

Office of Tax Simplification  
Capital Gains Tax Review

Via Email: [ots@ots.gov.uk](mailto:ots@ots.gov.uk)

**Management and Investment Resources**

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Response to Capital Gains Tax Review

Dear Sirs,

I am submitting these comments because I certainly agree that capital gains tax is over-complicated. I give my views as someone who personally pays the tax occasionally but I have also had some contact with the tax as a founder and manager of early stage companies. To commence I make some general comments followed by my detail comments on your specific questions in the “call for evidence” (apologies if my comments on the “Principles” have not met your deadline):

It is of course a horribly complex tax with several different rates and numerous exemptions. I need to employ an accountant to work out my self-assessment tax returns when I don't consider my affairs particularly complex – I am mainly invested in listed shares, although I do have a few EIS and VCT investments. My accountants use specialist software to do the calculations, not generally available to retail investors and even that seems to be prone to complex misunderstandings.

This also puts a great burden on HMRC in terms of administration when it brings in less than 1% of tax revenues. Plus there is an enormous amount of effort put in by investors and their advisors to avoid paying the tax (there are lots of ways to do so). Indeed one could argue that the current Capital Gains tax regime was invented by accountants as a “make work” project due to the complexity of the rules.

**The Principles**

1. *Allowances.* The current allowance is relatively small. It generates a considerable amount of effort to ensure the allowance is used each year and also causes sales of shares to take place when they might not be best timed, simply to use up capital gains tax allowances in the current tax year. Or even to anticipate changes to tax rates and allowances by decisions from new Chancellors or new Governments. It would certainly simplify the tax to remove the allowance but to avoid people being financially disadvantaged by such a change the tax rate should be adjusted to take that into account.

But one big problem is the lack of indexation of capital gains which was scrapped some years ago by Gordon Brown and replaced by allowances. This means that you pay tax not on the real change in the value of a share, but on that created simply by inflation when the shares are worth no more in reality. This may not seem a major issue in a period of low inflation, but with money being printed like it is going out of fashion by Governments, high inflation might well return. Even a low rate of inflation over many years can result in a very large tax bill, and even worse, you may not have the option to retain the holding. A takeover bid for a company can effectively force a sale. Indexation should be reinstated as it was not difficult to take it into account in your tax returns.

2. *Exemptions and Reliefs.* The current arrangements distort investment decisions. For example, you might hold on to a shareholding longer than you otherwise would because you know a large tax bill will result. So your portfolio may end up containing a lot of companies with poor prospects and their market share prices might remain higher than they otherwise would be, i.e. the market in the shares is distorted.

An alternative proposal to avoid the distortion of investment decisions would be to reform it so that a rollover of investments did not incur tax. In other words, if you reinvested the proceeds from a sale of shares or other assets into new assets within a period of time then no tax would be payable. If no net profit is actually realised, why should investors pay tax?

The existing arrangements encourage the use of investment trusts and funds rather than personal investors holding individual shares. This has had a negative impact on the stock market as investment decisions are now made by fund managers rather than real owners. It has also meant that much of the profits generated by public companies end up in the hands of the fund manager rather than the end investor who rake off 1%, 2% or more per annum which can often be a very high proportion of the real return generated by companies. It also has a negative influence on corporate governance as fund managers have little interest in controlling the pay of directors for example. In effect we have a lot of absentee owners as a result of the tax arrangements.

Property is taxed at different rates – an unnecessary complication, although the property you live in is exempt. This has of course encouraged people to invest in a home as an asset for their retirement. This has powered the house price bonanza in recent years and encouraged people to occupy bigger houses than they need. Although encouraging home ownership is meritorious, it is not clear why gains from owning a home should be tax free. Reforming this could be politically sensitive although a “roll-over” provision and other exemptions could mitigate the adverse consequences.

3. *Treatment of Losses.* No comments.
4. *Interaction of how gains are taxed to other types of income.* There is clearly the possibility of moving profits between capital gains and income or vice versa. It would be wise to harmonise the rates to avoid complex tax planning and to simplify the tax. This should be the objective, but clearly any abrupt change in rates or scope would damage the interests of many investors and undermine their tax planning. Any changes should be small and continual changes to rates avoided.

## **Structural CGT Issues**

1. *Acquisition and Disposal.*

- a) *As I mainly deal in public company shares, it is usually clear when an event is chargeable.*
- b) *I suggest most investors would be aware of the potential CGT liabilities but as the calculations are so complex there can be unexpected results. It is a minefield for the inexperienced investor.*
- c) *The current CGT rules certainly influence decisions on acquiring or disposing of assets as mentioned above. This is a particular problem for business creators although there are allowances that reduce their liability when a business is sold. Much tax planning activity is prompted by such outcomes which typically undermines the tax take. Another related issue is that high capital gains tax rates encourage wealthy entrepreneurs to move to countries where capital gains taxes are lower or even zero. We lose their expertise and also they spend their money in other countries as a result. The inability to roll-over gains has a big impact here.*
- d) *Practical challenges in the calculation of CGT abound. I certainly would not wish to try and do it myself.*
- e) *No comments on the other matters raised.*

## *2. Annual Exempt Amount.*

- a) *As mentioned above, I do take into account the annual exempt amount when planning disposals. This requires considerable and unproductive effort. I am aware that there is argument for an exempt amount in that it takes many people out of the necessity to report any capital gains. But that does not avoid the need for them to calculate the gains so the advantage may be small.*
- b) *I do not see any simple way of taking small gains out of the scope of capital gains tax.*

## *3. Different rates of CGT.*

- a) *The different rates of CGT certainly complicate tax calculations. Harmonisation of rates should surely be the objective.*

## *4. Reliefs and exemptions.*

*See comments above.*

## *5. Principle Private Residence.*

*See comments above.*

## *6. Chattels exemption.*

*I feel there is probably a general lack of awareness of this issue.*

## *7. Business owners and investors*

*This is an exceedingly complex area which results in owners/investors invariably having to take expert advice on the matter. The ability to defer gains on such assets as EIS qualifying companies (and VCTs in the past) creates enormous complexity even for investors like me with relatively simple affairs and affects investment disposal decisions very substantially as gains can be rolled back in many years later. A good simplification would be to simply exclude such investments from CGT.*

## 8. Specific Asset Classes

No comments.

## 9. Company Issues

No comments.

### **Administration of CGT**

#### 1. Administration.

*As previously indicated, administration of CGT is for me personally very costly as I need to employ an accountant who uses software to do all the calculations (and that software is not readily available to private investors) and then prepare a self-assessment tax return.*

#### 2. Payments.

I have not experienced any difficulties with payments.

#### 3. Claims.

It's just too complicated.

#### 4. Record keeping, valuation and calculations.

I have not experienced any difficulties although base costs can be problem for some investors.

#### 5. Estates in administration.

### **Interaction between CGT and IHT and with other taxes**

#### 1. Absence of CGT on death.

This certainly distorts and complicates disposal decisions, particularly as the tax rates are different. But it would be clearly unfair for assets on death to be taxed with both CGT and IHT, effectively taxing the same assets twice. As I suggested though, if roll-over to other investments was permitted as an exemption to CGT, this might remove the anomaly as the assets might only be eligible for tax when eventually disposed of on death. IHT is of course another complicated tax that generates relatively little tax for HMRC but a large administrative burden. It might make sense to scrap IHT and simply have CGT applied to disposals on death.

### **Other areas of complexity**

No comments.

### **Wider CGT Framework**

No comments additional to those already given above.

## **Summary**

In summary Capital Gains Tax is very complicated, has unclear objectives, generates relatively little in tax from very few individuals and is a disincentive to entrepreneurial activity. It can result in tax being paid on purely inflated share prices and when no actual cash is realised as the profits are soon reinvested. It does of course discourage therefore new investment and distorts the stock market.

In my opinion, capital gains tax needs a complete overhaul.

Yours sincerely

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Managing Director