

SUMMARY OF REPLIES TO CGT SIMPLIFICATION CONSULTATION

Introduction

1. This document summarises the responses to the recent consultation on ways to simplify capital gains tax (CGT), and gives the Government's response to the suggestions (starting at page 3). Before doing so, the document

- describes the consultation process, and
- provides details of the areas where the Government has committed itself to action on the points raised.

A contact point for information is shown at the end.

Process

2. In the 18 June 2001 *Enterprise for all* announcement, the Government said that it would "also consult whether there are worthwhile and good value for money options to simplify Capital Gains Tax within the existing policy framework". The press notice is available from HM Treasury's website, at

http://www.hm-treasury.gov.uk/Newsroom_and_Speeches/Press/2001.

3. 24 responses were received; eight from firms, five from individuals, and eleven from organisations or representative bodies. Meetings were held with the CGT Review Group of representative bodies to discuss their ideas further. A list of the members of the Review Group can be found at Annex A. The Government is grateful for the time and effort that the Review Group and those who responded to the request for views have devoted to this consultation.

4. Although an attempt was made to establish estimates of the compliance costs or savings of the various suggestions, in the absence of firm data this has not proved to be possible.

The Government's Proposals for Change

5. Some of the suggestions concentrating on additional reliefs and changes were outside existing policy. Those suggestions which Ministers have decided to implement (subject to legislation) comprise (and are described more fully in Inland Revenue Budget Note CGT Simplification):

- *Employee share disposals* – allowing employees who dispose of shares with a common date of acquisition, acquired under different share schemes, to choose to sell first those with an income tax liability and normally no CGT charge.
- *Incorporation relief* – making the relief that defers CGT when a business incorporates elective, to reduce the risk of people being caught out by unexpected offers to buy the company and thus facing a higher tax bill than expected because they have not yet accrued full taper relief on the shares.
- *Treatment of Securities* – certain loan notes that are securities for certain purposes in CGT will also be treated as securities for taper relief, and will benefit from business assets taper relief where appropriate.

- *Corporate Restructuring* – to incorporate into legislation the existing CGT treatment of corporate restructurings detailed in an IR Statement of Practice.
- *Settlor-interested trusts* – causing personal losses to be set against most amounts attributed to settlors in respect of gains of settlor-interested trusts.
- *Ensuring certain trading losses are set against the full value of capital gains* – instead of some losses being (unnecessarily) carried forward.
- *Changing the definition of a holding company* – this change will allow more shares in parent companies of trading groups to qualify for business assets taper relief.
- *Aligning the definition of trading company and trading group* - the definition of a trading company or trading group will be aligned with those used for the exemption of gains and losses on substantial shareholdings.
- *Joint Venture Companies (JVCs)* – certain corporate holdings in JVCs do not count as investment activities for taper relief. The existing requirement that 75% of the shares are held by five or fewer companies will be replaced by a requirement that they be held by five or fewer persons. The minimum holding in a JVC will be reduced from 30% to 10%. The taper relief definition of ‘joint venture company’ is being aligned with that used in the exemption for gains and losses on substantial shareholdings, and a corresponding change is being made to the taper relief definition of “joint enterprise company”.
- *Anti-avoidance* – the existing taper relief anti-enveloping provision will be repealed and a new provision will ensure that periods when a close company is not active do not count for taper relief.
- *Interests in shares* – introducing a definition for interests in shares for taper purposes to align with the definition being introduced in the exemption for gains and losses on substantial shareholdings.
- *Instruments of Variation* - removing the requirement to send an election to the Inland Revenue to make variations of wills effective for CGT and Inheritance Tax.

6. The Government is committed to continuing to investigate opportunities to simplify CGT. The Inland Revenue is continuing, without prejudice, to explore further areas where changes have been suggested. These include:

- *Holding periods* – particularly for those involved in monthly share schemes.
- *Excluding certain foreign currency transactions from CGT* - in certain cases it can be complex to calculate gains and losses arising on transactions in foreign currency, for example, where frequent deposits and withdrawals are made into and out of a bank account.

Because of the continuing nature of this work, the Inland Revenue is inviting members of the CGT Review Group to continue to contribute.

Summary of responses

(a) Taper Relief: Apportionment

Background

Taper relief reduces the amount of gain charged to tax the longer an asset has been held. There are different rates of taper relief for business assets and for non-business assets. Where an asset has been both a business asset and a non-business asset (owing to a change in status and/or mixed usage) the gain on disposal may need to be apportioned to reflect that split.

Proposals

Various suggestions were put forward to reduce the effect of apportionment as a result of the changes that were made to the definition of a business asset in Finance Act 2000.

Also mechanisms have been suggested to allow business asset treatment to be retained when the status of an asset is changed as a consequence of a specific event e.g. an unlisted company listing on a stock exchange.

Government response

The Government is not attracted to any of these suggestions. Taper relief is intended to be more generous for business assets. Backdating the effect of legislative change would be costly and give an unexpected benefit for past events, without any incentive effect for the future. And for future events, the Government's view is that it is right that taper relief should change, with consequent apportionment, if an asset changes its status.

(b) Rebasing / Indexation

Background

Assets held before 31 March 1982 are generally rebased to that date, ensuring that only an increase in value after that date is taken into account when working out the chargeable gain. For periods of ownership between that date and April 1998 indexation allowance is available when calculating the chargeable gain. The amount of indexation allowance depends on the date of acquisition and the subsequent movement in the Retail Price Index. Taper relief is available for periods from 6 April 1998.

Proposal

Various suggestions were made: rebasing to 1998; removing indexation for pre-1998 periods and replacing it with a taper; reversing the introduction of taper relief.

Government response

The Government is not attracted to any of these proposals. Rebasing to 1998 would be extremely costly with no incentive benefit. Taper relief was introduced in 1998 with indexation frozen at that date. The Government remains of the view that that was right.

(c) Non-business Asset Taper Relief

Proposal

Various suggestions were made regarding the non-business assets taper, most of them designed to change it to favour the investor in non-business assets – whether by making it shorter, the end-point more generous, or moving the defining line between business- and non-business- assets.

Government response

While some of these proposals have a simplification element, they are fundamentally proposals for further relief. As announced in the Budget, the Government is continuing to consider the case for changes to the CGT regime for non-business assets to encourage investment, in line with the productivity agenda.

(d) Taper Relief: Anti Avoidance Provisions

Proposal

Modify or abandon paragraphs 10 – 12 of Schedule A 1 to the Taxation of Chargeable Gains Act 1992. These paragraphs provide anti-avoidance provisions to protect taper relief against unfair exploitation

Most of the proposals for change related to paragraph 11 which, it was felt, had been too widely drawn and could interfere with some bona fide commercial transactions.

Government response

As these paragraphs are anti-avoidance measures, they cannot be scrapped altogether without reopening the possibility of tax avoidance. However, the Government has decided to replace paragraph 11 by a more closely-targeted provision (see paragraph 5 above).

(e) Taper Rates

Background

Taper relief is applicable to holding periods from April 1998. In general terms, the longer the asset is held, the smaller the part of the gain on which CGT is chargeable, down to a certain minimum.

Proposal

One proposal was to make the highest taper rates provide 100% relief, so that for assets held for a long enough period, no tax is payable on any part of the gain.

Government response

Complete relief on all gains held for a certain length of time is against the principle of taxation of gains – the Government believes that it is fair that all those who make substantial gains on a disposal should incur some CGT liability.

(f) Partnerships and Taper Relief

Proposal

For a partnership, the value of the goodwill owned by each partner changes each time a partner joins or leaves the partnership. It would make the calculation of chargeable gains easier if an individual partner's goodwill could be treated as a single asset, with the taper relief running from the date that the partner first joined the partnership.

Government response

The proposed simplification to partnership CGT calculations appears to have some merit. The Inland Revenue is considering how best to implement an improvement.

(g) Share Identification Rules

Background

Shares of the same class in the same company are fungible. Rules exist to determine which of the shares are treated as disposed of for CGT purposes in any transaction, the basic principle being 'last in – first out' (LIFO).

Proposals

Various proposals were put forward: change to FIFO (first in – first out); allow taxpayers free choice; change the rules for shares acquired on the same day; introduce a form of pooling compatible with taper relief.

Government response

The Government is not attracted to changing the identification rules generally. The benefits of an alternative approach are not seen as sufficiently great to justify the compliance costs in making a change.

However, the Government does accept that for shares acquired on the same day, it makes sense to allow an employee to have an element of choice in deciding which shares should be treated as sold (see paragraph 5 above).

More investigation is needed to see if simplification can be produced for shares bought under a monthly share purchase scheme.

(h) Trading Companies, Holding Companies, Trading Groups

Background

For non-employee investors, shares will only be business assets if they are shares in trading companies or the holding company of a trading company group. A trading company is one whose purpose is wholly trading or would be apart from purposes capable of having no substantial effect on the extent of the company's. Tax Bulletin 53 in June 2001 gave guidance on the definitions, in particular on the meaning of 'substantial'.

Proposals

Various suggestions: clarification of the definitions; regularise the position of holding companies; change to a company being trading if it is mainly (in excess of 50%) trading.

Government response

The Government is responding to clarify the definitions and ensure that holding companies can qualify in appropriate circumstances. However, the Government is not prepared to relax the definition of trading company to one that is only 50% trading.

(i) Annual Exempt Amount

Background

The CGT annual exempt amount (AEA) saves taxpayers and the Inland Revenue from having to account for large numbers of small gains. If a taxpayer's gains (net of losses allowable for set-off) within the year total less than the AEA then no CGT is payable. The proposed AEA for the year 2002-2003 is £7,700 for individuals and £3,850 for most trusts.

Proposals

Increase the AEA; allow it to be cumulative; have an AEA based on proceeds.

Government response

The Government is not attracted to any of these proposals. Although increasing the AEA would remove some people from CGT, it is not really a big simplification of the system. There are significant difficulties with a cumulative AEA: computing minor gains in order to determine the balance that could be carried forward from a year. A proceeds-based AEA looks superficially attractive, but defining which proceeds to include would involve making complex rules. And to avoid unacceptable 'cliff- edges' it would be necessary to retain the gains-based AEA.

(j) Losses

Background

Where an allowable loss has been realised rather than a chargeable gain, this loss can generally be offset against chargeable gains in the same or subsequent years. Taper relief is applied to chargeable gains after the deduction of allowable losses.

Proposals

Various suggestions were made: current year losses should be used only to reduce gains to AEA; loss relief should be made elective; taper losses; ensure that the loss relief rules work appropriately when trading losses are set against gains.

Government response

Using up current year losses only to reduce gains to the AEA is not a simplification, and would involve a cost to the Exchequer.

Making loss relief elective would further complicate CGT, requiring further records to be kept and analysis to be performed. Tapering losses would present the taxpayer with a further calculation to perform, as well as a decision as to which taper is applicable, and so would be a complication rather than a simplification.

The Government is amending the way in which the amount of trading losses to be offset against gains is worked out (see paragraph 5 above).

(k) Securities

Proposal

A suggestion was made that certain debentures acquired in share exchanges should be regarded as securities qualifying for business assets taper relief.

Government response to proposal

The treatment of securities is being addressed as mentioned in paragraph 5, in order to align definitions more closely.

(l) Let Property

Background

Let property is a business asset for taper relief if it is used by a person's qualifying company for the purposes of a trade.

Proposal

All let property, or all let property used for a trade, should be a business asset for taper relief.

Government response

Making all let property – or none – a business asset would be a simplification. But the benefit of a tax cut might be poor value for money. The Government is therefore not minded to make a wide-ranging change in order to simplify CGT. However, the Government is committed to looking further at non-business assets, including let property.

(m) Taper Relief and Deferral Relief

Background

On certain transactions, no CGT is payable immediately. Instead the tax may be deferred to a later disposal. Normally, accrued taper relief is lost.

Proposal

Taper relief should run through when deferral reliefs apply.

Government response

The Government's view is that it is right that the taper should restart when a new asset is acquired and when an asset is transferred to a new owner, even if reliefs apply to defer the charge. Nor would it be a simplification to make the taper period continuous. The Government has decided on a different approach to help improve the workings of Incorporation Relief, as mentioned in paragraph 5 above.

Other Suggestions

Various other suggestions were made by individual contributors. Some not discussed above include: the abolition of CGT; increasing the chattels limit; a single flat rate of charge; exemption of gains if the total value of shareholdings is less than £100,000. The Government was not attracted by any of these proposals.

Contact

Enquiries regarding the consultation, and requests for copies of the contributions not designated as confidential by the respondents, should be addressed to:

Mrs Mary Duff
Inland Revenue
Capital and Savings
Room 121, New Wing
Somerset House
London
WC2R 1LB

e-mail Mary.Duff@ir.gsi.gov.uk

Although the deadline for this consultation has passed, the Government continues to welcome ideas on the simplification of CGT. If you wish to send in ideas, they should be sent to the above address. While it may not always be possible to give a personal response to such correspondence the ideas expressed will be taken into consideration during the formulation of any policy changes.

Annex A

CAPITAL GAINS TAX REVIEW GROUP: LIST OF MEMBERS

Association of Chartered Certified Accountants

Association of Investment Trust Companies

Association of Unit Trusts and Investment Funds

British Property Federation

British Venture Capital Association

Chartered Institute of Taxation

Confederation of British Industry

Federation of Small Businesses

Institute of Chartered Accountants in England and Wales

Institute of Chartered Accountants of Scotland

Institute of Directors

ProShare

Quoted Companies Alliance

Society of Trust and Estates Practitioners

The Law Society of England and Wales

The Law Society of Scotland