains, and not just inflationary increases in prices.

Appendix 2: Consultation questions

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

7. We have provided a summary of the main areas of complexity, unfairness and potential for distortion in relation to the interaction of the capital gains tax rules with real estate investment businesses. Some of the issues raised will also be relevant in the context of some of the more generic questions – in particular, question 1 to 7 (on acquisition and disposals), and questions 16 to 18 (in the context of decisions made during the lifecycle of a business). Our membership in predominantly corporate, so for the purposes of this response, our comments relate predominantly to that taxation of gains within corporation tax.

8. We summarise the following areas of concern in turn:

    1. **Treatment of capital expenditure**
    2. **Complexity in relation to partnerships *(also relevant for question 38)***
    3. **Restrictions on utilisation of losses**
    4. **Indexation relief**
    5. **Interactions with the Transactions in Land Rules**
    6. **Short term vs long term gains**
    7. **High volume, low value gains**

9. <u>**Treatment of capital expenditure**</u>

10. Capital expenditure is currently deductible where expenditure which is wholly and exclusively incurred on the asset is "reflected in the state or nature of the asset at the time of disposal". This requires extensive record keeping of exact expenditure incurred in order to determine whether or not expenditure is indeed still reflected in the state of the asset at the time of disposal. This creates a huge administrative burder, particularly where expenditure was incurred potentially many decades ago.

11. Secondly, if there is expenditure which is no longer reflected in the state or nature of the asset, this expenditure will never receive any tax relief, which is unfair on the tax payer.

12. ***We recommend introducing a simpler eligibility test for capital expenditure which removes the requirement that the expenditure is still reflected in the state or nature of the asset at the time of disposal. This would result in a huge simplification, and improve the fairness of the tax system, ensuring all expenditure wholly and exclusively incurred on the asset is eligible for tax relief at some stage.***

13. **Complexity in relation to partnerships (also relevant for question 38)**

14. Partnerships can be used to hold property for a range of different investors and fund structures – from a couple of investors jointly holding a property to a widely held 'fund of funds' structure.

15. Statement of Practice D12 ("SP D12") sets out HMRC's guidance in relation to the application of Sections 59 and 59A of TCGA, in relation to the capital gains tax treatment of partnerships and limited liability partnerships respectively. However, the guidance in SP D12 together with HMRC's interpretations in its manuals can give rise to unclear and unfair results for partners in partnerships holding property and, in particular, can give rise to suituatons where investors are subject to tax on profits which are far in excess of their economic gain.

16. In addition, neither the legislation in Sections 59 and 59A, nor the guidance in SPD 12 distinguish between partnerships with a couple of investors and those partnerships which are used as fund vehicles to hold assets on behalf of a large number of investors. This leads to administrative burdens which are not appropriate for a widely held fund structure. For example, lots of investors coming in and out of a widely held fund trigger frequent 'deemed disposal' events for existing or remaining investors– creating a huge administrative burden, where there are no 'real' disposals or acquisitions for those investors.

17. Furthermore, we would highlight that the tax collection deadline of 30 days for some categories of investor is particularly difficult to meet for a widely held 'fund of funds' structure. The process is logistically challenging and time consuming as after the chargeable event and relevant investors have been identified, relevant information must be collected, calculations performed and sent to investors – and then the investors must make a tax payment. This is very difficult to achieve within 30 days. We would also note that HMRC still post UTRs to affected individuals which puts further pressure on the time this process takes.

18. ***We would recommend that the SP D12 rules for partnerships are reviewed and simplified – with a view to ensuring that investors' tax calculations are more closely aligned to their economic gains, and chargeable when they receive their gain. In addition, it may be hepful to consider some form of 'opaque' election for widely held partnershps, to ensure that a disposal of units by one invetsor does not result in significant deemed disposal events for the rest of the investors. Finally, it would be appropriate to extend the 30 day tax payment deadline for widely held partnership funds to reflect the complexity and logistical challenges with managing this process for widely held funds.***

19. **Restrictions on utilisation of losses**

20. The loss restriction rules have added significant complexity to the tax rules. The loss restriction rules were originally designed to apply to revenue losses – which typically arise on a more regular basis, and so over time, there may be more chance that losses accrued can be utilised. Capital losses are more irregular and sometimes one off – and therefore the consequence of the restrictions on capital losses is that unless they arise in the same period as a gain, there is a high risk that they could remain unutilised indefinitely.

21. These rules are incredibly penal for those that incur capital losses in a different period to their capital gains, as those companies will not be allowed to fully offset their losses, which results in businesses paying tax on profits which are far in excess of economic profits. The consequence of these rules is that it is incredibly important for businesses to try and align their capital gains and losses in the same

accounting period, in order to be able to utilise their losses in full – which can distort commercial decisions around timing of disposals.

22. ***We recommend increasing the timeframe that losses can be carried back in full to 3 years, and allowing losses to be carried forward indefinitely to offset against gains in full.***

23. **Indexation relief**

24. Indexation relief ensures that owners of assets are not charged to tax on inflationary gains which have arisen simply as a result of holding an asset for a long period of time. Our members can hold assets for a significant period – several decades or more in some cases, therefore this relief was incredibly important to ensure that they are taxed on a true economic gain, and not just inflationary increases in prices.

25. In the context of question 32, we would suggest that indexation is much simpler and more straight forward that a re-basing mechanism, which that requires a market valuation of an asset at a given date. Indexation is far simpler as it is based on actual cost and requires less judgement.

26. ***We recommend that the indexation relief that was removed in 2018 is reinstated.***

27. **Interactions with the Transactions in Land (TIL) rules**

28. The transactions in land rules are complex and can create unintuitive outcomes where tax relief on some expenses are completely restricted. The tax landscape has changed significantly since the TIL rules were introduced – notably, companies disposing of UK property will now be within the UK tax net (primarily as a result of the introduction of NRCGT), so it is not clear whether some of the functions served by the TIL rules are even necessary any more.

29. ***The function and purpose of the TIL rules should be reviewed in light of the new tax landscape – and the TIL rules should be simplified and reduced in scope to reflect where other tax rules are serving similar policy functions.***

30. **Short term vs long term gains**

31. We do not consider that the corporation tax rules create significant distortions in this regard. We do not think it would be appropriate to introduce different regimes for short and long term gains, as this could distort decisions in respect of timings of disposals.

32. **High volume, low value gains**

33. There should be a simplified, practical solution for corporates with high volume but low value gains – in the context of real estate investment, this may include rights to light and surrender premiums.

34. ***We would recommend that the thresholds in Sections 23 and 242 (TCGA) should be revisited and increased, to ensure that low value gains can be deferred until the actual sale of the property.***