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# Briefing document

## Office of Tax Simplification: first CGT review report

### Introduction

In July 2020 the Office of Tax Simplification (OTS) published a call for evidence seeking comments on Capital Gains Tax (CGT). The OTS requested initial comments, with more detailed comments to follow. On 11 November 2020 the OTS published their first report, which is on CGT policy design and the principles underpinning CGT. It takes account of the initial responses the OTS received. The second report will explore key tax technical and administrative issues and is due to be published in early 2021.

This briefing note comments on the first report published by the OTS.

### Context for the review

Chancellor Rishi Sunak asked the OTS to conduct a review of how individuals and small businesses are taxed on capital gains. The Chancellor specifically asked the OTS 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*".

The OTS is considering the operation of the system of chargeable gain taxation as a whole including, at the Chancellor's request, administrative and technical issues and areas where the present rules can distort behaviour or do not meet their policy objectives.

### OTS first report

#### Approach

The OTS' approach is that "*a starting point for an efficient tax system should be neutrality, to minimise distortions to taxpayers' business and family choices".* The OTS identified areas in which CGT is "*counter-intuitive, creates odd incentives, or creates opportunities for tax avoidance".* The OTS make various recommendations (see below) and comment that there are strong interconnections between income tax, CGT and Inheritance Tax (IHT) and so all three taxes should be considered if and when changes are made.

#### Tax rates and boundaries

The OTS consider one of the main sources of complexity to be the disparity between income tax and CGT rates. The OTS therefore recommend:

- Greater alignment between income tax rates (up to 45% on investment income) and CGT rates (10%, 18%, 20% and 28%), "*as the way income* [including gains] *is classified would not affect the tax position*".
- If this is done, the OTS recommend that the government consider i) reintroducing relief for inflation, ii) the interaction with company taxation (the corporation tax rate is currently 19%) and; iii) allowing losses to be used more flexibly.
- If there continues to be a difference between income tax and CGT rates, the OTS also comment that CGT would be simpler if there were two CGT rates rather than four, and if the link to income to determine CGT rates were removed.
- Alternatively, the OTS suggest consideration be given to the boundary between income and gains. Notably, the OTS recommend that the government consider whether employees' and owner-managers' rewards from personal labour are treated consistently and, in particular, suggest the government consider taxing more of the returns from share-based rewards arising from employment and accumulated retained earnings in smaller companies at income tax rates.

#### The annual exempt amount

Capital gains within the annual exemption are tax-free (£12,300 in 2020/21). The OTS are of the view that the annual exemption distorts investment decisions, and cite HMRC data showing that in the 2017/18 tax year around 50,000 taxpayers realised net capital gains close to the amount of the annual exemption. The OTS comment that they are mindful that one aspect of the annual exemption is that it provides an administrative threshold which reduces the number of people required to file tax returns with HMRC.

The OTS makes the following recommendations:

- If the government consider the purpose of the annual exemption to be administrative (i.e. reducing the number of people required to file returns for small amounts of tax), the government should consider reducing its level. The OTS consider that "*a true de minimis level lies in the range between £2,000 and £4,000*".

- If this is done, the government should consider i) introducing broader exemptions for personal effects, with only specific categories of assets being taxable, ii) formalising the arrangements for reporting as part of the real time capital gains service and linking this to taxpayers' HMRC personal tax accounts, and; iii) exploring requiring investment managers and others to report CGT information to both taxpayers and HMRC in order to make compliance easier.

### Capital transfers

Capital transfers relates to transfers (e.g. gifts or bequests) where both CGT and IHT may be relevant. Depending on the circumstances, both taxes, neither tax or one of the taxes may be payable. The OTS make the following recommendations:

- The OTS reiterate a recommendation they made in their July 2019 IHT report and state that it should not be possible to benefit from both an inheritance tax exemption and a tax-free CGT uplift to market value on death. The OTS instead recommend that, where an inheritance tax exemption applies on death, the inheritor should have a CGT base cost equal to historic base cost of the deceased instead of market value on death, and;

- The government should consider removing the CGT uplift on death more widely and implementing a general rule that when assets are inherited the person who inherits them has a CGT base cost equivalent to the deceased person's base cost, and;

- If this is done, the government should consider a general rebasing of base cost values for all assets (i.e. this would also apply to lifetime disposals) to a more recent value, in order to simplify administration. A rebasing date of 2000 could be considered (which would mean that all taxpayers would only need to calculate gains and losses based on the extent to which the value of assets has changed since the year 2000).

- Furthermore, consideration could be given to enabling gift holdover relief to be more widely available. Where holdover relief applies, instead of the donor being deemed to dispose of the asset concerned for market value with the result that CGT is payable, the donor is deemed to have received an amount that means that neither a capital gain nor loss arises on the gift, and the recipient agrees that their base cost for CGT purposes is equal to this amount. The recipient's CGT gain or loss on a future disposal of the asset is then calculated based on the amount they are deemed to have paid on acquisition.

### Business reliefs

The OTS focus on Business Asset Disposal Relief (BADR – formerly entrepreneurs' relief) and investors' relief. Both reliefs provide a 10% CGT rate on disposals of assets where the requisite conditions are met. The OTS recommend as follows:

- If BADR's purpose is to stimulate business investment and risk-taking, it is "*mistargeted".* The OTS report that the comments they received suggest that the most effective way to achieve these aims is for reliefs to apply on investment, rather than on an eventual disposal.

- Alternatively, the OTS comment that another understood purpose of BADR is to provide relief on retirement, since business owners may use their business as an alternative to a pension. If this is the purpose of BADR the OTS suggest that the government consider i) increasing the minimum 5% threshold for BADR to be available on shares to 25%, ii) increasing the minimum holding period to qualify for relief from two years to a longer period, perhaps to ten years, and; iii) introducing an age limit for relief, perhaps linked to the age at which people can access their pension (which is currently 55, though this is due to increase to 57 in 2028).

- The OTS comment that little interest has been shown in investors' relief and so recommend that it is abolished.

## Next steps

The OTS is an independent adviser to the government and makes recommendations for the government to consider. It cannot implement tax changes. The government have not indicated when they may respond to the OTS' first report on CGT, or to a separate OTS report on IHT that was published in July 2019.

Find out more…

This note reflects the law in force as at 11 November 2020 and the Office of Tax Simplification's first report into CGT published on 11 November 2020. The OTS first report can be viewed at https://deloi.tt/32CPMNk. Please be aware that this note does not cover all aspects of this subject. To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Michelle Robinson (michellerobinson@deloitte.co.uk).

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