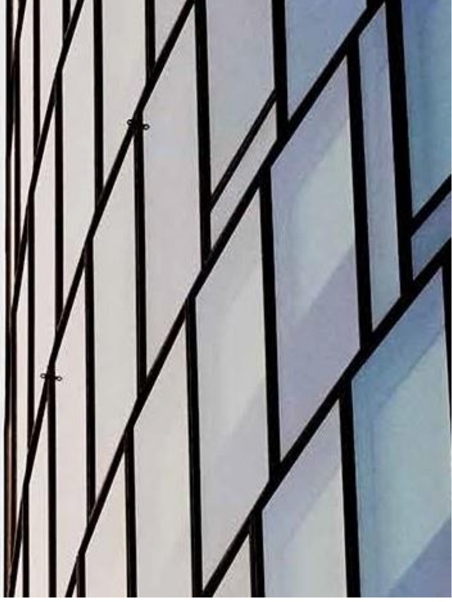

# Tax Newsletter: KPMG Isle of Man

**Issue 48**

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We hope you will enjoy this issue of our Tax Newsletter. Our purpose is to try and keep you abreast of topical UK tax issues which may affect you, your business, and/or your clients.

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## Draft Finance Bill 2018/19

On Friday 6 July 2018, the draft clauses of Finance (No.3) Bill ("Draft Finance Bill 2018/19") were released, along with explanatory notes and tax information and impact notes ("TIINs").

Despite expectations that there would be announcements relating to taxation of the digital economy, an expanded royalty withholding tax scope and the corporate intangible fixed assets regime, none of these have materialised. However, some of the key measures in Draft Finance Bill 2018/19 include:

- Oil and gas;
- Property;
- Anti-avoidance;
- Leasing; and
- Offshore time limits.

The draft legislation is now available for consultation until 31 August 2018, with the final contents of Finance Bill 2018/19 subject to confirmation at Autumn Budget 2018.

Our analysis of some of the key measures can be found below.

### *Changes for non-resident investors in UK property*

Following recent consultations, draft legislation has been published in relation to (1) taxing gains made by non-residents on all UK property from 6 April 2019; and (2) moving non-resident corporate landlords from income tax to corporation tax from 6 April 2020.

#### Capital gains

The capital gains draft legislation confirms that all non-residents will be subject to tax on gains on direct disposals of UK property, although those who are exempt from capital gains for reasons other than being non-resident, such as overseas pension schemes and sovereign immune investors will continue to be exempt.

The legislation also confirms that all non-residents will be taxable on indirect disposals of UK land. The indirect disposal rules will apply where a person makes a disposal of an entity that derives 75% or more of its gross asset value from UK land, subject to a number of exemptions, including:

- investors who hold less than a 25% interest; and
- disposals of interests in property-rich entities that hold the underlying property on trading account for a 12 month period before the sale, and where it is reasonable to conclude that the property will continue to be held on trading account (or sold) for a significant period after the sale.

It will be possible to calculate the gain or loss on a disposal using either the original acquisition cost of the asset or the market value of the asset at commencement of the rules, in April 2019. Both options will be available for both direct and indirect disposals.

Tax relief for losses arising to non-resident companies under the new rules will be available in the same way as capital losses for UK resident companies.

The draft legislation sets out the reporting requirements for the capital gains. The general rule will be that a return in respect of the disposal must be delivered to HMRC within a 'payment window' of 30 days following the completion of the disposal, and a payment on account made at the same time.

### Non-resident corporate landlords

The draft legislation in respect of non-resident corporate landlords confirms that from 6 April 2020 non-UK resident companies that carry on a UK property business, or have other UK property income, will be charged to corporation tax, rather than being charged to income tax as at present.

A non-resident company that has a period of account that straddles 5 April 2020 will be required to submit two tax returns, one under income tax for profits arising up until 5 April 2020 and one under corporation tax in respect of profits arising from 6 April 2020.

## *Tax avoidance involving profit fragmentation*

The anti-fragmentation targeted legislation aims to prevent UK businesses from avoiding UK tax by arranging for their UK-taxable business profits to accrue to entities resident in lower tax territories. The rules will commence with effect from April 2019 and will apply to an individual or a company carrying on a business within the charge to UK taxation, including partnerships.

The legislation contains a number of detailed provisions that will require careful consideration against individual fact patterns. However, broadly the rules will apply where:

1. there is a 'material provision', which requires receipts or expenses to be attributed to an overseas party rather than to a UK resident person carrying on a business;
2. the 'material provision' relates directly or indirectly to anything done in connection with a business which is subject to UK tax;
3. the 'material provision' is not on arm's length terms;
4. the 'material provision' results in a tax mismatch; and
5. a relevant individual, who is the UK resident person, or is a member of the partnership including the UK resident persons, or a participator in the company who is the UK resident person, meets the enjoyment conditions.

Tax mismatches and the enjoyment conditions are specifically defined under the rules.

Where the rules apply, arrangements must be counteracted by making adjustments that are just and reasonable. Furthermore, where certain conditions are met there will be a requirement for affected parties to notify HMRC of the arrangements.

## *Extension of time limits for offshore matters*

Currently HMRC have 4, 6 or 20 years (for mistake, careless or deliberate behaviour respectively) to assess tax that is due. Draft legislation issued on 6 July 2018 has extended the 4 and 6 year time limits such that HMRC will always be able to assess at least 12 years of back taxes for offshore non-compliance.

The 4, 6 and 20 year time limits will continue for onshore non-compliance. Therefore, for the first time there is divergence on periods taxable between onshore and offshore.

This new provision applies to income tax, capital gains tax and inheritance tax where the lost tax involves an "offshore matter" or an "offshore transfer", both of which are widely drawn and include income or capital gains arising on a source outside the UK, assets situated or held outside the UK and activities carried on outside the UK, or where the income or disposal proceeds are received outside the UK or transferred outside the UK.

The original consultation on extending the time limits included whether the provision should be extended to Corporation Tax but it has been confirmed it will not be.

This extended time limit does not apply if HMRC have received information from overseas by mandatory automatic exchange before the time limit that would otherwise apply (4, 6 or 20 years) and HMRC could reasonably have been expected to be aware of the lost tax from that information.  It is unclear how this will be interpreted.

The new legislation will apply for years 2013-14 and 2014-15 in cases where the loss of tax is brought about by careless behaviour and for years 2015-16 onwards in other cases, following Royal Assent.

### *Interest harmonisation and sanctions for late submission and late payment*

The Government has published proposals and draft legislation for amendments to the interest payable on late payments and repayments of tax, and for a new penalty regime for late payment. Draft legislation has also been published for the point-based late submission penalty regime which was set out in the Government's consultation response on this subject in December 2017.

Interest on VAT will be brought broadly into line with interest on direct taxes. There will be special rules to prevent repayment interest from being paid in respect of periods during which HMRC enquiries are in progress, taxpayers have outstanding returns or certain other requirements are not satisfied.

A new late payment penalty regime will be introduced for income tax, capital gains tax, corporation tax and VAT. There will be two elements:

- a 'first penalty' payable if tax remains due at the end of the 15 day period following the due date; and

- a 'second penalty' if any tax remains unpaid at the end of the 30 day period from the due date.

Draft legislation has also been published to implement the points-based penalty regime set out in the December consultation response for late submission of returns. The legislation covers VAT, income tax and capital gains tax, as well as excise, environmental and other taxes, but not corporation tax (although the same approach is to be applied to corporation tax at some future date).

The level at which penalties will be set has yet to be decided. Following consultation on the draft clauses, the proposals are expected to be implemented for VAT from 1 April 2020. Timescales for other taxes will be announced in due course.

## HMRC guidance on new non-dom rules

HMRC have published guidance on the new rules for individuals who are non-UK domiciled and offshore trusts which apply from 6 April 2017 and were introduced in Finance (No.2) Act 2017. Non-UK domiciled individuals will need to make sure they are familiar with these changes, and this guidance sets out an overview of the new rules for non-doms, offshore trusts and business investment relief.This HMRC guidance, entitled Deemed Domicile changes from 6 April 2017, currently consists of the following:

Business investment relief ("BIR") – The existing BIR guidance has been updated to include the Finance (No.2) Act 2017 changes.

Cleansing of mixed funds – This guidance provides a high level summary with examples of these transitional rules which allow a window up until 5 April 2019 to enable division of the income, capital gains, and 'clean' capital elements of existing non-UK bank accounts into separate accounts. If managed correctly, this would enable any non-dom who has previously been taxed on the remittance basis prior to 2017/18, to remit to the UK without a tax charge 'clean' capital from overseas which was previously trapped within a mixed fund.

Deemed domicile rules – A new short high level summary explaining the deemed domicile rules.

Overseas Workday Relief ("OWR") – The existing guidance (RDR4) has been updated to include the Finance (No.2) Act 2017 changes.

Remittance Basis Changes – A new short high level summary explaining that individuals who become deemed domiciled will no longer be able to use the remittance basis and will be taxed on worldwide income and gains.

Residence, Domicile and Remittance Basis Guidance ("RDR1") – The existing HMRC guidance set out in RDR1 has been updated and expanded to include the Finance (No.2) Act 2017 changes. RDR1 now includes basic guidance about the new deemed domicile rules for non-UK domiciled individuals who are long term UK residents.

Trust protections and capital gains tax changes – This new guidance, which takes the form of a detailed 54 page document, primarily covers the new rules for offshore trusts. This includes income tax and capital gains tax 'protections' for offshore trusts, transfer of assets abroad legislation trust protections, how trust protections can be lost through tainting and the valuation of benefits received from offshore trusts. In addition, this guidance also covers the transitional rules enabling individuals becoming deemed domiciled in April 2017 to benefit from rebasing of certain foreign assets to their market value on 5 April 2017. It also covers the changes to the rules for temporary non-residents, foreign loss elections and carried interest gains.

If you are a non-UK domiciled individual these new rules will impact you and there are actions you need to consider.

## HMRC IHT guidance on deemed domicile and UK residential property rules

HMRC has published high level guidance on the amended deemed domicile rules for Inheritance Tax ("IHT") and the new rules extending the scope of IHT to all residential properties in the UK. These changes also include within the scope of IHT those who lend money or provide security to purchase UK residential property. Such loans will be subject to IHT in the estate of the lender, regardless of the lender's residence and domicile position. These new rules apply from 6 April 2017. If you are a non-UK domiciled individual owning UK residential property these new rules will impact you and there are actions you need to consider. The guidance includes:

IHT deemed domicile rules – A new short high level summary explaining the deemed domicile rules for IHT purposes; and

Enveloped UK dwellings and related finance – New guidance on the rules which apply from 6 April 2017 and were legislated in the Finance (No.2) Act 2017. This new guidance contains a series of examples which provide a useful high level outline of the operation of the new rules.

## GAAR Advisory Panel opinion on employee incentive arrangement

The General Anti-Abuse Rule ("GAAR") allows HMRC to counteract tax advantages that arise from 'abusive' arrangements. For these purposes, arrangements are 'abusive' if they cannot 'reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions'.

Before invoking the GAAR, HMRC must refer the matter to the Advisory Panel for an opinion on the 'reasonableness' of the arrangements.

### Case summary

An employer established an employer funded retirement benefit scheme ("EFRBS") which was funded by way of a small cash contribution and assignment of the benefit of two deeds of covenant. The employer, the participating employees and a British Virgin Islands company then entered into a series of tripartite deeds which, through several steps, resulted in:

- funds being made available to participating employees for their use;
- the employer's resources being reduced by an amount equal to those funds; and
- the participating employees owing an equivalent sum to the EFRBS.

In substance, the arrangements resulted in a loan from the EFRBS to the participating employees.

The taxpayers contended that no income tax charges arose in relation to the arrangements (in particular, the 'disguised remuneration' legislation, set out in Part 7A ITEPA 2003, did not apply) and the employer was entitled to a corporation tax deduction in respect of the funding provided to the EFRBS.

### The Panel's view

The Panel noted that it is normal for an employer to establish an EFRBS in order to provide retirement benefits, and that the employee benefit legislation recognises employers have a choice of rewarding employees directly or via a trust.

However, the Panel formed the view that the method of funding the EFRBS and the complex series of transactions entered into to deliver benefits into the participants' hands were 'abnormal and contrived', and carried out solely for tax purposes.

Furthermore, the arrangements were intended to exploit perceived shortcomings in the drafting of the 'disguised remuneration' legislation and provide participants with loans from a trust structure without triggering immediate income tax charges (and PAYE and NIC obligations).

This was not a reasonable course of action in relation to the relevant tax provisions, as their underlying principle was that employees should not be able to avoid a charge to tax on employment income by entering into arrangements with parties other than their employer to receive employment reward (including by way of loans).

### Implications

The Panel's opinion in this case is unsurprising, and the message clear.

When implemented for *bona fide* reasons, EFRBS are a legitimate way of providing retirement benefits.

However, employers who seek to exploit such structures and ignore the 'keep off the grass' warning intended by the GAAR, in this case in relation to the 'disguised remuneration' rules, can expect a robust challenge from HMRC.

## Scope of Office of Tax Simplification review of IHT published

Following the Chancellor's request for a review of the IHT regime, the Office of Tax Simplification ("OTS") has now published a scoping document. This document clarifies that the principal aim of the review will be to *"identify opportunities and develop recommendations for simplifying IHT from both a tax technical and an* *administrative standpoint."* Specific issues that will be considered include the IHT submission process, the gift rules, routine estate planning, and perceptions of complexity.

This review has a much wider focus than just process and administrative issues and will cover: *"complexities arising from the reliefs and their interaction with the wider tax framework"*; and *"the scale and impact of any distortions to taxpayers' decisions, investments, asset prices or the timing of transactions because of the IHT rules, relevant aspects of the taxation of trusts, or interactions with other taxes such as capital gains tax"*.

The OTS confirms the intention to consult widely amongst stakeholders, with a call for evidence early in 2018. A report will be published in the autumn of 2018 providing an initial evaluation of the current IHT regime, identifying opportunities for simplification and making simplification recommendations for the Government to consider.

It is possible that following publication of the OTS report in the autumn, the Government may announce its decision to move forward with some or all of the OTS's recommendations in the 2018 Autumn Budget.

## Non-UK resident company entitled to claim income tax relief for trading losses of UK PE – Upper Tribunal decision

The Upper Tribunal ("UT") has agreed with the decision of the First-tier Tribunal ("FTT") that a non-UK resident company was entitled to claim income tax relief for trading losses generated by its UK permanent establishment ("PE") against letting income from its UK property rental business, even though any trading profit made by the PE would have been chargeable to corporation tax rather than income tax.

The UT agreed with the FTT that section 3 CTA 2009 only disapplied the parts of the Income Tax Acts that related to income tax on 'profits', which therefore could not also apply to losses. Further, the purpose of section 47 CTA 2009 was simply to make it clear that the rules in that and later chapters of the legislation should be used to calculate the losses, and this said nothing about the provisions governing the use of the loss once it has been calculated.

The UT also rejected HMRC's purposive construction arguments that Parliament had intended the corporate and income tax regimes to operate fully independently of each other, finding that there was no general principle which would demand the scope of application of the separate taxes to be mutually exclusive. There was also no clear reason why Parliament should have intended to prevent a company in the anomalous position of having two businesses, one subject to income tax and one subject to corporation tax, from being able to set a corporation tax loss off against general income.

Despite finding for the company on the domestic law points, the UT also considered at length whether HMRC's interpretation of the legislation would have breached EU rules on free movement of capital, and found that it would have done so. In this connection the Tribunal held that a Council Decision on the status of overseas countries and territories did not override the treaty provisions on free movement of capital and that property giving rise to letting income was not automatically to be regarded as a direct investment for the purposes of the treaty.

## Diverging views on what constitutes reasonable excuse for late NRCGT returns

A series of cases on what constitutes reasonable excuse for late filing of non-resident capital gains tax (NRCGT) returns reveals a divergence of views among tribunal judges.

Judge Anne Scott found that neither a taxpayer's lack of awareness of the need to file an NRCGT return, nor that of their advisers, was a reasonable excuse for late filing. Nor was the fact that there was no tax due. In contrast, Judge Richard Thomas followed his earlier judgments to find that ignorance of NRCGT filing requirements could be a reasonable excuse and a taxpayer could be entitled to rely on their adviser.

These diverging views, where the facts of each case are broadly similar, create uncertainty for taxpayers and their advisers. They follow a number of earlier decisions which have produced similarly conflicting outcomes.

## TRS: HMRC updates guidance on trustee record keeping and registration

On 5 July 2018 HMRC published changes to the guidance on records to keep for trusts. These have been made as a result of altered trustee obligations under the 4th Money Laundering Directive and the introduction of the Trust Registration Service (TRS).

The changes to record keeping guidance outline the information that must be kept for express trusts, including details of the settlor, trustees and beneficiaries, as well as when those records should be deleted (in compliance with GDPR). The guidance also makes it clear that certain UK law enforcement agencies are entitled to access information about beneficial owners.

Similar updates have also been made to HMRC's TRS guidance**.** The changes make it clear, with examples, when a trust must be registered and the time limits for doing so. Information has been added about the penalties that apply if registration deadlines are not observed separately. HMRC have clarified to us that the

5th October deadline for a "new liability" applies to both new trusts and existing trusts becoming subject to IT, CGT and IHT for the first time.

Helpfully HMRC has taken on board criticism of difficulties with the TRS and in some cases has incorporated solutions into the refreshed guidance. It also confirms that changes to the lead trustee's name and address should be notified to HMRC by letter but that other changes should not be notified at this time. The update facility may not be made available to trustees/agents until August 2019.

## HMRC clarifies meaning of residential property for SDLT purposes

On 4 July 2018, the Chartered Institute of Taxation and the Stamp Taxes Practitioner Group published a summary of a meeting with HMRC, the Welsh Revenue Authority and Revenue Scotland clarifying HMRC's view on the meaning of residential property for SDLT purposes.

The precise application of section 116 of the Finance Act 2003, which defines residential property for SDLT purposes for certain transactions is not clear and has caused disagreement between practitioners. The importance of the distinction between residential and non-residential property has increased in recent years due to the divergence between SDLT rates, and the introduction of penal SDLT rates on certain transactions involving residential property.

Among other things, HMRC stated that:
"*The separate sale of a garden is a residential transaction regardless of whether the garden has been fenced off or not. A subsequent sale of the garden by the buyer may be non-residential*". (This differs from HMRC's view for the purposes of the supplemental 3% SDLT charge because HMRC considers that the separate sale of a garden is not subject to the supplemental charge.)

The sale of six or more dwellings is not treated as residential if the sales are provided for in a single or overarching contract. It is not necessary for there to be a single land transaction. Consequently, completion of the acquisition of each dwelling may take place on different dates.

The summary discusses when construction or adaptation of a building for use as a dwelling has commenced. It also considers the relevance of legal conditions that restrict residential use (for example, planning permission conditions and restrictive covenants), business rates and council tax, and carrying on a trade or business at a dwelling.

HMRC has stated that some areas remain under review. In particular, the distinction between serviced apartments and hotels, the distinction between assisted living units and care homes, student accommodation, and build-to-rent developments. HMRC will update its SDLT manual, including to remove the statement at SDLTM00365, that an existing building that is marketed for domestic use is treated as residential property. Marketing material may be an indicator as to whether a building is suitable for use as a dwelling but it is not determinative.

## UK signs new double tax treaties with Jersey, Guernsey and the Isle of Man

On 2 July 2018, the UK signed new double tax treaties with Jersey, Guernsey and the Isle of Man.

The new treaties are largely identical to one another and are largely consistent with the OECD model tax convention. Each treaty differs from the treaties that are currently in force for each of those territories. Most notably, there is no place of effective management tiebreaker in the new treaties. Instead, the UK and Jersey, Guernsey or Isle of Man tax authorities must follow a mutual agreement procedure to determine residence (having regard to effective management).

The treaties also now include specific dividend, interest and royalty articles.

The treaties will come into force when the respective territories have completed their parliamentary procedures and exchanged written notes.