ICAEW REPRESENTATION 137/17
TAX REPRESENTATION

FINANCE (No2) BILL 2017-19 (also known as FB 2017-18) - Clause 35 and Schedule 10

ICAEW welcomes the opportunity to comment on the Finance Bill published on 1 December 2017.

This briefing of 20 December 2017 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 2 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

The body of this representation explains the various issues with the draft legislation and, for ease of reference, the Appendix contains a clause by clause explanation of the shortcomings in the draft legislation.

Contents

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BACKGROUND

1. The current Finance Bill is being referred to as both Finance (No 2) Bill 2017-19 (parliamentary website) and Finance Bill 2017-18 (HMT and HMRC). For ease of reference we refer to it by the former or simply the Finance Bill (or FB for short).

2. The draft legislation consists of a single section (35) which introduces a single schedule entitled “Settlements: Anti-Avoidance etc” comprised of 2 parts as follows:

   - Part 1: Capital Gains Tax (CGT)
   - Part 2: Income Tax

3. Part 1: CGT makes various significant amendments to the CGT settlements’ anti-avoidance legislation (s87 et seq TCGA 1992).

4. Part 2: Income Tax makes various significant changes to:

   - the settlement’s regime (at s619 et seq ITTOIA 2005); and
   - the transfer of assets abroad (ToAA) regime (s714 et seq ITA 2007).

5. Finance (No2) Act 2017 (F(No 2)A 2017) also enacts changes to all of the provisions listed above. This means that the clauses in this Finance Bill cannot be viewed in isolation; rather the Finance Bill provisions must be considered together with the F(No 2)A 2017 legislation as they are intended to form a coherent package of changes to the offshore trust provisions. Our comments below, therefore, pick up on the:

   - main concerns we have with respect to the Finance (No 2) Act 2017 legislation; and
   - the interaction between the Finance (No 2) Act 2017 legislation and the Finance (No 2) Bill 2017-19 legislation.

6. Our comments are confined to areas:

   - where the legislation:
     i) does not work in accordance with the Government’s policy intentions; or,
     ii) is insufficiently clear; or,
   - where we want to confirm our understanding of how the legislation is intended to work.

7. Where changes are required to the legislation enacted in F(No 2)A 2017, we suggest they are included in the current Finance Bill with retrospective effect.

8. A meeting was held on 16 October 2017 (at which time the consultation period for the draft legislation was still open) between HMRC policy and technical officers and representatives from the professional bodies and other stakeholders. We were represented at this meeting and found it helpful as it provided a forum to discuss various relevant issues. Specifically, the following new CGT and income tax provisions were discussed in some detail:

   - close family member legislation; and,
   - the onward gift provisions.

9. Where relevant we have drawn on the additional detail provided in that meeting regarding the intent behind the current Finance Bill legislation.

10. Our key concerns with both Finance (No) 2 Act 2017 and with the current Finance Bill provisions are set out below. Appendix 1 sets down our detailed comments on Schedule 10 of the current Finance Bill.

11. We welcome the engagement from HM Treasury and HMRC throughout this process. However, there have been significant timing issues. The various political developments in 2017 resulted in long periods of purdah, thereby significantly reducing the time for consultation. In addition, the drain on available resources as a result of Brexit has clearly been an issue, and looks set to continue to be a problem for the foreseeable future.

12. Given the complexity of the provisions that had to be amended this position is highly unfortunate. Whilst we appreciate the work that would have gone into it, the 13 September 2017 draft legislation had various problems that needed to be addressed. We and other professional bodies made various comments on it but there has not been sufficient time and resources to consider everything properly and make the necessary amendments. The Finance Bill legislation therefore contains a number of significant flaws which are discussed below.

13. Our ICAEW Representation 109/17 set down various concerns that we have with the offshore trust legislation that became law as part of Finance (No 2) Act 2017:

    - As discussed in paragraphs 14 to 54 below, there are some important areas where provisions passed in that Act need to be changed with retrospective effect.
    - Our other concerns could potentially be dealt with in HMRC guidance, although that brings problems of its own.

CHANGES TO THE FINANCE (NO 2) ACT 2017 PROVISIONS

14. There are, as mentioned above, some important areas where the provisions of F(No 2)A 2017 dealing with offshore trusts need to be modified. These are discussed in detail below. Changes should have retrospective effect given that our recommendations are intended to make the legislation work as intended and would not be disadvantageous to those affected.

Issues with the protected foreign-source income (PFSI) definition

15. The ToAA legislation is complex and any changes made were always going to be difficult to draft. This is particularly the case as the pre F(No 2)2 Act 2017 ToAA legislation is problematic (the Tax Law Rewrite making clear various problems with the legislation that the previous ICTA 1988 drafting covered up due to its comparative brevity).

16. In reality, the whole of the ToAA legislation needs a fundamental overhaul but that would be a highly laborious task taking far more time than is available now. Depending on how long a project is envisaged this is something that could be considered as part of the trust simplification work announced in the November 2017 Budget. We would be pleased to be involved in this should such a project be undertaken.

17. As stated in our ICAEW Representation 109/17 we are concerned about s 721A (see paragraphs 84 to 96 of our earlier response) and s 729A (see paragraphs 99 to 107 of our earlier response).

18. **Suggested changes** - s 721A needs to be adjusted so that where there is an underlying company:

    - the necessary link between the trustees and the underlying company is precisely established; and
    - the PFSI definition is adjusted, so that where there is a chain of underlying companies and the income of the underlying company at the bottom of the chain has been taxed on the settlor (as a result of being “dividended” up to a non-UK resident company) it cannot be taxed again when it is “dividended” up to the trust.

19. The comments in connection with s721A above also apply for s729A. In addition, we are not clear why s729A(4)(d) is included (s729A(4)(e) following on from this). We are concerned that these provisions will restrict what can qualify as PFSI for an underlying company under s729.

20. **Suggested changes** - s729A(4)(d) and s729A(4)(e), ITA 2007 should be deleted.

Remittances by trustees – ToAA issues

21. A key intention behind the income tax changes was to align the remittance basis provisions with those for s87, TCGA 1992. That is, there should only be a tax charge on the settlor/beneficiary where the benefit is remitted to the UK and the trustees should be able to spend both pre 6 April 2017 and post 5 April 2017 trust income in the UK without triggering a remittance.

22. As discussed in detail in our ICAEW Representation 109/17 (specifically paragraphs 120 to 125 and paragraphs 127 to 128) the necessary changes to the ToAA legislation were not put through F(No 2)A 2017 to achieve this. The same problem is present in the current Finance Bill for the settlements legislation (s643F, ITTOIA 2005).

23. The legislation is complex and if changes are not made, trustees relying on the Government's policy statements are likely to assume that the legislation enacts what was promised. This means that inadvertent taxable remittances will be triggered where benefits are paid out to the settlor (or taxed on the settlor as a result of the close family member rules) and trust income is brought into the UK (to invest for example). This outcome is unfair and contrary to taxpayers' legitimate expectations because Government statements will have encouraged the trustees to invest in the UK on the basis that there would no longer be an inadvertent remittance trap.

24. **Suggested changes** - the legislation should be amended, so that income arising to the trustees (or arising within an underlying company) is not taken into account when considering if remittances have been made.

25. Instead it should only be remittances of the actual benefits that causes a tax charge on the settlor/beneficiary.

26. The ToAA legislation in F(No 2)A 2017 should be amended retrospectively to 6 April 2017 to deliver what was promised. This is particularly important as trustees may have already taken actions relying on the announced policy intention.

Remittances by trustees – settlements' legislation issues

27. There are issues with respect to pre 6 April 2017 income.

28. There should be alignment between the ToAA legislation for remittances of transitionally protected foreign source income and the settlements' legislation. Currently the ToAA legislation is far broader.

29. **Suggested change** – the settlements' legislation should be aligned with the ToAA legislation.

30. If the change in paragraph 25 is not put through the comments, in paragraphs 58 to 65 of our ICAEW Representation 109/17, will still be valid. The problem is that the s628C, ITTOIA 2005 transitional provision only considers the position of trustees, so is insufficient when there is one or more underlying company in the structure (as will often be the case).

31. **Suggested change** - the legislation should be amended so that in addition to excluding trustees from the definition of relevant income in relation to "transitional trust income" all underlying companies are also excluded.

32. We do not understand why the reference to 2008/09 is necessary in s 628C and believe that it just causes confusion (see paragraph 62 of our ICAEW Representation 109/17).

33. **Suggested change** – the reference to 2008/09 in s628C, ITTOIA 2005 should be deleted.

34. In addition to the above issues with s628C there is no transitional provision for either s629, ITTOIA 2005 or s633, ITTOIA 2005 pre 6 April 2017 income.

35. **Suggested change** – either introduce transitional provisions for s629 and s633 modelled on amended s628C or have one transitional provision that applies to all the settlements' legislation charging provisions.

Inadvertent extension of the scope of ToAA to non-UK resident settlors

36. We understand that the changes made to the ToAA legislation at ss731 to 732 ITA were to enable s733A ITA to attribute to the UK resident settlor a benefit paid to a non-UK resident close family member.

37. However, while we understand that it was not intended, the actual legislation goes beyond this. The F(No 2) Act 2017 amendments mean that a non-UK resident settlor will be subject to UK tax where there is a benefit to the settlor or a non-resident close family member and a matching of the benefit charge to PFSI. We assume that this must be unintentional (and requires amendment), since the provision charges UK tax on PFSI where there is a non-UK resident settlor who has no link at all to the UK. This cannot be right as it subjects to tax a non-UK resident on foreign income, when the same non-UK resident would not be subject to tax on UK income (as for UK income the transferor power to enjoy charge applies).

38. Recent cases indicate that taxpayers cannot rely on HMRC guidance so this point will need to be dealt with via legislation rather than via guidance.

39. Further changes are made by the current Finance Bill. We are not absolutely clear what the intention behind these changes is, they may have been deemed necessary to enable the ToAA onward gift provisions to work but we do not think that objective has been achieved. The new sub-section (1C) which is to be inserted into s731, ITA 2017 does not seem to restrict the scope of the F(No 2)A 2017 changes to UK residents but rather extends the situations in which the charge can apply to non-UK residents to situations where the new ToAA onward gift rule applies.

40. **Suggested change** – amend s731, ITA 2017, with effect from 6 April 2017, to reinstate the principal that UK tax can only be due under that provision where the individual liable for the UK tax under the legislation is a UK resident.

Tainting a trust

41. We cannot see why the trust protection provisions in F(No 2)A 2017 were drafted such that a transfer/loan between trusts that both enjoy protected status should be treated as tainting the recipient trust. Likewise, we do not see why splitting protected trusts is seen as an issue. We have raised these issues a number of times during previous consultations.

42. We were, and remain, disappointed that despite the fact that we can identify no mischief in either action, no changes were made. If these actions are not allowed they will cause significant practical difficulties. For some settlors, the inability to undertake this administrative exercise will be sufficiently onerous to negate any advantages from the protections and lead to them leaving the UK, which is not in accordance with Government policy to encourage inward investment.

43. **Suggested change** - the current Finance Bill should be amended with retrospective effect to 6 April 2017 such that: (i) transfers/loans between trusts that both enjoy protected status do not

taint trusts; and (ii) protected trusts should be able to be split with the new trusts enjoying protected status.

Aligning the tainting provisions with the new value of benefits provisions

44. To avoid tainting a trust, the fundamental principle is that transactions must be entered into on arm's length terms. The legislation (F(No 2)A 2017 sch 8 inserting s628B(8) and 721B(8) into ITTOIA 2005) specifically defines what constitutes "arm's length terms" for loans and this aligns with the new benefits provisions legislation (also in F(No 2)A 2017).

45. However, the tainting legislation does not cover the two other benefits dealt with in the benefits valuation legislation (these being movable property and land made available).

46. The concern is that without specific legislation aligning the provisions the individual may have to choose between paying tax on a benefit/capital payment and tainting the trust (as the valuation provisions give rise to a higher valuation than is the case under arm's length terms). For example, if a trustee lends an asset to the settlor and the market based commercial fee is (say) 2% of capital value, the settlor will taint the trust if he pays a higher fee under the new benefit valuation rules so as to ensure there is no benefit/capital payment.

47. We understand that HMRC intend to deal with this in guidance but as previously noted recent examples indicate a taxpayer cannot rely on HMRC guidance.

48. **Suggested change** – as for loans the tainting legislation should cover benefits received in relation to movable property and land made available aligning the provisions with the new benefits provisions legislation.

Settlors can now be taxed on pre-arrival foreign income within the PFSI definition

49. The benefits charge (s731 et seq ITA) has always included income arising to the trust prior to a beneficiary becoming UK resident within the "relevant income" pool if that income has not been paid away. Similarly, the CGT provisions (s87 TCGA) include unmatched pre-arrival gains.

50. The settlements' legislation (s624 ITTOIA) and the transferor charge (s720 ITA) were, however, different. These charging provisions only subjected the settlor/transferor to tax on income arising after the settlor had become UK resident.

51. For foreign domiciliaries it was generally the case that the settlor/transferor charge was in point as the individual set up the trust with the intention of being a beneficiary during his or her life.

52. The new tax regime is different as foreign domiciled settlors (unless they are born in the UK with a UK domicile of origin or are deemed domiciled as a result of being UK resident for 15 of the immediately preceding 20 tax years and have tainted the trust) are subject to the ToAA benefits charge and where this does not apply they are subject to the settlor benefits charge on trust income (which broadly mirrors the benefits charge and is introduced by the current Finance Bill).

53. Where trusts have been established long before the settlor came to the UK and there is significant pre-arrival income within the settlement this is a serious issue for settlors who do not want to be taxed on what they see as "clean capital". The change may mean that some individuals decide not to come to the UK and may lead to others leaving prematurely once the scale of the issue is appreciated.

54. **Suggested change**:

    - an amendment is included in the Finance Bill retrospectively amending the provisions of F(No 2)A 2017 such that the ToAA matching rules only match PFSI arising after the settlor has become UK resident and

- the settlor benefits charge is changed in the same way.

ALIGNMENT OF PROVISIONS

55. Wherever possible the anti-avoidance provisions should be aligned. Alignment is simpler and should prevent both double charging and opportunities for avoidance occurring. What is most noticeable about the Finance Bill provisions is that although trying to do the same thing for different taxes, they are clearly the product of different teams within HMRC as they adopt entirely different approaches to solving the same issue.

56. **Suggested change** – at this stage the complexity of the legislation and the lack of time and resource may mean that it is too late for the changes necessary to align the provisions. This is unfortunate as given the complexity of the provisions we cannot be sure whether the misalignment may give rise to avoidance or double taxation.

OFFSHORE INCOME GAINS

57. Offshore income gains (OIGs) is an area that, prior to 6 April 2017, was already highly complex and badly in need of an overhaul (possible changes to the regime were raised in Budget 2008 but there was insufficient time to legislate for these changes). The position is worse this time round since it is still not clear that OIGs have been considered specifically in connection with the various changes enacted to the offshore trust provisions. At the most OIGs appear to have been an afterthought with an important change to the OIG regulations still required so the protections work for long-term resident deemed domiciliaries (see below).

58. OIGs must continue to be calculated in accordance with the CGT provisions and follow the CGT offshore trust provisions as amended by the Offshore Funds (Tax) Regulations 2009 (SI No 2009/3001 (OIGs being matched to prior to capital gains) unless they drop into the ToAA charge.

59. For settlors OIGs fall into the ToAA charge if they are not matched under s87 TCGA in the tax year in which they arise.

60. This is an issue for individuals who are deemed UK domiciled as without changing Reg 19 of SI 2009/3001 the trust protections will not cover OIGs.

61. This is because they will not be a PFSI because a PFSI covers only relevant foreign income. OIGs can only be relevant foreign income under current Reg 19 where they are subject to tax on the remittance basis, something they cannot be for deemed domiciliaries.

62. Without a change to Reg 19 there will, therefore, be a tax charge in the year regardless of whether a capital payment is made to the settlor or not. This is not the policy intention that was communicated to us. Reg 19 will need to be amended with retrospective effect to 6 April 2017.

63. **Suggested change** - Reg 19 needs to be adjusted (with retrospective effect to 6 April 2017) so that OIGs arising to long term deemed domiciliaries where the trust is not tainted can come within the PFSI definition and be within the protections.

CLOSE FAMILY MEMBER LEGISLATION

64. We welcome the changes made to the close family member definition and agree these do provide greater clarity.

Remittances

65. Where the close family member legislation applies it is not clear what counts as a remittance where the settlor is a remittance basis user. For income it should be the remittance of the

benefit by either the close family member or any other relevant person in connection with the settlor.

66. S643A is silent on this point and it is not clear to what the “deemed income” is linked for remittance purposes. The sister provision in s733A however has detailed rules in this regard (which incidentally link the deemed income to both the capital payment and the underlying income, which is contrary to the policy intention). The reason for the divergence is not clear.

67. **Suggested change** – the legislation should be aligned and a remittance of income should only be deemed to arise where the benefit itself is remitted (that is there should be no link to the underlying income).

Foreign tax credit issues

68. The legislation appears to proceed on the basis that a non-UK resident close family member will not pay tax on the offshore trust distribution in the territory where they are resident. This will not necessarily be the case and it is not fair for the same distribution to suffer double taxation with no relief.

69. **Suggested change** - the legislation should incorporate a relief mechanism so the settlor can claim relief for the foreign tax suffered. In addition, consideration should be given to switching off the provision where the non-resident close family member pays tax at an effective rate of 75% or above of our highest tax rate.

Aligning the provisions

70. Currently the CGT and income tax provisions are different. The CGT simply allocates the whole capital payment to the settlor. The IT provisions (both ToAA and the settlement legislation) on the other hand allocate on matched (“deemed”) income but do so in such a way that what is allocated to the settlor is dependent on what is taxed on the close family member.

71. In addition to introducing unnecessary complexity this means that there is the potential for a double charge.

72. **Suggested change** - Having considered the provisions it is our opinion that it would be better to amend the CGT provisions so that they are aligned, as closely as possible, with the ToAA income tax provisions. However, as set down in paragraph 57 realistically it may be too late for such significant change. Not aligning provisions does, however, cause concern as a lack of alignment makes it more likely that there will be issues with the interactions of the different provisions that either give rise to double taxation or anti-avoidance opportunities.

THE ONWARD GIFT PROVISIONS

Dropping or at least deferring and aligning the provisions

73. We have said in the past that, with the definition of capital payment in s97 TCGA 1992 (defined to include indirect payments), the Ramsay doctrine and the General Anti Abuse Rule (GAAR), we do not see the need for these provisions. This is particularly the case given how long and complicated they are.

74. Whilst there have been changes to the 13 September 2017 draft legislation, the current Finance Bill legislation is still long and extremely complicated. We certainly welcome the three-year cut off period introduced (though we believe that to tackle the mischief aimed at a shorter period of say 18 months would work just as well).

75. We strongly recommend that the three sets of provisions are dropped as:

- There is no consistency between the three sister sets of rules.
- There is little discernible principle underlying the different gateways (due to the complexity).

- The provisions can be circumvented due to this highly prescriptive approach (a simpler principle based purposive approach would have been better).
- Not least, because of how complicated the provisions are, it is not clear that they do not actually make the Exchequer position worse i.e. it may be possible to use the new "anti-avoidance" rules to avoid tax which would otherwise be payable.

76. **Suggested changes** –the need for these complex rules has not been adequately demonstrated and we are concerned that the complexity could result in unintended consequences. Ramsay and GAAR should be used to counter the avoidance the Government wants to tackle. If the Government wants to introduce new provisions we would suggest a deferral so further work can be done to improve the legislation. The three sister sets of rules should be aligned and a simpler principle based purposive approach taken when drafting the legislation.

Whose intention?

77. From our discussions with HMRC during the 16 October 2017 meeting we understand that HMRC's interpretation of all three sets of legislation is that it is necessary to consider whether either the trustee or the original beneficiary (with no other individuals being considered where there is a chain) intends the distribution to be passed to the subsequent UK resident recipient. We do not understand why the intention of the trustee alone is important, as the trustee cannot make the original recipient pass on the distribution if the recipient does not want to. It seems to us that it is the intention of the original recipient that matters and that this should be the only consideration.

78. **Suggested change** - the Finance Bill legislation should be amended to make it clear that it is just the intention of the original beneficiary that is being considered.

Clarification of "arrangements", "intentions" and "benefit"

79. We understand that the legislation is aimed at genuine cases of avoidance and that it is not intended to affect the majority of capital payments. Whilst this is comforting (as is the introduction of the 3 year time limit), it remains the case that the legislation is broadly written in terms of what can be caught within that 3 year window and it certainly is wider than the actual intention explained to us at the 16 October 2017 meeting. Although there is a clear target the widened legislation has the potential to result in unfair collateral damage.

80. **Suggested change** - we should like to see within the legislation a list (clearly stated to not be exhaustive) of actions that will **not** be taken to be arrangements or to show intentions such that the provisions would be triggered. The list should cover:

- Wills;
- Operation of Intestacy;
- Survivorship (such as the original beneficiary's property held by way of joint tenancy);
- Operation of reserved property right rules;
- Letters of Wishes.

81. **Suggested change** - the legislation should be changed to make it clear that "gift" (meaning "benefit") includes only gratuitous benefit, rather than (say) a benefit arising under a contract undertaken on commercial terms.

The removal of capital up to the amount settled

82. It does not seem to us to be appropriate that the legislation should apply when a non-UK resident settlor is receiving a capital distribution and the overall total of capital distributions received is less than what he or she settled in the trust. Where the trust was established without any UK tax considerations being taken into account the non-resident settlor should be able to remove his or her capital without triggering the provisions. A charge would not be

imposed if a non-resident individual had not settled funds into trust and made a gift from their own resources and it should not be different if the individual chooses to settle funds into trust and then withdraws some of those funds (by way of a capital distribution) to make a gift.

83. **Suggested change –** the legislation should be changed such that where the original beneficiary is a non-UK resident settlor who established a trust without taking UK tax consequences into account, the individual can remove his or her capital without triggering the provisions.

Foreign tax credit issues

84. The legislation appears to proceed on the basis that a non-UK resident close family member will not pay tax on the offshore trust distribution in the territory where they are resident. This will not necessarily be the case and it is not appropriate for the same distribution to suffer tax twice without any relief.

85. **Suggested change** - the legislation should incorporate a relief mechanism so the settlor can claim relief for the foreign tax suffered. In addition, consideration should be given to switching off the provision where the non-resident close family member pays tax at an effective rate of 75% or above of our highest tax rate.

Commencement provisions

86. The commencement provisions will only apply a charge where the onward payment occurs after 5 April 2018. This does not remove from charge situations where the trust distribution was made prior to 6 April 2018 and the onward payment after 5 April 2018. Going back to establish what capital payments have been made prior to 6 April 2018 and then looking to see if onward payments have occurred within 3 years of the original distribution will be onerous. It would be easiest if the new legislation only applies where both the capital distribution and the onward payment happen after 5 April 2018.

87. **Suggested change –** the legislation should only apply where both the original capital distribution and the onward payment occurs after 5 April 2018.

CHANGES TO THE SETTLEMENTS' LEGISLATION

88. The problem with s643F, ITTOIA 2005 is discussed above. Rather than remittances being linked to bringing the benefit into the UK, the link has been made to the income arising within the trust, meaning that the trustees cannot remit trust income to the UK. This was supposed to be possible in order to boost the economy by attracting funds from offshore trusts for investment.

89. **Suggested change -** the legislation needs to be amended so that there will only be a remittance where the benefit is remitted by the settlor or another relevant person in connection with the settlor.

90. In contrast to s735A, ITA 2007 of the ToAA legislation, s643G, ITTOIA 2005 of the settlements legislation will not match UK source income. There is, therefore an issue where the settlor can benefit under the trust and is non-UK resident and a close family member is UK resident and in receipt of benefits.

91. S624 will not tax the UK source income on the settlor (albeit it will be taxed on the trustees). The UK income will not form part of the PFSI by definition. It could therefore transpire that a trust with UK source income and foreign source income where the benefit is provided out of taxed UK income, will still be matched to PFSI. We believe that this is a defect in the legislation that needs to be corrected.

92. **Suggested change** - introduce a matching mechanism along the lines of s735A ITA 2007 so that matching will work properly where there is UK source income.

INTERACTIONS

93. The interactions between the two sets of income tax anti-avoidance provisions and the CGT offshore trust anti-avoidance provisions are extremely complex.

94. Since the charges can overlap it is critical that there are appropriate relieving provisions to prevent double charges from arising. We are concerned that there has been insufficient time to produce any detailed case study examples, let alone enough to be confident that the draft legislation has been stress tested.

95. Whilst we welcome the introduction of new provision s734A, ITA 2007 in the current Finance Bill legislation, we remain concerned that interaction issues may have been missed.

96. **Suggested change** - there should be a just and reasonable provision inserted into the three sets of anti-avoidance legislation such that if the legislation does not specifically provide for the necessary deductions to avoid double charging, such deductions can be claimed by affected taxpayers on a just and reasonable basis taking into account the current order of priority (so ToAA first, then settlements' charge, then OIGs and finally capital gains).

APPENDIX

SPECIFIC COMMENTS ON THE FINANCE BILL LEGISLATION

Background

1. Section 35 introduces Schedule 10. Schedule 10 inserts into various parts of the existing legislation certain anti-avoidance [sic] provisions.

2. We look at both parts of Schedule 10 in further detail below but, broadly speaking:

   - Part 1 introduces additional rules affecting the operation of s87 et seq TCGA 1992; and,
   - Part 2 introduces additional rules affecting both the Settlements legislation at s619 et seq ITTOIA 2005 and the Transfer of Assets Abroad (ToAA) legislation at s714 et seq ITA 2007.

Capital Gains Tax

Schedule 10 Part 1 Paragraph 1(1) - S87G TCGA

3. **What it is intended to do:** Section 87G is designed to attach to a UK resident settlor a <u>capital payment</u> which would otherwise be treated as received by a close family member. This is important as other, later sections attempt to attach gains and/or income rather than capital payments. S87G applies irrespective of the residence or domicile status of the original recipient i.e. it applies to the capital payment even if the recipient is a UK resident UK domiciliary. The provision is wider than the income tax provisions that attribute income from benefits received by close family members to the settlor**.**

4. **Our recommendation**: The legislation appears to proceed on the basis that a non-UK resident close family member will not pay tax on the offshore trust distribution in the territory where they are resident. This will not necessarily be the case and it is not fair for the same distribution to suffer tax twice without any relief.

5. We are also concerned about the differences between the capital gains and income tax provisions and the potential for double taxation that could result from this.

6. **Our suggested amendment**: The legislation should incorporate a relief mechanism so the settlor can claim relief for the foreign tax suffered. In addition, consideration should be given to switching off the provision where the non-resident close family member pays tax at an effective rate of, say, 75% or more of the highest UK tax rate.

7. **I**f time permits we also suggest amending the provisions so they are aligned with the income tax attribution provisions.

Schedule 10 Part 1 Paragraph 1(1) - S87I TCGA

8. **What it is intended to do:** S87I is the first of the “onward gift” provisions and acts as the gateway to turning on s87J and s87K. It is a very lengthy and highly prescriptive section.

9. Broadly speaking, the test in s87I(1) is met if there is a capital payment made to an individual and there is an intention to gift the payment on to another UK resident individual within 3 years of receipt and the original recipient is at some stage in those 3 years either non-UK resident or taxed on the remittance basis.

10. S87I(2) deals with chains of onward payments routed via non-UK residents to a UK resident and effectively says that where such a chain exists, the onward payment is treated as being made directly to the UK resident for the purposes of s87I(1).

11. S87I(3) – (7) deal with ancillary issues required to make the s87J and s87K work properly.

12. **Our recommendation**: The rules are incredibly complex and very difficult to follow. In the light of the definition of capital payment in s97 TCGA (defined to include "indirect" capital payments) and in light of both Ramsay and the GAAR, we do not think that such a prescriptive anti-avoidance rule is required. If the Government does want a specific rule it could be dealt with using a principles based approach aligned across the three anti-avoidance provisions. Currently the three sets of onward gift provisions run to nearly 30 pages of impenetrable law. This is disproportionate, especially when one considers that the effects can be avoided by simply waiting 3 years and then making the onward gift.

13. Finally, the underlying rationale seems to be that only the UK levies tax and none of the recipients will suffer tax in their home jurisdictions. There is no form of double tax relief or any recognition of other jurisdictions' taxing rights. What is more, as these are deeming provisions, tax suffered is unlikely to be subject to relief under any of the UK's double tax treaties.

14. **Our suggested amendment**: Ss 87I, 87J, 87K, 87L, 87M which all deal with the recycling of capital payments should be removed from the Finance Bill.

Schedule 10 Part 1 Paragraph 1(1) - S87J TCGA

15. **What it is intended to do:** S87J is turned on by S87I. It lays the ground work for s87K by splitting the original capital payment received by the original recipient into 3 slices:

    - the taxed amount;
    - the untaxed amount (U); and
    - the rest of the original payment (R).

16. Broadly speaking the taxed amount is the amount which is actually matched to stockpiled gains under s87 and taxed. The untaxed amount is the amount matched but which is untaxed due to being retained offshore on the remittance basis. And the rest is the balance of the capital payment once those two amounts have been calculated.

17. **Our recommendation**: See comments above re s87I.

18. **Our suggested amendment**: Ss 87I, 87J, 87K, 87L, 87M which all deal with the recycling of capital payments should be removed from the Finance Bill.

Schedule 10 Part 1 Paragraph 1(1) - S87K TCGA

19. **What it is intended to do:** This is the operative section which attributes to the onward payment recipient so much of gains and so much of capital payment.

20. How much is attributed to the onward recipient depends on the mix of the taxed amount, U and R (both U and R being established under s87J). S87K also introduces G, which is the amount of the onward capital payment.

21. By way of example:

    The trustees make a capital payment to A of £100,000. This is matched to gains such that it represents £65,000 gains and £35,000 is unmatched. A is a remittance basis user and doesn't remit. A then gifts £75,000 to B. The capital payments is sliced as follows:

    The taxed amount = £0;
    U = £65,000;
    R = £35,000;
    G = £75,000.

22. S87K(2) attributes to B £35,000 as a capital payment (as R>0 & G>R).

23. S87K(3) attributes £40,000 of gains to B (as G-R <= U).

24. A is left with £25,000 which is untaxed gains (i.e. taxable on the remittance basis).

25. **Our recommendation**: See comments above re s87I.

26. **Our suggested amendment**: Ss 87I, 87J, 87K, 87L, 87M which all deal with the recycling of capital payments should be removed from the Finance Bill.

Schedule 10 Part 1 Paragraph 1(1) - S87L TCGA

27. **What it is intended to do:** S87L sets out the cases where the settlor is liable for tax on the onward payment (notwithstanding the settlor is not the actual onward recipient). For the avoidance of doubt, earlier provisions (the s 87G close family member legislation) attribute the capital payment to the settlor for certain, "normal" capital payments. S87I deals with onward payments and attributes both capital payments and accrued gains to the onward recipient. Where the onward recipient is a close family member of the settlor s87L is engaged and it seeks to attribute those capital payments and accrued gains to the settlor.

28. **Our recommendation**: See comments above re s87I.

29. **Our suggested amendment**: Ss 87I, 87J, 87K, 87L, 87M which all deal with the recycling of capital payments should be removed from the Finance Bill.

Schedule 10 Part 1 Paragraph 1(1) - S87M TCGA

30. **What it is intended to do:** S87M is designed to deal with scenarios whereby the recipient of the onward capital payment is not the settlor, has gains or capital payment attributed under s87K and is a remittance basis user. In this case, parts of s87K are turned off and the capital payment is plugged back into s87I. This is presumably to deal with chains of onward payments by UK resident remittance basis users (as the chains dealt with by s87I(2) are only those chains involving non-UK residents).

31. **Our recommendation**: See comments above re s87I.

32. **Our suggested amendment**: Ss 87I, 87J, 87K, 87L, 87M which all deal with the recycling of capital payments should be removed from the Finance Bill.

Schedule 10 Part 1 Paragraph 1(4)

33. **What it is intended to do:** Removes split year treatment from matching under s87.

34. **Our recommendation/comment**: This was not announced prior to the publication of the draft clauses on 13 September 2017 which, as it is a substantial change, was surprising.

35. **Our suggested amendment**: No comment.

Schedule 10 Part 1 Paragraph 1(12)

36. **What it is intended to do:** This paragraph introduces the commencement dates for s87D and s87E. S87D & s87E. In addition to applying to all capital payments made after 5 April 2018 the legislation will apply to unmatched capital payments brought forward into 2018/19. This means trustees will need to establish the residence status of beneficiaries at the date they received the capital payments i.e. potentially a long time ago.

37. **Our recommendation**: Given the potential timing issues, applying the legislation correctly to unmatched capital payments as at 6 April 2018 will be onerous. We therefore strongly suggest that this commencement provision is re-considered.

38. **Our suggested amendment**: S87D and s87E should only apply to capital payments made after 5 April 2018.

Schedule 10 Part 1 Paragraph 1(14)

39. **What it is intended to do:** This paragraph introduces the commencement dates for s87I to s87M.

40. **Our recommendation**: The commencement provisions state that they apply to onward payments made after 5 April 2018. But there is no exclusion for original capital payments made prior to 2018/19. Given that the legislation requires an investigation into the subjective intention at the date of the original capital payment, these commencement provisions are effectively asking trustees to try and establish a past intention potentially going back a up to three years. It is disproportionately onerous and should be re-considered.

41. **Our suggested amendment**: The legislation should be amended such that it only applies to original capital payments made after 5 April 2018.

Schedule 10 Part 1 Paragraph 1(15)

42. **What it is intended to do:** This paragraph introduces the commencement dates for s87N and s87P.

43. **Our recommendation**: Same comments as for s87D and E.

44. **Our suggested amendment**: Same comments as for s87D and s87E.

Settlements Legislation – ITTOIA 2005

Schedule 10 Part 2 Paragraph 11 – S643A ITTOIA

45. **What it is intended to do:** S643A attempts to do two things: (i) introduce a benefits charge; and (ii) attribute said charge onto the settlor in certain circumstances (where there is deemed income and benefits paid to the settlor or, in certain circumstances, a close family member).

46. S643A(1) is the main provision. It treats income as income of an individual for a tax year where the individual has an untaxed benefits total for a settlement for the tax year. It draws on later definitions of untaxed benefits and available protected income but is subject to the provisions of subsections (2) to (5) which attribute the income to the settlor in certain scenarios.

47. **Our recommendation/comment**: There are several matching rules throughout the Taxes Acts. It is unclear why the draftsman has decided not to follow any of the existing approaches and instead has developed this approach.

48. Where there is more than one beneficiary in receipt of benefits, the draftsman has not offered to solve this problem at all except to say an officer of HMRC should apply a just and reasonable approach. This is despite this problem being already addressed by existing matching rules. After all, the UK tax system is a self-assessment tax system. Our preference would have been for an already familiar set of complete rules to have been deployed.

49. And as already mentioned, not only is the matching process itself novel, the attribution to the settlor of close family benefits is also novel in that it is an entirely different approach to that taken to the same problem for capital gains tax. Again, our preference would have been for a consistency of approach.

50. **Our suggested amendment**: Assuming that the whole approach to matching cannot be amended at this late stage, we would just suggest that where there is more than one individual to match to the legislation should state that matching should be proportional in relation to benefits in the tax year unless this would not be just and reasonable.

Schedule 10 Part 2 Paragraph 11 – s643E ITTOIA

51. **What it is intended to do:** This section facilitates the recovery by the settlor of the tax from the actual recipient of the benefit. There are similar provisions in the capital gains and ToAA close family member attribution legislation.

52. **Our recommendation/comment**: It is questionable how this will be enforced where the individual is resident in a foreign jurisdiction.

53. **Our suggested amendment**: No comment.

Schedule 10 Part 2 Paragraph 11 – s643F ITTOIA

54. **What it is intended to do:** This section attempts to apply the remittance basis to the 643A charge; there is no material reference in s643A to remittance issues. Under s643F, the deemed income is treated as relevant foreign income (RFI). And the benefit and available protected income (API) are treated as deriving from the deemed RFI.

55. **Our recommendation**: As both the benefit and the API (as defined in subsection (5)) derive from the deemed RFI, the trustees cannot bring the underlying protected foreign source income to the UK as if it is matched there will be an immediate tax charge. This is not in line with the Government intention to support the UK economy by changing the provisions so as to enable trustees to remit trust income to the UK without remittance issues for settlors. The same issue exists with the ToAA provisions.

56. **Our suggested amendment**: The provisions (s643F(4)) should be amended so that it is only the remittance of the benefit that can trigger a taxable remittance of the deemed income. A similar retrospective change is required for ToAA (see paragraphs 24 to 26 in the Tax Representation).

Schedule 10 Part 2 Paragraph 11 – s643G ITTOIA

57. **What it is intended to do:** This section expands on when the benefit or API “relates” to deemed income for the purposes of s643F. It is a matching rule similar to that found at s735A ITA 2007 and the objective is presumably to identify deemed income with real income so that it can be determine if the deemed income has been remitted (or not as the case may be).

58. **Our recommendation**: Unlike s735A, s643G will not match UK source income. Consider the scenario where the settlor is non-UK resident but a close family member is UK resident and in receipt of benefits. The UK source income will be taxed on the trustees. The UK income will not form part of the protected foreign source income by definition. It could therefore transpire that a trust with UK source income and foreign source income where the benefit is provided out of taxed UK income, will still be matched to protected foreign source income so leading to a double tax charge on what is effectively the same income.

59. **Our suggested amendment**: We believe that this is a defect in the legislation that needs to be corrected, by introducing a matching mechanism along the lines of s735A ITA so that there cannot be matching to PFSI.

Schedule 10 Part 2 Paragraph 11 – s643I ITTOIA

60. **What it is intended to do:** This section acts as the gateway to s643J, s643K and s643L. In combination with s643K and s643L it introduces rules to attribute deemed income to recipients of onward gifts.

61. There are some similarities between s643I and s87I. S 643I like s87I is lengthy, complex and highly prescriptive. There is also a similar underlying objective. However, s 643I take a fundamentally different approach to the capital gains legislation.

62. S643I attributes deemed income only. S87I et seq seek to attribute already accrued gains and unmatched capital payments to the onward recipient. The capital gains legislation does not try to attribute gains that may accrue in the future which is what s643I et seq attempt to do with income. Where there is no matching at the gift date, s87K just attributes on the capital payment and plugs that unmatched capital payment into the normal rules for future matching (if any). This temporal contortion in s643I et seq will pose practical difficulties in the future.

63. Since s731 et seq, s87 et seq and s643A et seq are all trying to capture the same thing (the onward gift of an original capital distribution that has escaped UK tax), our strong preference would have been for the rules dealing with onward attribution of gains, income or capital payments/benefits to: (i) be aligned; and (ii) to not try to attribute future income as the ITTOIA legislation does but rather plug any unmatched capital payment/benefit back into the normal rules for future matching (if any).

64. **Our recommendation:** Our comments are the same as above for s87I. The rules are incredibly complex and very difficult to follow. In light of the Ramsay and the GAAR, we do not think that such a prescriptive rule is required at all. As already stated, if the Government does want a specific rule it should be dealt with using a principles based approach (see paragraph 12).

65. Finally, the underlying rationale seems to be that only the UK levies tax and none of the recipients will suffer tax in their home jurisdictions. There is no form of double tax relief or any recognition of other jurisdictions' taxing rights. What is more, as these are deeming provisions, tax suffered is unlikely to be subject to relief under any of the UK's double tax treaties.

66. **Our suggested amendment**: Ss643I, 643J, 643K, 643L, 643M, 643N all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 11 – s643J ITTOIA

67. **What it is intended to do:** S643J attributes to the onward recipient an amount of income where: (i) the gateway in s643I is engaged; (ii) the onward recipient is UK resident in the year the original payment is matched to income; and (iii) the onward recipient is either taxed on the arising basis or is a remittance basis user and remits some of the onward payment to the UK in the matching year.

68. **Our recommendation**: See comments above re s643I.

69. **Our suggested amendment**: Ss643I, 643J, 643K, 643L, 643M, 643N all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 11 – s643K ITTOIA

70. **What it is intended to do:** Should the gateway at s643I be engaged and the onward recipient is not UK resident in the gift year or the matching year or does not remit all the onward payment in the matching year, this section attempts to plug the untaxed amount of the onward payment back into s643I to prevent further onward gifts from falling outside the scope of the charge.

71. **Our recommendation**: See comments above re s643I.

72. **Our suggested amendment**: Ss643I, 643J, 643K, 643L, 643M, 643N all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 11 – s643L ITTOIA

73. **What it is intended to do:** This section seeks to attribute to the settlor any income attributed to the onward gift recipient in certain scenarios (where the onward gift recipient is a close family member). However. in light of the number of conditions and pre-conditions that must be met (s643L requires s643A and s643I to be met before then requiring its own conditions to be met), it is hard to envisage what that scenario would look like.

74. **Our recommendation**: See comments above re s643I.

75. **Our suggested amendment**: Ss643I, 643J, 643K, 643L, 643M, 643N all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 11 – s643M ITTOIA

76. **What it is intended to do:** S643A and, therefore, s643I are dependent on the involvement of close family members. Without a further provision the legislation could have been circumvented by the benefit being paid to a non-close family member who then routed it to a close family member. S643M is designed to stop this. In this case it does it by treating the onward payment as a payment made by the trustees to the onward recipient if that recipient is a close family member.

77. **Our recommendation**: See comments above re s643I.

78. **Our suggested amendment**: Ss643I, 643J, 643K, 643L, 643M, 643N all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 11 – s643N ITTOIA

79. **What it is intended to do:** This section attempts to set out how the charges under s643J and s643L of the onward gift provisions interact with the remittance basis. In contrast to the charge under s643A, which (unfortunately) links the deemed income with both the benefit and the actual trust income, s643N links the deemed income under s643J and s643L to the onward payment only. As such, there will only be a remittance if the actual onward payment (the benefit) is remitted.

80. **Our recommendation**: See comments above re s643I. However, if the provisions are staying the s 643N interaction with the remittance basis is welcome.

81. **Our suggested amendment**: Ss643I, 643J, 643K, 643L, 643M, 643N all deal with onward gifts and should be removed from the Finance Bill.

Transfer of Assets Abroad

Schedule 10 Part 2 Paragraph 13

82. **What it is intended to do:** Inserts in s731, ITA 2007 subsection (1C). We believe that there may be a drafting error in (1A) and (1C) as the legislation does not seem to restrict the scope of the F(No 2) A 2017 changes to UK residents but rather extends the situations in which the charge can apply to non-UK residents to situations where the new anti-recycling rule applies. As set down in paragraphs 36 to 40 of this ICAEW Representation we believe that this must be a mistake and that it needs to be corrected.

83. **Our recommendation**: There is nothing to suggest that Parliament meant to extend the scope of the ToAA benefits charge to non-UK residents. The provisions are so complex that the issues have happened as a result of drafting errors when seeking to impose charges on UK residents when income is attributed from non-UK residents (either close family members or original benefits recipients). It is wrong in principle for non-UK residents to be subject to tax under the ToAA benefits charge when they have no links with the UK.

84. **Our suggested amendment**: The legislation needs to be amended (retrospectively with respect to the F(No 2) A 2017 changes) to restrict the scope of the ToAA benefits charge to UK residents.

Schedule 10 Part 2 Paragraph 16 – s733B ITA

85. **What it is intended to do:** This paragraph inserts a new s733B. The previous amendments (F(No 2)A 2017) to s731 et seq already introduced a new provision to attribute to the settlor (transferor) income which would otherwise be deemed to that of a close family member under s731.

86. In a manner similar to the proposed changes to s87I et seq, this Finance Bill finishes the work by introducing rules for:

    - The gateway (s733B);
    - Onward gifts (s733C and D) and,
    - Onward gifts attribution to settlor (s733E).

87. S733B is the gateway. It bears some similarities to s87I and s643I but also differences.

88. **Our recommendation**: This suffers from the same problems as s87I and s643I do. It is:

    - highly complex;
    - highly prescriptive;
    - impenetrable in large parts; and
    - its prescriptive nature means that it can be circumvented.

    As mentioned, we do not think that an additional anti-avoidance rule is required as Ramsay and the GAAR should be sufficient. If the Government wants a specific rule it should be a simpler principle based one and aligned across the three measures (s 87I et seq, s 643I et seq and these ToAA provisions).

89. **Our suggested amendment**: Ss 733B, 733C, 733D and 733E all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 16 – s733C ITA

90. **What it is intended to do:** This is the ToAA equivalent to s643J. It seeks to attribute to the onward recipient an amount of matched income; broadly the amount that is not taxed on the original recipient in the matching year.

91. **Our recommendation**: See comments above re s733B.

92. **Our suggested amendment**: Ss 733B, 733C, 733D and 733E all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 16 – s733D

93. **What it is intended to do:** This is the ToAA equivalent of s643K in that this section attempts to plug an amount of the onward payment back into s733B to prevent further onward gifts from falling outside the scope of the charge.

94. **Our recommendation**: See comments above re s733B.

95. **Our suggested amendment**: Ss 733B, 733C, 733D and 733E all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 16 – s733E

96. **What it is intended to do:** This is the ToAA equivalent of s643L in that it attempts to attribute to the settlor any income attributed to the onward gift recipient in certain scenarios.

97. **Our recommendation**: See comments above re s733B.

98. **Our suggested amendment**: Ss 733B, 733C, 733D and 733E all deal with onward gifts and should be removed from the Finance Bill.

Schedule 10 Part 2 Paragraph 19

99. **What it is intended to do:** Introduces a new s735C which seeks to apply the remittance basis to income attributed under s733C and s733E. It treats the income so attributed as RFI.

100. Unlike the rules introduced for s643A which treat the underlying income and the benefit as deriving from the deemed income, s735C is similar to s643N in that it is only the onward payment that is treated as derived from the deemed income.

101. **Our recommendation**: See comments re s733B.

102. **Our suggested amendment**: As this also pertains to the onward gift provisions it should also be removed from the Finance Bill. If this does not happen the provision should be retained unchanged as it applies the remittance basis correctly for these purposes.

Income Tax Commencement Provisions

Schedule 10 Part 2 Paragraph 21

103. **What it is intended to do:** This paragraph introduces the commencement dates for all the income tax provisions as being 6 April 2018 subject to the following:

- The onwards payments legislation does take account of benefits prior to this date albeit the onward payment must be made after this date.

- This is notwithstanding para 21(3) and para 21(4) adopt very different wording and that the latter is explicit while the former is silent on the matter of benefits paid before 6 April 2018.

104. **Our recommendation**: Given that the onward gifts legislation requires an investigation into the subjective intention at the date the original benefit is provided, these commencement dates are effectively asking trustees to try and establish past intention potentially going back a few years (not more than three). It is disproportionately onerous and should be re-considered.

105. **Our suggested amendment**: The legislation should be amended such that it only applies to original benefits provided after 5 April 2018.