



## ICAEW TAX REPRESENTATION

### REFORM OF THE TAXATION OF NON-DOMICILED INDIVIDUALS

Comments submitted in September 2011 by ICAEW Tax Faculty in response to a joint HM Treasury and HMRC consultation paper *Reform of the taxation of non-domiciled individuals: a consultation* published in June 2011

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# REFORM OF THE TAXATION OF NON-DOMICILED INDIVIDUALS

## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Reform of the taxation of non-domiciled individuals: a consultation* published jointly by HM Treasury (HMT) and HMRC on 17 June 2011 at [http://www.hm-treasury.gov.uk/d/consult\\_condoc\\_non\\_domicile\\_individuals.pdf](http://www.hm-treasury.gov.uk/d/consult_condoc_non_domicile_individuals.pdf).
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area. In particular we should welcome a meeting to expand on the areas where we suggest that further simplification is made to the existing remittance basis rules, see para 35 below.
3. On 19 July 2011 we attended a meeting with HMT and HMRC, in which we were able to put forward some key comments and concerns and discuss aspects of the discussion document.
4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

## WHO WE ARE

5. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
6. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
7. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

## KEY POINT SUMMARY

8. We welcome the majority of measures proposed in this consultation document and the announcement that there will be no further substantive changes to the taxation of non-domiciles for the remainder of this Parliament. We are concerned, however, in regard to the legislation brought in by Sch 7, Finance Act 2008 that there is much that could be done to simplify the existing legislation. The legislation was introduced in haste and at the time we pointed to a number of shortcomings which were published as TAXREP 31/08. The relatively short time available to respond to this consultation, combined with the fact that it has been issued over the holiday period, means that we have had insufficient time to undertake a thorough review of that legislation and make more than a few proposals. We should welcome the opportunity to take part in further discussions on the proposals for simplification.
9. In connection with the measures to encourage business investment our key points are:

- qualifying businesses should not be restricted to purely commercial property developments but should also include those with a residential element;
- the forms of business should include partnerships, trusts and sole traders;
- the requirement to take the proceeds out of the UK within two weeks of a disposal of the investment is far too short, we suggest six months is more appropriate;
- the relief should include those who were previously taxed on the remittance basis, who are now taxed on an arising basis, and wish to remit previously untaxed income/gains to make a qualifying investment; and
- we assume that HMRC will take all necessary advice and steps to ensure that the proposals do not infringe the European 'state aid' rules.

10. Our key points on the simplification measures are:

- the proposals on nominated income and foreign currency bank accounts should be extended to cover trusts and related vehicles;
- the time limit for taking proceeds out of the UK following an asset sale in the UK is too short, we suggest six weeks is more appropriate;
- these proposals should be extended to cover sales by a relevant person and should also defer any liability to a gain on disposal;
- the proposals should also exempt from charge any pre-eminent object or work of art brought into the UK which is to be gifted to the nation; and
- the de minimis limit of £2,000 for unremitted foreign income or gains should be increased to the level of the personal allowance.

## **MAJOR POINTS**

### **Increasing the Remittance Basis Charge**

11. The proposed increase in the remittance basis charge (RBC) to £50,000 after twelve years of residence will, in our view, be acceptable although not welcomed. We do not envisage this will cause a major change in an individual's behaviour.

### **Encouraging business investment**

12. With respect to the incentives for investment, we welcome the tone of the document and its aim to make the legislation free of unnecessary restrictions and simple to use.

13. We seek clarification on the inheritance tax (IHT) treatment of an investment by a non-domicile who has brought money into the UK under the proposals, who dies before the investment is realised and the money can be withdrawn from the UK and whose estate would thus be liable to IHT on the investment. We suggest that consideration be given to allowing the executor/personal representatives to sell the investment and withdraw the money from the UK within a specified time, say six months, to remove any IHT liability.

### **Types of business**

14. The definition, at para 2.23, of a qualifying trading business needs to ensure that any incidental investment related activity does not cause the company to cease to be a qualifying company. We suggest that the definition currently used to define a company qualifying for business property relief under the IHT rules might be appropriate. These rules are well understood and too narrow a definition in these proposals may deter investors.

15. We are concerned that limiting a 'qualifying business' to one that develops or lets commercial property is too restrictive. We suggest that combination developments should be allowed while purely residential ones could be excluded. We consider that it would be relatively simple to exclude developments wherein accommodation is provided to the investor or his family.

### **Form of business**

16. As the aim of this incentive is that it should be free of unnecessary restrictions we question the need to discriminate against partnerships, trusts and sole traders. We understand that partnerships in particular are a concern to HMT because of potential tax-avoidance, but in our experience 'trading' partnerships are often used in a start-up venture, while commercial property is frequently held in an LLP. We suggest that the existing legislation on sleeping or non-active partners could be used or referred to here to minimise avoidance while not ruling out proper commercial structures.
17. We suggest that the incentive should be extended to cover investment in all businesses which invest in UK commercial property and commercial/residential development whether or not they have a permanent establishment in the UK.
18. We consider that the new incentive should also apply to investments in companies listed on a recognised stock exchange as well as to those quoted on exchange-regulated markets, such as AIM. If, however, it is decided to confine the exemption to unlisted (including AIM) companies we suggest that a subsequent listing of that company should not be an occasion of charge per se.

### **Channel and form of investment**

19. We welcome the flexibility to allow offshore vehicles to use the relief in the same way as individuals. This is sensible and consistent as is the ability to invest via loan capital.

### **Anti-avoidance**

20. We understand and accept the need to prevent avoidance but the requirement at para 2.49 to take the money out of the country within two weeks should be re-considered, it is far too short a time. We suggest a period of six months from the date that the vendor is able to withdraw the funds from the UK, unless there was a qualifying reinvestment within that time. The remittance could be timed as occurring at the end of that six month period. We also suggest that in the event that these funds are subsequently remitted to the UK to satisfy a warranty or indemnity call that this should not constitute a taxable remittance. The legislation also needs to include provisions to apportion the amount required to be withdrawn from the UK where there is a part disposal of the investment.
21. The remaining anti-avoidance proposals do not cause us any concerns.

### **Interaction with the remittance basis charge**

22. We understand that it is intended, despite the wording at para 2.59, that the exemption will apply to a taxpayer taxed in the relevant year on an arising basis where remittance basis income and/or gains from earlier years are used in the investment. We welcome the clarification.

### **Compliance with European Law**

23. While we welcome the proposals we do have some concerns about their compliance with European law. We understand that HMT have taken preliminary advice and will take further advice on the compliance of individual measures.
24. We consider that prima facie a number of the proposed measures could contravene EU and EEA law particularly Article 49 (Freedom of Establishment), Article 63 (Free Movement of Capital) and Article 107 (State Aid) of the Treaty on the Functioning of the EU (TFEU).
25. Compliance can be assessed more fully when the draft legislation is published. Any uncertainty over the treatment will undermine the effectiveness and take up of the proposals. It would also mean that caveats would be required when advising clients.

26. In connection with Articles 49 and 63 we query whether, for example, the requirement that the company has a permanent establishment in the UK (para 2.38) might be deemed discriminatory.
27. Charges on non-domiciled individuals on remittances to the UK by trusts/companies in which they have an interest could arise under s 720 and s 731, Income Tax Act 2007 (ITA 2007) (see sections 726 and 735). We assume that appropriate adaptations will be made to ensure that the proposals are compliant with EU law.

### **Simplifying the existing remittance basis rules**

28. We welcome the proposed simplifications to the current rules which are long and complex. We also appreciate the opportunity to suggest further amendments in line with the principles set out in para 2.63.
29. In general we welcome the proposals relating to nominated income and foreign currency bank accounts (FCBA). We suggest that the FCBA rules should be extended to related vehicles such as trusts and the underlying companies where the relevant person rules apply or where it is evident that foreign currency is being held as a specific investment class. The calculation of gains and losses is just as complicated in these circumstances as it is for an individual and, as noted in the consultation document, the administrative burden is disproportionate to the tax payable or the losses allowed.
30. We note at para 2.80 the intention to include specific anti-avoidance provisions. However, the example given in this paragraph seems to us to be already covered under the Targeted Anti-Avoidance Rule at s 16A, Taxation of Chargeable Gains Act 1992 (TCGA 1992).
31. In para 2.86, the taxation of assets sold in the UK, we consider that two weeks to take the money out of the UK is insufficient time. In this case we would suggest a six week period or subsequent reinvestment in, for example, a qualifying business asset.
32. We consider that if this exemption is to be of any benefit it should extend to cover sales by a relevant person and to defer any liability on a gain on the disposal. If a chargeable gain were to arise on the disposal of these assets we think that this would act as a disincentive to selling them in the UK. Without these amendments we consider that the exemption will be little used.
33. We also suggest that these proposals extend to exempt an individual on the remittance basis from a charge to tax where a pre-eminent object or work of art is brought into the UK to be gifted to the nation, under the proposals in the consultation document *Gifts of pre-eminent objects and works of art* issued on 29 June 2011.
34. We consider that the £2,000 de minimis limit in s 809D, ITA 2007 needs to be reviewed. The volatility of exchange rates makes this limit insufficient to deal with relatively simple cases where there is no change in underlying circumstances. We think a more practical limit would be the level of the personal allowance. The arguments in 2008 that ministers were unhappy to grant remittance basis users the annual exemptions available to non remittance basis users were not in our view valid then and are less so now. The calculations are administratively costly and, we suggest, there is low level widespread non compliance. In our view this falls within the parameters in para 2.63 and we suggest that the limit is reviewed and aligned. An increased limit will also deal with a nominal level of capital gains.
35. We have a number of areas within the legislation where we consider amendments should be made to either simplify, clarify or to reduce the administrative burden. Such amendments should also reduce the cases of unintentional non-compliance. These include:
- simplifying and clarifying the definition of a remittance;
  - specifying the exchange rate to be used when converting income received in a foreign currency to sterling;

- amending the consideration for certain services exemption in s 809W, ITA 2007 to cover Conditions C and D in s 809L, ITA 2007 and removing the requirement to make the payment offshore;
- modifying the exemptions in s 809X, ITA 2007 to make them workable;
- changing the source ceasing rules in s 832(3), ITA 2007 so that they apply only where the source ceased after 5 April 2007 this would reduce the administrative burden on taxpayers;
- simplifying and clarifying the mixed funds rules;
- adjusting the rules in s 13, TCGA 1992 so as to not disadvantage those non-domiciles whose funds are kept within entities more akin to a company than a trust, eg LLCs; and
- modifying the legislation where the remittance basis provisions are inadequate, eg to take account of changes to the entrepreneurs relief provisions etc.

We would welcome the opportunity to take part in further discussions on these proposed simplifications.

## **RESPONSES TO SPECIFIC QUESTIONS**

### **Business Investment**

**Question 1: Are the proposed exclusions from the incentive appropriately drawn? Should other types of business be included or excluded?**

36. We suggest that businesses that undertake the development and letting of property which are combination developments, that is a mix of commercial and residential use, should be included.

**Question 2: What would be the impact on both investment and complexity of extending the incentive to listed companies?**

37. We consider that extending the incentive to listed companies is within the policy aims of the proposals, namely to attract investment to the UK.

**Question 3: Are the proposed anti-avoidance provisions suitable? Would it be appropriate to require remitted income or capital gains to be taken out of the UK or reinvested within two weeks of the disposal of the investment?**

38. In general we find the proposed anti-avoidance provisions suitable. We do, however, consider the two week period too short, see our comments at para 20.

**Question 4: Would a mandatory requirement to claim the relief for business investment on a Self Assessment tax return be an appropriate way of monitoring the policy? If not, what alternative monitoring approach would be appropriate?**

39. We are happy with this suggestion and would suggest that there is a specific box on the tax return to claim the relief.

**Question 5: Would the policy as outlined be an effective means of encouraging investment in the UK?**

40. We welcome the proposals to encourage investment in the UK and consider that they will be effective in doing so. We are concerned, however, that the proposals may not be compliant with European law, see paras 23-27.

### **Simplification**

**Question 6(a): Do you think the proposed solution for each simplification would be effective?**

41. The proposals on FCBAs should be extended to cover trusts and related vehicles.

42. The relief for the taxation of assets remitted to and sold in the UK should be extended to cover sales by any relevant person and defer liability on any gain on the disposal, see para 32. It should also extend to cover gifts to the nation of pre-eminent objects and works of art, see para 33.

**Question 6(b): Can you propose other ways in which the remittance basis rules could be simplified provided they meet the principles described in paragraph 2.63?**

43. The de minimis limit in s 809D, ITA 2007 should be increased, see para 34.

44. In para 35 we note a number of further areas where we consider that simplification is required. Some of these are complex technical proposals and we suggest that a further meeting might be appropriate to discuss them in detail.

**Question 7: Would two weeks be a suitable period of time before which the proceeds of the sale of an exempt asset should be taken out of the UK?**

45. We think that the time period should be extended to six weeks.

**Question 8: Should the situations outlined in paragraphs 2.98 to 2.101 fall within the new statutory treatment for employees who are not ordinarily resident and carry out duties in the UK and overseas? Are there any other situations which are not covered by SP 1/09 and might require legislative provision?**

46. We consider that all the situations outlined in paras 2.98 – 2.101 should fall within the new statutory treatment.

47. There are, however, a number of other situations where SP 1/09 needs to be extended. These have been discussed at the Joint Expatriate Forum on Tax and NICs and we would refer you to those discussions. A recent problem was noted in connection with repayments of overpaid PAYE. The current HMRC guidance is not consistent with the wider definition of a remittance and an amendment is required either through amending the direction provisions in s 690, ITA 2007 or by including it in the proposed legislation on SP 1/09.

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**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/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx> ).