CIOT responses to further consultation on non-domiciles

Personal tax

01 December 2016

Issues arising from: the introduction of deemed domicile for all tax purposes after 15 out of 20 years UK residence; charging inheritance tax on UK residential property held indirectly (enveloped) through offshore structures; possible changes to Business Investment Relief rules to encourage greater investment in UK businesses by non-UK domiciled investors.

The CIOT has responded to the further consultation on reforming the taxation of non-domiciliaries published on 18 August 2016. This consultation follows the earlier consultation in September 2015.

The further consultation covers three main areas:

1. the government's response to the original 30 September 2015 consultation on the new deemed domicile rules
2. a consultation on the proposals to charge inheritance tax on UK residential property held indirectly (enveloped) through offshore structures (as announced in the July 2015 Budget) and
3. a consultation on possible changes to the Business Investment Relief rules to encourage greater investment in UK businesses by non-UK domiciled investors, as announced at Autumn Statement 2015.

The CIOT has made a separate response to each element. Our comments also reflect consultative meetings we attended with HMRC over the summer.

Proposals to deem long term residents as UK domiciled for tax purposes once they have been resident in the UK for 15 out of 20 years

- It is proposed that years of residence include years spent in the UK while under 18. The CIOT considers that there is a good case to be made for excluding years of residence spent in full time education while below the age of 18 recognising particularly the importance to the UK economy of retaining an internationally competitive UK schools sector
- It is not clear whether the proposed rebasing of foreign assets for CGT will exclude assets held via a trust. Given that the apparent rationale of rebasing is to remove gains attributable to the period before an individual became deemed domiciled from the scope of a CGT charge, there seems little reason to preclude trust held assets from the benefit of rebasing.
- We questioned why the relief is not being extended on a rolling basis to those who are close to becoming deemed domiciled say, 14 out of 20 years, as at 6 April 2017. Fairness would seem to dictate that individuals in that position ought either to be able to elect into the deemed domicile 'early' so that they become deemed domiciled on 6 April 2017 or that those becoming deemed domiciled on 6 April 2018 or 2019 are also included
- There is a need for clarification, and perhaps further consideration of the way that the temporary window to allow mixed funds to be segregated into their constituent parts will operate.
- The CIOT considers that the proposals set out in the consultation response in respect of protections for non-resident trusts create technical and practical difficulties. There are two alternative proposals (both attached as appendices to the CIOT response which can be viewed at www.tax.org.uk/ref202). The first alternative is the proposals discussed at the 20 September 2016 consultative meeting, the 'lead HMRC proposals'. The second alternative is the ICAEW led proposals in which members of the CIOT and other representative bodies have been involved. Of the two alternatives, the CIOT prefers the ICAEW led proposals which have the merit of relative simplicity while at the same time seeking to deliver the then Chancellor's aims without extending the scope of the proposed changes.

Proposals to charge Inheritance Tax on UK residential property held indirectly (enveloped) through offshore structures

- It is proposed to bring residential properties in the UK within the charge to IHT where they are held within an overseas structure. This charge will apply both to individuals who are domiciled outside the UK and to trusts with settlors or

beneficiaries who are non-domiciled. To implement the extended IHT charge, the government proposes to remove UK residential properties owned indirectly through offshore structures from the definitions of excluded property currently provided by sections 6 and 48 of the Inheritance Act (IHTA) 1984. This will apply whether the overseas structure is owned by an individual or a trust.

- The CIOT prefers the draft IHT legislation whereby UK residential property which is held directly or indirectly by offshore structures is not to be 'excluded property' is based on the Non-Resident CGT definitions contained in Schedule B1 to TCGA 1992, rather than the definitions published with the original consultation document.
- We think that difficulties with certain Double Taxation Treaties may be capable of being overcome by deeming the relevant shares to be UK land. This could also provide eligibility for the Residence Nil-rate band.
- Where there is an IHT charge on the shares, based on the value of the underlying land, there should be a CGT uplift not only on those shares but also on the value of the underlying property.
- Gift with reservation complications arise from non-resident settlor interested trusts indirectly holding UK residential property. We suggest that these could be avoided either by disapplying the gift with reservation regime from cases which fall within the new regime or by allowing them to be treated as qualifying interests in possession outside of the relevant property regime.
- There should be just and reasonable apportionments where the property has not been a dwelling throughout the period or in cases of mixed residential and commercial use.
- There are considerable difficulties in implementing the government's proposals to disallow debts to connected persons. An alternative approach could be to deny deduction of connected party debts where the debt itself is excluded property.
- The CIOT is not persuaded that the inclusion of a TAAR is justified; and believes that the potential for the GAAR to apply should be sufficient protection.
- Whilst discussion with the professional bodies is commendable, it is regrettable that in a public consultation of such significance, an alternative version of the draft legislation (referring to the Non-Resident CGT definitions contained in Schedule B1 to TCGA 1992) which was released subsequently to the professional bodies was not updated on Gov.uk.

A consultation on ways Business Investment Relief (BIR) could be changed and expanded to make it easier for remittance basis users to bring their money from overseas to invest in UK businesses

Any legislative change will be included in Finance Bill 2017 and will take effect from 6 April 2017.

- The consultation follows extensive informal engagement by the CIOT on the flaws of BIR that has hindered take up.
- There are a number of relatively straightforward legislative amendments to the conditions and to the rules relating to the withdrawal of the relief that would achieve the policy aim.
- In terms of the current disproportionate triggers for withdrawal of the relief, these include i) ensuring that the withdrawal of the relief is proportionate to the benefit or extraction of value, ii) reform of the extraction of value rules for 'involved' companies, or perhaps abolishing those rules altogether and extending the benefit rules to operate after the date of investment.
- The requirement to start trading within two years is the single biggest restriction on larger projects and means that the relief is thought of only in the context of small private companies. An adjustment to this requirement is necessary if the policy is to encourage take-up of BIR by those wishing to invest in high value public projects.
- The response also considers ways of extending the scope of the relief including repeal of ITA 2007 section 809VO to allow a BIR investment to reduce the income/gains of a mixed-fund, a disapplication of the two-year Business Property Relief qualifying period for BIR investments to remove the existing IHT exposure when bringing in funds to invest, extending the conditions to allow investment in existing shares where the investor is taking over an existing business in order to invest further.
- Further dialogue between the professional bodies and HMRC is anticipated on all three aspects, leading to the publication of revised draft legislation for inclusion in Finance Bill 2017 and taking effect from 6 April 2017