Chartered Institute of Taxation
Excellence in Taxation

Reforms to the taxation of non-domiciles
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The proposals are at stage 2 (determining the best option and developing a framework for implementation including detailed policy design) of the government's tax consultation framework. However, the consultation has been preceded by a number of pre-consultation meetings held over the summer with stakeholders. We acknowledge the useful and extensive engagement with HM Treasury and HMRC that has resulted in a clear and concise consultation paper on the government's initial thinking. Ongoing engagement through continuing stakeholder meetings continues to contribute to framing the reforms.

1.2 We note that the consultation is prefaced with the robust statement that '*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'*[1]. One of the key conditions for attracting such individuals is stability. A message that no further negative changes will be made to the taxation of non-UK domiciliaries in this Parliament would help to reassure and attract such individuals. In addition we have engaged extensively with HMT and HMRC on the factors that discourage use of Business Investment Relief (BIR) and therefore investment in the UK by non-domiciliaries. We hope that changes will be made to the extraction of value rules of BIR to encourage greater use of this relief in accordance with the policy intent. In the same vein, further work is needed to clarify the position in relation to foreign income and gains used as collateral. The recent announcement of grandfathering for arrangements entered into before 4 August 2014 is welcome, but more work still needs to be done to clarify the position.

[1] Foreword David Gauke, Financial Secretary to the Treasury.

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2 Executive summary

2.1 Legislation implementing the proposed reforms will be included in two stages, partly in Finance Bill 2016 and partly in Finance Bill 2017. Our strong preference would be for the complete package of measures to be introduced into legislation at the same time rather than in stages i.e. legislating in respect of the entire package in Finance Bill 2017 with the benefit of prior consultation on the complex area of the treatment of offshore trust.

2.2 The stated policy aim is one of horizontal equity to ensure that those 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' (as defined at 3.1 below) based, as currently, 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, it is acknowledged that situations where the returning UK domiciliary rule may operate inequitably may be the exception rather than the rule and a grace period (for all tax purposes) before the returning UK domiciliary rule is engaged would help to mitigate the position for these exceptional cases. To the extent that the returning UK domiciliary rule goes beyond what is understood to be the policy intent, in respect of those unusual cases whose birth in the UK can genuinely be regarded as by 'happenstance' in that it was not reflective of their parents' (and their own immediately following) real living patterns over a meaningful period at the time, the challenge is to exclude them from the returning domiciliary rule. We suggest this challenge might be further explored.

2.3 The CIOT endorses the response of the Low Income Tax Reform Group (LITRG) in that the current £2,000 *de minimis* threshold for non-domiciled individuals should be retained and, in addition, this treatment should be extended to those individuals who are deemed-domiciled in the UK under the 15 out of 20 years rule.

2.4 While the CIOT recognises that the proposals put forward by the government to tax individuals who become deemed domiciled under the 15 out of 20 rule 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/ income position, we consider the proposal to be unworkable and potentially 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 i.e. by reference to the income and gains arising in the offshore structure.

2.5 A grace period (for IHT only) for those affected by the returning UK domiciliary rule has been included in the draft consultative legislation. The CIOT agrees that a reasonable and equitable grace period is needed, and not only for IHT. However, we do not consider that the proposed grace period deals adequately with all of the potential injustices arising from the returning UK domiciliary deeming provision particularly for an individual who has spent most of their life outside the UK and returns only to undertake a short term secondment or to care for a relative.

3 Pitfalls of legislating in stages

3.1 Legislation implementing the proposed reforms will be included in two stages, partly in Finance Bill 2016 and partly in Finance Bill 2017. All changes are intended to take effect from 6 April 2017.

It is envisaged that the 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:

i) he or she is UK resident for at least 15 of the preceding 20 years ('the 15 out of 20 years rule');

ii) 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').

It is envisaged that the 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 considers it to be essential that sufficient time is available for consultation on the proposals and draft legislation implementing the proposed changes given that these constitute a significant and complex reform of the tax regime applicable to non-domiciliaries.

3.2 Our strong preference would be for the complete package of measures to be introduced into legislation at the same time rather than in stages i.e. legislating in respect of the entire package in Finance Bill 2017 with the benefit of prior consultation on the complex area of the treatment of offshore trusts. Legislating in tranches has the potential to create mismatches or lacunae because full integration is interrupted by the passage of time. There is inevitable uncertainty engendered by the two-stage approach although we recognise that changes have been at least signalled early in the process.

3.3 The CIOT is concerned also that should the second tranche be abandoned for any reason, perhaps because of the inherent complexity, the consequence will be that taxpayers are left with half a package. The CIOT would, therefore, welcome a 'sunset clause' under which the Finance Bill 2016 measures fall away if the Finance Bill 2017 measures are not enacted. Such a clause would not only ensure coherence in that either both halves of the package are implemented or the entirety falls away but will also introduce a valuable element of post-legislative review thereby enhancing the policy making process. Failing that there should be an undertaking from the Financial Secretary to the Treasury that there will be a prompt review of the changes introduced by Finance Bill 2016 should there be a failure to implement the second tranche of changes in Finance Bill 2017.

4 Horizontal equity

4.1 The stated policy aim is that those 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. The aim is therefore one of horizontal equity: in considering whether non-domiciliaries are fairly taxed, a comparison is to be made with UK domiciliaries to assess whether the two groups are treated equally.

4.2 The returning UK domiciliary rule will treat individuals born in the UK but who have lived outside the UK for most of their lives in the same way as individuals who have lived all or most of their lives in the UK. To illustrate the inherent inequity created by

this concept, consider the position of an individual:

- born in the UK of UK domiciled but non-resident parents who are in the UK on holiday or for some other temporary purpose (under general principles, the individual acquires a UK domicile of dependency)
- who is taken out of the UK by his parents immediately after birth, grows up, lives and works abroad for the next, say, 30-40 years during which time he acquires a foreign domicile of choice under general principles;
- who is seconded by his employer to the UK on a short term basis or who returns to the UK to care for his elderly and infirm parents who have resumed residence in the UK

The individual will, under current proposals, be treated for income tax and capital gains tax purposes in the same way as a UK domiciliary.

This is arguably inequitable given that it is pure happenstance that the individual was born in the UK. The harshness of the rule is highlighted further if one compares the position with the individual's sibling who was born outside the UK and who is, therefore, not affected by the returning UK domiciliary proposal. The sibling may therefore take up temporary secondment in the UK or come to the UK to look after his/ her parents without incurring the same adverse consequences as the individual.

Although such cases may be the exception rather than the rule, given the relatively short period that may be spent in the UK in order to engage the returning UK domiciliary rule, it is arguable that the position of such an individual is not truly comparable to a UK domiciliary who has lived all or most of his life in the UK. Greater parity between the position of a returning UK domiciliary and a UK based domiciliary may be achieved by requiring the returning UK domiciliary to spend a longer time in the UK e.g. 5 years before the returning UK domiciliary rule is engaged.

It is noted that a short "grace period" of 1 year (for IHT only) is envisaged in the draft legislation so that, taking the case of the individual noted above, he will face the full IHT impact of the returning UK domiciliary rule after the expiry of one year in the UK. The reason for the choice of 1 year is not clear: it does not sit comfortably with the duration of the usual temporary secondment (see further comments in relation to question 6).

Further, as noted below, there are currently no proposals for protecting the income tax and capital gains tax position of offshore trusts created by the individual at a time when he had acquired a domicile of choice abroad.

To the extent that the returning UK domiciliary rule goes beyond what is understood to be the policy intent, in respect of those unusual cases who are caught by 'happenstance', the challenge is to exclude them from the returning domiciliary rule. We suggest this challenge might be further explored.

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4.3 The CIOT notes also the close link between inheritance tax and succession; individuals who acquire deemed domicile status and therefore liability to inheritance tax on their worldwide assets, may not benefit from the UK's freedom of testamentary succession.

4.4 The CIOT wonders also whether the returning UK domiciliary rule may be counter-productive. This can be illustrated by an example.

A number of individuals in, say, the Channel Islands may well have been born in the UK and potentially have a UK domicile of origin. Members report that, many such individuals say that these changes mean that they will now definitely not come back to the UK whereas previously it may have been in the back of their minds that that option was at least open to them.

Consequently, in legislating in this way, the UK may actually turn what was not a settled intention (to remain in the Channel Islands) into a settled intention –definitely to remain in the Channel Islands) - thereby depriving the UK (besides anything else) of the inheritance tax that might well have been due on the death of these individuals. In other words these very proposals might firm up a domicile of choice which was not otherwise present.

5 Legislating the deemed test

5.1 **Question 1: Do stakeholders agree that this is the best way to introduce the test for deemed-domicile status?**

5.2 Subject to the wider point at 5.3 below, in terms of the draft legislation, the CIOT's preference would be for the tests to form part of the main section setting out the application of remittance basis (section 809B) as a pre-condition rather than formulated as a separate additional condition in new section 809EA. Such an approach would markedly improve the way the legislation is read. As it stands the starting point for the application of the remittance basis is section 809B(1)(b) as being 'not domiciled in the UK in that year' with a further 3 intervening sections before arriving at new 809EA which would disapply the remittance basis.

5.3 From a wider perspective, the CIOT is generally in favour of greater standardisation of tax concepts of general application across the taxes. The introduction of standard definitions would require a review of the overall format of the tax statutes, perhaps involving the introduction of a separate definition or tax interpretation act where key concepts that have general application, including domicile, residence and other terms should be defined with variances from the standard signalled for clear policy reasons.

5.4 We consider that care is needed with the nomenclature. As a common law concept, domicile is relevant to wider personal rights. It should be clear on the face of the legislation that an individual who meets the deeming tests will be treated as domiciled for the purposes of the relevant tax statute only.

5.5 We are generally a little wary of the use of the term 'deemed domicile' without more. While it is arguably useful shorthand, we note that the term is not used in the initial draft legislation included in the consultation paper. The CIOT is concerned that the use of this term without more has the potential to confuse the use of the concept for UK tax legislation to determine the extent of an individual's liability to income tax, capital gains tax and inheritance tax (IHT) with its application in common law. Members have already reported many instances of clients having difficulty with the concept of being deemed domiciled for tax purposes while remaining non-UK domiciled for non-tax purposes such as inheritance, succession, divorce, jurisdiction

– and possibly for some remaining tax purposes such as trusts.

5.6 The CIOT's preference is to use a term that limits the scope of the deemed status to tax only. For example, "deemed domiciled in the UK for tax purposes".

An alternative formulation might be the "Compulsory Arising Basis" (CAB) or "Compulsory Worldwide Basis" (CWB). Compulsory Worldwide Basis has the advantage of encompassing IHT as well as income tax and CGT. Indeed adopting this term could arguably allow the legislation to read more logically by amending section 809B to add a new condition in section 809B(1)(ba) being that the individual "does not have CAB Status; and" with CAB status defined within the same or a following section.

5.7 The proposals envisage that the actual domicile position of minors (under general law) and their deemed domicile position will be considered separately. The new rules will count any year of residence in the UK while a child is under 18. As the status of a child is not dependent on the parent, a child can therefore become deemed domiciled (and lose deemed domicile status) before reaching 18. The effect is that a child born in the UK could become domiciled in the UK for tax purposes under the 15 of 20 years test between the ages of 13 and 15, depending upon their date of birth.

5.8 Given that establishing a minor's residence status under the Statutory Residence Test (SRT) in the very early years and at birth is far from easy[2] the CIOT suggests that, in the interests of simplicity, consideration should be given to applying the test to determine whether an individual acquires UK domicile status only from the age of 18. The years before 18 would still count but deemed domicile status would only apply from the age of 18 thereby removing the complexities of determining residence in the early years. This would have the merit of consistency with the current remittance basis charge which applies only to individuals who are aged 18 or over in a tax year (the relevant tax year) presumably in recognition of these difficulties.

5.9 The CIOT seeks clarification of the statement in the consultation document (paragraph 3) which states, "From the 16th year a foreign domiciliary will become deemed UK domiciled." Is it envisaged that this position will apply even where, in the 16th year, the individual is non-resident?

5.10 It is proposed that an individual who has lived in the UK for 15 consecutive tax years and who becomes non-resident for a period of 6 consecutive complete tax years will be treated as non-UK domiciled upon resuming residence for another period of 15 years assuming they have foreign domicile status as a matter of general law. In our members' experience, fundamentally taxpayers need certainty and clarity, objectives that are simply not met by differing time periods to establish non-UK residence for various tax purposes. The CIOT therefore suggests that a single period be stipulated which will apply for the purposes of shedding UK residence under all the applicable rules. The discussions during the workshops suggested that HMRC/HMT were amenable to this idea.

6 Split years/statutory residence test

[2] This is because the SRT requires conditions to be satisfied in preceding or succeeding years or over a period or at a particular time in a fiscal year. For example a child born on or after 20 February (21 February in a leap year) is automatically non-UK resident for that fiscal year because he/she will not have been resident in any previous year and cannot have spent 46 days or more in that year.

6.1 **Question 2: Are there any difficult circumstances that might arise as a result of this approach that could be avoided with a different test?**

6.2 For tax years before the SRT was introduced, the consultation notes that individuals will have to assess their residence status based on the rules in place at the time. (We note that the election to apply the SRT for years before it came into effect on 6 April 2013 is disapplied for 2017-18 (the last year in which it is possible to make an election in respect of a previous year) by the proposed amendment to FA 2013 Schedule 45. The CIOT suggests that where 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.

6.3 There is a particular concern for expatriate employees, who pre- SRT could become UK tax resident with immediate effect if they came to the UK for a period of at least two years for a purpose such as employment. This could make an individual tax resident for an entire tax year if he arrived in the UK on 5 April for tax years up to and including 2012/13. Where this leads to "extra" years of residence for individuals with several separate UK assignments it could markedly curtail the period over which the remittance basis is available to them. A fairer measure would be to allow years where the taxpayer had fewer than say 46 days (in line with SRT) in the UK to be ignored for the purpose of the 15 out of 20 years rule.

6.4 The CIOT suggests also that the position in relation to split years needs further consideration. There is a potential mismatch between the income tax and capital gains tax position on the one hand and the IHT position on the other hand where the year in which the 15 out of 20 years test is met is also a split year. The former provisions appear to give relief in respect of the non-resident part of the year but there is no relief in the latter provisions in relation to chargeable transfers made in the non-resident part of the year.

6.5 The CIOT proposes that there should be transitional rules for those who may already have completed a sufficient period of absence to break IHT deemed domicile (4 years) or to avoid a CGT re-entry charge (5 years). For instance a non-UK domiciliary who had been in the UK for many years, then left prior to 2011/12 and returned just after 2014/15 would have stayed for four complete tax years out of the UK. On their return he/she would have reasonably expected to be able to complete another 17 years in the UK before the current IHT deemed domicile 17/20 year test would have caught them again. It is not unreasonable for 17 years to be shortened to 15 years for such a case. However, it is unreasonable for the period to be shortened to zero years, because they will be become immediately deemed domicile again on 6 April 2017. Members report that several of their clients are in this situation and are now too late to organise a further period of non-residence prior to 6 April 2017.

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6.6 Anyone who has completed a suitable period of absence under the old rules should, as a transitional rule, have all years up to and including those years left out of account i.e. the 15 out of 20 years clock should restart for them on their return.

6.7 The same transitional rule should apply to those who are currently in the process of completing a period of non-residence.

7 £2,000 de minimis rule

7.1 **Question 3: The government is interested in views from stakeholders about the need for preserving the £2,000 de minimis threshold for those non-domiciled individuals who become deemed UK domiciled.**

7.2 The CIOT endorses the submission of the Low Income Tax Reform Group (LITRG) in respect of this question.

7.3 The CIOT is particularly concerned with the excessive administrative burden that abolition could introduce much of it for HMRC, for minimal extra tax yield. This burden will be exacerbated by the UK's tax year which is unlikely to align with any host country's reporting period. Therefore the individual will be obliged to file an extra tax return for a different period where a foreign tax credit will usually be claimed on the income. In addition, if the tax withheld at source is in excess of what is permitted under the double tax treaty, the individual will have to make a further claim in his home country, usually requiring a certificate of tax residence from the UK tax authorities, to limit and/or claim a refund of the host country withholding. This extra administrative burden is unlikely to be beneficial for either HMRC or taxpayers.

8 Treatment of offshore trusts

8.1 The CIOT notes that the consultation paper included no questions specifically relating to the proposals in respect of offshore trusts. Nevertheless, given the importance of this aspect in the package of measures announced, the CIOT seeks to outline its concerns here.

8.2 The CIOT considers that the proposal to tax individuals who become deemed domiciled under the proposed new ITA 2007 s 809EA rule on the value of benefits received rather than the value of the benefits that are matched with amounts of relevant income or TCGA 1992 section 2(2) gains is ill-conceived for the reasons set out below.

8.3 First, it will introduce a new and different system to the one currently in place. This will undoubtedly add complexity to the current system. As a general principle there should not be different tax regimes operating before or after the 15 year cut off or between UK and foreign domiciled beneficiaries (other than UK domiciled settlors). Further, there should be a single regime which applies to all trusts created by settlors who were non-domiciled and not deemed domiciled at the time. The availability of alternative regimes is likely to lead to unacceptable complexity and difficulties in application.

8.4 Second, it will mean that such individuals will be taxed on a different basis to those who are actually UK domiciled under general principles; the former will taxed in respect of benefits even if there are no matching amounts of relevant income or section 2(2) amounts whereas the latter will not be so taxed. This defeats the aim of achieving parity of treatment with UK domiciliaries.

8.5 Third, this disparity of treatment is arguably in contravention of EU rules that seek to prevent discrimination or curbs upon the free movement of capital or the freedom of establishment. EU law issues are considered further below (paragraph 9).

8.6 Fourth, the proposal will create practical problems of funding the charge where the trusts are "dry trusts" i.e. ones which do not realise income or gains.

8.7 As recognised in the consultation document the proposal is put forward in order to deal with the problem that would otherwise be faced by trustees in trying to work out the historic gains/ income position. While the CIOT is grateful for the government's acknowledgement of such issues, it is suggested that the proposal is not the appropriate way to address them.

8.8 The CIOT suggests instead, that rather than creating a completely different regime for such individuals, the better route is to treat them in the same way as actual UK domiciliaries who receive benefits from a trust. A charge in respect of those benefits would therefore be under the existing provisions of ITA 2007 section 731 et seq and TCGA 1992 section 87. Further, in order to achieve the stated aim of recognising the special position of offshore trusts created by such individuals, TCGA 1992 section 86 and ITA 2007 section 720 could be amended so that they cannot apply to UK born returning non-domiciliaries.

8.9 We note the paper submitted to HM Treasury on 4 November by various individuals who attended an HM Treasury consultation meeting on 9th October. That proposal was submitted in the names of those individuals in the interests of time. Having now reviewed the paper, the CIOT agrees that the proposal outlined in the paper offers a possible alternative method of taxing offshore trusts that is worth exploring in more detail. It is therefore appended to this response as an appendix. The paper refers to a separate note expanding upon what are regarded as insurmountable problems with a 'dry' benefits charge ie one not based on actual income or gains. The further paper is to follow.

9 Discrimination and EU law

9.1 The proposals regarding the treatment of offshore trusts in paragraph 3.2 of the consultation document give rise to concerns as a result of proposed differences in treatment between UK domicile taxpayers (by birth or by choice) and those whom are deemed-UK domiciled under the 15 out of 20 year rule. These differences maybe discriminatory under EU law.

9.2 It is proposed that an individual deemed UK domiciled under the 15 out of 20 year rule will be taxed on benefits received from the offshore trust (or its underlying entities) without reference to the income and gains arising in the offshore structure. This is a significant difference from the treatment of UK domiciled individuals who are, broadly, taxed on benefits received by reference to, and only to the extent of, untaxed gains (if the benefit received is capital) or untaxed income profits (if the benefit received is income).

9.3 The effect of the proposal would be particularly harsh in circumstances where gains in the trust fall to be taxed as they arise under TCGA section 86 (as a result of the settlor being UK resident). In such circumstances currently a payment of capital to a UK resident and domiciled beneficiary would not suffer further tax as it would be 'matched' to the gains in the trust, which had already been taxed on the settlor. The proposals suggest, however, that if a deemed-UK domicile beneficiary were to receive the same benefit from the trust, he would be taxable, regardless of the underlying tax position of the trust. A similar point will arise in respect of benefits paid out of income.

9.4 EU law is invoked in these circumstances because distributions from a trust are movements of capital and thus the freedom to move capital is invoked. The proposed difference in treatment between taxpayers who are UK domiciled by birth (or who have become UK domiciled by choice) and taxpayers who are deemed-UK domiciled as a result of the 15 out of 20 year rule, as described above, is, prima facie, indirect discrimination on grounds of nationality as the majority of the latter group are likely to be non-UK nationals, whereas those of the former group are more likely to be UK nationals.

9.5 Thus it is necessary to consider whether or not this discrimination can be justified. We note the suggestion in the consultation document that it may be administratively burdensome to have to recreate sufficient history of the transactions in the trust and that thus it is not proposed to impose a tax on the settlor of the trust. The proposals with regard to beneficiaries will also negate the need for this historical information regarding the position of the offshore trust. However, we are not certain that this provides sufficient justification for the difference in treatment to the detriment of deemed-UK domiciled taxpayers. In any event, if difficulties in obtaining information are the justification, the proposed treatment should be optional so that those who have the information are able to use it to 'match' benefits received with taxed gains and not suffer the additional tax charge.

10 Further consequences

10.1 At 3.3 of the consultation document, it is stated that the government intends that earnings (including earnings and other income from employment-related securities) which relate to a period while an individual was not domiciled and not deemed domiciled under the 15 out of 20 year rule but which are paid after the individual becomes deemed domiciled will be taxed under the remittance basis 'where all of the applicable conditions are met'. Currently employment income earned in a period when the individual is entitled to claim the remittance basis but paid afterwards continues to be eligible for tax relief, provided that it is paid outside and not subsequently remitted to the UK. We assume this position will continue but would welcome confirmation. Where a particular payment of employment income relates partly to a period where the individual was non-domiciled and not deemed domiciled, and partly to when he/she was deemed-domiciled, then it will be important that the employer is clear as to what to do on accounting for PAYE (given that the employer will not necessarily be party to the detail on the individual's domicile status). This will need to be clarified.

10.2 The consultation notes at 3.3 that the effect of becoming deemed UK-domiciled in the UK is that the individual will no longer be able to claim the remittance basis on a foreign pension. Clarification is sought in relation to individuals currently benefitting from "transitional corresponding relief"
http://www.hmrc.gov.uk/manuals/ptmanual/ptm111500.htm

These schemes were originally designed to provide benefits for individuals not domiciled in the UK but who were working and resident in the UK whilst being employed by a non-UK employer. They were more attractive and beneficial to those individuals than being a member of a UK registered pension scheme.

It appears that the policy intent is that deemed domiciled individuals may no longer be eligible to remain members of such schemes. If this is the case, it would be

helpful if pension scheme administrators and employers of individuals who might be affected by the change could be advised by HMRC of the proposed change and the actions needed.

11 Ensuring compliance for tax purposes on foreign income and gains

11.1 The CIOT recognises the government's attempts to resolve the compliance issues in relation to establishing historic trust income and gains: however, for the reasons set out above, the CIOT does not consider that the suggested proposal is appropriate.
The CIOT suggests that the government could consider the introduction of transitional provisions in relation to pre 8 July 2015 funds (in mixed accounts and within trusts) as such provisions would minimise the historic issues enabling individuals to go forward on a more secure foundation. Transitional provisions such as those set out in Finance Act 2008 Schedule 7 may, with appropriate modifications be a good starting point in respect of historic gains/ income.

12 Capital losses election

12.1 The CIOT notes the intention to introduce legislation to allow individuals who become deemed domiciled to claim foreign loss relief. The unblocking of such losses should, for consistency with the position of UK domiciliaries, extend to losses accruing in years 1-15 of the 15 out of 20 years period and should not be restricted to losses accruing from year 16 when deemed domicile status is assumed. Horizontal equity requires that non-UK domiciliaries are treated in the same way as UK domiciliaries; it follows that the pre- 6 April 2017 unused losses should be available irrespective of whether an election has been made under TCGA 1992 section 16ZA.

13 Implications for inheritance tax

13.1 The CIOT suggests aligning the test for determining whether an individual has become non-UK deemed domiciled so that the same test applies for all tax purposes.

13.2 The CIOT notes also that some clarification of the IHT treatment of offshore trusts created while the individual is non-domiciled is needed. It is suggested that such trusts should, as currently set out in IHTA 1984 section 48(3), continue to be regarded as excluded property settlements to the extent that they comprise non-UK situate assets.

14 IHT for UK domiciles leaving the UK

14.1 **On balance, the government favours a rule which treats a UK domicile as non-domiciled on the later of the date that they acquire a domicile of choice in another country, or the point when they have not been resident in the UK for 6 years.**

Question 4: Do stakeholders agree that changing the rules in this way is a straightforward and reasonable approach?

14.2 We agree that a rule that treats a UK domiciliary as non- UK domiciled on the later of the date that they acquire a domicile of choice under general law in another country and the point when they have not been resident in the UK for 6 complete consecutive tax years (aligning with the deeming position) goes some way to achieving horizontal equity and has the benefit of greater simplicity in reducing the number of different periods of absence.

15 Potentially exempt transfers

15.1 We note that a gift of excluded property made while non-UK domiciled will not constitute a failed PET if the individual acquires a deemed domicile and dies within seven years of making the gift. It is therefore logical that the same treatment should extend to the position where a transferor dies within seven years of a reservation ceasing in respect of an earlier gift with reservation of benefit.

16 Spousal election

16.1 **Question 5: Do stakeholders agree that the period an electing spouse needs to remain non-resident before the election ceases to have effect should be amended to 6 years?**

16.2 The CIOT agrees with a common period although we have queried above whether 6 years is too long in general. The current 4 year period should be preserved for those who have already elected.

17 Born in the UK

17.1 **Question 6 In what circumstances would having a short grace period for inheritance tax help to produce a fair outcome?**

17.2 It is noted that the suggestion of a grace period (for IHT only) for those affected by the returning UK domiciliary rule has been given legislative form in the proposed amendments to IHTA 1984 section 267.

17.3 The CIOT agrees that a reasonable and equitable grace period is needed (not necessarily only for IHT, as indicated above). However, we do not consider that the proposed grace period deals adequately with all of the potential injustices arising from the deeming provision particularly as a typical short term secondment period will extend over at least 3 years and periods caring for a relative with a severe illness or in decline does not extend neatly over 2 tax years. The CIOT recommends that the condition of residence should apply (as a minimum) if the taxpayer has been UK resident in both of the preceding two fiscal years, not one as currently drafted. Three illustrative examples are below.

17.4 Joe Cook was born in the UK of English parents in 1960. Six weeks after his birth

Joe's parents emigrated to Australia taking Joe with them. His parents decided to return to live in the UK on their retirement. However Joe's home remains in Australia where he lives with his wife and children and where he has built up a successful business in investment properties. He had not returned to the UK at all until his father underwent a complicated operation with an extended recovery time in the fiscal year 2017/18. As a consequence Joe spent 7 months in the UK (staying at his parents' home) in the fiscal year 2017/2018. Joe returned to Australia once his father had made a good recovery. He did not return to the UK at all in 2018/2019. However in 2019/20 his father and mother were both taken seriously ill and Joe returned on 1 May in that year to help out, again staying at his parents' home. Joe died suddenly in the UK on 1 November 2019.

2017/18 Joe is resident as he meets none of the Automatic Overseas Tests and he spends at least 183 days in the UK thereby meeting the First Automatic UK test.

2018/2019 Joe is non – UK resident (he meets the First and Third Automatic Overseas Test)

2019/2020 Joe is resident - he meets none of the Automatic Overseas Tests and he meets the First and possibly the Second Automatic UK test.

Turning to the amended section 267, Joe will be treated therefore as UK domiciled because he was born in the UK, his domicile of origin at the time of his birth was in the UK, he was resident in the UK for the tax year in which he died and he was resident in the UK for at least one (2017/18) of the two tax years immediately preceding the tax year in which he died. That result is inequitable. The test should at least require residence in the year of death and both of the preceding 2 years before the returning domiciliary rule bites.

17.5 Joe's twin brother Jim has worked for an Australian group of companies for many years. He is seconded by his employer on 1st May 2019. His secondment ends, and he returns to Australia, on 10th May 2020. On 1st April 2021 he dies. All of his assets are in Australia, have an aggregate value of £2,325,000 and do not qualify for Business or Agricultural Property Relief.

During his secondment he works for nine hours a day for five days a week, all of it in the UK, and he takes 25 days of holiday.

In 2019/20 Jim meets the First Automatic UK Test (and the Third Automatic UK Test) and none of the Automatic Overseas Tests and is therefore resident in the United Kingdom.

In 2020/21 the First Automatic Overseas Test does not apply because Jim dies in the year. The Second Automatic Overseas Test does not apply because he was UK resident in the preceding fiscal year. The Third Automatic Overseas Test does not apply because Jim does more than three hours work in the UK on more than 30 days in the fiscal year. The Fourth and Fifth Automatic Overseas Tests do not apply because he was resident in the UK in the fiscal year preceding his death. Again he meets the Third Automatic UK Test because in respect of a 365-day period part of which falls within the relevant fiscal year (for example, the year ended 10th May 2020) he works sufficient hours in the UK, there are no significant breaks from UK work in that period, more than 75% of the total number of days in that period in which he does more than 3 hours work are days on which he does more than 3 hours work in the UK and at least 1 day which falls both in that 365-day period and in the fiscal year concerned is a day on which he does more than 3 hours work in the

UK.

Jim is, thus, resident in the UK for 2019/20 and 2020/21 although he was on secondment here for less than 13 months not having been in the UK in the previous fifty nine years of his life and having left the UK when he was six weeks old.

His worldwide estate is subject to IHT. Australia does not impose an inheritance tax and so there is no question of double tax relief. Jim's estate pays £800,000 for the privilege of his having worked here for just over a year, an inequitable outcome.

17.6 The CIOT is also aware of a taxpayer who was born in the UK with a UK domicile of origin, but who has subsequently acquired a non-UK domicile of choice as a result of her living outside of the UK for the majority of her life. However the taxpayer recently returned to the UK to visit her brother. While here she was diagnosed with leukaemia and has been declared medically unfit to leave the UK. Although currently resident in the UK, this residency has been for a short term period only and it seems unduly harsh that should she live until these rules are enacted in, say, April 2017, all of her worldwide assets will become liable to UK inheritance tax simply as a result of the accident of her birth.

17.7 We suggest that, in addition to a grace period, there should be some exceptions to the general rule of deemed-UK domicile as a result of birth here followed by a short period of residence. Exceptions should be included in circumstances where the relevant conditions are met as a result of circumstances outside of the taxpayer's control as in the example immediately above.

18 Impacts of the reforms: returning domiciliary's compliance with the 10 year anniversary charge

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

18.1 The difficulty with which trustees are to be faced is that their settlors may become UK domiciled by reference to events of which the trustees are unaware. If an individual who has set up a trust, say, 30 years ago, inadvertently becomes UK resident the trustees may not be aware of it. There is no reason why the trustees should think to collect information in order to calculate a charge in a jurisdiction with which they have no connection.

18.2 The administrative burden associated with calculating the 10 year charge cannot be overstated. We understand that a taxpayer who ceases to be resident for the UK tax year in which the charge would otherwise fall may be regarded as being outside the 10 year anniversary charge and that this will not be regarded as tax avoidance. The consultation acknowledges that the rules may lead to trusts alternating between excluded property and relevant property status. It is possible that many taxpayers will wish to mitigate the administrative burden and cost, regardless of any actual tax involved, in this way.

19 Leaving the UK

On departure from the UK, and assuming the individual retained their foreign domicile status under general law, the individual is treated as being not domiciled again once they become non-resident, unless they have been resident in the UK for 15 of the past 20 tax years (this assumes they have retained their foreign domicile status under general law). The individual who returns to the UK for a short period will be treated as UK-domiciled only for the period they are resident in the UK.

Question 8 Do stakeholders agree this is the most reasonable way to deliver these reforms? Are there any circumstances when applying these rules that would produce unfair outcomes?

19.1 The efficacy of this rule will depend on the meaning of "short period": assuming that the period chosen takes into account the points made above about an adequate grace period, the proposal to shed any UK domicile acquired upon return seems sensible.

19.2 More generally, as noted at 6.6 above, there should be transitional rules which provide that those who may already have completed a sufficient period of absence are able to break deemed domicile for all tax purposes.

20 The Chartered Institute of Taxation

20.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,500 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
12 November 2015

Appendix

Discussion draft – Possible treatment of offshore settlements for non-domiciliaries after April 2017

Background

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

Please note that:

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

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

Executive Summary

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

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

Proposal	Outline of legislative changes
• No (or only minor) changes for UK domiciled settlors (including "returning doms")	
• We consider it essential that there should be a single coherent regime applicable to all settlors and beneficiaries of trusts set up by a non-domiciled settlor.	
• UK source income continues to be taxed on settlor (if settlor-interested). A subsequent actual payment of the taxed income should not be taxable.	s624 ITTOIA and s721 ITA restricted to UK source income and aligned more closely
• No changes to the current tax treatment of a	

life tenant of an IIP trust	
• All other income and gains (e.g. foreign source) to be matched with benefits / capital payments. Remittance basis may apply to foreign benefits. Deemed domiciled beneficiaries (including the settlor) taxed on worldwide benefits. Income genuinely paid away or used to pay expenses ceases to be relevant income.	s731 ITA and s87 TCGA largely unchanged. Amend s735 so that remittance rules only apply if benefit received in or remitted to the UK, not if the relevant income is remitted to the UK.
• Potentially combine s731 and s87 into a single code. This might involve loss of motive defence for non-transferor charge although we would only support the loss of the motive defence as a quid-pro-quo for the other changes suggested below.	Alternatively, s731 ITA repealed and s87 TCGA expanded to cover both income and gains. Possibly amend s736 to s742 ITA accordingly.
• Switching off imputation of income to settlor prior to deemed domicile could be made dependent on the settlor being a remittance basis user. This would have advantage that trustees could remit income to the UK in their own hands for investment.	Amendments to s809B ff. Potentially amend s809M so that a trust is not a relevant person in relation to trust income[3] Appropriate amendments to s624 ITTOIA and s721 ITA.
• Transitional provisions for existing trusts as at 6 April 2017 and those where settlor/beneficiaries newly arrive in the UK for the first time.	

Policy objectives and constraints

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

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

1= The new regime should not be unduly favourable or have significant yield implications but it has to be recognized that any change will inevitably bring winners and losers and in many ways yield from trusts will be unpredictable. In some respects the

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

regime for trusts suggested below could bring significant yield for UK PLC not least in that it simplifies the current over complex regime and encourages trusts to invest in the UK.

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

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

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

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

Set in the context of the above objectives, we put forward the following proposals.

Proposals

A. Proposals to apply only to "settlements"

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

The following proposals therefore apply only to "settlements" – that is trusts, trust-like equivalents[4], and (see further below) companies owned by trusts.

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

B. UK domiciled settlors

Where the settlor is UK resident and either actually domiciled or a "returning dom"[5] then the present rules should remain. Some limited aspects of the following proposals might be adopted to ensure consistency.

The following therefore applies only to non-UK domiciled settlors[6].

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

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

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

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

D. UK source income

UK source income is taxed broadly[7] as at present, i.e:

- on the Settlor if the settlor is UK resident and the trust is settlor-interested
- otherwise on the life-tenant if there is one;
- potentially - depending upon the exact situation - on the trustees themselves
- otherwise on the recipient if it is distributed as income.

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

Once income is taxed under the above, it is not taxed again if it is subsequently distributed[8].

[4] For instance Foundations to the extent to which they are akin to trusts
[5] i.e. under the new proposals he had a UK domicile of origin; was born in the UK; and is now UK resident.
[6] We suggest that the deemed domicile status of the settlor should be irrelevant: in practice deemed domiciled settlors are unlikely to create new settlements due to the inheritance tax entry-charge.
[7] We think it would be helpful to clarify the following order of priority and to eliminate the possibility of double-charging (e.g. trust is settlor-interested, but income is actually distributed to another UK resident)
[8] Income which arises at the "bottom" of a structure and which is taxed in accordance with these rules should not create a new source of income or chargeable gains if it is paid up through the structure.

E. Non-UK source income

Non-UK source income should be taxed:

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

Any credits attached to such income should be available to the taxpayer in the same way as at present. Once attributed to a taxpayer under any of the above, the income would no longer be available to be matched[9] and would not be taxed again if it is subsequently distributed.

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

F. Matching rules for other income

Any income not taxed in accordance with the above[10] would be matched either under s731 ITA or a modified form of those provisions as described in H below.

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

The matching would apply to beneficiaries wherever resident[11].

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

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

s731 should ideally be put onto a LIFO basis[12]. This would, in practice, address many of the problems of lack of records.

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[9] i.e. in present terminology, it would cease to be "relevant income".
[10] Given D above, this will principally be foreign income. It applies to (undistributed) UK income only where the settlor is deceased, non-resident or the trust is not settlor-interested.
[11] Any perceived avoidance can be tackled as it could now by a combination of more rigorous enforcement against "conduit" arrangements and greater use of the GAAR. A specific GAAR example could be put to the GAAR panel for approval if desired.
[12] Under our proposals at H, it would inevitably be put onto the same basis as s87, but we consider that it should be in any event.

G. Capital gains treatment as at present

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

H. Possible assimilation of s731 and s87

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

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

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

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

The price for amalgamation might be the loss of the motive defence for non-transferor trust cases[13]. **We should only support the removal of the motive defence as part of an assimilation of s731 & s87 in the form outlined in this section H and the proposals at section F.**

Additional Proposals

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

I. Transitional rules

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

J. No anti-forestalling rules

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

K. Schedules 4B and 4C should be removed

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

L. Carried interest

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

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

Comments

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

	Pros	**Cons**
C	Our proposals result in a consistent regime both before and after "year 15" and have major advantages in allowing the trustees to remit foreign-source income into the UK (in their own hands) for investment without thereby causing a remittance for the settlor (see F below). We think that having a very different regime before and after "year 15" would cause significant anomalies.	We recognise that, in allowing foreign source income to roll-up within trusts prior to "year 15", there might be concern that non-doms might come to view trusts as a cheaper alternative to paying the RBC from year 8 to 15. We think that this concern is overstated (because in not paying the RBC, worldwide benefits would then be matched). However, the position could be kept under review and if the government perceived trusts to be "abused" in this way then it would be possible – **although we do not necessarily support this** - for the switching off of s720/624/s727 to be made dependent (on a tax-year by tax-year basis) to the settlor being an RBU in that year[14].
F	Our proposals for income represent a major simplification of the current system where we currently have a combination of imputation (to settlor); tracing (to see whether remittance) and matching codes. In particular, this would enable the trustees to bring trust (or underlying corporate) income[15] into the UK in their own hands for investment without (as is presently the case) thereby causing a remittance for the settlor or beneficiary. We think that this would have significant advantages both for	We recognise that under our matching proposals benefits will give rise to deemed foreign income, even if the relevant income is UK source. However, given D above, this will only apply to UK source income in a limited range of cases (see footnote 10). Furthermore, the deeming as foreign income will be irrelevant for beneficiaries after "year 15" anyway. As such we think that a good case can be made for a single pool – which we note is currently

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

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

	trustees and for the UK economy.	the case for CGT under s87 TCGA. The switching-off of the motive defence in non-transferor cases is, in our view, a possible quid-pro-quo for this (see H above)