CAPITAL GAINS TAX REVIEW

Scottish Land & Estates (SLE) is a membership organisation for owners and managers of land, property and businesses across rural Scotland. While rural businesses operate in a different context to urban businesses they provide a range of employment opportunities in farming, estate management, tourism and in the provision of housing amongst other things and are a key part of the rural economy. SLE has a Taxation Group which is formed from a number of professional members who closely monitor fiscal policy and application and representatives have met with the Office of Tax Simplification (OTS) previously to discuss its Inheritance Tax review, and we are similarly making arrangements to discuss the main call for evidence on this current OTS review. We are therefore pleased to respond on the principles of Capital Gains Tax (CGT) at this time.

While we welcome the review of CGT we would hope that this is not change or alignment for the sake of change or alignment, but to genuinely simplify any unnecessary complexities and administrative burdens. We agree that reliefs and exemptions should be reviewed occasionally to ensure they are still delivering what they were meant to, that their cost remains reasonable and even to safeguard against any unintended consequences.

Overall, while we appreciate that the OTS does not have a policy remit, SLE is clear that any significant alterations to CGT and CGT reliefs at a time of transformational changes to the farming sector with the implications of Brexit and removal of direct payments should be examined in that wider context. Rural businesses require flexibility to adapt to changing circumstances to increase productivity and accelerate growth for the benefit of the wider UK economy.

We also consider it important to differentiate between short-term approaches of converting income to capital through hedge-funds and encouragement of longer-term investment. Land-based rural businesses have some distinctive features. These rural businesses are far more likely to be small businesses run by unincorporated traders and partnerships. They hold assets long term.

It is also clear that while public finances have been depleted through, and as we slowly emerge from, the Covid-19 pandemic, Capital Gains Tax is a modest source of government revenue. The Office for Budget Responsibility forecast that in 2019/20 CGT would raise around £9.1bn, which is about 1.1% of all tax paid in the UK. The approach to any reform of CGT therefore needs to be pragmatic and realistic as to outcome.

Clearly the UK Government is keen to ensure the economy gets back on track after the unprecedented challenges this year. Capital gains are broadly speaking different from other forms of return, since they typically accrue on risky assets and the manner in which they are taxed impacts on risk-taking, potentially to the detriment of the economy.

We would make the following points:

- The principal private residence relief is an important and welcome relief and ought to be maintained. Many taxpayers benefit from this relief each year, without even being properly aware of its existence. Aside from the embedded concept of home ownership in the UK, any restriction would make taxpayers less geographically mobile and goes against pressure to downsize. We also consider that changes to rates for second properties or buy-to-let properties might well mean that landlords simply choose to retain property for longer without disposing of it. Any major change to principal private residence relief would need to be clearly communicated as soon as possible, given the potential significant implications for the UK housing market.

- In relation to existing relief provisions, we have particular concern about rollover relief and the operation of CGT in terms of compulsory purchase. Rollover relief cannot be claimed when land that has been let on a farming tenancy is sold, except in the very special circumstance where it is compulsorily purchased and in that situation cannot be claimed if the proceeds of sale following the compulsory purchase are reinvested in new agricultural buildings on any remaining let farms, even though the modern agricultural buildings would help to improve the tenant's productivity or replace a building lost when the land upon which it stood was compulsorily purchased. The current CGT rules therefore add another set of barriers which prevent the optimal deployment of rural capital to meet environmental delivery and profit objectives. Overall, we would emphasise that deferral reliefs, such as rollover and holdover, are important in encouraging businesses to reinvest their gains back into their trades.

- Entrepreneurs' Relief was substantially cut back at the budget earlier this year. It is clear that there is requirement for such a relief. This allowance has changed over time with retirement relief ,taper relief and then entrepreneurs' relief and each time faults are found and perceived loop holes exploited so there appears to be a recognised policy need, but while government cannot seem to find the right structure, it is important that such a relief is retained for business holdings.

- Lack of capital is often the main reason a business cannot move to more efficient practices. There should be a greater advance towards specific funding or tax relief to encourage the uptake of efficiency measures for land management.

- The annual exempt allowance ought to remain as it provides a worthwhile function. If the current £12,300 annual CGT-free band is reduced there would be much trivia caught and increased red tape which would make the tax system function less efficiently. Most taxpayers realise only modest gains throughout their lifetimes and if the allowance was removed, both taxpayers themselves and HMRC would face a disproportionate administrative burden. This would likely mean an educational/awareness campaign which would need to be appropriately targeted; additional training for staff employed by HMRC in light of such reform; a new accessible reporting system which taxpayers and their professional agents could easily utilise; and further resources around CGT advice/helplines and over time compliance measures.

- We feel it is entirely appropriate to consider the appropriate baseline for taxation. The 1982 rate was set in 1988 and we feel a new retrospective rate at 2014/15 could be set now.

- While we appreciate the rate of taxation is always of interest in any review, it is vital that any measures recommended do not stifle growth, discourage investment, or depress the housing market. It should also be noted that the rate at which CGT is charged will not instantly generate significant additional revenue, given the lower tax take in comparison with other taxes. Also, under the current regime, there is no way of giving relief for inflation when a gain is realised other than through lower rates of tax. We would therefore request clarity if considering any change to CGT rates as to whether or not the government intends to reintroduce a relief for inflation – and if not be comfortable both from a behavioural and political angle with the higher rates which would become payable on notional gains.

- Current rates of CGT are proportionate and do not discourage sales and reinvestment. Taxpayers are willing to sell assets, pay the CGT at 20% or 28% as appropriate, and reinvest. A higher rate is likely to act as a disincentive to sell at all, so the government then loses out on tax cash flow, SDLT/ LBTT and there is reduced overall activity in the economy with the ripple effect benefits.

- In terms of the treatment of losses under the CGT regime, it is the business decision which drives the taxpayer's decision to sell, not the prospect of realising a capital loss. We consider that most owners of assets would not wish to crystallise a loss on an investment except when it is evident that they are better off realising the capital and investing it elsewhere. It is possible that a taxpayer may choose to crystallise a loss if they are also making other gains which the losses can be used against. This would though be dependent on there being a business reason to realise a capital gain at that point – if not, then the losses are still unlikely to persuade a taxpayer to make a disposal they would otherwise not choose to make, as the capital loss can, at the present time, be carried forward indefinitely to use against a future gain. While the prospect of utilising a loss is remote, we believe that the CGT system will be perceived to be fairer if that possibility is kept.

- We are strongly opposed to the introduction of a so-called "wealth" or "mansion house" tax and while we agree that this review of CGT is required, the introduction of an additional tax or punitive measures would be damaging for the economy and make the UK less economically competitive.

- We support capital taxation being reserved to the UK Parliament, but as we have stated to Scottish Government it is important that taxation consequences are considered in the round where policy objectives are enacted by the Scottish Parliament or other devolved body. Land reform legislation passed by the Scottish Parliament has had potential capital gains implications for both landowners and community bodies, yet there has been slow progress to update HMRC manuals. Generally, the UK Government has to ensure that any changes to CGT are considered in the wider context of the tax system. Any intended policy objectives from reforms should be stated up front, to allow for stakeholders to identify any potential issues as early as possible.

- Overall, we are keen that the principles of taxation of fairness, certainty, convenience, and efficiency as evolved over the years are followed. In one-off transactions the boundary between a profit which is taxed to income as opposed to capital, may be clear. However, where less obvious, legislation and case law and rules around trade are utilised to identify appropriate tax treatment. We feel that any complications should be kept to a minimum and that any reforms to the system should be patently clear as to the application of the CGT regime and tax treatment to give taxpayers that certainty and to make the system as convenient and efficient as possible.

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