



The Law Society

Reform of the taxation of non-domiciled individuals

Comments by the Capital Taxes Sub-Committee of the of the Tax Law Committee of the Law Society

Introduction

1. The Law Society is the representative body for over 140,000 solicitors in England and Wales. It negotiates on behalf of the profession, and lobbies regulators, Government and others.
2. This response has been prepared on behalf of the Society by members of the Capital Taxes Sub-Committee, which is made up of senior and specialist lawyers practising in this field.
3. The Law Society welcomes this opportunity to comment on the consultation paper 'Reform of the taxation of non-domiciled individuals' (published 17 June 2011) which concerns a package of reforms to the taxation of non-domiciled individuals.
4. The Law Society broadly welcomes the Government's recognition that:
 - resident non-domiciled individuals make significant contributions to the economy of the UK and should be provided with an incentive to encourage them to invest in this country;
 - the remittance basis rules are over complex and in need of simplification.
5. We have a number of comments on both the policy and the detail of the proposals which are set out below.

Increase in remittance basis charge

6. It is noted that the Government's policy is to increase the charge for longer term residents, and in this context, it is helpful that the IRS has now (over 3 years after it was introduced) confirmed that the remittance basis charge will be regarded as an income tax for the purposes of the US/UK double tax agreement so that it may be credited against a US citizen's US tax liability. Having said that, many US citizens will already have excess foreign tax credits, so that they will not, in practice, obtain relief for the charge.
7. There is also anecdotal evidence that the increase in the remittance basis charge combined with a top rate of income tax of 50% is causing a number of non-domiciliaries to consider whether they want to remain in the UK.

Encouraging business investment

8. The proposals are, in principle, welcome.
9. However, it is important to recognise that non-doms do not have to invest in the UK. If they wish, they can obtain an exposure to sterling and to UK assets through offshore investment vehicles. Even assuming that these proposals go ahead, there remain other disincentives to owning UK assets. Income is taxable and directly held investments are subject to inheritance tax and capital gains tax. Although the proposals will apply to investments held through trust and company structures – and many non-doms will want to own assets in this way, not all will. In many cases, structures simply add additional cost and complexity and in any event have their own tax issues.
10. The proposals do not actually provide an incentive to invest in the UK, but merely ameliorate one of the disincentives. It is therefore very important that the provisions are (as is stated to be the intention) broad and simple to understand and operate, and are not hedged about with onerous anti-avoidance provisions. If the provisions are sufficiently complex to require continual attention from advisors, resident non-domiciled individuals (“non-doms”) will simply invest elsewhere.
11. Non-doms would be more likely to take advantage of this “incentive” if there was a positive benefit to investing in the UK, or at least, no disincentive. We make some suggestions below.
12. For example, while many of the permitted investments will qualify for business property relief, at least after the relevant holding period, many will not. Might there be a case for arguing that investments made pursuant to the relief should be regarded as excluded property? We recognise that many non-doms hold their investments through trusts and/or company structures in any event, so that they could convert the assets into excluded property relatively easily. However, given the interaction between sections 13 and 87 Taxation of Chargeable Gains Act 1992, there are capital gains tax advantages in holding assets at trust level (rather than in an underlying company) which would expose UK investments which do not qualify for business property relief to potential inheritance tax charges.

Types of business

13. A number of issues arise in relation to businesses carrying out trading activity, many of which arose in relation to capital gains tax (“CGT”) taper relief.
14. The consultation states that trading must constitute “a substantial proportion” of the overall activities. From experience, some immediate queries will be: what is substantial? What happens about cash reserves/investments? What if the company starts out as a trading company but other activities expand over a period of time?
15. It should be clear that bringing money to the UK in order to make an investment before actually making it does not constitute a remittance as long as it is used within a specified time limit to make the investment and presumably not used for other purposes in the interim.
16. What happens if the intended deal falls through? It should be possible to remove the money from the UK within a time limit without the money having been remitted.

17. What if the investment is made and although the company intended to trade it never does? As in cases where a company begins by trading and then ceases to do so, or where other activities become “substantial”, the investor may have no control over the company. The investment may be illiquid and it may not be possible for the investor to extract his funds or sell so as to be able to remove the funds from the UK. There needs to be some provision preventing an unintended remittance in these situations.
18. Would HMRC consider establishing an advance clearance procedure where there may be doubt about whether an activity constitutes trading or whether the trading is sufficiently “substantial”?
19. We consider that the relief should cover investment in residential property provided it is a commercial investment. We recognise that it would be contrary to the policy objective for a non-dom foreign investor to derive a direct personal benefit from an investment but this should not mean that the whole category of investment in residential property or in a mixed portfolio should be excluded.
20. The same applies to businesses concerned with leasing and the provision of personal services. These are legitimate businesses which non-doms may wish to pursue.
21. As a general point, we consider that would be better to have a targeted exclusion prohibiting personal benefit (over and above the use of the relief) to the investor rather than excluding categories of investment.

Question 1: Are the proposed exclusions from the incentive appropriately drawn? Should other types of business be included or excluded?

22. As explained above, we consider that categories of investment should be as wide as possible with the policy objective of preventing personal benefit to the investor dealt with by a targeted exclusion to this effect.

Form of business

23. The requirement that the business must be carried on through a company only could cause problems as many private equity investments are made through partnerships. This would be a significant impediment to investment for many non-doms for whom private equity is a significant part of their portfolio. Equally, so soon after the creation of the LLP as a business tool, it seems perverse to deny it to non-doms. Under the Legal Services Act, outside investors will be able to invest in law firms. Most law firms are constituted as LLPs. Under the current proposals, non-dom investors could not take advantage of this new opportunity. A primary investment vehicle for many investors is the BUCA style private equity partnership. To avoid the type of concerns referred to in the Con Doc the type of partnership could be defined. There are existing definitions which could be adopted elsewhere in tax legislation. For example, paragraph 2 of Schedule 7AD TCGA contains a definition of a venture capital investment partnership. Alternatively, a definition could be based around the requirement that the partnership to be invested in is a limited partnership which is a collective investment scheme. This would require a FSA regulated manager and would be established within frameworks known to HMRC (2003 MOU, etc). Defining a partnership investment in this way should protect against avoidance concerns.
24. An alternative view is that an investment through a partnership is regarded as a series of investments in the underlying companies so that, as long as the underlying

companies qualify for the incentive, it will be available. We believe this view to be correct and the HMRC guidance in relation to partnerships to be misleading. The treatment of partnerships in the context of the proposals (and generally) needs to be clarified.

25. In the light of the comments at paragraph 33530 of HMRC's Residence, Domicile and Remittance Basis Manual, it should also be made clear that:
- the use of foreign income/gains to make a capital contribution to a UK partnership which is engaged in a qualifying business should not constitute a taxable remittance;
 - where a non-UK partnership carrying on a qualifying business is trading in the UK, a benefit to a partner consisting only of the allocation to him of his share of the UK income/gains should not trigger a taxable remittance.
26. We consider that the proposals **should** be extended to listed investments including AIM. While this might be less targeted at the businesses which have greatest difficulty raising capital, non-doms will not necessarily want to invest in those businesses and if the fundamental idea is to attract investment to the UK that should prevail. By making the categories of permitted investment as wide as possible, it will help to encourage a culture of UK investment among non-doms who currently are usually advised to exclude all UK investments from their portfolio. The current tax position contrasts sharply with immigration policy, where the rules for the Tier 1 (Investor) Visa give strong encouragement to wealthy foreigners (who will almost certainly be non-doms) to come to, and invest in, the UK. While the categories of investments which qualify under the visa rules are relatively restrictive, it seems to us that if the Government wants wealthy people to invest in the UK, they should make it easier, not harder, for them to do so tax efficiently. We would urge that serious consideration is given to these points, particularly if there is no intention to make further changes during the life of this Parliament.
27. While non-doms would need to keep track of their investments, provided that there is a sensible time limit for retaining funds in the UK and reinvesting, it should not create too many additional difficulties. Whatever a non-dom invests in there are likely to be mixed fund complications (see below).
28. A managed portfolio would usually include a fluctuating pool of cash awaiting investment. We suggest that, in order to simplify administration, there should be a de minimis amount of cash (or average cash over a period) which can be held in a managed portfolio at any time without triggering a remittance. This will avoid the need to decide if that is remittance basis money which has to be removed from the UK.

Question 2: What would be the impact on both investment and complexity of extending the incentive to listed companies?

29. We consider that if the incentive is extended to listed companies, this would tend to encourage UK investment generally and that there would not be a significant increase in complexity.

Channel of Investment

30. It is encouraging that the incentive will be available to investments made via trusts and companies.

Form of investment

31. It is also encouraging that the incentive will be available for both share and loan capital.
32. In this context, we hope that it will be made clear that the new incentive can be used to refinance existing debt whether generally or in the following circumstances:
- an existing company has borrowed money from a bank, or a non dom has borrowed and on lent to the company, in either case, secured on the non-dom's offshore income or gains; and
 - the non dom makes a further loan under the new rules, which the company uses to repay the original loan. Arguably, this would constitute a remittance by using income or gains "in respect of a relevant debt" (the first loan from the bank). The investor is not actually getting any personal benefit in the UK, he is simply refinancing the loan in a way which takes advantage of the new incentive, and we submit that this should be permitted.

UK businesses

33. The fact that the incentive will apply to non UK companies which are UK resident could be attractive to non-doms as these would be non UK assets for CGT purposes.

Companies holding shares in other companies

34. The comments on companies holding shares in other companies do not seem to be restricted to group holding companies, but would seem to allow investment in OEICs. If that is the case, why should it not also apply to unit trusts which satisfy similar conditions? This could be attractive as UK OEICs and authorised unit trusts are excluded property for inheritance tax purposes.

Connection to the qualifying business

35. It is encouraging that an investor can invest in what is effectively a family or personal company.

Anti avoidance

36. A time limit of two weeks for removing proceeds from the UK or reinvesting them is completely unrealistic. We suggest it should be three months at least. Given that the funds cannot be used for personal benefit and any income arising on the funds in the meantime would be subject to UK tax, there would not seem any reason against having a more generous period for investment or removal of funds.

37. Many disposals will involve an element other than cash and it will be important that the anti-avoidance provisions do not trigger a remittance where there are ratchet style exits, deferred consideration or other situations where the proceeds are not immediately available. For example, it is commonplace for part of the sale proceeds to be placed in an escrow account in order to meet potential claims under the vendor warranties.
38. The time limit should begin only if and when proceeds of sale are actually available in cash and capable of being removed from the UK or reinvested. In addition, to the extent that, for example, warranty claims are made against the proceeds and funds paid out for this purpose, there should be no remittance.
39. In paragraph 2.51 of the consultation document, there is reference to “permitted commercial payments”. What are these? Are they dividends/interest?
40. What are “amounts or value taken out of the business”? In the case of a loan, the concept is straightforward enough. Repayment of a loan is presumably an amount taken out of the business.
41. A number of issues arise in the context of sales in connection with the mixed fund rules.
42. If the investment has done well, the sale of the investment may realise a taxable UK gain. There is no reason why the taxed money should not remain in the UK, even if the original remittance basis money must be removed from the UK or reinvested.
43. If all the funds are removed from the UK, then the taxed gain element would be “income or capital not within another paragraph” within section 809Q(4)(i) ITA 2007. Under the normal mixed fund rules that would be the first thing to be remitted (assuming the gain was made in a later tax year than the investment). The consultation seems to suggest that this order would be reversed, so that the first slice of proceeds - and the first remittance - would be the taxable remittance basis money. If this is the case, it will be a significant disincentive to using the relief.
44. Strictly, of course, the gain and the invested money comprised in the proceeds cannot be segregated. There needs to be some provision for splitting the original investment (which must be removed from the UK or reinvested) from the taxed gain (which can be retained in the UK without further consequences). If the investor has to remove all the money from the UK in order to avoid triggering a remittance, it will be difficult to pay the capital gains tax which will be due, without incurring an additional tax charge.
45. How will a part disposal be treated in the context of the mixed fund rules? If this is regarded as “an amount or value taken out of the business” and so remittance basis money, which part of that money is it?
46. We suggest:
- the simplest way of dealing with these issues would be to allow the proceeds to be split on an arithmetical basis between the original investment and the remaining, taxable funds, at any time within the time limit for removal or reinvestment;
 - any remittance basis money which is used to pay capital gains tax should not be regarded as remitted. This would be a benefit to the investor but, as noted, some sort of positive incentive would be useful to encourage UK investment.

47. Further, if the investor had segregated clean capital and also had “tainted” capital and/or income and uses both funds to make the investment, he would, strictly, have mixed previously unmixed funds. There needs to be an ability to separate the clean from the tainted funds, again, possibly by division within the removal/reinvestment time limit.

Question 3: Are the proposed anti-avoidance provisions suitable? Would it be appropriate to require remitted income or capital gains to be taken out of the UK or reinvested within two weeks of the disposal of the investment?

48. See comments above. In particular, we do not consider that a time limit of two weeks is realistic.

Claiming the relief

Question 4: Would a mandatory requirement to claim the relief for business investment on a Self Assessment tax return be an appropriate way of monitoring the policy? If not, what alternative monitoring approach would be appropriate?

49. A requirement to claim the relief on the self assessment tax return would seem to be an appropriate way of monitoring the policy. We note that HMRC will require a minimum of information.
50. In order that the investor can properly self assess in the future, it will be important, as noted above, that the application of the mixed fund rules to the making of the investment and the realisation of the investment is clear.

Encouraging investment

Question 5: Would the policy as outlined be an effective means of encouraging investment in the UK?

51. As noted above, while the proposals are described as an “incentive” they are really the removal of one of several disincentives to a non dom making UK investments.
52. We have suggested above some positive benefits which we believe could be included within the proposals.
53. As a general point, it should be possible to bring funds to the UK to cover the fees and costs related to the acquisition of permitted investments and those funds should not be regarded as remitted. It should also be possible to pay the fees and expenses of sale out of the remittance basis income and gains element of the proceeds without triggering a remittance.
54. If the government genuinely wishes to encourage long term investment in the UK and to make it attractive for non-doms to bring funds here when they would normally avoid doing so, we suggest that after a specified period of holding qualifying investments (whether a single investment or consecutive investments) the imported income and gains should become “clean capital”. Perhaps the proportion of funds becoming clean capital could increase on a sliding scale over time.

Other issues

55. It will be important to ensure that the relationship between the investment incentive and the application of the trust income tax and capital gains tax anti avoidance provisions is properly thought through.
56. If trustees invest trust funds in the UK under the business investment incentive, the first thing one has to consider is, what part of the trust fund or its income has been brought to the UK. Where there is a mixed fund, will the mixed fund rules in sections 809Q to 809S ITA apply to determine what has been brought to the UK? The mixed fund rules apply only for the purpose of determining what has been "remitted to the United Kingdom", but presumably an investment under the proposals will not count as a remittance.
57. The funds invested in the UK under the new proposals may include trust income. To the extent that section 720 ITA applies to that income, the new legislation will presumably ensure that no charge arises on the transferor.
58. If the trustees make a payment of capital to a beneficiary of the trust other than the settlor, the payment will be matched with relevant income in the trust under section 731 ITA.
59. One would expect that the benefit could be matched with any relevant income which had been used to make the investment.
60. To the extent that the beneficiary is UK domiciled, it would not matter whether the income were regarded as remitted or not; there would be a tax liability.
61. If the beneficiary is a resident non domiciled individual who is claiming the remittance basis, section 735A ITA sets out rules to determine the items of relevant income with which the benefit is matched. Section 735 ITA provides that the matched relevant income and the benefit are treated as deriving from the foreign deemed income which is treated as accruing to the beneficiary under section 732 ITA. This means that the beneficiary will be subject to an income tax charge if either they remit the benefit or the trustees remit the matched relevant income.
62. If the benefit is retained outside the UK but the matched relevant income has been used to make an investment under the new proposals, it will be important that the deemed foreign income is not treated as remitted.
63. If the trustees then gave a further benefit, again outside the UK, to the same or another beneficiary, that should not be capable of being matched with the invested income which had been matched to the previous benefit.
64. If there is insufficient relevant income to match the whole of the benefit, the excess benefit could be matched with section 2(2) amounts arising in the trust under section 87 TCGA. For section 87 purposes, the remittance basis applies by reference to a remittance of the capital payment itself under section 87B TCGA. It does not matter for these purposes whether the gains arise in the UK or outside the UK. However, it should be clear that any part of the capital payment which has been matched with relevant income invested in the UK cannot be matched with section 2(2) amounts.
65. It should not be necessary for the non-dom to be a remittance basis user at the time of the claim. For example, a non-dom who is, at the time taxable on the arising basis may wish to claim the relief if he wishes to invest the foreign income or gains of

previous years which were taxable on the remittance basis. Similarly, a temporarily non resident non-dom should be able to claim the relief for investments made during the period of temporary non-residence.

Simplifying the existence remittance basis rules

Nominated income

- 66. Presumably this will apply to £10 of nominated income per year but this should be confirmed.
- 67. Will the tax return continue to ask for information about the source of the nominated income?
- 68. The proposal is helpful as it seem to mean that as long as a non-dom nominates less than £10 of income or gains a year, he can never fall foul of the reordering rules.
- 69. This will not help US citizens who will have to nominate the full amount of income and gains if they are to obtain a double tax credit for the remittance basis charge.

Foreign currency bank accounts

- 70. This is a very welcome simplification. However, the Consultation refers to the accounts of “individuals” (paragraph 2.79). The CGT on FCBAs should be abolished altogether. Otherwise, all the complications will remain for trusts and companies.

Taxation of assets sold in the UK

- 71. As in the case of business investment, the two week limit is unrealistic and should be a minimum of three months.
- 72. There should also be provisions that the proceeds of sale can be retained in the UK if invested in qualifying businesses within the time limit.
- 73. Paragraph 2.85 of the Consultation indicates that the exemption will only apply where the purchaser retains the assets sold in the UK. We do not see why the actions of the purchaser should affect the tax position of the seller.
- 74. In any event, it is difficult to see how this provision will greatly assist the art market.
- 75. Although the sale of the asset in the UK will not constitute a remittance of any income and gains comprised in the purchase price, the sale could trigger a taxable capital gain and the asset and proceeds would be vulnerable to inheritance tax while here. Owners of these assets can just as easily sell them in New York or Geneva. They are unlikely to wish to sell them in the UK if they are to be subject to capital gains tax on their gains.
- 76. As with the sale of qualifying businesses, provision would be needed for separating out the original investment from the gain. Similar mixed fund issues also arise, as does the problem of how to pay the capital gains tax on the gain element if all of the funds have to be removed from the UK and/or, the first slice of remitted proceeds would be treated as the original remittance basis income or gains.

77. In order to make this provision an incentive to sell assets and, in particular, art through the UK market we suggest there should be provisions:

- to prevent a charge to capital gains tax on the sale (as long as the proceeds are removed from the UK or reinvested in qualifying businesses within the time limit or used to pay capital gains tax or costs and expenses associated with the sale);
- making the assets/proceeds excluded property while they are in the UK.

Question 6:

(a) Do you think the proposed solution for each simplification would be effective?

(b) Can you propose other ways in which the remittance basis rules could be simplified, provided they meet the principles described in paragraph 2.63?

78. See above for our comments.

79. In addition, there are many non-doms, including those who have been in the UK a relatively short time, who claim the remittance basis but do not have significant assets/income and gains offshore. Such individuals may have investments which constitute mixed funds and/or they may be beneficiaries under relatively modest offshore trusts set up many years ago which, until 2008, did not require extensive record keeping.

80. Many of these individuals will wish to bring funds onshore but the cost and effort of computing the tax is entirely disproportionate to the amounts involved. In many cases, the trustees/offshore banks will simply not have the records to enable them to analyse the composition of the funds. Before 2008, it was not at all unusual for trustees not even to maintain trust accounts and where a trust or offshore portfolio goes back many years, the information needed to reconstruct the components of the mixed fund is unlikely to be available.

81. We suggest that there should be a simplified regime for those with assets or offshore income/gains below a certain limit. For example, for those who do have sufficient records to know how much of a fund represents income and how much represents gains but who are unable to analyse the composition of the mixed fund in detail, perhaps there could be a simplified rule that:

- income comes out first;
- gains and capital then come out in proportion.

i.e. a reverter to the pre-2008 practice.

82. For those who do not have adequate records, perhaps there could be a composite rate of tax which would apply to all remittances other than original capital.

83. These issues also affect wealthier clients and in the case of those with assets over any limit, we suggest it should be possible to elect into the simplified regime.

Contact details:

If you have any questions concerning these representations or would like to discuss anything contained in them, please contact the Chair of the Capital Taxes Sub-Committee, Penelope Williams (tel: 020 7597 6093, e-mail: Penelope.Williams@withersworldwide.com) or Marilyn McKeever (tel: 020 7760 4549, e-mail: marilyn.mckeever@blplaw.com).