Law Society of Scotland

Consultation Response

Taxing gains made by non-residents on UK immovable property

February 2018

Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

The Society's Tax Law Sub-committee welcomes the opportunity to consider and respond to the HMRC consultation: Taxing gains made by non-residents on UK immovable property. The Sub-committee has the following comments to put forward for consideration.

Specific comments

Question 1) Are there any issues specific to non-residents when considering how they fit into the UK definitions of persons chargeable to UK tax (CGT or CT)?

HMRC will require to clarify the UK tax treatment of a number of overseas entities which do not have an equivalent under UK law. An obvious example would be a Limited Liability Company (LLC); would it be transparent for these purposes with any gain being charged upon its members (subject to any available exemption) or would the LLC itself be the taxable person? Notwithstanding the *Anson v Revenue and Customs Commissioners,*[1] HMRC still maintain a case-by-case approach to LLCs. This causes uncertainty for the investor and the adviser which in turn will lead to looking at alternative jurisdictions in which to invest.

[1] [2015] UKSC 44

Question 2) Do you see any issues or complications arising with respect to rebasing which need to be addressed?

It seems unfair that rebasing is the only method allowed for the computation of indirect disposals. We would be interested to know the justification for this. If a loss arises using the acquisition cost but a gain arises on rebasing to April 2019, while it would be preferable for the seller to be able to recognise the actual loss, at the very least, no gain should be treated as arising.

Question 3) Do you agree with the basic principle that gains on direct disposals within these new rules should be computed using the same computational rules as other chargeable gains?

Yes, that is a sensible approach.

Question 4) Further to the specific modifications identified, are any other changes needed to recognise differences in how the tax system applies to non-residents?

We do not have any further specific changes to suggest.

Question 5) For businesses: Will the proposals for direct disposals mean that your company will now be required to register for UK CT?

It is unfortunate that this change is not running in parallel with the changes to the non-resident landlord scheme as, in 2019 at least, it will potentially require the non-resident entity to complete both an income tax return in respect of rental income and a corporation tax return in respect of any disposal. It would be preferable to dovetail these changes such that both apply from April 2020.

Question 6) For businesses: Will the proposals for direct disposals lead to an increase in your administrative burdens or costs? Please provide details of the expected one-off and ongoing costs.

While unable to provide estimates of the actual increased costs, these proposals will undoubtedly increase clients' administrative burdens and costs as a result of the compliance steps they will be obliged to undertake.

Question 7) For individuals: Will the proposals for direct disposals mean that you will be required to pay Capital Gains tax for the first time?

The proposals will undoubtedly mean that some non-resident individuals will be required to pay capital gains tax for the first time.

Question 8) Do you consider that the rules for indirect transactions are fair and effective?

The requirement that funding, even if secured on the property, is disregarded in calculating the value of the property could lead to situations where genuine trading companies are treated as “property rich” when it would normally not be appropriate to regard them as such but where the “trading” test for Substantial Shareholdings Exemption (SSE) cannot quite be met.

There will be particular issues around goodwill – for SDLT/LBTT “inherent goodwill” is regarded as running with the property and as a result taxable; will it be the same for this calculation or will goodwill be ignored altogether?

Particularly in Scotland, will large items of plant and machinery eg. wind turbines or solar panels be regarded as “property” for these purposes or will they be ignored as part of the equipment of the trade?

It is noted that the SSE rules, as expanded, will apply. However, will this be only available where the foreign entity being sold has share capital or as noted at answer one above, will consideration be given to extending SSE to equivalents in those foreign jurisdictions?

The 25% interest test is also in need of refinement. Given the five year lookback period it is important that relief from the charge is given to the initial founders of the entity in circumstances where it has subsequently become funded through seeding from other unconnected parties – a fairly common investment fund model. Although the founders holding may now be dwarfed by the investor, they will be subject to this charge by virtue of their initial holding. That seems unjust.

Also, the general connected persons rule would have an adverse effect on any single partner of a Scottish Limited Partnership, Limited Liability Partnership or general partnership – their holding would be aggregated with those of the other partners even if not otherwise connected. This provision should be switched off for these purposes.

Question 9) Are any other conditions necessary to ensure the policy is robust in meeting the objective of taxing non-residents on gains on indirect disposals?

No comment.

Question 10) For businesses: Will the proposals for indirect disposals mean that your company will now be required to register for UK CT?

See answer five above.

Question 11) For businesses: Will the proposals for indirect disposals lead to an increase in your administrative burdens or costs? Please provide details of the expected one-off and ongoing costs.

See answer six above.

Question 12) For individuals: Will the proposals for indirect disposals mean that you will be required to pay Capital Gains tax for the first time?

See answer seven above.

Question 13) Do you consider that it is right to harmonise ATED-related CGT given the changes proposed in this document?

Yes it makes sense to have one system applying across the board. Our preference would be to see the abolition of pre-2015 ATED gains charges. The complexity of the system is disproportionate to the tax it raises.

Question 14) Are there any issues, risks, or complexities created by harmonising the ATED-related CGT rules in the manner proposed, and how can these be addressed?

No. See answer 13 above.

Question 15) For businesses: Will the proposals for disposals of residential property mean that your company will now be required to register for UK CT?

See answer five above.

Question 16) For businesses: Will the proposals for disposals of residential property lead to an increase in your administrative burdens or costs? Please provide details of the expected one-off and ongoing costs.

See answer six above.

Question 17) For individuals: Will the proposals for disposals of residential property mean that you will be required to pay Capital Gains tax for the first time?

See answer seven above.

Question 18) Do you agree with the general approach to ownership of non-residential property through CIVs outlined above?

It seems to create an uneven playing field between exempt funds investing individually and those investing collectively through a non-resident collective investment vehicle (CIV). It should not do so. Similarly, it is not clear if an exempt foreign fund investing through a UK based CIV will be disadvantaged in comparison to a UK exempt fund, but it should not. Further clarification would be helpful.

Question 19) Will the proposals for CIVs mean that you will now be required to register for UK tax?

No comment.

Question 20) Will the proposals for CIVs lead to an increase in your administrative burdens or costs? Please provide details of the expected one-off and ongoing costs.

See answer six above.

Question 21) Are there changes needed to the rules for CIVs, particularly around exemptions, to ensure a robust system of taxing non-residents on gains on disposal of interests in UK property?

See answer 18 above. We would also query whether the "qualifying institutional investor" status for SSE is sufficiently drawn to cater for offshore entities which a broadly similar to but not exactly the same as their UK counterpart.

Question 22) Are there any specific circumstances where the treatment of gains on non-residential UK property should be different to the treatment of gains on UK residential property in the context of a CIV?

Not that we are aware of.

Question 23) Do you have any further comments on the taxation of gains on non-residential UK property held through CIVs?

No comment.

Question 24) Do you foresee any difficulties with the reporting requirements for the seller?

As the recent First Tier Tribunal cases on Non-Resident Capital Gains Tax reporting failures indicate,[2] there is likely to be a significant lack of awareness and understanding of these changes. There will need to be an extensive publicity campaign by HMRC to raise awareness with foreign investors.

Question 25) Do you foresee any difficulties with the charge on the UK group company?

This provision is more widely drawn in that it will seek recovery from a UK representative, which could mean a third party, outside the group is responsible. We would prefer to see it restricted to a group company or permanent establishment of the seller.

[2] See, for example *Jackson v Revenue and Customs Commissioners* [2018] UKFTT 64; *McGreevy v Revenue and Customs Commissioners* [2017] UKFTT 690; and *Hesketh v Revenue and Customs Commissioners* [2017] UKFTT 871.

Question 26) Do you agree with the proposal to use the normal CT Self-Assessment framework?

Yes.

Question 27) Will the proposed information and reporting requirements lead to an increase in your administrative burdens or costs? Please provide details of the expected one-off and ongoing costs.

See answer five above.

Question 28) For third-party advisors: what is the best way to ensure the proposed information and reporting requirements do not lead to an undue increase in your administrative burdens or costs? Please provide details of likely one-off and ongoing costs in respect of any options or proposals.

This proposal is of great concern given its current form – will all advisers in a transaction be under this obligation or only those acting for the seller? Given even that is unlikely to be one single firm, who among the seller's advisers should have responsibility? How does a UK based adviser on, for example, due diligence, get to know if and when (i) there has been a the indirect disposal of an offshore entity (ii) it was property rich and (iii) any party had a 25% interest in it. Often the UK adviser will have a very small part to play in the overall deal and will have no knowledge of the overall deal far less its timing. These obligations will add proportionately massive costs to the fees such advisers would otherwise charge. They are verging on unworkable in all but the simplest of cases.

Question 29) What channels and methods should HMRC use to raise awareness of this change in the law, to ensure that affected non-residents will know that they are impacted?

All available media should be used to raise awareness of the changes. See also answer 24 above.

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