# TECHNICAL RELEASE

TAXGUIDE 12/15 (TECH 15/15TAX)

**REFORMS TO THE TAXATION OF NON DOMICILES – MEETING NOTES**

**Note of meeting with HMRC/HMT on 26 October 2015 published by ICAEW Tax Faculty on 5 November 2015**

# ABOUT ICAEW

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 144,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including a monthly journal *TAXline* sent to more than 8,000 members, a weekly newswire sent to more than 36,000 subscribers and a referral scheme. The Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark the tax system are summarised in Appendix 1.



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# FOREWORD

In the Summer budget on 8 July 2015 the Chancellor outlined reforms to the taxation of non domiciles in the UK. Changes would be made to introduce the concept of deemed domicile for income tax and capital gains tax in Finance Bill 2016 to be effective from 6 April 2017.

Meetings were held in the summer, reported in TAXGUIDE 08/15, prior to the publication of the consultation document on 30 September 2015. Further meetings have been organised by HMRC/HMT following publication of the consultation on 26 October 2015 and 3 November 2015. ICAEW volunteers attended the October meeting and have produced these notes of the meeting.

HMRC have seen the note of the conference call and suggested some changes which have been accepted.

# NOTES OF MEETING HELD 26 OCTOBER 2015

**Consultation on reforms to the taxation of non domiciles**

**Attendees:**
**Officials from HM Revenue & Customs and HM Treasury ("HMRC/HMT")**
**Representatives of the various professional bodies (including ICAEW Tax Faculty), and various interested professional firms ("the Delegates")**

## Notes of the meeting

1. The consultation document reflects current thinking by HM Treasury (HMT) and HM Revenue & Customs (HMRC) on the changes to the taxation of foreign domiciliaries that the Chancellor announced during the Summer budget.

2. This document provides a note of the main points discussed during a meeting on 26 October. This meeting mostly focussed on offshore trust issues.

## Individuals

3. HMT/HMRC said that the draft legislation allowed a one year "grace period" for IHT purposes where an individual was born in the UK with a UK domicile of~~r~~ origin because the IHT consequences of dying in the UK during a short period of time back here would be so much worse than having to pay income tax and CGT as a UK domiciliary during that time.

4. Grandfathering of the 15/20 years rule prior to 6 April 2017 for individuals who remain resident after 5 April 2017 was discussed. In connection with IHT and those who leave the UK before 6 April 2017 who could still get caught by the 15 out of 20 rule, HMRC said that they wanted the present 17 out of 20 rule to apply to those individuals.

## Offshore trusts

5. As regards the taxation of offshore trusts once a UK resident settlor becomes deemed domiciled post April 2017. Legislation in relation to the taxation of trusts would now be enacted in FB 2017 (rather than FB 2016). In theory this meant that it could be as late as December 2016 before the publication of draft legislation, but HMRC/HMT said a skeleton outline of how the new proposals will work will be published as soon as possible next year and that a preliminary draft of the legislation would be published prior to December 2016.

6. Organised offshore pension trusts will not be subject to the new settlor charge and existing rules will apply to distributions to beneficiaries. Employee benefit trusts to the extent they are set up by an employee where the employee has no control over the company will not be subject to the new settlor charge, but if a director/shareholder procured the transfer into the trust HMRC may in such circumstances invoke S624 or S720 and in such circumstances the new settlor/transferor charge applying.

7. HMRC/HMT confirmed that in their view, if a trust were to be settled before 6 April 2017, even if it is settled in the taxpayers 16th year of residence (as meant in the deemed domicile test of 17/20), then that trust should benefit from the "new" trust regime for income tax/capital gains tax purposes – although what that new regime may be is still unknown.

8. HMRC/HMT confirmed that, the position as expressed in the consultation document (specifically paragraph 3.2), was that the deemed domicile settlor charge would be

triggered by payments of capital. The proposals in the consultation document were, however, preliminary and open for discussion (see paragraph 26 of these minutes).

9. If the consultative document proposal goes ahead the deemed domicile settlor charge would be triggered by payments of capital. The deemed domicile settlor charge would sit on top of the existing trust and income tax rules. Income tax settlement and s720 ITA 2007 would be switched off as regards settlor for foreign income only. So a settlor who received a benefit would pay a percentage tax charge, but other beneficiaries would be subject to s87 TCGA 1992 and s731 ITA 2007 as before.

10. This would mean that full record keeping would have to continue as before which is contrary to the statement in the consultation document that the proposal would ease record keeping; HMRC felt it would be easier as regards the settlor and said that presumably if there are currently UK resident beneficiaries receiving benefits from the trust irrespective of their domicile status the trustees will have had to have maintained such records as it will be for the beneficiary to decide under current rules whether to take advantage of the current remittance rules and if they do whether they remit benefits received to the UK

11. The settlor-deemed domicile charge would have to be dovetailed into the existing definition of s87 TCGA 1992 and relevant income. HMRC said the charge would reduce gains or income; new ordering rules would be needed to determine the allocation between income and gains. The delegates at the meeting believed this was making the matter unduly complicated particularly as it seemed to be matching by another name so would it not be more efficient to utilise the existing machinery?

12. At this meeting it was not clear to the ICAEW representatives whether or not s86 would apply to a deemed domiciled settlor.

13. Delegates at this meeting asked what would be the position where several people live in a house one of whom is the settlor, how would the deemed domicile settlor charge interact with the regular rules? This scenario would need further consideration by HMRC.

14. HMRC/HMT was also asked about the potential for a double tax charge when UK sources income was appointed out to a settlor HMRC said a provision was needed to deduct the tax on the UK source income from the tax assessed on the settlor.

15. On a matter of policy the delegates asked HMT/HMRC why, in a dry trust structure a deemed UK domiciliary settlor should be subject to an annual benefits tax charge just because he or she is enjoying the free use of the property. HMRC/HMT indicated there was a public expectation that non domicile deemed domicile settlors should be seen to be paying tax on the use of assets held by offshore structures. HMRC/HMT is considering an elective option whereby a deemed domicile could elect into being taxed as if he or she were a UK domiciled and resident taxpayer, i.e. s86 TCGA 1992 and income tax settlement and s720 ITA 2007 applied. This option seems to be aimed at dry structures that did not make gains but it was not clear who would have the right to elect; HMRC/HMT consider it should probably be the settlor.

16. In order to look at this option in a practical context, the meeting tried to work through an example where a trust held a UK property which had appreciated strongly in value. The settlor lives in the house owned by a foreign company, there are no other assets. If the settlor elects for s86 TCGA 1992 treatment there are currently no deemed benefits and no annual tax cost on the free accommodation the settlor is enjoying. If the settlor has to sell the property (the proceeds being distributed to the trust and then to him) to meet unexpected costs there is a CGT cost on the gain realised in the trust. If no election is

made then there will be both an annual benefit charge (on the enjoyment of the property), and a benefit charge on the sale (on the capital distribution). The advantage of the election is the avoidance of the benefit charges.

17. Given the example of an interest in possession settlement where the income was taxed under Baker v Archer-Shee and little or no gains realised, HMRC/HMT confirmed that appointments of capital would suffer a charge to tax. The delegates said this was unattractive and after discussion HMRC/HMT agreed it was unattractive where extensive capital appointments from a trust were likely.

18. There were discussions on the interaction of the new deemed domicile proposals where they apply to the settlor of a trust and the remittance and s87 TCGA 1992 taxing provisions. HMRC was asked what would happen if the trust held unremitted historic s720 ITA 2007 income (or unmatched s87 TCGA 1992 gains). If cash was paid out to the settlor would the flat rate charge override the unremitted income charge, or would there be 2 charges? Initially HMRC/HMT thought the new settlor deemed domicile charge would apply solely. Delegates queried whether that made sense from an HMRC perspective. For example say the trusts had £1m of unremitted s720 ITA 2007 income, the settlor is now deemed domicile and the old income in capital form is paid to him. Would the blended tax rate apply to this payment and switch off the remittance rules? The delegates thought the rate on the deemed domicile charge would have to be lower than the normal rates to reflect the possibility overall that capital may be paid to a settlor so did it make sense from an HMRC/HMT point of view? HMRC/HMT queried why the rate should be lower. HMRC also made a comment here about having to consider the transitional position re the interaction of the old and new rules where there was an historic position.

19. The delegates asked what was the position if after 5 April 2017 old unremitted income or gains (so unremitted historic s720 ITA 2007 or unremitted income and/or gains settled into the trust) was invested by the trustees in the UK, could that be a remittance? Following a discussion around trustees having to cease to be relevant a person HMRC/HMT said they would have to take point away for consideration as the transitional provisions were still under consideration. The objective is not to deter inward investment into the UK.

20. HMRC/HMT realise that rebasing and various transitional reliefs will be lost by having deemed domicile charge. There would be no new rebasing provisions.

21. It was pointed out that the UK returners' rules could cause an offshore relevant property trust to dip in and out of tax under the ten year charge rules. HMRC/HMT was asked if it would try to impose a periodic charge in these circumstances. The class of taxpayers in this category was thought to be very small and HMRC/HMT were not sure if a charge would be imposed.

22. There was a discussion about how the rules will work concerning the definition of domicile, because of the mix of English and Scottish domicile rules – it could result in an individual who would not be domiciled anywhere. HMRC/HMT said they regarded IHT being driven by the term UK domicile. Delegates said that domicile was based on individual domicile rules with UK. HMRC/HMT had spoken to the Solicitors office and the parliamentary draftsman and were confident that where the tax legislation refers to a UK domicile that is taken to mean "has a domicile in one of the countries that form the UK".

23. The delegates voiced their concern that the new proposals would not work and that more time was required to work through the complexities HMT/HMRC stated that it was not possible to defer beyond FB 2017 and that the provisions will come in from 6 April 2017.

24. HMT/HMRC made it clear that they were open to alternative suggestions and would look at a modified s 731 option if that would fulfil the criteria. However, it was made clear that the transfer of assets abroad rules do a much wider job than dealing with non-domiciliaries so any suggested changes to these rules must take that into account and not undermine the effectiveness of the provisions.

# 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 )

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