Tax Representation

ICAEW TAX FACULTY

TAXREP 39/08

Finance Bill 2008: Committee Stage Briefing on Clause 42, Homes outside UK owned through company etc

Parliamentary Briefing submitted on 20 May 2008 by the ICAEW setting out concerns and suggested amendments on the proposed changes to the tax rules governing homes owned outside the UK that are owned through a company and potentially subject to the income tax benefit in kind charge in s 97(2) ITEPA 2003.

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FINANCE BILL 2008: COMMITTEE STAGE BRIEFING ON CLAUSE 42, HOMES OUTSIDE UK OWNED THROUGH COMPANY ETC

Background

The general rule is that there is an income tax benefit in kind charge (as set down in s 97(2) ITEPA 2003) where an employer provides an employee with living accommodation which is not necessary for the proper performance of the job (strict conditions are set down in ss 99 and 100 of ITEPA 2003). There is a specific exemption where the employer is an individual and provides the accommodation "in the normal course of the employer's domestic, family or personal relationships."

The term employee is defined by section 66 ITEPA 2003 and includes a director of a company. A director is further defined in s 67 ITEPA 2003 and includes any person in accordance with whose directions or instructions the directors of the company are accustomed to act (commonly referred to as a "shadow director").

The problem with the existing legislation (before the Finance Bill changes) is that it can catch individuals who for non UK tax purposes acquire foreign property through a company rather than directly. Where foreign property is acquired through a company, then the individuals concerned will be directors for the purposes of the benefit-in-kind code (whether as actual directors or as shadow directors) and therefore a potential benefits in kind charge could arise. A benefit in kind charge would result in an annual income tax charge by reference to the market value of the property assuming it was rented out for the year.

The reality is that for all intents and purposes the property is acquired privately (typically as an overseas holiday home) and there is no employer/employee relationship. In these circumstances a UK income tax charge is wrong in principle.

This is a potentially significant problem because for non UK tax reasons many UK residents acquire foreign properties through companies. The legal systems in other countries differ from the UK and for various reasons ownership through a company may be necessary or desirable. For example:

- To avoid succession issues which apply to immovable property (such as land) but not to movable assets (such as shares).
- In some countries (such as Bulgaria) non residents cannot own land so it is necessary to effect the acquisition through a company resident in the territory.
- In America individuals are often advised to purchase a property though an LLC to protect against injury claims from third parties who visit the property.

Most individuals who have acquired their foreign holiday home through a company for such reasons will have no idea that the arrangements they entered into might result in a UK tax charge in respect of their private use of the foreign property.

The professional bodies made joint representations to HM Treasury and HMRC about this issue and several meetings took place. As a result of these meetings one of the Budget 2007 notes (BN 50) announced that in FA 2008 legislation would be enacted to ensure that specified individuals who have bought or who buy a property abroad, which is owned through a company, would not face a benefit in kind charge with respect to private use of the property. It was stated that the legislation would be retrospective and provide a complete exemption from the ITEPA charge provided the conditions are met. This was a very welcome development.

The Finance Bill legislation

Overview comment

The objective was set down in BN 50 as being to "*ensure that individuals who have bought or will buy a home abroad, will not face benefit in kind tax charge for any private use of the property if purchased through a company*". Draft legislation was released for comments on 17 July 2007 with the consultation period ending on 5 October 2007. Clause 42 of the Finance Bill 2008 makes some changes to reflect the concerns expressed in the earlier consultation. The approach adopted has been to "carve out" an exemption from the s 97(2) charge referred to above where certain conditions are met.

We are concerned that, despite the amendments made to the July 2007 draft legislation, the conditions are too tightly drawn and will mean that situations which one would expect to be covered by the exemption will not be covered. Our detailed comments below analyse in depth the clause 42 provisions (which introduce new sections 102A and 102 B into ITEPA 2003). We would recommend that a different, and we feel more logical, approach is taken such that the s 97 (2) charge is disapplied, unless specific conditions are met, in relation to living accommodation where although a person is the director (or shadow director) of a company, he is:

- unpaid;
- does not perform significant duties for the company;
- is entitled to occupy the property in the normal course of his domestic, family or personal relationships; and
- the property was acquired by the company either solely for the purpose of such occupation or primarily for that purpose but also with the purpose of being let when not required for such occupation.

We would welcome a statement explaining the Government's reasons for this approach and why it was decided not to adopt an exemption approach.

Proposed amendments:

Delete clause 42 and replace with:

"The tax charge in s 97(2) or ITEPA 2003 will be disapplied (the exemption) where a person is the director (or shadow director) of a company but is:

- unpaid;
- does not perform significant duties for the company;
- is entitled to occupy the property in the normal course of his domestic, family or personal relationships; and
- the property was acquired by the company either solely for the purpose of such occupation or primarily for that purpose but also with the purpose of being let when not required for such occupation.

This exemption shall be subject to conditions laid down in regulations for this purpose issued by the Treasury and shall be deemed to have had effect from such earlier time before the passing of this Act as Treasury may determine.

Request for clarification

The legislation is to be retrospective such that no benefit in kind charge should ever have applied where the conditions are met. We are concerned that taxpayers who sought to comply with the law are not penalised unfairly. Taxpayers who did not obtain advice or who were not otherwise aware of the position will not have declared a benefit and will now obtain retrospective relief. To exclude compliant taxpayers from the exemption would set a harmful precedent and undermine trust in the tax system. We would welcome Ministerial confirmation that taxpayers who sought to comply and have declared a benefit on their returns in the past (in accordance with the law as it stood at that time) will be able to claim a tax refund.

Detailed comments and suggested amendments

1. Requirement for all of the company's shares to be held by individuals – sub-section 100A(1) (a) ITEPA 2003 (Volume 1, pg 20)

Comment

We do not understand the rationale behind the requirement that all of the company's shares should be owned by individuals. Where a property is bought for use by the family we feel that is reasonable for the shares in the company that owns it to be owned by a partnership, a family settlement or for the company to be owned jointly by two generations of the family and the shares owned by infant children to be held via a family settlement.

We know that a fear that trusts are used for tax avoidance purposes has been suggested as the reason for this sub-clause. This seems to us to be overlooking sub-s 100B(4), which would not allow relief from the benefit in kind charge where "the living accommodation is provided in pursuance of an arrangement the main purpose, or one of the main purposes, of which is the avoidance of tax or national insurance contributions. Note sub-section 100B(8) defines arrangement widely as including 'any scheme, agreement or understanding, whether or not enforceable'.

Furthermore, we feel that there is unfair to treat trust structures punitively because of fears that trusts are sometimes used for the purposes of tax avoidance. HM Revenue & Customs Research Report 25 - Research on Trusts: Experience of Setting up and Running Trusts concluded that 'the main motivation for setting up a trust related to having the ability to control assets. Examples of controlling assets included: passing them on to children or grandchildren; providing for a beneficiary in a particular way; withholding assets until children reach a certain age; and ensuring money stays within the 'bloodline'.'

In certain civil law territories, such as Spain, there are succession reasons that mean that it is not desirable for a trust to hold property directly (Spanish law does not recognise the Anglo-Saxon concept of a trust or settlement and basically the law looks through the trust such that the forced heirship rules will still apply to the property). Accordingly, where a trust structure is desired a company is used to acquire the property with the company being owned by the trust. It seems to us inequitable for the exemption from tax to be available where the company is owned directly by individuals or by a company owned directly by individuals but not where a trust is involved.

Suggested amendment

In section 100A delete sub clause 100 A (1) (a).

2. ***Requirement that the company has been the holding company of the property at all times after the relevant time – sub-ss 100A(1) (b) (Volume 1, pg 21)***

Comment

We are concerned by the use of the expression 'the holding company' as this has a commonly used meaning which is different to the meaning herein. Whilst the meaning of 'holding company' is defined by sub-s 100A(2) we feel that the use of the term provides unacceptable scope for confusion.

Suggested amendment

In s 100A(1)(b), after 'the company has' replace 'been the holding company of the property at all times after the relevant time' with 'owned a relevant interest in the property at all times since it first owned such an interest and the conditions in subsection 2 below have been met throughout that period'.

3. ***Requirements that the company owning the property must meet so the exemption is available – sub-ss 100A(2) and 100A(3) ITEPA 2003 (Volume 1, pg 21)***

Comment

We are concerned that sub-ss 100A(2)(b) and (c) could be interpreted so as to deny relief in common situations. With respect to s 100A(2)(b) we would welcome clarity as to what is meant by 'main or own asset'. Main normally means over 50% which we think is reasonable. We would be concerned if the test were to be interpreted as being stricter than this. We have two specific concerns where we feel that holding other assets ought not to disqualify the company:

- where the property holds a certain amount of cash to secure the borrowing ; and
- where the company has an overseas bank account out of which to pay the running expenses of the company and into which rents can be banked.

We are also concerned that s 100A(2)(c) which denies relief where the company undertakes activities that are more than 'incidental to its ownership' of the interest in the property, is too restrictive. We believe that the policy intention was to allow relief to be available in the following situations but we are not convinced that under these rules it is available:

- where a family acquires the property with the intention of using it at Christmas, Easter and for six weeks during the summer, and asks the local agent to try to let the property during the remainder of the year; and
- if the property is situated in a location where the prime letting season is, say, June to September and the family ask a local estate agent to try to let it during that period and undertakes that the family will not itself use it during that time.

Sub-s 100A(3) allows for the exemption to apply where the company owning the property is owned not be individuals but by a holding company. The problem is that to qualify the company must be entirely owned by the holding company. It is possible that the acquisition could be made jointly by friends with each having their own holding company owning, say, a 50% share in the company that owns the foreign property. We do not see why relief should be denied in these circumstances.

Suggested amendments

In sub-s 100A(2)(c) insert after 'incidental to its ownership' the words 'or letting'.

After sub-s 100A(2)(c) insert.

'The company will satisfy sub-section 100A(2)(b) where as well as the property, it holds investments with respect to which a loan to acquire the property (or finance repairs or additional capital expenditure to benefit the property) is secured or there is a bank account used for the running expenses of the company, to receive payments with respect to the property and to make payments to the company's shareholders in respect of any net rental income that may arise in relation to the property.

In sub-section 100A(3)(a) after 'a company ("the subsidiary") which is wholly' insert the words 'or partially'.

4. Definition of 'relevant interest in the property' - sub-s 100A(4) (Volume 1, pg 21)

Comment

We would welcome clarification that the definition includes a timeshare interest. Such an interest would a right to exclusive possession of the property at certain times. Since the reasons for holding a timeshare interest within a company are the same as for a freehold or leasehold interest we do not see why such interests should not be included. For the avoidance of doubt we have suggested a possible amendment.

Suggested amendments

After the final sentence of sub-s 100A(4) insert:

'For the avoidance of doubt an overseas timeshare interest qualifies as a relevant interest in property.'

5. Definition of 'the relevant time' - sub-ss 100A(5) and (6) (Volume 1, pg 21)

Comment

We welcome the change to the relevant time definition in sub s 100A(6). In addition, we think that there should be transitional provisions (we suggest until 5 April 2009)) to enable individuals who do not currently come within the provisions to re-arrange their affairs so that they can qualify in future tax years.

Suggested amendment

Insert new s 100A(7) as follows:

"If before 6 April 2009 the conditions within this section are not met but were met from 6 April 2009, relief will be available under this section from 6 April 2009 and subsequent years."

6. *Exceptions to the relief set down in s 100A ITEPA 2003 – s 100B ITEPA 2003 (Volume 1, pgs 21 to 22)*

Comment

It seems to us that sub-s 100B(2) could penalise taxpayers who have not sought specialist advice and result in all entitlement to relief being forfeited., as set out in the example below.

Example
An individual may initially own his holiday home in France through a French company that also operates the French branch of the individual's business. To meet the s 100A ITEPA 2003 conditions he may decide that the company should sell the property to a parallel company. If the price at which he transfers the property turns out to incorporate a small undervalue, he will not come within the conditions. The well advised will include a price adjustment clause in the purchase agreement in case the price is challenged by either the local or UK tax authorities. Provided this clause is contained sub-s 100B(6) provides that relief is not lost (as it defines consideration to mean 'consideration provided at any time'). However, where such a clause has not been incorporated it seems to us that relief can not be claimed even if the undervalue should be made good as it cannot be argued that the subsequent payment was to 'acquire' the property. We feel that where there is no price adjustment clause in the purchase agreement it ought to be possible for the individual to escape the restriction through the making of a non contractual further payment to the vendor company such that the sum of the contractual and non contractual payments equates to the full market value consideration.

We feel that the wording contained in s 100B(3)(a) is too widely drawn. It would seem to us to mean that relief may be denied in the following situations where:.

- An individual has a Spanish building company, which refurbishes his Spanish villa, and the company owning the villa pays the market rate for the work. It seems to us that expenditure in respect of the property has been incurred by the building company (which is a connected to the company owning the villa) as it bought the building materials and paid its staff.

- One of the individual's accounts staff makes a mistake and accidentally draws a cheque on his UK company for work on the villa and the individual notices this a month later when he goes through the bank statements and immediately draws a cheque from the villa company to reimburse the trading company.

We believe that the underlying policy purpose should be to allow relief in these circumstances and it seems unreasonable to deny relief for all future years whilst the villa company owns the property.

Foreign domiciliaries has access to the remittance basis of taxation (albeit a remittance basis charge may be payable). Remittance basis users are only taxed on foreign income to the extent that the funds are remitted to the UK. We would welcome clarification that s 100B(4) will not be interpreted to deny relief where a foreign domiciliary used a foreign company to hold a foreign property. It could be argued that by using a foreign company rather than a UK company a tax advantage has been obtained as if the property is let out the foreign company will not be subject to a UK tax charge and the individual will only be taxed in the income if funds from the company are remitted to the UK. We do not think that this structure amounts to tax avoidance.

Suggested amendments

In s 100B(2)(a) after ‘at an undervalue’ insert the words ’and that undervalue has not been made good in the current or previous tax years’.

In s 100B(3) insert after ’by a connected company’ insert the words ’and not either incurred as the result of payment on arms length terms by the company with the interest in the property for work carried out in the course of the connected company’s business or representing a payment made on behalf of the company with the interest in the property and the amount incurred is reimbursed to the connected company.’

At the end of s 100B(4) insert the sentence:

’For the avoidance of doubt D will not be caught by this sub-section by reason only of:

a) owning the property through an offshore structure; and
b) being a remittance basis user and not remitting income arising from the letting of the property.’

Further information

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20 May 2008