TAXREP 56/13

(ICAEW REP 145/13)

ICAEW TAX REPRESENTATION

CONSULTATION ON MATCHING RULES FOR THE BENEFITS CHARGE ARISING OUT OF A TRANSFER OF ASSETS ABROAD

Comments submitted on 10 October 2013 by ICAEW Tax Faculty in response to HM Revenue & Customs consultation on the matching rules for the benefits charge arising out of a transfer of assets abroad included in the document Reform of an anti-avoidance provision: Transfer of assets abroad published on 18 July 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *Reform of an anti-avoidance provision: Transfer of assets abroad* published by HM Revenue & Customs (HMRC) on 18 July 2013.

2. This consultation paper follows on from consultation in 2012 (specifically the consultation document *"Reform of two anti-avoidance provisions (i) the attribution of gains to members of closely controlled non-resident companies, and (ii) the transfer of assets abroad"*, which was published on 30 July 2012). That document:

- set down the Government's proposals to respond to the European Commission's infraction notices against the two anti-avoidance provisions;
- proposed other changes to certain aspects of the provisions, including three specific changes to the transfer of assets abroad ("TOAA") regime (double charging , changes to legislate for the HMRC view on double taxation relief and new rules for matching the benefit received by a UK resident individual to the income of a person abroad under the benefits charge); and
- said that the Government would welcome suggestions for further improvements to the two anti-avoidance provisions as part of a wider review.

3. Finance Act 2013 made changes to both sets of anti-avoidance provisions with the aim of doing sufficient to prevent further EU proceedings. In our view this objective was not met and, particularly given the lack of proportionality in the TOAA provisions, we believe the provisions are incompatible with EU law.

4. Finance Act 2013 changes were also made to legislate for the proposals with respect to the prevention of double charging and legislating for the HMRC view on the TOAA legislation and double taxation relief.

5. Given the number of concerns raised with respect to the proposed rules for matching benefits received to relevant income the Government did not enact those proposals as it wanted to take further time to consider the issues. We welcomed this decision.

6. Various suggestions for further reform to the TOAA regime were received. These were not included in the December 2012 Government Response Document but it was announced that there would be a more detailed review of the TOAA regime and the TCGA 1992, s13 (attribution of gains) regime in 2013. We welcomed this news and looked forward to taking a positive role in both consultations.

7. Unlike the 2012 consultation this 2013 consultation process has separated out the TOAA income tax regime and the TCGA 1992, s13 (attribution of gains) regime. As the title suggests the consultation document *Reform of an anti-avoidance provision: Transfer of assets abroad* focuses solely on the TOAA regime. As such our comments herein do the same.

8. The July 2013 Consultation Document also introduces revised guidance on the TOAA rules and seeks views on it. We have very fundamental concerns with this draft guidance. To the extent that the consultation questions refer to the draft guidance we comment on it herein. In addition we have submitted (as requested) a separate response including our key concerns with the draft guidance and some other preliminary comments. We are taking part in a specific working group on the draft guidance.

9. On 6 September 2013 we attended a working party meeting with HMRC on possible changes to the matching rules with respect to benefits received and relevant income. During the course of this meeting we were able to put forward some key comments and concerns and discuss aspects of the consultation paper. The comments herein build on those we made at that

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

10. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

11. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

12. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

13. 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 TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

14. We set down very material concerns with the TOAA regime in the two response papers we submitted with respect to the original July 2012 consultation and the December 2012 Response Paper (that is TAXREP 53/12 and TAXREP 11/13) and also as part of our Finance Bill briefings (TAXREP 33/13). We made it clear in these responses that we supported the objectives that the Government was trying to achieve, namely making the TOAA regime compliant with EU law while protecting the exchequer. However, as set down then, it is our view that FA 2013 section 26/ Schedule 10 does not make UK law compliant with EU principles.

15. As we have stated in earlier responses, we believe that the limitations within s742A ITA 2007 (post 5 April 2012 exemption for genuine transactions) are not in keeping with the underlying EU case law. The EU case law is not limited to goods and services but instead looks to see whether there is a business carried on through a genuine establishment (see eg *Cadbury Schweppes*). As we have stated before it is not helpful to taxpayers (who must be prepared for expensive litigation) nor indeed HMRC (who may be faced by taxpayers asserting rights) for there to be only partially compliant legislation. The underlying European law will always prevail to the extent there is a conflict with UK law. This is another example of a situation that the draft guidance cannot remedy and where legislative reform is required (see paragraph 19).

16. We were disappointed that the points we made in our two earlier representations (TAXREP 53/12 and TAXREP 11/13) on those changes during the consultation process were, in the main, not taken on board. It was our view that, in addition to being non-compliant with EU law, the TOAA legislation as amended by FA 2013 would add to the complexity of legislation that was already incoherent and overly complex (indeed this was a factor which led the EC to say the measure was disproportionate).

MAJOR POINTS

17. Given our significant concerns with the TOAA legislation we were hopeful that the promised review of the regime would lead to positive legislative change. Unfortunately, the consultation document *Reform of an anti-avoidance provision: Transfer of assets abroad* is from our perspective a deeply unsatisfactory document as it proceeds on the basis that radical reform to the TOAA rules is not necessary. We believe that this is a fundamentally flawed conclusion and that the only way for the TOAA legislation to be made clear, certain and fair (for both taxpayers and from an Exchequer perspective) is for the provisions to be reviewed in their entirety. The legislation is incoherent and complex and Guidance, which has no statutory authority, cannot make up for this. This appears to us to be clear both from the complexity of the current draft guidance and the extent to which the draft guidance contains multiple caveats.

18. From an EU law perspective it seems to us that the TOAA regime is not compliant and that the draft Guidance makes this clear by showing both how complex the provisions are and how disproportionately the UK tax authority is suggesting they should be applied (our concerns with the extreme interpretations taken in the draft guidance are set out in summary in our separate response).

19. A root and branch reform of the legislation is required (as Schedule 12 of FA 2010 did, after extensive consultation, with the transactions in securities legislation). We recommend that HMRC is given a far wider remit such that it can enter into discussions with experts from representative bodies, and other key stakeholders, so that collaboratively we can devise a solution that not only conforms fully with EU law but also improves the TOAA legislation so that the provisions are:

- clear and workable at the coalface (taking into account the far greater international mobility that we have in the 21st century and the need to consider multiple jurisdictions and overall tax paid rather than just considering a structure from a UK tax perspective) in terms of ease of both taxpayer compliance and HMRC enforcement; and
- fair (such that the provisions do not work capriciously) to both affected taxpayers and the Exchequer.

20. We appreciate that reforming the TOAA legislation will not be a simple task but we do not think there is any other viable option given the current situation. The flaws in the regime are such that the more one tries to explain it in detail the more one finds that it is incoherent. Only a radical legislative solution can remedy this.

21. If our recommendation for a far wider review of the TOAA provisions is rejected it is our view that it will be very difficult to amend the matching rules with respect to relevant income in a way that will be acceptable. This is because we believe that, within the current legislative framework, providing greater legislative certainty may either result in unacceptable unfairness to the taxpayer or open up tax avoidance opportunities.

22. The various criticisms of the proposals to amend the matching rules that were set down in the July 2012 Consultation Document show the unfairness to the taxpayer that can result from amending the rules. If the Government is minded to amend the rules we would welcome the opportunity to take part in the consultations to try to arrive at rules that are as clear and fair as possible but think that without wider reform it will be a very difficult task.

23. We have very serious concerns with the comments about the current matching rules in the draft guidance. In our view the comments at INTM601680 and in other places take an extreme view that is unfair to taxpayers who, if this interpretation were correct, would find themselves faced with significant tax liabilities in connection with income they cannot benefit from. In our opinion the views expressed in the draft guidance are incorrect and they also represent a

significant departure from previous published HMRC guidance in this area and also HMRC practice.

RESPONSES TO CONSULTATION QUESTIONS

Q1: The draft guidance at INTM601680 confirms this application of the legislation. Is anything further needed to provide certainty?

24. For the reasons explained below we disagree strongly with the draft guidance at INTM601680, which takes an extreme view and seems to us to represent a significant change in the HMRC position. We believe that the current draft guidance has made the position less certain than it was previously.

25. The issues with respect to identifying relevant income are highly complex. The "timing" issue is a particular problem as there is more than one time that one could use to quantify the "relevant income" in relation to the individual receiving the benefit. The current legislation is defective in that it does not provide a clear answer.

26. Our view, which we understand to represent current practice, is that one determines whether there is relevant income available to provide a benefit to an individual by looking to the position at ***the later of***:

- the end of the tax year in which the income arises; and
- the end of the tax year during which the benefit is received by the individual.

27. In practical terms this means that where income is segregated from capital the relevant income pool will be reduced where the income is paid away (whether this is to settle a disbursement or make a distribution). The key point being that the income is removed from the structure such that it is not available to provide a benefit to other individuals. Where the income is used to make an income distribution that will be subject to tax under normal principles.

28. We consider the above to be an entirely equitable interpretation of the legislation and that the comments in the draft HMRC guidance at INTM601680 are extreme and could lead to unfair and disproportionate results as often trustees will not settle all expenses in the year they relate to (trust accounts often contain entries both for creditors and accruals) and may decide to wait until they have accounts for the year before making final decisions on distributions. Interpreting the legislation in the way suggested by INTM601680, such that relevant income can be reduced provided all expenses payments and distributions happen by the end of 5 April in the year the income arises, seems absurd in this context.

29. We accept that the statement at INTM601680 of the draft guidance that: *"once an amount has been determined as being relevant income of a tax year it will fall to be taken into account as relevant income in any subsequent years benefits charge calculation"* is one interpretation of the legislation. However, for the reasons stated, we do not believe it is the better interpretation. Furthermore, it appears to be a departure from the accepted HMRC Guidance as set down in April 1999 in an interpretation article in Tax Bulletin 40 (and reproduced as RI 201) which states:

> *"For the purposes of Section 740(3) the measure of "relevant income" is treated as not including such part of the income as has already been genuinely paid away to a beneficiary or to a bona fide charity.*
>
> *Once relevant income has arisen and continues to be available to provide a benefit, it must in the Revenue's view be carried forward year by year until extinguished by such a benefit, even if it is capitalised in the accounts of the overseas person."*

30. The emphasis here is correctly on the income continuing to be available to provide a benefit to the individual. The change of stance in the draft guidance at INTM601680 (and the paragraph at the start of page 17 of the Consultation Document) is disturbing, is not in our view an accurate representation of the law and has added to (rather than decreased) the uncertainty in this area.

Q2: How might more certainty be provided around allocation of relevant income without introducing opportunity for tax avoidance?

31. As discussed, we believe it will be very difficult to introduce acceptable new provisions for matching without making wider changes to the legislation.

32. Without more radical change, the concern to prevent tax avoidance may lead to new rules that can operate capriciously to penalise taxpayers by taxing them on income they have no entitlement to.

33. It would not be right to have a set of provisions that taxed a UK resident on all of the relevant income in the following scenario: two trust beneficiaries (one UK resident and one non-UK resident) are 18 in the same tax year and each receives a £500,000 capital distribution on their 18th birthday. There is brought forward relevant income of £500,000 (with current year income having been paid out to a different beneficiary). Just and reasonable provisions should apply such that the UK resident is only subject to tax on £250,000 of income.

34. Given the inherent complications surrounding the matching rules it seems to us that the only way for any changes to be fair is to make use of "just and reasonable provisions".

Q3: Are there workable alternatives that would provide greater certainty to the current "just and reasonable" apportionment of relevant income under sections 743 and 744 that would not introduce opportunity for tax avoidance?

35. If the parameters for this consultation were extended it might be possible by making other fundamental changes to the legislation to avoid the need for "just and reasonable" provisions. However, given the complex issues and the need to ensure fairness to the taxpayer and also avoid creating opportunities for tax avoidance even then this might not be possible. Taking into account the current scope, of the consultation we see no possibility of having fair legislation if the "just and reasonable" provisions are removed.

Q4: How can the matching rules be reformed to achieve greater certainty while managing complexity and operational difficulties?

36. As explained we do not think that the matching rules can be looked at in isolation. Even if this could be done sensibly, the complexity of the legislation is such that it would not be possible to provide a useful answer to the question without producing a very detailed paper, which it would not be appropriate for us to commit the necessary resource to without more detailed instruction and commitment to taking the proposals further. If the Government is minded to retain the limit on changes to the TOAA regime to a reform of the matching rules we will play a full role in the working party established.

Q5: How might the December 2012 draft legislation be amended to address concerns raised whilst providing greater certainty and maintaining effectiveness against tax avoidance?

37. Our key concerns with the December 2012 draft legislation were set down in TAXREP 11/13. In our view the proposals were inequitable (potentially taxing individuals on income they had no entitlement to) and unduly complex. We were also concerned that the proposed matching rules were not consistent with those introduced by FA 2008 for foreign domiciliaries.

38. As discussed above without more fundamental reform we are not sure that it will be possible to produce new rules that will be felt to be an unqualified success. If the government decides to go ahead with limited reform, and use the December 2012 proposals as a basis, there are a number of significant technical and practical issues (such as what happens with respect to relevant income pools where there are transfers between structures) that it will be necessary to work through. The working group on matching rules will be the place to do this and, as stated already, we are happy to play a full part in those discussions.

Q6: Does the draft guidance provide sufficient clarity and certainty on the operation of the matching rules? If not, how might the guidance be improved to provide this?

39. We set down our fundamental concerns with the guidance in our answer to question 1. We will be taking part in the working group on the guidance and will be able to discuss the issues in more detail then.

Q7: How might the current legislation be amended to provide greater certainty whilst maintaining its effectiveness against tax avoidance?

40. We are not entirely clear what this question is asking, since the consultation paper suggests that radical reform of the legislation is not currently felt to be an option. As stated above, we believe radical reform is necessary. We would be happy to go into greater detail in discussions but it would not be appropriate for us to produce the very detailed paper that would be necessary to set down how the legislation could be changed without clear instruction and a commitment to major legislative change in this area.

Q8: Could a new regime provide greater certainty whilst maintaining effectiveness against tax avoidance? How would this new regime operate, and could transitional provisions be designed that would be workable and equitable?

41. As set down in our key and major points, we believe that a fundamental reform of the TOAA provisions is required. We believe that positive reform is possible but it would be radical and to achieve that result it would require a very material amount of work and collaborative co-operation between the key stakeholders (see paragraph 19). As explained in the answer to question 7 it is not possible to go into how such a regime might operate here. The issues would need to be discussed at great length by the working party, as would the need for transitional provisions and what those might be.

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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)