**The Office of Tax Simplification - Capital Gains Tax review – Call for Evidence**

**Consultation Response: Wedlake Bell LLP**

**Section 1: Principles of CGT**

Wedlake Bell LLP is a central London law firm whose history goes back over 230 years. It has 68 partners and is one of the top 100 firms in the UK on turnover.

The firm welcomes the opportunity to respond to The Office of Tax Simplification's ('**OTS**') Capital Gains Tax ('**CGT**') review - Call for Evidence dated 14 July 2020 (' **the Consultation Document**').

Wedlake Bell's response has been prepared by its Private Client team who have extensive experience of advising individuals, including business owners, Executors and Trustees, on CGT. The team is ranked in the Legal 500 (tier 3) and Chambers High Net Worth guide (Band 4). Wedlake Bell has been short listed for law firm of the year at the Citywealth Magic Circle Awards 2020 to be held in October.

**Scope of Consultation – Section 1**

The OTS would like to invite views on the principles of CGT including whether its scope and  reach in the context of the wider tax system continue to be appropriate. Respondents are encouraged to think broadly but asked particularly to consider the themes  identified in the Chancellor’s letter including:

* allowances, including the annual exempt amount, its level and the extent to which it  distorts decision making;
* exemptions and reliefs, including how they fit together and the extent to which they incentivise some decisions over others;
* the treatment of losses within CGT, including the extent to which they can be used and whether the loss regime distorts decisions about when to buy or sell assets; and
* the interactions of how gains are taxed compared to other types of income, including how the boundary between what is taxed as gains rather than income works; and
* should there be different regimes for short-term gains, compared to long-term gains?

**Response**

Given there are currently five different CGT rates which could apply for an individual realising a capital gain, there is a compelling case for reform and simplification. There is a vast array of rules and exemptions underlying the CGT system. Furthermore, as CGT and inheritance tax ('**IHT**') combined raise less than 1% of total tax revenue for the Treasury, but there is significant cost of administration for HMRC to manage collection, a single flat rate of CGT could both raise revenue and alleviate this expenditure, as well as simplify the regime for taxpayers.

**Rates of CGT**

We recognise that taxing unearned gains from wealth at lower rates than earned income from work has been criticised as unfair, however, the widespread proposal to tax capital gains at the same rate as income needs careful thought. Those who pay CGT are twice as likely to pay higher rate income tax and CGT can effectively be a form of double taxation as invested capital is likely to have originated from income that has been previously taxed.

Too high levels of tax can also disincentivise taxpayers from making taxable disposals and ultimately result in less tax being raised. Any changes to CGT rates will need to be balanced against the risk of inadvertently causing markets to stagnate due to too high tax rates rather than creating a tax incentivising economy which can lead to an increase in the tax take. The effect of the recent, albeit not permanent, reprieve in Stamp Duty Land Tax rates being a good example of how tax rates can stimulate a market.

**Principal Private Residence Relief**

According to the National Audit Office, the exemption for people’s main home was worth around £26.7bn in the year 2018-19. It is therefore logical that the Treasury may consider if additional tax revenue could be raised from this area, perhaps by way of a per transaction or lifetime cap. This temptation should be avoided as it risks having a negative impact on the already struggling housing market. It would have much wider implications, and not simply affect wealthy investors. Without the relief, some people would have a sizeable tax bill which they could only afford by using some of the equity from a property sale, thereby impacting their ability to move up the housing ladder and slowing transactions. It would also penalise people who have lived in their property for a long time and impact downsizers planning to release cash for retirement, and could discourage taxpayers to take this, already big, step. There would need to be adjustments to allow for this, together with allowances for deductible expenses related to extensions and home improvements. Furthermore, any restriction to this relief would surely negate the impact of the Stamp Duty Land Tax 'holiday' announced by the Chancellor last month which, so far, seems to have had a positive impact on the property market and therefore perversely offers an opportunity to raise more tax than what the Treasury would have seen in a stagnant market. Taxing gains on second homes can already affect the housing stock available for first time buyers, thus influencing the housing market as a whole. If reforms have to take place then less radical options should be considered.

A clearer statutory definition of an individual's 'main residence' would be helpful to those who have more than one home so as to ensure that the relief is being applied and/or claimed correctly.

**CGT uplift on death**

This was previously recommended for abolition in last year's review by the OTS of IHT. Arguably this does distort decision making in the context of agricultural or business property, with people choosing to retain this form of property rather than passing it down to the next generation during lifetime at a more appropriate time for the business. It is unclear how any change would work in practice however, and whether it would only apply to businesses and agricultural property, or if it could lead to beneficiaries with an inherited property facing large CGT charges, having already paid up to 40% in IHT We agree that the rule merits review and further consideration of all of the relevant issues.

**Losses**

These can currently be carried over indefinitely. We recognise that limiting the period a loss could be carried over would both simplify HMRC’s administrative burden and would likely increase the tax take, however, these are actual losses suffered by taxpayers, sometimes with devastating consequences and it will often take many years for a taxpayer to be back in a financial position to realise gains once more, if at all. Furthermore, for those with historic losses, the value in real terms will have been diminished by inflation. If limiting the period losses can be claimed has to be introduced then taxpayers should be given good notice to allow them ample time, say over a 5 year period, to use the same.

**Other reliefs and exemptions**

Investors can currently make use of tax-friendly savings vehicles such as ISAs and pensions. The practice of to 'bed and ISA' (selling shares or investment funds held outside an ISA and then repurchasing them within the plan) meaning the holdings are then immune from CGT, could arguably be seen as a distortion to decision making. Investors can also currently mitigate tax by using unit trusts and investment trusts, reducing the need to trade constantly. The danger of taxing investments more would be to undermine the fragile confidence of savers and investors, and ultimately reduce the number of investors, arguably needed now by companies more than ever.

One consideration is to take into account how long an investment has been held. The current system can leave investors trapped in investments to avoid incurring a tax liability, another example of distorted decision making.

Many capital gains lie outside the current system, such as winnings from gambling - including lotteries - and wine and car investments. There may be little justification for retaining these exemptions.

**Summary**

A comprehensive review of all capital taxes to improve simplicity and fairness should be supported. It should be a system that promotes good long term investment decisions, and encourages wealth to pass between family generations especially given the economic situation facing the younger generation due to the coronavirus pandemic.

Wedlake Bell LLP

10 August 2020