TAXREP 52/14

(ICAEW REP 123/14)

ICAEW TAX REPRESENTATION

Comments submitted on 1 October 2014 by ICAEW Tax Faculty in respect of the 4 August 2014 change in the HMRC Guidance on using unremitted foreign income and gains as collateral for a loan enjoyed in the UK

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BACKGROUND

1. The ‘remittance basis’ is an alternative basis of UK taxation that can only be accessed by UK resident foreign domiciliary. It applies to foreign income and foreign chargeable gains of such eligible individuals. Where it does apply, such funds are only taxable when remitted to the UK. Specific legislation governs the remittance basis of taxation.

2. Finance Act 2008 made very significant changes to the remittance basis legislation. Amongst other changes, new rules were enacted to tax unremitted income or gains “used” in respect of a relevant debt (defined by s 809L(7), ITA 2007 and broadly where the funds are wholly or in part brought to the UK or used to provide any UK benefit by or for the taxpayer or any other relevant person). The new provisions on relevant debt were felt by many commentators to be both less clear and less effective than those they replaced.

3. The complexity of the Finance Act 2008 (FA 2008) remittance basis legislation combined with the lack of clarity that resulted from both the wide drafting and the lack of clear definitions for crucial terms such as “use” meant that HMRC issued a raft of Guidance on the new provisions. The original HMRC Guidance was published by HMRC in 2009 as a publication entitled “The new technical Guidance on the remittance basis”. This publication was extended in 2009 and then in 2010 the Guidance was moved to HMRC’s Residence, Domicile and Remittance Basis Manual (RDRM) where it is now.

4. Representatives from the various professional bodies along with other stakeholders held various meetings with HMRC (initially through the forum provided by the Residence & Domicile (FA 2008) Stakeholder Group) to discuss the FA 2008 changes and the HMRC Guidance. It was clear that various banking issues needed to be considered.

5. In August 2009 HMRC first published Guidance on the application of the FA 2008 relevant debt rules to situations where unremitted income or gains were used to provide collateral security. HMRC accepted that, so long as the debt was on commercial terms:
   - the use of the unremitted remittance basis income and/or gains as collateral would not constitute a remittance; and
   - there would only be a remittance if unremitted remittance basis income or gains were used to service or repay the loan (it was explicitly stated that there would be no remittance if the loan was serviced and repaid using non-taxable income or capital sources).

6. Whilst commentators believed the technical analysis was uncertain due to the lack of clarity in the legislation, the pragmatic approach HMRC was taking on the loan collateral issue was welcomed. This is because the HMRC stance meant that provided the loan was commercial various difficult technical and practical issues, that would otherwise have had to be resolved, were not a problem.

7. Without any prior consultation, HMRC announced (see Appendix 2 for the full text of the HMRC announcement) that effective from 4 August 2014 its position was revised such that it now considers that where unremitted foreign income and gains are used as collateral for a loan enjoyed in the UK:

   - there is a remittance where a UK resident foreign domiciliary uses remittance basis income and/or gains as collateral for a relevant debt; and
   - if the loan is serviced or repaid from different foreign income or gains, the repayments of capital and interest will constitute remittances in the normal way.

8. The ICAEW Tax Faculty was surprised by the announcement and concerned by:

- if unclear legislation is clarified by guidance such that individuals are taxed by guidance rather than legislation then any changes to that guidance should be subject to exactly the same process and scrutiny as a change in legislation;
- the general lack of clarity and inconsistencies in the HMRC announcement;
- the extreme nature of the change in the HMRC position from a stance that was favourable to the taxpayer to a position that could result in a penal double tax charge (that is a first charge in respect of the collateral used when the loan is taken out and, if different unremitted income and gains are used, a second charge when the relevant debt is repaid); and
- the limited nature of the transitional provisions.

9. It is our view that the problems with the 4 August announcement are such that additional clarifying HMRC Guidance is urgently required (particularly with respect to the transitional provisions and the meaning of collateral for these purposes).

10. Given the importance of the issue we have already been in contact with HMRC in connection with the announcement and were represented at the 11 September meeting between HMRC and HM Treasury representatives and representatives from the professional bodies. We are happy to discuss any aspect of our comments below and to take part in all future discussions in this area.

11. The notes of the meeting on 11 September are at Appendix 3; they have been agreed by all the professional body representatives at the meeting and have been seen by HMRC but not agreed by them.

12. Information about the Tax Faculty and ICAEW is given below. We have also included at Appendix 1 the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system. The first tenet is that the tax system should be statutory and this change of view by HMRC on the guidance is a perfect example of why the tax system should be statutory.

WHO WE ARE

13. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession.

14. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

15. 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.

SECTION 809L, ITA 2007 IS INSUFFICIENTLY CLEAR

16. As indicated in paragraph 3 this issue has arisen as a result of the drafting of s809L, ITA 2007. The wide drafting and the lack of clear definitions for crucial terms such as "use" has meant that the scope of the legislation is unclear. We expressed significant concerns about this when the legislation was introduced. At the time the Government put much store in HMRC guidance being able to assist taxpayers. Given the current situation this is not a viable solution for taxpayers and legislative amendments are required to clarify the scope of s809L.

17. We accept that the current HMRC interpretation of the relevant debt provisions is a valid reading of the legislation. However, it is not the only valid reading and not what we consider to be the better view.

18. Some respected commentators argue that the word "use" should be interpreted in such a way that it will only apply where the money or other property is actually used up (or consumed); meaning that there would be no remittance unless and until the bank enforces the security. This goes somewhat further than the old HMRC position as, if this view is correct, it is irrelevant whether or not the loan is commercial.

19. We are particularly concerned that the revised HMRC interpretation can lead to situations where there is a double charge. We had understood that the legislation should not be construed in such a way that double charges arise.

UNDERMINING FAITH IN THE TAX SYSTEM

20. This representation is concerned specifically with the change in the HMRC stance on using foreign income and gains as collateral for relevant debts. However, this cannot be viewed in isolation.

21. This is just the most recent example in what has been a worrying number of occasions in latter years of HMRC publishing clear statements of how it intends to apply legislation and then, some time later, without prior consultation and to the detriment of taxpayers, dramatically changing its stance and applying that change of stance retrospectively with either no transitional provisions or (as in this case) wholly inadequate transitional provisions.

22. ICAEW Tax Faculty representatives, together with representatives from the other professional bodies attended a series of meetings (the first on 19 November 2012 and the second on 7 February 2013) in connection with the HMRC change of stance on *Mansworth v Jelley*, the wider policy issues with respect to the reliance that can be placed on HMRC Guidance and when HMRC will accept that legitimate expectation applies. Concerns over the changes of HMRC stance on home loans (in the context of Pre Owned Asset Tax and Gifts With Reservation of Benefit) and specialty debts were also raised during those meetings.

23. HMRC gave permission for the full text of the agreed minutes to be published (which we did as a technical release with the reference TAXGUIDE 3/13). The meetings and publication of the minutes were helpful in clarifying the HMRC position on legitimate expectation. However, as the following extract from the end of the minutes of the second meeting shows no actual progress was made in terms of addressing the concerns expressed:

"The attendees from the representative bodies felt that the current position with respect to reliance of HMRC Guidance is not acceptable, as the inability to rely on Guidance undermines the tax system; the problem being that sometimes taxpayers can rely on Guidance but sometimes not and what is 'good' and what is 'bad' Guidance that is subject to changes is unknown. There is therefore no certainty that Guidance will not be changed retrospectively. In these circumstances, the current use of Guidance to fill in gaps and resolve problems in the legislation is simply not justified because it cannot be relied on and therefore provides little reassurance. The current uncertainty needs to end."

24. The HMRC volte-face on collateral and relevant debts just exacerbates the position. In many cases significant sums are involved and the short period that HMRC has stated taxpayers have to unwind will in many cases be wholly inadequate.

25. We are concerned about the detrimental impact HMRC's behaviour on this will have in terms of the trust taxpayers have in the system. To give an example, we understand that the use of the business investment relief exemption is not as high as the Government had hoped when it was introduced as part of the Finance Act 2012 package of reforms to the taxation of UK resident foreign domiciliary. Given that there are also interpretation issues with that legislation, (as highlighted by the extract in Appendix 5 from an October 2012 TAXline article) leading to reliance on how HMRC has said it will interpret the legislation we would expect that even UK resident foreign domiciliary who are not directly affected by the change of stance on collateral and relevant debts will be very concerned by HMRC's behaviour and that this may impact negatively on future use of business investment relief.

TIMING AND MANNER OF THE ANNOUNCEMENT

26. It is regrettable both that this announcement was made without any prior consultation and that the announcement released on 4 August is unclear.

27. The lack of prior consultation is particularly unfortunate given the history behind the original guidance. As set down in paragraph 4, various practical issues were raised in 2008 and 2009 and the original HMRC position on collateral and relevant debts allowed the various complexities to be avoided where the loan was commercial. The revised HMRC position means that these complexities now need to be addressed. In our view these technical issues should have been discussed before an announcement was made rather than leave affected taxpayers in a position of uncertainty and anxiety.

28. The announcement of so fundamental a change in HMRC position during the height of the holiday season is also unfortunate. Even if unrepresented taxpayers are in the habit of checking the HMRC website for changes in HMRC Guidance (which we think is unlikely) a change in August is more likely to be missed. For our members the timing will have made contacting affected clients and liaising with banks more difficult.

29. The reasons given for the HMRC change in stance are confusing. It seems that HMRC was concerned that loan arrangements were being entered into, which whilst being described as commercial were not so in reality. As such, this may be another case where taxpayers in general are penalised by what HMRC perceives to be the "bad" behaviour of some individuals.

30. HMRC also seems to have been concerned that its interpretation did not result in sufficient tax being collected as in a number of cases the interest and capital payments were being paid from clean capital or UK earned income. We are puzzled as to why HMRC should now consider this to be an issue, as stated in paragraph 5 above, the HMRC Guidance up until 4 August 2014 was clear that this was acceptable (see Appendix 3 for the full text of the pre 4 August Guidance). We can only assume that HMRC thought originally that generally the loans would be serviced and repaid from remittance basis income and gains and as this has not been the case there has been a change of view.

REFERENCES TO THE PREVIOUS HMRC POSITION BEING CONCESSIONARY

31. The HMRC announcement refers to its original position on the Guidance as having been "concessionary". This comment was as much of a surprise to us as the fundamental change in HMRC's view.

32. As explained in paragraph 4, ICAEW Tax Faculty representatives were party to various discussions on this and other HMRC Guidance on the remittance basis. Whilst it was appreciated that the HMRC position on collateral and relevant debts was favourable to taxpayers we understood that the Guidance represented HMRC's settled view based on an interpretation of the legislation that it believed to be correct. Indeed, we were given to understand that post *Wilkinson* HMRC's legal advice was that its care and management powers were not sufficient for it to be able to introduce on-going concessions which were contrary to its settled technical view of how legislation should be interpreted.

33. We appreciate that certain commenters have suggested that the position in the old Guidance was a concessionary interpretation of the legislation. However, as set down in paragraph 16, this is not the only view. More importantly, there is nothing in the old HMRC Guidance to suggest to taxpayers that the position set down was concessionary. Indeed the concept of “masking” that is referred to appears to be a technical justification for the HMRC interpretation. Taxpayers reading the old guidance will have assumed that the position set down represented HMRC’s interpretation of the law and the August announcement will have bewildered those affected.

TECHNICAL CONCERNS NOT COVERED BY THE 4 AUGUST ANNOUNCEMENT

34. As set down above (paragraphs 15 to 17) the new HMRC stance on collateral and relevant debts is not necessarily correct. If it is correct there are various technical issues that are not addressed in the announcement. We discussed the key issues during the 11 September 2014 meeting and hope that dialogue and correspondence on these points will continue.

35. A particularly important issue is the definition of collateral. HMRC does not define what it means by “collateral” at any point in the 4 August announcement. As such, we do not know whether the scope of the HMRC announcement is restricted just to loans where there is a formal charge over property representing or derived from unremitted income and/or gains or on all loans even if there is no formal charge.

36. Taking its widest meaning the term “collateral” could be said to apply to situations where there is no formal charge but there is a right of set off, and/or an “all monies” security provision. This is a particular concern as many financial institutions include such provisions as part of their standard banking and loan agreements. If HMRC are going to interpret collateral in its widest sense then affected individuals will be forced to either set up a new client reference with their bank (as the rights of set off clauses etc for some banks only cover accounts/investments under the same client reference) or (where the bank’s terms are wider such that there is cross pledging etc), it may be necessary to negotiate a loan with a different institution to their normal bank.

LOANS TAKEN OUT PRIOR TO 4 AUGUST 2014

Loans in progress as at 4 August 2014

37. Taxpayers expect that HMRC Guidance will be consistent. Having checked a point relevant to them they will not keep going back to the HMRC website to see if there has been a change in stance. As such, where an application was started prior to 4 August 2014 and the HMRC stance on collateral and relevant debts was checked before starting the loan application, an unrepresented taxpayer is unlikely to have revisited the HMRC website and become aware of the change of view. The loan paperwork will be agreed and the loan taken out after 3 August 2014 with the individual having no knowledge of the HMRC change of stance. We do not think this is fair. At a minimum HMRC should only seek to apply its new interpretation where there is a new loan application on or after 4 August 2014. Ideally we would like to see a later start date as individuals may have checked the website slightly before starting the loan application.

Scope of the transitional provisions

38. The HMRC announcement indicates that the transitional provisions will only apply where the loan funds have been brought to the UK or used for UK expenditure.

39. It would seem to follow from this that HMRC view loan funds, from pre 4 August 2014 arrangements, which have not been remitted as being reclassified as at 4 August 2014 such that their remittance would (if an exemption does not apply) be taxable.

40. Re-characterising the unremitted loan funds is unduly harsh given that the taxpayer entered into the arrangements on the understanding that the funds could be used for UK expenditure without a tax charge. There could also be significant adverse practical repercussions where an affected individual has just operated one offshore "clean capital" account and the unremitted loan funds are mixed with other funds (gifts, UK taxed income etc). If this is the HMRC view then effectively, through no fault of the taxpayer, the "clean capital" account has become tainted.

41. Given the inequity that will result from re-characterising tainted funds we would suggest that HMRC removes the requirement that the funds must have been brought to the UK or used for UK expenditure prior to 4 August 2014.

What about rolled over loans?

42. Loans are not always taken out for the time period required. It is very common for foreign banks to have "rollover loans" where the interest rate is set for a stated period and then when the loan rolls over it changes (to take account of market conditions etc). In some cases (it will depend on the precise terms) this will give rise to what is strictly a new debt. When the individual took out the loan (prior to 4 August 2014) it would have been on the basis that the roll overs would occur. As such, will HMRC confirm it will allow grandfathering in such cases, provided all substantive terms, with the exception of the rate of interest, remain unchanged?

The length of the transitional period

43. Loans are generally long term undertakings, so a transitional period that is less than two years long is unreasonable. As a point of comparison, when FA 2008 changed the law such that the servicing of the interest on a relevant debt constituted a remittance, the transitional provisions (FA 2008, Sch 7, para 90) allow for a 20-year period (so until 5 April 2028) for pre-existing loans taken out to acquire an interest in residential property.

44. It is likely that some affected non domiciliary individuals will be unable to rearrange their loans and unable to pay the tax on the income and gains that will be treated as remitted and so will have no option but to become non-resident.

45. There may be an error in the announcement, as it states that the unwinding must happen “before 5 April 2016”. It seems strange to have a deadline lapsing one day before the end of the tax year. It may be that it should say “before 6 April 2016”.

Clarifying the transitional provisions conditions

46. As set down in correspondence and discussed during the 11 September 2014 meeting there were various ambiguities in the paragraphs within the 4 August announcement on the transitional provisions. HMRC provided various helpful clarifications during the meeting and we will be publishing the note of that meeting agreed between the representatives of the professional bodies who attended the meeting. We do, however, think it would be appropriate for HMRC to issue further guidance to clarify the issues.

When does the tax charge apply if the arrangement is not unwound in time?

47. We understand HMRC’s view is that the tax charge should have arisen when the tainted collateral was first used. However, this will mean that there will be many cases where HMRC cannot collect tax on tainted collateral if pre 4 August 2014 arrangements are not unwound by the end of the specified period. This is because the tax charge will have arisen in a tax year that is now closed to enquiry. Assuming the loan was commercial such that the old HMRC position would apply to it, the tax return would have been filed on the basis of accepted practice so HMRC will not have grounds to raise a discovery assessment.

48. The legislation is clear that a discovery assessment cannot be raised where a return is filed on the basis of accepted practice there is no requirement that there should be disclosure that this is so on the tax return. Indeed it would not be practical for taxpayers to include disclosure for every case where a tax return has been prepared in accordance with accepted practice.

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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)

APPENDIX 2

THE TEXT OF THE 4 AUGUST 2014 HMRC ANNOUNCEMENT

Remittance Basis

Using unremitted foreign income or gains as collateral for a loan enjoyed in the UK - withdrawal of concessional treatment for commercial loan arrangements.

Background

1. Under the rules in Chapter A1 of Part 14 of ITA 2007 there is a remittance of foreign income or chargeable gains if:
   - money or other property is brought to, or received or used in the UK by or for the benefit of a relevant person (section 809L(2)(a) ITA 2007), and
   - foreign income or gains are used outside the UK (directly or indirectly) in respect of a relevant debt (section 809L(3)(c) ITA 2007). There is a relevant debt if the debt relates (wholly or in part, and directly or indirectly) to property within (a) (section 809L(7) ITA 2007).

2. Where, as a remittance basis taxpayer, you:
   - have obtained a loan in the UK or overseas, secured using foreign income or gains that remains overseas, and
   - remit part or whole of that loan to the UK

   you are considered to have remitted foreign income or gains to the extent of the loan amount remitted. For example, if you have a £1 million loan facility secured by foreign income or gains of £1 million, and £100,000 is borrowed and brought to the UK, then you are making a taxable remittance of £100,000 at that point.

3. This has always been HM Revenue & Customs (HMRC) view of the law. However, it was recognised that there is another potential source of taxable remittances in respect of secured loans. If you made loan repayments using a different source of foreign income or gains you would make a second remittance at that point. The result would be taxable remittances of double the amount of loan brought to the UK.

4. Accordingly, in 2010 a concession was published in HMRC's Guidance manual RDRM33170. This concession applied to loans made on commercial terms that were regularly serviced from foreign income or gains. In those circumstances only the servicing payments would be taxed and not the use of the underlying collateral.

5. HMRC is seeing large numbers of arrangements which are not considered to be commercial and not within the intended scope of the concession. For example, loans repaid from non-foreign income or gains that are not charged as a remittance, despite foreign income or gains collateral having been used in the UK.

HMRC's revised position

6. The concessional treatment for commercial arrangements is being withdrawn and HMRC is replacing the Guidance at RDRM33170, with effect from today's date. From today, money brought to or used in the UK under a loan facility secured by foreign income or gains will be treated as a taxable remittance of that amount of foreign income or gains. If the loan is serviced or repaid from different foreign income or gains, the repayments of capital and interest will constitute remittances in the normal way.

APPENDIX 2 *continued*

THE TEXT OF THE 4 AUGUST 2014 HMRC ANNOUNCEMENT *continued…*

HMRC's position on arrangements set up before today's date

7. You should notify full details to HMRC if you have used foreign income or gains as collateral for a loan and have not declared a remittance. HMRC will take no action to assess those remittances if the loan arrangements were within the terms of the concession in RDRM33170, provided:
   - you give a written undertaking (which is subsequently honoured) by 31 December 2015 that the foreign income or gains security either has been, or will be replaced by non-foreign income or gains security before 5 April 2016, or
   - the loan or part of the loan that was remitted to the UK either has been, or will be repaid before 5 April 2016

   The notification should include the amount of foreign income or gains used as collateral and the amount of the loan remitted to the UK (if not the full amount).

   Notifications should be sent to: HM Revenue & Customs PTI Risk Team SO708 Room 220 PO Box 203 BOOTLE L69 9AP.

8. HMRC will assess remittances in any of the following circumstances:
   - the notification indicates that the conditions will not be met
   - the notification is not in fact met
   - it is discovered no notification was made and arrangements are not unwound within the specified period

9. If you have any questions about this announcement, please email martin.white1@hmrc.gsi.gov.uk

APPENDIX 3

NOTE OF MEETING AGREED BY THE REPRESENTATIVES OF THE PROFESSIONAL BODIES ATTENDING

HMRC WERE INVITED TO COMMENT ON THE TEXT OF THIS NOTE BEFORE PUBLICATION AND THE NOTE REFLECTS SUCH OF HMRC'S COMMENTS AS WERE ACCEPTED BY THE ATTENDEE REPRESENTATIVES AS ACCURATELY REFLECTING STATEMENTS MADE BY HMRC AT THE MEETING. FOR THE AVOIDANCE OF DOUBT, HMRC HAVE NOT AGREED THIS NOTE

Re revisions to RDRM33170: 4 August Announcement ("the Announcement") advising of HMRC's change of Guidance on treatment of foreign income or gains ("FIG") used as collateral for a relevant debt

Meeting on: 11 September 2014 12noon-2pm

Attendees:
Officials from HMRC and HM Treasury
Representatives of CIOT, STEP, the Expatriate Forum, ICAEW Tax Faculty and The Law Society ("the Representatives")

KEY POINTS ARISING

1. HMRC withdrew their previous Guidance at RDRM33170 as advice was received from HMRC solicitors that it was incorrect in law and ultra vires. HMRC viewed the Guidance as concessionary (a view which is not universally shared by external commentators). It was noted that the CIOT had asked HMRC back in September 2009 whether this was concessionary or not[1] but had not received a response on this. Concern was expressed that it is only after the change in Guidance that HMRC is stating that its original position was concessionary. It was also queried whether, even if it was a concession, it was *intra vires*. The then Chief Secretary to the Treasury, Jane Kennedy, had written to CIOT on 22 July 2008 saying that she recognised that the legislation was not perfect and that she was leaving HMRC and the professional bodies to fill in the gaps. She had given a similar answer in relation to a parliamentary question by Mark Hoban. In *Wilkinson* terms this gives credence to the argument that, even if concessionary, the previous Guidance at RDRM33170 just amounted to HMRC filling in the gaps (interstices) in the legislation.

2. HMRC recognise that not everyone will agree with its revised interpretation of the relevant legislation and that there are likely to be legal challenges on the substantive technical issues. The representatives thought judicial review proceedings on the grounds of legitimate expectation were also likely.

3. The Representatives felt that the legislation was not sufficiently clear and that this had led to the current difficulties. The particular problem being that there is no definition within s 809L, ITA 2007 of "used". The Representatives felt very strongly that the law should be changed to provide clarity with grandfathering for existing loans.

4. **The Representatives stated that they did not necessarily accept that the revised HMRC view was correct. For the rest of the discussion it was, however, necessary to (without prejudice) proceed on that basis so as to clarify various points with respect to the Announcement.**

[1] Email from CIOT to HMRC: 24 September 2009 @ 15:54 attaching list of CIOT outstanding questions. See question 34.

APPENDIX 3 *continued*

The transitional provisions

5. HMRC do not consider the change to be retrospective as they are allowing taxpayers a period of time (20 months) to "unwind" affected arrangements. Representatives advised that a significant number of individuals will not be able to unwind their arrangements within the permitted timescale and that some are likely to sell up and leave the UK unless more generous transitional provisions can be agreed. In some cases this is because the individuals do not meet the affordability tests imposed by UK banking regulations to be granted a conventional UK mortgage: for example, the lack of UK income is a stumbling block to securing a conventional UK mortgage.

6. The Representatives were of the view that amending the transitional provisions to give complete grandfathering (or at least in line with the grandfathering provisions in para 90, Sch 7, FA 2008) would all but eliminate the risk of a case being taken for litigation. Given the points on discovery and enquiries below, it was likely that the affected population would only be cases after 6 April 2013 (and even then excluding those who had filed their 13/14 tax returns early). So the numbers affected by giving complete grandfathering are likely to be only a small proportion of those who have done this. Given that many will have been induced into giving such collateral by HMRC's previous statement it would also seem equitable not to treat differently those who happened to have filed tax returns earlier than those who have not. The case for complete (or significantly better) grandfathering is therefore very strong.

7. HMRC would welcome real life examples of scenarios where taxpayers will suffer hardship as a result of this change and indicated that they would consider such cases sympathetically although HMRC was unable to provide any clear Guidance on what would be regarded by them as hardship. In particular, it was not clear from the meeting whether having to sell the UK family home in order to repay the relevant debt would be regarded by HMRC as "hardship". It was also unclear whether HMRC is interested in hardship either (a) to inform the need for grandfathering or (b) because HMRC will accept that in such cases it is prevented from raising a tax assessment because it accepts that its Guidance created a legitimate expectation that the taxpayer was entitled to rely on.

Interaction with Business Investment relief

8. If there is now a remittance of FIG in respect of a loan brought to the UK on or after 6 April 2012, which satisfies the conditions for Business Investment Relief (BIR), a claim for BIR can be made. For remittances in 2012/13 (the first year for which BIR was available), the claim must be made by 31 January 2015. This means that a claim may need to be made **before** a decision has been made on whether it is possible to "unwind" so as to take advantage of the transitional provisions contained in the Announcement (affected taxpayers have until the end of 5 April 2016 to "unwind" the arrangements). It may be that the arrangements will be "unwound" and the BIR claim did not actually need to be made. Practically, there was thought to be no downside from making an unnecessary claim apart from the compliance cost. The Representatives stated that the earlier 2012/13 BIR deadline needs to be publicised so taxpayers that can make a BIR claim realise they have an option other than "unwinding" but that to take advantage of it they need to act earlier.

APPENDIX 3 *continued*

HMRC Clarifications

Transitional arrangements

9. HMRC clarified the following in relation to the transitional notification "requirements" in paragraph 7 of the Announcement:

  - The "requirement" to provide a written undertaking (which is subsequently honoured) applies to both the option to replace the security and the option to repay the loan (or the part thereof remitted).
  - Whilst referred to as a "requirement" HMRC accepts that it has no authority to impose such a disclosure requirement on affected taxpayers. It would prefer that disclosure is made but provided the arrangements are "unwound" on or before 5 April 2016 it accepts that the taxpayer is entitled to the transitional relief and will not seek to raise an assessment (assuming the loan was commercial and so within the old HMRC Guidance). If disclosure is not made and HMRC finds out about the loan it is more likely that an enquiry will be opened.
  - The references to "before 5 April 2016" should be read as "on or before 5 April 2016".
  - The stated ways to 'unwind' the arrangements are examples and not exhaustive. HMRC accept that there are other ways to "unwind" and that a mixture of strategies might be used. What matters is that the FIG collateral has been removed prior to 6 April 2016.

10. The issue of "revolving loans" (where the loan facility is reviewed on a regular (e.g. monthly) basis) was raised. The concern is that the "roll over" after 3 August could be said to give rise to a new debt, which the transitional arrangements would not apply to. HMRC's initial thinking was that it would accept that such loans remained within the transitional provisions provided all substantive terms remain unchanged. To be able to consider this further HMRC requested sight of typical Terms and Conditions.

11. HMRC confirmed that individuals who had exchanged contracts on a property purchase prior to 4 August but had not completed the purchase until 4 August or later would be regarded as within scope of the transitional rules even though the loan was not in fact brought to or used in the UK prior to 4 August. This application of the transitional rules may also apply where binding contracts for other purchases have been entered into prior to 4 August 2014, and a loan facility drawn down over a period either before or after 4 August 2014. However each case will depend on individual circumstances, and individuals are welcome to contact HMRC if they have any questions about this.

12. It, therefore, appears that HMRC is not currently minded to allow all loans entered into prior to 4 August to come within the transitional arrangements regardless of when the funds enter the UK. Concern was expressed where the arrangements cannot be "unwound" prior to 6 April 2016 as, where HMRC will not accept that the transitional arrangements can apply, this could mean that an affected taxpayer has unwittingly tainted a clean capital account by including undrawn pre 4 August loan funds in the same account as funds received by way of birthday gifts etc.

On-going technical queries

13. HMRC confirmed that its view is that the date of the remittance is the date when the loaned monies are brought to the UK; whether or not the loan is secured using FIG at that point in time determines both (i) whether or not there is a taxable remittance and (ii) the quantum of that taxable remittance. The potential ramifications of this analysis were explored further. The analysis would suggest that where an account containing clean capital is used as security for a

relevant debt so that no remittance occurs at the time the security is given (unless and until there is further drawdown on a loan facility) the fact that:

- FIG might arise in that account later would be disregarded;
- Other additional collateral may later be offered after that point in time is irrelevant.

14. HMRC was happy with the first bullet but wanted to consider the second further. Typical loan agreement terms would require additional collateral if the value of the collateral fell below a certain level and HMRC asked to be provided with a typical loan agreement so the terms could be reviewed.

15. HMRC commented on the following issues arising from the change of practice (as raised in CIOT's letter of 8 August and in other correspondence) regarding collateral and when FIG are "*used...(directly or indirectly) in respect of a relevant debt*":

    - HMRC confirmed that generally the examples in RDRM 35270 continue to stand, so if there is contractual priority this will be respected. However, in relation to secondary security, a right of set-off or an all-monies security over FIG, HMRC have requested the BBA to supply typical Terms and Conditions to enable them to understand the reality of the scenario.

    - In scenarios where there is superfluous security, the amount of FIG treated as remitted will be limited to the amount of the loan brought to the UK. However, where there are no priority rights the fact that the clean capital collateral is in excess of the relevant debt will not mean that there is no remittance. If there is a relevant debt of £1 million, and collateral of £1.5 million of which £1 million is clean and £500,000 is FIG the HMRC position is that there may be a £500,000 remittance depending on the mixed fund ordering rules (see RDRM35270 example 3). This could be an issue where there are no priority rights and a right of set off or all monies security provision. The Representatives said that such terms were often standard and altering the standard terms might not be possible. HMRC again asked to see standard Terms and Conditions so it could consider the matters further.

    - HMRC accepts that there is no remittance where a loan is unsecured, but it is clear that it is only given because the lender is aware of the various assets the borrower has (some of which will represent or be derived from FIG). Since there is no "contractual matrix" the lender has no right of recovery against the assets representing or derived from FIG, so the FIG cannot be said to be "used" in connection with a relevant debt, HMRC consider that the legislation will not be engaged.

    - Although the matter had not been fully considered, HMRC thought that it would not try to argue that there was "use" where a loan is only made as a result of a credit agency check (which would have taken into account the individual's assets representing or derived from FIG).

16. Where one loan is taken out and it is partially used offshore and partially used in the UK (so only an element of the loan is a relevant debt) HMRC stated that the mixed fund rules should be applied with the collateral being seen as the "mixed fund" from which remittances are made.

The enquiry window for 2012/13 tax returns

17. HMRC recognise that, where there was a remittance in 2012/13, for returns filed on time, the enquiry window will close (at latest) on 31 January 2015. This is before it will be clear whether individuals are availing themselves of the transitional provisions. HMRC is unlikely to know which taxpayers are affected before then. HMRC do not, however, intend to issue provisional

APPENDIX 3 *continued*

enquiries to all non-domiciliaries as a population before the 31 January 2015 deadline as a result of this announcement and indeed expressed the view that it would be a misuse of its enquiry powers to blanket-enquire into all UK resident non-domiciliaries simply in order to preserve time-limits.

The discovery provisions

18. HMRC acknowledges that it is bound by the discovery rules and will only make discovery assessments where it has the legal right to do so.

19. The Representatives thought that in practice this meant no discovery assessment could be raised where the enquiry window had closed. Where returns have been filed on time this would mean that no assessment could be raised in respect of a pre-6 April 2012 remittance or a remittance in 2012/13 where the enquiry window has lapsed. It was stated that this was correct regardless of whether there was any disclosure on the tax return. Indeed, it was felt that there was very unlikely to be disclosure given that prevailing practice was being followed. HMRC did not comment on the Representatives' views as each case will depend on its facts.

20. The technical support put forward by the Representatives for the assertion that HMRC could not raise a valid discovery assessment in such cases comes from the discovery conditions at s 29, TMA 1970 where it stated that a taxpayer should not be assessed if the return was made on the basis of or in accordance with the practice generally prevailing at the time. HMRC said that it did not necessarily accept that this was correct and needed to consider the issues further.

21. The Representatives asked if HMRC could at least confirm that it accepted that a taxpayer who filed their tax return on the basis of the HMRC Guidance could not be said to have been "careless" (meaning that HMRC accepts that it cannot not raise discovery assessments in cases where there would have been a pre-6 April 2010 remittance). HMRC said that it was unlikely that it would argue that following HMRC Guidance was "careless" but that it depended, as ever, on the facts of each individual case, so it would not be appropriate to provide a generalised answer.

The need for further clarification

22. HMRC will consider the need to publish further Guidance on this issue; if they do so it will probably be in the form of FAQs. The Representatives stressed the need for further Guidance as it is clear that several important points need to be answered before individuals can decide what action they need to take, if any. However, it was reiterated that further Guidance, while helpful, is not a substitute for proper legislation. This is because the legislation is so unclear that there is a risk that any further Guidance issued will later be considered concessionary.

23. The Representatives pushed HMRC for its revised interpretation to be codified in legislation. The number of issues raised at the meeting made it clear that the 2008 rules were inadequate. Any new HMRC interpretations (for instance as to set-off, secondary security, revolving loans etc.) would be difficult to rely on, as HMRC might again change its mind in the future. The Representatives said that they thought that new legislation would not be a significant exercise and gave HMRC an initial draft of what such legislation might look like.

24. HMRC reminded Representatives that legislation is not a straightforward process and that the introduction of new legislation will always be dependent upon Ministerial decision, and may be further complicated by the proximity of the General Election.

APPENDIX 4

PREVIOUS VERSION OF RDRM 33170 (FROM PUBLICATION TO 3 AUGUST 2014)

RDRM33170 - Remittance Basis: Identifying Remittances: Conditions A and B: Condition B - collateral in respect of relevant debt

Foreign income and gains may be used as collateral for a loan which is brought to the UK or otherwise used for a purpose to which ITA2007/s809L(2) applies (that is, there is a relevant debt).

Such foreign income and gains used as collateral are used ‘in respect of’ the relevant debt, so there may be a taxable remittance at this point.

The foreign income or gains used as collateral may be used directly, that is, the lender may receive a charge over cash assets in a bank account. However it is more likely they will be offered indirectly, often in the form of an asset such as a property or bond note that is ‘derived from’ the foreign income or gains.

This situation only arises where remittance basis users offer their foreign income or gains for use as collateral for a relevant debt, whether to a UK-based or an offshore lender. In many cases UK property or non-taxable offshore property is offered as collateral in respect of a relevant debts; there is no remittance of this collateral within Condition B (ITA2007/s809L(3)(c)).

To determine the amount of remittance where foreign income or gains are used as collateral in respect of a relevant debt refer to RDRM35050 Condition B - Collateral in respect of relevant debt.

Foreign income and gains used to pay interest on the debt and to repay the borrowed capital are also ‘used in respect of’ a relevant debt, and will be taxable as a remittance. Thus there are potentially two possible sources of a taxable remittance charge in respect of the relevant debt - the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.

In the majority of commercial situations, neither party to the relevant debt transaction expects or intends that the collateral offered as security will be taken by the lender. Instead it is planned that the loan will be serviced and the capital repaid without recourse to the security charge. In such cases using foreign income or gains to regularly service or make capital repayments in respect of the relevant debt effectively ‘masks’ the collateral being used. In such cases the only taxable remittance will occur as and when the foreign income or gains are used to service or repay the loan. The payments, and thus the taxable remittances, will be spread over the loan period.

Example 1

In 2012/13 John, a remittance basis user takes out a loan for £200,000 from a Guernsey bank. John uses the loan to purchase a horse and a stable/paddock in Chester to indulge his young daughter’s latest hobby; so the loan is a relevant debt.

John offers as collateral for the loan a 5-year offshore bond, due to mature in 2015. He purchased this bond in 2010 (a year in which he was also a UK resident remittance basis user) using £200,000 of his untaxed relevant foreign income from that year.

John repays £18,000 of the loan (principle plus interest) in 2012/13, using his relevant foreign earnings from his separate employment in Guernsey.

John is using the offshore bond as collateral for the loan; the offshore bond derives directly from his foreign income so John is using his relevant foreign income in respect of the relevant debt. However John is also using his relevant foreign earnings to both service and repay the debt

APPENDIX 4 *continued*

PREVIOUS VERSION OF RDRM 33170 (FROM PUBLICATION TO 3 AUGUST 2014) *continued…*

capital; this 'masks' the collateral and so John will only be regarded as remitting the £18,000 Relevant Foreign Earnings in 2012/13.

Note - In the example above, the relevant debt could also be serviced and repaid using non-taxable income or capital sources; in which case there would be no taxable remittances of foreign income or gains. However the servicing/repaying of the loan effectively masks the collateral offered, so there is still no remittance of the collateral in this circumstance.

In some cases, usually involving avoidance or non-commercial arrangements, the relevant debt is not serviced or repaid by the borrower, or only a token amount is offered. In these circumstances the foreign income or gains offered as collateral are being utilised in respect of the relevant debt, that is, to delay or minimise service charges or repayments. As there is only one possible tax charge in respect of the relevant debt, that is the charge HMRC will take. The charge is taken up-front when the collateral is offered. Such arrangements are expected to be rare.

This should not be mistaken with interest-only repayment terms, or commercial arrangements that offer payment breaks and so forth. Always check the terms and general availability of the loan arrangements on offer.

If you think there is a remittance of foreign income or gains offered as collateral in respect of a relevant debt you should obtain copies of all the relevant arrangements, including all loan agreements and repayment schedules.

If you require further advice a full submission should be made to Specialist Personal Tax, PTI Advisory , Foreign Income and Remittance Basis Team.

APPENDIX 5

CURRENT VERSION OF RDRM33170 (FROM 4 AUGUST 2014)

RDRM33170 - Remittance Basis: Identifying Remittances: Conditions A and B: Condition B - collateral in respect of relevant debt

Foreign income and gains may be used as collateral for a loan which is brought to the UK or otherwise used for a purpose to which ITA2007/s809L(2) applies (that is, there is a relevant debt - see RDRM33160).

The foreign income and gains used as collateral are used 'in respect of' the relevant debt, so there is a taxable remittance when the loan is brought to the UK.

The collateral containing the foreign income and gains may be a charge over cash assets in a bank account or other possessions, such as property or financial instruments that are 'derived from' foreign income or gains.

This situation only arises where remittance basis users offer their foreign income or gains as collateral for a relevant debt, whether to a UK-based or an offshore lender. In many cases UK property or non-taxable offshore property is offered as collateral in respect of a relevant debt; there is no remittance of this collateral within Condition B (ITA2007/s809L(3)(c)) as the property used as collateral will not contain foreign income or gains.

To determine the amount of remittance where foreign income or gains are used as collateral in respect of a relevant debt refer to RDRM35050 Condition B - Collateral in respect of relevant debt.

Foreign income and gains used to pay interest on the debt and to repay the borrowed capital are also 'used in respect of' a relevant debt, and will be taxable as a remittance. Thus there are potentially two possible sources of a taxable remittance charge in respect of the relevant debt - the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.

Example 1

In 2012-13 John, a remittance basis user takes out a loan for £200,000 from a Guernsey bank. John uses the loan to purchase a horse and a stable/paddock in Chester to indulge his young daughter's latest hobby; so the loan is a relevant debt.

John offers as collateral for the loan a 5-year offshore bond, due to mature in 2015. He purchased this bond in 2010-11 (a year in which he was also a UK resident remittance basis user) using £200,000 of his untaxed relevant foreign income from that year.

John repays £18,000 of the loan (principal plus interest) in 2012-13, using his relevant foreign earnings from his separate employment in Guernsey.

John is using the offshore bond as collateral for the loan; the offshore bond derives directly from his foreign income so John is using his relevant foreign income in respect of the relevant debt. However John is also using his relevant foreign earnings to both service and repay the debt capital; both the £200,000 foreign income from 2010-11 and the £18,000 foreign earnings from 2012-13 are regarded as remitted in 2012-13.

Note - In the example above, the relevant debt could also be serviced and repaid using non-taxable income or capital sources in which case there would be no taxable remittances of foreign income or gains in respect of the servicing payments.

If you think there is a remittance of foreign income or gains offered as collateral in respect of a relevant debt you should obtain copies of all the relevant arrangements, including all loan agreements and repayment schedules.

APPENDIX 5 *continued*

CURRENT VERSION OF RDRM33170 (FROM 4 AUGUST 2014) *continued…*

Note - Previous HMRC Guidance did not follow the position given above and suggested that collateral in 'commercial' situations was not taxable if 'regular' servicing payments were made. This Guidance was withdrawn on 4 August 2014. If you require further advice a full submission should be made to Specialist Personal Tax, PTI Advisory, Foreign Income and Remittance Basis Team.

APPENDIX 6

EXTRACT FROM THE BUSINESS INVESTMENT RELIEF FOR NON-DOMS ARTICLE THAT APPEARED IN TAXLINE, OCTOBER 2012

HMRC Clarifications

There was concern that a narrow reading of the legislation could result in taxable remittances in the following circumstances:

1. Where a UK-resident foreign domiciliary makes an investment in a UK close company (or a foreign company that would be close if it were UK-resident), and that company (being a relevant person in connection with the individual) brings the funds to or uses the funds in the UK.

2. Where an individual makes an investment offshore in a foreign company, which would be close if UK-resident, and that company (being a relevant person in connection with the individual) brings the funds to, or uses them in, the UK.

3. Where an individual makes an investment in a company by taking out a loan, and remittance basis foreign income or gains are used to service the loan and/or make repayments of capital.

The situation for a UK-resident close company that is a relevant person (point 1 above) is covered in existing HMRC guidance at page 17 of HMRC's guidance note Changes to the Remittance Basis (hmrc.gov.uk/cnr/guide-remit.pdf).

The other two are not currently covered in published guidance but HMRC has confirmed its settled view that there will be no remittance. We understand that all three situations will be covered when guidance on business investment relief is added to the HMRC Residence, Domicile and Remittance Basis Manual.

In the first two situations HMRC's view is that once a qualifying investment has been made, the foreign income and gains will only be taxed under the remittance basis if there is a potentially chargeable event and the appropriate mitigation steps are not taken within the grace period. In short, s809VA, ITA 2007 trumps s809L, so that the use of the income and gains in the UK by a relevant person would not be a remittance. In the third case, HMRC takes a wide view of the meaning of s809VA(1)(b), ITA 2007 and specifically the words "by virtue of the event".

Note that where the initial qualifying investment is made from loaned funds, the claim for the exemption has to be made in relation to the servicing or repayment of the loan from remittance basis income and gains. If this happens in a different tax year it will have an impact on the claims deadline. Where the payments are spread across a number of tax years claims will be required for each tax year. Careful records will have to be kept to show that the loan ties into the qualifying investment made.