NOTE OF MEETING AGREED BY THE REPRESENTATIVES OF THE PROFESSIONAL BODIES ATTENDING

HMRC WERE INVITED TO COMMENT ON THE TEXT OF THIS NOTE BEFORE PUBLICATION AND THE NOTE REFLECTS SUCH OF HMRC'S COMMENTS AS WERE ACCEPTED BY THE ATTENDEE REPRESENTATIVES AS ACCURATELY REFLECTING STATEMENTS MADE BY HMRC AT THE MEETING. FOR THE AVOIDANCE OF DOUBT, HMRC HAVE NOT AGREED THIS NOTE

Re revisions to RDRM33170: 4 August Announcement ("the Announcement") advising of HMRC's change of Guidance on treatment of foreign income or gains ("FIG") used as collateral for a relevant debt

Meeting on: 11 September 2014 12noon-2pm

Attendees:
Officials from HMRC and HM Treasury
Representatives of CIOT, STEP, the Expatriate Forum, ICAEW Tax Faculty and The Law Society ("the Representatives")

KEY POINTS ARISING

1. HMRC withdrew their previous Guidance at RDRM33170 as advice was received from HMRC solicitors that it was incorrect in law and ultra vires. HMRC viewed the Guidance as concessionary (a view which is not universally shared by external commentators). It was noted that the CIOT had asked HMRC back in September 2009 whether this was concessionary or not[1] but had not received a response on this. Concern was expressed that it is only after the change in Guidance that HMRC is stating that its original position was concessionary. It was also queried whether, even if it was a concession, it was *intra vires*. The then Chief Secretary to the Treasury, Jane Kennedy, had written to CIOT on 22 July 2008 saying that she recognised that the legislation was not perfect and that she was leaving HMRC and the professional bodies to fill in the gaps. She had given a similar answer in relation to a parliamentary question by Mark Hoban. In *Wilkinson* terms this gives credence to the argument that, even if concessionary, the previous Guidance at RDRM33170 just amounted to HMRC filling in the gaps (interstices) in the legislation.

2. HMRC recognise that not everyone will agree with its revised interpretation of the relevant legislation and that there are likely to be legal challenges on the substantive technical issues. The representatives thought judicial review proceedings on the grounds of legitimate expectation were also likely.

3. The Representatives felt that the legislation was not sufficiently clear and that this had led to the current difficulties. The particular problem being that there is no definition within s 809L, ITA 2007 of "used". The Representatives felt very strongly that the law should be changed to provide clarity with grandfathering for existing loans.

4. **The Representatives stated that they did not necessarily accept that the revised HMRC view was correct. For the rest of the discussion it was, however, necessary to (without prejudice) proceed on that basis so as to clarify various points with respect to the Announcement.**

<u>The transitional provisions</u>

5. HMRC do not consider the change to be retrospective as they are allowing taxpayers a period of time (20 months) to "unwind" affected arrangements. Representatives advised that a significant number of individuals will not be able to unwind their arrangements within the permitted timescale and that some are likely to sell up and leave the UK unless more generous transitional provisions can be agreed. In some cases this is because the individuals do not meet the affordability tests imposed by UK banking regulations to be granted a conventional UK mortgage: for example, the lack of UK income is a stumbling block to securing a conventional UK mortgage.

6. The Representatives were of the view that amending the transitional provisions to give complete grandfathering (or at least in line with the grandfathering provisions in para 90, Sch 7, FA 2008) would all but eliminate the risk of a case being taken for litigation. Given the points on discovery and enquiries below, it was likely that the affected population would only be cases after 6 April 2013 (and even then excluding those who had filed their 13/14 tax returns early). So the numbers affected by giving complete grandfathering are likely to be only a small proportion of those who have done this. Given that many will have been induced into giving such collateral by HMRC's previous statement it would also seem equitable not to treat differently those who happened to have filed tax returns earlier than those who have not. The case for complete (or significantly better) grandfathering is therefore very strong.

7. HMRC would welcome real life examples of scenarios where taxpayers will suffer hardship as a result of this change and indicated that they would consider such cases sympathetically although HMRC was unable to provide any clear Guidance on what would be regarded by them as hardship. In particular, it was not clear from the meeting whether having to sell the UK family home in order to repay the relevant debt would be regarded by HMRC

[1] Email from CIOT to HMRC: 24 September 2009 @ 15:54 attaching list of CIOT outstanding questions. See question 34.

as “hardship”. It was also unclear whether HMRC is interested in hardship either (a) to inform the need for grandfathering or (b) because HMRC will accept that in such cases it is prevented from raising a tax assessment because it accepts that its Guidance created a legitimate expectation that the taxpayer was entitled to rely on.

<u>Interaction with Business Investment relief</u>

8. If there is now a remittance of FIG in respect of a loan brought to the UK on or after 6 April 2012, which satisfies the conditions for Business Investment Relief (BIR), a claim for BIR can be made. For remittances in 2012/13 (the first year for which BIR was available), the claim must be made by 31 January 2015. This means that a claim may need to be made **before** a decision has been made on whether it is possible to “unwind” so as to take advantage of the transitional provisions contained in the Announcement (affected taxpayers have until the end of 5 April 2016 to “unwind” the arrangements). It may be that the arrangements will be “unwound” and the BIR claim did not actually need to be made. Practically, there was thought to be no downside from making an unnecessary claim apart from the compliance cost. The Representatives stated that the earlier 2012/13 BIR deadline needs to be publicised so taxpayers that can make a BIR claim realise they have an option other than “unwinding” but that to take advantage of it they need to act earlier.

<u>HMRC Clarifications</u>

Transitional arrangements

9. HMRC clarified the following in relation to the transitional notification “requirements” in paragraph 7 of the Announcement:

   - The “requirement” to provide a written undertaking (which is subsequently honoured) applies to both the option to replace the security and the option to repay the loan (or the part thereof remitted).
   - Whilst referred to as a “requirement” HMRC accepts that it has no authority to impose such a disclosure requirement on affected taxpayers. It would prefer that disclosure is made but provided the arrangements are “unwound” on or before 5 April 2016 it accepts that the taxpayer is entitled to the transitional relief and will not seek to raise an assessment (assuming the loan was commercial and so within the old HMRC Guidance). If disclosure is not made and HMRC finds out about the loan it is more likely that an enquiry will be opened.
   - The references to “before 5 April 2016” should be read as “on or before 5 April 2016”.
   - The stated ways to ‘unwind’ the arrangements are examples and not exhaustive. HMRC accept that there are other ways to “unwind” and that a mixture of strategies might be used. What matters is that the FIG collateral has been removed prior to 6 April 2016.

10. The issue of “revolving loans” (where the loan facility is reviewed on a regular (e.g. monthly) basis) was raised. The concern is that the “roll over” after 3 August could be said to give rise to a new debt, which the transitional arrangements would not apply to. HMRC’s initial thinking was that it would accept that such loans remained within the transitional provisions provided all substantive terms remain unchanged. To be able to consider this further HMRC requested sight of typical Terms and Conditions.

11. HMRC confirmed that individuals who had exchanged contracts on a property purchase prior to 4 August but had not completed the purchase until 4 August or later would be regarded as within scope of the transitional rules even though the loan was not in fact brought to or used in the UK prior to 4 August. This application of the transitional rules may also apply where binding contracts for other purchases have been entered into prior to 4 August 2014, and a loan facility drawn down over a period either before or after 4 August 2014. However each case will depend on individual circumstances, and individuals are welcome to contact HMRC if they have any questions about this.

12. It, therefore, appears that HMRC is not currently minded to allow all loans entered into prior to 4 August to come within the transitional arrangements regardless of when the funds enter the UK. Concern was expressed where the arrangements cannot be “unwound” prior to 6 April 2016 as, where HMRC will not accept that the transitional arrangements can apply, this could mean that an affected taxpayer has unwittingly tainted a clean capital account by including undrawn pre 4 August loan funds in the same account as funds received by way of birthday gifts etc.

On-going technical queries

13. HMRC confirmed that its view is that the date of the remittance is the date when the loaned monies are brought to the UK; whether or not the loan is secured using FIG at that point in time determines both (i) whether or not there is a taxable remittance and (ii) the quantum of that taxable remittance. The potential ramifications of this analysis were explored further. The analysis would suggest that where an account containing clean capital is used as security for a relevant debt so that no remittance occurs at the time the security is given (unless and until there is further drawdown on a loan facility) the fact that:

   - FIG might arise in that account later would be disregarded;
   - Other additional collateral may later be offered after that point in time is irrelevant.

14. HMRC was happy with the first bullet but wanted to consider the second further. Typical loan agreement terms would require additional collateral if the value of the collateral fell below a certain level and HMRC asked to be provided with a typical loan agreement so the terms could be reviewed.

15. HMRC commented on the following issues arising from the change of practice (as raised in CIOT's letter of 8 August and in other correspondence) regarding collateral and when FIG are "*used...(directly or indirectly) in respect of a relevant debt*":

    - HMRC confirmed that generally the examples in RDRM 35270 continue to stand, so if there is contractual priority this will be respected. However, in relation to secondary security, a right of set-off or an all-monies security over FIG, HMRC have requested the BBA to supply typical Terms and Conditions to enable them to understand the reality of the scenario.

    - In scenarios where there is superfluous security, the amount of FIG treated as remitted will be limited to the amount of the loan brought to the UK. However, where there are no priority rights the fact that the clean capital collateral is in excess of the relevant debt will not mean that there is no remittance. If there is a relevant debt of £1 million, and collateral of £1.5 million of which £1 million is clean and £500,000 is FIG the HMRC position is that there may be a £500,000 remittance depending on the mixed fund ordering rules (see RDRM35270 example 3). This could be an issue where there are no priority rights and a right of set off or all monies security provision. The Representatives said that such terms were often standard and altering the standard terms might not be possible. HMRC again asked to see standard Terms and Conditions so it could consider the matters further.

    - HMRC accepts that there is no remittance where a loan is unsecured, but it is clear that it is only given because the lender is aware of the various assets the borrower has (some of which will represent or be derived from FIG). Since there is no "contractual matrix" the lender has no right of recovery against the assets representing or derived from FIG, so the FIG cannot be said to be "used" in connection with a relevant debt, HMRC consider that the legislation will not be engaged.

    - Although the matter had not been fully considered, HMRC thought that it would not try to argue that there was "use" where a loan is only made as a result of a credit agency check (which would have taken into account the individual's assets representing or derived from FIG).

16. Where one loan is taken out and it is partially used offshore and partially used in the UK (so only an element of the loan is a relevant debt) HMRC stated that the mixed fund rules should be applied with the collateral being seen as the "mixed fund" from which remittances are made.

<u>The enquiry window for 2012/13 tax returns</u>

17. HMRC recognise that, where there was a remittance in 2012/13, for returns filed on time, the enquiry window will close (at latest) on 31 January 2015. This is before it will be clear whether individuals are availing themselves of the transitional provisions. HMRC is unlikely to know which taxpayers are affected before then. HMRC do not, however, intend to issue provisional enquiries to all non-domiciliaries as a population before the 31 January 2015 deadline as a result of this announcement and indeed expressed the view that it would be a misuse of its enquiry powers to blanket-enquire into all UK resident non-domiciliaries simply in order to preserve time-limits.

<u>The discovery provisions</u>

18. HMRC acknowledges that it is bound by the discovery rules and will only make discovery assessments where it has the legal right to do so.

19. The Representatives thought that in practice this meant no discovery assessment could be raised where the enquiry window had closed. Where returns have been filed on time this would mean that no assessment could be raised in respect of a pre-6 April 2012 remittance or a remittance in 2012/13 where the enquiry window has lapsed. It was stated that this was correct regardless of whether there was any disclosure on the tax return. Indeed, it was felt that there was very unlikely to be disclosure given that prevailing practice was being followed. HMRC did not comment on the Representatives' views as each case will depend on its facts.

20. The technical support put forward by the Representatives for the assertion that HMRC could not raise a valid discovery assessment in such cases comes from the discovery conditions at s 29, TMA 1970 where it stated that a taxpayer should not be assessed if the return was made on the basis of or in accordance with the practice generally prevailing at the time. HMRC said that it did not necessarily accept that this was correct and needed to consider the issues further.

21. The Representatives asked if HMRC could at least confirm that it accepted that a taxpayer who filed their tax return on the basis of the HMRC Guidance could not be said to have been "careless" (meaning that HMRC accepts that it cannot not raise discovery assessments in cases where there would have been a pre-6 April 2010 remittance).

HMRC said that it was unlikely that it would argue that following HMRC Guidance was "careless" but that it depended, as ever, on the facts of each individual case, so it would not be appropriate to provide a generalised answer.

The need for further clarification

22. HMRC will consider the need to publish further Guidance on this issue; if they do so it will probably be in the form of FAQs. The Representatives stressed the need for further Guidance as it is clear that several important points need to be answered before individuals can decide what action they need to take, if any. However, it was reiterated that further Guidance, while helpful, is not a substitute for proper legislation. This is because the legislation is so unclear that there is a risk that any further Guidance issued will later be considered concessionary.

23. The Representatives pushed HMRC for its revised interpretation to be codified in legislation. The number of issues raised at the meeting made it clear that the 2008 rules were inadequate. Any new HMRC interpretations (for instance as to set-off, secondary security, revolving loans etc.) would be difficult to rely on, as HMRC might again change its mind in the future. The Representatives said that they thought that new legislation would not be a significant exercise and gave HMRC an initial draft of what such legislation might look like.

24. HMRC reminded Representatives that legislation is not a straightforward process and that the introduction of new legislation will always be dependent upon Ministerial decision, and may be further complicated by the proximity of the General Election.