Call for Evidence:
Capital Gains Tax Review

To: Office of Tax Simplification

By: The Intergenerational Foundation

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The Intergenerational Foundation (www.if.org.uk) is an independent think tank researching fairness between generations. IF believes policy should be fair to all – the old, the young and those to come.

Introduction

As IF is the UK's leading think tank which exists to promote the rights of younger and future generations, we think that intergenerational inequality needs to be an important consideration when deciding the future design of the UK's Capital Gains Tax (CGT) regime.

We were the first think tank in the UK to draw attention to the way in which the CGT regime contained loopholes which could be exploited by landlords in our 2013 research into the taxation of the buy-to-let (BTL) sector.[1] Although these loopholes have now been closed to an extent, we are still concerned about the way in which the CGT regime can work to the advantage of wealthy asset-owners (who tend to be older members of the society) while disadvantaging younger people.

We would particularly like to bring the following points to the OTS's attention:

[1] Kingman, D. (2013) *Why BTL equals "Big Tax Loophole"* London: Intergenerational Foundation

1) **The Annual Exempt Amount is regressive and unfair on younger people who can't afford to save**

The Annual Exempt Amount currently allows taxpayers to keep the first £12,300 which they receive in taxable capital gains tax-free. The main intent of this policy appears to be firstly, to avoid creating a disincentive for people to invest their money which might exist if the full amount of capital gains was subject to CGT; and secondly, to reduce the administrative burden that would be created for both taxpayers and HMRC if very small gains were subject to CGT.

However, IF believes that there are strong arguments against the Annual Exempt Amount being this generous.

Firstly, because it is relatively high, it creates incentives for wealthy people who've enjoyed very large gains to dispose of assets over a longer period of time in order to minimise their tax liabilities, which reduces the overall level of revenue which CGT raises.

Secondly, as HMRC data suggest, the vast majority of capital gains accrue to older people and high-earners, which means that they benefit more from the Annual Exempt Amount than younger, poorer people do. HMRC's Capital Gains Tax statistical tables show that in the 2017-18 tax year, almost two-thirds of all capital gains (before the Annual Exempt Amount was deducted) accrued to people who earned over £50,000 per year, and 85% accrued to people who were over the age of 45.

Thirdly, the need to have the Annual Exempt Amount to act as an incentive to encourage people to invest their savings has clearly been diminished by the growth of other tax-free savings vehicles and allowances which also create similar incentives, such as ISAs and Business Asset Disposal Relief.

For these reasons, IF believes that the Annual Exempt Amount should be halved, to a level of around £6,000 per year, in order to improve the fairness of the current system.

2) **Landlords should pay a CGT surcharge**

As mentioned above, IF drew attention to the ways in which the CGT regime worked to the advantage of landlords in our 2013 research into the taxation of BTL.

Although landlords are now treated less favourably by the CGT regime, particularly as they can no longer claim Private Residence Relief on the final three years for which they owned a rental property if it was their main home at some point, and can only claim Letting Relief if they were in shared occupancy with their tenant, the government could still go further to discourage people from becoming BTL investors. This is desirable because the effect would be to increase the supply of housing which is available for young first-time buyers.

Given that property investors and second home owners in the UK now have to pay a surcharge of 3% on Stamp Duty when they purchase an additional property, IF considers it appropriate for second home owners to also have to pay an additional rate of CGT on the gains which they realise from disposing of extra properties. This would make owning additional properties less attractive to would-be purchasers. The precise design of this additional rate would be up to the OTS and HMRC, but an extra 10% could be sufficient to discourage investors from putting too much of their money in property, while also raising additional tax revenue..

3) **HMRC should publish data on the annual value of all CGT reliefs and exemptions**

The CGT regime has become very complex since it was first introduced, with a large number of allowances and exemptions having been created. However, HMRC seems to publish very little of the kind of data that would be required to facilitate an in-depth analysis of how these reliefs and exemptions affect taxpayers' behaviour, and whether they benefit the whole of society in an equitable way.

IF believes that HMRC should start collecting and publishing regular data on CGT reliefs, including the Principal Private Residence relief on main residences, to allow analysts to develop a clearer picture of whether these reliefs are beneficial to wider society.

IF would also like to see HMRC undertake regular intergenerational impact assessments which would look at the impacts which tax reliefs and exemptions (both existing ones and proposed reforms to them) would have on people of different age groups, to ensure that they are fair to people of all generations.

4) **HMRC should investigate whether Private Residence Relief is still in the public interest**

IF would particularly like to draw HMRC's attention to the question of whether Private Residence Relief from CGT on the disposal of a property which was the owner's main home is still in the public interest.

Historically, the UK has not levied CGT on the gains which sellers realise when they dispose of a property which was their main residence. However, IF believes there are now very strong arguments in favour of doing so.

Firstly, it would be in the interest of both intergenerational and intragenerational fairness to tax the large gains which older homeowners who got on the property ladder in the 1970s and 1980s, when property prices were generally far lower than they are now, have enjoyed. The Social Market Foundation (SMF) has recently estimated that £4.2 trillion worth of historic capital gains are likely to be realised on the sale of UK property over the next 25 years, and under our present tax regime a very large proportion of these gains are likely to go untaxed because of the extremely favourable treatment which capital gains on main residences receive under both the CGT and Inheritance Tax frameworks.[2]

Although it would be politically unpopular, taxing these gains appears to be one of the fairest ways of finding additional tax revenue to help repair the damage which Covid-19 has done to the public finances, and it should also help reduce wealth inequalities both within and between generations.

Secondly, main residences are subject to CGT in some other OECD countries. Research carried out by IF suggests that out of 36 of the OECD's current member states (Colombia was excluded because of missing data), 14 already charge some level of CGT on the disposal of a main residence, including Sweden, Switzerland, Italy and Japan.

Thirdly, Private Residence Relief is also complex to administer, with a large number of rules and exemptions which are designed to take account of special circumstances. If it was removed, the UK could potentially move over to a simpler system where CGT was levied on all disposals where the gains were above a certain threshold, and all gains below that threshold were completely exempt.

However, IF is also cognizant of the potential drawbacks of removing Private Residence Relief, particularly if other aspects of the UK's tax system were not reformed in tandem.

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[2] Social Market Foundation (2020) *£421 billion plan to tax rising house prices to pay for the Coronavirus crisis* London: SMF

For example, levying CGT on the sale of all main residences where the gains were above a certain size could create a perverse incentive for homeowners not to sell their homes while they are still alive, as the present rules would allow them to pass on the property to their heirs without them paying tax on the capital gains. Therefore, reforms in this area need to take a holistic view of how CGT interacts with other aspects of the UK's tax code, in order to ensure that the benefits of reform can genuinely be realised.

If you would like to learn more about the work of the Intergenerational Foundation please contact:

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