Katten

TAX ADVISORY

Putting the ‘S’ in OTS: UK Capital Gains Tax

June 25, 2021

In the last six months, the Office of Tax Simplification (OTS) has published two reports evaluating the effectiveness of the capital gains taxation system in the UK. These reports suggest amendments to the existing system. This article discusses the journey of capital gains tax (CGT) in the last year and provides commentary on the expected future of CGT.

Undoubtedly, 2020 has put a strain on the UK’s finances. Therefore, Chancellor Rishi Sunak will be keen to ensure that the government recoups some of the money spent during the COVID-19 pandemic. According to the Institute for Government, the deficit is estimated to be £394bn in 2021, which is £339bn higher than had been anticipated before COVID-19 restrictions were first imposed back in March 2020[1]. In addition, tax revenues are forecasting to be lower than was originally expected in March 2020. In particular, CGT will likely provide 29 percent less revenue this year than was initially estimated at the beginning of the pandemic in March of last year[2]. Although, it is worth mentioning that CGT is not the only tax to underperform, as business rates are expected to provide 39 percent less revenue and stamp duty land tax to provide 34 percent less revenue than was anticipated in March 2020.

These statistics provide some context to explain the comments from Chancellor Rishi Sunak in July 2020, when he encouraged the OTS to focus on ways to change the CGT system: *“I would like this review 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. In particular, I would be interested in any proposals from the OTS on the regime of allowances, exemptions, reliefs and the treatment of losses within CGT, and the interactions of how gains are taxed compared to other types of income.”*

First OTS Report — November 2020

The suggestion of the Chancellor to compare CGT and income tax was taken on board by the OTS, who consequently recommended that the rates of CGT should be closely aligned with those of income tax. This, the OTS considered, would remove some of the incentive for people to seek to characterise certain receipts as capital gains rather than income, or to favour activities and investments that generate capital gains rather than income.

A way to achieve this alignment, the OTS said, is for the government to consider reducing the number of CGT rates to two (there are currently four). There is indication that the two rates of CGT to be removed are likely to be the two basic rates.

The OTS also turned its attention to share-based remuneration. The report recognised the desirability of certain employee share schemes and specifically drew attention to growth shares, where any profit on the sale of the shares is subject to CGT rather than income tax, whereas profits from other conceptually similar arrangements such as share options are taxed as income.

Furthermore, the OTS recommended that business asset disposal relief (BADR) and investors’ relief be abolished.

---

1 Institute for Government: https://www.instituteforgovernment.org.uk/explainers/cost-coronavirus

2 Ibid

In the case of BADR, the OTS recommended that it be replaced with a relief more focussed on retirement and suggested the government consider:

- increasing the minimum investment to 25 percent;
- increasing the holding period to 10 years; and
- re-introducing an age limit, perhaps linked to age limits in pension freedoms.

As for investors' relief, the OTS considered that there is little evidence of people using this relief and consequently recommended that it be abolished. It is worth noting that this relief was only introduced in 2016 and the first year in which qualifying disposals might have taken place is the 2019/2020 tax year; therefore, there has not been much opportunity for people to use the relief.

As a result of the financial upheaval of 2020, there was a general consensus that CGT was likely to change and there was commentary recommending that transactions be pushed to complete before CGT rates increased. Nonetheless, no such change came.

Second OTS Report — May 2021

The OTS' May report focused more on practical and administrative issues as well as topics such as raising awareness about when and how taxpayers pay CGT and increasing the 30-day window for filing a non-resident CGT return to 60 days.

However, from a business perspective, there was a key suggestion from this report that CGT should be charged on a 'receipts' basis. This would be applicable to situations where the proceeds of a sale are deferred and would mean that tax is paid when the proceeds of a sale are actually received. The OTS argued that the current system, which requires tax to be paid on an estimate of future proceeds, is not intuitive and may result in tax being paid on future proceeds that are never realised (even though there would be some form of tax or capital loss adjustment to reflect this). As a result, the OTS expressed concerns that a system which allows for payment of tax on future proceeds may result in distortion and push taxpayers away from arrangements that make the most commercial sense in order to take advantage of tax on deferred proceeds. This suggestion seems somewhat at odds with the main points of the first OTS report. The first report was clearly focused on ways to receive more tax revenue from the CGT system. Yet, the second report proposes a method of tax calculation that would bring in less revenue in the short-term as the payment of tax would not be required until the entire proceeds of sale were received. Compared with the current system which facilitates payment of CGT immediately even if the amount has to be adjusted as the future proceeds are realised.

Some of the other suggestions from the second report included:

- calculating gains or losses on foreign assets in the relevant foreign currency and then converting into sterling at the exchange rate on the date of disposal; and
- simplifying the process for applying for the Enterprise Investment Scheme.

What Does All This Mean?

Over the last year, CGT has received a lot of attention from both the government and the OTS. Many people predicted last year that there would be a rise in CGT but the expected increase did not happen.

It is quite likely that there will be some change to the CGT system this year, as it is was purposefully highlighted by the Chancellor. Indeed, this year may be the year for higher CGT rates. Nevertheless, it is worth considering that the CGT changes may not be one-dimensional. It is clear from the extensive commentary from the OTS that there are a myriad of ways in which the CGT system could be changed and there are definitely strong suggestions, particularly in the first report, that the rates might be increased. But arguably the OTS commentary is multi-faceted. For example, the critique of the deferred proceeds system points to the fact that the OTS is not solely dedicated to finding ways to gather as much revenue as possible, as fast as possible, from capital gains. Maybe the OTS reports should not be viewed as a call for increasing tax proceeds of capital gains, but actually as a request to make the system of CGT a bit, well, simpler.

One could consider that the words of the Chancellor in July 2020 are a hint that the CGT system will change to become a system that is very closely comparable with income tax. Even so, caution against tunnel vision as the changes to CGT may be less straightforward than a simple rise in CGT rates.

CONTACTS

For more information on CGT, contact your Katten lawyer or either of the following:

Charlotte Sallabank
+44 (0) 20 7776 7630
charlotte.sallabank@katten.co.uk

Christy Wilson
+44 (0) 20 7770 5241
christy.wilson@katten.co.uk