



ICAEW REPRESENTATION 13/17

TAX REPRESENTATION

Reforms to the taxation of non-domiciliaries and offshore trusts

ICAEW welcomes the opportunity to comment on the [draft Finance Bill 2017 legislation](#) published by HMRC on 5 December 2016 and in particular the reforms to the taxation of non-domiciliaries and offshore trusts:

- draft clause 18: Business Investment Relief
- draft clause 40 & sch 12: deemed domicile: income tax and capital gains tax
- draft clause 41: deemed domicile: inheritance tax
- draft clause 42 & sch 13: overseas property with value attributable to UK residential property

This response of 1 February 2017 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 1 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.

CONTENTS	Para
General comments	1-12
Business Investment Relief (Clause 18)	
Background	13-14
Measure	15
Deemed domicile (Clauses 40 and 41 and Sch 12)	
Background	16
Measure: Clause 40	17
Measure: Clause 41	18
Measure: Schedule 12 Part 1 Paragraphs 4 & 5	19
Measure: Schedule 12 Part 1 Paragraphs 15 & 16	20
Measure: Schedule 12 Part 2 Paragraph 18	21
Measure: Schedule 12 Part 2 Paragraph 19(1) (General)	22
Measure: Schedule 12 Part 2 Paragraph 19(1) (s87D) Disregard of capital payments to non residents	23
Measure: Schedule 12 Part 2 Paragraph 19(1) (s87G) Cases where settlor liable for section 87 charge on closely-related beneficiary	24
Measure: Schedule 12 Part 2 Paragraph 19(1) (s87I) Non-UK resident settlements: attribution of gains to onward gifts	25
Measure: Schedule 12 Part 2 Paragraph 19(2)	26
Measure: Schedule 12 Part 2 Paragraph 19(4) & (8)	27
Measure: Schedule 12 Part 3 Paragraph 21 Capital gains tax rebasing	28
Measure: Schedule 12 Part 4 Paragraph 24 Cleansing of mixed funds	29



ICAEW REPRESENTATION 13/17

TAX REPRESENTATION

IHT on overseas property (Clauses 42 and Sch 13)		
	Background	30
	Measure: Clause 42	31
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(1)	32
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(2)	33
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(5)	34
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 3	35
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 4	36
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 4 & 5 General	37
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 5(4)	38
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 6	39
	Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 10	40
Queries on the Draft Finance Bill 2017 legislation submitted to HMRC		App 1
ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM		App 2

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 147,000 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.

Copyright © ICAEW 2017
All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

GENERAL COMMENTS

1. We appreciate that our views have been requested on the draft Finance Bill 2017 legislation published in December 2016 and we provide detailed comments on the clauses below. We are concerned about the implementation date and recommend that it is deferred until 6 April 2018.
2. Whilst we appreciate that the changes were originally announced in Summer 2015 various issues have meant that, as matters stand today, less than 3 months before the proposed changes are due to take effect, we have yet to see various parts of the necessary legislation. Most importantly we have not seen the draft legislation relating to the income tax position of foreign resident trusts. In addition what has been published relating to both the capital gains tax (CGT) position of foreign resident trusts and the IHT position of UK resident property is, we understand, still being worked on. How substantial the amendments will be is as yet unknown although they may be significant. As set down in the specific comments below, there are a number of clarifying measures that need to be made to the draft December 2016 legislation and the legislation published in December 2016 was incomplete.
3. Until there is reasonable clarity as to what the changes will entail, the UK's non-domiciliary population are faced with considerable uncertainty about the tax consequences of any actions they take and enable them to arrange their affairs accordingly. We believe it is unrealistic to publish very complex draft legislation so close to the date on which the changes are due to take effect.
4. It will take time for a consensus to be formed as to what the provisions mean, for complex affairs to be reviewed and for appropriate advice to be given to ensure compliance. There is not enough time left before 6 April 2017 to allow for these, especially since foreign advice will also often be required. The problem is particularly acute where third party lending is secured on UK residential property owned by corporate bodies and it is necessary to refinance the arrangements, not least because the terms on which banks lend now are more onerous and any renegotiation could be prolonged.
5. This places affected taxpayers in a very difficult position. Clients expect their tax advisers to be able to provide advice as to the consequences of actions taken now but, until the final form of the changes is known, this will often not be possible. Taxpayers are therefore at risk of getting this wrong.
6. It is our view that a change of this magnitude requires a considerable amount of time for consideration. Unfortunately, the changing political environment in 2016 has resulted in a considerable amount of time for proper consultation being lost and we believe that the start date should be deferred by a year to allow for further consultation.
7. We believe that it is not just taxpayers that will suffer if the timetable is not deferred. We believe that pushing ahead with a 6 April 2017 commencement date will also defeat many of the Government's policy objectives.
8. It is clear that the UK wishes to remain an attractive destination for international wealthy non-domiciliaries. Pushing through with the current draft legislation so close to its start date is likely to run counter to this policy as it is likely to deter non-domiciliaries from basing themselves in the UK.
9. Further, non-domiciliaries who are already UK resident may decide to leave rather than have to deal with the uncertainty as to what the tax landscape will look like post April 2017.
10. For those that are becoming deemed domiciled in April 2017 this will be the second time in 9 years that they have had to deal with this. Changes of this nature do not make the UK an attractive destination for non-domiciliaries and a significant number may decide to become non-UK resident, thus reducing the overall tax take.

11. We appreciate that the proposals have been costed and that deferral will reduce the expected tax take. However, the costing occurred prior to the vote to leave the EU and the landscape has changed considerably. We believe that the best interests of the UK economy and taxpayers will be served by deferring the start date until 6 April 2018. This should give time to:
- appropriate scrutiny of the legislation (so it is clear and does not contain loopholes);
 - allow for a sensible and orderly transition to the new regime; and
 - to highlight that the UK is still open for business and that it remains an attractive location for non-domiciliaries.]
12. As set down in our previous representations [TAXreps 59/15](#) and [159/16](#) we do not believe that an individual's place of birth and domicile of origin should impact on their tax situation in the way the draft legislation envisages. Both place of birth and domicile of origin are facts that an individual has no control over. Whilst we recognise that FDR's should be in the same position as persons who have not left the UK, arbitrary results can arise where a child was taken abroad by his or her parents. By way of just one example. brothers return to the UK from Australia where they have lived all their lives to start a business: However their parents moved just after the birth of the first child so one born here and one not. As such, there is a completely different tax regime applicable to each. This situation has resulted in a significant business deciding not to relocate to the UK. This seems contrary to the policy objective and we therefore recommend an amendment should be made to only apply this new rule in cases where the individual was born in the UK and at birth has a domicile of origin in the UK which is not displaced in their minority by a domicile of dependency outside the UK. This would remove children who are taken overseas and whose parents change domicile whilst the children are minors from the impact of the proposals which seems fairer as they have no control before that age.

Business Investment Relief (Clause 18)

Background

13. Clause 18 sets out several changes to the current Business Investment Relief (BIR) provisions. Most of the changes are to make the relief more attractive. One amendment, however, is to adjust the legislation to reflect HMRC's position that a company that is a partner in a partnership is not to be regarded as carrying on the trade carried on by the partnership.
14. We would have preferred the changes to be more extensive (as per the various suggestions submitted in our [ICAEW REP 159/16](#). However, we recognise that the timetable made this impossible and hope that the comments in the Response Document about looking into further changes will result in additional legislation in Finance Act 2018.
15. **Measure: Clause 18**
- **Our concern:** The new "hybrid" company category is too narrow only allowing a company that is both trading and stakeholder to qualify. Often there will be companies that are both stakeholder and holding (possibly also trading but all three is less common).
 - **Our view:** See above.
 - **Our recommendation:** The new "hybrid" company category needs to be widened.
 - **Our suggested amendment:** The legislation is amended so a company that has elements of trading, stakeholder and holding or any two out of the three will qualify for BIR.

Deemed domicile (Clauses 40 and 41 and Sch 12)

16. Background

Clause 40 sets out the rules on what constitutes becoming deemed domiciled for Income Tax and CGT.

Clause 41 sets out the rules on what constitutes being deemed domiciled for IHT purposes.

Schedule 12 contains four parts as follows:

- Part 1 deals with the application of deemed domicile;
- Part 2 deals with the protection of foreign resident trusts for CGT purposes;
- Part 3 deals with the CGT rebasing election; and,
- Part 4 deals with the cleansing of mixed funds.

17. Measure: Clause 40

- **Our concerns:**
 - (i) Terminology; and
 - (ii) Point 1 under clause 41 below about deemed domicile occurring in a year of non-UK residence. This is a practical income tax and CGT issue for settlors of offshore trusts.
- **Our view:**
 - (i) We feel that all the references should be to “individual”.
 - (ii) See our comments under clause 41 point 1 below
- **Our recommendation:** See below.
- **Our suggested amendment:**
 - (i) Adjust new s835BA(5)(b) so “individual” is substituted for “person”.
 - (ii) See our comments under clause 41 point 1 below

18. Measure: Clause 41

- **Our concern:** The deemed domicile rule for inheritance tax has the effect that an individual who is UK resident for 15 years in a 20 year period will become deemed domiciled for inheritance tax purposes in the following year, even if he has left the UK during the fifteenth year of UK residence.
- **Our view:** The effect is that in order to avoid becoming subject to UK inheritance tax on a worldwide basis, a non-domiciliary will have to leave the UK during his fourteenth year of UK residence. This is directly contrary to most people’s understanding of what was announced in 2015 – i.e. that an individual could safely remain UK resident for 15 years without becoming subject to UK tax on a worldwide basis.
- **Our recommendation:** It would only require a simple change to the draft legislation to avoid this result; it is unlikely to have a significant Exchequer cost and we would urge the government to reconsider this point. The current transitional provision could be extended so that it is a general provision that gives relief where the individual is not resident in the year and left the UK prior to becoming deemed domiciled.
- **Our suggested amendment:** See above.

Again there are terminology issues with “person” being used in various places rather than “individual”.

19. Measure: Schedule 12 Part 1 Paragraphs 4 & 5

- **Our concern:** The deemed TCGA 1992 s162ZA to 162ZD legislation introduced by the 2008 Finance Act is complex without further changes. As such, we feel that any amendments made to this legislation must be very carefully thought through.

We think the legislation does achieve the aim of breaking the link when the individual becomes deemed domiciled so losses can be relieved as normal. We also think that it does achieve the aim of allowing a new election if an individual re-sets the domicile clock and becomes foreign domicile again. However, we do not think the latter position is so clearly achieved and the legislation could be improved.

Our main concern is that where the election was made it does not seem to be clear enough how brought forward capital losses, as at the crossover to deemed UK domicile will be treated.

- **Our view:** We assume that brought forward capital losses will be available to set against losses in future deemed domiciled years in the normal way.
- **Our recommendation:** That in respect of the points set down above the draft legislation is clarified.
- **Our suggested amendment:** See above.

20. Measure: Schedule 12 Part 1 Paragraphs 15 & 16

- **Our concern:** The relief appears to be structured (see para 15(2)) such that the returning temporary non-resident can make a “partial claim” for the remittance basis.
- **Our view:** Para 15(3) switches off ss809C, G and H but does not amend s809B. It is not clear whether a “partial claim” is possible without amending s809B. The effect of s809F would appear to make a claim under s809B an “all or nothing” claim. Para 15(2) appears to effectively allow a claim under s809B if Para 15(2) is met which if an “all or nothing” claim will turn on the remittance basis in full for the year of return notwithstanding that the returner will be deemed domiciled.
- **Our recommendation:** It may be worthwhile considering whether the provisions as drafted give the effect of being able to make a “partial claim” under s809B.
- **Our suggested amendment:** See above.

21. Measure: Schedule 12 Part 2 Paragraph 18

- **Our concern:** The provisions dealing with “tainting” do not provide sufficient clarity as to what will and what will not constitute tainting of a protected trust. This is a material point for all non-domiciled settlors as triggering s86 TCGA would have a significant negative impact on the settlor’s tax position. The list of “disregarded” provisions of property is also too narrow not allowing for funds to be provided for the trusts capital expenses and there is also concern as to whether the definition would allow for funds to be provided for the expenses of an underlying company or companies.
- **Our view:** There is a genuine possibility that actions need to be taken by trustees before April 2017 to unwind many common arrangements which may potentially be construed as “additions” and, therefore, taint the trust post 6 April 2017. However, as matters stand, there is significant uncertainty over what will and will not be deemed to be an “addition. The risk for trustees and their advisers is high and there is an urgent requirement for these provisions to be clarified.

Clients are particularly concerned to understand if interest free repayable-on-demand loans to trusts will be treated as tainting them and, if so, how HMRC will apply this. That is, whether it will only be new loans advanced after the settlor has become deemed domiciled that are caught or all loans outstanding after the settlor is deemed domiciled (that is also fixed term loans made prior to the settlor becoming deemed domiciled). There is a precedent in the now archaic Esc D41 that suggests that tainting will take place by reference to the position when the precursor of s86TCGA 1992 was originally introduced. However, the justification for such a view was never clear.

If the latter, the trustees will need to make arrangements prior to the foreign domiciliary becoming deemed domiciled to repay the loans or vary the terms, both which take time (especially the former if liquidating portfolios is required). Our view is that, on the basis that the funds are provided when the loan is made, it should only be loans made after the settlor is deemed domiciled that have the potential to taint.

Some settlors (especially where there is a US settlor or beneficiary) have trusts where they have the power of revocation. From a US point of view this makes the trust a grantor trust and results in a more favourable tax outcome for the US connected individual. There is significant concern that post 5 April 2017 a settlor who retains this power will be seen as "providing property to the trust". We do not think this can be correct as the settlor is refraining from doing something rather than adding property. However, given how significant the funds within these trusts can be it is a significant concern and again certainty on the point is required.

Whilst we do not agree that it is fair our understanding of the draft legislation is that transfers between trusts will be treated as tainting as regards the recipient trust notwithstanding both trusts were protected trusts before the transfer. Likewise splitting protected trusts will cause tainting to occur as regards the newly formed trusts derived from the original settlement. See the proposed para 5A(1)(e) to be inserted into Sch 5 TCGA.

We do not understand why this should be the case nor can we identify the mischief being targeted.

- **Our recommendation:** We would welcome confirmation as soon as is possible what principles HMRC intend to apply in interpreting what constitutes tainting i.e. whether it be some, all or none of the principles contained in SP5/92. Given the extreme consequences of tainting, the sooner HMRC's guidance can be provided the better. There are various possible loan arrangements and we have provided a separate paper (also included as Appendix 2 to this response) which includes possible scenarios that it would be very helpful for HMRC to comment on.

Where HMRC will take the view that a loan outstanding after an individual has become deemed domiciled should be seen as providing property to the trust we would ask that given the lack of time to re-arrange affairs prior to 6 April 2017 the most affected individuals (that is those who will be deemed domiciled as at 6 April 2017 and 6 April 2018) are given until 5 April 2019 to re-arrange their affairs.

We would also welcome an amendment to ensure that transfers between protected trusts and splitting protected trusts does not cause the protection to be lost.

To make the provisions more operable in practice, we would welcome some form of relief provision in the case of inadvertent tainting. This could be along any of the following lines:

- a de minimis exemption – say an addition of 5% or less of the value of the trust assets;

- a loss of protection only in relation to the funds which are added and not in relation to funds which were already in the trust; or,
- an ability to reverse an inadvertent addition within (say) two years after it is known about.

New sch 5 TCGA 1992 para (5A)(2)(c) should be widened to make it clear it applies to expenses of underlying companies and also so that it extends to capital expenses of the trust.

- **Our suggested amendment:** See above and one specific point: the draft legislation states that “*For the purposes of sub-paragraph (1)(e), ignore property or income provided under a transaction entered into at arm’s length...*”. Almost by definition, this cannot be the case between settlor and trustees. We assume that this is a drafting error and that (...“at arm’s length...”) should be amended to read “on arm’s length terms”.

22. Measure: Schedule 12 Part 2 Paragraph 19(1) (General)

- **Our concern:** As set out in our response to the last consultation document (para 113 *et seq* of our response), we have concerns about the potential for the changes to s87 TCGA to trigger double tax.
- **Our view:** We had been hoping that some form of relief would be provided as double tax is something which clients find very unpalatable and is generally accepted to be unfair (hence the UK having one of the most complete networks of Double Tax Agreements of any jurisdiction). Unfortunately, the draft provisions released to date do not provide for relief from double taxation. We are not sure if this is because the legislation was not ready by the December 2016 release date or that there is no intention to produce it. It is a crucial issue for clients (especially US citizens) and we believe it will turn out to be far more important in terms of whether US clients stay in the UK than the issue over the Remittance Basis Charge in 2008. We would be happy to go into this in more depth and share ideas on how relief provisions might be drawn up.

In addition the ‘onward payment’ legislation (s87I *et seq* dealt with further below) could be extremely unfair given the non-resident recipient of the original trust distribution may have suffered tax in their home country. If the onward payment is made to a UK recipient, that would then cause both receipts to be taxed albeit in different countries without any relief available under the treaty (because different people are being assessed) – in the worst case scenario, the gift itself could also be subject to gift tax thereby causing up to three occasions of tax charge on the same distribution.

- **Our recommendation:** We strongly urge the Government to consider how double tax charges can be removed. Given the various provisions in the Taxes Acts, the Government clearly believes that double taxation should not be suffered by taxpayers without relief and we think it inequitable not to provide similar reliefs under the current proposals simply because it is too hard, too complicated or there is not enough time to consider the permutations. As we understand it the policy objectives are to encourage high net-worth non domiciled settlors to pay a fairer share of the overall national tax cost rather than force some of them to leave the UK because they have to pay an excessive rate of overall taxation (bearing in mind that such individuals take into account the overall tax they pay rather than just the UK part).
- **Our suggested amendment:** Provisions for double tax relief are necessary and we are happy to assist with framing them if the Government indicates that it is minded to proceed with these suggestions.

23. Measure: Schedule 12 Part 2 Paragraph 19(1) (s87D) Disregard of capital payments to non residents

- **Our concern:** Our primary concern, as we have indicated previously, is that this amendment is outside the scope of the original policy ambit announced by the former Chancellor and that it will also impact UK domiciliaries.

We also believe that this change has the potential to generate inequitable results for internationally mobile families.

- **Our view:** We believe that most UK domiciliaries will not be aware that they will be impacted by these changes and will be caught unawares. This will also be the case for foreign domiciliaries who were not born here or did not have a UK domicile of origin and who have been UK resident for far less than 15 years. From previous announcements such individuals had no reason to think they were being targeted by the changes and in the absence of an announcement no reason to consider the December Response Document and draft legislation.

The potential for unfairness is best illustrated by an example: consider a trust established in 2018 by a non-resident non-domiciliary who has never been UK resident. None of the beneficiaries are UK resident nor have they ever visited the UK. In 2028 a beneficiary becomes UK resident for the first time. In the ten years since the trust was settled, the trustees have realised considerable gains. These have been paid out to the beneficiaries in the years that they arose (all before 2028). As capital payments to non-residents will not reduce the stockpiled gains pool, the first beneficiary to become UK resident will have capital payments matched to stockpiled gains which have already been paid out of the trust (ignoring income matching under s731 ITA).

There are two points here:

- there is no policy justification for such a disproportionately adverse effect; and,
- such a regime presupposes that the UK should have taxing rights over gains that are realised even though there is no link to the UK at the time of realisation and no UK tax avoidance motive. Again, there can be no policy justification for such an approach.

We accept that a similar issue arises on the Income Tax Transfer of Assets Abroad (ToAA) non-transferor charge provisions. In that case however, there is a motive defence to resolve the issue in practice. For s87 purposes also it has not been an issue in practice as the ability to reduce stockpiled gains by making distributions to non-residents has helped mitigate the position. In light of the proposed changes to s87 *et seq* however, it will become an issue going forward.

- **Our recommendations:** We recommend that there is an immediate announcement by the Chancellor that the scope of the policy is being widened and there will be an impact on UK domiciliaries. We believe it is very unfair to introduce changes affecting UK domiciliaries while badging them as changes to the taxation of non-domiciliaries (particularly as the changes have previously been said to apply to those born in the UK with a UK domicile of origin and long-term domiciliaries, so many short term non-domiciliaries will also be unlikely to appreciate the impact these changes will have on them); taxpayers who are UK domiciled and advisors who do not specialise in advising non-domiciliaries will not be following these changes (thinking they are not relevant) and ultimately will be taken by surprise or inadvertently become non-compliant.

In order to remove the unfairness, highlighted in our example we recommend that s87 be amended such that:

- gains are not stockpiled until such time as at least one beneficiary or the settlor become UK resident; and/or
- a motive defence is introduced similar to that which operates for s13 TCGA.

- **Our suggested amendment:** See above.

24. Measure: Schedule 12 Part 2 Paragraph 19(1) (s87G) Cases where settlor liable for section 87 charge on closely-related beneficiary

- **Our concern:** We will not reiterate our concerns about double taxation here (see above) but if the settlor is charged to tax then it is not clear how the beneficiary is removed from charge. See our comments below on Paragraph 19(2).

It is also not clear whether the intention is for s89G(3) to provide the settlor with an enforceable right to recover the tax due from either the beneficiary or the trustee. If so, it is not clear how this to be enforced where the beneficiary or trustee is foreign resident.

Additionally, it is not clear if:

- the reimbursement of the tax from the trustees will count as a capital payment and be taxable as such; or
- the reimbursement of the tax from the beneficiary will fall within s87I and so itself be charged.

The draft legislation does not envisage a situation where the settlor does not have the funds to pay the tax himself. As currently drafted if the beneficiary or trustee advances the funds for the tax to be paid rather than reimbursing the settlor there would appear to be an issue. We do not think that this is fair.

- **Our view:** We question whether the close family provisions are required at all – they introduce an enormous amount of complexity into an already complex area for what appears to be little reward. The draft legislation as it stands is still far from being workable.

In terms of the additional tax the measures may raise: UK resident beneficiaries would be chargeable in their own right if and when the funds are remitted. If they are not remitted in the year of receipt then they are treated as the settlor's gains. But if the settlor is on the remittance basis then there will be no tax either as there is no remittance.

So the changes appear to only have an effect where the recipient is taxed on the remittance basis or is non-resident and the settlor is not, presumably because he or she is deemed domiciled for all tax purposes or legally domiciled within the UK. This would imply that the target of these provisions is where trust payments are made to a spouse or the settlor's minor children who are taxable on the remittance basis or are non-resident. We think that the population of individuals who would potentially fall within these provisions is likely to be very small. Practically it would be far easier for the family concerned to simply cease to be resident in the UK, rather than build a strategy to fall outside the circumstances outlined. We do not think that the additional complexity of introducing this provision is cost effective.

- **Our recommendation:** We recommend that the close family provisions are not implemented as we consider them too complex and they seek to address a problem which we are not convinced exists on a significant scale.

Failing this, we recommend:

- it is made clear that receipts under s89G(3) are not taxed on the settlor as capital payments and specifically excluded from s87I; and

- that s 89G is widened so that beneficiaries and trustees can make payments to settlors in advance to pay the tax due without there being a tax liability.

We also recommend that it is made clear that if the settlor is taxed on a capital payment then the beneficiary cannot be taxed.

Finally we recommend that in s89G(2) it is made clear that the gains accruing to the settlor are still foreign gains and so subject to the remittance basis, if the settlor is a remittance basis user for the relevant tax year. This clarification is particularly necessary as a result of concerns (articulated below) we have as to the effect of para 19(2).

- **Our suggested amendment:** See above.

25. Measure: Schedule 12 Part 2 Paragraph 19(1) (s87I) Non-UK resident settlements: attribution of gains to onward gifts

Again we have terminology issues in this paragraph with “person” being used in some places rather than “individual”.

- **Our concern:** This provision is not required as we consider there is sufficient existent anti-avoidance legislation (and case law) to counter “recycling”. Even if an additional provision were required, we do not consider new s87I to be fit for purpose in its current form.
- **Our view:** As mentioned above we do not think this is required. However even if it were required, it is fundamentally flawed as drafted.

The primary issue is that there is no direct causal link between the capital receipt by the beneficiary and onward gift. For example, the original recipient may have asked for a capital distribution to enable him to put down sufficient funds as deposit on a UK property so that a mortgage can be acquired for the remaining funding to make the house purchase. If two years later the individual makes a Christmas gift out of taxed employment income there is no reason why this later gift should fall within the ambit of the provisions and be taxable under s87I but as currently drafted it will fall foul of the provisions. It seems clear to us that this is an unfair result that needs to be corrected.

There are a host of timing and double tax issues inherent in what s87I is attempting to achieve. For instance, if the original recipient is a temporary non-resident upon receipt of the capital distribution and then makes a gift which falls within s87I and is taxed as a result, how is the charge under s87E (temporary non-residents) relieved from double taxation when they return?

The current draft also leads to unfairness as it only considers the date of the onward payment.

Consider (A) who has lived overseas her entire life. Her father has received funds from a family non-UK resident trust (the fact the trust is not UK resident is quite understandable as the settlor/beneficiaries have never lived in the UK). A is then assigned to the UK for work reasons and A’s father decides to gift funds to his daughter to help her purchase a home in the UK. He received the funds at a time A was non-resident, but it would seem that if A is UK resident when she receives the ‘onward’ gift (irrespective of the actual source of funding as regards A) and the transfer is made within 3 years of the distribution, she will be taxable to CGT on the capital gains of the trust matched to that gift.

Had she taken the funds directly from the trust when non-resident (assuming the capital payment would have been matched to gains in the non-resident year), the distribution would not have been taxed in the UK (if indeed she were a beneficiary) or if the gift is made to her before she comes to the UK – but if the gift is unfortunately timed after A becomes UK

resident, it is taxed. A's father may also suffer tax on the trust receipt in his home country (see above).

This would seem to be a very unreasonable extension of s87 – it would be preferable and fairer, whilst stopping 'mischief', for the legislation to require the recipient beneficiary to be UK resident at both i) the time the distribution from the trust is made to the non-resident beneficiary as well as ii) at the date of the onward gift.

Where the "three year rule" applies we would also highlight the absence of any limitation requiring the onward recipient to be a beneficiary of the trust – why is it that a gift from a non-resident individual to a UK resident individual brings about a tax charge as if the recipient were a trust beneficiary if the trustees cannot actually make a distribution to the UK resident recipient direct? This makes no sense and again brings about unfairness.

Also, it would seem very odd if the UK recipient is expected to ask the transferor how they funded the gift and whether by any chance they had received any funds from any offshore trust within the past 3 years. More generally, we would also have grave concerns about how this could be managed in practice. The onward recipient will not be in a position to obtain the necessary information to comply with the law. And there is no *de minimis* so in effect, this provision could make a large proportion of taxpayers with friends and or family who receive distributions from offshore trusts non-compliant.

Finally, it appears that capital payments made pre-April 2017 can be classified as an "original payment" under s87I – is this the intention? This seems unfair as "original beneficiaries" will not necessarily have been tracking funds received in the last 2 years with a view to being able to comply with the proposed s87I.

- **Our recommendation:** We believe this provision should be dropped entirely. It is unnecessary and unworkable. If the decision is made to continue with this provision then it needs to be redrafted and consideration needs to be given as to how it interacts with all the other provisions and how the double and multiple tax charges on the same sum of money are removed.
- **Our suggested amendment:** See above.

26. Measure: Schedule 12 Part 2 Paragraph 19(2)

- **Our concern:** We believe the intention is to remove the charge on the beneficiary but that it is ineffective and there remains a double charge.
- **Our view:** We referenced this issue above when discussing s87G. The capital payment is made to the original beneficiary. If under s87I the capital payment is attributed to the settlor, para 19(2) amends s87B such that s87B does not apply to the beneficiary's gain (or, it appears, the settlor's attributed gain).

Section 87B operates to classify the gain as a foreign gain.

If s87B is turned off then it appears to just make the gain non-foreign but it does not appear to remove the gain from charge. Hence there is a double charge, one on the settlor and one on the beneficiary. We assume that this is a drafting error rather than intentional.

- **Our recommendation:** We recommend that the provision is re-written so that it achieves the intended result.
- **Our suggested amendment:** See above.

27. Measure: Schedule 12 Part 2 Paragraph 19(4) & (8)

Our concern: The commencement provisions change the treatment of tax payments already made.

The Paragraph 19(4) commencement provisions are unclear and read literally (which they are being by some leading tax counsel) para 19(4)(b) requires a re-working of all historic stockpiled gains pools to remove payments to non-residents. In effect this will result in retrospective taxation, which could go back well over 20 years. To require a re-working of historic matched capital payments could have a dramatic effect on some trusts and the interests of beneficiaries where trustees planned for current and future beneficiaries taking account of tax pools calculated in accordance with the law at the time.

As discussed when we commented on new s809I above these commencement provisions apply to capital payments made prior to 6 April 2017.

- **Our view:** We had understood that the intention behind new s87 D and 87E was only for: (i) unmatched capital payments already made to be disregarded from April 2017; and (ii) capital payments made after that date to be disregarded. This is set down very clearly in the Response Document and the draft legislation needs to be amended to make it equally as clear.

Regarding para 19(8), as discussed above, this is unfair as “original beneficiaries” will not necessarily have been tracking funds received in the last 2 years with a view to being able to comply with the proposed s87I.

- **Our recommendations:** For para 19(4) the intention, that the draft legislation was supposed to be in line with the Response Document, should be confirmed as soon as possible as this is causing a lot of confusion and concern and the drafting of para 19(4) should be amended to make the commencement provision clear since Response Documents and HMRC answers to queries cannot be used as interpretative aids before the Tribunals.

For para 19(8) the legislation should only apply where the capital payment has been made after 5 December 2016 (the day the draft legislation was released).

- **Our suggested amendments:** See above.

28. Measure: Schedule 12 Part 3 Paragraph 21 Capital gains tax rebasing

- **Our concern:** We are concerned that the draft legislation does not go far enough to achieve the stated policy objective.
- **Our View:** It is not clear that the rebasing is available on partnership (and LLP) assets; based on the language used in para 21 (“the asset was held by P on 5 April 2017”) that this will be the case (cf s59A TCGA and SP D12). We would expect that such assets should be rebased.

We welcome some of the relaxations but it seems to us to be a puzzling policy decision to exclude non-reporting funds. This is a common class of investment for non-domiciliaries and is often both a long-term hold and a less liquid asset class than securities; non-reporting funds are likely to only have certain times in the year when redemption is possible. In reality a lot of foreign funds (especially the US ones) do not obtain distributor status because it impacts on a relatively small proportion of their investors and the cost is thought to be unjustifiable as a result. Hence the issue is likely to be relatively widespread where resident non-domiciliaries are involved.

If the policy decision is that rebasing of foreign assets should be allowed to mitigate the unfairness of taxing long-term capital appreciation on the arising basis then there can be no logical reason for not extending this to offshore funds which are taxed at an even higher rate than capital gains.

The policy rational here is also puzzling. We understand that one of the policy motives behind rebasing is to encourage the ingress of funds into the UK to assist with investment as well as boost the consumer economy. If rebasing for non-reporting funds is not introduced it will simply prevent the proceeds from the sale of such funds being remitted. “Manual rebasing” will of course take place through the actual disposal and reacquisition of such assets prior to 6 April 2017, but the proceeds received will not be remitted to the UK at any time in the future because to do so would precipitate a tax charge.

We are disappointed that there is still no rebasing for offshore trust assets as there was in 2008.

We are also disappointed to see that rebasing of company assets was not included in the draft Finance Bill and we are not sure why it has not been included. The consequence is that steps will have to be taken to manually rebase assets pre-April 2017 to give the same outcome. The tax will not be payable as it will be covered by the remittance basis. As such, not allowing company assets to be rebased via the statutory relief is likely to have a negligible impact on Exchequer receipts as the tax will not be payable in any event but it will make life much simpler for non-domiciliaries.

Allowing rebasing would also mean that the proceeds could come to the UK and be spent here – if we have to manually rebase assets we will end up with trapped capital offshore and by the time it can be converted into cash, the cleansing window is likely to have closed and, assuming the individuals are unwilling to incur unnecessary or unfair tax charges they will retain funds outside the UK. This seems contrary to the Government’s objective and not extending rebasing could end up costing the Exchequer.

As a corollary, many companies will have made disposals over the years and those gains will have been attributed to the shareholders under s13 TCGA. However, they will have been sheltered from tax as the proceeds have been retained offshore in the company. When they come to liquidate the company in due course, or sell it, the rebasing will not be effective as the proceeds will remain tainted by the s13 gains. Again, if the intention is to free these monies so that they can come to the UK it would be helpful if this issue could be resolved as part of the rebasing. The alternative will be for taxpayers to argue that s13 TCGA is and was contrary to EU Law cf [European Court Judgement](#).

On a separate note, the mechanism used to provide the rebasing is a deemed acquisition on 5 April 2017. Unfortunately, this begs the question as to what the rebased gain (that is the gain on the deemed 5 April 2017 sale and acquisition) should be classified as for the mixed fund rules and to what year it should be allocated. The disposal proceeds will be a mixed fund and the mixed fund rules require that we be able to allocate the proceeds into categories (foreign income, foreign gains, capital etc) per tax year. It would be helpful if the draft Finance Bill could be as explicit on this point as the consultation document. Without this clarity non-domiciliaries will be forced to sell assets within the cleansing window because otherwise they will have no comfort that the funds can be segregated. Our understanding from our discussions is that the rebased gain will be seen as “clean capital” arising in the tax year that the asset is actually disposed in.

The deemed acquisition also raises the question as to what market value to use. Is it the market value a third party would pay or the market value the actual taxpayer would pay factoring in his other assets? For example, X may own 30% of a company indirectly via a holding company and 70% directly. Is the 70% to be rebased to a market value which reflects a minority discount or a “full” market value? The latter would appear to be the correct answer

as this is what he would pay to obtain control in an acquisition but the legislation is unclear on the correct approach.

Clarification is needed as to how the rebasing interacts with carried interest taxable under s103KA TCGA 1992? The rebasing provision treats P as acquiring the asset on 5 April 2017 for consideration equal to market value. S103KA only allows “permitted deductions” from the proceeds to be made in calculating a carried interest gain (to prevent base cost shift). The permitted deductions include amounts either taxed as income, or consideration “paid in cash”. The existing rebasing provisions would not seem to go far enough to help here. Is this the policy intention?

- **Our recommendations:** We would welcome confirmation that partnership assets can be rebased and for this to be made clear on the face of the legislation.

In order to achieve the policy objective we would also welcome the extension of rebasing to:

- trust assets;
- company assets for the reasons given above along with consideration of how to deal with the historic s13 gains issue; and
- the extension of rebasing to include all offshore funds.

We would also welcome clarity on the carried interest issue raised above.

- **Our suggested amendment:** See above.

29. Measure: Schedule 12 Part 4 Paragraph 24 Cleansing of mixed funds

- **Our concern:** The draft provisions for cleansing provide no clarity as to what is expected. Additionally, we have already seen HMRC guidance which whilst helpful to an extent needs amending as at points it is not consistent with either itself or the draft legislation.
- **Our view:** The effect of para 24(2) is to turn off S809R(4). We would welcome confirmation that in turning off s809R(4) the intention is not to have the detailed ordering rules in s809Q apply. Or put another way, if the offshore transfer rules in s809R(4) are turned off, no statutory rules apply except the nomination referenced in para 24.

We are aware that leading tax counsel are interpreting the current draft provisions such that the rules in s809Q do step into the breach left by disapplying s809R. If this is correct then the cleansing relief is nothing like what we had expected and will be far more onerous to apply.

Assuming we are correct that the intention is not for s809Q to apply, (and we believe we are as this is consistent with what was discussed in the stakeholder meetings), the current drafting is an issue as it seems to be a slightly circular as follows:

- 809R(4) directs one what to do in the case of an offshore transfer;
- 809R(5) defines what an offshore transfer is but does so by reference to s809R(4);
- The draft legislation says 809R(4) does not apply to an offshore transfer.

On a separate point, we think that it is necessary for the draft legislation to actually be explicit in what is required for a nomination so there is clarity. At the moment there is a reference to a nomination but no actual nomination rules.

As mentioned, we have seen a note on cleansing provided to our representative on the new HMRC Expatriate Strategic Tax and NI Forum and a revised note sent around prior to Christmas. This note sets out a position that we cannot see is entirely consistent with para 24 (going further than the legislation in terms of the flexibility allowed – though as discussed above we would like the legislation to be clarified to make what is permissible clear) or the examples in the note (the definition of “transfer possibly being an issue here).

- **Our recommendation:** We recommend that para 24 is amended as outlined above.
- **Our suggested amendment:** See above.

IHT on overseas property (Clauses 42 and Sch 13)

30. Background

Clause 42 introduces Schedule 13.

Schedule 13 contains one part made up of seven paragraphs.

Paragraph 1 inserts into IHTA 1984 Schedule A1 which is comprised of three parts as follows:

- Part 1 Overseas property attributable to UK residential property;
- Part 2 Supplementary; and,
- Part 3 Interpretation.

31. Measure: Clause 42

- **Our concern:** We have no concerns with this clause.
- **Our view:** See above.
- **Our recommendation:** See above.
- **Our suggested amendment:** See above.

32. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(1)

- **Our concern:** We are concerned that the drafting is far wider than intended and will catch a whole host of scenarios which should not be within its scope.
- **Our view:** Para 2 applies (broadly) to a right or interest in a close company which is attributable to UK residential property.

Consider the following: A owns a Jersey Company (JCo) which owns UK residential property and B lends monies to JCo which JCo invests in private company shares (CCo), and B has a lien over the shares as security. CCo fails and is wound up. Now B has a loan to a JCo which can only be repaid from (i.e. it is attributable to) the proceeds of the UK residential property sale as JCo has no other assets. It therefore appears that B has an interest within para 2. This is presumably not the intention.

Additionally, it is not clear at what stage does the loan comes within para 2: when CCo begins to fail or once it has failed? If the former, at what stage does the loan fall outside para 2 if CCo recovers?

Nor is it clear how any of the above will interact with guarantees. If in the example above A guarantees the loan from B, then if CCo fails, presumably the loan is not attributable to the UK residential property as it can now be recovered from A.

- **Our recommendation:** We recommend that the term “attributable” is clarified. At present it has a very wide meaning which is likely to catch unintended scenarios.
- **Our suggested amendment:** See above.

34. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(2)

- **Our concern:** We are concerned that the drafting is not effective to remove interests from the scope of paragraph 2 when there is an “open” company within the chain of ownership.
- **Our view:** Based on our discussions and the consultation document, we understand that paragraph 2 is to only apply to close company interests. The draft provisions state:

(1) This paragraph applies to the right or interest that a participator in a close company has in that company, if and to the extent that the value of the right or interest is directly or indirectly attributable to a UK residential property interest.

(2) For the purposes of sub-paragraph (1) the value of a right or interest in a close company is indirectly attributable to a UK residential property interest only if it is attributable to such an interest by virtue of one or more qualifying interests (which need not be owned directly by the close company).

*(3) In this paragraph “qualifying interest” means—
(a) a right or interest in a close company, or
(b) an interest in a partnership.*

It is not clear to us that the above is effective in restricting the charge to close companies only in scenarios where there is a chain of companies. For the avoidance of doubt, we are assuming that the intention is not to catch a scenario where there is an open company (a collective investment scheme for example) somewhere in the chain of ownership.

This can be illustrated with an example:

A Jersey company owns UK residential property (“UK resi” hereafter) and is a foreign collective company (CollectCo) and so is not close and it has 50 investors. John is a non-dom and owns 100% of TopCo (a Jersey company) which owns 2% of shares in CollectCo. John’s interest in TopCo is not within the scope of the changes because it does not have a direct interest in UK resi nor does it have a “qualifying interest” as CollectCo is a not close company.

However, if we insert a wholly owned sub (“MiddleCo”) (between TopCo and CollectCo the analysis seems to change although nothing economically has changed and the same answer should result.

In summary John owns 100% of TopCo which owns 100% of MiddleCo which owns 2% of CollectCo.

TopCo still does not have a direct interest in UK resi.

Turning to the indirect interest limb in para 2(2) the question one must ask appears to be: does TopCo have an interest in UK resi land by virtue of an interest in a close company? Writing out the test in full one gets: *the value of a right or interest in TopCo is indirectly attributable to a UK residential property interest only if the value or right in TopCo is attributable to a UK residential property interest by virtue of an interest in a close company.*

The test does not specify what type of interest the close company must have (unlike para 1(2) which specifies both direct and indirect interests) and therefore in our scenario one can conclude that TopCo does have an interest in UK resi by virtue of a close company. MiddleCo does not have a direct interest but this does not seem to be the test – it just says “by virtue of [an interest in a close company]”.

- **Our recommendation:** We recommend that it is put beyond doubt that where there is an “open” company in any stage of the chain of ownership, the interest falls outside para 2.

35. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(5)

- **Our concern:** There is uncertainty over what is to be valued.

Our view: Whether it is the shares or the property that are to be valued will make a big difference to the result (particularly in a minority interest scenario). We assume that the intention is for the shares to be valued as to do otherwise would be to discriminate against foreign domiciliaries where minority shareholdings are involved. In addition such an approach would be in keeping with the principle that it is the company shares that are being brought into charge rather than seeking to tax a share in the UK residential property. We are pleased that the draft legislation has been written in that way.

However, the Response Document refers to the value of the UK residential property. It also suggests that detailed legislation with respect to valuation of joint interests and minority interests has been published. Unfortunately we cannot see anything in the legislation published so assume the standard rules for company valuation apply.

- **Our recommendation:** It is necessary to put it beyond doubt that it is the shares that are to be valued. Since the legislation appears to do this we just need confirmation that the Response document comment was inaccurate in this context. We are not of the opinion that further legislation is required as normal valuation principles can be used in such cases but if there is to be specific legislation that should be published as soon as possible.
- **Our suggested amendment:** See above.

36. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 3

- **Our concern:** There is no restriction on the scope for partnerships to mirror the “close” restriction on companies.
- **Our view:** If a residential property fund is structured as a partnership rather than a company, the holders of the interests in the fund (i.e. the partners) will still be exposed to inheritance tax whereas if they had held shares in a company, they would not. This is a significant issue as some large overseas banks are partnerships and the extension of the legislation to loans will cause significant commercial difficulties unless something is done.
- **Our recommendation:** A similar test needs to be introduced for partnerships otherwise the legislation will be unworkable in practice.
- **Our suggested amendment:** See above.

37. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 4

- **Our concern:** Whilst we understand the point of these provisions, they will lead to considerable unfairness as there will be multiple IHT charges suffered on the same property. These charges could be suffered by the same person or many. There is also a mis-match between a loan being deductible and a loan being chargeable which needs to be rectified.
- **Our view:** Regarding the loans provisions, as they are drafted they could lead to IHT being charged on multiples of the value.

To illustrate by way of example:

- John owns a Jersey company (JCo) with a UK resi worth £20 and £80 of other assets.
- John owns an Irish trading company (ICo) which loaned £20 to JCo to buy the UK residential property.
- John is exposed to IHT on £16 as a result of his ownership of JCo and £20 as a result of his ownership of ICo.

The draft provisions also mean that multiple people can be subject to IHT on the same property. This approach is fundamentally unfair.

Again by example:

- John owns a Jersey company (JCo).
- JCo has £80 of liquid assets and wants to buy a UK resi worth £20.
- JCo borrows £20 from Peter who is a family friend (non-resident non-domiciliary).
- Peter asks for the loan to be secured on both the property and the shares (securing on the shares makes life easier as Peter can take control of the company in the event of default and is not uncommon).
- John has £16 exposure as a result of his ownership of JCo.
- Peter has £20 exposure on the debt.
- And John also seems to have exposure on the collateral for the loan (up to £80?).

For the avoidance of doubt, this is a different issue to the loan issue identified above and which arises under para 2(1).

Our recommendation: We would suggest that some form of cap is introduced on the value that can be charged and the number of times it can be charged. In addition as a back stop we suggest that you introduce a just and equitable apportionment position. Provisions like this are inherently fraught with difficulty and the decision of the House of Lords in [Vestey v Inland Revenue Commissioners](#) [1980] A.C. 1148 underlines that the Courts take a hostile approach where there is a suggestion that a tax charge may be levied on many people and it is only the forbearance of HMRC that prevents multiple taxation.

- **Our suggested amendment:** See above.

38. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 4 & 5 General

- **Our concern:** We consider both para 4 and 5 to be problematic from a practical and enforcement point of view.
- **Our view:** We consider that both paragraphs 4 and 5 presuppose that a (probably) foreign resident non-domiciliary will be aware that lending money to a family member or friend runs the risk of generating a UK IHT exposure. We would think it highly unlikely that this will be the case and, in the case of the proceeds of a loan repayment (para 5), we consider it even less likely that the lender will realise that the proceeds are exposed to UK IHT for a further two years after repayment.

To summarise, the individuals involved are likely to:

- Have no links to the UK;
- Have no awareness of the UK's IHT laws or any reason to acquire that awareness.

In addition they may have no control over what the loaned funds are used to acquire and have no way of extracting said information.

Coupled with a law that is not intuitive means that the default position for most of these individuals will be inadvertent non-compliance. We do not believe that legislation such as this should be enacted.

- **Our recommendation:** No comment
- **Our suggested amendment:** No comment

39. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 5(4)

- **Our concern:** There is no time limit on the exit charge where discretionary trusts are involved. In addition we consider that there will be an automatic relevant property exit charge where there is a disposal of a qualifying interest in UK residential property at the point that (typically) the proceeds of sale are invested in other than UK sited assets. This is as a result of the failure of the proposed provisions to mesh with s65(7) IHTA 1984.
- **Our view:** At the least, we believe that it should be subject to a 2 year time frame as per para 5(2). We cannot see any reason why the potential for an exit charge would persist indefinitely until the charge is triggered as this runs completely contrary to the whole scheme of IHT.

It will also lead to the difficult practical issue of tracing as para 5(1)(c) speaks of direct or indirect representation.

- **Our recommendation:** We recommend that there is a 2 year time limit (aligning with the treatment for individuals and qualifying interest in possession trusts) for all issues with respect to discretionary trusts such that after this period the proceeds or loan repayments can benefit from the usual tax benefits of excluded property and there is no exit charge as a result of no longer being seen as UK situs assets.
- **Our suggested amendment:** See above.

40. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 6

- **Our concern:** The TAAR is far too wide and not appropriate in the context of IHT.
- **Our view:** This is an issue we raised last year during the consultation on the proposed DOTAS hallmark for IHT. A tax advantage TAAR is not appropriate in the context of IHT as everything done in relation to IHT is done to reduce the IHT exposure. This is as true of lifetime potentially exempt transfers (PETs) made by individuals and gifts out of income as it is of aggressive off-the-shelf schemes.

However, it is clear that Parliament does not consider reducing IHT through a PET as behaviour to be discouraged as it specifically legislated for PETs. Therefore introducing a TAAR based on a tax advantage alone for IHT is not sufficient to distinguish behaviour Parliament wishes to discourage; something more is required.

The TAAR as drafted is so wide that it would catch a gift of shares in a foreign company owning UK residential property (i.e. a PET) because, in some cases, the main purpose will be to reduce IHT on death by avoiding the effect of para 2.

We would assume HMRC would not expect to see the TAAR applied against PETs. However but it is not clear on what grounds HMRC would be able to disapply the TAAR so perhaps all PETs and other generic IHT planning involving UK residential property will have to be disregarded after April 2017.

Taking this to an extreme, if gifts of UK residential property companies have to be disregarded then there will be multiple IHT charges as both the disponent and donee will have the company in their estates. And any other future gift recipients etc.

- **Our recommendation:** We recommend that the TAAR is narrowed in scope, so it is clear that it is there to deal with aggressive anti-avoidance only.
- **Our suggested amendment:** see above.

41. Measure: Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 10

- **Our concern:** Typo Partnerships Act 1890 is not correct.
- **Our Recommendation:** It should be amended to Partnership Act 1890.

APPENDIX 1

Queries on the Draft Finance Bill 2017 legislation submitted to HMRC
(avoiding policy issues)

CLAUSE 40 & SCH 12: DEEMED DOMICILE: INCOME TAX AND CAPITAL GAINS TAX

Foreign Loss Election

Schedule 12 Part 1 paragraphs 3 and 4 and 5

1. Our reading of the amendments to the foreign loss election is that losses accrued while the foreign loss election is in place (i.e. losses realised but not offset against gains) will be available to offset gains once the taxpayer becomes deemed domiciled. However, we do not think it the changes make this as clear as it could be.

Is it the intention that losses can be carried forward to the deemed domiciled period?

Capital Gains Tax (CGT) offshore trust issues

Schedule 12 Part 2 Paragraph 18

Urgent guidance is required on what HMRC will and will not regard as adding property for the purposes of the trust.

2. In the context of loans, which of the following will and will not be regarded as adding property for the purposes of the trust assuming all the loans were made BEFORE the settlor became deemed domiciled:
 - I. Interest free repayable upon demand loan
 - II. Repayable upon demand loan with interest charged at a commercial rate but rolled up
 - III. Repayable upon demand loan with interest charged at a commercial rate and paid each year
 - IV. Commercial loan structured as a deep discounted security
 - V. Interest free fixed term loan repayable when the settlor dies
 - VI. Fixed term loan repayable when the settlor dies with interest charged at a commercial rate but rolled up
 - VII. Fixed term loan repayable when the settlor dies with interest charged at a commercial rate and paid each year
 - VIII. Fixed term loan repayable when the settlor dies with the loan structured as a commercial deep discounted security
 - IX. Interest free fixed term loan repayable after a set number of years (would the number of years make any difference to the HMRC response)
 - X. Fixed term loan repayable after a set number of years (would the number of years make any difference to the HMRC response) with interest charged at a commercial rate but rolled up
 - XI. Fixed term loan repayable after a set number of years (would the number of years make any difference to the HMRC response) with interest charged at a commercial rate and paid each year
 - XII. Fixed term loan repayable after a set number of years (would the number of years make any difference to the HMRC response) with the loan structured as a commercial deep discounted security

- XIII. Fixed term loan facility for 15 years, negotiated before the settlor is deemed domiciled, where the loan can be drawn down after the settlor becomes deemed domiciled in annual variable tranches on commercial terms and conditions.
3. Can you confirm that where an individual has a power of revocation not exercising that power after he becomes deemed domiciled will not be seen as providing property to the settlement?
 4. Would HMRC regard adding funds to the settlement to cover the administration fees of an underlying company as being able to come within para 18 (specifically new para Sch 5 TCGA 1992, para 5A(2)(c)) ? Whilst we think they should it does not seem clear from the legislation as it only refers to the “*settlement’s expenses*”.
 5. Can HMRC confirm that the reference in para 18 (specifically new para Sch 5 TCGA 1992, para 5A (2)(a) to “...*at arm’s length*” should read “*on arm’s length terms*”? Can HMRC also say whether if the settlor sold an asset to the trust at market value and the purchase price was left outstanding there could be an issue and if there could be what factors it would take into account?

Schedule 12 Part 2 Paragraph 19(1) (s 87 D)

6. The provisions disregarding capital payments to non-residents and making individuals deemed domiciled will result in taxation in different jurisdictions. The draft legislation does not include any provisions to mitigate this. Is that intentional?

Schedule 12 Part 2 Paragraph 19(1) (s87G)

7. Is the intention that s 89G(3) provides the settlor with an enforceable right to recover the tax due from either the beneficiary or the trustee? If so, we are unclear as to how it is to be enforced where the beneficiary or trustee is foreign resident.
8. Can HMRC confirm that:
 - I. the reimbursement of the tax from the trustees will not count as a capital payment and be taxable as such; and
 - II. the reimbursement of the tax from the beneficiary will not fall within s87I and so itself be charged.

Schedule 12 Part 2 Paragraph 19(1) (s87I)

9. Can HMRC confirm that the current draft provision is too wide and there is only an intention to catch onward gifts where there is a direct causal link with the original capital payment?
10. If the original beneficiary is a temporary non-resident upon receipt of the capital distribution and then makes a gift which falls within s87I and is taxed as a result, how is the charge under s87E (temporary non-residents) relieved from double taxation when he returns?

Schedule 12 Part 2 Paragraph 19(2)

11. We understand that this was supposed to be a relieving provision to remove the charge on the beneficiary but as drafted it is ineffective. The problem being that rather than removing the gain from charge it just switches off the provision classifying the gain as foreign. Can HMRC confirm that there is a problem with the drafting that will be addressed?

Schedule 12 Part 2 Paragraph 19(4)

12. The Paragraph 19(4) commencement provisions are unclear and read literally (which they are being by some leading tax counsel) para 19(4)(b) requires a re-working of all historic stockpiled gains pools to remove payments to non-residents.

In effect this will result in retrospective taxation, which could go back well over 20 years. To require a re-working of historic matched capital payments could have a dramatic effect on some trusts and the interests of beneficiaries where trustees planned for current and future beneficiaries taking account of tax pools calculated in accordance with the law at the time.

This was never discussed in stakeholder meetings and we understood that it was just: (i) unmatched capital payments as at 6 April 2017; and (ii) capital payments after 5 April 2017 that would be disregarded. Can HMRC confirm that this is the intention and that the draft legislation will be amended so the point is clear?

CGT Rebasing

Schedule 12 Part 3 Paragraph 21

13. Is the intention that partnership and LLP assets can be rebased?
14. An individual who is deemed domiciled in 2017/18 and who becomes temporarily non-resident after 2017/18 will not benefit from the rebasing. Is this the intention?
15. The mechanism used to provide the rebasing is a deemed acquisition on 5 April 2017. This begs the question as to what the rebased gain (that is the gain on the deemed 5 April 2017 sale and acquisition) should be classified as for the mixed fund rules and to what year it should be allocated. Our understanding from our discussions etc is that the rebased gain will be seen as "clean capital" arising in the tax year that the asset is actually disposed in. Can you confirm this is correct?
16. The deemed acquisition also raises the question as to what market value to use. Is it the market value a third party would pay or the market value the actual taxpayer would pay factoring in his other assets? For example, X may own 30% of a company indirectly via a holding company and 70% directly. Is the 70% to be rebased to a market value which reflects a minority discount or a "full" market value? The latter would appear to be the correct answer as this is what he would

pay to obtain control in an acquisition but the legislation is unclear on the correct approach. Can you confirm the correct approach?

Cleansing Mixed Funds

Schedule 12 Part 4 Paragraph 24 and version 2 of the draft guidance

17. The draft legislation is relatively clear that there cannot be more than one nominated transfer from account A to a first account B.
18. However, it is also clear that more than one nominated transfer can occur from account A i.e. by making a transfer to a second account C (or to further transferee accounts).
19. Example 1 in the draft guidance is in line with this analysis. However, the guidance also states (paragraph 8) that: *"A cleansing transfer can only be made if no transfer has previously been made from the account which holds the mixed fund. This is the case even where a subsequent transfer is made into a different receiving account."* This seems to be at odds with both the example and the draft legislation. Can you clarify this? Can you also confirm that it is just nominated transfers that are not allowed and that offshore transfers for other purposes (such as bank fees/charges) would not be an issue?
20. The guidance also states (paragraph 12) that in the absence of s809R applying to the transfer, s809Q will not apply to the transfer and so the amounts transferred will be determined by the actual amounts in the mixed fund: *"P nominated these transfers for the purposes of the cleansing rules which are not subject to section 809R(4) as a result. In the absence of statutory identification rules, the composition of the transfers will be determined by the actual amounts of income, gains and capital in the accounts immediately before the transfers take place."*

On what legislative basis is this asserted? Whilst we wish it were correct to our mind it is not at all clear that this "default" position can be supported from the draft legislation. Or put another way, there is no way of taking a pound from a mixed fund and being able to say with certainty this pound is capital (or income or gains etc), so specific legislation is required so the cleansing relief can operate in line with the intention.

CLAUSE 41: DEEMED DOMICILE: INHERITANCE TAX

21. Apart from where the transitional provision at sub-section (10) applies, a foreign domiciliary leaving the UK after 15 years of residence will become deemed domiciled in the year they leave even though this is a year of non UK residence. Is this the intention? It appears to run counter to the policy intention originally announced.
22. In clause 41(11)(a) it states: ...in the settlement on or before that date is...". To what does the word that refer? Is it the 5 April 2017 mentioned in cl 41(9)? We think it should be made clear.

CLAUSE 42 & SCH 13: OVERSEAS PROPERTY WITH VALUE ATTRIBUTABLE TO UK RESIDENTIAL PROPERTY

Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(1)

23. Any unconnected creditor of a close company or partnership which holds UK residential property appears to be caught by these provisions? The terms are extremely wide ranging. Are they intended to be construed in such a far reaching manner?

24. Can you confirm how widely you intend “indirectly” to be read? If a company owning a UK residential property sold the property such that it then held cash would you argue that the cash was indirectly related to the UK residential property such that the two year rule at Paragraph 1 Schedule A1 Part 2 Paragraph 5 applied?

Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(2)

25. Did you really mean to catch cases where a subsidiary in a close company owns shares in an open company or fund which has an interest in UK residential property?

26. During the course of various stakeholder meetings we were led to believe that ownership of interests in an open company or fund would fall outside the scope of these rules; that does not appear to be the effect; is this intentional or a drafting issue that will be amended?

Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 2(5)

27. Is it your intention that shares held in close companies should be valued on normal share valuation principles, so that minority discounts for companies will apply? The draft legislation suggests so but we are concerned by certain comments in the December Response Document.

28. Please confirm that before applying minority discounts, the value of the shares would be based around their open market commercial value which would also take into account the value of contingent liabilities as against the net asset value of the company concerned. This should include a discount for:

- (i) the costs of liquidating the company
- (ii) capital gains tax
- (iii) ATED
- (iv) administration costs
- (v) the risk of undisclosed corporate liabilities, such as if the company had inadvertently been centrally managed and controlled from the UK, and there is a liability to UK taxation on the company's profits as a result.

These principles will be applied where a UK domiciliary owns a foreign company holding a UK residential property, so there should be no issue as we understand that the policy was to put foreign domiciliaries on the same Inheritance Tax (IHT) footing as UK domiciliaries.

Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 3

29. Did you really mean to impose a charge to tax on investors who hold interests in an open fund structured as a partnership which invests in UK residential property whereas had they invested using a company no such charge would have arisen?

Schedule 13 Paragraph 1 Schedule A1 Part 1 Paragraph 4

30. A charge to tax is imposed by reference to a loan used to acquire an interest in UK residential property. Could you please outline in what circumstances a loan can have a value which is indirectly attributable to a UK residence. The meaning of indirect is unclear, and appears unlimited.

31. Can you please clarify the position by reference to the following scenarios where the lender is a wealthy non-UK resident and domiciled individual who has no financial interest in the shares held. In each case please assume that the lender dies on 6 April 2017, so determining whether there is a relevant loan matters. All of the companies are resident and incorporated outside of the UK:

- (i) Company A owns UK residential property worth £10m and UK commercial property worth £20m. There is no debt encumbered on the residential property but there is debt charged on the commercial property to the value of £15m. The debt was used to acquire the commercial property.

We consider that the debt charged on the commercial property is not a relevant loan because it has not been used directly or indirectly to finance the acquisition of UK residential property.

- (ii) Company B has the same circumstances as Company A save that there is floating charge for all the loan debt against all of the company's property?

We consider that the fact there is a floating or general charge secured on all of the properties is irrelevant; we consider that what matters is the way the debt is applied in acquiring the property concerned. So as no debt was used to acquire UK residential property the debt is not a relevant loan.

- (iii) Company C has the same circumstances as Company A, save that a defect has been found in the leasehold interest held in relation to the commercial property it owns which has reduced its value to £5m, meaning that the lender will have recourse to the residential property if the debt is unpaid. There is a potential right of action against the solicitors who acted for the company which would enable the company to recover £15m. But whether or not the action would succeed is unclear, and the position will not be known until the case is heard in the High Court in 5 years' time.

We consider that as no loan debt was used to acquire the UK residential property, the loan debt cannot be considered to be a relevant loan. The fact that the loan creditor might subsequently seek to recover the balance of any funds due from the UK residential property does not cause the loan to become a relevant loan.

Taking the above three scenarios if you agree with us that the loans are not relevant loans could you also comment on whether you would argue in any of the

three cases that there was an indirect interest in UK property as a result of the loans?

32. Some banks (particularly offshore banks) are structured as partnerships so are caught by the draft legislation with respect to relevant debts even though the loans are on commercial arm's length terms. This will be a serious economic problem if it is not addressed. Can you confirm that catching banks was not intentional and that adjustments to the legislation will be made to avoid this?

33. Did you mean to impose a charge to tax by reference to a loan used to acquire an interest in land where the loan is not wholly deductible in reducing the value of the residential property interest held (Sch A1 IHTA 1984 para 2(5))?

34. Were any of the following intentional or are they drafting issues that will be amended:

- I. defining qualifying interest so widely that the combined values of collateral, loan company or partnership interests can exceed the value of the underlying residential property to a very significant extent?
- II. placing no cap on the maximum amount of tax that can be collectively levied?
- III. having no order of priority as to who amongst a potentially large number of individuals might be taxed under this legislation?

Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 5(4)

35. There is no time limit on the exit charge that can apply where discretionary trusts are involved. Can you confirm that this was not intended and that the draft legislation will be amended?

36. In addition, we consider that under the draft legislation there will be an automatic relevant property exit charge where there is a disposal of a qualifying interest in UK residential property at the point that (typically) the proceeds of sale are invested in other than UK sited assets. This is as a result of the failure of the proposed provisions to mesh with s65(7) IHTA 1984. Is this intended? Assuming it is not can you confirm that the draft legislation will be amended?

Schedule 13 Paragraph 1 Schedule A1 Part 2 Paragraph 6

37. Do you really intend to impose a tax advantaged TAAR as distinct from one which applies where tax avoidance is involved? For example, in the IHT context making a potentially exempt transfer is a tax advantaged step, but because the relief is provided for in the legislation it can hardly be considered to be tax avoidance. Similarly, making a gift of property to a spouse is a tax advantaged step because of the spouse exemption, but it is hardly tax avoidance. We had assumed that you had intended to catch cases involving 'tax avoidance' where tax was saved in a way that Parliament had not envisaged. Whilst we do not think that a TAAR provision is actually required, if the provision is to be introduced we think that it should target 'tax avoidance' and not tax advantaged scenarios.

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 <http://www.icaew.com/-/media/corporate/files/technical/tax/tax-news/taxguides/taxguide-0499.ashx>).