FINANCE BILL 2017 – CHANGES RELEVANT TO NON UK DOMICILIARIES

CLAUSE 28: BUSINESS INVESTMENT RELIEF

CLAUSE 41 & SCH 13: DEEMED DOMICILE: INCOME TAX AND CAPITAL GAINS TAX

CLAUSE 42: DEEMED DOMICILE: INHERITANCE TAX

CLAUSE 43 & SCH 14: SETTLEMENTS AND TRANSFER OF ASSETS ABROAD: VALUATION OF BENEFITS

CLAUSE 44 & SCH 15: OVERSEAS PROPERTY WITH VALUE ATTRIBUTABLE TO UK RESIDENTIAL PROPERTY

ICAEW welcomes the opportunity to comment on the Finance Bill published on 20 March 2017.

This briefing of 19 April 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 1 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.

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GENERAL COMMENTS

1. Although the changes to the taxation of non UK domiciliaries (non doms) was first mooted in Summer 2015 and there have been consultations along the way the draft legislation has been somewhat hurried. There were several problems with the drafts published in December 2016 and January 2017 and we have worked with HMRC and HM Treasury to try and iron out the issues but some still remain in the published Finance Bill 2017. This is a very complex area of legislation and as so much is still uncertain it is impossible for those individuals becoming deemed domiciled in the UK from 6 April 2017 to plan and structure their affairs with any certainty.

2. The thrust of the changes are to deem long term UK residents as domiciled in the UK for all taxes after they have been resident for 15 out of 20 years, non doms have long been deemed domiciled for inheritance tax (IHT). The consequences of this for those becoming UK domiciled on and after 6 April 2017 is the cause of many problems and complications in the drafting. We are pleased the decision was taken to defer some of the changes until Finance Bill 2018 to allow further time to ensure the legislation is right. It is much simpler and less time consuming to get the legislation right in the first place rather than having to correct it subsequently.

3. There is a short schedule introducing specific valuation rules for three types of benefit under the settlements' regime and transfer of assets abroad legislation.

4. There are also changes to bring overseas property representing UK residential property into the inheritance tax net regardless of the domicile status of the owner or settlor of the offshore trust.

5. Changes are also proposed to business investment relief, these are mainly to simplify the process whereby non doms can invest in UK businesses without the funds remitted from overseas becoming liable to UK tax when it is brought into the country (though one change legislates for a current disputed HMRC interpretation of the pre 6 April 2008 legislation).

6. This briefing covers the five clauses and three schedules introducing the changes.

Business Investment Relief (Clause 28)

7. **Background:**

   Clause 28 sets out several changes to the current Business Investment Relief (BIR) provisions. Most of the changes are to make the relief more attractive. One amendment, however, is to adjust the legislation to reflect HMRC's position that a company that is a partner in a partnership is not to be regarded as carrying on the trade carried on by the partnership.

   We would have preferred the changes to be more extensive (as per the various suggestions submitted in our ICAEW REP 159/16.) However, we recognise that the timetable made this impossible and hope that the comments in the Response Document about looking into further changes will result in additional legislation in Finance Act 2018.

8. **Measure: Clause 28 (3A)**

   What it is intended to do: The new "hybrid" company category is too narrow only allowing a company that is both trading and stakeholder to qualify. Often there will be companies that are both stakeholder and holding (possibly also trading but all three is less common).

   Our recommendation: The new "hybrid" company category needs to be widened.

   Our suggested amendment: The legislation is amended so a company that has elements of trading, stakeholder and holding, any two out of the three or all three will qualify for BIR.

Deemed domicile (Clauses 41 and 42 and Sch 13)

9. **Background:**

Clause 41 sets out the rules on what constitutes becoming deemed domiciled for income tax and capital gains tax (CGT).

Clause 42 sets out the rules on what constitutes being deemed domiciled for IHT purposes.

Schedule 13 contains four parts as follows:

- Part 1 deals with the application of deemed domicile;
- Part 2 deals with the protection of foreign resident trusts;
- Part 3 deals with the CGT rebasing election; and,
- Part 4 deals with the cleansing of mixed funds, mixed funds contain original capital, income and capital gains.

10. **Measure: Clause 41**

What it is intended to do: Introduce the definition of deemed domicile for income tax and CGT purposes.

Our recommendation: That references in the proposed s835BA to “person” be changed to “individual”, individual is used elsewhere so to be consistent it should say individual.

Our suggested amendment: See above.

11. **Measure: Clause 42**

What it is intended to do: Amend the definition of deemed domicile for IHT purposes.

Our recommendation: That references to “person” be changed to “individual”, individual is used elsewhere so to be consistent it should say individual.

Our suggested amendment: See above.

12. **Measure: Clause 42**

What it is intended to do: Amend the definition of deemed domicile for IHT purposes.

Our recommendation: The deemed domicile rule for inheritance tax as drafted has the effect that an individual who is UK resident for 15 years in a 20 year period will become deemed domiciled for inheritance tax purposes in the following year, even if he has left the UK during the fifteenth year of UK residence. The effect is that in order to avoid becoming subject to UK inheritance tax on worldwide assets, a non dom will have to leave the UK during their fourteenth year of UK residence. This is directly contrary to most people’s understanding of what was announced in 2015 – i.e. that an individual could safely remain UK resident for 15 years without becoming subject to UK tax on a worldwide basis.

Our suggested amendment: Clause 42(1)(c) be amended to include a requirement that the taxpayer also be resident in the relevant tax year.

13. **Measure: Schedule 13 Part 2 Paragraph 18 Para 5A**

What it is intended to do: This para inserts two new paragraphs, 5A and 5B into Sch 5 TCGA.

Para 5A sets out certain circumstances in which s86 TCGA will not apply. Para 5A(5) – (9) deal specifically with what is called "tainting" i.e. actions taken that will cause s86 to apply (s86 provides that the settlor of the trust is taxable on all gains made by the offshore trustees, even if they do not actually receive anything from the trust but these rules can only apply if the settlor is UK resident and domiciled).

Our first recommendation: Para 5A(5) requires that "no property or income is provided directly or indirectly for the purposes of the settlement by the settlor, or by the trustees of another settlement of which the settlor is the settlor or a beneficiary…". It is not clear whether the direct or indirect limb refers to the provision of the property or income (i.e. direct or indirect provision) or the purpose (e.g. direct or indirect purpose).

This is particularly relevant as it may entice some to try to provide property indirectly via a company. Or alternatively it may entice others to try and provide property to a wholly owned subsidiary of a trust.

Our first suggested amendment: We recommend the position is put beyond doubt to avoid any potential temptation as follows: "no property or income is provided for the purposes of the settlement (be it to the trustees or otherwise to an underlying person) either directly or indirectly by the settlor, or by the trustees of another settlement of which the settlor is the settlor or a beneficiary…".

Our second recommendation: Whilst we have made this point in our earlier representatives to no avail we feel it is so important that we need to reiterate our belief that a transfer/loan between trusts that both enjoy protected status should not be treated as tainting the recipient trust. Likewise splitting protected trusts should not cause tainting to occur as regards the newly formed trusts derived from the original settlement.

Our second suggested amendment: Widening the addition categories to allow the transfers specified.

14. **Measure: Schedule 13 Part 2 Paragraph 18 Para 5B**

What it is intended to do: This para inserts two new paragraphs, 5A and 5B into Sch 5 TCGA.

Para 5B elaborates on what constitutes "tainting".

Our recommendation: In a manner similar to that mentioned above, Para 5B could be read as focusing on loans to the trustees only and not loans to underlying persons (e.g. a wholly owned company). Paras 5B(2)(c), (d), and (e) for example all have wording along the following lines: "the principal of a loan made to the trustees" (para 5B(2)(c)). Para 5B(3), (5) and (8) all have the same defect.

Our suggested amendment: Para 5B should be amended so that where there is a special treatment for a loan to the trustees (say), the same treatment also applies to loans to underlying persons (e.g. wholly owned companies). Failure to do so will lead to unfairness for some and attempts to game the rules by others.

15. **Measure: Schedule 13 Part 2 Paragraph 21 s628A**

What it is intended to do: This para inserts s628A and s628B into ITTOIA.

S628A sets out certain circumstances in which s624 ITTOIA will not apply to certain foreign income. S628A(8) – (12) deal specifically with what is called "tainting" i.e. actions taken that will cause s624 to apply to foreign source income arising to the trustees.

Our recommendation: This new section seeks to limit the scope of s624 ITTOIA 2005 by excluding from its remit 'protected foreign-source income' (PFSI) for the year. In doing so it relies upon the definition of relevant foreign income as being equivalent to foreign source income. In reality the ambit of relevant foreign income (RFI) is narrower than foreign source income. There are 24 categories of RFI altogether. Some types of foreign income are not included in this definition, with the most important category being chargeable event gains.

It may be that it was intentional to limit PFSI to categories of foreign income than can benefit from the remittance basis. However, holding investments through insurance wrappers is a relatively common way of managing investments. To include chargeable event gains within the PFSI definition will be attractive to settlors and may be important in decisions taken about whether to leave the UK prior to becoming deemed domiciled here.

S628A(8) – (12): the wording used in the Capital Gains Tax legislation has been drawn on. As such we have the same concerns as those highlighted in our para 13 above.

Our suggested amendment: The definition of PFSI should be expanded beyond RFI to include all foreign income. The same comments as per our para 13 above apply vis-à-vis tainting.

16. **Measure: Schedule 13 Part 2 Paragraph 21 s628B**

    What it is intended to do: This para inserts into ITTOIA s628A and s628B.

    S628B elaborates on what constitutes "tainting".

    Our recommendation: The wording used in the CGT legislation has been drawn on. As such we have the same concerns as those highlighted in our para 14 above.

    Our suggested amendment: The same comments as per our para 14 above apply vis-à-vis tainting.

17. **Measure: Schedule 13 Part 2 Paragraph 22**

    What it is intended to do: This provision seeks to introduce the same limitation in relation to s629 ITTOIA 2005 (income paid to relevant children of settlor). The wording used in this paragraph is similar to that in Sch 13 para 21 of the Finance Bill and/or refers to new s628A (enacted by Sch 13 para 25). As such, our comments in 15 (above) are also relevant here.

    Our recommendation: See above.

    Our suggested amendment: See above.

18. **Measure: Schedule 13 Part 2 Paragraphs 23 - 25**

    What it is intended to do: The aim here is to introduce the same restriction to the definition of income capable of being assessed on a settlor by reference to capital payments made. Again the same observations apply here as they do in relation to Sch 13 paras 21-22.

    Our recommendation: See above.

    Our suggested amendment: See above.

19. **Measure: Schedule 13 Part 2 Paragraph 28 s721A**

    What it is intended to do: this clause introduces s721A and s721B into the Transfer of Assets Abroad (ToAA) legislation (found at s714 et seq ITA 2007).

S721A sets out certain circumstances in which s720 ITA will not apply to certain foreign income. S721A(2) deals with income arising to trustees and s721A(3) deals with income arising to companies owned by trusts.

S721A(2)(f) and s721A(3)(g) deal specifically with what is called “tainting” i.e. actions taken that will cause s720 to apply to foreign source income arising to the trustees or to the company (as appropriate).

Our recommendation: S721A(2)(b) and s721A(3)(b) borrow the term 'originating' from the income tax settlement rules by way of s721A(4) in order to help with the process of identifying income which can be classified as being 'protected foreign-source income'. It is not clear that it meshes in fully with the meaning of income attributed under a power to enjoy for the purposes of s720 ITA 2007. In that context income is identified by virtue of transfers abroad and related associated operations. Also the transfer of assets abroad rules are much wider than the equivalent income tax settlement rules. For example under the transfer of assets abroad rules s722(3) provides that in determining whether an individual has power to enjoy income for the purposes of s721, regard must be had to the substantial result and effect of all the relevant transaction. This mismatch in the definitions implies that there could still be some foreign source income that would fall to be assessable under s720, once income identified by reference to the income tax settlement rules had been excluded.

The meaning of s721A(3)(e) remains unclear. It is contained in a part of the legislation providing clarification as to the meaning of the term protected foreign source income. It provides that such income includes cases where income is retained by the person abroad but if not retained would be paid out in respect of the trustees direct or indirect participation in the person abroad. It is not clear what the position is where the trustees have provided an interest free loan to a foreign company in which they do not hold any shares, or where instead of making a loan they have provided zero rate preference shares. This is because they would not receive the income in question were it to be paid out.

The tainting provisions draw upon those discussed above and therefore we have the same concerns.

Our suggested amendment: See suggestion that the term “originating” is recast to fit with the general scheme of the ToAA legislation.

S721A(3)(e) should be recast so that it reads along the following lines: “the income is income that would be deemed to be the transferor’s under s721 as a consequence of being the settlor but for this section”.

The same comments as per our para 13 above apply vis-à-vis tainting.

20. **Measure: Schedule 13 Part 2 Paragraph 33**

What it is intended to do: this clause removes the current rule that a transferor who is within the scope of s720 is not within s731.

Our recommendation: As currently drafted, the relevant income pool for transferors will also include income which has arisen before the transferor became UK resident. This is a departure from the current regime – is this intentional?

Our suggested amendment: a transitional provision should be included to ensure that only income arising after the transferor has become UK resident can be matched.

21. **Measure: Schedule 13 Part 3 Paragraph 40**

What it is intended to do: this introduces a new rebasing relief for those becoming deemed domiciled on 6 April 2017 such that, if certain conditions are met, they will be treated for CGT purposes as having acquired their foreign assets at their market value on 5 April 2017.

Our recommendation: It is not clear that the rebasing is available on partnership (and LLP) assets; based on the language used in para 40 ("the asset was held by P on 5 April 2017") that this will be the case (cf s59A TCGA and SP D12). We would expect that such assets could be rebased and understand that this is also HMRC's opinion. However, we would like the legislation to be clear.

Our suggested amendment: The legislation should be clarified to make it clear that holding an asset via a partnership constitutes holding an asset for the purposes of this relief.

22. **Measure: Schedule 13 Part 3 Paragraph 43**

What it is intended to do: allow for the cleansing of mixed funds during a two year period. It is understood that a Finance Committee Bill amendment will be introduced to allow the cleansing of pre 6 April 2008 income, gains and capital as per the Budget announcement.

Our recommendation: whilst the concept is simple the complexity of the mixed fund legislation means that there are various issues that need to be considered to enable taxpayers to carry out cleansing exercises with certainty. HMRC need to be able to be flexible and guidance needs to be issued for consultation and then published as a matter of urgency.

It appears that there may be delays in issuing guidance for all but very simple cases. We would, therefore suggest that whilst the legislation should still come in from 6 April 2017 the deadline should be extended to two years after Finance Act 2017 receives Royal Assent.

Our suggested amendment: Schedule 13 Part 3 Paragraph 43 (5) should be deleted. It has the effect that if a taxpayer accidentally nominates more of an income type than actually exists the whole nomination is invalid. This will mean that taxpayers could trigger inadvertent taxable remittances. Rather than being an all or nothing approach the better approach is as follows: if it is established that an individual has over nominated an amount then the actual nominated amount should still be treated as cleansed and removed from the originating account and not disturb the remaining nominations. The over nominated amount could then be treated as a mixed fund in its own right comprised of the intended cleansed amount and the excess over nomination.

An extension to the deadline for when the cleansing window closes as set down above.

Valuing Benefits (Clause 43 and Sch 14)

23. **Background:**

    Clause 43 introduces Sch 14, which provides statutory valuation rules for the purposes of the settlements and transfers of assets abroad regime for the following benefits:

    - Interest free or low interest loans.
    - Making movable property available.
    - Making land available.

24. **Measure: Valuation of benefit where movable property is made available new s97B, TCGA 1992 and new s742D, ITA 2007**

    What it is intended to do: Provide a statutory framework for the purposes of the settlements and transfers of assets abroad regime for valuing the benefit when movable property is made available.

    Our recommendation: Certain allowable costs paid for by the beneficiary can be set against the value of the benefit provided. Security is not shown as one of these costs and yet where the immovable property is sufficiently valuable that can be an extremely high cost. As such, this needs to be added in. Maintenance is included as an allowable expense. We are not sure if this would include costs for ensuring the movable property is kept at the right temperature etc to prevent any deterioration (again critical for valuable movable property such as paintings). Clarification on this is required

    Our suggested amendment: Include “security” in new s 97B, TCGA 1992 and new 742D, ITA 2007. Clarify whether costs for ensuring the movable property is kept at the right temperature etc are included in maintenance and if not adjust accordingly.

IHT on overseas property representing UK residential property (Clause 44 and Sch 15)

25. **Background:**

Clause 44 introduces Schedule 15.

Schedule 15 contains one part made up of nine paragraphs.

Paragraph 1 inserts into IHTA 1984 Schedule A1 which is comprised of three parts as follows:

- Part 1 Overseas property attributable to UK residential property;
- Part 2 Supplementary; and,
- Part 3 Interpretation.

Paragraphs 2 – 9 deal with consequential amendments and commencement provisions.

26. **Measure: Schedule 15 Para 1 Schedule A1 Part 1 Para 2**

What it is intended to do: Defines the scope of the interests in UK property which are within the scope of Sch A1. This includes direct interests and indirect interests held via certain companies and partnerships.

Our recommendation: Para 2(2)(i) requires only that an indirect interest in UK residential property be held via a close company. However, where the direct ownership is via an open company and the taxpayer owns an interest in the open company via a close company, then this interest too will be within the scope notwithstanding the policy intention as stated was to bring ownership via close companies only within scope.

Our suggested amendment: We recommend that para 2(2)(i) is amended so that where there is an open company in the chain of ownership between the taxpayer and the UK residential property, then such an interest falls outside the scope of Sch A1.

27. **Measure: Schedule 15 Para 1 Schedule A1 Part 1 Para 2**

What it is intended to do: Defines the scope of the interests in UK property which are within the scope of Sch A1. This includes direct interests and indirect interests held via certain companies and partnerships.

Our recommendation: Sch A1 does not contain an overall cap on the value that can be charged to IHT. As drafted, it is possible to have multiple IHT charges on the same underlying UK property falling on a single or multiple persons.

Our suggested amendment: We recommend that a cap is introduced that places a limit on the value liable to the potential IHT charges that can arise from a single UK residential property; this should not be no more than the value of the partnership interest or shares if they were owned by a UK domiciled individual and certainly no more than the value of the property.

28. **Measure: Schedule 15 Para 1 Schedule A1 Part 1 Para 2**

What it is intended to do: Defines the scope of the interests in UK property which are within the scope of Sch A1. This includes direct interests and indirect interests held via certain companies and partnerships.

Our recommendation: Para 2 applies (broadly) to a right or interest in a close company which is attributable to UK residential property.

Consider the following: A owns a Jersey Company (JCo) which owns UK residential property and B lends monies to JCo which JCo invests in private company shares (CCo), and B has a lien over the shares as security. CCo fails and is wound up. Now B has a loan to JCo which can only be repaid from (i.e. it is attributable to) the proceeds of the UK residential property sale as JCo has no other assets. It therefore appears that B has an interest in the residential property within para 2. This is presumably not the intention.

Additionally, it is not clear at what stage does the loan come within para 2, when CCo begins to fail or once it has failed? If the former, at what stage does the loan fall outside para 2 if CCo recovers?

Nor is it clear how any of the above will interact with guarantees. If in the example above A guarantees the loan from B, then if CCo fails, presumably the loan is not attributable to the UK residential property as it can now be recovered from A.

Our suggested amendment: We recommend that the term "attributable" is clarified. At present it has a very wide meaning which is likely to catch unintended scenarios.

29. **Measure: Schedule 15 Para 1 Schedule A1 Part 1 Para 2**

What it is intended to do: Defines the scope of the interests in UK property which are within the scope of Sch A1. This includes direct interests and indirect interests held via certain companies and partnerships.

Our recommendation: Since there have been no changes to the draft legislation as published in December 2016 we assume that the shares are to be valued with normal valuation principles prevailing (for minority interests in a company etc).

Our suggestion: That HMRC makes this clear and states that the position set down in the December Response Document, where it referred to the value of the property being valued, is not correct.

30. **Measure: Schedule 15 Paragraph 1 Schedule A1 Part 1 & 2 Paragraphs 3, 4 & 5 General**

What it is intended to do: Paragraphs 3 and 4 are anti-avoidance provisions which are widely drawn and bring loans made by foreign domiciliaries that have been used by the borrower to fund the acquisition of UK residential property within the scope of UK IHT.

Paragraph 5 is an anti-avoidance provisions that basically continues to treat the proceeds of disposal or loan repayments as being within the scope of UK IHT for two years after the date of disposal or repayment.

Our recommendation: We consider that paragraphs 3, 4 and 5 presuppose that a (probably) foreign resident non-domiciliary will be aware that lending money to a family member or friend runs the risk of generating a UK IHT exposure. We think it highly unlikely that this will be the case and, in the case of the proceeds of a loan repayment (para 5), we consider it even less likely that the lender will realise that the proceeds are exposed to UK IHT for a further two years after repayment.

To give the appropriate context, the individuals involved are likely to:

- Have no links to the UK; and,
- Have no awareness of the UK's IHT laws or any reason to acquire that awareness.

In addition they may have no control over what the loaned funds are used to acquire and have no way of extracting said information.

Coupled with a law that is not intuitive means that the default position for most of these individuals will be inadvertent non-compliance. We do not believe that legislation such as this should be enacted.

Our suggested amendment: No amendment suggested but consideration needs to be given to the enforceability of the provision and how potential taxpayers can be made aware of it.

31. **Measure: Schedule 15 Paragraph 1 Schedule A1 Part 1 Paragraph 3 – interests in a partnership**

    What it is intended to do: Bring all loans in connection with UK residential property into the scope of IHT.

    Our recommendation: There should be a restriction on the scope of the legislation as it applies to partnerships to mirror the fact that only “close companies” are within the scope of the legislation. This is a significant practical issue particularly with the extension of the legislation to loans, as some large overseas lenders (including banks) are partnerships.

    Our suggested amendment: A “close partnership” definition should be introduced and the legislation should only apply to partnerships where this definition is met.

32. **Measure: Schedule 15 Paragraph 5**

    What it is intended to do: switch of exit charges etc when property ceases to be subject to the charges within new Sch A1, IHTA 1984.

    Our recommendation: We are concerned that there could be an issue such that this does not work as planned. The legislation refers to the IHT charging provisions at paragraphs 2 and 3 of Sch A1 but no mention is made of paragraph 5.

    Our suggested amendment: adjust new s65(7B), IHTA 1984 inserted by paragraph 5, Sch 15 to read “to which paragraphs, 2, 3 or 5”

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 via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).