Technical CONNECTION

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## SPECULATION ON POSSIBLE CGT REFORM IN THE 2021 BUDGET

The current capital gains tax (CGT) regime is relatively favourable to the taxpayer. The Office of Simplification (OTS) have made recommendations on reform and possible CGT reform may affect current planning strategies.

Primarily, as a result of the cost of support provided to diminish the detrimental economic impact of the pandemic, Government debt has soared. Most accept that tax reform will need to be a contributor to providing for debt repayment.

Both the International Monetary Fund (IMF) and the Institute for Fiscal Studies (IFS) have recommended that Government focus at the current time should be on economic stimulation, but that, at an appropriate time in the future, attention should be given to restoring public finances. This would probably mean an increase in taxes.

While all taxes (personal and corporate) could be in the “firing line” for review and reform, the OTS have already reviewed inheritance tax (IHT) in 2019 and more recently (as a result of a request from the Chancellor) CGT, which is a tax that is relatively favourable to the taxpayer. To begin with, basic rate taxpayers pay tax on chargeable gains at 10%. And the top rate is 20% (28% for gains on residential property and carried interest) for higher or additional rate taxpayers. This is less than half the top rate of income tax at 45%.

Other "taxpayer friendly" provisions include:

- an annual exemption of £12,300 for everybody;

- the rebasing of assets on a person's death so that all capital gains drop out of account – in particular where no IHT is payable, for example, because of the spouse/civil partner exemption or business relief; and

- a number of attractive reliefs – including business asset disposal relief and investment relief.

As stated above, in order to address their options on CGT reform, in the Summer the Chancellor instructed the OTS to consider ways in which the current rules may be changed and, in particular, where the existing rules distort taxpayer behaviour or do not meet their policy intent. The OTS has, as a result of this relatively wide brief, been able to consider areas such as rates of tax - which is much more than just simplification.

In the first part of its report (with the second part due in early 2021), the OTS made two "stand-out" observations:

(i) that the rates of income tax and CGT should be more closely aligned (although not necessarily dependent on income tax rates); and

(ii) that the annual exempt amount should be substantially reduced - say to somewhere between £2,000 and £5,000.

An increase in the rates of CGT would not necessarily be without complexity though. If rates are increased, it might be thought necessary to consider other provisions. For example:

- if the Chancellor wanted to prevent large gains that have accrued over a reasonable period being crystallised and all being taxed at a higher rate in one year some method (say like "top-slicing" relief for investment bond gains), will need to be introduced;

- some allowance for inflation would need to be introduced if only "real" gains are to be taxed;

- there could be scope for more flexible use of losses; and

- measures could be introduced to discourage people from using companies solely as a means of CGT reduction or deferment.

Of course, this is only speculation on what areas might need to be addressed.

Given the current low rates of CGT and the relatively low numbers of individuals who actually pay CGT, it would not be surprising if rates were increased at some point. In 2010, when the top rate of CGT was last changed, research indicated that 20-28% was the optimal tax rate for raising revenue.

Anything higher, as for increases in any tax, could mean that taxpayer behaviour could change with the object of CGT avoidance and this could ultimately mean less revenue for the Treasury.

So, although there is no certainty that CGT rates will increase, it is definitely a possibility. Being aware of this is important for two particular reasons:

(i) if a person is imminently considering realising a capital gain in excess of their annual exempt amount, it may be worth considering (subject to commercial considerations and the taxpayer being absolutely clear that the disposal is the right thing to do for other than tax reasons) bringing the disposal forward to, ideally, before the Budget on 3 March 2021 to benefit from the current regime; and

(ii) if a person is considering making a claim to defer the date at which CGT is payable, such as through an EIS deferment claim or a hold-over relief claim, they would need to bear in mind that when CGT is eventually paid it may be at a rate that is greater than the current rate. Of course, the deferral may give other benefits – for example, with a CGT deferral claim under an EIS, there may be the prospect of later IHT business relief at 100% which would mean that, under current legislation, on the death of the investor there would be no CGT or IHT.

It is clearly important that clients are made aware of these possible changes in tax rules before they take action to defer the payment of CGT.

And, of course, as for any tax year, it is definitely worth considering whether you should make disposals to use the annual exemption as this exemption cannot be carried forward if not used. Of course, you will need to carefully consider the "bed and breakfast" anti-avoidance provisions if you are looking at any reacquisition post disposal.

In conclusion, it is essential (especially given the IFS and IMF warnings, combined with the Chancellor's expressed caution in relation to the economic impact of tax increases) to exercise caution in relation to the expression of views on the likelihood of tax change. However, it is also important to know about what has been published in relation to potential changes to CGT. While it would be precipitous and potentially misleading to encourage pre-Budget disposal purely on tax grounds, if the disposal is going to be made anyway then executing it ahead of the Budget would definitely be worth considering. And, of course, as for any other tax year and subject to non-tax considerations, as stated above, careful thought should be given to using the CGT annual exemption.

## ZERO-RATE EMPLOYER NICs FOR ARMED FORCES VETERANS

From 6 April 2021, employers will be able to save around £5,000 in NICs on the salaries of veterans of the regular armed forces during the first year of civilian employment.

HMRC has published a technical consultation on draft legislation that will enable employers to apply a zero-rate of secondary Class 1 Employer National Insurance contributions (NICs) on the earnings of veterans during the first year of their civilian employment. It is intended this will provide employers with a relief worth around £5,000 for each qualifying veteran they hire.

A veteran will qualify if they have completed at least one day of basic training in Her Majesty's regular armed forces. Employers will be able to claim this relief for the 12-month period starting on the first day of the veteran's first civilian employment since leaving the regular armed forces.

Subsequent and concurring employers will be able to claim the relief during this period. This zero-rate will apply up to the Upper Secondary Threshold (currently £962 per week, or £50,000 per year). Class 1 Employer NICs are currently normally payable at 13.8% on earnings above £169 per week, or £8,788 per year.

A public consultation for this measure was held in Summer 2020, and a summary of responses has been published. This latest technical consultation closes at 11:45pm on 8 March 2021, and the new rules are intended to take effect from 6 April 2021.

Further detail on how employers will claim this new NIC relief will be published shortly.

## FURTHER EXTENSION OF SUPPORT FOR MORTGAGE BORROWERS: NEW FCA GUIDANCE

The FCA has announced further proposals to support mortgage borrowers impacted by the coronavirus. In November 2020, the Financial Conduct Authority (FCA) announced further support for mortgage and consumer credit borrowers experiencing payment difficulties as a result of coronavirus (Covid-19). This included guidance that firms should generally not enforce repossessions before 31 January 2021.

### Mortgage guidance

The FCA has now published draft guidance setting out its proposed approach to repossessions from 31 January 2021. Its current guidance on mortgage repossessions means firms should not enforce repossessions before 31 January 2021 except in exceptional circumstances, such as a customer requesting that proceedings continue. The FCA now proposes extending this guidance so that firms should not enforce repossessions before 1 April 2021.

This approach takes account of the worsening coronavirus situation and the Government's tighter coronavirus-related restrictions which mean that consumers could experience significant harm if forced to move home at this time as a result of repossession proceedings. The FCA says it recognises that there are also Government bans on evictions in some nations, which could also prevent firms from enforcing home repossessions.

### Consumer credit guidance

The FCA's current consumer credit guidance means that before 31 January 2021 firms should not terminate a regulated agreement or repossess goods or vehicles under the agreement that the customer needs, except in exceptional circumstances.

The FCA now proposes changing this so that consumer credit firms will be able to repossess goods and vehicles from 31 January 2021. However, the FCA says, this should only be as a last resort, and subject to complying with relevant Government public health guidelines and regulations, for example on social distancing and shielding. Importantly, firms will also be expected to consider the impact on customers who may be vulnerable, including because of the pandemic, when deciding whether repossession of goods or vehicles is appropriate.

The FCA believes that its proposed approach reflects the different risks and harms that customers with goods or vehicles on credit are likely to face compared to those who are at risk of losing their home.

It believes that for customers who remain in payment difficulties under a relevant consumer credit agreement, continuing to restrict repossessions may not be in their interests. The shorter terms and higher interest rates on these agreements, combined with the depreciating value of the goods or vehicles, means that they could end up owing more in the long term if repossessions are prevented.

The FCA invited comments on both sets of draft guidance by 10am on 18 January 2021.

## NEW LEASEHOLD REFORMS

The Government announced on 7 January leasehold reforms that will mean millions of leaseholders will be given a new right to extend their lease by 990 years with a ground rent at zero. Ground rents will also be reduced to zero for all new retirement properties (see later).

At present, leaseholders are liable to ground rent which may be subject to automatic, pre-determined, periodic rises which can cause charges to become prohibitively high over time. This in turn could make it increasingly difficult for leaseholders to sell their property.

Additionally, whilst it is possible under current rules for a leaseholder to extend their lease, the extension is usually restricted to a maximum of 90 years and the cost of doing this can be very high, running in to thousands or even tens of thousands of pounds.

The changes, announced by the Housing Secretary, will allow any leaseholder to extend their lease for much longer (990 years as opposed to 90 years) at a lower cost and, in doing so, avert ground rent payable to the freeholder. The Government is also abolishing prohibitive costs, such as 'marriage value', to ensure fees are fairer, cheaper and more transparent. An online calculator will be introduced to make it simpler for leaseholders to find out how much it will cost them to buy their freehold or extend their lease.

'Marriage value' in this context assumes that the value of one party holding both the leasehold and freehold interest is greater than when those interests are held by separate parties. This announcement means that marriage value will be removed from the premium calculation.

The Housing Secretary said:

"Across the country people are struggling to realise the dream of owning their own home but find the reality of being a leaseholder far too bureaucratic, burdensome and expensive… We want to reinforce the security that home ownership brings by changing forever the way we own homes and end some of the worst practices faced by homeowners… These reforms provide fairness for 4.5 million leaseholders and chart a course to a new system altogether."

Further measures will be introduced to protect the elderly. The Government is already committed to the restriction of ground rents to zero for new leases. This will also now apply to retirement leasehold properties (i.e. those built specifically for older people), giving purchasers of these homes the same rights as other homeowners.

Leaseholders will also be able to voluntarily agree to a restriction on future development of their property to avoid paying a 'development value'.

The Government is also establishing a Commonhold Council – a partnership of leasehold groups, industry and Government – that will prepare homeowners and the market for the widespread take-up of commonhold. The commonhold model allows homeowners to own their property on a freehold basis. This gives them greater control over the costs of home ownership, such as block management charges, since when someone buys a flat or house it is truly theirs and any decisions regarding its management is theirs too.

Professor Nick Hopkins, Commissioner for Property Law at the Law Commission, said:

"We are pleased to see government taking its first decisive step towards the implementation of the Law Commission's recommendations to make enfranchisement cheaper and simpler… The creation of the Commonhold Council should help to reinvigorate commonhold, ensuring homeowners will be able to call their homes their own."

Legislation will be brought forward in the upcoming session of Parliament, to set future ground rents to zero. This is the first part of seminal two-part reforming legislation in this Parliament.

## THE BUDGET RUMOURS START

With the Budget now just five weeks away, rumours are emerging…or are they distracting kites being flown?

It is the time of year for Budget rumours to start appearing in the press. As usual, at this stage it is impossible to tell which are the genuine possibilities, as opposed to distractions promulgated by the Treasury to evoke relief when proven to be unfounded. Two 'ideas' that are grabbing the headlines at present are an increase in corporation tax and a revamping of residential property taxes. In this article we look at the former.

Mr Sunak already has form on corporation tax. Section 5 of his first Finance Act as Chancellor (Finance Act 2020) scrapped the reduction in the rate of corporation tax from 19% to 17% which had been legislated for in the Finance Act 2016 by George Osborne. To be fair, the U-turn was set out in the Conservative's 2019 Election manifesto, albeit only obliquely. Boris Johnson revealed the decision to reverse the planned cut to the CBI conference in mid-November 2019, so that by the time the Conservative manifesto was published at the end of that month all it said was '…by cutting corporation tax from 28 per cent to 19 per cent, we have encouraged more businesses to invest and grow in the UK'. A look at the costings document that accompanied the manifesto revealed the extra 2% on corporation tax to be producing the lion's share of anticipated extra revenue - £5,200m out of £5,780m in 2021/22.

The pandemic has cut expectations of corporation tax inflow significantly. Back in March 2020, the Office for Budget Responsibility (OBR) projected onshore corporation tax receipts of £57.2bn in 2020/21, £58.7bn in 2021/22 and £61.4bn in 2022/23. By the time of the November Spending Review, it had revised those figures to £43.2bn, £48.5bn and £56.4bn respectively. Nevertheless, corporation tax remains the fourth largest source of revenue for the Treasury, after income tax, National Insurance and VAT. That leading trio are all subject to the manifesto pledge not to increase rates. The three also each put considerably more into the Exchequer's coffers: £188.2bn, £140.8bn and £116.3bn respectively, based on the OBR's November projections for 2020/21.

The HMRC tax ready reckoner, published last May, estimated that a 1% increase in corporation tax in 2020/21 would have meant an extra £2.4bn of receipts during that year, rising to £3.1bn in 2021/22 and £3.4bn in 2022/23. Those figures take no account of the pandemic fall out, but suggest that each 1% increase from April 2021might yield around £3bn extra by 2023/24.

From a political viewpoint, corporation tax has the benefit of generally not *directly* affecting the electorate. As we have noted before, the Great British public is in favour of tax increases, as long as the rises do not apply to them personally. In practice, corporation tax would hit some individuals directly – those who choose to work through their own private companies. The Chancellor has already shown limited interest in this sector - witness the way many company directors reliant on dividends have been allowed to fall between the Coronavirus Job Retention Scheme and the Self-Employed Income Support Scheme.

The UK has a low rate of corporation tax in comparison with other major economies. The OECD average for 2020 (including local taxes) is just over 23%, but this is distorted by many smaller economies with ultra-low rates (e.g. Hungary with 9% and Ireland with 12.5%). Larger countries tend to have higher rates – Germany has a 29.9% rate and France 32.02%, for example. At the last Election, the Labour Party proposed raising the main corporation tax rate to 26% by 2022 (and introducing a small companies' rate of 21%). It noted that such increases would still "…leave corporation tax rates for all firms lower than they were when the previous Labour government left office in 2010".

Rates are only one part of the corporate tax mix, however. One other important element is investment allowances, where for large businesses the UK ranks down towards the bottom of the OECD tables. Mr Sunak could choose to combine improved capital allowances (the annual investment allowance has already been pegged at £1m for another year) with increased corporation tax rates as a package to encourage growth and tax only profits.

***COMMENT***

*The Chancellor has been somewhat painted into a corner by manifesto pledges made in the pre-pandemic era which appear not to be amenable to the standard issue, pandemic-justified Government U-turn. Corporation tax rises look to be an attractive option, but would only be part of any long-term financing solution.*

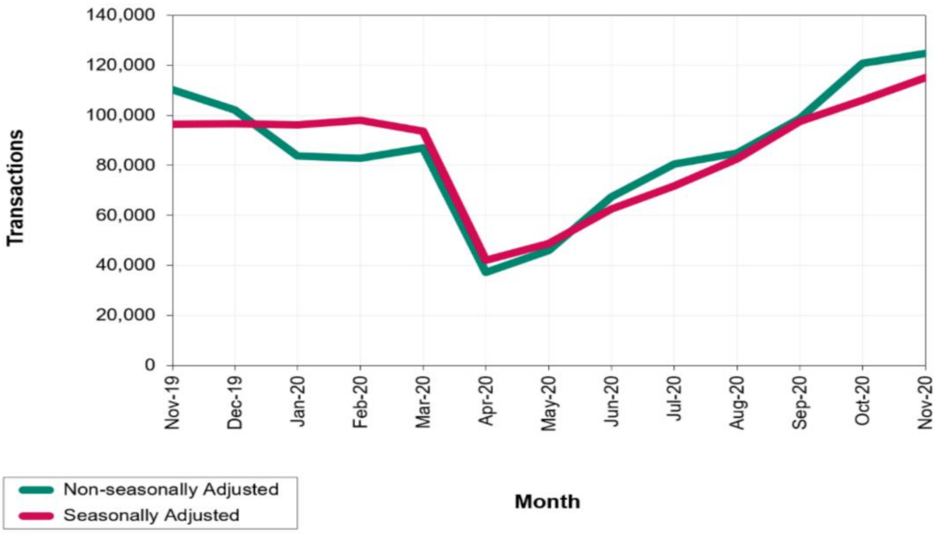
## LATEST UK PROPERTY STATISTICS SHOW AN INCREASE IN THE NUMBER OF TRANSACTIONS IN NOVEMBER

The latest property statistics provide UK residential and non-residential transactions estimates during the previous 12 months. The figures show the provisional seasonally adjusted and non-seasonally adjusted UK residential transactions estimates have both increased in November 2020 compared to November 2019.

As can be seen from the chart below, UK residential transactions remained relatively stable between November 2019 and March 2020. While there were substantial decreases in April and May 2020, UK residential transactions have since increased each month, reflecting the gradual easing of coronavirus public health restrictions for the property market.

The figures also show that the provisional non-seasonally adjusted estimate of UK residential transactions in November 2020 is the highest transactions total during the previous 10 years. This increase is likely to be as a result of the nil rate band for Stamp Duty Land Tax (SDLT) being increased to £500,000 until 31 March 2021.

**Chart 1: UK residential property transactions by month (November 2019 to November 2020).**




## CRYPTOASSETS AND STABLECOINS – CONSULTATION ON THE REGULATORY APPROACH

The Government has published a consultation on cryptoassets and stablecoins.

The consultation is the first stage in the Government's process concerning a broader regulatory approach to cryptoassets. It seeks views on how the UK can ensure its regulatory framework is equipped to harness the benefits of new technologies, supporting innovation and competition, while mitigating risks to consumers and stability.

The document also includes a call for evidence on investment and wholesale uses of cryptoassets, and the broader use of distributed ledger technology (DLT) in financial markets. With this in mind, the Government invites views from a wide range of stakeholders, and particularly firms engaged in cryptoasset or DLT activities – responses can be submitted via email. This consultation closes on 21 March 2021.

In the meantime, we are expecting results of an earlier consultation on cryptoasset promotions which closed in October 2020.

## INCOME WITHDRAWAL RATE FOR JANUARY 2021

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in January 2021 is 0.5%.