



Chartered
Institute of
Taxation

30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: post@ciot.org.uk

Office of Tax Simplification: Capital Gains Tax review – tranche two

Response by the Chartered Institute of Taxation

1 Introduction

1.1 CIOT technical committee members met the OTS on 26 October 2020 to discuss the second tranche of their CGT review focusing on the technical detail and practical operation of CGT. This submission considers a number of specific areas identified in those discussions.

1.2 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.3 Our stated objectives for the tax system include:

A legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences.

Greater simplicity and clarity, so people can understand how much tax they should be paying and why.

Greater certainty, so businesses and individuals can plan ahead with confidence.

A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).

Responsive and competent tax administration, with a minimum of bureaucracy.

1.4 References are to the Taxation of Chargeable Gains Act 1992 unless otherwise stated.

2 Re-introducing a general gifts relief?

2.1 We reiterate the point made in our letter of 12 August in respect of tranche one of the review: the impact of any extension of holdover relief on the interaction with (in particular) income tax and inheritance tax would need to be fully considered including the implications for trusts and corporate capital gains. A general CGT

holdover for all lifetime gifts may be considered as a quid pro quo for removing the CGT uplift on death – to a no-gain/no-loss holdover – such that the CGT treatment for gifts, whether made during life or on death, is CGT neutral. However, as we noted previously, it is difficult to gauge how any such changes might affect taxpayers' behaviour with regard to lifetime gifts: some might be encouraged towards making lifetime gifts; others however would still retain assets until their death, either to provide financial security in their own mature years or not wishing to risk the next generation dissipating their assets through divorce or insolvency. The effect would differ again if, for example, the CGT uplift were to be removed on death in respect of all chargeable assets, or only for those that do not attract an IHT charge.

- 2.2 Members report that where holdover relief is not available under section 165 (business assets) the less restrictive holdover relief under section 260 may be utilised to facilitate the passing on of assets to members of the family as part of succession planning via a transfer into a trust. The choice to utilise section 260 holdover is not necessarily driven by the benefits of a trust structure which therefore adds some complexity and behavioural distortion. Depending on the policy intent, removing this distortion might involve an extension to holdover relief to facilitate succession planning.
- 2.3 We note the current mismatch between section 162 relief on transfer of a business and the more restrictive section 165 holdover relief for business assets.

3 Private Residence Relief (PRR)

- 3.1 The OTS report on tax reliefs in 2011 recommended that PRR should be reviewed. We agree with the essential point, that is what should be a simple relief has become overcomplicated, with scope for taxpayers to go wrong, so that they need professional help to establish their liability exacerbated by the different rates and the difficulty of calculating CGT liability mid-tax year for the 30-day return. For basic rate taxpayers, the most common interaction with the CGT regime is likely to be with PRR.
- 3.2 The number of cases taken to the First-tier Tribunal is a good indication of an area that needs attention. The tribunal often reaches different conclusions on the availability of PRR on marginally different facts such as in relation to the required degree of permanence needed to establish a main residence. In the recent FtT case of *Leslie Phillips and Catherine Phillips v HMRC*¹ the tribunal agreed that in determining the area of land which is required for the reasonable enjoyment of a dwelling-house having regard to the size and character of the dwelling-house in question, the assessment which must be carried out involves 'an appreciation of the requirements of occupiers of residential property, and a knowledge of the residential property market' requiring expert evidence.
- 3.3 One possible solution is a statutory set of principles or a numerical statutory test similar to the approach taken with the statutory residence test to determine the question of what constitutes an only or main residence. Although the result may not be simple in the sense of more statutory provisions, it would provide a clear decision tree which gives an answer with less need for recurrent and costly litigation.
- 3.4 We suspect that many homeowners are unaware that the final period exemption is now nine months, in fact many homeowners may have been unaware the final period exemption was in fact reduced from thirty-six months to eighteen months from 6 April 2014. We think steps to increase awareness of the current PRR rules

¹ <https://www.bailii.org/uk/cases/UKFTT/TC/2020/TC07859.html>

particularly the final period exemption is necessary perhaps as part of the communications in relation to the 30-days reporting.

- 3.5 Preservation of the thirty-six-month final period exemption for disabled persons and care home residents is welcome and appropriate. We think there is a case for extending the thirty-six-month period to circumstances where a person leaves the main residence to move in with relatives or friends when independent living becomes difficult due to age or infirmity.
- 3.6 The change to lettings relief in FA 2020 limits the relief to those who share occupation of their house for disposals made on or after 6 April 2020. There are a number of fairly common place situations where an owner may share their home where the availability of PRR and/or the application of lettings is not straightforward.

Occupant	Availability of PRR/lettings relief
A single lodger² within S/P14/80 who shares living accommodation with the owner and takes meals with them.	No restriction to PRR and letting relief irrelevant.
A lodger who does not fall strictly wholly within S/P14/80 eg, someone who shares accommodation but does not take meals with the owner	Probably no restriction to PRR because the owner has not given up the use of any part of the property as a residence.
More than one lodger eg, two people sharing a room	CG64702 states: <i>The reference to a lodger is important. The domestic arrangements of individuals are endlessly variable and you must aim to operate the statutory code flexibly and fairly. A distinction was intended by the Statement of Practice between a person who takes a single lodger into their home and a person who is running a lodging house as a business. The relief available to the latter should be restricted. You should not consider any restriction of relief where there is a single lodger but should consider doing so to an appropriate extent where there is more than one lodger, whilst bearing in mind that if relief is restricted lettings relief may be due, see CG64710+</i> .
Tenant with own cooking and bathroom in a self-contained part of the home eg, top floor using main entrance	Letting relief available ³ but if the self-contained accommodation has a separate entrance, HMRC may take the view that the tenanted portion is a separate entity and therefore no PRR for the separate asset.

² ² SP14/80 itself refers to 'a lodger' which could be argued to refer to apply separately to each individual lodger in the case of more than one, or otherwise to include the plural if we were to apply s6 of the Interpretation Act, which says unless the contrary intention appears words in the singular include the plural –acknowledging this is not legislation and arguably there is the contrary intention at CG64702

³ Paragraph 9 of the Explanatory Notes to Finance Act 2020 indicates that it is intended to apply where the owner shares occupancy **with a tenant**. (*Our emphasis*). This indication is consistent with the consultation. However, paragraph 10 of the Notes refers to shared occupation with another individual 'who has no interest in the residence'. It is not entirely clear therefore whether or not the intention is that the new relief would be available for a tenant who would in fact have an interest (by virtue of the lease) in the residence.

B&B or family run hotel where the owner occupies part of the building as a private home	Letting relief may be available subject to the separate entity question. Not a straight forward question as HMRC's guidance recognises – see CG64710 ⁴
Airbnb – different variations eg, Booking a room in someone's house	Letting relief may be available subject to the separate entity question. Letting relief may be available subject to the separate entity question
Booking an annex to someone's house	No shared accommodation therefore no letting relief, effect on PRR calculation depend on period of absence?
Booking someone's whole house	

It would be helpful if there was specific HMRC guidance on commonplace modern scenarios, including how the Rent a Room rules operate in relation to the CGT PRR legislation. (Renting a room to one person has no effect on PRR. Multiple rent a rooms in the same home may be a business but letting relief should be available in line with the analysis for lodgers above.) Guidance might be enhanced by the use of a graphic to illustrate some of the finer distinctions – see for example <https://www.litrg.org.uk/tax-guides/savers-property-owners-and-other-tax-issues/capital-gains-tax/selling-your-home>.

- 3.7 A possible simplification is to align the CGT treatment of shared occupation with the 'Rent-a-Room' relief, such that if the renting out of part of your home qualifies for Rent a room Relief, there is no restriction on PRR aligning what appear to be similar policy objectives. At the moment there are three categories; where PRR is not reduced; where PRR is reduced but lettings relief applies; and no relief at all. Removing lettings relief and bringing PRR in line with Rent-a-Room relief would reduce it to two more clearly defined categories.
- 3.8 There is also the question of the point at which lettings become a business or trade. The question of what constitutes a business of letting is not consistent across the tax system and is not well understood. The Upper Tribunal case of *Elisabeth Moyne Ramsay v HMRC*⁵ [2013] UKUT 0226 (TCC) considered the question of whether a residential property letting was a business for the purposes of TCGA 1992 section 162. The decision considers the meaning of business carried on by an individual in the capital gains tax context more generally. Mere passive receipt of rent would not normally be regarded as the carrying on of a business. The decision indicates that regard should be had to the factors referred to in *Customs and Excise Commissioners v Lord Fisher*⁶ together with the degree of activity undertaken (in the sense that in order to constitute a business, the degree of activity must outweigh what might normally be expected to be carried out by a mere passive investor.) As the test depends largely on questions of fact taxpayers may struggle to apply the test to their particular circumstances.
- 3.9 We think HMRC's guidance on the application of PRR to 'home offices' could be usefully updated and expanded in the light of the substantial increase in the number of people working from home since 16 March as a result of Covid-19. CG64690 indicates that HMRC take a relaxed view unless a substantial part is set aside

⁴It is also important to properly identify the entity making up the dwelling house where the property is used for a trade which involves letting as this may not be a straightforward question. This is covered in more detail at [CG64723+.](#)¹

⁵ https://assets.publishing.service.gov.uk/media/5764f7cf40f0b652dd000060/Elisabeth_Moyne_Ramsay_v_HMRC.pdf

⁶ [1981] STC 238

however it is not clear what this means in practice. Many will have reconfigured their home and created dedicated working space, and some will have created home offices in gardens.

- 3.10 The conditions for job-related accommodation relief in section 222(8)(a) are fairly restrictive. They were originally introduced by FA 1978 and therefore appear due for review to ensure that the policy intent is reflected in current working practices more widely.
- 3.11 The periods of absence rules in section 223(3) are difficult to follow and over-restrictive, for example section 223(2)(b) does not allow for any duties to be performed in the UK even if incidental to the overseas employment as stated at CG65040:

All of the duties of the employment must be performed outside the United Kingdom. You can ignore any return to the United Kingdom for holidays, but you should not ignore any duties which are in practice performed in the United Kingdom even if they are only incidental to the main duties performed outside the United Kingdom.

This stated position is in contrast to the employment income rules (see ITEPA 2003 section 39(2)). However see the exchange in Hansard when section 223(2)(b) was first introduced indicating the Minister's view that incidental duties were intended to be permitted: https://api.parliament.uk/historic-hansard/commons/1965/jul/07/clause-28-private-residences#column_1742

Alignment with the full-time working abroad test in the statutory residence test might be considered.

- 3.12 Under the current rules the three-year absence in section 223(3)(a) requires an individual to move back into the home, a requirement that is relieved for the other periods of absence by section 223(3B) (b) if work keeps the individual away from home. The periods of absence provisions could be simplified into one straightforward rule that if you need to leave your home so that you work elsewhere (whether through employment/self-employment) then you will be deemed to continue to occupy your original home.
- 3.13 There are issues in practice with how nominations interact with periods of absence. Pre- Finance Act 2015 a period of absence could not be claimed if an individual had a main residence somewhere else (to stop the possibility of the relief covering two properties at the same time). Now, if an individual takes up a new residence during the period of absence, he or she must nominate between that one and the deemed residence under the period of absence rules. This was achieved by removing the requirement for no other residence in that period in section 223(7B), and adding the statutory references for making the nomination in section 223(3) (first line).
- 3.14 Many people who leave the UK to work abroad rent a new house in the destination country. The UK property is covered by the period of absence in 223(3)(b) but there is little awareness of the need to make a nomination due to them having a new residence abroad. Whilst they may be able to make a late nomination under the recently enacted ESC D21, it would be better if the system was more intuitive.
- 3.15 Finance Act 2020 legislated ESC D21 allowing for a late nomination stating which of two or more residences is their main residence where one of those residences has no market value. Instead of legislating D21, our strong preference is to address the underlying practical issues by excluding the need to consider interests that have no capital value (and therefore potential for a gain) when deciding which of two properties is a main residence for PRR.
- 3.16 Consideration could be given to abolishing the two-year time limit for a PRR nomination more widely, and simply enable PRR nominations to be made following a disposal. The two-year period offered some protection

against repeated switching where the final exempt period was thirty-six months but with a much reduced final period exemption that justification has less weight. This approach would have the advantages of aligning the position of UK residents with that of non-UK residents, who are not subject to the two-year time limit and would also remove the bear-trap of people commencing UK residence when the two-year time limit has already elapsed, meaning they are out of time to make a nomination. We agree with the OTS recommendation on the Claims & Elections Review that the facility to make a nomination should be added to the personal tax account

- 3.17 PRR is only available to personal representatives where beneficiaries who occupy a property are entitled to seventy-five per cent of net sale proceeds (section 225A). By contrast, there is no such seventy-five per cent condition where properties are occupied by trust beneficiaries under trustees' dispositive powers (section 225). This causes confusion in practice, especially where there the personal representatives and trustees are the same people.
- 3.18 The interaction with PRR and divorce is considered below.

4 Divorce

- 4.1 For CGT purposes, transfers of assets between spouses living together are treated as made on a 'no gain/no loss' basis (Section 58(1)). This treatment also applies to transfers in the tax year in which separation takes place, even though the spouses or civil partners may not be 'living together' at the time of transfer. Transfers made following the tax year of permanent separation (and before decree absolute) are deemed to be made at market value as the spouses/civil partners are connected parties for CGT purposes. It is therefore necessary to effect transfers of chargeable assets within the year of separation to ensure the transfers take place at no gain/no loss which is likely to be challenging in practice, even more so if the separation takes place towards the end of the tax year (exacerbated further by the current pandemic). This short window can distort behaviour and encourage manipulation of the separation date.
- 4.2 In addition, where a sale of the family home is to be made to a third party (instead of to a spouse/civil partner within the circumstances envisaged by section 225B), it may not be possible to arrange for the sale within the now reduced final exemption period for PRR of nine months so the spouse or civil partner who leaves the home may be exposed to an unexpected gain (subject to the availability of the annual exemption) with potential consequences for the financial settlement.
- 4.3 Where a gain is deemed to arise on a gift of business assets from one separated spouse or civil partner to another, that gain may be sheltered from CGT by the use of hold-over relief. However, HMRC's practice in relation to business assets and holdover on divorce has changed over time causing some confusion. Until 2003 HMRC's view was that a transfer under the terms of a court order was made in consideration of the beneficiary relinquishing financial claims and therefore no holdover under section 165 was available. Following the family law case of *G v G*⁷, there was a change in the guidance to view the transfer instead as the exercise of the jurisdiction of the court and therefore section 165 holdover was available. HMRC's view changed again in December 2019 apparently reflecting the judgment in the insolvency case of *Haines v Hill*, decided in 2007, some time prior to their change of view in 2019. We think the availability of holdover in these circumstances should be clarified in legislation.

⁷ [2002] EWHC 1339 (Fam)

- 4.4 Transfers after the tax year of separation but before the decree absolute can give rise to ‘clogged’ losses that can only be used by transferring assets standing at a gain pre-divorce, and if not used by decree absolute the losses are lost.
- 4.5 The CGT treatment is not consistent across the tax code particularly when compared to the wider exemptions for IHT and SDLT. Arguably the CGT approach fails to recognise that a division of assets on divorce is not conceptually the same as a disposal to a third party. The CGT treatment is distortive leading to the need for expert witness statements and difficult decisions on how to divide assets based on the tax treatment. Providing for any transfers made in connection with divorce to be on a no gain no loss basis would offer a solution.
- 4.6 Alternatively extending the no gain/no loss treatment to a period of two years from the end of the tax year of permanent separation and to all disposals under or ratified by a court order would alleviate these issues in most cases.

5 The operation of the rule in *Marren v Ingles* – is there a better approach?

- 5.1 Under *Marren v Ingles* a right to deferred consideration is treated for tax purposes as an asset (a chose in action) itself. When the right is satisfied, there is a disposal for CGT purposes. The base cost of the right will be the agreed (discounted) value of the right on the date it was created (generally the date of sale). Valuing the earn-out right is difficult, and costly to establish because it is normally discounted for uncertainty and the time value of money. If the seller receives more deferred consideration than the discounted value, a chargeable gain will arise on the disposal. If an allowable loss arises on the realisation of an earn-out right, under section 279A, a taxpayer can elect for the loss to be carried back and set off against any capital gain that arose on the original sale of the shares.
- 5.2 A *Marren v Ingles* right arises most commonly in relation to earn-outs when part of the consideration for the sale of shares is calculated by reference to the future performance of the target. There are a number of different ways the earn-out can be structured eg payable in shares or loan-notes; conventional cash earn-out taxed under *Marren v Ingles*; top-down earn out where you specify the maximum price but may reduce that subsequently – all of which have different tax treatments; may or may not preserve reliefs (such as BADR) and generally are a trap for the unwary. A key simplification to mitigate the complexity of balancing multiple routes and structuring to access reliefs with differing tax consequences and uncertain valuation issues would be a simple rule whereby unascertainable consideration is taxed on receipt with the disposal treated as deferred consideration for the original asset (not as a chose-in-action). The advantages are the removal of a potentially substantial dry tax charge on proceeds that may never be received, the behavioural distortions involved in planning round adverse tax consequences, the need to value a separate asset and for a separate election when a loss arises. It is recognised that the proposal may not be revenue neutral because exemptions and reliefs available on the original disposal would also apply to the deferred element.

6 Distortions in Business Asset Disposals Relief (formerly Entrepreneurs’ Relief)

- 6.1 The consultation on ‘Financing growth in innovative firms: allowing Entrepreneurs’ Relief on gains before dilution’ in 2018 re-stated the objective of what was then ER as being ‘*to promote enterprise by offering a reduced rate of tax to individuals who, with significant initiative and risk, have contributed to the creation and*

growth of a business'. The link between this objective and the rationale for the 5% test in the 'personal company' definition (TCGA 1992 section 169S(3)) appears to be somewhat tenuous.

- 6.2 While there may be some merit in a 'bright line' condition the 5% test is out of alignment with the position for partners in a trading partnership or employees with EMI shares where there is no minimum percentage, and also with EIS relief where there is no limit.
- 6.3 A minimum percentage creates an arbitrary cliff edge limit giving rise to potential distortions in behaviour and offering the trap of inadvertent dilution. Increasing the percentage would appear to retain these risks.
- 6.4 Although there is now a mechanism (introduced by FA 2019) to elect for BADR when a shareholding is about to be diluted by a share issue, for example on the raising of new finance to grow the business, in these circumstances much of the gain may come from that growth so the availability of BADR on the gain before dilution may be quite small. The need to make an election at all is a complexity.
- 6.5 The additional requirements for the 5% test relating to economic ownership (the profits and assets test and the sale proceeds test) were introduced by FA 2019. The definition of relevant terms (profits available for distribution, assets available for distribution on a winding up and equity holders) are based on the corporate group relief rules. They are complex to apply and likely to unfamiliar to many claiming BADR. It is also not clear what they achieve.
- 6.6 A personal company must be a trading company, or the holding company of a trading group. A trading company means a company that does not, to a substantial extent, carry on non-trading activities (Sch 7ZA Pt 1, para 1). CG64090 provides HMRC's view on what is meant by 'substantial', the term is not defined in the statute. CG64090 suggests that non-trading activities should be taken to be 'substantial' if they amount to twenty per cent or more of the activities of the company and that, whilst no single factor is determinative, it is useful to consider the test in the light of some or all of the following factors: income from non-trading activities; the asset base of the company; expenses incurred, or time spent, by officers and employees of the company in undertaking its activities; and the company's history. The company's trading status is determined by taking an overall view of the position and is not necessarily easy to apply⁸. We note there are similar issues for Business Property Relief in applying the wholly or mainly test for holding investments. Codification of the test might provide certainty but at the cost of extended legislation.
- 6.7 In terms of the two-year holding period (as extended by FA 2019), views are mixed. On one hand the business life cycle is usually longer so the existing holding period may appear relatively short and promote manipulation. On the other hand, in a technology driven business, bringers of innovation can drive high values in the early stages of a business with a buyer better able to invest and grow the business so a shorter qualifying period promotes growth.

⁸ See for example *Allam v Revenue and Customs Commissioners* [2020] UKFTT 216 (TC) and paragraph 159 of the FtT decision 'As regards, the HMRC guidance, we can understand that it is useful for HMRC staff to have some practical guidance to assist them in the application of the legislation, but there is no sanction in the legislation for the application of a strict numerical threshold. Furthermore, although the guidance accepts that the factors to which it refers should not be regarded as individual tests and they are just factors which may point one way or another and which need to be weighed up in the context of the individual case, we would counsel against any form of exclusive list. It is not permissible to substitute another test for the test dictated by the legislation. The question for us must be whether or not the activities of ADL include non-trading activities to a substantial extent. We must assess that question in the context of the facts and circumstances of the case as a whole and so by reference to the activities of the company as a whole.'

- 6.8 If SEIS relief is withdrawn or reduced, a chargeable gain is deemed to accrue to the investor in the tax year in which the shares were issued. However, that gain cannot attract BADR because it is a ‘new’ gain, it does not reinstate the original gain that may have qualified for BADR (this disincentive to invest was specifically addressed for EIS by sections 169T -169V inserted by FA 2015 section 44).

7 Land assembly for housing developments

- 7.1 Local authorities are increasingly looking at larger multi-owned sites for housing developments. Where multiple landowners are involved, the CGT code (and the wider tax system) militates against using a land pooling mechanism (to promote more sustainable developments and patient investment over short term return) as opposed to the ‘traditional’ route where a landowner pursues an option and sale arrangement with a developer or a promotion agreement and sells the land upfront. At its simplest ‘land pooling’ may involve an ‘equalisation’ agreement under which each disposing landowner will pay a share of the proceeds to the others based on the respective acreages contributed into the ‘pot’. However, equalisation payments made by each landowner on the sale of their land are non-deductible for CGT purposes (see *Burca v Parkinson*⁹) while being fully taxable in the hands of the recipient landowner. Equalising payments do not benefit from BADR (or IHT) reliefs.
- 7.2 The CGT and wider tax barriers inhibiting land pooling as a means of land assembly were explored in our submission to the Department for Communities and Local Government consultation in 2017 *Fixing our broken housing market*¹⁰. The submission considers in outline some of the alternative routes to pooling, the most common of which are a land pooling trust (landowners enter into a pooling trust such that each landowner holds an undivided share of the whole area equal to the percentage of land introduced relying on case law: *Jenkins v Brown*, *Warrington v Brown*¹¹) and use of cross options (each landowner grants all the others an option to acquire the relevant percentage of landowner’s land for an exercise price equal to today’s market value. As land is drawn down the developer pays the landowner for the land and the other landowners to release their options). However, neither alternative works perfectly and both are hampered by uncertainties in tax outcome. The tax issues in point include wide-ranging features of the tax system such as the questions of income versus capital and whether an activity is trading or investment.
- 7.3 The CIOT’s position is that there should be a level playing field in tax terms between the pooling and non-pooling route such that the economic decision about which route to pursue is not distorted by a tax bias towards an un-pooled route. We think it may be necessary to consider both short term measures and a comprehensive longer term solution.
- 7.4 In the short term, achieving greater certainty in terms of HMRC’s view (for CGT and other taxes) of the two main pooling models (a land pooling trust or cross options) particularly where there are risks of dry tax charges would mean landowners would be more willing to commit to these models despite them not offering a whole solution. It might be possible for the professional bodies to agree ‘model arrangements’ with HMRC in

⁹ In *Burca v Parkinson* [2001] STI 1016, Chancery Division it was held the obligation to pay part of the proceeds from the sale of shares to another party under the terms of a loan agreement did not affect the amount of consideration received for CGT purposes.

¹⁰ <https://www.tax.org.uk/policy-technical/submissions/fixing-our-broken-housing-market-ciota-comments>. This link includes HMRC’s response.

¹¹ 1989 STC 577

advance in the same way as has been done for the pre-agreed ways of structuring loan notes into Qualifying Corporate Bonds (QCBs) or non-QCBs for CGT purposes.

7.5 In the longer term, solutions could include:

- Principles-based legislative drafting – the principle to be formulated is that transactions which are structured differently from the traditional options based sale route to accommodate a patient capital pooled development should enjoy a comparable tax treatment.
- a tax neutral ‘land-pooling’ vehicle specifically designed to provide a neutral tax treatment without affecting the wider tax code
- a series of dedicated reliefs for CGT, IHT and possibly other taxes or amendment to existing reliefs or provisions.

There are pros and cons in each case as examined briefly at appendix 1. On balance, the complexity of design involved in encompassing all relevant taxes in the case of a separate vehicle, and the extensive changes to the statutory code required for dedicated reliefs, points towards the principles-based drafting as our preferred longer-term solution.

8 The *Crowe v Appleby* trap

- 8.1 The *Crowe v Appleby* case is problematic in two ways, firstly the trap caused by its application (see case study examples at 8.4 –8.6) and secondly the scope for errors that occur across potentially many years of returns if the rule is not recognised and therefore not applied correctly (see 8.3). The trap applies if the settled property is an undivided share in land in England or Wales for example a joint interest in a field.
- 8.2 Where a trust includes land held for a class of beneficiaries in undivided shares, there is no deemed disposal by the Trustees for CGT until all members of the class have become absolutely entitled following Goff J in *Crowe v Appleby*¹². For example, if a trust holds undivided shares in land for each of a testator’s grandchildren to take absolutely at age 25, it is only when the last surviving grandchild reaches the age of 25 that the grandchildren can direct the trustees to transfer the property to them and a CGT charge then applies under section 71. At that time, it is only the youngest grandchild who can claim holdover relief under section 260 as only the youngest child has a simultaneous IHT charge (the others having become absolutely entitled for IHT purposes when they attained age 25).
- 8.3 There is low awareness of this arguably illogical rule and its consequences. Typically, an adviser may take on a client where the client was not aware of the rule. Thus there may have been numerous returns over many years filed on an incorrect basis that need to be amended potentially out of time. One example quoted by a member was taking on a trust with 9 beneficiaries, several of whom had passed age 25 and the assumption had been made that the part shares in the property had passed to them such that on a future disposal they were individually liable to CGT.

A disposal of the whole property now needed to be dealt with (which correctly would be entirely taxable on the trustees) but over the years there had been disposals where the assumption was that the parts of the

¹² 51 TC 457

asset had left the trust, holdover had been claimed/ assumed, and part disposals reported as made by and taxed on individual beneficiaries as well as the Trustees. Records therefore would incorrectly show:

- holdover claimed on multiple ‘disposals’ by the trustees (as each beneficiary reached age 25) over a period of years;
- part disposals by beneficiaries (which under the rule in *Crowe v Appleby* should have been taxed on the trustees);
- part disposal calculations held by different beneficiaries (and advisors).

Correcting these understandable errors would require amendments to numerous returns over numerous years.

8.4 Case study 1

The transferor set up an Accumulation and Maintenance Trust in February 2006. The property settled was a house in North London, which has always been let to third party tenants by the trustees. The property was held in trust for the benefit of the settlor’s three children, each having an undivided share in the property.

On 5 April 2008, the trustees irrevocably appointed the trust fund to be held on trust for the beneficiaries who attain the age of 25. The intention was to make the trust fall within the terms of the section 71D of the Inheritance Tax Act 1984. This requires each of the beneficiaries to become absolutely entitled to their share of the trust fund on reaching the age of 25.

Upon the eldest beneficiary reaching 25, the trustees were subject to an exit charge on the beneficiary’s one-third share. A further exit charge arose when the remaining two beneficiaries (twins) turned 25 in June 2020.

Following *Crowe v Appleby*, where a beneficiary becomes entitled to an undivided share in land, there is no CGT disposal by the trustees until such time as all the beneficiaries became entitled to the land. Therefore, it was not until June 2020 when all beneficiaries become entitled to the property on reaching the age of 25, that there was a disposal of the residential investment property by the trustees.

Under section 260 gains which arise on the appointment of assets to beneficiaries, where the distribution is a chargeable transfer for inheritance tax purposes, can be deferred (held over). However, as only two-thirds of the property was subject to an exit charge on the date of deemed disposal by the trustees, only two-thirds of the gain can be deferred. The other one-third is subject to CGT at 28% in the hands of the trustees.

8.5 Case study 2

A new client came to us with a trust for two brothers, where their father had died. The brothers are entitled to income and capital at twenty-five. One brother is twenty-seven and the other twenty-four. The trust consisted of a let commercial premises (‘Premises A’) valued at £300,000 and a half share in a set of let industrial units (‘Premises B’). The half share was valued at £200,000. So the rule in *Crowe v Appleby* applied to Premises A but not Premises B (see [CG37552](#)). The trustees received an offer for sale of both premises and the question initially put to us was who was liable for the tax.

In the case of Premises A, as the rule in *Crowe v Appleby* applied, it was a sale by the trustees, with their half annual exemption and their liability to the highest rates of CGT. In the case of Premises B, as the rule did not

apply, 25% of the Unit was a trustee sale and the other 25% held by the trust was a bare trust sale for the older brother so he could use his full CGT annual exemption and had lower CGT rates if the gain exceeded his CGT annual exemption.

8.6 Case study 3

The case involved a farm which was settled for two siblings (a brother and sister) on a pre-22.3.06 life interest trust. The property vested once the siblings reached the age of fifty. The elder sibling (the sister) attained fifty, three years before her younger brother. There was frustration that the elder sibling was unable simply to wind up her share of the trust and operate independently. There was also an investment portfolio, income from which was used to support the farm. The trustees had power of appropriation, so a similar analysis applied as for the land (see [CG37530](#)).

- 8.7 The illogicality particularly exemplified in case study 2 suggests some statutory override might be considered to address these areas.

9 Lease extensions and tenant-owned flat management companies

- 9.1 As part of leasehold enfranchisement, many lessees of residential flats have acquired the freehold of the block of flats. A company purchases the freehold as nominee for the lessees. When a lessee sells their flat, there are two disposals – one of the leasehold interest and one his or her share of the freehold reversion. If the flat is the lessee's main residence, PRR relief ought to be available on both disposals, but it is not totally certain.

However, very often developers have assigned the freehold reversion to a company whose shareholders are the lessees of the flats. The directors are appointed from among the lessees. The lessees may regard themselves as already enfranchised but it is not the same. This structure gives rise to potential CGT (and other tax issues) except where lessees are initially granted leases of 999 years, in which case the value of the company's freehold reversion is negligible.

Generally, those who have shares in the company owning the freehold of the block consider that they now own their flats and have security of tenure. However, as the residual term of the lease reduces below eighty years, it can become difficult for a lessee to sell his or her flat, as a bank may be reluctant to lend against a short lease. Therefore, at that point lessees are likely to want to extend the terms of their leases (ideally to 999 years, effectively bringing the full value of the flats into the leasehold interest). The extension of the leases can raise tax issues for the lessees and for the company that are not widely recognised.

- 9.2 On the extension of a lease, the company would be treated as making a part disposal for capital gains tax purposes (the grant of the new lease to the lessee is a part disposal of the freehold interest).
- 9.3 It is relatively common for lessees to leave what they might regard as the formality of extending their leases to sometime in the future, until one of them wants to sell their flat and the buyer's mortgage provider asks for the lease to be extended. As the lessees control the company, they are able to ensure that no premium is actually charged for the extension. However, even if no actual consideration is paid, the disposal will be treated as being at market value under TCGA 1992 section 17 and the gain in the company will be subject to a corporation tax charge that needs to be funded by the lessees as the company normally has no funds to meet the liability. As far as each lessee is concerned, he/she is also disposing of their old lease and acquiring the new extended lease. As long as the flat is the tenant's main residence, any gain by the tenant should be

relieved by PRR, however if the absence of consideration represents a distribution, there may be an income tax liability for the lessees (as shareholders) or an income tax liability on them as directors, with a Class 1A NIC liability for the company.

- 9.4 Where lessees acquire a share in the freehold of the flats for their personal benefit, it appears contrary to the intention of leasehold enfranchisement that lessees should be subject to tax on the value of their own homes when extending their leases in the circumstances described. Lessees (and their respective freehold companies) who have not sought advice before extending leases may not be aware of the need to consider the tax position where the lease extensions concern their homes.
- 9.5 There is a lack of awareness of the CGT and wider tax issues arising where the freehold is an asset of the freehold company (other than as bare trustee) as explored in Leigh Sayliss's article in Tax Adviser¹³ and little HMRC guidance on the specific issues. We think this lack of awareness should be at least addressed. Although amounts may not be material in many cases, high values in certain areas will produce gains above the annual exemption. In terms of a potential solution, the issues could be addressed if the lessee shareholders could elect to treat the company as transparent and therefore for CGT purposes each lessee's share of the freehold would be treated as part of their interest in the flat.

10 Relief for loans to traders TCGA 1992 section 253

- 10.1 Members point to a number of pitfalls that investors find in trying to claim relief for genuine economic losses under this provision as illustrated by the case study below.
- 10.2 Loans to traders – experience from practice:

Case study 1

Issues arise from the requirement in TCGA 1992 s.253(3)(a) that a capital loss can only be claimed on a loan to a trader if the loan has 'become irrecoverable'. Both of those words caused difficulties in a protracted enquiry by HMRC into a client's claim.¹⁴ The client had made loans to a trading company over time when the company urgently needed funds for wages and other operating costs. The client decided after 10 years to cut his losses and wind up the company in view of very difficult trading conditions. HMRC argued simultaneously that the majority of the loans were not recoverable when made (and therefore cannot be said to have become irrecoverable), and that the loans which were accepted as recoverable when made were not yet irrecoverable because the company had not entered administration. This in itself was confusing – how could the majority of the loans be irrecoverable when made if the others were not yet irrecoverable?

The implication of the first argument (the loans were not recoverable when made) for the client was that he was poor investor who should have known that he was effectively throwing good money after bad. With the benefit of hindsight, it may have been possible to say that the business was not going to succeed but he was genuinely interested in trying to turn the fortunes of the business around. Even if it had become obvious that his money would not be returned, there was no tax avoidance here, and economically speaking he was still in a loss position: for each £1 that he loaned, he could only recoup 20p of capital gains tax.

¹³ <https://www.taxadvisermagazine.com/article/tax-traps-tenant-owned-flat-management-companies>

¹⁴ Where a series of loans is made, disputes also arise over when the loans became irrecoverable.

The client, as a majority shareholder, considered it his duty to fund the business even after it had stopped trading so that the company could pay for its debts. A claim for these loans was not made (after all it had stopped trading at this point); however there was no relief for the real economic loss incurred in settling liabilities.

- 10.3 Furthermore, there is a disparity between how a capital loss is claimed on loans and on shares which creates difficulties. Firstly, there is no requirement when claiming that shares have become of negligible value under section 24 (or when claiming a capital loss on shares after the company has been struck off) for the capital to have been recoverable when the investment was made. Secondly, a capital loss on shares can be set against income under ITA 2007 section 131 in certain circumstances. For this reason, HMRC have understandably tried to prevent people from converting loans into shares prior to the company being wound up, arguing that the value of the loans at that date is negligible and therefore the shares were purchased with nil consideration. The side-effect of this argument, though, is that those who have converted loans to shares as part of a normal restructuring of the company's debt (and not for tax purposes) may find themselves with little to no relief on their shares if they are disposed of at a loss. Therefore the taxpayer goes from having the potential for a capital loss (by claiming section 253 relief on the loan) to having no capital loss at all.

11 Estates in administration / position on death

- 11.1 SP 02/04 gives an allowance, on a published scale, to personal representatives (PRs) of an estate for the costs of establishing title. There is always the alternative of the PRs claiming a higher actual cost if this can be established. In some cases, these costs can be quite substantial. However, illogically, this CGT allowance applies only to a disposal by PRs. Any legatee, whether a will trust or individual, does not obtain the benefit of this practice.
- 11.2 When an individual dies there is a deemed disposal of assets and a CGT exemption applies to the deemed gain so realised. There is no such exemption for income tax purposes. This means that an income tax charge arises on death where gains are within the scope of income tax as assets are deemed to be disposed of but no exemption applies. This is relevant to, for example, offshore income gains on non-reporting funds. The position for income tax and CGT should be aligned.
- 11.3 On death, asset values are rebased for CGT purposes to the value agreed with HMRC for IHT purposes (section 274)). Values are not agreed in respect of excepted estates, exempt assets or assets fully relieved from IHT (eg under APR or BPR). In such circumstances the value needs to be agreed separately with HMRC. This is a point that is widely misunderstood. It can lead to taxpayers attempting to amend IHT400s once the point around CGT rebasing becomes clear. This does not provide an ascertained figure, but is often done where estimates or incorrect low values have been entered onto the IHT forms when the link between CGT and IHT figures becomes apparent and the lower value produces an unanticipated chargeable gain.

12 30-day reporting and payment

- 12.1 Residents who dispose of a UK residential property that is not covered by PRR and non UK-residents who dispose of UK land and buildings are required to submit a return to HMRC and pay an estimate of the tax due within 30 days of the disposal. The design of the new system as an 'add-on' micro system meant there were a number of teething problems when it first went live, for example initially it was only possible to report one

disposal per year. That element has been remedied however one firm's experience (before it was remedied) was being told to write in to provide details of subsequent disposals, then to report them electronically once they were able to do so. Penalties were then raised for each disposal. These teething problems are being ironed out although problems remain, for example a member reported incurring very extensive professional time (over nineteen hours at a total cost of £1,600 excluding the actual computation) in attempting to simply register a trust for 30 days filing, and there is some confusion over the instructions for which payment reference to use when making payment (the property account number / the payment reference number).

We question the net benefit of developing standalone systems that operate independently of mainstream systems such as the personal tax account and the agent services account especially where they require their own separate agent authorisation process. In addition, there remains the fundamental issue of a general lack of awareness by the public of the obligation to report and pay within 30 days.

- 12.2** While awareness will bed in over time for those making serial disposals, it remains an issue for occasional disposals particularly of gifts of interests in residential property and deemed disposals. Engagement with intermediaries such as conveyancers to find ways of alerting individuals and trustees to their filing obligations seems to be the best avenue for extending awareness perhaps by exploring with those intermediaries the provision of HMRC-produced information/ material to clients or using the conveyancing process to build in an alert that a filing obligation may arise.
- 12.3** GOV.UK guidance operates on an 80:20 basis aiming to set out guidance covering the large majority of users. This appears to mean that non-resident investors in a property rich fund are not covered in the GOV.UK guidance. The guidance for indirect disposals: <https://www.gov.uk/guidance/capital-gains-tax-for-non-residents-uk-residential-property#indirect-disposals> provides very little to help the (unrepresented) non-UK resident who may have little other contact with the UK tax system. In fact, the reference to the 25% de minimis for indirect holdings, without qualification, might mislead them into thinking there is no need to report. We suggest there is at least a link in the GOV.UK guidance to more detailed guidance for non-residents disposing of interests in property rich funds to increase awareness.
- 12.4** The way in which non-residents without a national insurance number or UTR who cannot therefore set up a Government Gateway account, need to register to report and pay is not very obvious or accessible. The CIOT website highlighted the relevant steps and screens – see <https://www.tax.org.uk/policy-technical/technical-news/report-and-pay-capital-gains-tax-uk-property-%E2%80%93-non-residents-who>. However, we think this pathway needs to be signalled more clearly in the GOV.UK guidance.
- 12.5** Where an individual is not in self-assessment, the window for HMRC to enquire into a 30-day return is based on treating the return as having been filed on 31 January following the year of assessment in which the disposal takes place (unless the CGT return was submitted after that date). For example, an individual sells a property on 6 April 2021 reporting the disposal before 5 May 2021. The individual does not need to file a self-assessment tax return (SATR). The enquiry window is open until 31 January 2024, two years and nine months after the initial filing. In contrast for someone in self –assessment the enquiry window ends twelve months after the submission of the SATR. We suggest reference is made in the GOV.UK guidance to the enquiry period and the need to retain records for the extended period.

13 Record keeping

- 13.1** A common problem for property disposals is lack of information about holdover claims made in the past details of which are not recorded or recalled (including hold-over relief claimed on an only /main residence on a transfer into a trust thereby denying PRR on a future disposal by the trustees), and keeping track of details of enhancement expenditure and deferred EIS and SEIS gains. We suggest the facility for individuals and their agents to record these details when made or incurred in the personal tax account would be highly beneficial. Potentially that might also include recording expenditure disallowed as capital in the rental profits computation as submitted in the SA return.
- 13.2** The share-pooling rules across different holdings held by multiple investment managers can provide time-consuming difficulties, for instance if an individual holds share portfolios with both HSBC and Barclays (say) and their portfolios with them both include shares in the same company (say Diageo). It can cause complications because when HSBC (say) dispose of the Diageo shares, the disposal may be part of a pool also including the Diageo shares in the individual's Barclays' portfolio. This causes issues – not least for banks in preparing proper tax packs. It would be fairly easy to solve this issue by simply treating them as separate pools where they are held by different nominees.

14 The Chartered Institute of Taxation

- 14.1** The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

9 November 2020

Appendix 1**Land pooling - alternatives for a longer term solution**

Alternatives for a longer term solution include

- Principles-based legislative drafting
- a tax advantaged 'land-pooling' vehicle
- a series of dedicated reliefs

There are pros and cons in each case, as examined briefly below.

Principles-based legislative drafting

By definition principles-based drafting requires a clear statement of the underlying principle that captures all the intended outcomes in a particular context. The principle to be formulated here is that transactions which are structured differently from a model options-based sale (the traditional development model) principally to accommodate a patient capital based pooled balanced development approach, should enjoy a comparable tax treatment.

The aim would be to provide a legislative framework setting out high level principles for the taxation of 'strategic' land pooling (that is, above a certain size, perhaps to be certified by planning authorities). Provided that the overall effect of arrangements is simply to allow landowners to equalise proceeds from their land, then HMRC would be able to grant them such reliefs as would put them in the same tax position that they could have achieved via the conventional un-pooled model provided that was consistent with parameters of the legislative framework. The tax reliefs or exemptions would vary depending on the circumstances of the landowners.

It would require the taxpayers/landowners broadly to cover HMRC costs through payment of a fee.

Pros

- No collateral damage to the wider tax code;
- Tax reliefs/exemptions granted can reflect wider housing policy
- Flexibility to encompass varied circumstances of ownership
- May prove a model for better tax legislation avoiding a 'black-letter' approach¹⁵ that is more open to exploitation and adds complexity.
- Principles-based drafting here might serve as a model for other areas of the tax code.
- Payment discourages speculative applications

¹⁵ The 'black - letter' approach is drafting provisions in a prescriptive technical way that is open to the criticism that taxpayers are able to exploit technical gaps in the wording of the provisions and thereby avoid their operation.

Cons

- Dependant on the exercise of discretion/negotiation by HMRC albeit within a defined framework and set of principles
- Principles- based drafting is relatively untested in the UK in terms of legislative drafting and in the courts
- Mechanism may be required for resolving disputes on points of interpretation during the negotiation process
- Probably initially excludes smaller schemes (although would be capable of being extended if successful)
- Payment for a form of clearance may create an undesirable precedent.

A tax advantaged 'land-pooling' vehicle

Pros

- Specifically designed for land pooling thereby providing the optimal tax treatment across the taxes without collateral damage to the wider tax code.
- There is precedent in the tax system for tax advantaged property vehicles eg the UK real estate investment trust (REIT) regime (for qualifying property rental businesses and their shareholders), Property authorised investment funds (PAIFs) (open-ended investment companies that invest in real estate)

Cons

- Complexity of design in terms of covering all the taxes for example extending or mirroring APR for IHT as well as deferring or rationalising CGT A tendency to hedge such vehicles with so many conditions that in practice usage is relatively low.
- The use of a separate vehicle raises the question of tax charges on entry and on un-winding in the event that the development does not proceed.
- Inevitable questions of why existing vehicles (such as REITs) do not already facilitate pooling.

Dedicated reliefs

This approach would require various new reliefs (mainly CGT and IHT, possibly SDLT, income tax, corporation tax and stamp duty) or amendments to existing reliefs.

Pros:

- Certainty in terms of a statutory basis for the reliefs

Cons:

- Extensive changes to the statutory codes of the main taxes with the consequential addition of significant complexity
- Drafting challenges in needing to meet a multiplicity of circumstances
- Runs the risk of not covering all relevant taxes
- Possible unintended consequences – potentially opening new loopholes for other situations, leading to the need to hedge the reliefs with restrictions and anti-avoidance conditions making their application as problematic as the status quo.