Changes to the taxation of non-UK domiciliaries

Personal tax

01 January 2016

The Technical Team reports on recent developments

There has been much activity in this area of tax recently.

Loan collateral – Revenue & Customs Brief 16/2015

On 4 August 2014 HMRC announced a significant change to its guidance at RDRM33170 (now archived).

The change concerns remittance basis users who have pledged foreign cash or investments, representing their unremitted foreign income and gains, as collateral for loans used in the UK.

From 4 August 2014, in a change to their previous practice, HMRC stated that money brought to or used in the UK under a loan facility secured by foreign income or gains will be treated as a taxable remittance of that amount of foreign income or gains. The CIOT made immediate representations to HMRC and talks are continuing. On 15 October 2015, HMRC issued RCB 16/2015 confirming grandfathering for arrangements entered into before 4 August 2014. However, significant issues remain. Immediately after the RCB, a conference call was held between HMRC and the CIOT and other stakeholders to continue to address these issues. The note of this conference call will be posted to the new CIOT website as soon as possible but, in the interim, a copy can be ordered by emailing technical@ciot.org.uk.

‘Reforms to the taxation of non-domiciles’ consultation

In the summer Budget the Chancellor outlined proposals on new deemed domicile rules with further detail given in the technical briefing issued on 8 July 2015.

The consultation was published on 30 September 2015 and the CIOT and LITRG responded. The CIOT was strongly represented at the series of stakeholder events held by the Treasury and HMRC to inform and develop the proposals. The CIOT is continuing its engagement with the Treasury to contribute to framing the reforms.

Stability

The consultation is prefaced with the robust statement: ‘The government wants to attract talented individuals to live in the UK who will help to contribute to the success of this country by investing here and creating jobs.’

The CIOT emphasised that a key condition for attracting such individuals is stability. Therefore a message that no further negative changes will be made to the taxation of non-UK domiciliaries in this parliament would provide reassurance and help to attract more talent.

Part of this stability is certainty on the loan collateral changes. Although the confirmation of grandfathering for arrangements entered into before 4 August 2014 is welcome, more clarification is needed. In addition, the CIOT has engaged extensively with the Treasury and HMRC on the factors that discourage use of business investment relief (BIR) and therefore investment in the UK by non-domiciliaries contrary to the policy intent. The announcement in the Autumn Statement 2015 Blue Book at paragraph 3.22 that the government will consult on changing the BIR rules to encourage greater use of the relief to increase investment in UK businesses is a welcome step.

Pitfalls of legislating for the reforms in stages

Legislation implementing the proposed reforms will be included in two stages, partly in Finance Bill 2016 and partly in Finance Bill 2017.

It is envisaged that Finance Bill 2016 will include the changes to ensure that an individual shall be deemed to be domiciled in the UK for all tax purposes if:

- he or she is UK resident for at least 15 of the preceding 20 years ('the 15 out of 20 years rule'); and
- he or she was born in the UK with a UK domicile of origin (but has subsequently acquired a non-UK domicile of choice) and becomes resident in the UK ('returning UK domiciliary rule').

Finance Bill 2017 will include further (perhaps entirely new) rules (as yet unknown) in relation to offshore trusts and in relation to inheritance tax and residential property structures.

The CIOT's strong preference would be for the complete package of measures to be introduced into legislation at the same time rather than in stages – in other words, legislating on the entire package in Finance Bill 2017 with the benefit of prior consultation on the complex area of the treatment of offshore trust. Legislating in tranches has the potential to create mismatches or lacunae because full integration is interrupted by the passage of time. Further, if the second tranche is abandoned, perhaps because of the inherent complexity around offshore trusts (as explored in the CIOT's response), the consequence will be that taxpayers are left with half a package.

Fifteen out of 20 years rule

The CIOT's response raises various issues about the 15 out of 20 years of residence test. For tax years before the statutory residence test (SRT) was introduced, the consultation says that individuals will have to assess their residence status based on the rules in place at the time.

To mitigate uncertainty we suggested that if a person's residence status is uncertain for periods before 6 April 2013, the SRT test is used as a proxy test to determine when the 15-year period begins. There are particular concerns for expatriate employees who in the pre-SRT period could become UK tax resident with immediate effect if they came to the UK for at least two years for a purpose such as employment. In addition, the position in relation to split years needs further consideration. The CIOT proposes transitional rules particularly for those who may already have completed a sufficient period of absence to break IHT deemed domicile

(four years), or to avoid a CGT re-entry charge (five years), or who are completing a period of non-residence.

Returning UK domiciliary rule

The stated policy aim is one of horizontal equity to ensure that individuals who live in the UK for a long time will pay UK tax on their personal foreign income and gains, as would an individual who is domiciled in the UK under general law. It is doubtful that 'the returning UK domiciliary rule' based, as now, purely on the accident of the individual's place of birth wholly meets this aim, and is potentially counter-productive by tipping the balance away from a return to the UK. However, the CIOT acknowledged that situations where the returning UK domiciliary rule may operate inequitably might be the exception rather than the rule. It suggested that a grace period for all tax purposes before the returning UK domiciliary rule is engaged would help to mitigate the position for these relatively unusual cases.

Offshore trusts

The CIOT recognises that the proposals put forward by the government to tax individuals who become deemed domiciled on the value of benefits received from an offshore trust is intended to deal with the problems that would otherwise be faced by trustees in trying to work out the historic gains or income position. However, we consider these to be unworkable and perhaps contrary to EU law. We suggest that a better route is to treat them in the same way as actual UK domiciliaries who receive benefits from a trust, namely by reference to the income and gains arising in the offshore structure.

LITRG's response

LITRG focused on issues of concern for low-income individuals who may also be affected by the proposals. In particular, the consultation questioned whether the current £2,000 *de minimis* threshold for non-UK domiciliaries should be retained without offering any justification for its removal. Thus, LITRG submitted robust arguments in favour of both its retention and also its extension to individuals who become deemed-domiciled in the UK. LITRG also recommended a review of the threshold, with a view to increasing it.

The £2,000 *de minimis* threshold was a hard-fought concession obtained by LITRG to prevent many low-income non-UK domiciliaries finding themselves on the wrong side of the law. The rationale behind the threshold remains. For low-income individuals with overseas income, gains or assets, the failure to retain a suitable *de minimis* threshold would result in a significant administrative and reporting burden. It would also result in extra work for HMRC and would in many cases not produce any revenue due to the availability of double tax relief.

LITRG also raised a concern that low-income, unrepresented migrants would be unfairly penalised by the changes proposed, especially the introduction of a strict liability offence for failures to declare offshore income and gains. Many low-income migrants will be unable to afford to pay for tax advice. It is likely that even the most diligent and thorough migrant will find it difficult to understand the complexities of the UK tax system.

LITRG questioned some of the assumptions on which the consultation was based. For example, the consultation states that most non-UK domiciliaries leave within a few years. No statistical basis was provided for this; most non-UK domiciled individuals do not complete tax returns, and self-assessment declarations represent only a fraction of the true number.

The LITRG submission is available on the LITRG website.