TECHNICAL RELEASE

TAXGUIDE 08/15 (TECH 11/15TAX)

INITIAL MEETINGS ON NON-DOMICILIARY ANNOUNCEMENTS MADE AT SUMMER BUDGET 2015

Note of meetings with HMRC published by ICAEW Tax Faculty in September 2015

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FOREWORD

In the Summer Budget on 8 July 2005 the Chancellor outlined proposals on new deemed domicile rules; more detail is given in a technical briefing published the same day by HM Revenue & Customs (HMRC).

The intention of HMRC is to publish a consultation on the proposals after the summer recess; the legislation will be included in Finance Act 2016 and take effect from 6 April 2017. In advance of the consultation HMRC are holding meetings with professional bodies and other interested groups to inform the consultation paper. ICAEW volunteers have attended a number of these meetings who have produced notes on the meetings they have attended. The notes have been passed to HMRC for review; the notes as reproduced below and incorporate some of HMRC's comments.

The first meeting was held on 23 July 2015 and the notes of that meeting were published as TAXguide 04/15. That TAXguide has now been withdrawn and consolidated within this TAXguide which includes the notes of two subsequent meetings held on 13 and 25 August.

THE HMRC/HMT THINKING IS AT A VERY PROVISIONAL STAGE, SO IT WILL DEVELOP AND EVOLVE AND THE POSITIONS TAKEN IN THE CONSULTATION DOCUMENT MAY BE VERY DIFFERENT TO THAT SET DOWN IN THESE MINUTES. HOWEVER, THE CHANCELLOR HAS SET DOWN THE PARAMETERS, SO THE OVERALL POLICY WILL NOT CHANGE.

NOTE OF MEETING THURSDAY 23 JULY 2015 FROM 14:30

Re Changes to the taxation of foreign domiciliaries announced by the Chancellor at Summer Budget 2015

Attendees:
Officials from HMRC and HM Treasury ("HMT")
Representatives of the various professional bodies (including ICAEW Tax Faculty), the Expatriate Forum and various interested professional firms ("the Representatives")

1. Introduction

The changes announced by the Chancellor are seen as being split into two parts (as per the two short technical notes issued with the Summer Budget papers):

1) Changes to the taxation of foreign domiciliaries (extending the deemed domicile rules and the ramifications thereof).
2) New rules for UK residential property held indirectly by foreign domiciliaries.

There will be two separate consultation papers issued.

Whilst both sets of changes will be effective from the same date (6 April 2017) the Chancellor intends the first to be enacted in Finance Bill 2016 and the second in Finance Bill 2017. As such, the consultation document on the changes to the taxation of foreign domiciliaries will be issued first.

The announcement of the changes at the Summer Budget has meant that there was insufficient time to prepare a consultation document before the Summer Recess. It has also meant that current HMRC and HMT thinking on this is at a provisional ("green") stage. To place things in context it was explained that the Chancellor has set down specific parameters for HMRC/HMT. The overarching policy has been decided and represents a package of measures that the Chancellor feels achieves the right balance between fairness and still making the UK attractive for foreign domiciliaries. Individuals who were not born in the UK can remain in the UK for 15 years and benefit from IHT advantages and the advantages of the Remittance basis. To offer something to set against the significant disadvantage of worldwide taxation on the Arising Basis for those who meet the "15 out of 20" Officials will consider what protections are necessary for offshore trusts established prior to the deemed domicile period and how anti-avoidance rules should work.

HMRC/HMT are very open to thoughts being fed into the process (provided the parameters are kept to). A number of meetings (three more being planned after this) will be held between HMRC/ HMT and interested stakeholders prior to Parliament returning and the feedback obtained from these meetings (and any other feedback received from interested parties) will inform the preparation of the consultation document. The aim is for the consultation document to be published soon after Parliament returns in early September and this will be accompanied by draft legislation too. There will not be the full 12-week consultation period but it is hoped that the earlier meetings and publishing draft legislation in the consultation document will go some way to making up for this reduced timescale.

The aim is for the consultation document on the new rules for UK residential property held indirectly by foreign domiciliaries to be published in late autumn 2015. The full 12-week consultation period will apply to this since the legislation for these provisions will go into Finance Bill 2017.

Various technical issues were discussed during the meeting and the key points are summarised below. As such, this note provides readers with additional detail on current HMRC/HMT thinking.

2. Deemed domicile – the "15 out of 20" rule

The definition

Various requests for clarification were made to HMRC/HMT with respect to the definition.

The current thinking is that "deemed domicile" would be triggered where an individual has been UK resident in 15 of the preceding 20 tax years (that is modelling it on the wording for the remittance basis charge). The wider implications of this change remain under consideration.

In straightforward cases this would mean that 6 years of non-UK residence might be required to break "deemed domicile" status (depending on the thinking on split year). This was felt to be unfortunate as there could be alignment issues with the time period that it was necessary to be outside of the UK to avoid the various temporary non-residence rules[1]. The Representatives argued that having a standard five-year non-UK resident period across the board would be simpler.

HMRC/HMT thinking on how the statutory split year rules will interact with the provisions is only at a provisional stage. Initial HMRC/HMT thoughts are that, when considering whether the "15 out of 20" preceding tax year test is met, any tax year during which the individual was UK resident will count in full (regardless of whether split year applies). This is because an individual can only come within one of the Sch 45 Part 3, FA 2013 "split year" cases and qualify for split year treatment if they are UK resident for the tax year so this issue would fall away.

If the tax year that the individual becomes "deemed domiciled" is also a tax year during which the split year rules apply there will be a misalignment between (i) Income Tax and CGT where relief under the statutory split year provisions will apply for the income and gains in the overseas part of the year; and (ii) IHT where (unless special provisions will be enacted) there will be no relief for chargeable transfers of value. Currently there are no plans for such an IHT relief but it is not an issue that the HMRC/HMT representatives had considered before the meeting and was noted down for further consideration.

Concern was expressed over the comments in the technical note on the "inheritance tax tail" and potential transitional provisions. Whilst a transitional period, for those who had left the UK prior to the Chancellor's announcement, before moving to the "more than five years of non-UK residence" requirement was welcomed it was felt that this should be limited, so that the on-going legislation was not unduly complex. HMRC/HMT had not envisaged any transitional period so had not had the chance to consider these issues in detail and again made a note of the points made.

Offshore trusts

The intention is that UK resident individuals who are deemed domiciled under the "15 out of 20" rule will only be taxed to the extent that benefits are received. The technical note issued on this at the time of the Budget suggested the same treatment for all income. The HMRC/HMT officials at the meeting said that it was only to apply to foreign income and UK income would be taxed as usual on the Arising Basis. There was some concern that this distinction would complicate matters and was in contrast to the position for CGT. However, the reasons why the Government would not want to change the position for UK income were understood.

HMRC/HMT's thinking on this issue is at a very early stage. Current thinking is that for an individual who becomes deemed domicile an alternative charge would be introduced such that they would not be charged under the current settlements legislation or the transferor charge. The new

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[1] As a result of the introduction of the statutory split year rules FA 2013 Sch 45 Part 4 adjusted the timeframe an individual has to remain outside of the UK to avoid the various temporary non-UK residence provisions to more than five years. Where split year applies as little as five calendar years and one day will avoid the rules. Where split year does not apply, six-tax years of non-UK residence are required.

charge would look to charge the deemed domiciled individual on the value of any benefits that they received from the structure. Such an approach was not without its difficulties and consideration would need to be given to situations were funds were remitted to the UK by relevant persons and whether such sums would be charged as a remittance as they are at present. Some of the Representatives expressed concern about the additional complexity that would be introduced as a result of the plans to have three different Income Tax anti-avoidance regimes:

- the rules for individuals with an actual UK domicile under general law;
- the rules for foreign domiciliaries who have not met the “15 out of 20” test; and
- the rules for individuals with a foreign domicile under general law who are “deemed” UK domiciled.

Such individuals felt that to avoid the complexity any change should apply to all foreign domiciliaries.

Since the thinking is at such a provisional stage it is not clear whether there will be new legislation modelled on the non-transferor charge or the legislation will tie into the current ITA 2007 non-transferor charge legislation (in the same way as was done for the CGT anti-avoidance legislation in Finance Act 2008). If the non-transferor charge relevant income pool is to be used the Representatives said that there should be a transitional provision so the settlor/transferor is only subject to tax on post 5 April 2017 income.

It was appreciated that the transfer of assets abroad motive defence will be a far more active issue after 5 April 2017 as prior to then, in many cases, the funds have just been kept offshore so there has been no need to make the claim.

For CGT purposes the TCGA 1992, s 87 beneficiary charge will continue to apply where there is a capital payment. It was suggested that for individuals caught by the “15 out of 20” rule there should be a 5 April 2017 rebasing (in place of the 5 April 2008 rebasing) to reflect the fact that such individuals had expected to not have a CGT liability provided the Remittance Basis Charge was paid and there was no remittance of capital payments. Whilst it was not ruled out this is not something that HMRC/HMT are currently looking at. The Representatives did comment that such a rebasing might encourage distributions so funds could be brought to the UK, which would be good for the wider economy.

3. Deemed domicile - the returning UK domiciliary rule

Definition

HMRC/HMT stated that the intention was that the new provisions would **not** catch individuals who were **born outside of the UK who had a UK domicile of origin**. Many of the Representatives greeted this response with surprise, as they did not see why being born in the UK should be a deciding factor. The HMRC Officials said that:

- Individual’s s born outside the UK to UK domiciled parents were already UK domiciled by law.
- They did not need to rely on any deeming provisions especially as it was considered that someone born outside the UK was more likely to have parents who stay outside the UK so the individual may genuinely acquire a non UK domicile of dependency/choice before returning to the UK.

The Representatives pointed out that the new rules could work very harshly. The fact that nothing has been announced to disapply the provisions to individuals who acquire domiciles of dependency in other countries or have lived for significant portions of their lives in other countries was felt to be a particular issue.

Various examples were given of occasions when the rules would be very unfair:

- An individual is born in the UK to parents who are married and the father has a UK domicile of origin. A year later the family emigrates to New Zealand. The individual becomes a citizen of New Zealand and lives there for 50 years. She only returns to the UK as an aunt has become very unwell and needs nursing. She does not envisage being in the UK for much longer than one tax year. The new provisions will mean that she cannot access the Remittance Basis and should she die her worldwide estate will be subject to IHT.
- An individual is born in the UK to parents who are married and the father has a UK domicile of origin. A year later the family emigrates to Canada. The individual becomes a Canadian citizen and lives in Canada for 40 years. He gets seconded to London for an 18-month period at the end of which he expects to return to Canada. The new provisions will mean that he cannot access the Remittance Basis (including not being able to benefit from Overseas Workday Relief) and should he die his worldwide estate will be subject to IHT.

HMRC/HMT appreciated that the rules could result in harsh outcomes in what the Officials felt to be a minority of cases and representations can be made about this. However, it was also recognised that the new rules were more generous than they could have been; for example an alternative deeming provision could have been proposed to catch anyone born in the UK regardless of whether they had a UK domicile of origin or whether or not they stayed here for very long. Ministers did not want to go this far to avoid complexity and for fairness. Additionally, the HMRC Officials are of the view that the illustrated scenarios are at the margins and the rules will provide winners and losers. In the above scenarios, the individuals will have certainty and will be able to rearrange their affairs as necessary. At present, these individuals have no certainty whether or not HMRC views them as UK domiciled or not (regardless of the amount of time spent outside the UK). This is seen to be fair to current UK domiciled individuals.

It was commented that provided the “15 out of 20” rule is not met and the individual’s domicile of origin has not actually revived there is no “IHT tail” when the individual leaves the UK. This was welcomed.

Retroactivity concern

It was pointed out that there was a failed PET issue if the individual makes a transfer of value offshore (at a time when they may have no thought of coming back to the UK) becomes UK resident and dies within seven years of making the transfer of value. It was suggested that for these individuals the legislation should just look back to the time when the individual first becomes deemed UK domiciled.

Offshore trusts

Current HMRC/HMT thinking was that for settlor interested trusts the same Income Tax and CGT anti-avoidance provisions would apply as for a UK domiciliary (so the settlement’s regime, transferor of assets abroad, and the TCGA 1992, s 86 settlor charge).

Various concerns were expressed about the IHT tax consequences where settlor interested offshore trusts are involved. Current HMRC/HMT thinking is as follows:

- Where an individual within the provision comes to the UK part way through a ten-year cycle and is in the UK at the time of the ten-year anniversary the decennial charge will be based on the quarters he has been deemed UK domiciled.
- If the individual leaves the UK prior to the ten-year anniversary there will be no IHT charge.
- The Gift with Reservation of Benefit (GROB) legislation will apply even if the trusts were settled in the period when the individual had the foreign domicile of choice.

4. Overseas Workday Relief (OWR)

No actual changes will be made to the OWR legislation but since it can only be accessed by foreign domiciliaries being "deemed domiciled" will mean an individual cannot made an OWR claim.

5. CGT losses election

The current TCGA 1992 s 16ZA legislation did not envisage deemed domicile being brought in for CGT. As such, it needs to be amended. The Representatives felt that where an individual becomes "deemed domiciled" from that point forward he or she should have access to UK and foreign capital losses in the same way as a UK domiciliary, that is:

- an individual who previously could not claim foreign capital losses, as he or she did not make the election, should be able to claim foreign capital losses (in addition to the UK capital losses they have always been entitled to claim); and
- an individual who opted into the alternative (potentially less favourable) capital loss regime, so as to be able to continue to claim foreign capital losses, should going forward be able to claim all capital losses on the same basis as UK domiciliaries.

6. Problematic interaction with temporary non-UK residence rules

One of the Representatives gave an example of a problematic interaction between the new provisions and the temporary non-UK residence rules.

On 2 January 2015, prior to the announcement, an individual, who would have met the "15 out of 20" rule if it had been in force, left the UK on a three year secondment. Between January and June 2015 she made various disposals of foreign assets at very significant gains with the expectation that when she returned she would pay the £90,000 Remittance Basis Charge and not have to pay tax on the gains (as there would not be any remittances). Without a transitional provision the changes mean that she will not be able to access the remittance basis when she returns to the UK, so she will have a very significant CGT liability. This seems wholly unfair since she had no way of knowing about this change she they made the disposals.

Again HMRC/HMT said they would take the point away and consider it. Additionally, it should be noted that HMRC can still challenge an individual who claims to be non UK domiciled so if she had returned to the UK and HMRC successfully challenged her domicile status, she would have had the CGT liability anyway.

7. De minimis less than £2,000 of unremitted income and gains

The £2,000 de minimis was brought in to ease compliance burdens and was particularly aimed at the lower paid and migrant workers. It was felt unlikely that such individuals would be caught by the "15 out of 20" rule. However, it was acknowledged that the Representatives who were attending the meeting were not best placed to respond on this issue and it was suggested that HMRC/HMT contact TaxAid and Low Income Reform Group (LITRG).

HMRC/HMT Officials commented that savings income of £2,000 was still a relatively large amount for some individuals and that even if these individuals were brought into SA, it was likely that UK tax would be offset by tax paid in their home country. The onerous nature of being within SA and making the treaty claim was commented on.

8. General IHT issues

Change of dates

As at 6 April 2017 a number of individuals will acquire “deemed domicile” status. Whilst there is no grandfathering this is not retrospective in so far as it does not impact on past actions taken. For example: a trust settled on 17 January 2017 when an individual is not deemed domiciled under either the current “17 out of 20” rule or the “three year” rule but would be under the proposed “15 out of 20” rule will continue to be excluded property after 5 April 2017 (though see the comments in section 3 on settlor interested trusts). If property is added after 5 April 2017 it will be partly excluded and partly relevant property with all the difficult compliance issues that results in.

9. Transitional provisions to make compliance easier

The Representatives made a number of points with respect to the complex compliance issues for individuals.

Under the current tax regime individuals can remain subject to the Remittance Basis throughout their time in the UK (provided they do not acquire a UK domicile under general law). This means that such individuals never have to report their income and gains on a worldwide basis. Since doing so can be extremely complex (particularly with offshore structures where there are significant entity classification difficulties) this in itself represents a huge remittance basis benefit and many individuals will even pay the £90,000 charge on an annual basis just to avoid the compliance burden of the Arising Basis.

The case was made for transitional provisions for pre 8 July 2015 funds (in mixed accounts and within trusts) as such provisions would minimise the historic issues enabling individuals to go forward on a more secure foundation. A flat rate tax at 10% (to reflect the fact that when the analysis is carried out there is typically significant capital within the fund) was suggested. There was concern from HMRC/HMT that this was not “fair” and would again give foreign domiciliaries an advantage. It was suggested that for offshore trusts this transitional provisions could be extended to everyone regardless of domicile as a way to simplify the compliance. It was appreciated that even then concerns could be raised with respect to “fairness” but the strategy should result in tax being paid and funds coming into the UK, so overall the UK should benefit. Like the LDF it could be said to represent a pragmatic way forward. HMRC said that the main thrust of the proposals is to put deemed UK domiciliaries on an even footing with UK domiciliaries and not only would the suggested charge be perceived as unfair but it would introduce another tax and another level of complexity.

10. Offshore trusts - compliance

It was felt that the compliance issues could be challenging for offshore trustees and HMRC. An example was given of a settlor born in the UK with a UK domicile of origin who lived in Hong Kong for 25 years, set up a charitable trust, left Hong Kong and had no further contact with the trustees. The question posed was how would the trustees or HMRC know about the whereabouts of the settlor. HMRC felt that the Common Reporting Standards and the 4th Money Laundering Directive should make this easier. Many of the Representatives felt that these sources of information would not necessarily be sufficient.

11. New rules for UK residential property held indirectly by foreign domiciliaries

It was made clear that the existing provisions with respect to UK residential properties held within enveloped structures (ATED and ATED-related CGT) would not be abolished as a result of this measure, as the Government saw them as being necessary to prevent SDLT avoidance. This was considered unfortunate by a number of the Representatives since “envelope” structures were used for an IHT shelter not SDLT avoidance, so the changes addressed this issue.

Detailed issues with respect to the proposals were not discussed as there was no time and there is longer to consider the proposals (since legislation is being included within Finance Bill 2017 rather than Finance Bill 2016).

One point that was raised was what would happen with respect to deductibility where debt is secured on shares of the company rather than on the UK residential property itself. Initially HMRC/HMT said that the debt would not be allowed. There was further discussion and it was pointed out that this would be very unfair given that when the loan was taken out and security given this change could not have been foreseen. Allowing a deduction, since there was a UK tax charge on the underlying UK property, did seem in keeping with the intention of the Government and it was hoped that the legislation would be written in such a way that such loans would be deductible. HMRC/HMT accepted that this issue needed further consideration.

There was a discussion with respect to enveloping and getting out of structures. It was stated that the Government would like individuals to exit such structures and that it was appreciated that doing so could result in dry tax charges. It was explained that these could be very significant and prevent an individual from exiting the structure.

There was no desire on the part of HMRC/HMT to have on-going legislation to enable a structure to be collapsed in such a way that dry tax charges could be avoided but there was the possibility of relief for a limited period. The Representatives agreed that all that was required was a transitional provision but that the period needed to be long enough to allow the necessary time for re-organisations to take place (keeping in mind the need to liaise with foreign advisers). SDLT and IHT charges might be waived to enable structures to be wound up. For CGT it would seem that holdover without either the ATED-CGT or normal CGT base costs uplifts is the best envisaged. It was suggested that main residence relief should be allowed where the individual to whom the residential property is transferred has used it as their main residence. HMRC/HMT said they would consider this further with the ultimate decision as always lying with Ministers.

It was agreed that enacting transitional provisions to allow structures to be collapsed without dry tax charges would be best. A second best alternative would be a US tick the box approach. This would mean ticking the box to treat the company (or other corporate entity) as transparent for UK tax purposes with details of the beneficial owner being provided. This would also be appropriate where a company was required for non-tax purposes but the owners wanted the structure to be transparent for UK tax purposes.

12. Related matters – collateral and relevant debts

The Representatives asked HMRC when clarification could be expected with respect to the August 2014 HMRC announcement (see webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/news/remittance-basis.htm) that it had changed its settled view on the use of foreign income and/or gains as collateral for a relevant debt. It is hoped that there will be further HMRC guidance published in the next few months. In the interim the only clarification of the August 2014 announcement is the published minute (included within TAXREP 52/14 available from www.icaew.com/en/technical/tax/tax-faculty/tax-faculty-representations/2014-tax-representations) from a September 2014 meeting between Officials from HMRC/HMT and representatives of CIOT, Expatriate Forum, ICAEW Tax Faculty, Law Society and STEP.

Postscript
A follow up meeting between HMRC Officials and representatives of CIOT, Expatriate Forum, ICAEW Tax Faculty, Law Society and STEP has been arranged for the afternoon of 7 October 2015. It is hoped that further guidance will be published soon after this meeting.

NOTE OF MEETING THURSDAY 13 AUGUST 2015 FROM 14:30

Re Changes to the taxation of foreign domiciliaries announced by the Chancellor at Summer Budget 2015

Attendees:
Officials from HMRC and HM Treasury ("HMT")
Representatives of the various professional bodies (including ICAEW Tax Faculty), the Expatriate Forum and various interested professional firms ("the Representatives")

1. Introduction

The same ground was covered as at the 23 July meeting.

It was made clear that the work on the changes to the taxation of foreign domiciliaries were only being given priority over the IHT changes to the taxation of UK residential property held indirectly by foreign domiciliaries/excluded property trusts, as the Chancellor has decided that the changes to the taxation of foreign domiciliaries will be enacted in Finance Act 2016 and the IHT changes to the taxation of UK residential property will be enacted in Finance Act 2017. Prioritisation is necessary as (broadly) the same HMT/HMRC people are working on both.

Since both sets of changes are effective from 6 April 2017, it is appreciated by HMT/HMRC Officials that foreign domiciliaries are just as concerned about the IHT changes to the taxation of UK residential property held indirectly by foreign domiciliaries/excluded property trusts as they are about the more general changes. It was also appreciated that affected individuals needed sufficient time to consider re-arranging structures. As such, the Consultation Document on the residential property changes will be published as soon as possible (hopefully before the end of 2015).

The Chancellor has set the yield that he wants to achieve from the changes, so the scope for movement is limited and any changes to the proposals must overall be tax neutral.

It is hoped that the Consultation Document on the changes to the taxation of foreign domiciliaries will be published soon after Ministers return in early September. There was a request from the Representatives that a further series of meetings be held after the Consultation Document is published, perhaps about three quarters of the way through the consultation period.

The Consultation Document will contain some draft legislation on the basic concepts such as the definition of the "15 out of 20" test and the "reversion of UK domicile of origin" rule. Some points in the document will have been further thought through by HMRC and others will be more open to discussion. It will be clear which are which.

The negative impact that constant change has on UK resident foreign domiciliaries was raised. A request was made for a statement from the Chancellor that there would be no further negative changes during this Parliament. The HMT/HMRC officials said that this was something that the Representatives could include in their representations.

HMT/HMRC Officials acknowledged the mobility of UK resident foreign domiciliaries and said that the costings had taken into account:

- individuals ceasing to be UK resident; and
- planning through the use of an offshore trust.

The Representatives said that it was very important to not repeat the mistakes of 2008, as this could be disastrous with respect to the individuals that the UK economy needs to attract. It was

pointed out that the issue is not just who leaves but also who does not come to the UK because of the measures (indeed this was said to be more important and can never be measured).

There was also a general plea for simplification. As part of this improving the Business Investment Relief legislation was raised (designed to encourage foreign domiciliaries to invest in UK trading companies but the take up has been disappointing because of issues with the legislation). HMT/HMRC said that the Minister was keen for this to be discussed and moved forward.

HMT/HMRC was asked whether there would be anti-forestalling rules to prevent pre 6 April 2017 planning (particularly settling offshore trusts) and on-going rules to prevent the establishment of offshore trusts in the 15th tax year. No such rules are currently being considered.

2. Deemed domicile – the “15 out of 20” rule

The definition

Thinking on this has been developing and the issue will be covered in detail in the consultation document.

There was an initial desire to have an aligned test for Income Tax, capital gains tax (CGT) and inheritance tax purposes (IHT), but HMRC Officials were not now entirely sure that this would work given the IHT “deemed domicile tail” and the temporary non-residence provisions for Income Tax and CGT.

The HMT/HMRC position was still that:

- residence in any part of a tax year should count,
- years during which the individual is dual resident and treaty resident in a different jurisdiction should count; and
- it would be the 16th year in which “deemed residence” kicked in.

It was suggested that counting residence in any part of a tax year was unfair and that there should be a disregard where the tax year was a year during which the individual spent less than 45 days in the UK. This was, however, felt by some to be introducing unnecessary complexity and that applying the split year rules and just counting the UK part would be better if one is only to reflect actual residence in arriving at the 15-year threshold.

Concerns were raised about determining residence with certainty for years prior to the statutory residence test (SRT). It was suggested that transitional provisions could be introduced so individuals had the option to elect for these purposes to determine residence for pre SRT years using the SRT rules. It was pointed out that pre SRT uncertainty over residence had always been an issue for IHT deemed domicile and was going to be an issue for Income Tax and CGT with the new £90,000 charge for access to the Remittance Basis.

It was agreed that a six year break was necessary to re-set the “deemed domicile clock if the intended “15 out of 20” provision is enacted. Where the taxpayer did not qualify for split year this was in line with the temporary non-UK residence provisions for Income Tax and CGT (see footnote 1 to the minutes of the 23 July 2015 meeting).

The technical paper suggested adjusting the IHT tail with respect to “deemed domicile” so individuals cannot lose an “actual” UK domicile quicker than “deemed UK domicile. It was stressed that this was just a proposal but the HMT/HMRC Officials did say that the simplification benefits (from having the one definition) were attractive.

However, the Representatives expressed concern about what would be a doubling of the IHT tail for those seeking to loose an actual UK domicile of origin and gave an example of an individual who:

- left the UK for what he or she thought was a temporary period of absence in Zurich;
- lived in Zurich for four years;
- after four years decided to stay in Zurich permanently.

Making such an individual spend an additional six years outside the UK before he or she could lose their UK domicile of origin did not seem right, since it was so hard to lose an “actual” UK domicile of origin.

Offshore trusts

Again the same ground was covered as at the 23 July meeting. The Chancellor wants a loosening of the anti-avoidance provisions to provide a limited counter balance for the loss of the Remittance Basis. To make this a reality HMRC were considering the following new regime just for those caught by the “15 out of 20” rule:

- UK source Income Taxed as it is now on the Arising Basis;
- Foreign source income only taxed where benefits are received.

Working this through was, however, throwing up a number of complicated problems in terms of the transition between being UK resident foreign domiciled and UK resident deemed UK domiciled. There were various anomalies and there is a significant amount of further work to do on this.

The Representatives made the point that that these complex issues could be avoided, and encouragement given to investment in the UK, if the rules were changed for ***all*** foreign domiciliaries (whether or not deemed domicile has kicked in) such that there was taxation only when benefits were received. Broadly this would be aligning the Income Tax anti-avoidance rules with the CGT rules. It was appreciated that HMT/HMRC would be concerned that the tax yield would be reduced by the proposal, so the following points were made:

- Careful segregation of income and appropriate Remittance Basis claims will shelter foreign income from UK tax where an individual would not meet the “15 out of 20” test (so is taxed under the settlement’s regime/transferor charge), so going to one rule based on benefits received should not result in a reduction of the tax yield.
- Offshore trusts do not now generally invest in UK assets so changing the provisions such that UK source income would not be taxed on the Arising Basis would not significantly alter the tax yield but might encourage investment in the UK (so overall benefit the UK economy). It was, however, appreciated that it might be difficult for HMRC to let tax on the Arising Basis on UK source income go.

The current intention is that the “relevant person” provisions will fall away when an individual becomes deemed domiciled meaning that an offshore trust can invest in the UK using trust foreign income without this being a deemed remittance by the settlor/beneficiary.

As mentioned, the Chancellor has made it clear that he wants a special regime for trusts only (not companies owned directly by a UK resident foreign domiciliary). It was pointed out that the legislation contains a number of different definitions of trusts (TCGA 1992, s 86 (which is the same as the definition in the Income Tax settlements’ legislation), TCGA 1992, s 87 and the IHT definition). It was felt that it would be appropriate for the definition used to be the widest (so the TCGA 1992, s 86 definition). HMRC said it would consider the issue.

There are no plans for the special regime to apply to entities other than trusts.

3. Deemed domicile - the returning UK domiciliary rule

Definition

In line with comments at the 23 July meeting the Representatives expressed considerable surprise that the current plans were to restrict the scope of the legislation to those born in the UK. If those with a UK domicile of origin were to be targeted it was generally felt that it should apply across the board, since where an individual was born could be arbitrary. HMT/HMRC said that this could be a question in the Consultation Document.

HMRC asked about whether steps might be taken to try to ensure children were not born in the UK if the legislation as currently contemplated was enacted. It was felt that this would be the case.

EU issues with respect to freedom of movement were raised briefly.

The potential unfairness of the proposals was also raised with similar concerns to those voiced at the 23 July meeting. It was felt to be very unfair to penalise individuals for something beyond their control when they had established a foreign domicile of choice and were only returning to the UK for a temporary period. Some of the representatives felt that if this was the Government policy then it had to be followed and the unfairness was just inherent, as any softening would lead to complexity. Others felt that complexity could be avoided and there could be a softening if there was a period of grace during which the individual could be UK resident without the “deemed domicile” provisions coming in. It was suggested that it might be tax neutral to extend the scope to cover all individuals with a UK domicile of origin but introduce a period of grace of say three years (this would cover a typical secondment and be long enough to also cover any temporary period of residence to care for a sick relative).

Individuals born in the UK to foreign domiciled parents were specifically not being targeted by these proposals, as the Chancellor did not feel they were so connected to the UK. If they do remain in the UK for a sufficiently long period they will be caught by the “15 out of 20” rule.

It was pointed out by HMT/HMRC Officials that the provisions could become very complex and that this was not acceptable since the Chancellor had specifically decided to keep as much as possible to the general law domicile definition and not to have a statutory domicile test.

Gift made prior to UK residence period followed by death within 7 years

HMRC confirmed that there are no plans to change the legislation, so the IHT rules on deemed domicile will work as now meaning that a gift made offshore when the individual was foreign domiciled will not be a failed PET if the individual acquired a deemed domicile and dies within seven years of making the gift.

4. Employment income issues raised

The rules with respect to general earnings, bonus and stock options will not be changed and will mean that any such elements that relate to a period of foreign domicile will be taxed as such even if paid out when the individual is deemed to be UK domiciled. The position is, however, different for pensions. It was agreed that this was the case and HMT/HMRC do not see any reason for special provisions.

5. CGT losses election

Same ground covered as at the 23 July meeting. It was agreed that “deemed” UK domiciliaries should be treated in the same way as “actual” UK domiciliaries. Unused losses from the foreign domiciled period can be brought forward where an election has ***not*** been made. At the 25 August

meeting HMRC suggested that the positon might be different if the individual had made the TCGA 1992 s 16ZA election (it is not clear why this should be the case).

6. Amnesty suggestion

At the 23 July meeting the complex compliance rules were raised and a request made for transitional provisions with a flat rate (say 10% - to reflect the fact that when the analysis is carried out there is typically significant capital within the fund) tax charge on remittances. HMT/HMRC rejected this on the grounds that it cut across the “fairness” policy. A similar proposal (though this time with the higher 28% CGT rate being suggested) was made at this meeting with it being referred to as an “amnesty”. This was rejected by HMT/HMRC for the same reasons as they gave at the first meeting.

7. Rebasing

Some of the representatives made the point that individuals will be taking part in very significant rebasing exercises with respect to investments (particularly shares and securities) prior to 6 April 2017 and that the sales and acquisitions (after 30 days) might impact on the stock exchange. As such, a request was made for rebasing so the actual sales and acquisitions would not be necessary.

Whilst the point being made was appreciated it was pointed out that there was no rebasing when an individual became UK resident.

8. General trust issues

It was agreed that whether an individual was deemed UK domiciled under the “15 out of 20” rule or the “reversion to UK domicile of origin” rule he or she could not benefit from the FA 2008, Sch 7, para 126 “rebasing election” as that legislation can only benefit individuals who for UK tax purposes are treated as foreign domiciliaries.

The trust issues are felt to be the most difficult aspect of the changes. It is possible that drafting on these may not be finished by the time the draft Finance Act 2016 clauses are published in early December 2015.

9. New rules for UK residential property held indirectly by foreign domiciliaries

The Government policy is very clear in that IHT should apply in addition to ATED and ATED-related CGT. ATED will not be abolished.

The provisions as they are expected to apply to trusts were clarified. Where there is a UK residential property within a company held by a trust there will be:

- exit charges;
- decennial charges; and
- charges on death if the gift with reservation of benefit provisions apply.

To prevent manipulation of the ten year charge (by removing the UK residential property just before it is due) there will be a charge if there was UK residential property in the structure at any point during the ten years. The charge will be on the period during the ten years that the UK property was within the structure. Consideration needs to be given to the date to be taken for determining the market value of the property.

The question of how liabilities would be treated was again raised and as at the 23 July meeting HMRC said that it was considering the issues.

HMT/HMRC confirmed that there would be nothing in the Consultation Document about treaties. It was commented that the US/UK IHT treaty might provide protection to US domiciliaries against these provisions. The interaction with other treaties was raised; this was said to be a matter for a different HMRC team.

De-enveloping

De-enveloping was discussed and the same issues were raised as at the 23 July meeting in connection with "dry" tax charges. The Representatives asked for relief so that structures could be collapsed without incurring such charges. HMT/HMRC was not opposed to this but did not want a permanent relief to be enacted. The Officials did, however, appreciate that affected individuals would not want to do anything until they have seen the final legislation, so it was agreed that a 5 April 2017 deadline for re-organisation would not be appropriate.

Whilst the Representatives agreed with HMT/HMRC that there should be sunset clause it was felt that the relief should last until at least 5 April 2022 (five years after the legislation coming into effect) to give non-residents long enough to appreciate the impact of the changes on their situation and to then re-arrange.

For non-residents it was explained that stamp duty land tax (SDLT) was a particular issue as often the UK residential property was acquired at least in part using loan finance

From a CGT perspective the simplest way forward was suggested to be to effectively hold/roll over the gain by transferring the company's base cost and acquisition date to the foreign domiciliary/non-UK resident trust. HMRC will consider how far this deeming might go (that is could the company be deemed to have not existed such that main residence relief can be claimed).

The HMT/HMRC Officials felt that it was going too far to allow a transitional relief so a UK residential property could be removed from a trust structure to an individual beneficiary without a tax charge arising at that point. Trying for a hold/roll over of the specific gain to the beneficiary receiving the property was felt to be too complicated given the way TCGA 1992, s 87 works and their aim is just to get UK residential properties out of corporate structures.

As there are different definitions for settlement for IHT, TCGA19992 s86 and TCGA1992 s87 it was essential the right definition was used for the relief provisions and this needed to be considered.

NOTE OF MEETING TUESDAY 25 AUGUST 2015 FROM 10:30

Re Changes to the taxation of foreign domiciliaries announced by the Chancellor at Summer Budget 2015

Attendees:
Officials from HMRC and HM Treasury (“HMT”)
Representatives of the various professional bodies (including ICAEW Tax Faculty), the Expatriate Forum and various interested professional firms (“the Representatives”)

This meeting lasted around an hour. The discussions mostly covered issues raised in earlier meetings. HMT/HMRC thinking had, however, developed somewhat and the attendees were different so the discussions did cover some new ground.

1. Introduction

The same ground was covered as at the previous meetings.

Further detail was given about how the £500 million the changes were scored to yield was arrived at. The figure was calculated by HMT based on information held by HMRC in the High Net Worth unit and other sources, and did not include estimates for secondary impacts (PAYE, VAT etc.).

HMRC is still hoping to publish the Consultation Paper on the “deemed domicile” changes soon after 7 September 2015 (when Parliament Returns) but wanted to consult as much as possible before hand as there was a risk that publication could be delayed. If this did happen the time available for commenting on the Consultative Document might be as little as five weeks; HMRC emphasised that comments could still be made during that truncated period and meetings held.

2. Deemed domicile – the “15 out of 20” rule

The same ground was covered as at the previous meetings.

Legislative wording

HMRC thinking on the wording of the “15 out of 20” rule and whether it would be possible to align “deemed domicile” for Inheritance Tax (IHT) with the “deemed domicile” concept for Income Tax and Capital Gains Tax (CGT) has been fluid. At this meeting HMRC stated that it intended to amend the wording in the inheritance tax (IHT) legislation to be consistent in methodology with new deemed domicile rules for Income Tax and Capital Gains Tax (CGT). This does not, however, mean that the wording used for the test will be consistent with that for the Remittance Basis Charge tests.

Moving between being foreign domiciled and “deemed” UK domiciled

The Representatives asked how HMRC envisaged the new rules working in the scenario of an individual who:

- when foreign domiciled, purchases units in (for example) an offshore non reporting fund using a mixture of remittance basis income and gains;
- becomes deemed domiciled and sells the units at a profit,

Assuming there were no changes to the taxing provisions the profit element would be subject to Income Tax on the Arising Basis and the initial sum invested would be taxable only if remitted (with normal matching rules applying). The Representatives asked the HMRC Officials to confirm that no changes were envisaged and to agree the analysis and the HMRC Officials were able to do this.

Offshore settlor interested trusts

The Chancellor determined that pre "deemed domicile" trust structures should retain UK tax protections as an encouragement to foreign domiciliaries who might otherwise leave or never come to the UK.

- The IHT provisions will be unchanged with the trust continuing to be excluded property.
- For CGT the individuals will continue to be excluded from TCGA 1992, s 86 (attribution of gains to settlors with interest in non-resident or dual resident settlements) and within the scope of TCGA 1992, s 87 (Non UK resident settlement: attribution of gains to beneficiaries).
- Broadly, for income tax purposes, a new regime is proposed:
  - UK source income will continue to be taxed on the Arising Basis; and
  - foreign income will only be taxed when benefits are received from the structure.

  As set down in the minutes to the previous meetings, enacting the necessary provisions will be complex.

HMRC technical specialists have continued to consider the challenges in enacting the new Income Tax regime. They are not attracted to modelling a new charge on the TCGA 1992 s 87 provisions as these allow for gains to be "paid away" through capital payments to non-residents.

HMRC also stated that it could introduce a new charge on benefits, which was not modelled on either the current settlement's legislation or the transfer of assets abroad rules. The Representatives suggested this was the equivalent of determining that the non-transferor charge should automatically apply to all such settlements. HMRC said that this was not the case as:

- the current rules for taxing UK source income on the settlor/transferor on the Arising Basis would continue to apply; and
- they were looking to widen existing "benefit in kind" rules.

3. Deemed domicile - the returning UK domiciliary rule

The same ground was covered as at the previous meetings. Again the Representatives commented that the proposals could result in some very capricious results.

4. CGT losses election

Same ground covered as at the previous meetings that is "deemed" UK domiciliaries to be treated in the same way as "actual" UK domiciliaries.

The position with respect to unused capital losses accruing in the foreign domiciled period was discussed. Provided a TCGA 1992, s 16ZA has ***not*** been made HMRC officials were clear that the losses should be available to be carried forward.

The position where a TCGA s 16ZA election has been made had not been fully thought through and HMRC Officials thought that the changes might result in such individuals losing pre 6 April 2017 unused capital losses. It is not clear why the distinction should be made.

5. Practical issues

UK/Swiss Agreement

The Representatives stated that Banks would need guidance in relation to the UK/Swiss agreement as to the application of the withholding tax rules.

Amnesty

As at previous meetings the complexity of the Remittance Basis rules was raised and a request made for simplification and transitional provisions with a flat rate tax charge on remittances. Again HMT/HMRC rejected this on the grounds that it cut across the "fairness" policy.

Offshore trusts

The Representatives emphasised the practical problems where existing offshore settlements, for which it had never been anticipated that there would be any UK tax exposure, were now caught up in the new rules as a result of UK resident beneficiaries being "deemed domiciled". In many cases records were not available, especially where there had been changes in Trustees and the previous Trustees did not provide detailed historical records.

The HMRC Officials did not consider that the issue would be as significant as suggested, they felt that such problems could be addressed by FAQ's, but the Representatives disagreed as they felt the guidance given would need to be so significant that it would amount to legislation by the Administration rather than by Parliament.

The Representatives suggested that there were insufficient professional resources available to advise a significant number of clients with modest (say less than £500,000) offshore trusts.

6. Rebasing

As at previous meetings a request was made for rebasing, so affected individuals did not have to carry out significant exercises involving disposals of shares and securities prior to 6 April 2017 and acquisitions after 30 days (sheltering the gain by claiming the Remittance Basis and securing a higher base cost for disposals in future tax years when they will be taxed on the Arising Basis).

HMT/HMRC appreciated that without rebasing provisions such exercises would be carried out. There are no current plans for rebasing but the points raised would be passed on to Ministers and individuals could raise it again in their responses to the Consultation Document.

7. New rules for UK residential property held indirectly by foreign domiciliaries

Detailed issues with respect to the proposals were not discussed as there was no time and there is longer to consider the proposals (since legislation is being included within Finance Bill 2017 rather than Finance Bill 2016).

The Representatives did raise one technical issue with respect to how an exit charge will be calculated where the previous decennial anniversary has fallen in the period before the new law applied (so prior to 6 April 2017). HMRC/HMT accepted that this issue needed further consideration. It was suggested by the Representatives that the LDF Composite rate scheme might be a precedent to address this problem.

Re-structuring

The Representatives asked what the approach would be to retaining existing offshore companies as legal owners but changing the arrangements so that they became nominees of the existing Trustees/beneficiaries. HMRC did not answer this question but commented that they would be unhappy to see the corporate owner continuing to exist.

Similar discussions took place as in the previous meetings with respect to the need for a relief to enable structures to be collapsed. The Representatives:

- asked that rollover relief be given for CGT with the charge only applying on ultimate sale; and

- highlighted the stamp duty land tax (SDLT) issues in de-enveloping where existing mortgages/loans needed to be replaced. A relief would need to remove the SDLT charge in these circumstances.

Information issues

The Representatives asked HMRC what the approach would be where they were unable to ascertain the beneficial owner or corporate owners of UK residential property. HMRC were aware of the problem and suggested that information might be requested in ATED returns. The Representatives pointed out that the Directors of such bodies corporate, who were responsible for completion of the ATED form, might now know the identity of the beneficial owner.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)