

## TAXREP 10/08

### **‘PAYING A FAIRER SHARE’: A CONSULTATION ON RESIDENCE AND DOMICILE**

*Representation submitted on 14 February 2008 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to HM Treasury on the consultation document on residence and domicile ‘Paying a fairer share’ published on 6 December 2007.*

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# **‘PAYING A FAIRER SHARE’: A CONSULTATION ON RESIDENCE AND DOMICILE**

## **INTRODUCTION**

1. The consultation document *Paying a fairer share: a consultation on residence and domicile* was published by HM Treasury on 6 December 2007 at [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/residence\\_domicile/consult\\_residence\\_domicile.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/residence_domicile/consult_residence_domicile.cfm). We submitted initial comments in December 2007 on that document which were published as TAXREP 80/07 (see <http://www.icaew.com/index.cfm?route=153399>)
2. This representation should be read in conjunction with TAXREP 80/07 and contains further comments on the implementation of the measures set out in Chapter 2 of the consultation document together with comments on the question of whether further changes should be considered.
3. The Tax Faculty will make a further representation on the legislation that supplements the consultation document. This legislation was published on 18 January 2008.
4. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex 1. The Tax Faculty’s *Ten Tenets for a Better Tax System* that we use as a benchmark are summarised in Annex 2.

## **KEY POINT SUMMARY**

5. In order to arrive at legislation that achieves the Government’s aim of being fair while safeguarding the UK’s international competitiveness, we consider there is a need for:
  - full and open consultation on these measures;
  - greater clarity on the figures and assumptions used;
  - a clear and statutory test of residence;
  - consideration of the effect on lower paid/middle income groups;
  - tax compliance issues to be addressed; and
  - a clear assessment to be made of the administrative burden that will be placed on HMRC.
6. So that these issues can be properly addressed we urge the Government to:
  - defer the start date until 6 April 2009;
  - if the start date is not deferred, we think there is still a good case to defer some of the more complex measures until 6 April 2009.
  - include in the legislation a statutory test of residence;
  - consider raising the de minimis limit for unremitted income and gains;
  - reconsider some of the proposed legislation to correct ‘flaws and anomalies’ so as to ensure that the rules are clear and workable and do not result in unexpected and unwelcome damage to the UK; and
  - defer the consideration of any future changes until the current proposals have been assimilated and the full effects have been quantified.

## GENERAL COMMENTS

### The need for full and open consultation

7. In our initial comments on the consultation document we noted that the abrupt conclusion to a consultation process that had been underway since 2002 was both unwelcome and unexpected. Furthermore, no consultation was invited on the content of the proposed changes, merely the implementation thereof.
8. The taxation of international people and issues of residence and domicile are of crucial importance if the UK is to maintain its pre-eminence as an international centre of business. Accordingly any changes should be subject to a full and open consultation from a wide variety of stakeholders. We are particularly concerned about the uncertainty that has already arisen and that the estimates for the number of people leaving the UK (or not coming to the UK) as a result of these changes have been underestimated.
9. Our members have reported that their overseas offices, in particular their Swiss firms, are being 'inundated' with enquiries from those both currently resident in the UK and those who were previously considering coming to the UK. Our attention has also been drawn to international magazines, in addition to UK newspapers such as the *Financial Times*, which have reported claims that the new measures will damage the UK's standing as an international centre. The *Financial Times* reported on 12 February that the Baltic Exchange will leave the UK, which we understand could cause the loss of several thousand posts in the UK providing related maritime services

### The need for greater clarity on the figures and assumptions used

10. In our initial comments on the consultation document we noted that it did not set out with sufficient clarity the methodology and assumptions for us to make objective comments on the revenue projections. We accept that this is an area where data is limited and a prudent and cautious approach is needed. We are concerned, however, that crucial aspects have either been under-estimated or it is not clear to us that they have been included in the projections.
11. The first aspect that concerns us is the behavioural changes that the proposals will engender. We note at 2.11 of the document that it is estimated that 3,000 of the 21,000 individuals affected by the changes to the remittance basis will become non-resident in response to those changes. Our members are reporting a far higher number of individuals who are seriously considering becoming non - resident, somewhere between one-third and one-half of all currently resident non-domiciles. This figure is in line with the recent survey undertaken by STEP. An under-estimate of behavioural changes of this order will seriously impact on the revenue projections.
12. The figures in the document also need to take account of the reduction in UK tax revenue and the loss to UK GDP as a result of these departures. On a very simple basis, using the figures provided at 1.1, 2.11 and Table 1 (Appendix B), the 3,000 longer term residents who are expected to leave the UK make a contribution of £300 million to UK GDP and pay £110 million in income tax alone. If in fact one-third of **all**

non-domiciled resident individuals leave the UK the reduction in tax revenue will significantly exceed the total additional revenue projections in this document. The comments we have seen suggest that in practice it is likely to be those with more significant assets that will choose to leave: the revenue costs will therefore be considerably higher than the pro-rata assumption used in our estimate of £300 million and £110 million as the cost.

13. In addition to those who decide to leave the UK as a result of the changes we also consider that others will be dissuaded from coming here. There could be a significant impact on the UK economy if international firms were to find it difficult to persuade key overseas employees to relocate to the UK.
14. In connection with the proposed changes to day counting, again we query whether the behavioural aspects have been under-estimated. There is an estimate at 2.23 of the document that of the 23,000 likely to be affected by these changes only 7,000 will adjust their patterns of visits to remain non-resident. If these individuals have already adapted their behaviour to remain non-resident under the current rules, we fail to see why a greater number would not make further adaptations to remain non-resident under the new rules.
15. For those who are unable to adjust their patterns of visits it is likely that the individual will also be resident in a country with which the UK has a double tax treaty. We are unable to see where the effect of such agreements has been taken into account in the revenue projections.

#### **The need for a clear and statutory test of residence**

16. The proposed changes to the residence rules have highlighted the unsatisfactory nature of the UK's residence test. A test which in the most part relies on case law and HMRC practice is unacceptable given the importance of determining residence in the proposals. Amending the residence rules to take account of days of arrival and departure do nothing to address the inherent uncertainties in, for example, the 90-day averaging test. We consider that the need for a clear and objective test of residence which is codified in the legislation is now essential.
17. We would welcome a further consultation to develop such an objective test.

#### **Reasonable expectations and the need to defer changes to 6 April 2009**

18. The extreme sensitivity of any changes in this area necessitates measured consideration of the proposals and the legislation. In addition the Government has always acknowledged that taxpayers should have sufficient time to consider proposals that impact on their tax affairs.
19. We appreciate that the Government has been reviewing this area for many years but we consider that the consultation period in relation to these particular changes has been too short and the start date is too soon. The complexity of some of the legislation is such that further time is required to assimilate the changes. Further, taxpayers' reasonable expectations need to be respected and taxpayers need to be given a reasonable period of time to reorganise their affairs. We do not think that the proposed start date of 6 April 2008 respects taxpayers' reasonable expectations and consideration should be given to the start date until 6 April 2009.

20. Our detailed submission on the proposed legislation will indicate those aspects that we consider need further drafting and consultation before being introduced. It is not in anyone's interest to introduce legislation that is inadequately drafted, unclear and unworkable.

### **The need for consideration of the effect on lower paid/middle income groups**

21. We welcome the setting of a de minimis limit below which the new provisions will not apply. We consider, however, that a limit of only £1,000 for unremitted income and gains is likely to have a disproportionate impact on those individuals with relatively modest incomes.
22. A number of the individuals working in the UK are likely to have property in their home country (often their former residence) which they will let out during their time in the UK. If the rent is above £20 a week they will exceed the de minimis and be required to file a tax return in the UK. Similarly, seasonal workers in the UK who work, say, for eight months in the UK and the balance of the year in their home country will be required to report that overseas income in the UK.
23. In both these cases it is likely that such income will be taxable in the other country for which credit can be claimed so little or no additional revenue will be generated for the UK Exchequer. The individuals will be required, however, to file UK tax returns to claim the relief. This will create a significant extra administration burden for HMRC for little additional revenue. Further, the proposal is likely to lead to inadvertent non-compliance by those least likely to have an adviser.
24. We suggest that the de minimis limit be increased so as not to disproportionately disadvantage those on modest incomes. An increase in the limit to equate to the personal allowance would be simple to legislate for and should be adjusted annually. There is no logic to over-complicating the PAYE system for those in the UK for a relatively short time where the additional revenue from foreign income is likely to be insignificant.
25. Similar considerations apply in respect of the CGT annual exemption. The annual allowance is designed at least in part for the administrative convenience of both taxpayers and HMRC. Given the overseas nature and inherent complexity of non-domiciles' tax affairs, withdrawing the annual exemption is likely to be burdensome and possibly cost ineffective for HMRC as they will be required to deal with numerous small gains.

### **The need for tax compliance issues to be addressed**

26. We are concerned that there are a significant number of individuals, with relatively small amounts of overseas income, who will now be required to file UK returns. Such people would include, for example, those currently fully in the PAYE system, children and non-earning spouses. Unless resources are allocated to advertising the changes and assisting taxpayers to apply the new measures (remembering that English may not be their first language) then it is likely that there will be substantial non compliance or incorrect compliance. This is highly undesirable situation and it could undermine the culture of good tax compliance that lies at the heart of the UK tax system.

27. It is vital therefore that the measures are clear, well publicised, easy to understand and workable in practice. HMRC has given no indication, as yet, of how it intends to assist such people in identifying their compliance obligations. The resulting underpayments of tax may be difficult to collect.
28. Employers often have tax equalisation or tax protection policies in place particularly for US citizens. If the changes go ahead they will need to review those policies to decide how they should deal with the changes. As this will involve discussion and re-negotiation of a contractual position, it will not be possible for employers to do that in time for a 6 April 2008 start given that the draft legislation was not available until 18 January 2008 and is clearly not yet in its final form.

**The need for a clear assessment to be made of the administrative burden placed on HMRC**

29. We have identified a number of areas where there will be a significant increase in the administrative burden placed on HMRC. In many cases there will be little, or no, additional revenue to the Exchequer.
30. There will be a significant number of people required to file returns who were previously not required to do so. All these returns need to be processed.
31. PAYE coding notices will be required to be updated more frequently to collect small underpayments of tax on overseas income or to remove/reinstate personal allowances.
32. There may be an increase in the number of dual resident individuals filing returns. HMRC will have to allocate a high level of resource to deal with such individuals particularly when determining tie-breaker clauses in treaties. Again, in many cases there will be no additional tax generated.
33. There will be time costs involved in identifying and bringing within the system those who were previously not required to file UK tax returns. Such individuals are unlikely to have professional representation and will rely on HMRC to assist with their filing obligations. It is of course difficult to estimate the increase in the number of individuals who will be required to file. We note some figures issued by the Department for Work and Pensions (DWP) which might help in this regard. In the two years ended 5 April 2007 the DWP allocated 1,375,000 National Insurance numbers to overseas nationals entering the UK. If we assume that a similar number entered in 2007/08, and the figures have risen every year to date, that would mean that over 2 million have entered the UK to work over the last three years. Not all those entering will have remained in the UK, and not all will have overseas income, but all those who are still in the UK will need to be made aware of their filing obligations.
34. Again if our suggestions in paragraph 23 above were adopted the burden on HMRC would be eased.

## **COMMENTS ON THE DETAILED PROPOSALS**

### **Changes to the remittance basis**

35. For the reasons given above we suggest that the de minimis limit be increased.
36. We note that para.2.5 of the document indicates a reducing revenue stream, presumably reflecting the number of individuals leaving the UK. Recent experience of our members suggests that this number may be far higher than that estimated in the consultation document, as indicated at para 11 above. Please clarify how the estimates have been computed and confirm that they factor in a reduction in tax yield based on Treasury estimates of the number of those who will leave the UK.
37. We are concerned as to whether the proposed £30,000 charge is contrary to EC law.. There needs to be an allowance for the £30,000 tax paid in calculating tax on any remittances. The £30,000 charge should be regarded as off-setting the first £30,000 of tax that would otherwise be due on remittances and gains. We accept that in the interests of administrative convenience there would not be a refund.
38. At the moment the £30,000 charge is unlikely to be creditable under a double tax agreement. If the charge was said to be 'the lower of £30,000 or £30,000 plus the usual tax on the remittance' this might enable credit for it to be obtained in other jurisdictions, at no cost to the Exchequer.

### **New rules on personal allowances**

39. The new rules for personal allowances may have a disproportionate effect on those individuals in the lower paid/middle income groups for the reasons given at paras 18–21 above.

### **Changes to day counting**

40. We note in para. 2.2 of the document that one of the aims of the proposed changes is to ensure that everyone who has made their home in the UK pays a fairer share in tax. We are unclear as to how this fits with the changes in day counting. The two examples given at 2.23 clearly state that the individual 'lives' elsewhere.
41. For the reasons given at para 12 above we consider that the behavioural changes of the individuals concerned have been under-estimated.

### **Correcting flaws and anomalies**

42. We will comment on the changes to correct perceived anomalies and flaws in the current rules in our representation on the proposed legislation. The outline in the consultation document is not in sufficient detail for us to form an objective view. We note that some of the proposed changes go further than correcting flaws and anomalies, a fact that has been confirmed by the legislation recently published.
43. We would like at this stage to make the general comment that the proposed rules are likely to act as a disincentive to investment, consumption of goods and services,



loaning of works of art, and charitable giving in the UK, outcomes which are presumably not intended nor considered desirable.

44. We remain concerned about the impact of these measures and recommend that the more complex measures regarding offshore companies and trusts are deferred pending further consultation, in order to ensure that the rules are fully understood and workable in practice.

## **COMMENTS ON THE PROPOSALS FOR FURTHER CHANGES**

### **Should further changes be considered?**

45. We welcome the fact that we are being consulted on this aspect of the document.
46. The Tax Faculty adopts neither of the positions outlined at para.3.1 of the document. The comments that we make in this representation are made by reference to our *Ten Tenets for a Better Tax System* summarised at Annex 2.
47. Our overriding concern is, however, that no-one knows what the effect will be of the current proposed changes. We suggest that consideration of any further changes be deferred until these can be quantified. As indicated earlier we have serious concerns about the behavioural aspects of these changes, the revenue yield, the problems of taxpayer compliance and the additional burden on HMRC.
48. We agree with para 3.4 of the document that a key question to be considered is whether further changes could be introduced without undermining the UK's attractiveness to the internationally mobile.
49. We consider that other factors that need to be taken into account include:
- the fact that changes should be simple and certain; and
  - that the tax system should be constant. Thus any changes to the underlying rules should have a justifiable economic and/or social base.
50. If further changes are to be made it becomes even more urgent for an objective test of residence to be codified.

### **A flat rate applied without a grace period**

51. We agree with the Treasury conclusion at para 3.11. A flat rate of £25,000 applied without a grace period is likely to make the UK a less attractive destination and undermine UK competitiveness.

### **An additional, higher charge being levied on those here after ten years**

52. We note that the purpose of the £30,000 charge is to ensure that all those who have made their home in the UK pay a fairer share in tax. We are unclear why an increased charge of £50,000 after ten years is deemed to be even fairer.
53. We seek clarity on why a ten year period has been chosen and on the estimate of revenue generated. The Data Analysis at Annex B of the document gives no



indication of the estimates of those non-domiciled individuals who have been resident for more than ten years.

**Setting an upper time limit on access to the remittance basis for non-domiciles**

54. This proposal would bring the income and capital gains tax regimes into line with the deemed domicile provisions on inheritance tax. The only benefit of this proposal is consistency, enabling a non-domiciled individual to make a decision on their future based on the full range of personal taxes.
55. We are unable to comment on the additional revenue projection without further information on the calculation both on numbers of individuals and estimated unremitted overseas income and gains. We observe, however, that the caveats on statistics do not seem to have been considered when formulating the policies and implementation thereof in this document. We request that an impact assessment of the changes is published as soon as possible.

PC

14 February 2008

## **THE ICAEW AND THE TAX FACULTY: WHO WE ARE**

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter TAXline to more than 11,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [tdtf@icaew.com](mailto:tdtf@icaew.com) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

## **THE 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 <http://www.icaew.com/index.cfm?route=128518>).