Treatment of loans secured on foreign income or gains by remittance basis users

Introduction

1. The purpose of this note is to highlight a change in HMRC's approach to the treatment of loans made to remittance basis users where assets of the borrower are held by the lender. The note is to assist taxpayers and their professional advisers in considering the technical and practical issues in each client's specific context.

2. The note has been sent to HMRC for comment and will be updated to reflect any comments HMRC make.

Background

3. This note applies to present or former remittance basis users who have otherwise unremitted foreign income and gains. It refers to such a remittance basis user as "the RBU" and to the unremitted foreign income and gains as "FIGs".

4. The facts this note covers are in point where the RBU has incurred a debt either in the UK or abroad and the money borrowed or property deriving from it is brought to the UK or used in the UK in such a way as would constitute remittance. Using the terminology in the legislation the debt is here referred to as "the Relevant Debt" (see ITA 2007 s 809L(7)). This note is also in point where the borrowing or use is by a trust, company or family member that is a relevant person in relation to the RBU.

5. The law – ITA 2007 s809L(3) - is that FIGs are treated as remitted if either:

   (a) The FIGs are "used outside the United Kingdom (directly or indirectly) in respect of a Relevant Debt"; or
   (b) "Anything deriving (wholly or in part and directly or indirectly from [the FIGs] is used [in respect of the Relevant Debt]".

6. The paradigm case of use in respect of the Relevant Debt is repayment of principal or payment of interest.

HMRC's original view

7. When the present remittance basis legislation was being enacted in 2008, there was discussion as to whether FIGs are used in respect of the Relevant Debt if they form part of the security package for it or otherwise serve as collateral. HMRC's published practice was to treat FIGs as not so used, at least so long as principal and interest were paid in a timely manner. There are several technical arguments to support this interpretation. The implicit rationale was that if the FIGs were to be treated as so used, the Relevant Debt would potentially be taxed twice, once

by reference to FIGs provided by way of collateral or security and once by reference to the FIGs used in repayment (assuming the two were not the same).

HMRC's change of view in 2014

8. In August 2014 HMRC abandoned this practice and adopted the position that FIGs used as collateral or security for a Relevant Debt were to be treated as remitted. This revised practice was published on 4 August 2014 in What's New – latest news from HMRC – see archived page. It was admitted the result would be that the same Relevant Debt could result in two or more lots of FIGs being taxed.

9. The revised guidance published as a result of the 2014 change made it clear that there was a cap on the amount of FIGs comprised in the collateral or security that could be treated as remitted. This equalled the Relevant Debt or (if less) such of it as was brought to the UK (see now withdrawn version of RDRM 35270 – archived page).

10. Discussions with HMRC in 2015 disclosed uncertainty as to what legal arrangements needed to be in place for the FIGs to be treated as used in respect of the Relevant Debt. Was a formal pledge or blocking of the FIGs required or was it sufficient that the lender could have recourse to the FIGs under an 'all monies'[1] clause. If the latter was correct, the RBU would potentially find all FIGs held by the lending institution could count as used in respect of the Relevant Debt.

11. In practice this latter issue was often of academic significance only in view of the cap on what could count as remitted.

HMRC's latest change of position

12. Between 17 December 2020 and 21 July 2021[2] changes to HMRC's Residence, Domicile and Remittance Basis Manual indicated, HMRC had again revised their position. HMRC now contend that all FIGs used in respect of the Relevant Debt are to be treated as remitted if 100% of the borrowed money is brought to the UK. But if not all the borrowed money is brought to the UK, the cap still applies, the cap – ITA 2007 s809P(10) - being what is brought to the UK.

13. Members will need to consider the implication of this change of practice when filing on behalf of RBUs. Further details of HMRC's present approach are set out in RDRM 37050 (appendix 5).

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[1] The term 'all monies clause' usually means any security will cover all amounts the debtor owes to the lending institution under any arrangements (including future arrangements) regardless of how they arise.

[2] RDRM37050 Appendix 5 was updated on 17 December 2020. The current version of RDRM35270 was updated on 18 May 2021 and RDRM35050 was updated on 21 July 2021.

Possible technical views

14. The professional bodies do not advocate a particular technical view. There are alternative technical interpretations with arguments for and against in each case.

15. As stated in paragraph 7 there are several technical arguments supporting the original 2008 analysis. One technical position is that the original 2008 practice was correct avoiding as it does the risk of more than one lot of FIGs being taxed by reference to the same Relevant Debt. Others argue the point in relation to the more general issue as to when "collateral" is used with respect to the relevant debt and the counter-intuitive results that can arise from the revised HMRC interpretation. Such positions also avoid the contortion implicit in the proposition that there is no cap if 100% of the borrowed money is brought to the UK but that there is a cap if less than 100% is brought to the UK.

16. The opposite technical position is that everything HMRC are now saying is correct, including the 2020/21 change that if 100% of the borrowed money is brought to the UK, the amount taxed as remitted equals the FIGs used in respect of the Relevant Debt even if those FIGs exceed the debt.

17. An intermediate technical position is that HMRC were right in 2014, but not in 2020/21, so that there is always a cap on the taxable remittance equal to the amount brought to the UK (and not just in cases where part only of the borrowed funds are brought to the UK).

18. Unless the position is taken that HMRC's original 2008 practice is correct, a further technical issue is whether FIGs are used in respect of the Relevant Debt only if formally charged as security or pledged as collateral. One view is that this is correct. An alternate view is that any funds the lender holds are used in respect of the Relevant Debt, including subsequent investment return generated by those funds. This would be in point if the loan documentation includes an all monies clause. An intermediate position – which appears to be the stance which HMRC is taking in RDRM 37050 - is that funds are caught if their deposit with the lender is a condition of the making or continuance of the loan. An alternate intermediate view is that FIGs are used where their availability to the lender in the event of default forms part of the substantive negotiations of the security package for the loan but not where the possibility that they might be taken in repayment is simply part of the boiler-plate terms and conditions of the loan and unlikely to be relied upon by the lender in practice.

19. Paragraph 23 in Professional Conduct in Relation to Taxation Help sheet A: Submission of tax information and Tax Filings gives helpful guidance as to when additional disclosure should be considered:

> "23. Cases will arise where there is doubt as to the correct treatment of an item of income or expenditure, or the computation of a gain or allowance. In such cases a member ought to consider what additional disclosure, if any, might be necessary. For example, additional disclosure should be considered where:
> • There is inherent doubt as to the correct treatment of an item, for example, expenditure on repairs which might be regarded as capital in whole or part, or the VAT liability of a particular transaction; or
> • HMRC has published its interpretation or has indicated its practice on a point, but the client proposes to adopt a different view, whether or not supported by Counsel's opinion. The member should refer to the guidance on the Veltema case and the paragraph below. See also HMRC guidance."

This will be useful when (i) filing returns for 2021/22 (the current tax year) and subsequent years; or (ii) filing returns for 2020/21 (filing deadline 31 January 2022) or amending returns already submitted for 2020/21.

Historic compliance issues

20. When HMRC announced the 2014 change of practice grandfathering was allowed for those who had relied on the 2008 practice. No such grandfathering has been allowed as respects the 2020/21 change. A compliance issue therefore arises for RBUs who have relied upon HMRC's previous post-2014 practice, particularly where the time period for amending the return remains open and: (i) the remittance has been disclosed on a tax return; or (ii) no remittance was disclosed (the loan agreement giving priority to the clean capital collateral and this clean capital being equal to or in excess of the value of the remittance). Advisers will need to consider whether they agree with the latest HMRC change in position and how they should advise their clients to proceed.

21. Taxpayers and their advisers will also need to consider whether a discovery assessment could be competent as respects a return filed in accordance with the 2014 practice where the enquiry window has closed. Advisers will, in particular, need to consider carefully the terms of Taxes Management Act 1970 s29(2) in relation to years up to and including 2019/20.

22. In other cases public law remedies may be available where the RBU has relied to their detriment on HMRC's practice and might be able to claim "legitimate expectation".

Knock-on implications of historic remittances

23. There may be knock-on implications where taxpayers and their advisers accept that, as a result of HMRC's change of practice, a remittance has previously been made. The general rule – ITA 2007 s 809P(12) – is that where FIGs have been remitted once, they cannot be remitted again. Taxpayers and their advisers will need to consider carefully whether this rule only applies where the first remittance has been taxed, or whether it applies irrespective of whether the first remittance has actually suffered tax. If the latter position is taken, it should be accompanied by white space disclosure and explanation to the client.

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