

Briefing document

Office of Tax Simplification review of taxation of capital gains

Introduction

On 13 July 2020 Chancellor Rishi Sunak wrote to the Office of Tax Simplification (OTS) and asked it to conduct a review of how individuals and small businesses are taxed on capital gains. The Chancellor specifically asked the OTS to “*identify and offer advice about opportunities to simplify the taxation of chargeable gains, to ensure the system is fit for purpose and makes the experience of those who interact with it as smooth as possible*”.

While the OTS are considering the operation of the system of chargeable gain taxation as a whole, at the Chancellor’s request the review will specifically consider administrative and technical issues and areas where the present rules can distort behaviour or do not meet their policy objectives. The Chancellor is particularly interested in hearing OTS proposals on the regime of allowances, exemptions, reliefs and the treatment of losses, and the interactions of how gains are taxed “*compared to other types of income*”.

The OTS will not be considering residence and domicile issues, nor will they be considering the tax position of trustees.

While changes could be made to the taxation of chargeable gains following the review, it should be noted that the remit of the OTS as borne out by the Chancellor’s letter for this review is to suggest simplifications: not to suggest ways in which the government could raise revenue.

OTS review

The OTS will consider both Capital Gains Tax (CGT), which applies to individuals, and corporation tax on chargeable gains (for brevity, the OTS collectively refer to both taxes as CGT and we do the same in this note). As the first step in conducting their review, the OTS have published a call for evidence. The OTS seek evidence in two stages:

1. The principles of CGT, with a deadline of 10 August 2020. The OTS plan to use these comments to “*help shape the balance of the work*” and may use this as a basis to provide an interim update on their review.
2. Detailed comments on the technical detail and practical operation of CGT, with a deadline of 12 October 2020.

The OTS is an independent office of HM Treasury which gives advice to the government. The government could choose to implement all, some or none of any recommendations made by the OTS. No date has been given for when any changes could be announced, though it is possible that the Chancellor may announce that some of the proposals made by the OTS are to be put forward for consultation in the Autumn Budget (date to be announced).

Principles of CGT

In the first part of the call for evidence, the OTS specifically seek comments on the following:

- Allowances, including the annual exemption and ways in which they distort decision making.
- Exemptions and reliefs, including how they fit together and the way in which they incentivise some decisions over others.
- Losses, including how losses can be used and potential distortions of decisions about whether to buy or sell assets.
- The interaction of how capital gains are taxed compared to “*other types of income*”, including the boundary between what is taxed as income or as gains, and whether short-term and long-term gains should be subject to different regimes.

Detailed comments

In addition to requesting more detailed comments on the areas listed above, the OTS also seek comments on the following:

- The overall scope of CGT and the various CGT rates, reliefs, exemptions and allowances that can apply.
- The position of individuals, partnerships, estates in administration, unincorporated businesses (including the setting up, selling or winding up of such businesses) and stand-alone trading or investment companies. The OTS will not be considering and do not seek comments on group structures or large companies.

- Any distortions to taxpayers' personal or business investment decisions.
- Interactions with other taxes (more detailed comments on this point are included below).

Key points of interest

Some key points of interest in the OTS call for evidence are set out below.

The boundary between income tax and CGT

- The OTS ask whether there are any particular issues around the boundary between income tax and CGT. The examples they give are of the boundary between trading and investment, and around shares or share rights received by employees.

Annual exemption

- The OTS seek comments on whether the annual exemption encourages individuals or agents to maximise its use in order to manage down their tax liabilities, and whether there could be a simpler or more targeted method of exempting small gains.

CGT rates

- The OTS ask whether it is always clear which of the four different CGT rates that can apply to individuals should apply, whether the different rates cause complexity, whether CGT rates could be simplified, or whether complexity is inevitable where rates are linked to income tax thresholds.

Reliefs and exemptions

- The OTS note that reliefs and exemptions serve various purposes: simplifying taxation by taking small gains out of the tax system, protecting revenue through disallowing capital losses (e.g. on cars) or supporting an asset class (e.g. main homes).
- Private Residence Relief (PRR) removes most or all of the capital gains on disposal of only or main homes from CGT. The OTS ask what complications arise in this area, potentially relating to more modern lifestyles, whether the details of the rules are consistent with the aims of PRR, and, whether administration can be improved where an individual can nominate which available residence is his or her main home.
- Chattels are exempt from CGT where they are acquired for and disposed of for less than £6,000. Chattels are tangible moveable property such as paintings. The OTS ask whether or not taxpayers are aware that significant gains on chattels are taxable, and also asks whether there are any ways in which the taxation of chattels could be simplified.

Business owners and investors

- The OTS ask if CGT creates any barriers or distortions in the key stages of the business lifecycle, including start-up and incorporation, financing for growth, succession, disposal and/or cessation, and whether these rules could be simplified.
- Evidence is also sought on complications or rules that unduly affect the ways in which businesses operate where a business is sold other than for cash, and whether there is a tension between claiming a tax relief at the point of sale and deferring the tax charge until cash is received.
- Various questions are posed about the reliefs available to business owners and shareholders, such as business asset disposal relief (previously called entrepreneurs' relief) and the Enterprise Investment Scheme (EIS). The OTS ask whether the scope of the various reliefs available is intuitive, whether there are practical differences between them that pose problems for businesses and whether there are any points that are unclear or particularly difficult to utilise in practice.
- The OTS also ask whether there are any aspects of the CGT rules that distort decision making, such as around business structure, choice of business vehicle and, where reliefs are concerned, the timing of asset disposals or cash retention.
- Finally, the OTS ask if gift relief (holdover relief) should be extended to a wider range of business assets and investments. Gift relief enables business assets to be given away or sold for less than market value without the donor/vendor being charged to CGT in certain circumstances.

Interaction with Inheritance Tax (IHT)

- The OTS previously published a report on IHT simplification, which commented that the interaction between IHT and CGT can distort decision making, particularly when the decision relates to how and when to pass assets to the next generation. The CGT call for evidence refers to the previous IHT report, and asks whether the CGT-free uplift of the value of assets on death distorts decision making.
- The OTS also ask whether there are any other aspects of gifts or other disposals below market value that would benefit from being simplified, and also asks about the impact of a potential extension of holdover relief in this context.

Interaction of CGT with other taxes

- Evidence is sought on whether particular complexity or difficulty arises when CGT interacts with other taxes. Specific reference is made to income tax, particularly in the context of employment related securities, stamp duty land tax, corporation tax, and capital allowances.

Partnerships

- The OTS ask whether there are any areas of complexity related to partnerships.

Administration, tax payments, record keeping and valuation

- Evidence is sought as to ways in which the above mentioned areas could be simplified and improved for taxpayers, how administrative burdens could be reduced and compliance by individuals and businesses ensured.
- The 30 day reporting and tax payment requirements that may apply when UK land is disposed of are specifically referenced, as the OTS are interested to hear of any problems either experienced or anticipated in this area.
- The OTS also ask about any difficulties with and potential improvements to valuing assets at either acquisition or disposal. Notably, the OTS ask whether changing to a CGT rebasing date more recent than 1982 would make finding the base cost of assets easier, or whether any such benefit would be outweighed by the number of valuations that would then be required.

Find out more...

This note reflects the law in force as at 15 July 2020, and the OTS CGT simplification call for evidence published on 14 July 2020. The call for evidence can be viewed at <https://deloi.tt/3fxvGbE>. Please be aware that this note does not cover all aspects of this subject. To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Michelle Robinson (michellerobinson@deloitte.co.uk).

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