HM Treasury

# Reforms to the taxation of non-domiciles:

## response to further consultation

December 2016

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# Contents


| | | Page |
|---|---|---|
| Chapter 1 | Introduction | 3 |
| Chapter 2 | Summary of responses: deeming provisions | 9 |
| Chapter 3 | Summary of responses: Inheritance tax on UK residential property | 17 |
| Chapter 4 | Summary of responses: Business Investment Relief | 25 |
| Annex A | Respondents | 31 |

# 1 Introduction

## 1.1 Summary

The government announced its intention to reform the non-domicile ("non-dom") regime in the Summer Budget 2015. Its objectives were to create a fair and competitive tax regime by:-

- ending permanent non-dom status
- preventing those who are UK born with a UK domicile of origin from claiming non-dom status
- applying inheritance tax (IHT) to all non-dom owned UK residential property and
- reforming Business Investment Relief (BIR)

A technical document was published at Summer Budget 2015 and was followed by the first consultation on the proposals "Reforms to the taxation of non-domiciles" on 30 September 2015. Parts of the draft legislation were published on 9 December 2015 and 2 February 2016.

The September 2015 consultation set out the government's proposal that those non-doms who had been UK resident for 15 of the past 20 years would be deemed as UK domiciled for tax purposes.

In responding to the consultation, the government announced at Budget 2016 that it would introduce two transitional measures to the deeming provisions (rebasing of foreign assets and cleansing of mixed funds), alongside a technical document outlining proposals concerning offshore trusts. They also detailed how these changes along with those announced at Summer Budget 2015 will be legislated as a consolidated package at Finance Bill 2017.

The most recent consultation, published on 19 August 2016, provided further detail on previously announced proposals and asked a number of questions on extending the charge to IHT to all UK residential property and reforming the BIR scheme to encourage greater investment.

The government has carefully considered responses to the consultation and has decided to continue with the reforms as announced, along with amendments in light of the consultation. This document sets out the final package of reforms.

There are three main elements to the reforms. First, it ensures that the tax treatment of the most long-term UK resident non-doms is brought in line with UK domiciled residents. Tax will be charged on worldwide income and gains. The reforms also mean that a UK-born individual whose domicile of origin was in the UK cannot choose a foreign domicile and then subsequently return to the UK as a non-dom. This section of the reforms are referred to as the "deeming provisions." Second, the changes to the IHT rules ensure that non-doms cannot hold a UK property indirectly (for example, through an offshore company). This closes the loophole that a large number of non-doms use to avoid paying UK IHT. And third, the government sets out a package of reforms to Business Investment Relief to incentivise inward investment into UK businesses. This is designed to allow non-doms to bring more overseas income and gains into the UK to support economic growth and investment.

As the government has previously set out, a package of arrangements will be introduced to help non-doms adjust to the new regime, in respect of the rebasing of foreign assets, cleansing of mixed funds and provisions for offshore trusts. Further detail of these measures is set out in this document.

Combined, these proposals form the package of reforms to the UK non-dom taxation regime which will be legislated together as part of the 2017 Finance Bill to take effect from April 2017.

Draft legislation for these reforms, with the exception of the income tax arrangements for offshore trusts, has been published as part of the draft Finance Bill. The draft legislation for the income tax arrangements for offshore trusts will be published no later than the date for the publication of the 2017 Finance Bill.

## 1.2 Consultation overview

On 19 August 2016, the government published a second consultation "Reforms to the taxation of non-domiciles: further consultation" setting out proposals to charge IHT on residential property and inviting recommendations on how the BIR scheme could be changed to stimulate increased investment in UK business. This document also gave an update on the deeming provisions and arrangements, and was published alongside additional draft legislation. The consultation closed on 20 October 2016.

77 responses to the consultation were received. The government has carefully considered each of these responses and is grateful to the representative bodies, businesses and individuals who provided their views on the proposals. A list of respondents can be found at Annex A. The government's in-depth response to these views are provided below.

### 1.2.1 Deeming UK domicile for long-term residents

The government considers that the overall aim of the policy is settled and did not directly consult on the policy in the most recent consultation, but has taken views on the details of how best to legislate these proposals. Further detail on these reforms was set out in the consultation response document published in December 2015. For IHT purposes this new regime simply shortens the current rules, which provide that a UK resident non-dom will become deemed domiciled if they had been resident for 17 out of 20 years.

A significant number of respondents made representations on this issue. These included responses on cleansing of mixed funds, rebasing of directly held foreign assets and trust provisions. A summary of these representations, and the government's response is set out in Chapter two.

### 1.2.2 Born in the UK with a UK domicile of origin

The September 2015 consultation outlined the government's proposals that deemed an individual as UK domiciled for tax purposes if they had a UK domicile of origin and were born in the UK. The intention of this measure was to prevent those with the most significant links to the UK from returning here from abroad and claiming non-dom status.

The government considers that this policy is settled in line with previous consultations and as such has not provided any further commentary on the policy.

### 1.2.3 Inheritance tax on UK residential property

Under the current rules, non-UK domiciled individuals are only liable to IHT on UK situs assets. Unlike UK domiciles, any assets a non-dom owns outside the UK are not liable to UK IHT. This means that there is a strong incentive for an individual who is not domiciled in the UK to set up an arrangement where their UK property is owned by a foreign company. The individual holds company shares which are a foreign asset and thus outside the scope of UK IHT. Mitigation of IHT in this way is not available to UK domiciled individuals.

From 6 April 2017, the government proposes to extend the IHT charge to enveloped UK residential property. This will be achieved by amending the definitions of excluded property in the Inheritance Act 1984.

The government intends to implement the reform to IHT on residential property as previously announced. Following the consultation responses, minor amendments to implementation of these changes are detailed in Chapter three.

### 1.2.4 Business Investment Relief

Non-doms who have elected to be taxed on the remittance basis only pay tax on overseas income and gains when they are brought into the UK. While this is advantageous from a tax perspective, the remittance basis does represent a significant disincentive to making any inward investment to the UK. Business Investment Relief was introduced in April 2012 to remove the disincentive for remittance basis users to invest in the UK, on funds that were invested into UK business to stimulate growth and encourage investment in the UK.

This scheme has so far incentivised non-doms to invest over £1.5billion in UK business. However, the government has been made aware that BIR could be more effective at encouraging investment. To this end, it was announced at Autumn Statement 2015 that there would be a consultation on how the scheme could be improved to stimulate greater use. The government is keen to expand BIR to make it easier for remittance basis taxpayers to use their overseas money to invest in UK business.

The consultation asked for innovative ideas on how the scheme could be amended and expanded to increase take up. Concerns had been raised that the scheme was overly complex and that the anti-avoidance provisions in the legislation overreached themselves and put off potential investors. The government asked how BIR could be simplified whilst still maintaining its purpose.

The government has carefully considered all of the suggestions it received and has outlined its response in Chapter 4. Legislative changes will be included in Finance Bill 2017 and will take effect from 6 April 2017. The government will continue to consider further, more far-reaching changes to BIR for a future Finance Bill.

## 1.3 Content of the response to the consultation

The consultation "Reforms to the taxation of non-domiciles: further consultation" focussed on IHT on UK residential property and BIR reform. However, the government also received a significant number of responses on the deeming provisions, on which we had previously consulted. These representations have been reflected in the government's responses in Chapter two.

### 1.3.1 Deeming provisions

- deeming UK domicile for long-term residents announced at the Summer Budget 2015
- transitional arrangements announced at Budget 2016
  - cleansing of mixed funds
  - rebasing of foreign held assets
- provisions for trusts announced at the Summer Budget 2015

### 1.3.2 Inheritance tax on UK residential property consultation questions

1 Are there any difficulties in introducing the IHT charge by amending the legislation in this way?

2 Are there any reasons why the extended charge should not apply to all chargeable events?

3 Do you agree that the definition of a dwelling introduced for the purposes of non-resident capital gains tax (CGT) would provide the most suitable basis for the extended IHT charge?

4 Do you agree that this is the most suitable approach for dealing with situations where the use of a property is mixed or has changed over time?

5 Are there any potential difficulties in this approach?

6 Are there any difficulties in this approach to determining the value of property chargeable to IHT?

7 Will the proposed anti-avoidance rule be an effective way of countering attempts to avoid the IHT charge?

8 Do stakeholders agree that these steps will effectively ensure compliance?

9 Are there any hard cases or unintended consequences that will arise as a result of there not being any tax relief for those who want to exit their enveloped structures?

### 1.3.3 Business Investment Relief consultation questions

10 In what ways might the current scheme be changed to encourage greater investment in the UK?

11 Are you able to provide any evidence which might indicate that these changes will lead to a significant increase in UK investment?

12 What aspects of the scheme might usefully be simplified while maintaining its policy objective and encourage greater take up?

13 What changes would you make to ensure the anti-avoidance provisions are properly targeted to prevent tax avoidance?

# 2 Summary of responses: deeming provisions

This section covers the proposals to treat non-doms as "deemed domiciled" once they have been resident in the UK for 15 of the past 20 years (the "15/20 test"). It also covers the two transitional arrangements (cleansing of mixed funds and rebasing the cost basis of foreign assets) announced at the March 2016 Budget and the arrangements for overseas trusts announced at the 2015 Summer Budget. This chapter details the representations made by respondents about these issues.

## 2.1 Deemed UK domicile for long-term residents

The government consulted last year on the 15/20 test. The test is based on the number of tax years that an individual has been resident in the UK. The consultation document outlined the intention to count years of residence, including years spent while the individual is under the age of 18. The individual could lose their deemed-UK domiciled status if they became non-resident and spend at least six years as a non-resident.

### 2.1.1 Inheritance tax tail

The main issue raised during the September 2015 consultation on deemed UK domicile was the effect of the 15/20 test which would mean that an individual would continue to be deemed domiciled in the UK for a long time after they had left the UK and become non-resident for tax purposes. Following representations made, the government proposed in the consultation published in August 2016 ("Reforms to the taxation of non-domiciles: further consultation") that there should be a proviso to the deeming rule for IHT purposes only so that where a person had met the 15/20 test, had left the UK for 4 consecutive years and had not returned, they would lose their deemed domicile status. So for example, a person who is UK resident for 15 years and is then non-resident in year 16, 17, 18 and 19, would lose their deemed domicile status at the beginning of year 20, provided they were still non-resident in that year.

#### Summary of responses

However, respondents to the August 2016 consultation have pointed out that the way in which the legislation has been formulated effectively means that a person has to be absent for 5 consecutive tax years to benefit from the let-out. This contrasts with the existing 17 out of 20 test, whereby a person will lose their deemed domiciled status at the beginning of the fourth year of absence provided they are non-resident for that tax year.

#### Government response

The draft legislation has therefore been amended so that it is in line with the existing 17/20 rule. This means that those who go abroad and stay abroad lose deemed domicile status for the purposes of IHT at the start of the fourth tax year of non-residence.

The government believes that the proposals outlined in the consultation document and the draft legislation strike the right balance between fairness in the way the rules operate and does not propose to make any further changes to these rules.

## 2.2 Transitional arrangements announced at Budget 2016

### 2.2.1 Cleansing of mixed funds

The August 2016 consultation outlined proposals that individuals who have been taxed on the remittance basis will be able to rearrange their mixed funds held in overseas bank accounts. This will enable long-term remittance basis users to remit amounts representing capital and other amounts which would be taxed at a lower rate to the UK in priority to amounts representing income or capital gains. The consultation document proposed that the opportunity to cleanse mixed funds would last for the 2017/18 tax year.

#### Summary of responses

Respondents welcomed the cleansing proposal, although a number felt that it should be extended to assets other than funds held in overseas bank accounts. Others felt that one year would not be sufficient time in which to allow people to rearrange their mixed funds and should be extended to two years.

#### Government response

The government is not attracted to the proposal to extend cleansing to assets other than amounts held in bank accounts as this would require complicated statutory rules to deliver. However, the government accepts that individuals might need more than one year in which to cleanse their mixed funds, and has therefore extended the opportunity to do so for two tax years from April 2017.

### 2.2.2 Rebasing of foreign held assets

The government announced that those individuals who will become deemed domiciled from April 2017 because of the 15/20 test, will be able to rebase their directly held foreign assets to their market value on 5 April 2017. The government felt it would be punitive to require long-term resident non-doms to pay CGT on gains which had accrued on foreign assets held while they were a non-dom, potentially even including assets that were acquired before they became UK resident.

#### Summary of responses

Most of those who responded welcomed the rebasing proposal. A number felt that it should be made available more widely, in particular to those who became deemed domiciled in later years, and a number of respondents thought that rebasing should be extended to assets owned indirectly through trusts and similar structures. Others suggested that rebasing should also be available for certain investment funds in which gains are chargeable to income tax rather than CGT.

### Government response

The purpose of this transitional measure was to support those non-doms who needed to adjust to the new deemed domiciled regime from April 2017. The government thinks that the case for extending its scope to those who become deemed domiciled in later years is less compelling, as they will have longer to plan for the new regime. It therefore does not propose to extend rebasing in this way.

It also does not accept the argument for extending rebasing to gains in trusts or to gains which are subject to income tax. There are separate measures which will apply to gains arising in trusts. In addition, the aim of rebasing is to relieve gains which have accumulated in overseas assets that cannot be easily liquidated: this is not the case for gains arising in investment funds.

## 2.3 Provisions for trusts announced at Summer Budget 2015

Summer 2015 Budget announced a proposal for non-doms who will become deemed domiciled under the 15/20 test after April 2017 relating to overseas trusts created before they become deemed domiciled. The provision ensures that the settlors of those trusts that are treated as protected trusts will not be taxed on either the foreign income or the gains that are retained in the trust or its underlying entities. Such trusts will continue to have the same IHT treatment as at present.

### Summary of responses

Virtually all of those who responded to the consultation had concerns with the government's proposals to extend section 86 of the Taxation of Chargeable Gains Act (TCGA) 1992 to apply to all non-doms who become deemed domiciled. While settlors of protected trusts would not have been subject to section 86 charges unless they, their spouse, or their children received a benefit from the trust, protection would have been lost completely in that event. Stakeholders thought that instead, gains should be taxable only to the extent of benefits received under section 87 (TCGA) 1992, which taxes UK resident individuals on capital payments received from a non-resident trust to the extent that they can be matched against gains arising in the trust.

Another concern for most stakeholders was around additions made to settlements after the settlor has become deemed UK domiciled. Most of the responses requested clarity on the rules that would allow certain additions, for example, for expenses, not to taint the trust. Others felt that there should be some flexibility for resettlements, especially where there were extended families involved, whilst other stakeholders called for a de-minimis rule for small additions or a limited grace period to correct accidental additions.

A number of stakeholders made the point that the proposal to tax the income of an asset held in a company underlying a trust was at odds with the offer of provisions for income and gains arising in the trust. The draft legislation published in August 2016 required dividends to be paid out to the trust if the income arising to the underlying foreign company was to also be protected. Stakeholders commented that if underlying companies were forced to pay dividends up to the trustees this would be impractical, produce unnecessary administration burdens and reduce investment in UK located assets. They felt it would be simpler if the protection from section 720 Income Tax Act (ITA) 2007 applied both at the trust level and at all underlying entity levels. There would be no loss to the Exchequer if protection was subsequently lost as then income at the trust and all underlying entity levels would be subject to UK income tax in the hands of the settlor on an arising basis.

### Government response

The government recognises the concerns raised in connection with the loss of trust provisions as a result of settlors or close family members taking a benefit from the trust. The government has therefore considered an alternative approach to deliver the trust provisions so that liability to income tax or capital gains tax only arises to the extent that benefits are received from the trust. However, while this may address the difficulties that stakeholders were concerned about, it also raises avoidance issues that need to be addressed. The details of the alternative approach are set out below.

## 2.3.1 Treatment of capital gains in trusts

Under current rules, a beneficiary of an overseas trust who is UK resident only pays tax on gains arising in the trust when the trust makes a capital payment to them: in such cases, the payment to the beneficiary is 'matched' against the pool of gains in the trust and the beneficiary is treated for tax purposes as having received the gain. However, where a beneficiary is not UK resident, no tax is due. Making a capital payment to such a beneficiary has the effect of reducing the gains in the pool and the amounts available to match against any subsequent payments to UK resident beneficiaries. For tax purposes, the pool of gains has been depleted by the payments to non-residents – even though the non-residents did not pay tax on the gain.

### Potential Avoidance

The government is concerned that there will be an increased opportunity and incentive for those who are deemed domiciled and therefore benefit from the trust arrangements, to benefit further from existing rules that allow the “pool” of taxable gains in overseas trusts to be reduced when capital payments are made to non-resident beneficiaries.

In order to address this opportunity for tax avoidance under the new regime capital payments to a non-resident beneficiary either made after April 2017 or matched after that date will therefore not be matched against the pool of trust gains. This is regardless of the domicile status of the settlor and whether or not the recipient of the payment is the settlor or another beneficiary of the trust. This will ensure that the pool of gains against which payments to UK beneficiaries are matched will not be depleted because of payments made to non-residents.

Following the introduction of the new deemed domicile rules, all deemed domiciled individuals will be taxed on an arising basis on all capital payments received from an overseas trust.

## 2.3.2 Close family members

Payments to close family members of a UK resident settlor which are made on or after 5 April 2017, whether the settlor is UK domiciled, deemed domiciled or non-domiciled, which are matched to gains arising in the trust will be attributed to and taxed on the settlor according to their tax status. This means that the settlor will be taxed if they are UK resident on an arising basis or the remittance basis if that applies to them. A charge to CGT will arise on the beneficiary in the tax year if they are resident and either deemed domiciled or actually UK domiciled, or if they are resident and non-domiciled and have remitted the payment - in which case the family member will be taxed in priority.  If the matching already results in a charge to CGT on the family member in that tax year, there will be no charge on the settlor. Where the beneficiary is non-resident or is a non-domiciled remittance basis user who has not remitted in that tax year, the UK resident settlor will be taxed on the gain. If the non-resident beneficiary or remittance basis user remits the capital payment to the UK at a later date, there will be no charge to tax because the payment has already been attributed to the settlor.

Close family members are defined as spouse, cohabitee and minor children but not minor grandchildren. The definition will apply for both income tax and capital gains tax purposes.

There will be a right of reimbursement from the trustees or the beneficiary where a settlor has been taxed in respect of a benefit paid to a close family member.

## 2.3.3 Taxation of foreign income in overseas trusts

Under the government's alternative approach, foreign income arising in overseas trusts (or any underlying corporate structure) set up by a non-dom will not be taxed on the settlor on an arising basis when the individual becomes deemed domiciled under the 15/20 test. The existing settlor charges under both the settlements legislation and Transfer of Assets Abroad legislation will be dis-applied to such income both where the settlor is deemed domiciled and where the settlor remains foreign domiciled for tax purposes. There will be no changes to the taxation of foreign income for overseas trusts set up by UK domiciled settlors.

Instead, such foreign income will be taxed on the foreign domiciled or deemed domiciled settlor only by reference to the benefits received by the settlor or close family members and where those benefits are not already subject to income tax in the hands of the recipient. The trust provisions will still remain in place even after a benefit has been received so tax is paid on amounts paid out of the trust, but amounts that remain in the trust will not be taxable. The settlor will be taxed on the remittance basis if they are non-domiciled and a remittance basis user, or on benefits received worldwide if they are deemed domiciled.

The settlor charges under the transfer of assets legislation will be dis-applied at the trust level and in respect of any underlying corporate structure without the need for the underlying company to pay dividends up to the trust. The settlor charges under the settlements legislation will not need to be dis-applied to foreign income of any corporate structure underlying the settlement, because the settlements legislation only applies to income arising to a settlement.

The trust provisions will not apply to any transferor who has become deemed domiciled and owns a non-resident company which is not held in trust. In these circumstances section 720 to 730 ITA 2007 will apply to the settlor as to a UK domiciled transferor. The remittance basis will continue to apply as at present to a foreign domiciled transferor in relation to corporate income where there is no trust structure.

### UK source income

UK source income will still be taxed on the settlor or transferor (whether deemed domiciled or not) of a settlor interested trust under the transfer of assets code or settlements legislation.  The position will remain as at present.

If UK source income arises and is not taxed on the settlor on an arising basis (for example because the settlor is dead, non-resident or excluded) then such income, as at present, will be taxed on the beneficiary according to their status.

Where UK income arises at the corporate level (with the company owned by the trust) and is identifiably paid up to the trust as a dividend and then out to the settlor it will not be taxed again as a new source of foreign income.

## 2.3.4 Tainting protected settlements

The provisions for deemed domiciled settlors who set up non-resident trusts while non-domiciled will be lost permanently when property or income is paid into the trust after the settlor has become deemed domiciled under the 15/20 test. However, if the settlor leaves the UK and loses their deemed domiciled status, any additions to the settlement while the settlor is non-domiciled again for tax purposes will not taint the settlement. An addition by someone other than the deemed domiciled settlor will not taint the settlement. However, when property is added by the trustees of any other settlement of which the deemed domiciled settlor is a settlor or beneficiary, the trust will be tainted and the provisions will be lost. Where trust provisions are lost due to tainting, or where the settlor has become domiciled in the UK either as a matter of general law or under the returning UK domicile rule, the foreign income within settlor interested trusts will be taxed on an arising basis on the deemed domiciled transferor while UK resident.

### Transitional rules

Undistributed foreign trust/corporate income arising prior to April 2017 and retained in the trust structure will become protected relevant income as at April 2017. This income will be available for matching to any benefits received after April 2017.

If the pre April 2017 retained foreign trust/corporate income has already been taxed on the settlor (for example, because it has been remitted by the trust/company) it will not be taxed again and will not form part of the income that can be matched to future benefits.

Benefits or other capital payments made before April 2017 to the settlor will be taxed as under current law, i.e. there is no close family member rule, and no tax unless the settlor or any relevant person remits that benefit and it has been provided out of income or it is matched to trust gains. Unmatched pre-2017 capital payments and benefits made to the settlor will not be matched to the relevant income pool.

However unmatched pre April 2017 capital payments or benefits to a beneficiary other than the settlor can be matched to the section 731 ITA pool after April 2007 and taxed by reference to the status of the beneficiary.

## 2.3.5 Recycling benefits from protected settlements

The government is aware that if payments are made from a trust to a beneficiary who is not a close family member and who is not UK-resident, or to a beneficiary who is a remittance basis user, the recipient could agree to hold the money for a period of time before giving or lending it back to a beneficiary in the UK. This would allow the UK-resident beneficiary to receive payments from the trust without paying any UK tax on the distribution. The government is concerned that this relatively straightforward tax planning could increase significantly once the new non-dom rules have been implemented. This would enable individuals to easily sidestep the intention of the rules, which is that settlors are taxed when they or close family members receive benefits from the trust.

The government will take steps to ensure that, where payments are made from a trust to a non-resident or to a remittance basis user who gives or lends it back to a beneficiary in the UK within the following three years, the payment from the trust will be taxed on the UK-resident beneficiary.

## Valuations

The government is proposing a fixed valuation procedure which would apply to all beneficiaries receiving capital payments from non-resident trusts, whatever their tax status and whether or not the settlor is deemed domiciled. It is envisaged that the new rules could work as follows:

The benefit on the use of all art will be deemed to be the official rate of interest multiplied by the acquisition price, less any payments actually made by the beneficiary for use of that art including insurance and storage.

There would be a fixed value for the taxable benefit of chattels which can be reduced or eliminated by payment of consideration equal to that amount, but any difference would be considered to be the value of the benefit.

Interest-free loans are currently valued as giving rise to an annual benefit equal to the official rate of interest multiplied by the amount lent. There will be new provisions in the legislation to ensure that where a loan is made to any beneficiary (whatever their domicile status and whether or not the settlement has a deemed domiciled settlor) the loan is deemed to give rise to a benefit equal to the official rate of interest less any interest actually paid (not just rolled up) in that year. Therefore, if no interest is paid but is rolled up there will be a deemed benefit equal to three percent at current rates. If the loan is interest-free, the deemed benefit will still be three percent. If interest is paid in that year the benefit will be three percent less interest actually paid.

The new valuation rules will also apply to the use of property and other assets. The rules would apply across both the CGT and the income tax benefits charge.

## Other

The government proposes to provide for any gains representing carried interest in section 103KA (Part III, TCGA 1992) to be excluded from the provisions that will charge tax on benefits taken from a protected trust. This will ensure that no double tax charges arise.

The legislation setting out the income tax changes for non-resident trusts, the new valuation procedure and carried interest will be published no later than the date for the publication of the 2017 Finance Bill.

# 3 Summary of responses: Inheritance tax on UK residential property

This section covers the proposals to bring UK residential properties into the scope of IHT where they are held by non-doms through overseas structures.

Individuals who are non-domiciled in the UK are only liable for IHT on their property which is situated in the UK. This contrasts with the position of UK domiciled individuals who are liable to IHT on their worldwide property.

This difference in treatment has been used by some non-doms as a means of avoiding paying IHT on UK residential property by holding property indirectly through overseas vehicles such as companies and trusts.

## 3.1 Excluded property

The August 2016 consultation stated that the IHT charge would be implemented by changing the treatment of shares in offshore close companies and similar entities so that they will no longer be excluded property if, and to the extent that, their value is derived from UK residential property. This was illustrated in the draft legislation published alongside the consultation.

**Question 1: Are there any difficulties in introducing the IHT charge by amending the legislation in this way?**

### Summary of responses

Most of those who responded to the consultation were supportive of the approach of treating the shares in a company as not being excluded property rather than looking through that company as if the individual owned the UK property directly. However, a number were concerned that the legislation provided insufficient detail on the scope of the charge. In particular, some respondents felt the legislation did not make sufficiently clear which overseas structures would be subject to IHT where they held an interest in UK residential property.

A number of other respondents pointed out that clarity was needed about how the charge would apply where a double taxation agreement is in place which gives taxing rights on UK property to an overseas jurisdiction.

### Government response

The government welcomes the broad support for the draft legislation and recognises the need for further detail on the types of structures to which the charge will apply. The revised legislation published alongside this response therefore contains greater detail on this point and makes explicit that the extended charge will apply to UK residential properties which are held through overseas close companies, trusts and partnerships. The charge will also apply to certain types of loan which are related to the maintenance or repair of UK residential properties or for purchasing such properties. It will also apply in cases where collateral is used in arrangements known as back to back lending.

The legislation also makes clear that only UK residential properties held through close companies and partnerships will be affected by the changes.

The government also recognises the potential difficulty created by certain double taxation agreements which give the taxing rights on transfers of property to another jurisdiction rather than the UK. To address this, rules in the legislation will ensure there will be a charge to tax in the UK in cases where there is an agreement in place, if the other jurisdiction concerned does not have a tax in place which creates an effective charge in respect of the property concerned.

## 3.2 Application of the extended charge

The consultation document proposed that the extended charge will apply to all chargeable events which take place after 5 April 2017. This will mean that the charge will apply in the same way as any other charge under IHT.

**Question 2: Are there any reasons why the extended charge should not apply to all chargeable events?**

### Summary of responses

Many respondents agreed that the extended IHT charge should apply to all chargeable events which take place after 5 April 2017. However, some respondents suggested that certain exceptions should be introduced, such as when there has been a gift with reservation which has not been made at the point at which a transfer of value takes place. Others suggested that Potentially Exempt Transfers (PETs) should be excluded where they have been made before April 2017.

### Government response

It is the government's intention that, once UK residential property owned indirectly is brought within the scope of IHT, the same rules, exclusions and reliefs will apply as they currently do to all other property. It therefore sees no compelling case for excluding any chargeable events from tax once the new legislation comes into effect. This approach will also mean that there will be no need for any fundamental revision to the existing IHT rules which might create unnecessary complexity.

## 3.3 Defining a UK dwelling

The consultation sought views on whether the IHT charge on UK residential property should be based on the definition currently used for the purposes of non-resident CGT or on that used for the purposes of the annual tax on enveloped dwellings (ATED).

**Question 3: Do you agree that the definition of a dwelling introduced for the purposes of non-resident CGT would provide the most suitable basis for the extended IHT charge?**

### Summary of responses

There was no clear consensus on which was the better approach to defining a UK residential property. However, almost all respondents made the point that introducing an entirely new definition might increase complexity and that using one already familiar from other regimes was the right approach.

### Government response

The government believes that the extended IHT charge should follow the way a dwelling is defined for the purposes of non-resident CGT. This will mean that the definition for the charge will be one with which many people will already be familiar. It would also be closer than the definition used for the purposes of ATED since the IHT charge will apply to all properties of whatever value and where the property is used by the individual as their place of residence. Neither is the case for ATED.

## 3.4 Changes of use

The consultation document considered how to deal with cases where a residential property had previously been used for a non-residential purpose and proposed charging IHT on any property which had been used as a dwelling at any time within two years preceding a transfer. This was to deal with cases in which the use of a property is changed from residential to commercial immediately before a transfer takes place in order to avoid a tax charge.

**Question 4: Do you agree that this is the most suitable approach for dealing with situations where the use of a property is mixed or has changed over time?**

### Summary of responses

Almost all respondents found this proposal unwelcome. They also said that this two-year look back would be contrary to the general approach of IHT which operates on the basis of the value of an estate at the point at which a chargeable transfer is made.

### Government response

The government accepts the arguments made for dispensing with the two-year condition and agrees that the risk of avoidance from changing the use of a property immediately before a chargeable event would not be significant. It has therefore decided to remove this condition.

Instead, the IHT charge will only apply to the value of an estate at the point at which when a transfer of value is made. This is reflected in the draft legislation.

The government is also aware that a further rule will be needed to cater for situations in which a property has both a residential and a non-residential use. This will be included when the revised legislation is published in the Finance Bill next year.

## 3.5 Valuation

The government proposed that the most effective approach to valuing property for the purposes of IHT would be to charge tax on the open market value of any UK residential property within an estate.

**Question 5: Are there any potential difficulties in this approach?**

### Summary of responses

Many of those who responded agreed with this approach in principle, but some pointed out that more detailed rules would be needed for complex situations, such as where the ownership of a property is shared between a number of overseas companies, or where a company owns a residential property as part of a wider range of assets.

### Government response

The government welcomes the support for this approach to determining the value of residential property. It also recognises that more detailed rules are needed to cater for more complex structures including shared and multiple ownership. The legislation published as part of the draft Finance Bill therefore includes rules which deal with situations in which a residential property is held in more complex structures.

## 3.6 Debts and disposals

In the August 2016 consultation, the government proposed that any loans made between people who are connected with each other which relate to a UK residential property should be disregarded when determining the value of the property which will be chargeable to IHT. This was to ensure that such loans cannot be used to decrease the value of property in an estate.

**Question 6: Are there any difficulties in this approach to determining the value of property chargeable to IHT?**

### Summary of responses

The majority of those who responded to this question felt that it would be unfair simply to disregard connected party loans in the way suggested. The general feeling was that doing so would be unreasonable, particularly where the loans have been made for genuine commercial reasons. Others made the point that the term 'connected party' was not defined in either the consultation document or the draft legislation.

### Government response

The government has considered the concerns about this proposal and has concluded that it would be inappropriate to disregard all connected party debts. Instead, the government intends to treat any loans taken out in order to acquire or maintain a UK dwelling as within the charge to IHT in the hands of the lender. This will mean that the debt will be allowed to offset the value of an estate which holds a UK residential property, but will also be treated as part of the UK estate of the person making the loan. This will apply to all loans, not just to those made between connected parties.

The legislation also deals with cases where a UK residential property owned through an overseas vehicle has been sold. In such cases, the proceeds of the sale will be treated in the same way as a UK residential property for the two years following the disposal.

## 3.7 Tax avoidance

The draft legislation contained a targeted anti-avoidance rule to deter potential attempts to sidestep the extended charge.

**Question 7: Will the proposed anti-avoidance rule be an effective way of countering attempts to avoid the IHT charge?**

### Summary of responses

The majority of respondents were not convinced of the need for such a rule along the lines proposed in the consultation document. A number also pointed out that such a rule would be redundant, given that the government had recently introduced a General Anti-Avoidance Rule (GAAR) in Finance Act 2013.

### Government response

The government still intends to include a targeted provision to deter deliberate tax avoidance once the extended charge comes into force. The introduction of the GAAR does not mean that more specific anti-avoidance rules such as the one proposed will no longer be required. HMRC will continue to tackle tax avoidance using existing anti-avoidance methods as well as the GAAR, where appropriate.

## 3.8 Liability and accountability

The consultation document proposed expanding HMRC's existing powers to impose a charge on UK properties which would prevent the sale of property on which there is an outstanding IHT charge. It also proposed imposing a new liability on any person who has legal ownership of the property, including any directors of the company which holds that property.

**Question 8: Do stakeholders agree that these steps will effectively ensure compliance?**

### Summary of responses

Many respondents felt it would be logical to extend the existing charge on property to UK residential properties in the way suggested, but felt it was unreasonable to impose a liability on the directors of companies which held such properties because they might not be aware that a transfer had taken place.

### Government response

The government accepts that there might be cases where making the directors of a company liable for unpaid IHT would be impractical in some circumstances, particularly where they might not be aware that there is an IHT charge on a residential property in the UK. It therefore does not propose to proceed with this suggestion.

The government will instead consider what alternative approaches would be appropriate for ensuring that the extended charge can be effectively enforced.

## 3.9 Transitional arrangements

The consultation document stated that the government does not think it would be appropriate to provide a new incentive to encourage individuals to exit from their enveloped structures.

**Question 9: Are there any hard cases or unintended consequences that will arise as a result of there not being any tax relief for those who want to exit their enveloped structures?**

### Summary of responses

Many respondents were disappointed that there would be no relief in cases where an individual removes a UK residential property from an overseas structure. A number suggested that relief should be provided to refund amounts of the annual tax on enveloped dwellings (ATED) which had previously been paid, and to reflect the stamp duty land tax (SDLT) and capital gains tax (CGT) costs which might arise when a property is de-enveloped.

## Government response

The government remains unconvinced that there is any case for providing tax relief for an individual who removes a property from an overseas envelope. The provision of such a relief would have a significant fiscal cost to the Exchequer. The government does not think it would be fair or appropriate to raise taxes or cut spending to fund it.

# 4 Summary of responses: Business Investment Relief

This section covers the suggestions received after the government invited respondents to provide innovative ideas on how best to reform Business Investment Relief (BIR). It summarises the comments made by respondents and the changes the government intends to make.

BIR enables non-doms who are taxed on the remittance basis to remit funds to the UK without incurring a tax charge, provided they are invested in a UK business.

At Autumn Statement 2015 the government announced it would consult on ways BIR could be changed and expanded to increase take-up of the scheme. Some of the rules were seen as complicated and discouraging participation in the scheme. The proposed changes to the rules seek to rectify this to encourage further investment in UK businesses. The government intends to consider the suggestions that were made for further reforms to the scheme for a future Finance Bill.

## 4.1 Expansion of the scheme

**Question 10: In what ways might the current scheme be changed to encourage greater investment in the UK?**

This question brought forward many wide-ranging responses. Responses covered a variety of issues such as suggestions for ways in which the various anti-avoidance rules could be better targeted, changes to the requirements of the scheme and ways to radically widen the scope of the scheme.

Many issues were raised and several common themes for change were identified. Overall, respondents wanted the rules to be less complex with more incentives and wider opportunities to invest via the scheme.

As a result, the government has now decided to make changes to the rules in the following areas:

### 4.1.1 Avoidance issues

#### Summary of responses

Respondents generally disliked the extraction of value rule. This rule is breached if an investor receives a benefit that is directly or indirectly linked to their investment. An extraction of value can be either money or money's worth received by or for the benefit of the investor. If a breach of the rule occurs, the recipient of the benefit will be treated as having made a taxable remittance on the whole investment unless they take the appropriate mitigation steps. Many respondents believed that it was too punitive, particularly when accidental errors were made. It was felt that instead of the "all or nothing" nature of this rule, a de-minimis threshold could be used for the value of any benefits received, above which the rule would be breached.

Other respondents mentioned the issues around associated companies which is closely connected to the extraction of value rule. Currently this rule is breached if an investor receives any benefits directly or indirectly from the target company or any company associated with it, whether or not the benefit is connected to the investment. The target company is the company where the investment is planned to be made. Again respondents felt it was unfair to penalise an investor if they receive a benefit from an associated company that they have not actually invested in. Many felt the reference to an associated company should be removed from the extraction of value rule altogether.

#### Government response

The revised legislation will remove any reference to an involved company in the extraction of value rules. This change means that the legislation will instead treat the rule as having been breached where a benefit is received from anyone in circumstances directly or indirectly attributable to the investment. This change will remove some of the disincentive for using the scheme and ensure that the anti-avoidance rules do not put people off from making an investment.

### 4.1.2 Criteria of the scheme

#### Summary of responses

Respondents felt that the current 45 day time limit to make an investment in a UK business after funds have been remitted to the UK is too short. They suggested that the time limit could be extended to 6 or 9 months without damaging the integrity of the scheme.

A number of responses looked at the various time limits for carrying out mitigating steps. The general feeling was that they were too short and so did not give investors sufficient time to either decide what to do next with their funds or to remove them offshore.

Some respondents asked for the time limit for investing in a company before it starts trading to be increased from the current two years. They felt this would be beneficial for investing in companies involved in major infrastructure projects such as building a new rail link or power station. For many businesses it takes much longer than two years to go from start up to production.

#### Government response

The government will make the following changes to simplify and broaden the criteria for BIR:

- a new "hybrid" company category will be added to the investment company definitions. This will enable a company that is both trading and a stakeholder company to attract BIR in future. Previously a company had to be either one or the other rather than a mixture of both to attract relief
- the time limit for investing in a company before it starts to trade will increase from the current two years to 5 years

- the rules will be changed to extend the definition of a qualifying investment to also make relief available on the acquisition of existing shares as well as on the acquisition of new shares in qualifying target companies
- the grace period for a potentially tax chargeable event will be increased to enable any income or gains to remain in a non-operational company for a period of up to two years after the date upon which the investor becomes aware that the target company has become non-operational

When BIR was introduced, the rules specifically prevented the relief from applying to investments in partnerships. It has been the government's position from the outset that this exclusion extends to corporate members of partnerships and HMRC have consistently refused claims for BIR on investment in such corporate members. However, respondents have suggested that the legislation is not clear on this point. The legislation which defines a trading company for BIR purposes has therefore been amended to further clarify the position on corporate partners. The changes make clear that a company which is a partner in a partnership is not to be regarded as carrying on the trade of the partnership, meaning that unless the target company is carrying on a commercial trade in its own right, it will not qualify for BIR.

### 4.1.3 Widening the scheme

#### Summary of responses

Many of the respondents also expressed their belief that the BIR rules should be changed to encourage investors to keep their funds as clean capital in the UK once their investment had ceased. Timelines of between two and 10 years length for investing were suggested to enable this to happen.

Several responses suggested broadening the scope of BIR qualifying investments to include government debt, family-provided funds, Venture Capital Trusts, hybrid companies, UK fund vehicles and unincorporated businesses.

In addition, a large number of responses asked for BIR to be extended to include partnerships – particularly offshore structures and sole traders, including LLPs which own UK listed companies.

Respondents felt that more people would use the BIR scheme if they were able to diversify their investments, facilitated by a professional manager overseeing the allocation into a portfolio of unquoted trading companies.

#### Government response

Going forward, the government is prepared to look further at some of the suggestions. Some were potentially promising but would need careful consideration and could not be legislated in time for Finance Bill 2017. The government will consider further changes to BIR for a future fiscal event.

## 4.2 Impact on investment

**Question 11: Are you able to provide any evidence which might indicate that these changes will lead to a significant increase in UK investment?**

### Summary of responses

The majority of the respondents were unable to provide any specific evidence to support their suggested changes. However, many tax advisors said that the complex rules and risks around the scheme, particularly around the extraction of value, made them hesitant to recommend the scheme to their clients.

Others suggested that HMRC should widen the rules and hold an amnesty period to allow anyone who had got things wrong to amend their affairs.

### Government response

The government believes that the changes to the BIR scheme announced above will be welcomed by both potential and current investors and will have the desired effect of leading to an increase in the use of the scheme.

## 4.3 Simplification of the scheme

**Question 12: What aspects of the scheme might usefully be simplified while maintaining its policy objective and encourage greater take up?**

### Summary of responses

The majority of the responses mirrored the suggestions received for the previous question. Many respondents called for a relaxing of the rules around receiving benefits from an investment. Stakeholders also suggested a review of the various tax chargeable events and the rules around receiving a benefit from an associated company as again they were considered too wide–ranging and open to unintentional breaches. Respondents also made the point that the time allowed for taking corrective action before facing a taxable charge if any rules were breached should also be increased.

Many responses asked for consideration to be given to increasing the various time limits around the scheme. These included increasing the time allowed to keep an investment in a company that becomes non-operational whilst consideration is given on what to do with that investment. Respondents also suggested that the time limit for the requirement on a company to start trading should be increased.

### Government response

The government is mindful of the general concerns raised around the receipt of benefits, particularly where there is an involved company. The new changes will ensure investors do not accidentally breach the rules. Likewise the extension to some of the scheme timetables will allow:

- the time limit for investing in a company before it starts to trade to increase from the current two years to 5 years and
- the grace period for a potentially tax chargeable event to be increased to enable any income or gains to remain in a non-operational company for a period of up to two years after the date upon which the investor becomes aware that the target company has become non-operational

This will support investments in companies that are involved in long-term projects and allow investors more time to make decisions.

## 4.4 Tax Avoidance

**Question 13: What changes would you make to ensure the anti-avoidance provisions are properly targeted to prevent tax avoidance?**

### Summary of responses

Overall, most respondents wanted fewer avoidance rules that would be made simpler and more focussed. Many suggested the extraction of value rules should be replaced with a Targeted Anti-Avoidance Rule. Others felt there was no real need for any anti-avoidance rules as HMRC already had the General Anti-Avoidance Rule.

### Government response

Whilst the government is keen to expand the rules of the scheme to encourage additional investment, it is also mindful that any changes do not result in the opportunity to use the scheme in a way that was not intended. The BIR rules will continue to need anti-abuse rules in place. However, the government will bring in new rules on benefits received from an investment and will clarify investment through a corporate partner. These changes should balance the worry of being caught accidently whilst protecting the scheme from widespread abuse.

# A Respondents

Anglo Chinese Group

BDO LLP

Bircham Dyson Bell LLP

Blick Rothenberg

Boodle Hatfield

Burgess Salmon

Buzzacott LLP

British Private Equity & Venture Capital Association (BVCA)

C Hoare & Co

Carter Lemon Camerons LLP

Casenove Capital Management

Charles Russell Speechlys LLP

Charter Tax Consulting Ltd

Chartered Institute of Taxation

Crowe Clark Whitehill LLP

Deloitte LLP

Ernst & Young LLP

Field Fisher LLP

Firefly Group

Fitzroy Tax Services Ltd

Forsters LLP

Frank Hirth Plc

Garnham Family Office Services

Gowing WLG

Grant Thornton LLP

Grays Inn Chambers

Herbert Smith Freehills LLP

Hillier Hopkins LLP

Howard Kennedy LLP

Institute of Chartered Accountants in England and Wales

Investment Law

Irwin Mitchell Solicitors

Kingston Smith LLP

KPMG LLP

Kreston Reeves LLP

London Society of Chartered Accountants Taxation Committee

Lutea Consultancy Ltd

Macfarlanes LLP

Maurice Turnor Gardner LLP

McDermott Will & Emery LLP

Mishcon de Reya LLP

Moore Stephens LLP

Munslows LLP

Ocean Tax Ltd

Opalegal Ltd

Osborne Clarke LLP

Payne Hicks Beach Solicitors

Penningtons Manches LLP

Pinsent Masons LLP

PricewaterhouseCoopers LLP

Rawlinson Hunter

Rooks Rider Solicitors

RSM UK Tax & Accounting Ltd

Saffery Champness

Saffron Tax Partners LLP

Smith & Williamson

SNH Tax Ltd

STEP

Stonehage Fleming Law Ltd

Tax Advisory Partnership

Taylor Wessing LLP

Telford & Co LLP

The Law Society

Triple Point

Trowers and Hamlins LLP

Wedlake Bell LLP

Westleton Drake LLP

Wiggin Osborne Fullerlove Solicitors

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