DEEMED DOMICILE TRUST PROTECTIONS – OFFSHORE INCOME GAINS (OIGs)

We reproduce below:

- the summary technical analysis as to why the trust protections should apply to OIGs and

- HMRC's opinion as to why the technical analysis is **NOT** correct

THE PROFESSIONAL BODIES ARE NOT ENDORSING EITHER POSITION.
Rather both positions are set out below so that professional advisers can consider the issues for themselves using their own professional judgment

THIS DOCUMENT CONSTITUTES NEITHER ADVICE NOR GUIDANCE.

SUMMARY TECHNICAL ANALYSIS AS TO WHY THE PROTECTIONS SHOULD APPLY TO OIGS – NOT ENDORSED BY HMRC (SEE PAGES 4 TO 5)

1) The argument put forward is that section 721A ITA 2007 requires the reader to postulate that the income received by the person abroad is received by the transferor and ask whether it would be relevant foreign income (RFI) in that case.

2) Regulations 18 & 21 of the Offshore Funds (Tax) Regulations 2009 deem an OIG to be income for these purposes.

3) Taking points 1 and 2 together the analysis states that s721A(3) can be engaged as it focuses on income.

4) Having got to this stage the question put is whether the income would meet the definition of RFI at section 830 ITTOIA 2005 if received by the transferor directly.

   There are 2 conditions to be RFI.

   Condition 1: Is the OIG foreign income?

   All income must have a source (various case law can be cited in support of this contention), so if one carries through the deeming in line with *Marshall v Kerr* (quoted from below) then the deemed income must too have a source.

   > *"I further bear in mind that, because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so."*

   In the case of offshore income gains the source should be the foreign fund (it is argued that nothing else is plausible (as stated at the beginning readers must make their own evaluation on this and the other issues).

   Condition 2: Is the OIG chargeable under one of the provisions listed in s830(2), one of which is Chapter 8 of Part 5 (income not otherwise charged)?

   The analysis postulates that under s721A(3) the income is received by the transferor (see point 3 above). The analysis goes on to say that Regulation 18 would then be the relevant charging provision in this case (charging individuals under Chapter 8 of Part 5 ITTOIA 2005).

   Taking all of the above into account, the analysis concludes that both conditions 1 and 2 are met.

   Having gone through the above, the analysis concludes that:
   - the OIG does meet the definition of RFI at section 830 ITTOIA 2005; and
   - the corollary of this conclusion is that the OIG falls within the trust protections on first principles.

What is the purpose of regulation 19(2) and s830(4)(aa) ITTOIA 2005?

Various arguments have been put forward. The first is that regulation 19(2) was included by the draftsman to put the matter beyond any doubt.

Lord Hoffmann in Walker v Centaur Clothes Ltd [2000] STC 324 at 330:

> *"[Counsel for the Revenue] said that the objection to [the construction proposed by Lord Hoffmann] was that it would make [a particular subsection] unnecessary…My Lords, I seldom think that an argument from redundancy carries great weight even in a Finance Act. It is not unusual for Parliament to say expressly what the courts would have inferred anyway."*

Alternative arguments are that:

- regulation 19 deals only with remittance basis users but is not exclusive; or
- in 2009 regulation 19 unnecessarily re-enacted s762ZB ICTA 1988 without appreciating that the 2008 reforms had already brought OIGs within chapter 8 part 5 ITTOIA.

Whichever argument is correct the analysis states that the existence of regulation 19(2) and s830(4)(aa) ITTOIA 2005 does not preclude the technical argument made that OIGs should fall within the trust protections on first principles.

What of the settlements' legislation?

The argument put forward is that this is not an issue due to the fact that Regulation 20(1) disapplies the settlements' legislation entirely.

HMRC RESPONSE REJECTING THE TECHNICAL ANALYSIS

Having considered the analysis HMRC **CANNOT AGREE THAT IT IS A CORRECT INTERPRETATION** for the OIG situation and we would make the following observations:

1) Whilst we appreciate that Regulation 18 of the Offshore Funds (Tax) Regulations 2009 (the Offshore Funds Regulations) treats OIGs arising to participants in non-reporting funds as income which arises at the time of the disposal to the person making the disposal "for all the purposes of the Tax Acts" we do not agree that it follows that OIG income is relevant foreign income as defined in s 830(1) Income Tax (Trading and Other Income) Act 2005 (ITTOIA).

2) For the purposes of s 830(1) ITTOIA relevant foreign income means income which:

    a) arises from a source outside the UK; and
    b) is chargeable under any of the provisions listed in s 830(2)

    We do not consider that OIG income treated as arising under Regulation 18(2) of the Offshore Fund Regulations can be said to be income which arises from a source outside the UK. Whilst Regulation 18(2) treats the OIGs as income which arises at the time of the disposal to the person making the disposal it does not treat it as income arising from a source outside the UK. To do so would be to take the deeming provision too far. Therefore it is our view that while it may be correct to say that such deemed income is chargeable under Chapter 8 of Part 5 ITTOIA and thus falls within s 830(2)(o), it does not fall within the definition of relevant foreign income.

3) S 830(4) ITTOIA refers to the treatment of "other income" as relevant foreign income. The wording of this provision makes it clear that it was intended to deal with the treatment of income which had not already been covered in the preceding subsections. It refers to the "treatment" of these categories of income as relevant foreign income rather than stating that they will fall within the definition of relevant foreign income. This is because only some of the statutory provisions listed treat the income in question as relevant foreign income for all purposes. Others such as the provision relating to OIG income limit this treatment.

4) We do not believe that it is correct to say that the provision in Regulation 19(2) of the Offshore Funds Regulations simply restates the position which already existed as a result of applying the definition of relevant foreign income set out in section 830(1) and (2) ITTOIA (on the assumption that OIG income fell within it). If OIG income was correctly categorised as relevant foreign income under s 830(1) and (2) ITTOIA, that would have enabled an individual who was a non-domiciled remittance basis user access to the remittance basis in respect of that income. However there are also other consequences of income being categorized as relevant foreign income which apply to those other than non-domiciled remittance basis users. For example, Part 8 Chapter 3 ITTOIA contains provisions about deductions and reliefs available where relevant foreign income is charged on the arising basis.

Therefore, if it was correct to say that OIG income falls within s 830(1) ITTOIA, the effect would be not only that non-domiciled remittance basis users would be able to claim remittance basis in respect of that income, but that those individuals in receipt of OIG income who are not non-domiciled remittance basis users would be entitled to those deductions and reliefs.

When the Offshore Fund Regulations were made, Regulation 19(2) could have stated that OIG income treated as arising under Regulation 17 was treated as relevant foreign income of the individual. However it did not do so – it specifically limited treatment of OIG income as relevant foreign income to those cases where the individual was a non-domiciled remittance basis user.

5) If HMRC were to accept that OIG income already falls within the definition of relevant foreign income in s 830(1) and (2) ITTOIA, the effect would be wider than simply enabling OIG income treated as arising to offshore trustees to be within the definition of protected foreign source income for the purposes of section 721A Income Tax Act 2007. It would also mean that individuals not entitled to claim remittance basis could treat their OIG income as relevant foreign income for the purposes of the rules about expenses and deductions in Part 8 Chapter 3 ITTOIA both before and after the 6 April 2017 date. This would appear to frustrate the intentions of Parliament in enacting section 830 ITTOIA, which clearly indicates that it is s 830(4)(aa) and the provisions of the Offshore Funds Regulations which are to determine the treatment of OIG income as relevant foreign income.

You have referred to the statement in Marshall V Kerr as authority for the proposition that where, as here, there is a statutory deeming rule, the consequences of this should be followed through unless this would lead to injustice or absurdity. In our view to carry the consequences of the regulation 18(1) of the Offshore Fund Regulations deeming through to s 830(1) ITTOIA would be to take the deeming too far. The intention behind Regulations 18 and 19 of the Offshore Funds Regulations is clear, in that those provisions, rather than s 830(1), are to determine the relevant foreign income treatment of such deemed income and this is confirmed by the wording of s 830(4)(aa) ITTOIA. Here we have a provision which deems an OIG to be income arising at the time of the disposal to the person making the disposal but does not go on to deem it to be income arising from a foreign source. There is nothing in the deeming provision which is irreconcilable with the conclusion that the OIG income, being deemed rather than actual income, does not have a source.