OLD SQUARE
TAX CHAMBERS

NEW FINANCE BILL 2017 DRAFT CLAUSES RE. DEEMED DOMICILE AND PROTECTED TRUSTS

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Contents

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A Deemed domicile

1. Introduction

a. Politics

George Osborne, July 2015 budget speech:
"*British people should pay British taxes in Britain – and now they will…*"

b. Process

"Technical Briefing on Non-Dom changes" (July 2015)
Consultation paper "Reforms to the taxation of non-domiciles" (September 2015)
Policy paper "IHT: reforms to the taxation of non-domiciles" & draft IHT clauses (September 2015)
Policy paper "Domicile: Income Tax and CGT" & draft IT/CGT clauses (2 Feb, updated 5 Feb 2016)
Budget 2016
"Reforms to the taxation of non-domiciles: further consultation" (August 2016)
Draft Clauses (December 2016).

2. Overview

New deemed domicile rules:

To be 4 categories of IHT deemed domicile and 2 categories of IT/CGT deemed domicile.

2 of the IHT deemed domicile types exist already: the current 3 year rule[2] & the current spousal election rule[3].

The rest are all proposed new rules.

[2] Section 267 IHTA 1984:
"A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if— (a) he was domiciled in the UK within the three years immediately preceding the relevant time…"

[3] Section 267ZA IHTA 1984: to deal with the restriction on the general spousal exemption from IHT, which limits the amount of the spousal exemption in circumstances where one spouse is UK domiciled and the other is not.

IHT deemed domicile	Comment	IHTA section
3-year rule	Unchanged	267(1)(a)
Returning domiciliary	New	267(1)(aa)
15-year rule	Was 17-year rule	267(1)(b)
Spouse-election	Unchanged	267ZA

CGT/IT deemed domicile	Comment	
Returning domiciliary	New	Condition A
15-year rule	New	Condition B

(The 15 year rule differs slightly from the IHT 15 year rule)

3. Draft clauses

Cl. 40 & 41 FB 2017 draft clauses.

There are no major changes to the trailed rules.

a. IT/CGT application

Clause 40 of FB draft clauses inserts section 835BA into ITA 2007

Deemed domicile: income tax and capital gains tax:

> "(1) This section has effect for the purposes of the provisions of the **Income Tax Acts or TCGA 1992 which apply this section**.
>
> (2) An individual not domiciled in the United Kingdom at a time in a tax year ("the relevant tax year") is to be regarded as domiciled in the United Kingdom at that time if—
>
> (a) condition A is met, **or**
>
> (b) condition B is met."

b. IT/CGT Condition A

> (3) **Condition A** is that—
>
> (a) the individual was **born in the United Kingdom**,
>
> (b) the individual's **domicile of origin was in the United Kingdom**,
>
> and

(c) the individual is **UK resident for the relevant tax year**.

c. IT/CGT Condition B

(4) Condition B is that the individual has been UK resident **for at least 15 of the 20 tax years immediately preceding** the relevant tax year.

(5) But Condition B **is not met** if—

(a) the **individual is not UK resident for the relevant tax year**, **and**

(b) there is **no tax year beginning after 5 April 2017 and preceding the relevant tax year in which the person was UK resident**."

So, if P would otherwise be deemed UK domiciled under Condition B, but is not resident in the relevant tax year, and not resident in any other tax year since 5 April 2017, it doesn't bite. This is a transitional relief of sorts.

d. IHT deemed domicile: formerly domiciled resident

Clause 40 of FB draft clauses amends section 267 of IHTA 1984 so it will provide:

"(1) A person not domiciled in the UK at any time (in this section referred to as "the relevant time"**) shall be treated for the purposes of this Act** as domiciled in the UK (and not elsewhere) at the relevant time if ...

(aa) **he is a formerly domiciled resident** for the tax year in which the relevant time falls ..."

Clause 40 then amends section 272 of IHTA 19854 (interpretation) so it will provide:

"**formerly domiciled resident**", in relation to a tax year,

means a person—

(a) who was **born in the United Kingdom**,

(b) whose **domicile of origin was in the United Kingdom**,

(c) who was **resident in the United Kingdom for that tax year**, and

(d) who was **resident in the United Kingdom for at least one of the two tax years immediately preceding that tax year**;".

N.b. Condition (d) is unique to IHT.

e. IHT deemed domicile: 15 year rule

Clause 40 of FB draft clauses amends section 267 of IHTA 1984 so it will provide:

"(b) he was resident in the United Kingdom—

(i) for at least **fifteen of the twenty tax years** immediately preceding the relevant tax year, and

(ii) **for at least one of the four tax years** ending with the relevant tax year."

This does not have effect in relation to a person if—

(a) the person is not resident in the United Kingdom for the relevant tax year, and

(b) there is no tax year beginning after 5 April 2017 and preceding the relevant tax year in which the person was resident in the United Kingdom.

(See clause 41, sub-clause (10).)

f. IHT formerly domiciled residents: excluded property trusts

Clause 41 also amends section 48 of IHTA 1984 (settlements: excluded property) to insert:

"(3E) In a case where the settlor of property comprised in a settlement is not domiciled in the United Kingdom at the time the settlement is made, **the property is not excluded property** by virtue of subsection (3) or (3A) above **at any time in a tax year if the settlor was a formerly domiciled resident for that tax year**."

An equivalent amendment is made to section 64 of IHTA 1984 (charge at ten-year anniversary). This applies to trusts including those existing pre-6 April 2017.

So, it will often be sensible to aim to ensure that at relevant times when a charge would arise, that a UK born person with a UK domicile of origin is not UK resident for that tax year.

Section 65 of IHTA 1984 (charge at other times) is amended to insert:

> "(7B) Tax shall not be charged under this section by reason only that property comprised in a settlement becomes excluded property by virtue of section 48(3E) ceasing to apply in relation to it."

I.e. there is no charge on property becoming excluded because a formerly domiciled resident ceases to be UK resident for a tax year.

Section 82 of IHTA 1984 (excluded property) is amended:

> "(1) In a case where, apart from this section, property to which section 80 or 81 applies would be excluded property by virtue of section 48(3)(a) above, that property shall not be taken to be excluded property at any time ("the relevant time") for the purposes of this Chapter (except sections 78 and 79) unless **Conditions A and B are satisfied**.";

Condition A is the existing single condition, i.e. the settlor was not domiciled in the United Kingdom when that settlement was made.

Condition B is new.

> "(4) Condition B referred to in subsection (1) above is—
>
> (a) in the case of property to which section 80 above applies, that the person who is the settlor in relation to the settlement first mentioned in that section, and
>
> (b) in the case of property to which subsection (1) or (2) of section 81 above applies, that the person who is the settlor in relation to the first or second of the settlements mentioned in that subsection,
>
> was **not a formerly domiciled resident for the tax year in which the relevant time falls**."

g. IHT definition of "foreign-owned": new definition

Section 272 of IHTA 1984 (interpretation) is further amended to provide that "foreign-owned" property is only "foreign-owned" if a person is not a formerly domiciled resident in the tax year in question.

h. Incorporation of the new clauses

The new clauses are not automatically applicable in all cases. Rather, schedule 12 of the draft clauses specifies where they apply in relation to the tax year 2017-18 and subsequent tax years, including:

Section 266A of ICTA 1988 (relief for life assurance premiums paid by employer to an EFRBS: not available to non-UK domiciliaries).

Section 69 of TCGA 1992 (trustees of settlements are UK resident if, *inter alia*, the settlor was UK resident or UK domiciled when the settlement is created)

in a case where the settlement arose on the settlor's death, where the settlor died on or after 6 April 2017; and

in any other case, where the settlor made the settlement (or was treated for the purposes of TCGA 1992 as making the settlement) on or after 6 April 2017.

Section 86 of TCGA 1992 (attribution of gains to settlors with interest in non-resident or dual resident settlements)

Section 275 of TCGA 1992 (location of assets), as it applies to non-sterling bank account debts of foreign domiciliaries, irrespective of when the asset was acquired by the person holding it.

I.e. these are UK situs if the non-UK domiciliary is UK resident and the branch of the bank [etc] is in the UK.

Para 3 of Schedule 5A of TCGA 1992 (settlements with foreign element: information).

I.e. UK resident, UK domiciled settlors must provide information on non-resident trusts. This applies only to people who are domiciled/deemed domiciled "at that time" when they are the settlor and must be done within 3 months of the "relevant day", which is the day the settlement is created, and for settlements created on or after 6 April 2017. There is, accordingly, no obligation to put in a return under schedule 5A paragraph 4 for a pre-2017 settlement on becoming UK deemed domiciled.

Section 355 of ITEPA 2003 (claims for deductions for employee's expenses in respect of payments by non-domiciled employees with foreign employers which would reduce UK tax in corresponding circumstances).

Section 373 of ITEPA 2003 (non-domiciled employee's travel costs and expenses where duties performed in UK).

Section 374 of ITEPA 2003 (non-domiciled employee's spouse's etc travel costs and expenses where duties performed in UK).

Section 376 of ITEPA 2003 (foreign accommodation and subsistence costs and expenses (overseas employment)).

Section 476 of ITA 2007 (UK residence of trustees: how to work out whether settlor meets condition C in section 475, specifically the requirement (*inter alia*) that the settlor was UK resident or UK domiciled when the settlement is created), for settlements coming to existence after 6 April 2017.

Section 718 of ITA 2007 (meaning of "person abroad" for TOAA purposes).

Section 834 of ITA 2007 (residence of personal representatives: determining UK residence if one /more are not UK resident).

Do we expect further drafting for the amendment to the transfer of assets abroad provisions? The August 2016 con doc had said:

> "To deliver the protections, it will be necessary to partially dis-apply the part of the TOAA legislation at section 720 ITA 2007 that would apply to deemed-domiciled settlors who set up a non-resident trust before they become deemed-domiciled, to prevent them from being taxed on the foreign income of the trust or any underlying entity if it pays out dividends to the trust. If it doesn't, the income arising to the foreign company will still be taxed under section 720."

At present, there is no published proposed amendment the ITTOIA 2005 settlements legislation, either. This is likely to need to follow in conjunction with the TOAA clauses.

i. Remittance basis amendments

In ITA 2007, the remittance basis sections in chapter A1 of Part 14 are consequentially amended. The remittance basis is not to be available to those who are deemed domiciled under the new rules.

The remittance basis charge of £90,000 for those resident for 17/20 years is abolished because those people will be deemed domiciled under the new 15 year rule.

j. Pre-domicile planning: matters to think about

If as formerly domiciled resident: review trusts made by individual (including charitable trusts. Definition of charitable: *Routier*.).

If deemed domiciled under 15 year rule: consider creating pre-domicile trust: see in particular section 86 transitional provisions below.

Review interest-free loans to trusts or underlying companies.

Consider arranging foreign income and gains to arise while remittance basis still applicable.

Pre-April 2017, consider with particular care rebasing/cleansing reliefs, below.

B "Protected Trusts"

Part 2 of Schedule 12

1. Section 86 TCGA 1992

UK resident UK-domiciled settlor is taxable on the gains of a non-resident trust if he/another "defined person"[4] can benefit ("the settlor charge").

At present, a foreign domiciled settlor is exempt from these attribution provisions, regardless of whether the Remittance Basis is claimed.

Para 18 of Schedule 12 of the Draft Clauses inserts para 5A to Schedule 5 of TCGA 1992 to preserve this treatment for deemed UK-domiciliaries but only provided certain conditions are met.

Nb. Conditions are cumulative.

"5A (1) **Section 86 does not apply** in relation to a year ("the particular year") if—

(a) the particular year is the tax year 2017-18 or a later tax year,

(b) the settlor is not domiciled in the United Kingdom when the settlement is created,

(c) where the settlement is created on or after 6 April 2017, it is created at a time when the settlor is not regarded for the purposes of section 86(1)(c) as domiciled in the United Kingdom as a result of section 835BA of ITA 2007 (see section 86(3A)),

"(d) **there is no time in the particular year** when the settlor is—

(i) domiciled in the United Kingdom, or

[4] Spouse; child of settlor/spouse; spouse of such a child; grandchild; spouse of a grandchild; company controlled by any of these people; a company associated with a company controlled by any of these people: see para 2 of Schedule 5 of TCGA 1992.

> (ii) **regarded for the purposes of section 86(1)(c) as domiciled in the United Kingdom as a result of section 835BA of ITA 2007 having effect because of condition A** in that section being met, and"

That is the returning UK domiciliary of origin rule.

> "(e) **no property or income is provided directly or indirectly for the purposes of the settlement by the settlor, or the trustees of any other settlement of which the settlor is a beneficiary or settlor, at a time in the period**—
>
> (i) beginning with **the later of** the creation of the settlement and **the start of 6 April 2017**, and
>
> (ii) **ending with the end of the particular tax year, when the settlor is regarded for the purposes of section 86(1)(c) as domiciled in the United Kingdom as a result of section 835BA of ITA 2007 having effect because of condition B** in that section being met."

I.e no additions made when the 15/20 year rule is in effect & applies.

Two key questions to avoid tainting:

> Who is the settlor?
>
> What counts as the provision of property?

See HMRC historic commentary on this in SP 5/92:
https://www.gov.uk/government/publications/statement-of-practice-5-1992/statement-of-practice-5-1992:

> "Finance Act 1991 ss 83 to 92, Sch 16 to 18 introduced new rules for Capital Gains of certain offshore trusts. These are now in TCGA 1992 ss 80 to 98, Sch 5. This statement explains the practice HM Revenue and Customs (HMRC) will follow in applying the new rules in the circumstances set out below."
>
> Revised August 2002.

See also chapter 87 of TFD.

HMRC take the view that provision of property to a company wholly owned by a trust is in principle provision of property for the purpose of the trust, and so makes the provider a settlor. See *IRC v Mills* 49 TC 367.

Is the provision of advice, e.g. unpaid investment advice, to the trustees is not the provision property? Is the adviser the settlor?

HMRC take the view that making an interest free loan is the provision of property to a settlement. The lender is the settlor.

What about an existing interest free loan? Can this be left outstanding? To do so is risky.

Are loan guarantees in the case of back-to-back loan arrangements the provision of property and, if so, is the guarantor a settlor? It seems likely that in both cases the answer is yes: see *Wachtel v IRC* 46 TC 543.

Are loan guarantees without back-to-back loan arrangements the provision of property?

Is the provision of an indemnity by a beneficiary receiving trust property the provision of property?

Is the repayment of a loan owed to a trust the provision of property: see sub-clause (2) below?

Is an overpayment of a loan or the overpayment of interest provision of property?

Is the issue of shares to a trust at an undervalue the provision of property? Yes. See: *Crossland v Hawkins* 39 TC 493.

If income is not paid out to a life tenant, has the life tenant provided property? If there is an administrative delay in paying out the income that has vested in that beneficiary. If, however, the beneficiary directs the trustees to retain this income on the terms of the settlement, this is a provision of funds.

The draft legislation continues:

> "(2) For the purposes of sub-paragraph (1)(e), ignore—
>
> (a) property or income provided under a transaction entered into at arm's length,
>
> (b) property or income provided in pursuance of a liability incurred by any person before 6 April 2017, and
>
> (c) where the settlement's expenses relating to taxation and administration for a tax year exceed its income for that year, property or income provided towards meeting that excess if the value of any such property and income is not greater than the amount of the excess."

So:

(1) arm's length additions: is this provision of property in any event?

(2) pre-existing liabilities: should these now be created? It may be sensible, but watch section 5 of IHTA 1984.

(3) people paying trust tax when it cannot be paid from trust income.

are protected.

Also, property provided by a 3rd parties, who are not the settlor or relevant trustees of a trust should not affect the relief. (Although they may be taxed as settlors themselves.)

2. Rebasing for CGT

"21 (1) This paragraph applies to the disposal of an asset by an individual ("P") where—

(a) the asset was **held by P on 5 April 2017**,
(b) the disposal is **made on or after 6 April 2017**,
(c) the asset was not situated in the United Kingdom at any time in the **relevant period**, and
(d) P is a **qualifying individual**.

(2) The relevant period is the period which—

(a) begins with 16 March 2016 or, if later, the date on which P acquired the asset, and
(b) **ends with 5 April 2017**.

(3) P is a qualifying individual if—

(a) section 809H of ITA 2007 (claim for remittance basis by long-term UK resident: charge) applied in relation to P for any tax year before the tax year 2017-18,
(b) **P is not an individual—**
(i) who was born in the United Kingdom, and
(ii) whose domicile of origin was in the United Kingdom,"

Re: 809H applying: this applies where a claim for the remittance basis is made under section 809B of ITA 2007; it may be worthwhile claiming for 2016/17 in order to obtain rebasing.

I.e. is not a returning UK domiciliary of origin.

"(c) **P was not domiciled in the United Kingdom** at any time in a relevant tax year, and

I.e. not domiciled under the general law.

"(d) **P met condition B in section 835BA of ITA 2007 in relation to each relevant tax year**.

I.e. the 15/20 rule.

(4) The relevant tax years are—

(a) **the tax year 2017-18**, and

(b) if the disposal was made after that tax year, **all subsequent tax years up to and including that in which the disposal was made**.

(5) In computing, for the purpose of capital gains tax, the gain or loss accruing on the disposal, it is to be assumed that P **acquired the asset on 5 April 2017** for a consideration equal to its market value on that date.

(6) Where under section 127 of TCGA 1992 (including that section as applied by sections 132 and 135 of that Act) an original and a new holding of shares or other securities are treated as the same asset, the condition in sub-paragraph (1)(c) applies to both the original and the new holding.

(7) Words and expressions used in this paragraph and in TCGA 1992 are to be construed in accordance with that Act.

"22 (1) This paragraph applies for the purposes of paragraph 21(1)(c) in the case of an asset which is brought to, or received or used in, the United Kingdom in circumstances in which section 809L(2)(a) of ITA 2007 applies.

(2) The asset is to be regarded as not situated in the United Kingdom at any time in the relevant period—

(a) if the asset is, under section 809X of ITA 2007, treated as not remitted to the United Kingdom at the time it is brought to, or received or used in, the United Kingdom, and

(b) the asset is not under section 809Y(1) of that Act treated as remitted to the United Kingdom at any time during the relevant period.

"23 (1) An individual may make an **election for paragraph 21 not to apply** to a disposal made by the individual.

(2) Sections 42 and 43 of TMA 1970 (**procedure and time limit for claims**), except section 42(1A) of that Act, apply in relation to an election under this paragraph as they apply in relation to a claim for relief."

There is therefore a 4 year limit from the end of the tax year in which the disposal took place.

"(3) An election under this paragraph is **irrevocable**.

(4) All such adjustments are to be made, whether by way of discharge or repayment of tax, the making of assessments or otherwise, as are required to give effect to an election under this paragraph."

There is no rebasing for trust assets nor for company assets. Cf. 2008 rebasing.

What about partnership assets? Partnerships are transparent – section 58 of TCGA 1992. A partnership asset should qualify as an asset held by P.

For clients not already IHT deemed domiciled who own property themselves, query settle now & take advantage of IHT advantages of current non-domicile & the s. 86 benefits above; or take advantage of re-basing by continuing to hold assets personally.
If already IHT deemed domicile, different considerations apply re IHT but s. 86 benefits available.
Much will depend on the trust. Consider e.g. pre-2006 IIP trust where the settlor has the interest in possession. Trust owns company. Gift made to company: no fall in value of estate of the settlor and so no IHT charge.
Similarly, consider whether to appoint out assets now if assets non UK situs & remittance basis is available.

3. Cleansing

> "24 (1) This paragraph applies for the purposes of the application of section 809Q(3) of ITA 2007 in relation to an individual ("P")."
>
> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund …"

The rule is that s.809R(4) (offshore fund rule) is disapplied. Instead, the usual onshore transfer rules apply. So rather than apportioning income/tainted gains/clean capital, it is possible to transfer out in tranches under the rule in section 809Q:
Income to one account; tainted capital next; clean capital next.
If different years, it will be Y2 income; tainted capital; clean capital, followed by each for Y1.
Therefore, cleansing will require careful compliance.

It is available where 6 conditions, found in sub-paragraph 2 are met.

> "(2) …
> (a) the transfer is made in the tax year 2017-18 or the tax year 2018-19,"

The clock is ticking. N.b. it is available also 2018/19, however.

> "(b) the transfer is a transfer of money,"

This includes foreign currency money. HMRC have seen fit in another context to clarify that they do not consider bitcoins to be money, but that is a niche concern.
Remember, of course, mixed funds needn't be money.
To take advantage of cleansing, assets may need to be sold.

"(c) the mixed fund from which the transfer is made is an account (account A) and the transfer is made to another account (account B),"

2 accounts are an absolute requirement. This can include individual bank accounts under an umbrella arrangement with a bank. See HMRC's RDR Manual at 35230.

"(d) the transfer is nominated by P for the purposes of this subparagraph,

(e) at the time of the nomination no other transfer from account A to account B has been so nominated, and"

You must nominate. More than one transfer can, of course, be nominated. N.b., however, the requirement that if you wish to nominate more than one transfer, it must be either from or to a separate bank account from any other transfer. In most cases, this will happen anyway, but in some cases it will increase complexity unnecessarily.

"(f) P is a qualifying individual.

(3) P is a qualifying individual if—
(a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applied in relation to P for any tax year before the tax year 2017-18, and
(b) P is not an individual who—
(i) was born in the United Kingdom, and
(ii) whose domicile of origin was in the United Kingdom."

This is not identical to the definition for rebasing. Cleansing does not require payment of the remittance basis charge under s.809H of ITA 2007. Similarly, it is not, however, available to formerly domiciled residents.

"(4) In this paragraph "mixed fund" and "offshore transfer" have the same meanings as in section 809R(4) of ITA 2007."

4. Comparison: rebasing / cleansing

Rebasing	**Cleansing**
Asset held 5/4/17	Asset acquired any time
Disposal any time post 6/4/17	Account transfer 2017/18 or 2018/19
Any asset	Money only
Asset non-situate 16/3/16-5/4/17	Asset unremitted
P pays remittance basis charge 08/09 - 17/18	Not required

P not formerly domiciled resident	Same
P meets 15-year rule in 17/18	Not required
Election to disapply	Nomination to apply

Consider deferring remittances from mixed funds until 2017/18, in order to take advantage of cleansing relief.

Those who will become deemed domiciled in April 2017 may do well to avoid disposals before 6 April 2017 of any property which will qualify for rebasing.

(1) If the individual qualifies for 2017 rebasing:
- (a) keep the asssets until 2017
- (b) dispose of assets in 2017/8 or 2018/19 (no/minimal gain on disposal due to rebasing)
- (c) use cleansing relief if necessary to separate out the proceeds and segregate clean capital.

(2) If the individual does not qualify for 2017 rebasing (not having been in the UK long enough) but does qualify for cleansing:
- (a) dispose of assets when the gain qualifies for the remittance basis
- (b) use cleansing relief to separate out the proceeds into gain and clean capital.

Lincoln's Inn
10 January 2017