



Response from ICAS

Capital Gains Tax Review – call for evidence First stage – principles of CGT

10 August 2020

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good.
2. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.
3. ICAS welcomes the opportunity to respond to the Capital Gains Tax review – call for evidence, issued by the OTS on 14 July 2020. This response addresses the first stage of the review covering the principles of CGT- and derives from a discussion with a small number of members who were available at short notice. We may wish to revert to some of the issues in a response to the second stage, after discussions with a wider range of members.
4. We look forward to meeting with the OTS in September, as part of the second stage of the review.

Overview

5. The general direction of travel should be towards a simpler regime with a single rate of CGT and fewer reliefs.
6. As a general principle it is arguable that CGT rates on the straightforward disposal of assets should be lower than income tax rates to take account of the fact that many gains will largely reflect the effects of inflation (since the abolition of indexation relief), rather than a real increase in wealth.
7. If CGT rates were to be equalised with income tax rates, it would potentially be necessary to re-introduce some adjustment for inflation (or a distinction between long term and short term gains), which would increase complexity.
8. The AEA should be retained; it is a straightforward, simple and comprehensible way of removing the need to report small gains. The exemption for chattels/wasting assets should also be retained; again, this removes the need to report small gains but also, importantly, excludes any relief for losses on assets within the definition.
9. Reliefs should be subject to regular review to assess whether they provide value for money and whether they are achieving their objectives. Reliefs which do not meet these tests should be abolished.
10. Reliefs which are retained should be simplified wherever possible. Simpler rules would create less uncertainty and reduce litigation.
11. The use of ISAs and the taxation of pension savings has more of an impact on CGT receipts than many CGT measures. If the government's main aim is to increase receipts, then these would need to be considered. PPR also has an impact – we discuss this further below.
12. In making any recommendations for CGT it will be important to take account of any issues arising from devolution and the impact on the devolved jurisdictions. The review covers the interaction of CGT with other taxes, including income tax, which is partially devolved; it is important to recognise that the potential behavioural impact of changes to the CGT/income tax base could be greater where devolved income tax rates are higher.
13. We discuss below some issues relating to differences in taxation arising from differing business structures – where there are undoubtedly distortions. Making changes to one aspect, without considering the entire picture, would have wider consequences. We therefore believe this whole area should be subject to a separate review. We do not believe that difficulties/distortions in this area should determine the appropriate CGT rates for more general chargeable gains arising from the disposal of assets

14. We make some initial observations below on the interaction between CGT and IHT, but we will revert to this area in Stage 2 of the review.
15. Members are encountering numerous practical problems with HMRC's new IT system for reporting chargeable gains – particularly with the digital handshake required to appoint an agent. We do not discuss these further in this first stage response, as the focus is on the principles of CGT.

Principles of CGT

Rates of CGT

16. The current multiple rates of CGT cause complexity and uncertainty. With the introduction of 30 day reporting and payment for residential property gains, the link to the BR and HR income tax thresholds causes practical problems for calculations required before the end of the tax year. Ideally, there should be a single rate of CGT – as was briefly the case in 2008/09 and 2009/10.
17. The lower rates of CGT (linked to the basic rate income tax band) are arguably unnecessary, given the AEA. Having one fixed rate for CGT would also eliminate any scope for manipulation (by shifting income, such as dividends, out of the year in which a gain is realised).
18. The CGT rates (or the single rate) should arguably be lower than income tax rates (or the higher rate of income tax) to take account of the fact that many gains arising on the straightforward disposal of assets are largely the result of inflation, i.e. there is no real increase in wealth. If CGT rates were to be set at the same level as income tax rates there should be a mechanism for removing the inflationary element of gains (as used to be the case before the abolition of indexation allowance). This would, however, add complexity; retaining lower CGT rates is a simpler option.
19. Arguably, there are some gains which currently fall within CGT but could more appropriately be treated as income. This could be addressed by bringing them within income tax, rather than equalising CGT rates with income tax rates for all chargeable gains. Examples where this might be considered include carried interest.
20. There may also be a case for treating some distributions made by close companies in liquidation as income rather than chargeable gains - where these effectively represent 'rolled up' income (and to the extent that they are not already caught by the 2016 TAAR). However, this is one of a number of issues relating to differences in taxation arising from differing business structures (particularly distinctions between incorporated and unincorporated businesses). There are undoubtedly distortions, due to differing CT and IT rates – and differing CGT and IT rates – but making changes to one aspect, without considering the entire picture, would have wider consequences. We therefore believe this whole area should be subject to a separate review, so that a range of options can be considered – including, for example, the reintroduction of some form of close company apportionment. We do not believe that difficulties/distortions in this area should determine the appropriate CGT rates for more general chargeable gains arising from the disposal of assets.
21. Distinguishing between short term and long term gains for CGT purposes would add considerable complexity (as illustrated by taper relief, for example), but could be necessary if CGT and income tax rates were the same. It would be preferable instead to reclassify some very short term gains as income (where that reflects their real nature) – and to continue to compensate for the inflationary element of longer term gains with lower CGT rates.
22. People can often choose whether (or when) to sell an asset. High CGT rates may disincentivise sales, with potentially adverse economic consequences if an asset is retained rather than passed on to be used to better economic effect by someone else.

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

23. The AEA has a useful purpose and should be retained in its current form. It removes the necessity to report small gains in a simple, straightforward and understandable way. The administrative costs for HMRC and the taxpayer of reporting such small gains are unlikely to be justified by the tax collected.
24. It is possible that some wealthy individuals with advisers deliberately generate sufficient gains to use their AEA each year, but our experience suggests that such individuals are relatively few in number,

so the benefits of the AEA outweigh any disadvantage. We do not believe it would be possible to replace the longstanding, simple AEA with a more targeted way of taking small gains out of tax, without adding unnecessary complexity.

25. Removing the AEA would also be out of line with the direction of travel in other parts of the tax system, where annual exempt amounts (or an equivalent) have been introduced in recent years, for example, the £1,000 trading and property allowances and the savings and dividend allowances.

Exemptions and reliefs, including how they fit together and the extent to which they incentivise some decisions over others

26. As a general principle we would like to see a move towards a single rate of CGT (as discussed above this might be lower than the income tax higher rate) but with a reduction in the number of reliefs – and the simplification of other reliefs.
27. The exemption for chattels/wasting assets should be retained. Like the AEA this removes the need to report small gains – but also, importantly, ensures that losses cannot be claimed on tangible moveable property within the definition.
28. We may consider some specific reliefs in more detail in our response to the second stage of this CGT review. It is clear that reliefs do affect (and distort) taxpayer behaviour. For example, recent changes to entrepreneurs' relief have already altered the focus of business owners. Before the changes there was a 'fixation' with obtaining the 10% rate on exit. Now, there appears to be a shift towards holding on and planning a long term transfer to the next generation.
29. As a general approach, we believe there is a strong case for implementing a system for reviewing CGT reliefs regularly, to assess the costs, value for money and whether they continue to achieve their objectives – or whether they distort behaviour in a detrimental way. This would be in line with suggestions from the NAO and the OTS.
30. Even where reliefs are still meeting their original objectives it would also be worth considering whether those objectives remain desirable – or whether circumstances have changed. For example, is there still a valid reason for permitting relief for some capital losses against income? Do the CGT reliefs linked to EIS encourage investment? And, if so, is it investment in the right sectors – and could those sectors change post COVID-19?
31. Reliefs which are not value for money, are no longer in line with government objectives, or produce unacceptable distortions should be removed. Reliefs which remain should be simplified wherever possible.
32. We have briefly considered PPR; our initial view is that we doubt that removing PPR entirely would be sensible. It would distort behaviour by causing a reluctance to sell homes where this would give rise to large gains (particularly if accompanied by an increase in CGT rates). This could mean, for example, owners not downsizing, or employees being reluctant to move for work. Paying CGT might also restrict the purchase of the next property.
33. However, there is scope for simplification – and potentially for some restriction of the relief (for example, suggestions have been made for some form of lifetime allowance, or a 'rollover' system – and lettings relief has already been abolished).
34. One area where simplification should be possible is the approach to gardens/the permitted area. Another is the ability to make an election to treat a property as the main residence (where more than one property is owned), which offers some scope for manipulation.

The treatment of losses within CGT, including the extent to which they can be used and whether the loss regime distorts decisions about when to buy or sell assets

35. The general CGT loss regime works well and is easily understandable – losses are carried forward to set against future gains. Over time only the overall net gain is taxed, which is fair.
36. The introduction of the 30 day reporting and payment requirement for residential property gains may cause some distortion around the timing of disposals; there will be an incentive to dispose of an asset

which will generate a loss, before selling the residential property, in order to reduce or eliminate the gain.

37. As noted above, some specific CGT loss reliefs (for example, the ability to offset some capital losses against income) should be subject to regular review to ensure they provide value for money and continue to meet policy objectives.

The interactions of how gains are taxed compared to other types of income, including how the boundary between what is taxed as gains rather than income works.

38. We have commented above, in the section on Rates of CGT, on some aspects of the interaction of CGT with other types of income.
39. As set out, we believe that consideration should be given to reclassifying some items currently treated as gains, as income.
40. However, there should also be a separate review to cover the much broader area of differences in taxation arising from differing business structures (particularly distinctions between incorporated and unincorporated businesses). We do not believe that problems and distortions in this area should determine the appropriate CGT rates for chargeable gains arising from the disposal of assets.

CGT and IHT

41. As noted by the OTS the interaction between CGT and IHT is complex and can distort decision making, particularly in the context of deciding when and how to pass assets to the next generation. Where assets qualify for BPR/APR a lifetime gift may be unattractive because retaining the assets until death will obtain the CGT uplift. However, if the CGT uplift on death is removed, an asset with a low base cost (which does not qualify for APR/BPR), would effectively suffer two charges – IHT and a significant CGT charge.
42. There are also practical advantages to the CGT uplift on death because records relating to assets held for long periods may be difficult to obtain; resetting the base cost can therefore be helpful.
43. As suggested in the call for evidence there are issues with gifts. The OTS has already considered gifts and IHT (ICAS submitted a response to this review) – and made recommendations. There is a widespread lack of awareness of the CGT consequences of gifts; it is not clear what percentage of gifts (particularly of assets other than land and property) get reported to HMRC.
44. We can see a case for extending gift holdover relief to a wider range of assets – given that tax will be paid when the property is eventually sold. For assets which do not qualify for APR/BPR there is also potential unfairness where CGT is paid on a gift – but IHT also subsequently arises, because the PET becomes chargeable on death.