Finance (No 2) Bill 2017

International Tax **Large Corporate** **OMB** **Personal tax**

01 October 2017

The CIOT commented on the draft legislation published in July 2017 in relation to non-doms and substantial shareholding exemption (SSE); these provisions are now incorporated into Finance (No 2) Bill 2017 published on 8 September 2017. In addition, the draft legislation published in July reflected a change that the CIOT had recommended in relation to hybrid mismatch arrangements. The Finance (No 2) Bill 2017 also reflects a change to SSE rules which addresses the concern we raised.

On 13 July 2017, the government announced that the 'Summer' Finance Bill would not be published until September, however, they also provided some information about the content of the Bill and when measures in it will take effect. The government announced that measures dropped from the previous Finance Bill as a result of the general election will all be reintroduced in more or less the same form, from the initially planned commencement dates.

Alongside this announcement, the government published revised legislation relating to a number of measures including non-doms reform and the new institutional investors exemption for SSE. In addition, HMRC published revised legislation relating to the hybrid mismatch rules, which reflected a change to the legislation that the CIOT had said was required to achieve the position that HMRC purported to want in their guidance.

At the time of writing the Finance (No 2) Bill 2017 has just been published which incorporates these measures (on 8 September). While we are getting to grips with the Finance Bill as a whole, we report below on the representations we made over the summer on the draft legislation published in July and recap on the position with regards to hybrid mismatches. We are, however, pleased to note that the test for the new institutional investors exemption in SSE has been amended to address the concern that we raised.

Non-doms tax reforms

As noted above, in the summer, the government confirmed its intention to proceed with the non-doms reforms as previously announced (to apply retroactively from 6 April 2017) and published revised draft clauses and schedules. The IHT provisions were substantially unchanged from the earlier 15 March version. However for CGT and income tax, changes were made to the provisions on trust protections and those for cleansing of mixed funds.

At that stage we were particularly concerned about the points detailed below:

IHT: Clause and Schedule on IHT Overseas Property with value attributable to UK residential property

- **Overlapping charges where there is loan collateral [paragraph 3(b)]**
  The provisions are unclear as to the consequences when the collateral for a loan to acquire UK residential property is greater than the value of the loan, and also where there is more than one type of collateral provided. The principle should be that the total IHT charge should be on a value no greater than the loan. For example, Ferdinand gives as collateral for a relevant loan (of say £10m) (a) his house in Spain (worth

£11m) and (b) a floating charge over his portfolio (worth say £20m). It is unclear whether the additional wording at the end of paragraph 3(b) restricts the overall collateral to £10m (but if so how does one apportion this?) or whether it simply restricts each item of collateral to £10m.

- **Acquisition by an intermediary [paragraph 4(1)(b)]**
  As currently drafted there seems to be a clear lacuna. Although paragraph 4(1)(b) includes the wording '... and the acquisition by the intermediary [of UK residential property] ...', a loan taken out to buy an already existing company/partnership structure which already has a UK residential property within it, does not appear to be a relevant loan, and so escapes the IHT charge.

- **Anti-avoidance [paragraph 6(1)]**
  The anti-avoidance provision extends to 'minimising' the effects of the operative provisions. To our knowledge, this wording does not appear elsewhere in the tax code; its novel use therefore creates uncertainty. First, its use could bring into question an otherwise normal commercial transaction which would not in the *Willoughby* sense constitute avoidance. Second, does 'minimising' mean 'reducing' or 'making as low as possible'? For example, Agnetta could take out a £7m loan against her £10m close company (assuming that is the maximum any bank will lend on a loan-to-value basis). But instead, she chooses to take out a £6m loan. If 'minimising' means 'reducing' then Agnetta is caught as her IHT liability would be less. But if it means 'making minimal' then Agnetta has not absolutely minimised the effect of paragraph 1 (because she could have gone further by borrowing even less).

The CIOT wrote to HMRC about these concerns over the summer.

Income Tax/CGT Deemed domicile

- **Mixed funds cleansing (a two year window to 5 April 2019)**
  The provisions governing identification of clean capital have some significant areas of uncertainty that will prevent or hinder extraction of clean capital for UK investment and expenditure. The mechanisms will involve segregation into different bank accounts. It is therefore essential that not only taxpayers but also their banks have confidence in the way the provisions are intended to operate. There are a number of relatively small but significant legislative amendments required.

- **Tainting a protected trust**
  The protected trust provisions ensure that a deemed domiciliary (deemed UK domiciled as a result of having been UK resident for more than 15 years) will not be taxable on income/gains of an offshore trust unless he/she receives a distribution. These protections are lost if the trust is tainted by an addition to the trust. Given the dire consequences of tainting by even a very small inadvertent addition, the current uncertainties need addressing in the legislation if the policy intent of encouraging affected individuals to remain is to operate as intended.

- Perhaps less significant but certainly compounding complexity is the divergence between the amendments to the settlements code and the transfer of assets abroad provisions, aspects of the transfer of assets amendments and the changes to the valuation of trust benefits.

There are also a number of anti-avoidance provisions, some of which will apply to all offshore trusts not just those with non-UK domiciled settlors that have been deferred to a later Finance Bill. Continued engagement with the professional bodies will be essential.

The full CIOT comments can be found on our website.

The CGT & Investment Income Sub-Committee and the Succession Taxes Sub-Committee will be reviewing the clauses and schedules in the Finance (No2) Bill 2017 published on 8 September.

Substantial Shareholding Exemption (SSE)

The revised draft legislation published on 13 July dealing with the SSE only related to the proposed new exemption for investing companies owned by qualifying institutional investors, which has no trading requirement and allows the substantial shareholding requirement to be satisfied for investments of less than 10% but costing at least £20m.

The CIOT wrote to HMRC to raise concerns around the way in which the definition of a ‘substantial shareholding’ would operate for qualifying institutional investors in circumstances where the shareholding is less than 10%, but cost more than £20m.

We said that, in our view, the test in new paragraph 8A(3) regarding the ‘proportionate percentage’ was too strict and may cause the test to be failed in circumstances where the policy intention is that the exemption should be available. The problem arises from the words ‘…percentage *equal* to the percentage of ordinary share capital...’ in new paragraph 8A(3). This drafting is very restrictive and will mean that even a very small disparity between the percentage of the shareholding and the amounts available to equity holders would be sufficient to disqualify a sub-10% holding from relief. Thus, for example, the existence of even a small amount of convertible debentures issued by the company invested in could deny relief. We pointed out that this stringent test may be a common difficulty with the application of new paragraph 8A, which means that the policy intention will not be fulfilled. We suggested some possible solutions.

The full text of our comments can be found on the CIOT website.

We are pleased to note that the Finance (No 2) Bill 2017 published on 8 September 2017 addresses this concern. The provision includes a new sub-paragraph (5) in the new paragraph 8A, which will be inserted into TCGA 199 Schedule 7AC which permits ‘insignificant’ discrepancies between percentages of the shareholding and the amounts available to equity holders. This seems to be a sensible result.

Hybrid mismatches

As reported in Technical Newsdesk of July’s *Tax Adviser*, we wrote to HMRC to express our concern around a conflict between the draft guidance on hybrids and other mismatches and the wording of the legislation.

The comments in the updated hybrid and other mismatches guidance published in March 2017 regarding the operation of the legislation as it applies to state and local taxes did not reflect the actual language of the legislation. We said that if the comments remain in the guidance once this is finalised, it would lead to great uncertainty for taxpayers who would have to decide whether to apply the new rules in accordance with what they consider the law to be, or in accordance with a contrary position that is the published view of HMRC.

We went on to say that if HMRC is aware of financing structures where the income is subject to state taxes, but not US federal taxes and, in respect of which, HMRC would like to see a deduction for the interest paid disallowed in the UK, then in our view the correct approach would be to amend the legislation to achieve the desired outcome as we did not believe the current legislation achieves this. This is what HMRC has done.

The revised draft legislation published on 13 July 2017, and now incorporated into Finance (No2) Bill 2017, amends the hybrid mismatch rules so that the rules will bite if the income is subject to state taxes.