

TAXATION

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Classified appointments

Domicile or bust?

KEVIN SLEVIN believes that it is time for a fundamental rethink of the rules for non-domiciles and overseas income and gains. Meanwhile, in the following article, RICHARD CURTIS goes back in time to look at the Government's record on its promises to reform this area.

HAVE NO idea how many words it will take to capture the essence of what I want to say but I can state at the outset of this article – an article which I hope will be more than just a rant – what my conclusion is. Simply put, I have come to the conclusion that all UK resident taxpayers in receipt of income and/or capital gains should be exposed to the burden of taxation on the same basis (nb, patent applied for). As is the situation in so many other countries, a resident's place of domicile should not be a factor in determining UK taxation. If a change from the present system would harm the economy, is there not another option?

1997 and all that

Since the general election in 1997, tax advisers have been awaiting the outcome of the Chancellor's review of the tax treatment of UK resident but non-UK domiciled individuals ('non-doms'). Gordon Brown had made clear his intentions if elected. The more seasoned readers will have been waiting to see if the so-called 'economic benefits argument' put forwarded by the non-doms' lobby would eventually win the day. We understand that previous Chancellors have walked away having gone to the brink of a disaster for the country's economy by encouraging a mass exodus of wealth and talent from the UK by changing our tax system.

As a reader of *Taxation* it is more than likely that you will already know that individuals domiciled outside the UK do not need to pay income tax or capital gains tax on the gains derived from their overseas activities – providing they do not remit the funds back to the UK while still resident here. Not only this, but I and fellow tax planners take advantage of ways to effectively use these overseas funds to good effect within the UK without technically making 'remittances'. Non-doms can borrow from abroad and often invest into the UK property market through offshore trusts. There exist special rules taxing Irish income

KEY POINTS

- Is there an economic benefit to changing the tax rules for non-domiciles?
- The benefits of bearer shares have been ended.
- Tax or exempt income by reference to residence, not domicile.
- Are there unknown 'non-doms' in the UK?
- Should all second generation immigrants consider their domicile status?

arising to UK resident Irish domiciled individuals, but that is another story (not least whether the rules in question breach EU law by discriminating against the Irish!)

On the BBC 2 programme 'Newsnight' some weeks ago, a man wearing a red tie – and therefore possibly Labour – was saying words to the effect that collecting full taxes from 'eighty thousand' or so non-doms was not a priority for the Government. Unfortunately, Jeremy Paxman was not doing the interview; so much was left unsaid.

“ *The website of the DTI alerts potential overseas businessmen as to how to avoid paying the same taxes as someone with a UK domicile.* ”

There is little point running through the various government discussion papers and initiatives taken by the Chancellor since 1997 or quoting the words of the Chancellor leading up to the 1997 election, but it is reasonably safe to assume that the threat of the many multi-billionaire individuals leaving the country with the consequential huge loss to the economy is such that rules for taxing non-doms will never be changed in the foreseeable future. Indeed, the non-dom tax rules have remained so well established under this Chancellor that, according to the 'Newsnight' programme, the website of the Department of Trade and Industry alerts potential overseas businessmen as to how they could live in the UK and avoid paying the same taxes as someone with a UK domicile; one might say a form of positive discrimination?

One small step for the Exchequer

It is fair to say that the Chancellor has not been totally inactive on this front. In 2005 he acted to close one option. As indicated above, non-doms do not normally pay capital gains tax on capital gains made on assets situated outside the UK. It was accepted by HMRC that, while normally registered shares in a UK registered company were located for taxation purposes in the UK, so-called 'bearer shares'

held in a UK registered company (the owners of which do not have to be recorded in the register of the company) were considered to be situated for tax purposes where the shares certificates themselves were situated. For obvious reasons, such shares were referred to as the non-doms' 'flexible friend'. The location of the shares could be easily changed and, providing the bearer shares certificates were located otherwise than within the UK, a UK resident non-dom would pay no UK capital gains tax on disposing of his or her bearer shares in a UK registered company. Yes, there was a stamp duty cost but, essentially, the creation of bearer shares in a valuable company provided a route by which one could put an otherwise bolted horse back in its stable and then start tax planning using the overseas asset rule for non-doms. The Chancellor extinguished this luxury by changing the law with effect from on or after 16 March 2005 (F(No 2)A 2005, s 34, Sch 4) deeming all shares and securities of a UK registered company to be situated within the UK wherever the share certificates were to be found. He did not go further.

The above change was not a major blow to non-doms because it only impacted on those non-doms who had not sought timely UK taxation advice about how to structure their investments in UK companies.

A convincing argument against change?

I am told that one cannot examine this issue from a taxation standpoint alone. It is my recollection that the Chartered Institute of Taxation and other professional bodies urged the Chancellor to be cautious because of the major adverse economic results which could be expected should the UK's tax rules as regards non-doms be changed.

I do not know what authoritative research has been carried out or whether the warnings about the overall loss to the economy are purely anecdotal, but let us assume that the Government spokesman interviewed on 'Newsnight' was so persuasive in his argument that we all become convinced that the status quo as regards non-doms should be maintained. How can we have a fair taxation system which copes with and welcomes non-doms to the UK, yet does not discriminate against a large number of people domiciled in the UK?

Could it be that the Government is staring the solution in the face, but has yet to recognise it?

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It has recently been rumoured that the Chancellor is of a mind to exempt from UK corporation tax the profits of UK resident companies derived from overseas trading activities and overseas investments. It sounds like a good way to encourage the economy! Of course, this story could be just another example of government spin going wrong, but let's pause for a moment and focus upon the following question.

If we assume that the positive discrimination in favour of non-doms is brought about because of necessity; i.e., the Chancellor must not do anything which would encourage these individuals to move abroad because of their overall contribution to the economy, is it not time to change the taxation of the UK system so that there is just one rule governing overseas interests for income tax and capital gains tax purposes?

Should we not take one of two courses.

1. Exempt from income tax and capital gains tax those gains derived by all individuals – wherever domiciled – from overseas activities and remitted to the UK – along with the above-mentioned rumoured changes to UK corporate taxation?
2. Failing this, should we adopt the reverse policy and state that all individuals will be taxed identically as regards both UK and overseas gains – they will only be taxed in the UK if they are silly enough to bring the money back to these shores? We might well need to tweak the meaning of 'remittance' and create more anti-avoidance rules, but the end result might be a more equitable system.

Of course, if (1) and (2) cannot be allowed, we could just change the rules so that all UK resident individuals are taxed on worldwide income, as is the case in many other countries, and see what happens.

We live in a global economy after all, don't we?

How many non-doms?

I was amused to hear the Chancellor's spokesman on 'Newsnight' estimate the number of non-domiciled individuals and I wondered if he had any concept of what was meant by 'domicile'. Did he know, for example, that an individual normally obtains at birth his domicile of origin which is usually considered to be the same domicile as that of his father and does he understand how difficult it is for the authorities to show that a domicile of origin has been displaced?

It is a fact that very few people explore technically their domicile position, yet they may well fall to be treated as domiciled outside the UK if they only knew the rules. For example, the adult children of immigrants, be they born and educated in the UK, may well have plans for their futures about living in their parents' country of origin or, say, in Australia or Canada and who might therefore not see the UK as being their natural home.

Immigrants from war-torn areas of the world may be yearning to go 'home', but are unaware of the tax ramifications of their position. One does not lose one's overseas domicile simply by becoming valued members of the community, having a successful career or business in the UK, or by holding a British passport.

Voluntary taxpayers?

The rules for determining one's 'domicile of origin' or 'domicile of choice' are just that, 'rules', albeit laid down largely by case law. In particular, first and second generation immigrants who don't ascertain their domicile in accordance with the strict interpretation of the position and who fail to structure their investments wholly or partly overseas may well be, in essence, voluntary taxpayers in the UK.

Very few people explore their domicile position, yet they may well fall to be treated as domiciled outside the UK if they only knew the rules.



Perhaps, if the rules are to be left unchanged, the Government should do more to explain the relative ease of establishing an overseas domicile where, say, the domicile of both parents of an individual is located overseas. Possibly, HMRC should produce a leaflet entitled 'Are you sure you know where you are domiciled (you could be paying too much tax)?' Has not the DTI already shown the way? This is what open government is all about, is it not? Do I not also remember a minister talking about joined-up government in 1997, or was that an episode of 'The West Wing'?

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Stuck in the groove!

RICHARD CURTIS goes back in time to look at the domicile record.

JOHAN PEEL, WHEN told that the benefit of compact disc technology over the plastic record was that there was no background noise, is alleged to have replied, 'background noise? The world's full of background noise!' Not only that of course, but what do you actually get for your money with a CD? Don't try to tell me that that little piece of silver plastic in a plastic box is worth £14.99 of my hard-earned money. Where's my see-through vinyl disc, where's my gatefold or pop-up album sleeve, where's that carefully art-worked album cover so useful for displaying or using for various other purposes? What use is that little plastic box that's almost always cracked or scratched when you buy it anyway? But what has that little rant got to do with the rules on non-domiciles? Well, having been involved in reviewing the Budgets over the past few years, it did come into my mind that I was seeing the same old phrases coming around with monotonous regularity. Now, many a successful career in rock music has been built on a three chord riff, but there's got to be a bit more imagination than the C, F and G chords repeated ad infinitum.

I understand that Gordon Brown first suggested the abolition of the tax rules relating to non-domiciles in a 1997 pre-election speech. After a few years of apparent inaction – perhaps the equivalent of a band spending some time in the studio 'getting its head together', the record was released to an eager public in 2002. Although Kevin Slevin suggests above that 'there is little point in running through the various government discussion papers', I thought it might be illustrative to simply look at the Budget pronouncements.

First verse

Budget Report 2002. Paragraph 5.83 – Residence and domicile. 'The Government is reviewing the residence and domicile rules as they affect the tax liabilities of individuals. The Government believes that modernisation of these rules needs to be based on clear principles: the rules should be fair, clear, easy to operate, and support the competitiveness of the British economy. As this is a complex area, all those affected should have the opportunity to contribute to the discussion. The Government will report on this issue in time for the Pre-Budget Report.'

Second verse

Pre-Budget Report 2002. Paragraph 5.81/5.82 – Residence and domicile. 'Budget 2002 announced a review of the residence and domicile rules as they affect the tax liabilities of individuals ... The Government welcomes the comments received in response to the Budget announcement, and invites further contributions to inform the ongoing work in this area ... Building on this work, the Treasury and

the Inland Revenue will assess how the current rules work in practice, and will publish a background paper to aid discussion of how the rules compare with the Government's principles.'

Third verse

Budget 2003. Paragraph 5.93. Residence and domicile. 'The 2002 Pre-Budget Report gave further details of the Government's review of the residence and domicile rules. The Government is today publishing a background paper, *Reviewing the residence and domicile rules as they affect the taxation of individuals*, which takes forward continuing work in this area. The paper describes the current rules and their historical perspective, analyses international experience, and develops the principles that the Government believes should underpin any modernisation of the system. The paper will provide a framework for further analysis and discussion and ensure that any specific options for reform of the current rules are based on the widest possible understanding of their effect.'

The middle eight

Background paper 2003. This document, *Reviewing the residence and domicile rules as they affect the taxation of individuals: a background paper*, can be found on the internet at <http://snipurl.com/domrev>. James Kessler (in *Taxation of Foreign Domiciliaries*) commented that 'it may be unfair to criticise the (unnamed) authors of this facile document. Their instructions may have been to be totally uncontroversial; by saying nothing there is nothing in the document to which anyone of any political view could possibly object. Whatever future developments occur, they will not occur as the result of this background paper.'

Fourth verse

Pre-Budget Report 2003. Paragraph 5.108/9 – Residence and domicile. 'At Budget 2003, the Government published a discussion paper on reform of the residence and domicile rules ... The Government recognises that this is a complex and far-reaching issue and is determined to proceed on the basis of evidence and in keeping with its key principles. The Government is continuing to examine responses to the background paper and welcomes further contributions. Once this process is complete, it will move forward with a formal consultation paper on possible approaches to reform.'

Fifth verse

Budget Report 2004. Paragraph 5.103 – Residence and domicile. 'The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals, and is considering various aspects of this issue in the light of the responses to the paper published at Budget 2003. The Government remains determined to

proceed on the basis of evidence and in keeping with its key principles. It would welcome further contributions to the debate, which will then be taken forward by the publication of a consultation paper setting out possible approaches to reform.'

Sixth verse

Pre-Budget Report 2004. Paragraph 5.101 – Residence and domicile. 'The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals, and is considering various aspects of this issue in respect of the responses to the background paper published at Budget 2003. The Government remains determined to proceed on the basis of evidence and in keeping with its principles. It would welcome further contributions to the debate, which will then be taken forward by the publication of a consultation paper setting out possible approaches to reform.'

Seventh verse

Budget Report 2005. Paragraph 5.116 – Residence and domicile. 'The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals and will proceed on the basis of evidence and in keeping with its principles. It would welcome further contributions to the debate, which will then be taken forward by the publication of a consultation paper setting out possible approaches to reform.'

James Kessler was singularly unimpressed. 'This statement has now been made four times over the last two years. The first two times it was credible, though with the benefit of hindsight it is difficult to believe that it was true. In any case, one must be credulous to believe it now ...'

However, he did give the Government the benefit of the doubt. 'Another possibility is that the Government does propose to change the law, but wished to postpone making a politically contentious announcement until after the 2005 election: if that is right some developments can be expected in the 2006 Budget'.

But with regards to the Budget 2005 statement, James asked 'How many more times can this statement be repeated before even the Government is embarrassed to do so again?'

The answer turned out to be 'twice'!

Eighth verse

Pre-Budget Report 2005. Paragraph 5.103 – Residence and domicile. 'The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals, and in taking the review forward will proceed on the basis of evidence and in keeping with its principles.'

Ninth verse

Budget 2006. Paragraph 5.104 – Residence and domicile. 'The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals and in taking the review forward will proceed on the basis of evidence and in keeping with its principles.'

Fade out?

Following this report, even the Government seemed to concede that they were sounding somewhat like a vinyl record with the needle stuck in the groove and there was no mention of residence and domicile in the Pre-Budget Report 2006.

However, just when one might have thought that the record had been consigned to the local charity shop or perhaps melted into a stylish flowerpot, someone in the Exchequer obviously decided to get out his anti-static record cloth and give it a good rub over, before plonking it back down onto the turntable, taping a coin to the top of the cartridge and placing the needle carefully down at the beginning of side one ...

Slight return

One musical 'trick' that can be quite effective is where the song ends, only for there to be another section following a few seconds of silence (or background noise if you are listening to the original vinyl version), hence 'Budget 2007. Paragraph 5.120 – Residence and domicile. "The review of the residence and domicile rules as they affect the taxation of individuals is ongoing."

An IMF working paper has recently identified the UK as an offshore financial centre, in the company of the Bahamas, Bermudas, Jersey, etc.

”

End of side one

So music lovers, there you have it. You will either conclude that this is a repetitive drone and were unsure whether the record was stuck or you might be admiring the fugue like structure of the regular announcements. Either way, this is not to say that there has been no progress in this regard. An International Monetary Fund working paper (www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf) has recently identified the UK as an offshore financial centre (OFC) in the company of the Bahamas, Bahrain, Bermuda, the Cayman Islands, Cyprus, Hong Kong, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, Malta, Netherlands Antilles, Singapore and Switzerland; and Ed Balls MP recently reported that there are now 112,000 individuals who indicated that they were non-domiciled on their self-assessment tax returns for the year ended 5 April 2005 – a 74% increase over the figure for 2002. The extent to which this increase has been encouraged by the Department of Trade and Industry's promotion of the UK as a tax haven (as referred to by Kevin) through its UK Trade & Investment agency's 'entrepreneurs' website (<http://snipurl.com/haven>) remains to be seen. However, no doubt the promise of access to finance and grants, 'first class research and development' (and presumably to tax relief for such work carried out through a company owned by a non-dom) as well as 'first class education and housing', yet with the benefit of 'an opportunity to minimise your tax liability as far as possible' could well prove attractive. ■