# Further written evidence submitted by the Chartered Institute of Taxation (FB10)

## Domicile, overseas property etc
## (clauses 29-33 and schedules 8-10)

NB. This briefing note is separated into two parts – the first covers clauses 29-31 and related schedules, the second covers clause 33 and the linked schedule

### A) Deemed domicile – income and CGT (clauses 29-31 and schedules 8-9)

| 1 | **Key concerns** |
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| 1.1 | These clauses and related schedules fundamentally change the taxation of foreign domiciliaries who are UK resident with effect from 6 April 2017. The policy intention of creating fairness in the tax system is welcome. Although we have a number of detailed concerns on the very complex draft legislation implementing the reforms, we focus here on three fundamental concerns:<br><br>• A counter-intuitive consequence of the reform<br>• Deficiencies in the new benefits charge for offshore trusts<br>• A number of problems with mixed fund cleansing and at least two key problems that require drafting amendments |

| 2 | **The counter-intuitive result** |
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| 2.1 | The counter-intuitive result arises in respect of the new deemed domicile rule. The deemed domicile rule applies if someone is UK resident for 15 out of the previous 20 tax years. Once deemed domiciled from the start of the 16th tax year, the taxpayer is taxed on a worldwide basis on all foreign income and gains and is subject to inheritance tax on his or her worldwide estate.<br><br>Contrary to the technical brief issued in July 2015 (see https://tinyurl.com/ppsroo8) which indicated at para 3.2 that foreign domiciliaries would only become UK domiciled in their 16th year of residence, a foreign domiciliary will become deemed domiciled for all tax purposes in year 16 irrespective of whether or not they are UK resident in that year.<br><br>It appears counterintuitive that an individual can become deemed UK domiciled during a period when he/she is not in fact resident in the UK. |
| 2.2 | The practical result is that from 2017/18 onwards a taxpayer will need to leave the UK in the 14th year of residence rather than the 15th year to avoid becoming deemed domiciled in year 16 (despite being non-resident) and subject to UK tax on a worldwide basis. Failure to appreciate this result would also have severe consequences for the new statutory |

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| | protections for a trust established before the settlor becomes deemed domiciled. Any inadvertent direct or indirect addition to such a trust in year 16 would taint the trust resulting in permanent loss of protection for both capital gains tax and income tax purposes. It is of course a political decision as to whether deemed domicile should flow automatically from 14 rather than 15 years of residence but we suggest that it makes little sense to have the main practical effect at odds with the headline description of the proposal in this regard in a way that risks catching those affected unawares. |

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| **3** | **Deficiencies in the new charging mechanism for offshore trusts** |
| **3.1** | In the consultation document published on 30 September 2015 it is stated at paragraph 3.2 that<br><br>'…the government does not intend that non-domiciliaries who become deemed-UK domiciled should have to pay UK tax on income and gains in offshore structures which were set up before they became deemed-domiciled simply because the individual was the settlor of the trust or was considered a transferor under the Transfer of Assets Abroad legislation. As a part of these reforms, the government will ensure that any individual who becomes deemed-UK domiciled will continue to be protected from UK tax on offshore trusts that they have settled while neither they nor their spouse or children receive any benefit from the trust.<br><br>The government intends to base the new rules on the taxable value of benefits received by the deemed domiciled individual without reference to the income and gains arising in the offshore structure.'<br><br>The draft legislation implements this policy intent by removing deemed domiciled ( and non-domiciled) settlors of protected trusts from the transferor charge and instead assessing the settlor on benefits received whether in the UK or overseas and whether the benefit is conferred on the settlor or on a non-resident close family member of the settlor such as a non-resident spouse. |
| **3.2** | However, if the policy intent of the replacement of the transferor charge with a benefits charge on the settlor is that remittances of income from an offshore trust should be possible without giving rise to UK tax liabilities in order to facilitate investment into the UK, the technical drafting does not achieve this end in two important respects:<br><br>• Although the draft legislation allows trustees or their underlying entities to invest income in the UK without it being treated as a taxable remittance, as drafted, a non-UK domiciled beneficiary could pay tax if he/she receives benefits from the trust irrespective of whether the benefit is wholly enjoyed abroad and not remitted to the UK. **The practical effect is to deter trustees with foreign domiciled beneficiaries from investing in the UK.**<br>• A non-UK domiciled settlor who comes to the UK and receives benefits from the trusts will be taxed on benefits received by reference to pre- arrival income. Moreover if after a couple of years he/she leaves and receives benefits from the trust after departure the way the legislation is framed means he/she can be subject to UK tax by reference to income arising pre- departure. The effect is **to potentially deter a non-domiciled settlor from taking up residence in the UK at all.** |

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| **3.3** | If the thrust of the policy intent is to both retain and attract investment into the UK by foreign domiciliaries as part of a tax system that balances fairness and international competitiveness[1], the above two points appear potentially out of step with this policy. The amendments required to address these deficiencies are largely technical and minor. |

| **4** | **Mixed funds cleansing** |
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| **4.1** | Mixed funds in broad terms are offshore accounts held by non-UK domiciliaries that consist of a mixture of income, capital gains and capital (and/or which derive from different tax years). Under current remittance basis rules, taxable income and capital gains are treated as remitted ( and therefore taxed) before non-taxable clean capital. The current rules also prevent the separation of the non-taxable clean capital from the other taxable elements into separate offshore accounts.<br><br>The effect of this creates a perverse disincentive for non-domiciliaries not to bring their money into the UK. Monies which could be remitted (e.g. capital which arose before the individual was ever UK resident) are trapped behind unremittable monies. |
| **4.2** | The draft legislation provides for a temporary window of 2 years until April 2019 for deemed domiciliaries to separate out income, capital gains and clean capital and remit from those accounts paying the appropriate amount of tax (in the case of income and gains) and bringing in clean capital to the UK for investment or consumption. |
| **4.3** | There are a number of issues with the draft clauses implementing this measure. However two aspects require drafting amendments to achieve the intended result. These are:<br><br>• There seems to be a discrepancy in the draft clauses between Schedule 8 para 44(3)(b) and para 45(2)(b)(1) .Paragraph 45 extends mixed fund cleansing to transfers from a mixed fund arising before 6 April 2008. It is assumed that the definition of a qualifying individual for paragraph 45 should be therefore consistent with paragraph 44, as reflected in the Explanatory Notes. The inconsistency appears to be an error.<br>• The draft clauses at Schedule 8 para 44 apply only to an ‘offshore transfer’. In certain circumstances, under existing rules, something is not an ‘offshore transfer’ in the first place if, at the end of the tax year, it has actually been remitted or there is some sort of plan/intention to remit it. The failure to switch off those sections appears to undermine the policy intent. |

| **5** | **Further background** |
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| 5.1 | The government announced its intention to reform the non-UK domiciliaries regime in Summer Budget 2015. The objective was ‘to create a fair and competitive tax regime’ by: |

[1] See the Introduction to Reforms to the taxation of non-domiciles: further consultation at https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles-further-consultation/reforms-to-the-taxation-of-non-domiciles-further-consultation

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| | • ending permanent non-UK domicile status,<br>• preventing those who are UK born with a UK domicile of origin from claiming non-UK domicile status for tax purposes<br>• applying inheritance tax to UK residential property owned by foreign domiciliaries through foreign entities (the subject of a separate briefing), and<br>• reforming Business Investment Relief (the subject of a separate briefing). |
| 5.2 | The proposals have been through a lengthy but disjointed consultation, with elements of draft legislation published in tandem with consultation documents. On 5 December 2016 the government published further (but not yet complete) Finance Bill consultative clauses (together with a response to the further consultation issued in August 2016), and further clauses again on 26 January 2017. |

## B) IHT UK residential property held in offshore structures (clause 33 and schedule 10)

| **1** | **Key concerns** |
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| 1.1 | This clause and its schedule brings the value of UK residential property held indirectly through offshore structures such as trusts and companies into charge to inheritance tax with effect from 6 April 2017. The policy intention of creating fairness in the tax system is welcome. The change is achieved by removing the protection of being 'excluded property' for IHT purposes from interests of more than 5% in a non-UK closely held company or partnership holding UK residential property. The IHT charge extends to loans made or collateral provided for the acquisition of UK residential property. Our major concern is that the wording of Schedule 15, paragraph 3(b) may be insufficient to exclude an IHT charge in all circumstances where the value of the collateral is greater than the underlying loan. |
| 1.2 | Schedule 10 para 3(b) charges IHT on funds provided offshore as collateral security for a loan to finance the acquisition of UK residential property but limits the collateral 'to the extent that it does not exceed the value of the relevant loan'. The position is unclear if there are two lots of security for the same loan.<br><br>For instance, a loan of £10m for daughter to buy UK house, and the security given is £10m foreign house and £10m offshore share portfolio. Both are collateral, neither exceeds the value of the relevant loan. But there is now £20m collateral potentially brought into the IHT net, whereas the loan value is only £10m. Could the government provide the reassurance that the collateral components are apportioned, so that only £10m of collateral is subject to IHT?<br><br>It is more difficult if the security is provided by different people – e.g. brother provides his £10m foreign house and mother also provides a personal guarantee secured on her £10m offshore share portfolio. Again, government reassurance is required that each has a potential IHT liability on £5m of their £10m collateral.<br><br>It is also problematic if the loan is more than the value of the property, e.g. £4m is borrowed to buy a house, but the house then falls in value to £3m. The IHT charge should be restricted to the lower of the value of the loan and the value of the property. |

| 2 | **Background** |
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| 2.1 | The government announced its intention to reform the non-UK domiciliaries regime in Summer Budget 2015. Part of the objective ‘to create a fair and competitive tax regime’ was to be achieved by applying inheritance tax to UK residential property owned by foreign domiciliaries through foreign entities |
| 2.2 | These proposals have been through a lengthy but disjointed consultation, with elements of draft legislation published in tandem with consultation documents. On 5 December 2016 the government published this clause and schedule in draft (together with a response to the further consultation issued in August 2016). Not all of the concerns raised in response to the draft provision have been addressed in the published Bill. |

*17 October 2017*