



TAXREP 29/12

(ICAEW REP 105/12)

ICAEW TAX REPRESENTATION

FINANCE BILL (No 4) 2012 - BRIEFING

FOREIGN INCOME AND GAINS - CLAUSE 47 AND SCHEDULE 12

Briefing submitted in June 2012 by ICAEW Tax Faculty in relation to the Foreign Income and Gains provisions in Finance Bill 2012

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INTRODUCTION

1. ICAEW submitted Briefings to the Public Bill Committee on various clauses in Finance (No 4) Bill 2012. The present TAXREP reproduces the content of the Briefing on the provisions in clause 47 and Schedule 12 relating to Foreign Income and Gains.

WHO WE ARE

2. 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 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. 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.
4. 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.

BRIEFING

FOREIGN INCOME AND GAINS (Clause 47 and Schedule 12)

Clause 47 and Schedule 12 introduce changes to the remittance basis of taxation that applies to UK resident but non-domiciled taxpayers. The four parts are as follows:

- Part 1 increases the remittance basis charge from £30,000 to £50,000 for individuals claiming the remittance basis and who have been UK resident for twelve or more of the fourteen tax years preceding the tax year of claim;
- Part 2, which comprises most of the Schedule, introduces an important new relief to encourage business investment in the UK without triggering the remittance basis charge; and
- Parts 3 and 4 simplify the existing rules relating to:
 - sales of exempt property (Part 3); and
 - nominated income (Part 4).

A short note at the end of this briefing provides the background to the proposed measures. The changes in Part 2 in particular are designed to encourage investment and growth in the UK and is therefore important parts of the Government's growth agenda. The changes in Part 3 are designed to ensure that the UK remains an attractive international sales market, again encouraging growth. We would like to place on record our appreciation of the open and constructive way in which the consultation process on these changes was carried out by HM Treasury and HMRC.

KEY POINTS

For the most part our key points address areas of the legislation where we consider that amendments are required to remove uncertainty. Non-domiciles have a choice in where they invest their money or sell their assets. If the legislation is unclear and/or uncertain they will quite simply avoid the UK, thereby potentially reducing potential investment in the UK and damaging growth.

The detailed comments below amplify the key points and suggest possible amendments to the legislation. We have set out proposed amendments where the drafting is straightforward but in other cases our suggestions would need to be considered further by Parliamentary Counsel.

Our key points are:

Part 2 – Remittance for investment purposes

- We believe the policy intention is that the business investment relief should apply in the following situations:
 - where a UK resident foreign domicile makes an investment in the UK in a close company (or a foreign company that would be close if it were UK resident) and that company (being a relevant person in connection with the individual) uses the funds in the UK;
 - where an individual makes an investment offshore in a foreign company which would be close if UK resident and that company (being a relevant person in connection with the individual) brings to/uses the funds in the UK; and
 - where an individual makes an investment in a company by taking out a loan and remittance basis foreign income or gains are used to service the loan and/or make repayments of capital.

However, we consider that draft legislation does not achieve relief in these circumstances. It therefore needs to be amended so that it does.

- A pre-transaction clearance procedure is essential if the legislation is to achieve its policy objective of attracting inward investment.
- Taxpayers should be a right of appeal to the First Tier Tribunal where HMRC does not agree to extend the grace period for the appropriate mitigation steps.
- If a relevant person other than the taxpayer made the qualifying investment it should not be necessary for the disposal proceeds to be taken offshore if a potentially chargeable event occurs. The taxpayer should be able to take an equivalent sum offshore.
- We remain of the view that a qualifying company becoming listed should not be a potentially chargeable event. It seems perverse to force an investor to dispose of their investment in a successful UK company to satisfy the conditions for the business relief.

Part 3 – Sales of exempt property

- We understand that one of the policy intentions is to exclude sales of property derived wholly or partly from clean capital from the capital gains tax (CGT) exemption. We believe that this policy intention will significantly reduce the benefit of this measure to the UK economy.
- If this is the policy intention, we do not think that the proposed legislation achieves this intention.

Part 4 – Nominated income

- We suggest a further simplification of these rules to allow an election, with a four year time limit, to amend previous elections.

We would be happy to provide further information on anything set down within this briefing or to meet to discuss these issues in more detail. For further information please contact Tax Faculty head Frank Haskew on 020 7920 8618 or Sarah Buckley, Public Affairs Manager, on 020 7920 8694.

DETAILED COMMENTS ON SCHEDULE 12

We submitted our detailed comments on the draft legislation published on 6 December in TAXREP 3/12 and are pleased that a number of our concerns have been addressed. The complexity of the remittance basis of taxation has meant that carving out new reliefs has not been a simple process. It is likely that, as the legislation is applied, practical issues will arise. We hope that the government will keep this under review and address any such issues in the next Finance Bill.

PART 1 – INCREASED REMITTANCE BASIS CHARGE

We have no comments to make. We do, however, welcome the commitment made by the Chancellor that there will be no further increases to the remittance basis charge during the lifetime of this Parliament.

PART 2 – REMITTANCE FOR INVESTMENT PURPOSES

Part 2 enacts a relief aimed at attracting significant additional investment in the UK by foreign domiciles. We support this policy objective which helps to support the Government's growth agenda. We do, however, have concerns that the legislation as currently drafted may undermine the policy objective and thereby reduce the UK growth potential.

Foreign domiciles have various investment choices and this relief will only be successful if they can be certain that they come within the terms of the exemption. It is vital therefore that the meaning of the legislation is clear and provides the necessary degree of certainty.

Given the importance of absolute clarity in order to achieve the policy objective, it is not sufficient for any shortcomings in the legislation to be addressed by way of HMRC guidance. While we appreciate the intention behind any such guidance, the fact remains that any such guidance has no statutory authority and can be changed at any time.

General comments

Investment in a close company or a company which would be close if it were UK resident

This was a major concern that we raised in TAXREP3/12. We understand that HMRC believes that where a qualifying investment has been made in a close company the use of the invested funds by that company will not trigger s 809L, Income Tax Act 2007 (ITA 2007) and therefore no remittance will occur because:

- once a qualifying investment is made, the foreign income and gains are not treated as a taxable remittance by virtue of s 809VA(2); and
- those income and gains will only subsequently become taxable in the UK where a potentially chargeable event occurs and the investor fails to take the appropriate mitigation steps within the grace period.

However, we do not consider that the draft legislation achieves this. Under s809VA(2) the relief can only apply where the conditions in s 809VA(1) are met. For this to be the case there must both be a relevant event and, but for the relief, the relevant event would result in a remittance.

We believe this causes two problems as set out below.

- Where the qualifying investment has been made by the relevant person bringing funds into the UK it is clear that the investment is exempt. However, where the investment is in a company which is a relevant person in connection with the taxpayer, we do not think that the wording of the legislation operates to make it clear that the subsequent use of the invested funds by the company will also be exempt.

Suggested amendment

On page 294, line 16 add the following words to the end of s 809VA(2):

‘unless and until a potentially chargeable event occurs at which point the question of whether there is a UK remittance will be determined by the provisions at s 809VI.’

- Where there is an investment offshore in a foreign company the investment itself cannot give rise to a remittance, this means that s 809VA(1)(b) cannot be met and the relief cannot, therefore, apply. There would therefore be a problem if the company brings to/uses the funds in the UK.

Suggested amendment

On page 294, line 13 add the following words to the end of s 809VA(2) after the words 'by virtue of that event' add:

'or any subsequent action which may be taken by the qualifying company with respect to the funds invested provided no benefit is provided to a relevant person'

Relevant debt issue

Where an individual makes an investment in a company by taking out a loan the relief will not generally be in point as bringing loaned funds into the UK will not normally give rise to a taxable remittance. However, the subsequent use of remittance basis foreign income and/or gains to service the loan and/or make repayments of capital is not covered by the proposed relief.

Suggested amendment

The legislation should be extended to provide relief in this circumstance to enable an investment in the UK to be funded by this method.

The need for a clearance procedure

The December 2011 response document indicated that the Government accepted that there would need to be a clearance procedure to provide investors with pre-transaction certainty. An efficient pre-transaction clearance procedure is essential if this legislation is to be successful in its policy objective of attracting significant additional investment to the UK. This is particularly important given the wide anti-avoidance provision at s 809VA(7), which, if read literally, makes the legislation inoperable.

Comments on the legislation

Sections 809VA(6) and 809VB(3) – These sub-sections require amounts to be determined on a 'just and reasonable basis'. In both contexts a 'just and reasonable basis' would be apportionment and to provide greater certainty we suggest that this word is substituted.

Suggested amendments

On page 294, line 34, substitute the words 'by apportionment' for 'on a just and reasonable basis'.

On page 295, line 12, substitute the words 'by apportionment' for 'on a just and reasonable basis'

Section 809VH(4)(b) – the reference to a company in which the target company 'intends to make an investment' should be removed. Legislation which needs to provide certainty should not include references to intentions. Intentions can be frustrated and may be difficult to prove.

Suggested amendment

On page 299, line 36, after 'in which it has made' delete the words 'or intends to make'.

Section 809VJ(1)(b) – actions of relevant persons other than the taxpayer can result in a potentially chargeable event. It is important that HMRC officers are instructed to apply this part of the legislation reasonably by reference to all the circumstances. Where the relevant person is, for example, an estranged spouse the taxpayer may not know what actions have been taken.

Section 809VJ(4) – the explanatory notes give some example of cases where it is thought regulations will be introduced to extend the grace period. We welcome this. However, if a stock exchange listing remains as a potentially chargeable event, we consider that an extended grace

period should be allowed where there is no lock in period, but where selling so soon after the listing could damage the company.

Section 809VJ(7) – it is important that requests to extend the grace period because of exceptional circumstances are dealt with by appropriately experienced and trained HMRC officers. The promised guidance cannot cover every eventuality and requests should not be denied because they are outside the examples in the guidance. We suggest that a taxpayer be given the right to appeal to the First Tier Tribunal should HMRC refuse an extension request.

Sections 809Z9(4)(b), 809Z9(6) and 809Z(9) – we welcome this legislation but consider it to be too narrowly drafted. It should be extended to permit the taxpayer to take offshore an equivalent sum where a relevant person other than the taxpayer disposes of all or part of holding. In this circumstance a taxpayer cannot direct what the relevant person does, so the requirement that the sales proceeds be exported may be impossible to comply with and a remittance basis charge will be triggered.

In addition, if the listing of a company is the chargeable event we consider it must be beneficial to the UK economy to allow the taxpayer to take out an equivalent sum. If this is not done the foreign domiciled individual is forced to sell the UK quoted shares to satisfy the requirement.

PARTS 3 AND 4 SIMPLIFICATION MEASURES

The new tax regime for the taxation of non-domiciled individuals, introduced in the Finance Act 2008, included a number of provisions that were so complicated that in some cases it is difficult, if not impossible, for taxpayers to be fully compliant. We therefore welcome the simplification measures in Parts 3 and 4 of this Bill and the promise of further measures in Finance Bill 2013. We look forward to participating in the consultation process in due course and would be delighted to meet with HMRC to discuss our concerns in more detail and how they may be addressed.

Part 3 – sales of exempt property

Part 3 introduces a new exemption for the tax which would arise on the remittance of foreign income and gains when exempt property is sold in the UK. It also treats any UK gain which arises on such sales as a foreign chargeable gain.

We understand from the explanatory note, and subsequent discussions with HMRC, that it is intended that the CGT exemption is only to apply where the property sold was wholly or partly derived from remittance basis income and/or gains. Paragraph 196 of the explanatory note states that 'Exempt property does not include property which derives wholly from capital or from UK income and gains or a combination of the two'.

We have two particular concerns as set out below.

- Excluding property which derives wholly from clean capital from the CGT exemption will significantly reduce the benefit of this measure to the UK economy. Furthermore, foreign domiciles may have sets (such as artwork by the same artist or chattels) which they wish to sell as one lot to achieve the optimum price. A set may have been acquired over a period of time using a mix of funds, including clean capital. If the capital gain on the sale is wholly or partly subject to UK capital gains tax, the foreign domicile will simply sell the property overseas and not in the UK.
- We do not agree, in any event, with HMRC's interpretation of s 809X, ITA 2007 and thus consider the legislation does not work as intended. We do not consider that the definition of exempt property within s 809X, ITA 2007 specifies that the property must derive wholly or partly from remittance basis income and/or gains. We consider that, on a literal interpretation, property derived entirely from clean capital qualifies for the foreign situs asset deeming provision. The purposive construction of the section by HMRC results in a chargeable UK gain on an asset brought to the UK for sale which has been purchased

wholly from clean capital. In addition, where the asset derives from a mixed fund the CGT exemption will only be available on the proportion of the property which derives from remittance basis income and gains.

We suggest that it is accepted that s 809X does **not** specify that the property must derive wholly or partially from remittance basis income and gains.

If, however, the policy intention is to subject the whole or the part of the gain that derives from clean capital to UK capital gains tax, then the legislation needs to be amended to make this clear. Any uncertainty will simply undermine the proposals.

Part 4 – Nominated income

We welcome this part of the legislation as it should deliver real simplification for remittance basis users. It means that in the future there will be no need to ring-fence nominated funds.

As a further simplification we suggest the inclusion in the legislation of an election to allow individuals to apply the 2012/13 rules in prior tax years (going back to 2008/09). Such a provision would assist in reducing the large number of small bank accounts that are currently ring-fenced. It would be revenue neutral for the Exchequer but would be a real simplification in terms of compliance costs.

BACKGROUND

In general terms UK residents are required to pay UK tax on their worldwide income and capital gains. However, non-UK domiciled individuals may claim to pay tax on the remittance basis, which is they pay UK tax on their UK income/gains and their foreign income/gains to the extent that they are brought in ('remitted') to the UK.

Long term UK residents, those who have been resident in the UK for seven out of the last nine tax years, pay an annual remittance basis charge of £30,000 to access the remittance basis. The Finance Bill increases this charge to £50,000 for those who have been resident for twelve of the fourteen tax years preceding the year of claim.

The new business investment relief in the Finance Bill aims to encourage UK resident but non-domiciled taxpayers to invest in the UK and thereby help to encourage growth. This relief will enable a UK resident non-domicile to bring their overseas income/gains to the UK to invest in UK trading companies without an immediate charge to UK tax on the remittance of those funds. The companies in which an investment is permitted must, in broad terms, be a private limited company whose shares are not listed on a recognised stock exchange and which carries on a commercial trade.

Under the current remittance basis rules assets purchased overseas using foreign income/gains are normally liable to tax when they are brought to the UK. There are limited exemptions for certain assets, eg works of art, known as 'exempt assets', to be brought to the UK without incurring a tax charge. However, these exemptions are not available where the asset in question is subsequently sold in the UK. In this situation a charge to tax arises under the normal rules. The new exemption in the Finance Bill provides that exempt property sold in the UK will not be treated as a taxable remittance when sold and no capital gain arises on that sale until the money is subsequently remitted to the UK. The new exemption is intended to make the UK a more attractive place for the sale of assets by non-domiciled individuals.

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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)