TAXREP 59/15 (ICAEW REPRESENTATION 152/15)

REFORMS TO THE TAXATION OF NON DOMICILES

ICAEW welcomes the opportunity to comment on the consultation paper *Reforms to the taxation of non domiciles* published by HM Treasury on 30 September 2015.

Whilst we appreciate that HM Treasury and HM Revenue & Customs have held meetings allowing us and other interested parties to discuss the proposals both before and after the publication of the consultation document it is contrary to the government's consultation guidance to allow less than 12 weeks consultation for such a major change to the legislation. https://www.gov.uk/government/publications/consultation-principles-guidance.

The consultation document does not contain numbered paragraphs so we have had to refer to section numbers and headings in this response.

This response of 11 November 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 2 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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

We attended meetings with HM Treasury / HMRC jointly with other professional bodies before and after the consultation document was published in which we were able to put forward some key comments and concerns and discuss aspects of the initial proposals and the consultation document. Our notes of those meetings have been published as TAXGUIDE 08/15 and TAXGUIDE 12/15.

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ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working 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 144,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

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.

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INTRODUCTION

1. Given the importance of this Consultation Document it is disappointing that a PDF booklet type document with page numbers and paragraph numbers was not produced.

2. The questions asked did not focus on all the key areas, so in addition to answering the specific questions we have covered additional matters in the key issues section below.

EXECUTIVE SUMMARY

3. Whilst we support some of the comments within the consultation document we have some very serious concerns (all of which are developed further in either the key issues section or our responses to specific consultation document questions):

- As an overall comment, the provisions as presently outlined are neither fair nor reasonable nor proportionate, and could be contrary to EU law. The potential damage to the UK economy could outweigh any anticipated exchequer gain.
- The proposals are so radical that in our view more time is required to get them right and that they should be enacted as one complete package rather than over a period of two years. Ideally the effective date should be deferred by one year.
- Foreign domiciliaries have been subject to too much change. We are concerned that, even for those who are not affected by the proposals, it may seem like an indication that the UK does not really want them and that they may either decide not to come here or to leave earlier than they would otherwise have done. A clear statement that there will be no further detrimental changes and a commitment to simplify the existing remittance basis rules would be helpful.
- To avoid serious practical issues with the changes transitional provisions are required. These will encourage foreign domiciliaries to bring funds into the UK that would otherwise have remained offshore, so will not actually have a real tax cost and the funds being in the UK will be good for the economy.
- Grandfathering/transitional provisions are required for individuals when the 15 out of 20 test is applied to prevent the changes operating retroactively.
- Taxpayers should be able to re-arrange prior to the changes coming into effect, so there should be no anti-forestalling legislation.
- The benefits charge set down at 3.2 of the Consultation Document does not seem to achieve the government's aims. We endorse the alternative CIOT, Law Society, STEP and ICAEW proposal in Appendix 1.
- Taxing an individual with a foreign domicile differently because he or she was born in the UK with a UK domicile of origin is not justified: a closer connection with the UK should be required for the penal tax proposals in the consultation document to apply. If the general principle is retained then the period of grace should be at least three tax years to allow for a secondment to the UK.
- We have significant concerns with the proposals with respect to trust taxation where the settlor was born in the UK with a UK domicile of origin. In summary we think that trusts should retain their excluded property status where the settlor cannot benefit, and, where the settlor can benefit, the legislation should be adjusted, so, just in these circumstances, the gift with reservation of benefit provisions have priority, meaning the relevant property charging regime is switched off.

THE KEY ISSUES

Deferring the legislation

4. The proposals radically change the taxation of foreign domiciliaries. The trust changes for individuals caught by the 15 out of 20 test will be particularly difficult to enact in such a way that they meet the objective of the Chancellor (see Appendix 1). We are, therefore, pleased that the trust legislation will not now be enacted until 2017 Finance Act. However, it would be

better if all the legislation was deferred and enacted together as one package of changes to ensure everything ties in and no interactions are overlooked.

5. Delaying the legislation to the 2017 Finance Act with a 6 April 2017 start date leaves little time for affected taxpayers to re-organise their affairs with certainty. The effective date of the legislation should be deferred so affected taxpayers can see the final legislation and re-organise their affairs accordingly.

6. If the start date is not deferred, the relevant 2017 draft legislation should be published as early as possible so there can be various consultations (in the same way as occurred for the statutory residence test) and not deferred until December 2016. A document setting out the general structure of the legislation and draft legislation to date should be published as early as possible in 2016 (possibly Budget time) with any additional draft legislation published as and when it is ready. Comments made on the initial draft legislation would then inform the work for the draft clauses to be released in December 2016.

Constant change and the lack of transitional provisions undermines faith in the tax system

7. We were pleased that the Chancellor, in his Summer Budget 2015 speech, made it clear that many foreign domiciliaries make a considerable contribution to public life and tax revenues. The Financial Secretary to the Treasury echoes this in the comments to the foreword of the Consultation Document stating that the *"government wants to attract talented individuals to live in the UK"* and that the proposals *"have been carefully targeted to address some unfairness in the current rules in a way that will not deter those individuals who might be considering a move to the UK."* However it is our view that the proposals have the opposite effect and they will be a deterrent and will cause non domiciles already in the UK to review their country of residence.

8. Foreign domiciliaries value certainty. Constant changes to the underlying rules are unsettling especially when those changes are all disadvantageous and add greater complexity to their tax affairs. Using this opportunity to simplify some of the more complex aspects of the remittance basis and giving a commitment to make no more significant changes to the remittance basis (such a commitment to also mean no increases to the remittance basis charges) would be helpful.

9. For the UK resident foreign domiciliary the lack of commitment to introduce transitional provisions (the paragraph in sub-section 3.3 headed "Ensuring compliance for tax purposes on foreign income and gains" is not reassuring as it gives no indication to how or what measures will be introduced) or have grandfathering (with respect to the 15 out of 20 test) is a significant concern. Our suggestions with respect the transitional provisions can be found in paragraphs 14 – 17 below and our suggestions with respect to grandfathering for the 15 out of 20 rule in paragraphs 33 – 36 below.

10. UK resident foreign domiciliaries whose returns will have to be prepared on the arising basis for the first time will be concerned about the compliance issues where there may be significant gaps in the data or it is not clear how a product/structure should be treated (again the paragraph in sub-section 3.3 headed "Ensuring compliance for tax purposes on foreign income and gains" is of no help). Discussions between HMRC and the professional bodies will be required to go through the practical issues to try to arrive at pragmatic strategies that are acceptable and practicable.

11. Unless there is a radical re-think there is very little that can be done to make the UK attractive for individuals born in the UK with a UK domicile of origin. The proposed period of grace will generally be insufficient and unless they have very simple financial affairs the best advice for such individuals will be to remain outside the UK. We do not see how that will be of benefit to the UK economy, particularly as it could be an issue for a multinational employer (see paragraphs 46 - 47).

No anti-forestalling rules and the need for transitional provisions

12. There should not be any anti-forestalling rules. It is important that in the period to 6 April 2017 foreign domiciliaries can re-organise their affairs.

13. Re-organisations will not always be able to improve the situation and as such, there should be transitional provisions. For affected individuals the changes that will be enacted are more significant than the 2008 Finance Act changes which fundamentally changed the remittance basis provisions for all foreign domiciliaries. These changes mean that affected individuals will not be able to access the remittance basis at all and thus the argument for transitional provisions is even stronger now than it was then.

14. Given the complexities of the remittance basis such individuals will have various mixed funds where there was never any intention to remit the funds to the UK and they had no idea of the composition. All that may be known is that the unremitted income and gain amounts have been invested (sometimes many times over). Without a transitional provision individuals will keep these funds outside the UK and may even avoid selling the asset after 6 April 2017 as they would be taxed on the gain but would not be able to bring in the entire proceeds without identifying the acquisition base cost. In such a situation no tax would be lost if there were a transitional provision and tax could be gained as it could encourage a sale (resulting in CGT on the arising basis) and then the proceeds being brought to the UK and used to benefit the UK economy (possibly generating indirect tax and profits for UK business resulting in corporation tax being paid).

15. We suggest that a transitional provision modelled on Sch 7 para 86(3) Finance Act 2008 is introduced but that this transitional provision should cover relevant foreign income and relevant foreign gains (as gains will often be reinvested as well as income). The provision would, therefore, be along the following lines: If before 8 July 2015, property (other than money) consisting of or deriving from an individual's relevant foreign income or foreign chargeable gains was acquired by a relevant person, treat the relevant foreign income or foreign chargeable gains as not remitted to the United Kingdom on or after 6 April 2017 (if it otherwise would be regarded as so remitted).

16. The definitions of property and money would be the same as those used for the purposes of sch 7 para 86(3) Finance Act 2008.

17. Since the provision will go back to 8 July 2015 there can be no possibility of abuse as the provisions were either met at that date or not.

Treatment of offshore trusts

18. Sub-section 3.2 of the consultation document reiterates the point made at the time of the Summer 2015 Budget that the government intended there to be some protection for those individuals caught by the 15 out of 20 test who had set up offshore trusts before they became deemed domiciled. Where the structure is settlor interested we understand that the government is committed to UK income continuing to be taxed on the arising basis but non-UK income was to only be taxed when benefits were received.

19. We are supportive of the government's stated objective with the only proviso being that we are strongly of the opinion that there should only be one regime for all foreign domiciliaries (the difference being that those who are not deemed UK domiciled can use the remittance basis so they are not taxable on foreign benefits).

20. An additional attractive corollary of the government's strategy is that it will mean that the foreign income arising to the trust will not be the income of the settlor, so can be invested in the UK without being a remittance and resulting in the settlor having a UK tax liability. We have been asking for a change to allow this since the initial 2008 changes so we very much welcome this side effect.

21. We do not, however, think that the proposals set down in 3.2 are the best way to achieve the government's aim, as taxing an individual on the value of benefits received without reference to whether there are any income or gains in the structure could be very unfair:

- Some trusts are dry structures with non-income producing assets (such as properties that beneficiaries are allowed to use) and no income or gains whatsoever.
- Some trusts have limited income and gains but a far more significant level of initial capital settled such that taxing a capital distribution without reference to the income and gains in the structure would be inappropriate.

Where there is significant income and gains in the structure the reaction of affected individuals will depend on the tax rate that will apply (we do not yet know what this is to be). An income tax rate will be unattractive to the taxpayer but the lower CGT rate may be seen by the public as allowing foreign domiciliaries to continue to pay tax at lower rates.

22. Whilst it is not entirely clear we understand that the provisions set down in the consultation document only apply to the settlor of a settlor interested trust. There is no explanation as to how these new provisions will interact with the existing provisions to avoid double counting but some kind of removal of income from the s733 ITA 2007 pool seems to be envisaged. However, given how the s733 legislation is framed (income pools relating to individuals it could in theory benefit rather than an actual pool like the s 87 TCGA 1992 legislation), getting this interaction to work properly could be difficult (particularly since there could be negative income). We should welcome confirmation that at that stage there would be a deduction from any available offshore income gains pool and any available capital gains pool.

23. If the changes suggested are to apply to all deemed UK domiciliaries caught by the 15 out of 20 rule then there will be some very unfair results with respect to Will Trusts since they represent pure capital.

24. We do not think that allowing affected individuals to elect out so that they are taxed as a UK domiciliary solves the problems. It may avoid being taxed where there is a dry trust or where capital is received, but it does not achieve the Chancellor's objective of providing these individuals with some incentive through better provisions for offshore trust taxation.

25. Taking the above into account and that the consultation document made it clear that the government is continuing to consider the issues and how to achieve its objectives we together with CIOT, Law Society and STEP have prepared a discussion paper (Appendix 1) setting out an alternative proposal. The paper proposes a modified version of the existing non-transferor charge (s731 ITA and s87 TCGA), as the basis for taxing non-resident trusts set up by foreign domiciliaries.

26. We think that building on existing legislation is a safer way of approaching this than a new charge with the potential risks that this brings in terms of trying to connect completely new provisions to the various existing anti-avoidance legislation. We also think that provided the motive defence is kept at company level (should there be a company in the trust structure), the proposal in Appendix 1 is at least as compliant with EU law as the proposals in 3.2 of the consultation document.

27. We acknowledge that many trusts do not have detailed records of transactions as they were not required (a main reason given in the consultation document for the proposal to have a benefits charge). However, if our proposals in Appendix 1 are accepted matching will move from a FIFO to a LIFO basis, which will partially address the records issue. The residual problem can be dealt with through appropriate transitional provisions for:

- existing trusts as at 6 April 2017; or
- at a later date where the settlor/ beneficiaries arrive in the UK for the first time after 5 April 2017.

28. We appreciate that the paper in Appendix 1 is only a first step and that if there is interest from the government much more work will be required. We and the other representative bodies would be prepared to work with HM Treasury and HMRC to take this forward.

The inequity of the born in the UK with a UK domicile of origin proposals

29. We appreciate why the government would want to remove the ability to access the remittance basis from those who have been UK resident for a sufficiently long time. We are not entirely clear why 15 out of the preceding 20 years is felt to be the correct time period but this is for the government to decide. We do not, however, understand why the government wants to introduce penal tax legislation for matters beyond the control of individuals, i.e. their country of birth. Individuals cannot control where they were born or what their domicile of origin was and it should not have such a profound impact on their tax situation.

30. The suggested provisions will lead to ridiculous results, for example:

> Elizabeth and William Pink are UK resident and UK domiciled when their daughter Katie is born. They leave the UK when Katie is a year old and move to Geneva. Katie's sister Clara is born two years later in Geneva when her father still has a UK domicile. Elizabeth and William acquire a domicile of choice in Geneva five years later with their daughters acquiring domiciles of dependency in Geneva. A year later the family return to the UK as William has an 18-month secondment (he retains his domicile of choice in Geneva as he always intends to return there). During this time Katie's brother Hans is born. The family return to Geneva after the secondment ends.
>
> Katie is the only sibling to be caught by the proposed provisions, as she was unlucky enough to be born in the UK with a UK domicile of origin. Clara is not caught, as she was not born in the UK. Hans is not caught, as whilst he was born in the UK he does not have a UK domicile of origin.
>
> Katie could remain outside of the UK for 30 years and still be caught should she be UK resident for just two tax years, whilst her younger siblings would only have to be concerned by the 15 out of 20 year test.

31. At a minimum (as discussed in paragraphs 44 - 48 below) a period of grace for all tax purposes of three tax years (coinciding with the overseas workday relief period) would be more equitable.

32. We have significant concerns with the proposals with respect to trust taxation where the settlor was born in the UK with a UK domicile of origin. Specific questions are, however, asked about these proposals and our responses are below (paragraphs 49 - 52). In summary :

- trusts should retain their excluded property status where the settlor cannot benefit; and
- where the settlor can benefit the legislation should be adjusted, so, just in these circumstances, the gift with reservation of benefit provisions has priority, meaning the relevant property charging regime is switched off.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do stakeholders agree that the approach outlined in this document is the best way to introduce the test for deemed-domicile status?

and

Q2: Are there any difficult circumstances that might arise as a result of the intended approach that could be avoided with a different test?

33. The Chancellor announced in the Summer 2015 Budget that *"anyone resident in the UK for more than 15 of the past 20 years will now pay full British taxes on all worldwide income and gains".* It is clear that this policy decision is not open for consultation and it is the framing of the test that is being consulted on. We have grouped our answers to question 1 and question 2 together as both relate to the framing of the 15 out of 20 test:

- Question 1 relates to the sub-section of the consultation document entitled "3.1 Legislating the deemed test"; and
- Question 2 relates to the sub-section of the consultation document entitled "3.1 Split years/statutory residence test".

These sub-sections consider the remittance basis (IHT issues being addressed later in the consultation document and, therefore, later in this representation).

34. We appreciate the difficulties in framing the 15 out of 20 test and understand how the decisions made in the consultation document have been arrived at (the wording used being based on that for the remittance basis charge qualifying condition). Given the policy parameters (that for continuous residence the deemed domicile status should be triggered for the 16th tax year of residence and that for other patterns of residence a rolling period of 20 tax years preceding the relevant tax year should be considered) we think that the test itself is reasonable.

35. The 15 out of 20 test will mean that residence in a number of pre statutory residence test years will be important and the draft legislation specifically states that the position for those years must be determined in accordance with the old rules. We should welcome confirmation that where self-assessment returns have been filed on a non-resident basis and the enquiry window has closed HMRC will accept the non-resident status for those years.

36. To prevent the changes operating in a retroactive manner grandfathering provisions are required for:

- Foreign domiciled individuals currently in the UK who left the UK and stayed away for four tax years, so as to break UK deemed domicile status for inheritance tax (IHT). We would suggest that for such individuals the period from which one starts to look when considering the 15 out of 20 test is the tax year they return to the UK.
- Foreign domiciled individuals who are currently not UK resident who left prior to Budget Day, so as to break their deemed domiciled status for IHT, thinking that they would only have to remain outside the UK for four tax years. For these individuals the old rules should apply until they return to the UK (that is a period of absence of 4 complete tax years is sufficient to break deemed domicile status and the period from which one starts to look when considering the 15 out of 20 test is the tax year that they return to the UK).

37. Transitional provisions are also required for individuals who left the UK prior to Summer Budget 2015 at a time when they were deemed domiciled for IHT, knew they would not be outside the UK long enough to either avoid the temporary anti-avoidance provisions or break their deemed domiciled status for IHT but expected to be able to pay to access the remittance basis to shelter foreign income and gains realised in the temporary non-residence period. In such cases the individual had a reasonable expectation that he or she would be able to shelter the foreign income and gains and so, just for the tax year of return, should be allowed to access the remittance basis paying the £90,000 remittance basis charge (which could be retained purely for this class of individuals).

Q3: The government is interested in views from stakeholders about the need for preserving the £2,000 de-minimis threshold for those no-domiciled individuals who become deemed UK domiciled.

38. The £2,000 de-minimis threshold was introduced in the 2008 Finance Act for a number of practical reasons. It seems less likely that it will be required in this context but it may be helpful to retain it. We are not best placed to comment on this issue and would suggest that the views of Low Incomes Tax Reform Group (LITRG) and TaxAid are taken into account.

Q4: Do stakeholders agree that the approach outlined in this document which will change the inheritance tax rules for those UK domicilliaries who are leaving the UK is straightforward and reasonable?

39. We agree strongly that there needs to be alignment, so that the same period of non-UK residence is required to shed actual and deemed UK domicile (where the 15 out of 20 tax year test applies). However, we do not think that the proposals in the consultation document are practical.

40. As the consultation document (in the last paragraph of sub-section 3.4 “Implications for inheritance tax”) acknowledges, once an individual is non-UK resident their domicile status is only relevant for IHT purposes. In our view the legislation deeming the individual to be deemed domiciled for six tax years after departure is not workable:

- In some cases tax treaties will mean the UK does not have a right to collect the tax that would otherwise be due.
- In other cases HMRC will just not know about the chargeable events. Even with the greater flow of information that will occur as a result of the Common Reporting Standard coming into effect, where both the individual and the assets are outside the UK for such a long time there will be many events that HMRC simply does not know about and a significant amount of tax that will not be collected through the ignorance of the individual and HMRC.

41. Overall, therefore, the proposal should be amended. Our recommendation is to retain the three-year rule for individuals who were UK domiciliaries when they left the UK and have shed their UK domicile and to align with this add a further condition to the 15 out of 20 test where the individual is not UK resident in the relevant tax year to say the test would only apply if the individual was resident in the UK in the three immediately preceding years.

42. There appears to be a typo in the current draft IHT legislation (the unnecessary word is shown below in red and struck through):

(1) In section 267 of IHTA 1984 (persons treated as domiciled in the United Kingdom), in subsection (1)— (a) in paragraph (a), omit the final “or”; (b) after that paragraph insert— “(aa) the following conditions are met— (i) he was born in the United Kingdom, (ii) his domicile of origin at the time of his birth was in the United Kingdom, (iii) he was resident in the United Kingdom for the tax year in which the relevant time falls, and (iv) he was resident in the United Kingdom for at least one of the two tax years immediately preceding the tax years in which the relevant time falls, or”; (c) in paragraph (b)— (i) for the words from “in not less than” to “the year of assessment” substitute “for at least ~~than~~ fifteen of the twenty tax years immediately preceding the tax year”;

Q5: Do stakeholders agree that the period a spouse needs to remain non-resident before the inheritance tax spouse election ceases to have effect should be amended to 6 years?

43. We agree the period of UK residence required to lose deemed domicile acquired either as a result of meeting the 15 out of 20 test or making the IHT spouse election should be aligned. However, for all the reasons explained above, we do not consider that it is practical to specify a six tax year period of non-residence is required to break any kind of deemed domicile status.

If, despite our comments, the government decides to extend the period of non-residence required there should be a transitional provision so that elections made prior to 6 April 2017 are subject to the old rules (the four year period) if they were made prior to the government announcing the extended period of non-residence.

Questions (6- 9) on the proposal to treat those who are born in the UK with a UK domicile of origin as domiciled while they are living in the UK:

Q6: In what circumstances would having a short grace period for inheritance tax help to produce a fair outcome?

44. We appreciate the Government wishes to restrict access to the benefits of the remittance basis to prevent those with close connections to the UK avoiding paying their "fair share" of tax. However, the criteria of "born in the UK with a UK domicile of origin" goes too far, catching individuals who severed ties to the UK long ago and may only have to return for limited or one off family or work purposes. For example:

- Louisa is born in the UK to parents who are married and the father has a UK domicile of origin. A year later the family emigrates to New Zealand and Louisa acquires a domicile of dependency in Auckland. She becomes a citizen of New Zealand and lives there for 50 years. Louisa only returns to the UK as an aunt has become very unwell and needs nursing in the last years of her life. Louisa is in the UK for around three tax years. The new provisions will mean that she cannot access the remittance basis and should she die whilst she is UK resident her worldwide estate will be subject to IHT.
- Thelma is born in the UK to parents who are married and the father has a UK domicile of origin. A year later the family emigrates to Canada and she acquires a domicile of dependency in Ontario. Thelma becomes a Canadian citizen and lives in Canada for 40 years. She gets seconded to London for a 3-year period at the end of which she intends to return to Ontario. The new provisions will mean that Thelma cannot access the remittance basis (including not being able to benefit from Overseas Workday Relief) and should she die whilst she is UK resident her worldwide estate will be subject to IHT.

45. The provisions are not fair, reasonable or proportionate and could be contrary to EU law.

46. We are particularly concerned about the impact on how competitive the UK economy is seen as being, since this may put off multinational employers, if they are to do business in the UK multinational companies will need to second employees to the UK and will want to be able to second the best employee for the job.

47. The suggested rules are penal and affected employees with actual foreign domiciles of choice will either not want to come to the UK or look to the employer to provide a remuneration package to compensate them, so they are in the same position as unaffected colleagues would be in they had been seconded here. This will restrict the flexibility of employers as they will either not be able to have who they want where they want or they will have to pay more for it. Neither option is likely to be attractive and may in time lead to the employer deciding to downscale the UK operation and look to somewhere with a simpler and less arbitrary tax system.

48. To avoid these issues at a minimum there should be a three-year period of grace. This would align with the period for overseas workday relief and national insurance provisions.

Q7: What difficulties do stakeholders envisage there could be for trustees tasked with calculating the 10-year change in these circumstances?

49. We can understand why the Government does not want trusts that the individual can benefit from to escape the UK IHT net but it is unfair for trusts settled when the individual was foreign domiciled and that he or she cannot benefit from to also be caught. This is particularly harsh for foreign charities (that do not qualify for IHT relief as they do not come within our Taxes Acts definition of charity because of their geographical location).

50. Where the settlor can benefit from the trusts rather than have to calculate ten year charges, whilst he or she is UK resident, it would be easier to switch off the relevant property rules such that, just for these specific purposes, only the gift with reservation of benefit provisions apply (that is to say, the property is seen to be within the estate of the individual).

51. If the proposal in the consultation document is progressed it will be essential for a pragmatic approach to be adopted to calculating the tax charge as many trustees will not have kept the historic information that will be required to calculate ten year charges and the settlor may not be able to remember the history. As such, where there is no evidence to the contrary it may be necessary to assume for the purposes of the calculations that the settlor had a full nil rate band available and there were no related settlements.

52. The issues could become more complex where the settlor is UK resident on the date of the ten year anniversary but has drifted in and out of UK residence in the ten year period. It appears that in these circumstances the trust property will only be seen as relevant property during the time the settlor is UK resident. There would need to be communication between the settlor and the trustees (which could have broken down where the settlor is not a beneficiary of the trust) for the charge to be calculated accurately. These issues would be avoided if our suggestions in paragraph 50 are taken forward.

Q8: Do stakeholders agree this is the most reasonable way to deliver these reforms? Are there any circumstances when applying these rules would produce unfair outcomes?

and

Q9: Would the rules as described leave any significant uncertainty? If so, how?

53. As set down in our key issues and the answer to question 6 above, we do not think that having special rules targeting those born in the UK with a UK domicile of origin is fair. This is because these individuals may be as internationally mobile as any other foreign domiciliary and with as few ties to the UK, indeed in some cases the individual may be more internationally mobile and have fewer UK ties.

54. Having said all of the above, we consider that the proposals for leaving the UK are reasonable as (provided they remain foreign domiciled and do not fail the 15 out of 20 test) the individual can shed deemed domicile status in the first tax year they are not UK resident.

APPENDIX 1

DISCUSSION DRAFT – POSSIBLE TREATMENT OF OFFSHORE SETTLEMENTS FOR NON-DOMICILIARIES AFTER 6 APRIL 2017

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Background

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Policy objectives and constraints

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Background

This paper has been prepared by representatives of the CIOT, Law Society, STEP and ICAEW who attended a meeting with HM Treasury and HM Revenue & Customs on 9 October 2015. It describes in more detail one possible way in which trusts with non-domiciled settlors / beneficiaries could be taxed after 6 April 2017.

Please note that:

- While this paper is produced by representatives of the above bodies, **it is intended merely as a discussion draft**. It does not constitute the formal policy of any of those bodies and has not (yet) been through the full review procedures of those bodies. As such it should not be attributed as the official view of those bodies

- This paper is intended merely as an outline of one possible method of taxing offshore trusts. More detail would be needed to flesh-out this proposal.

Executive Summary

We consider that the "dry benefits" tax charge set out in the condoc has a number of insurmountable problems. This is the unanimous view of all those participating and we are aiming to send you a separate note shortly about the many issues which arise under that proposal.

In its place this paper proposes a modified version of the existing non-transferor charge (s731 ITA and s87 TCGA) as the basis for taxing non-resident trusts set up by all non-doms. The essential elements of this are as follows.

Proposal	Outline of legislative changes
• No (or only minor) changes for UK domiciled settlors (including "returning doms")	
• We consider it essential that there should be a single coherent regime applicable to all settlors and beneficiaries of trusts set up by a non-domiciled settlor.	
• UK source income continues to be taxed on settlor (if settlor-interested). A subsequent actual payment of the taxed income should not be taxable.	s624 ITTOIA and s721 ITA restricted to UK source income and aligned more closely
• No changes to the current tax treatment of a life tenant of an IIP trust	
• All other income and gains (e.g. foreign source) to be matched with benefits / capital payments. Remittance basis may apply to foreign benefits. Deemed domiciled beneficiaries (including the settlor) taxed on worldwide benefits. Income genuinely paid away or used to pay expenses ceases to be relevant income.	s731 ITA and s87 TCGA largely unchanged. Amend s735 so that remittance rules only apply if benefit received in or remitted to the UK, not if the relevant income is remitted to the UK.
• Potentially combine s731 and s87 into a single code. This might involve loss of motive defence for non-transferor charge although we would only support the loss of the motive defence as a quid-pro-quo for the other changes suggested below.	Alternatively, s731 ITA repealed and s87 TCGA expanded to cover both income and gains. Possibly amend s736 to s742 ITA accordingly.
• Switching off imputation of income to settlor prior to deemed domicile could be made dependent on the settlor being a remittance basis user. This would have advantage that trustees could remit income to the UK in their own hands for investment.	Amendments to s809B ff. Potentially amend s809M so that a trust is not a relevant person in relation to trust income[1] Appropriate amendments to s624 ITTOIA and s721 ITA.
• Transitional provisions for existing trusts as at 6 April 2017 and those where settlor/beneficiaries newly arrive in the UK for the first time.	

[1] It could remain a relevant person in relation to income/gains of the settlor.

Policy objectives and constraints

While preparing this paper it has become apparent that the policy objectives that the government wishes to achieve in relation to offshore trusts – and particularly the priority between competing objectives - are not entirely clear. We think it is helpful, therefore, to set out our understanding of those objectives (as we discern them from conversations with HMRC and Treasury and from the consultation documents which have been issued). This should help to clarify any misunderstandings at an early stage. We believe that the policy objectives (in approximate order of priority) are as follows:

1 = The new non-residents trusts regime for non-doms should deliberately act as something of a counter-balance to the major changes to the taxation of non-doms announced in July whereby under the so-called deemed domicile proposals non-doms will be taxed on their worldwide personal income and gains after 15 years. It should enable non-dom settlors and beneficiaries to remain in the UK without extensive reporting and compliance obligations on what are often international trusts with little connection to the UK provided that, and for as long as, they do not receive benefits from such trusts.

1 = The new regime should not be unduly favourable or have significant yield implications but it has to be recognised that any change will inevitably bring winners and losers and in many ways yield from trusts will be unpredictable. In some respects the regime for trusts suggested below could bring significant yield for UK PLC not least in that it simplifies the current over complex regime and encourages trusts to invest in the UK.

2 The proposals should not leave scope for avoidance – but recognising in that statement that "avoidance" does not include taking advantage of a relief clearly afforded by Parliament. Consequently, recognising the above two objectives, the straightforward use of offshore trusts to give a better position than would have been the case had assets been owned personally, does not amount to avoidance for these purposes.

3. The regime should be as coherent as possible – that is to say that the income tax and capital gains tax aspects of it should hang together and not be subject (as they are at present) to radically different codes. Within that objective, the regime should be as simple as possible, but recognising that this is a tertiary objective which may need to be compromised in favour of the objectives listed above. It also needs to be borne in mind that trusts come in many shapes and forms and, when coupled with the range of permutations thrown up by the residence, domicile and deemed domicile of settlor and beneficiaries, this inevitably creates a complex position.

4. The position for UK resident AND domiciled settlors should remain largely as it is now. The proposals below are aimed at trusts set up by foreign domiciled settlors. As a general principle we do not think there should be different tax regimes operating before or after the 15 year cut off or between UK and foreign domiciled beneficiaries (other than UK domiciled settlors). Further, there should be a single regime which applies to all trusts created by settlors who were non-domiciled and not deemed domiciled at the time. The availability of alternative regimes is likely to lead to unacceptable complexity and difficulties in application. Of course there may be differences in impact because of the remittance basis but the same regimes should operate.

5. We would also note that the remittance basis has always contained an inherent contradiction within it. The remittance basis has always acted as an incentive to non-doms to remain in the UK, but at the same time it has acted as a disincentive for them to bring funds into the UK (to the detriment of creating economic activity in the UK). While respecting that the government has made a policy decision not to alter the fundamentals of the remittance basis as part of this package of measures, it is our view that if the proposals can meet the above objectives (particularly in terms of yield) then to the extent to which they may permit funds to be brought into the UK (thereby being attractive to non-doms and good for the UK economy) this should be considered as a positive feature, even though it may spoil the "purity" of the remittance basis.

Proposals

A. Proposals to apply only to "settlements"

In the same way that other offshore structures, such as insurance bonds and offshore mutual funds, have their own separate regime, we would propose that offshore "settlements" should be subject to their own single regime as described below.

The following proposals therefore apply only to "settlements" – that is trusts, trust-like equivalents[2], and (see further below) companies owned by trusts.

The Transfer of Assets code would be kept as a residual category for stand-alone companies and other non-trust structures.

B. UK domiciled settlors

Where the settlor is UK resident and either actually domiciled or a "returning dom"[3] then the present rules should remain. Some limited aspects of the following proposals might be adopted to ensure consistency.

The following therefore applies only to non-UK domiciled settlors[4].

C. Same rules to apply before and after "year 15"

In our view there are significant difficulties with a very different regime applying before and after "year 15". For instance there would be scope for planning either side of that anniversary. There would be further issues if a settlor subsequently lost deemed domicile through 6 years of non-residence.

We therefore propose that the same rules, but with modified effect, should apply throughout.

The following proposals ensure a consistent regime applies to settlements without the trustees having to keep track of the deemed domicile status of the settlor. However, although the regime is consistent the effects vary – in particular after "year 15" the settlor will be incapable of being an RBU and would therefore be taxed (see F below) on worldwide benefits.

D. UK source income

UK source income is taxed broadly[5] as at present, i.e.:

- on the Settlor if the settlor is UK resident and the trust is settlor-interested
- otherwise on the life-tenant if there is one;

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[2] For instance Foundations to the extent to which they are akin to trusts
[3] i.e. under the new proposals he had a UK domicile of origin; was born in the UK; and is now UK resident.
[4] We suggest that the deemed domicile status of the settlor should be irrelevant: in practice deemed domiciled settlors are unlikely to create new settlements due to the inheritance tax entry-charge.
[5] We think it would be helpful to clarify the following order of priority and to eliminate the possibility of double-charging (e.g. trust is settlor-interested, but income is actually distributed to another UK resident)

- potentially - depending upon the exact situation - on the trustees themselves
- otherwise on the recipient if it is distributed as income.

If none of the above apply the UK source income is taxed under the matching rules described at F below.

Once income is taxed under the above, it is not taxed again if it is subsequently distributed[6].

E. Non-UK source income

Non-UK source income should be taxed:

- on the Settlor if UK resident and either:
    - the Settlor, the Settlor's spouse or the Settlor's minor children have an IIP in that income; or
    - it is otherwise distributed as income to any of them;
- on the recipient (or person entitled) if it is distributed as income to any other person or that other person has an IIP in that income;
- otherwise under the matching rules described at F below.

Any credits attached to such income should be available to the taxpayer in the same way as at present. Once attributed to a taxpayer under any of the above, the income would no longer be available to be matched[7] and would not be taxed again if it is subsequently distributed.

Income attributed to a person in accordance with the above would be taxed according to the residence, domicile and RBU status of that person.

F. Matching rules for other income

Any income not taxed in accordance with the above[8] would be matched either under s731 ITA or a modified form of those provisions as described in H below.

This would apply to income that has been retained in the trust (whether formally accumulated or simply rolled-up) and which has not been distributed or used to pay expenses.

The matching would apply to beneficiaries wherever resident[9].

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[6] Income which arises at the "bottom" of a structure and which is taxed in accordance with these rules should not create a new source of income or chargeable gains if it is paid up through the structure.
[7] i.e. in present terminology, it would cease to be "relevant income".
[8] Given D above, this will principally be foreign income. It applies to (undistributed) UK income only where the settlor is deceased, non-resident or the trust is not settlor-interested.
[9] Any perceived avoidance can be tackled as it could now by a combination of more rigorous enforcement against "conduit" arrangements and greater use of the GAAR. A specific GAAR example could be put to the GAAR panel for approval if desired.

If the beneficiary was UK resident this would give rise to a tax charge but – as is currently the case for capital gains – the deemed income would be treated as having the same source as the benefit with which it had been matched. Consequently:

- benefits received in the UK would therefore automatically be taxed;
- benefits received anywhere in the world by a deemed domiciled recipient would also be taxed;
- benefits received outside the UK would potentially be subject to the remittance basis if the recipient is an RBU.

s731 should ideally be put onto a LIFO basis[10]. This would, in practice, address many of the problems of lack of records.

G. Capital gains treatment as at present

The capital gains position of trusts would be largely as at present.

H. Possible assimilation of s731 and s87

The matching proposals described at F and G above could be dealt with under the existing s731 and s87 mechanisms in a modified form.

However, we think that there is scope within the proposal to go further. Although this is not a necessary part of our proposals we think that there is a good case for amalgamating s731 and s87 into a single regime. The regime would broadly match income first (subject to income tax); OIGs (subject to income tax) second; and capital gains third (subject to capital gains tax + supplementary charge as appropriate).

A single matching code would be a significant improvement in many regards. It would remove many of the difficulties that there are at present – for instance around offshore income gains; around the fact that s731 matches on a FIFO basis but s87 on a LIFO basis; and the difficulties with s733 matching. It would also give less scope for interstices between the two codes.

Thought would need to be given to whether full alignment of s87 and s731 is possible and, in particular, to companies owned by trusts.

The price for amalgamation might be the loss of the motive defence for non-transferor trust cases[11]. **We should only support the removal of the motive defence as part of an assimilation of s731 & s87 in the form outlined in this section H and the proposals at section F.**

[10] Under our proposals at H, it would inevitably be put onto the same basis as s87, but we consider that it should be in any event.

[11] As mentioned above, the Transfer of Assets regime would remain as a residual category for non-trust cases

Additional Proposals

The following additional proposals should also be adopted although they are not part of our core proposal.

I. Transitional rules

There should be transitional rules for trusts created before 6 April 2017 and for those arriving in the UK for the first time. This would address the main difficulty, as identified in the condoc, of lack of records.

J. No anti-forestalling rules

There should be no anti-forestalling rules. It is of the essence of the period until 6 April 2017 that non-doms should have a sensible chance to re-organise their affairs.

K. Schedules 4B and 4C should be removed

This should be accompanied by (panel approved) GAAR guidance saying that any arrangements designed along flip-flop lines would be considered to be caught by the GAAR.

L. Carried interest

The overriding policy, as stated in the condoc, of only taxing benefits should be followed through consistently. In particular, carried interest held by trusts should not face double-taxation as it may do under the recent proposals.

Comments

While we have aimed to formulate proposals that meet the perceived objectives in a balanced way, we recognise that some of our proposals above have pros and cons. We attempt to summarise some possible concerns in this section.

	Pros	**Cons**
C	Our proposals result in a consistent regime both before and after “year 15” and have major advantages in allowing the trustees to remit foreign-source income into the UK (in their own hands) for investment without thereby causing a remittance for the settlor (see F below). We think that having a very different regime before and after “year 15” would cause significant anomalies.	We recognise that, in allowing foreign source income to roll-up within trusts prior to “year 15”, there might be concern that non-doms might come to view trusts as a cheaper alternative to paying the RBC from year 8 to 15. We think that this concern is overstated (because in not paying the RBC, worldwide benefits would then be matched). However, the position could be kept under review and if the government perceived trusts to be “abused” in this way then it would be possible – **<u>although we do not necessarily support this</u>** - for the switching off of s720/624/s727 to be made dependent (on a tax-year by tax-year basis) to the settlor being an RBU in that year[12].
F	Our proposals for income represent a major simplification of the current system where we currently have a combination of imputation (to settlor); tracing (to see whether remittance) and matching codes. In particular, this would enable the trustees to bring trust (or underlying corporate) income[13] into the UK in their own hands for investment without (as is presently the case) thereby causing a remittance for the settlor or beneficiary. We think that this would have significant advantages both for trustees and for the UK economy.	We recognise that under our matching proposals benefits will give rise to deemed foreign income, even if the relevant income is UK source. However, given D above, this will only apply to UK source income in a limited range of cases (see footnote 8). Furthermore, the deeming as foreign income will be irrelevant for beneficiaries after "year 15" anyway. As such we think that a good case can be made for a single pool – which we note is currently the case for CGT under s87 TCGA. The switching-off of the motive defence in non-transferor cases is, in our view, a possible quid-pro-quo for this (see H above)

[12] This would potentially cause further “anomalies” in that settlors would have to pay the RBC from years 8-15 in order to switch-off s720 but after year 15 it would switch off automatically. That said, after year 15, settlors would be taxed on worldwide benefits whereas before year 15 they would only be taxed on UK benefits – so there is some asymmetrical logic to this. Briefly, however, we think that “anomalies” will arise whatever system is adopted.

[13] Note that this would apply just to trust (or underlying corporate) income. It would not apply to the settlor’s own income (which he might have settled into the trust) as the trust would still be a relevant person in relation to the settlor’s income.

APPENDIX 2

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 via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).