

Pulling the wool over our eyes?

Has inheritance tax been considered in relation to non-domiciled MPs, asks **KEVIN SLEVIN**.

Could the institution most of us simply call ‘Parliament’ be preparing to shoot itself in the foot, yet again? It is well known that, prior to the calling of the 2010 general election, behind the scenes MPs and civil servants were working on drafts of new legislation of a constitutional nature. Although now on hold (due to the election) the broad idea appears to have been to seek to exclude from the House of Lords, if not both Houses of Parliament, individuals who are unable to demonstrate that they are resident, ordinarily resident and domiciled in the UK.

Before continuing, I should make clear that by ‘UK’ I mean the United Kingdom of Great Britain and Northern Ireland; furthermore, that I realise one is never considered domiciled in the UK as such, rather one is domiciled in one of the countries: England, Scotland, Wales or Northern Ireland. Nevertheless, I shall simply refer to the UK.

Restoring the good name?

As I understand it from the media, the great and the good from the main political parties have been discussing new rules as regards the implications of non doms standing for election to the House of Commons, or either being nominated for a seat in the House of Lords or already possessing such a seat.

KEY POINTS

- Non-domiciled MPs may have pay UK tax on all their income.
- Special rules apply to non doms for inheritance tax.
- Assets can be excluded by creating a non-resident settlement.
- Are MPs aware of the inheritance tax issue?
- Tax advisers should talk to their MPs.



I have no details of these discussions but, from reports in the media, it seems that moves are afoot to prevent, one way or another, situations arising where, say, a member of the House of Lords can take his seat while continuing to be regarded as domiciled in a country outside the UK – and therefore potentially paying substantially reduced UK taxes.

As a separate but not unrelated matter, there has of late been much chatter about a statutory definition of residence for UK tax purposes. It is my reading of the situation that the vast majority of tax practitioners would welcome the introduction of a well drawn statutory definition of residence. At the very least, it would give a far greater degree of certainty to tax practitioners, if not to the public generally.

However, one possible addition to the new measure might be that a statutory definition of residence might include a provision along the following lines:

An individual shall be regarded as resident in the UK for all purposes of UK taxation throughout any income tax year if at any time during that year he or she is an elected Member of Parliament or is entitled to sit in the House of Lords.

Likewise, the scope of legislation could be extended to include the following:

If not already considered domiciled in the UK under any other statutory provision, an individual shall be regarded as domiciled in the UK for all purposes of UK

taxation throughout any income tax year in which he or she is, or becomes, an elected Member of Parliament or he or she is, or becomes, entitled to sit in the House of Lords.

Not only is the likelihood of a statutory definition in the immediate future very much in doubt, but the additions above are only my suggestions.

However, any new House of Commons committee to be charged with the task of restoring the good name of Parliament (after the election) may not be prepared to wait for tax law changes to take place. Recent events suggest that the House will want to be seen to be taking action. One suggestion is a rule change so that it will not be possible for an individual to become a member of the House of Lords unless it can be shown that:

- he or she is already domiciled and resident in the UK; or
- he or she, being domiciled outside the UK, has irrevocably elected to disapply the aspects of tax legislation benefiting non-doms from a UK taxation standpoint.

A clear impression is given that non-UK domiciled peers of all parties (and the cross-bencher peers, i.e. those with an allegiance to no party) are resigned to having to give up their non-domicile status for UK taxation purposes if they want to remain in the House of Lords.

Less than meets the eye?

While there is no doubt that it is a great honour to be invited to sit in the House of Lords, the question which crossed my mind recently is this. Why would a member of the House of Lords, being lawfully entitled to enjoy the tax breaks open to an individual domiciled in the UK, be willing to surrender this favourable tax treatment in order to remain a member of the so-called Upper House? As one of their lordships might put it, 'having to pay extra income and capital gains tax could well prove to be a bit of a downer. Having to pay the £30,000 annual subscription to join the remittance basis club is bad enough'.

Some non doms might not have significant income arising outside the UK and some might not have substantial assets situated outside the UK, but there has to be another reason why non-domiciled peers would be willing to give up all tax breaks enjoyed by other non doms in order to remain peers. Then, like a bolt from the blue, it struck me. No one is talking about non-domiciled peers having to lose the benefit of IHTA 1984, s 48. Section 48 has been of incredible value to non doms. As things stand, it looks set to continue to be available to peers because until now no one seemed to be talking about it.

What is s 48?

Broadly, IHTA 1984, s 5(1) defines a person's taxable estate on death. It states in particular that 'the estate of a person ... does not include excluded property'. Accordingly, the value of the excluded property is not added to the value of the remainder of the deceased's property in calculating the amount upon which

tax is payable. However, excluded property is still to be taken into account in carrying out certain of the calculations required in respect of the chargeable estate.

Section 48 is a frequently overlooked provision which was not amended by the FA 2008 changes to the tax treatment of non doms which concerned income tax and capital gains tax. It defines 'excluded property' and in particular subsection 3 states:

- 'Where property comprised in a settlement is situated outside the United Kingdom –
- (a) the property ... is excluded property unless the settlor was domiciled in the United Kingdom at the time the settlement was made, and ...'

HMRC's *Inheritance Tax Manual* states at paragraph IHTM04271 in relation to foreign property:

- 'Property ... situated abroad and comprised in a settlement is excluded property ... unless the settlor was domiciled ... in the UK at the time the settlement was made ...'

Planning potential

Under first principles, whereas persons domiciled in the UK are liable to inheritance tax on their worldwide assets, persons

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domiciled elsewhere are liable to inheritance tax in the UK only on the value of assets situated in the UK.

In an attempt to bring the foreign assets of long-term UK residents into the UK inheritance tax net, there is a special rule which deems an individual to be treated as domiciled in the UK, whether or not he is domiciled overseas under general law, where it can be shown that he or she satisfies the following residence test. Where an individual has been resident in the UK in not less than 17 of the 20 income tax years of assessment preceding the tax year in which an inheritance tax chargeable event occurs, e.g. on death or the making of a chargeable transfer lifetime, the individual will be deemed to have been domiciled in the UK for inheritance tax purposes throughout the year of the chargeable event in question.

Exploiting the ‘excluded asset’ rule

For more years than I care to recall, persons approaching a point where they may become domiciled in the UK (or, more likely, about to fall within the deemed domicile rule referred to above), have been able effectively to perpetuate the inheritance tax exemption afforded to their foreign property by taking a simple step. By establishing a non-resident settlement before becoming either actually domiciled in the UK or becoming treated as domiciled here, it is possible to create a fund held offshore which falls within s 48(3). The assets held in the excluded property settlement effectively escape the inheritance tax net.

What is more, with careful planning it remains possible to structure the ownership of assets situated in the UK through a so-called excluded property trust. Assets which are in reality situated in the UK can be taken outside the scope of inheritance tax by arranging for the offshore trustees to invest in the UK via a corporate vehicle.

In summary, the excluded property provisions are designed by Parliament to perpetuate the inheritance tax exemption for those having non-dom status as regards foreign situs property. The excluded property rule operates well, encouraging wealthy people from overseas to settle in the UK on a long-term basis in the knowledge that only their UK assets need to be exposed to inheritance tax if they follow the proper channels. This presumably is thought to be for the benefit of the economy as a whole.

Whatever the intention of Parliament when deciding to include certain offshore trusts as excluded property, it cannot have been envisaged that the excluded property rule could operate so as to create a situation giving non-dom peers a continuing advantage over other peers at a time when politicians are openly saying that peers should pay the same taxes as the UK domiciled electorate.

A step too far?

Let’s say that the momentum for change continues after the general election and steps are taken by the newly elected MPs to introduce a rule requiring all those sitting in the House of Lords (and the possibly members of the House of Commons) to be

treated as domiciled in the UK for income tax and capital gains tax purposes. Would it not be wholly inequitable for members of the legislator to introduce a statutory measure in the knowledge that well-advised members – including those forced to give up their hitherto non-dom status – could, by acting in good time, effectively circumvent the inheritance tax implications of such a measure by exploiting the tax break afforded under s 48(3)?

To describe such a course of action as being disingenuous would be an understatement. Imagine the uproar when the electorate discovered what had happened. For any MP to take his seat purporting to pay the same taxes as the rest of the population, all the while legally contriving to avoid UK inheritance tax on the assets included in his or her excluded asset trusts, would be an affront to electorate would it not? Our politicians would not do this, or would they? The short answer is that we just don’t know.

Tax advisers – we need you!

As with almost any article on a tax-related topic, there is more to be explained than time or space permits. For example, there are the income tax and capital gains implications of a UK resident establishing an offshore settlement whether before or after the 2008 Finance Act. In addition to the implications of the £30,000 annual subscription to the remittance basis club already alluded to, there is the need to get to grips with the new rules relating to the meaning of ‘remittances’, as well as the anti-avoidance legislation, etc.

However, the focus of this article is whether, as a matter of principle, non-UK domiciled MPs – be they current or future members of the unelected House of Lords or members of the House of Commons – should be able to enjoy the same benefits as other non-doms when it comes to inheritance tax.

If the income tax and capital gains tax benefits of being domiciled outside the UK are to be withdrawn for members of either or both Houses of Parliament, should not the s 48(3) inheritance tax break be surrendered too? If not, should the continuation of the inheritance tax advantage be publicised when the new rules are being announced to the electorate? At the moment, it appears the interested parties may wish to shy away from addressing the matter.

The problem is that only lawyers, accountants and tax practitioners understand the topic. Unless they raise the matter, it could well be overlooked. Imagine the hoo-ha if matters were to progress without any changes being made to the inheritance tax position yet with the electorate being given the impression that non-doms sitting in the House of Lords will in future pay taxes like most people. The purpose of this article is to alert readers to the issue and thereby reduce the chances of this happening – helping prevent the politicians from shooting themselves in the foot again.

If further reforms of Parliament are announced covering the non-dom issue, ask your MP whether the application of s 48 is to be restricted. Explain that otherwise the electorate might get the impression that MPs are trying to pull the wool over its eyes, again. ■