TECHNICAL RELEASE

TAXGUIDE 11/15 (TECH 14/15TAX)

USE OF FOREIGN INCOME AND GAINS AS LOAN COLLATERAL

Agreed note of conference call with HMRC published by ICAEW Tax Faculty in October 2015

ABOUT ICAEW

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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

An announcement was made by HMRC on 4 August 2014 to take immediate effect regarding the use of offshore unremitted gains or income as collateral for a loan enjoyed in the UK.

The HMRC news item set out a change in its position where remittance basis users use remittance basis unremitted foreign income or gains (FIG) as collateral for a "relevant debt" (defined at s809L(7), Income Tax Act 2007). The change was not to the legislation itself but to HMRC's published guidance in its manual at RDRM33170. Prior to the change, where a loan on commercial terms was regularly serviced, the loan collateral would not be treated by HMRC as a remittance even though it comprised unremitted income and gains.

From 4 August 2014, where offshore unremitted gains or income are used as collateral for a loan enjoyed by a non-UK-domiciled person in the UK, HMRC treats the use of the FIG as a remittance, as well as the servicing payments if they come out of different FIG – a potential trap which could be seen as a double tax charge (though HMRC do not accept this as different FIG is involved).

Together with other professional bodies we have been in discussion with HMRC since the announcement to gain some clarity on how the revised position would operate with particular regard to existing loans. We published our views of the announcement in TAXrep 52/14, which also contains the minutes of a meeting we (and other representatives from the professional bodies) attended with HMT/HMRC representatives in September 2014.

On 15 October HMRC published Brief 16 which announced that *"HMRC has decided it will, with effect from today, not seek to apply the change announced on 4 August 2014 to arrangements where the loan was brought into or used in the UK before that date. From today, there is no requirement to repay or replace foreign income and gains collateral with non-foreign income and gains collateral before 5 April 2016."*

Following on from the announcement HMRC arranged a conference call with the interested parties to address specific issues with respect to the 15 October 2015 announcement and this TAXguide is a record of that call.

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

REVENUE AND CUSTOMS BRIEF 16 (2015): REMITTANCE BASIS TREATMENT OF FOREIGN INCOME AND GAINS USED FOR LOAN COLLATERAL

Conference Call 16 October 15:00 to 16:00 between HMRC representatives and stakeholders

Paul Jefferies (PJ) the HMRC policy lead chaired the conference call. He explained that the purpose of the call was to address specific issues with respect to the 15 October 2015 Announcement and that there would be a face to face meeting for a detailed discussion of the legislation and the way it is applied.

It should be noted that the HMRC technical view set down in the 4 August 2014 Announcement is disputed. This point was raised by a number of stakeholders. It was, however, decided that pragmatically it was necessary to agree to differ on that point so as to get clarity on HMRC's view on how it would look to apply the transitional provisions it felt were necessary.

Background/reasons for the 15 October 2015 Announcement

PJ wanted to provide some background to where we are now. He explained that he had been the HMRC policy-lead in this area since May/June 2015. He came into the situation then with a fresh pair of eyes and reviewed the position.

PJ said that from an HMRC perspective it could not consult prior to the 4 August 2014 announcement because it felt that some individuals were taking advantage of its RDRM Guidance on FIG and collateral to enter into transactions that HMRC considered to be of an avoidance/abusive nature.

The HMRC terminology (avoidance/abuse) used in connection with transactions using FIG as collateral for relevant debts was not accepted by stakeholders, but it was felt that this was an issue where agreement over terminology would not be reached, so it needed to be set aside if the call was to move forward productively.

PJ said that having worked through the issues it was appreciated that there were genuine concerns with the transitional provisions and so a decision was made to revise the position set down in the 4 August 2014 Announcement to ensure HMRC's change of practice operates as intended. Working through the issues took time and they had to get further legal advice and this was why it took so long for the publication of a follow up Announcement.

Questions with respect to the 15 October 2015 announcement

Disclosure requirement now dropped in its entirety

The 15 October Announcement makes it clear that: *"From today, there is no requirement to repay or replace foreign income and gains collateral with non-foreign income and gains collateral before 5 April 2016."* There is no mention made of disclosure but it is assumed that HMRC no longer requires disclosure with respect to either loans that have or have not been repaid/replaced. PJ confirmed that this was correct and that the whole disclosure requirement has now been dropped by HMRC for loans falling under HMRC's previous practice.

Timing issues

HMRC was asked about the position for loans taken out pre 4 August 2014 where the funds were not brought into the UK prior to that date.

HMRC Technical, specifically Paula Ciuraj, (PC)) answered this question. PC said that the facts of each case would need to be considered with the key issue being whether the loan was taken out for something for which there was a binding contract for sale prior to 4 August 2014. For example:

- HMRC would be more likely to accept that grandfathering applied if a loan was taken out pre 4 August 2014 for the acquisition of a UK property with respect to which contracts were exchanged on 3 August 2014 and the funds came into the UK on 5 August 2015.
- Where a £100,000 loan secured on FIG collateral is taken out on 17 July for general UK expenditure, £75,000 is brought in prior to 4 August 2014 and the remaining £25,000 is brought in on 25 October 2014 there **is** grandfathering with respect to the **£75,000** but HMRC will argue that the £25,000 is a taxable remittance.

HMRC felt that this timing issue was only likely to apply in a small number of cases and since the answer as to whether grandfathering would apply was likely to be so fact specific it was suggested that individuals (or their tax agents) contact PC and PJ (using the e-mail addresses provided at the end of Revenue and Customs Brief 16 (2015).

When does a loan become a new loan?

There was some discussion about when a loan would become a new loan, a specific concern being rollover loans. Stakeholders felt that simply changing the interest rate did not create a new loan. HMRC felt that the issue was too technical for the conference call so it was held over for the meeting.

Business investment relief

A question was asked about the potential for a business investment relief claim where there is a post 3 August 2014 remittance and no binding contract (so grandfathering does not apply). This was covered in some of the draft FAQ material shared in the discussions between HMRC and the stakeholders but not in the 15 October 2015 Announcement. This was another issue that HMRC felt was sufficiently technical to hold over until the meeting.

Other issues

The point was made by stakeholders that HMRC's new interpretation (if correct) means that tax may have been collected where FIG was used as collateral for pre 4 August 2014 loans and the funds were used/brought to the UK pre 4 August 2014. The fact that HMRC decided not to proceed did not affect that, so on the basis that a remittance can only happen once stakeholders suggested it was technically possible (if the HMRC interpretation is correct) to bring the FIG into the UK (or use it to provide a UK benefit) without triggering a tax charge.

HMRC expressed the view that using or bringing the FIG in the UK on or after 4 August 2014 should be taxable, but they would consider the position under the legislation and clarify this at the meeting.

To an extent stakeholders could understand the HMRC position on the above. However, there was considerable concern about individuals who had crystallised tax liabilities prior to the 15 October 2015 announcement, incurred legal costs and/or re-financed on less beneficial terms. Such individuals were understandably very upset and felt that they had been penalised for doing what HMRC required when it would have been better for them to have held out to see what might happen. The stakeholders all felt that it was only fair that there should be relief at least where tax liabilities had been crystallised unnecessarily. HMRC did not see how this could be possible as from the perspective of the technical team a remittance was a remittance and there was no scope to allow a specific relief for re-arranging/re-winding the loans in accordance with its 4 August Announcement.

PJ said that it was accepted that this was not a comfortable situation and that the 4 August 2014 Announcement had not been meant to cause unnecessary tax liabilities. The aim was to stop what it saw as the abuse and sort out the position going forward. It was unfortunate that there was such a long time between the 4 August 2014 Announcement and the 15 October 2015 Announcement. The issues did, however, need to be looked into carefully and legal advice was required. HMRC could have stuck to the 4 August 2014 position but it felt it was better to change to assist those who could not unwind.

The stakeholders felt that the key issue, which had caused the problem here, was the failure to consult over the transitional provisions. Whatever the HMRC protocol on not consulting where it felt there was avoidance and abuse it was felt that it could have issued a briefer announcement in August 2014 with a statement that it would consult on the transitional provisions. It was felt that this could have avoided these issues.

PJ acknowledged there are difficult issues and rough edges with respect to the transitional provisions. There will also be difficult issues with the position going forward. HMRC want to arrive at a sensible and pragmatic position with respect to the operation of the legislation going forward and that will be the main purpose of the face-to-face meeting.

The follow up meeting

Everyone wants the face-to-face meeting to be held as soon as possible. Given the logistics the meeting is likely to be in a couple of weeks. PJ will send through a selection of possible meeting dates so the best one can be determined.

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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