Chancellor will struggle to tax overseas homeowners

Based on a single report from Sky News at the end of last month – which cited no source – there has been mounting speculation that the chancellor is "actively investigating" the extension of capital gains tax to non-resident owners of UK residential property.

Whatever the truth of the matter, it is fair to say that most UK voters would be surprised to learn that wealthy foreigners – often from countries where most people live in poverty – are given an enormously valuable tax break on their UK property. This government talks a lot about "fairness" in taxation, yet is this tax break fair to UK taxpayers?

Leaving politics aside, there are certain main considerations here: the prime London and, increasingly, country house residential markets have historically provided reliable year-on-year increases in capital values that appear to be, literally, "safe as houses".

The icing on the cake is the tax-free gain for foreigners on disposal of the property, at least as far as the UK is concerned. In theory, tax on the gain is probably payable in the home country, but as many such properties are held within offshore company and trust structures, the tax may not actually be paid. Realistically, taking off this icing on the cake would be unlikely to affect the prime London market to any significant extent.

Most countries tax the capital gains on sales of property owned by foreigners, so a similar move by George Osborne would simply bring us into line. However, such a tax may raise little revenue because it would only bite at point of sale. Wealthy foreigners, having secured their London trophy house, are often reluctant to sell, given the secure annual paper gain.

Therefore, there is relatively low turnover of existing homes held as investments and many come to market through developers and London families cashing in. A tax on such homes could restrict the supply further.

Many homes are also held within foreign companies that can sell shares tax free, rather than the property.

What is more, the tax would probably be based on 2014 market values, which means that only paper gains accruing from them would be taxable. If revenue raising was the government's aim, surely a simple extension of the annual council tax at an enhanced rate on homes held by non-residents would be simpler and more effective? Oversized council tax revenues could be redirected to central government, rather than given as a windfall to local authorities in wealthy areas.

Company benefits

An extension of capital gains tax to individuals could encourage them to put properties into foreign companies. They would then be subject to the annual tax on enveloped dwellings (ATED). Yet this would not stop them from eventually selling these companies, free of capital gains and stamp duty land tax.

There is also a long list of ATED exemptions, including those for property rentals, which would probably not apply to individuals so ATED would look more attractive. This would be strange, as ATED was originally intended to encourage properties to be transferred out of companies and into individual ownership so that stamp duty would be payable.

A further problem is collection of tax on a sale by a non-resident. It would be sensible to introduce a requirement on purchasers' solicitors to hold back, say, 20% of the purchase price on a sale to a non-resident, and account for that to Revenue and Customs in a similar way to how the previous development land tax process worked – leaving the seller to reclaim it after paying whatever tax was due.

What is clear is that an extension of capital gains tax in this way may be considered "fair", but it would raise little revenue in the short-to-medium term and complicate the UK tax system even further.

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