TAXREP 14/14

(ICAEW REP 33/14)

ICAEW TAX REPRESENTATION

DRAFT LEGISLATION FINANCE BILL 2014

Comments submitted on 13 February 2014 by ICAEW Tax Faculty in response to HM Revenue & Customs draft legislation on the "Artificial use of dual contracts by non-domiciles" published on 16 January 2014

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft legislation ***Artificial use of dual contracts by non-domiciles*** published by HM Revenue & Customs (HMRC) on 16 January 2014.

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

3. On 7 February 2014 we were represented at a meeting with HM Treasury/HMRC that had been organised to obtain early feedback on the Draft Legislation from interested parties. Key comments and concerns were put forward and aspects of the Draft Legislation were discussed.

4. The Draft Legislation on *Artificial use of dual contracts by non-domiciles* was published on 16 January 2014, more than a month after the bulk of the Draft Finance Bill 2014 clauses (published on 10 December 2013) and at an exceptionally busy time for private client tax practitioners. As the deadline for comments was set at 13 February 2014 the time for producing this response has been limited and thus this response outlines our key concerns and some preliminary comments; it is not exhaustive.

5. 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

6. 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.

7. 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.

8. 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 POINTS

9. We welcome the clear commitment to maintaining overseas workday relief ("OWR") and the fact that the new proposals will have no impact on the operation of that relief. However, this is the only part of the proposals we can welcome.

10. We have very significant concerns about the draft legislation which we is so widely drafted that it will, if enacted, represent a clear breach of the Government's commitment (made during the 2011 consultations and repeated in 2012) to make no further substantive changes to the remittance basis for the rest of this Parliament. In addition, by adversely impacting on the most senior employees of a company, it will detract from the positive measures taken in the Corporate Tax sphere to make the UK more attractive to multinational companies.

11. We understand that the Government want to take measures to prevent the remittance basis of taxation being abused and that there would be legitimate concern if it were possible to

manipulate the rules to effectively claim the remittance basis on UK employment income. However, such a thing is not possible (as explained in paragraphs 19 to 22 below). Rather than adding another layer of legislation the existing legislation should be invoked.

12. The issue of multiple contracts is not new. HMRC expressed concerns that some foreign domiciliaries had dual contracts that did not reflect the reality of the situation in a Tax Bulletin article in April 2005. Since then HMRC has been active in challenging arrangements it has considered to be artificial and has had significant success. Given this long history we do not understand why it was necessary to introduce this change as an urgent anti-avoidance measure such that there was no preliminary consultation. Rushing legislation through without adequate scrutiny, particularly in such a complex area where there is the potential to do lasting harm to the UK's global competitiveness is short sighted. The legislation should be held back from the 2014 Finance Bill to allow a proper consultation period.

13. We accept that the Draft Legislation will make it easier for HMRC to challenge Dual Contract arrangements but this is because the legislation is so widely drafted that it will catch not just artificial arrangements but also genuine commercial arrangements. If enacted unchanged, it will only be possible for a senior employee to claim the remittance basis on foreign earnings where he or she has an associated UK employment if the foreign tax rate applicable to the income is at least 75% of the additional UK tax rate.

14. Rather than targeting artificiality, the draft legislation is targeting internationally mobile senior employees with an associated UK employment who it deems are not paying enough foreign tax on their foreign employment income. Given that internationally mobile senior employees are the decision makers in a multi-national organisation targeting them in this manner could have significant long term implications for the competitiveness of the UK on the global stage.

15. At a minimum Condition 3 needs to be replaced with far narrower wording. Whilst it is not our preferred approach, (and we do not accept that it is necessary) provided there is also a statutory clearance system, replacing the current Condition 3 with the following wording would address our most serious concerns with the draft legislation:

Condition 3 is that it would be reasonable to draw the conclusion that the arrangements are not commercial arrangements and avoiding liability to UK taxation was the purpose for which the arrangements were effected.

16. Given our concerns with the current draft legislation we welcome the fact that Condition 4 ameliorates its impact. However, in our view the 75% of the additional rate for the relevant year is too high. This is particularly the case given that one can only take into account the amount that would be allowable for foreign tax credit relief (ignoring for example social security deductions and local taxes). Given the way the US tax system works and the interaction of the state and federal systems there will be particular issues for US taxpayers.

17. In addition, we are puzzled as to how the legislation could be said to be focussed on targeting "contrived arrangements" when without any amendment to the employment arrangements:

- an increase in the UK additional tax rate will result in arrangements being caught by the provisions that previously were not;
- a decrease in the UK additional tax rate will result in arrangements falling out of the provisions; and
- changes to the foreign tax credit (which could, for example, happen as a result of either: (i) changes in the tax rate in the foreign jurisdiction; or (ii) by fluctuations in the individual's marginal rate caused by annual differences in the income breakdown or reliefs claimable) will for some individuals mean that in some years they will meet Condition 4 and in some years they will not.

18. To try to even this out we suggest that if an individual falls outside of condition 4 in one tax year he or she is also deemed to have fallen outside of condition 4 in the following two tax years but even this will not eliminate the inherent unfairness of the condition.

NO NEED FOR ADDITIONAL LEGISLATION

19. As stated in paragraph 11, we do not understand why new legislation is considered necessary. Where overseas workday relief is not in point, the current legislation only allows the remittance basis to be claimed on "chargeable overseas earnings" with this definition being very strict and only applying where:

- the foreign domiciliary has a foreign employer; and
- the duties of the employment are performed wholly outside the UK (with an exception for merely incidental duties).

In addition there is already an anti-avoidance provision (ITEPA 2003 s 24) where an employee has contracts with more than one associated employer, which provides that the emoluments from the employments must be aggregated and re-apportioned between the two employments in a reasonable manner.

20. Under the current legislation HMRC can, therefore, already prevent "contrived arrangements". Officers of HMRC can and have challenged such arrangements successfully on the basis that:

- the foreign employment contract is a sham and that there is really only one contract of employment;
- substantive duties of the foreign employment are performed in the UK (just one substantive duty being performed in the UK meaning that the employment fails to meet the "chargeable overseas earnings" definition) or
- the ITEPA 2003 s 24 anti-avoidance provision applies.

21. HMRC's robust position in this area was set down very clearly in the article in Tax Bulletin 76 (April 2005) which is reproduced at EIM77030 of the HMRC Employment Income Manual. There is no suggestion in this guidance that HMRC had any difficulty with challenging artificial arrangements under the current legislation and we do not understand what could have changed to require additional legislation (let alone legislation as wide ranging as is proposed).

22. If anything our experience has been that HMRC officials have been seeking to apply the current legislation more zealously than is appropriate. The attitude from some officers being that UK residents cannot possibly have a foreign employment which is carried out wholly outside of the UK even where the facts all show clearly that this is the case.

EACH CASE SHOULD BE LOOKED AT ON THE FACTS

23. The draft legislation and the rhetoric around it appears to be a clear departure from HMRC's previously published commentary in this area where it has accepted that there can be dual contracts where there are distinguishable jobs.

24. Condition 3 of the Draft Legislation is drafted as widely as possible with paragraphs (a) to (f) merely giving examples of what would be seen as "related". We are unable to reconcile the width of the Condition 3 drafting with the comments within EIM77030 of the Employment Income Manual.

25. In the guidance at EIM77030 HMRC explicitly accepts that:

"Where there are two employment contracts and the written contracts reflect this, dual contracts provide a legitimate way to structure an individual's employment relationships."

26. There is also the following example given in the HMRC Guidance of an acceptable dual contract arrangement:

"HMRC takes the view that a dual contract arrangement is unlikely to work unless there are two distinguishable jobs. For example, a French resident employer 'A' sends employee 'B' who is domiciled outside the UK to establish an office in London for its UK subsidiary 'C'. A requires B to work in its Paris office servicing their existing portfolio of French clients two days per week. On the other three days, C requires B to work in London. This is likely to constitute a proper basis for B holding separate employment contracts with A and C. "

27. On the basis that B is being sent to establish an office in London there is a good chance that he or she would be a senior employee such that the only thing that will prevent B being caught by this proposed new legislation is the level of French tax he will be paying. It is bizarre that an example HMRC has said is acceptable will if France reduces the tax rate be seen as a "contrived arrangement" with the UK employer seen as "non-compliant" (the word used in the Impact assessment).

28. We reject totally the notion that when an individual reaches a certain position of seniority within a multinational company they cannot have genuine multiple contracts with distinguishable jobs. It all depends on the specific facts and senior employees can and do have distinguishable jobs with associated employers in the same way as less senior employees can and do. Equally there will be many situations in which UK domiciled employees have multiple contracts.

29. Condition 3 will catch many entirely commercial situations and it should not be left to Condition 4 (which is predicated on the workings of foreign tax systems) to determine which genuinely commercial arrangements will and which will not be caught. The following examples where Condition 3 would apply illustrate our point that it is too widely drawn and should be replaced in its entirety:

- A foreign domiciled individual started to work for a multinational corporation in the jurisdiction where she was domiciled and moved up the ranks to be heading up the Continental European subsidiary. After working in that position for a few years she also took up a role on the board of directors of the ultimate parent company and a few years after that she was sent to the UK to oversee the start-up of the new UK company (the thinking being that she would be required in this position for around five years). She carries on in her foreign roles as her input there is still required (and will be for many years after she has finished in the temporary UK position) so she has three completely distinguishable jobs. Such an arrangement is clearly driven by commercial considerations and to call it contrived would be perverse.

- An individual starts to work for a UK subsidiary of a foreign parent and does so well that he or she becomes the Chief Executive Officer of the UK company and is seen as someone who the parent company wants to be involved in the running of the group. The individual, therefore, becomes a member of the board of the parent company. These are two very distinct roles and the domicile of the individual concerned would have no impact on the fact that he or she would have two separate contracts. As such, where the individual is a foreign domiciliary it is perverse to say such arrangements are contrived.

TIMING ISSUES WITH RESPECT TO DETERMINING WHETHER CONDITION 4 IS MET

30. Different jurisdictions have different tax administration systems and it can sometimes take many years to determine the rate of foreign tax payable. It may be that the final determination will not be until after the end of the self-assessment amendment window for the tax year. In cases where it is not clear whether the individual will meet condition 4 or not this will result in various practical issues which are not currently accounted for.

DELAYED REMUNERATION

31. There is some confusion about whether foreign employment income is caught by the new legislation if it is for a tax year where there is no related UK employment but arises in a tax year where there is a UK related employment. In our view it would be inequitable to apply the legislation to income for a tax year where there is no UK related employment and our reading of the draft legislation is that it does not do this (new ITEPA 2003, s (1A) refers to "for the tax year" as does new 41C (4A). However, at the meeting on 7 February it was suggested that the intention was that the new legislation should apply if the income arises in a tax year where there is a UK related employment even if the employment did not exist in the tax year the income is for. If this is the intention then we would ask for the issue to be re-considered as it should be the circumstances for the tax year that are the determinant as to whether the remittance basis should apply to the foreign income or not.

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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)