This file contains the table of contents, introduction and chapter 1 of **Taxation of Non-Residents and Foreign Domiciliaries** *10th Edition by James Kessler QC*

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INTRODUCTION AND WHAT'S NEW

Scope of this book

There are three themes to this book:
(1) Taxation of foreign domiciliaries
(2) Taxation of non-residents on UK assets; and
(3) Taxation of UK residents on foreign assets.
To attempt to cover all these topics is ambitious, and this book is in danger of bursting, particularly because often foreign aspects can only sensibly be discussed in a wider context. But one cannot address the first topic without the second and third: in taxation, as in life, everything is connected to everything else. I hope as a result that the book will help with all offshore aspect of UK tax issues.

Thus what started as a book on foreign domiciliaries has become a book on offshore taxation. I have revised the title accordingly.

The year 2010/11 in review

It is only a year since the last edition but the pace of tax reform is frenetic.

HMRC have issued a new version of HMRC6 (residence) and guidance on trustee residence (25 pages). They have ceased to give rulings on domicile. A new statement on interaction of GWR and excluded property settlements vindicates the views expressed in the earlier editions of this book.

The most important development of the year, as far as this work is concerned, is the European Commission action requiring the UK to amend the transfer of asset rules and s.13 TCGA to make them EU law compliant. Reform is inevitable though it is not likely to come any time soon.

The state of UK tax legislation

The chancellor stated in the Budget speech 2011 "our tax code has become so complex that it recently overtook India to become the longest in the world.."[1] Since then Parliament has added an additional 400 pages of Finance Act. Set against that, the Office of Tax Simplification has achieved little, and as matters stand it is unrealistic to hope for much.[2]

These have been bad times for tax policy. The CIOT expresses itself strongly: "the way tax law is developed and effected in the UK is deeply flawed."[3] Two recent publications shed a good deal of light on what has gone wrong with tax legislation in recent years. Firstly, Demos:

> The centralisation of [tax policy-making power] is a particular problem because of the lack of institutional accountability of the Treasury on taxation policy and the lack of accountability of chancellors themselves in matters of taxation. ... The concept of checks and balances in tax policy is nonexistent.
>
> ... the current relationship between the Treasury and HMRC was 'very dysfunctional', had 'almost gone as wrong as it could have gone'...
>
> At the moment, pursuing a career only in tax policy is not valued within the Treasury hierarchy. Officials pass through the tax teams rather than making tax policy a career choice. ... High turnover results in a lack of experience in the tax section and little institutional memory...
>
> ... There are traditional areas that are ring-fenced as not for consultation, including tax rates and anti-avoidance measures. ...
>
> ... 'at the moment [anti-avoidance] works like a drive-by shooting. You might hit your objective but you also hit a lot of other people.'
>
> At present, policies are frequently changed without understanding the

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1 The comment is probably based on CIOT, "The Making of Tax Law" (June 2010) para 3.3, *www.tax.org.uk/attach.pl/9328/10960/CIOT_tax_law_Jun10.pdf*. It is hard to empirically assess a claim that the UK has the longest tax code in the world, but there seem to be no other serious contenders for that title.

2 "[The OTS] cannot be an effective solution to the problem of over-complication without the Treasury allowing it a far more fundamental role." Ussher and Walford, *National Treasure* (Demos, 2011) accessible *www.demos.co.uk/files/National_treasure_-_web.pdf?1299511925*.

3 Letter from CIOT to George Osborne, 19 May 2010 *www.tax.org.uk/showarticle.pl?id=9279*

impact the policy has initially had in practice.[4]

Along with a decision not to consult is a government policy which is not so much deaf to the views of the tax profession as vociferous in their rejection. The Director of the HMRC Tax Avoidance Group 2004-2009 records:

> ... I was never happier than when a new tax avoidance initiative was greeted with howls of protest from the tax avoidance quarter.[5]

This confirms what anyone could have inferred from a variety of provisions, that preventing avoidance - a term which HMRC do not construe narrowly or technically - has been a priority that trumps all other policy considerations such as certainty, workability and the rule of law; and listening to the tax avoidance quarter - a term which includes STEP, the CIOT, and any practitioner who said what HMRC did not want to hear - has been ruled out.

The consequences of a decade or so of that policy can be seen in seeking to state the law, as this book seeks to do, or in seeking to understand the law, as you the reader will do now.

Panaceas to improve the tax system

There is one route and one route only to a good tax system: sound tax policy devised by those with a sound understanding of the current tax system; a leisurely timetable of legislative drafting; and the 10 tax tenets of the ICEAW.

That is not an easy prescription, and it is tempting to look for an easier solution. Recent attempts include the tax law rewrite and (perhaps) the HMRC charter.

The 2010/11 edition of this work did not have much time for the charter:

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4 Ussher and Walford, *National Treasure* (Demos, 2011) accessible *www.demos.co.uk/files/National_treasure_-_web.pdf?1299511925*.

5 Tailby, "Some reflections on Tax Avoidance" [2011] PCB 41.

> HMRC have published a charter called (absurdly) "Your Charter".[6] Dicey's comment on constitutions also applies to charters:
>
> > ... any knowledge of history suffices to show that foreign constitutionalists have, while occupied in defining rights, given insufficient attention to the absolute necessity for the provision of adequate remedies by which the rights they proclaimed might be enforced. ...[7]
>
> An unenforceable charter is a cross between a PR exercise and a sermon.

I have not noticed any significant references to the charter since its publication, and "Your charter" died even sooner than the taxpayer's charter produced by John Major in 1990 (which was never, as far as I recall, publically withdrawn).

As to the Rewrite, last year I wrote:

> Parliament have passed the final two Bills from the Tax Law Rewrite project: CTA 2010 (which should not have been given the same title as CTA 2009) and TIOPA. This brings the 14 year project to an end, and it can now be seen to be a disappointment which has not met its founders hopes of a substantially improved tax system.[8]

Increasing familiarity with the new legislation has not changed this view.[9]

The next big idea on the agenda - not a new one - is a GAAR. Comment will have to wait for the publication of the report of the General Anti Avoidance Rule Study Group, promised October 2011.

Thanks ...

I am very grateful to my colleagues Robert Venables QC and Stephen Brandon QC for discussions on many aspects of tax. I owe a great debt to Jane Hunt who works patiently on an intractable manuscript.

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6 Presumably "Taxpayers charter" was rejected because HMRC do not currently like to use the word "taxpayer".

7 Introduction to the Study of the Law of the Constitution, Dicey, (LF ed.) (1915) part II, The Rule of Law, chapter 4.

8 "... it would have been better to put the effort into simplifying the system rather than just the wording. The Institute believes that bringing the Rewrite to a close is correct." (CIOT, 20 Nov 2009.)

9 See for instance 31.1 (Offshore funds – Introduction).

... and request for help

Comments from readers would be of the greatest value and interest to the author. In the 9th edition of this work I said it has taken 2 years to complete a *preliminary* analysis of the provisions in what the House of Lords Economic Select Affairs Committee called the "absolute shambles" of the FA 2008. Now, 3 years after introduction of 2008 rules I still making new discoveries and do not believe that a full analysis could ever be written.

The pleasure in writing this book consists in the interest of the questions which it raises and the success which it may have achieved in answering them. It seeks to state the law as at 1 August 2011.

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CHAPTER ONE

FOREIGN DOMICILE: TAX POLICY AND REFORMS

1.1 Introduction

The topics of this chapter are:
(1) The policy arguments for and against a lighter fiscal regime for foreign domiciliaries (or some similar class of footloose individuals)[10]
(2) A history of foreign domicile tax reforms
(3) An assessment of the 2008 reforms
The chapter concludes with a glance into the future.

1.2 Economic arguments

All UK residents have a choice where to reside, but foreign domiciled individuals are in general less securely attached to the UK. The economic argument claims that if their tax burden was as great as that of a UK domiciliary, fewer would choose to live in the UK, and overall the UK economy would lose:
(1) directly, from tax paid by the foreign domiciliaries (including VAT); and
(2) indirectly, from investment and expenditure in the UK which is more likely to be made by UK residents.
Similarly, UK firms competing for expertise in the international labour

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10 Also, UK firms competing for expertise in the international labour market will find recruitment easier if the tax regime for foreign employees is lighter. Some potential employees would not choose, or could not afford, to come if the UK tried to tax them as it does its own domiciliaries.
For discussion on policy issues, see 'Residence and Domicile: Response to Background Paper' (STEP, 16 June 2003); 'Reviewing the Residence and Domicile Rules' (CIOT, 1 August, 2003); PBRN18 (Residence & Domicile Review), CIOT, 20 November 2007; all accessible on *www.kessler.co.uk*.

market will find recruitment easier if the tax regime for foreign employees is lighter. Some potential employees would not choose, or could not afford, to come if the UK tried to tax them as it does its own domiciliaries.

1.2.1 *Assessing the strength of foreign tax competition*

The argument requires an assessment of the strength of international tax competition.

In principle there are many low-tax or preferential tax regimes to which wealthy individuals can move. Switzerland, for instance, has a lump sum taxation regime for non-Swiss citizens specifically targeted for this purpose.[11]

In assessing the tax competitiveness of the UK relative to other countries, several points must be borne in mind.

Effective low tax may be achieved in other countries by relaxing legal provisions at administrative level, in a non-transparent way.

One paragraph summaries of other countries tax systems are bound to be misleading.

The terms of statutory tax law are only one aspect of tax competition. Compliance costs are important. The quality of tax administration is important. An OECD study lists six desiderata: a developed legal system, confidentiality, impartiality, proportionality, responsiveness [I am not sure what is meant by that] and competence. They add:

> Frequent changes in legislation, particularly where there has been an absence of consultation, can have an adverse impact on the taxpayers and their advisers trust in the tax system.[12]

---

11 Though this is currently politically controversial and it was abolished in Zurich in January 2010.
The OECD study "Engaging with High Net Worth Individuals on Tax Compliance" para 34 (May 2009) singles out Ireland, France, the Netherlands and the UK for what it terms "preferential regimes for specifically defined groups of taxpayers"; see *www.oecd.org/document/5/0,3746,en_2649_33749_42902277_1_1_1_1,00.html*

12 "Engaging with High Net Worth Individuals on Tax Compliance" (May 2009) para 208 and 243; see *http://www.oecd.org/document/5/0,3746,en_2649_33749_42902277_1_1_1_1,00.html.*

But there are others: can a tax authority subject an individual to an expensive and intrusive tax investigation without any evidence to justify doing so? Certainty is very important. Perception matters as much as reality. By many of these measures, the UK scores poorly.[13]

In the 6th and earlier editions of this book, I said:

> The UK tax system is largely[14] based on the rule of law rather than informal practice and discretion.

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13 Not just in foreign domicile taxation. See, for instance, KPMG, *Taxation & the Competitiveness of UK Funds* (October, 2006):

> "For all fund types, the UK tax regime is viewed less favourably than those of Ireland and Luxembourg ...The negative perception of the UK tax regime is driven more by uncertainty than by any specific factor. ...A key feature of [structured] products is that promoters must be as certain as possible of the tax analysis for investors over a period of five years and more, and hence the uncertainty of the UK regime in this area makes the UK an unsuitable domicile location. Accordingly, most firms look immediately overseas when establishing these products. ... The most common concern with the UK tax regime is not a specific tax measure that can be fixed by a change in legislation. Rather, it is the overall management of the UK tax regime, characterised by the pace of change and the style of consultation... The majority of participants made strong calls for certainty and stability, regarding the lack of these as a key adverse factor of the UK tax regime. ...The lack of constructive consultation has led to an increasing number of surprising changes to the regulations and a number of proposed changes that were reversed after further prolonged consultation. ... Comments on derivatives caused uncertainty by questioning the appropriateness of an accounts based regime that was introduced just two years before, and the suggestion that QIS would not benefit from the established regime for authorised funds, significantly slowed development of UK based QIS. As one participant commented: 'By this stage Ireland and Guernsey were laughing.' ...There is also a view among participants that HMRC is focused on targeting avoidance rather than creating an environment to support industry development and growth. ...
>
> "The UK tax system undergoes constant change, or threat thereof, which results in ongoing uncertainty as to the tax treatment of funds and investors on assets totalling many billions. The UK Revenue can overturn arrangements without consultation albeit of very many years standing and is not seen to be working with the industry for the benefit of UK Plc, quite the reverse. This approach is very much at odds with that in other territories."

14 But see 9.23 (Forward tax agreements).

To the extent this is true it is something to boast of,[15] and a feature which makes the UK an attractive choice for anyone choosing where to reside. However, it is far less the case than formerly, due to:

(1) over-wide, over-complex, or wholly vague anti-avoidance provisions mitigated by informal practice, discretion or oversight.[16]

(2) an increasing use of retrospective legislation.[17]

1.2.2 *Attitudes to the economic argument*

The debate about international tax competition is very long standing and is not restricted to foreign domicile taxation.[18]

Most though not all commentators would accept that the economic argument is a powerful consideration.

Where the UK faces tax competition, those making the law sometimes acknowledge it expressly:

> The [investment manager] exemption enables non-residents to appoint UK-based investment managers without the risk of UK taxation and is one of the key components of the UK's continuing attraction for investment managers.[19]

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15 The boast is at least as old as Blackstone: Commentaries (1765) vol 2 chap 37 ("a country like this, which boasts of being governed in all respects by law and not by will...").

16 Examples include the POA rules (2004); restrictions on allowable losses (2007); the ITA remittance rules (2008).

17 Examples include the IHT reforms (2006); the ITA remittance rules (2008).

18 See the evidence of Lord Vestey to the 1920 Royal Commission, accessible *www.kessler.co.uk*.

19 SP 1/01. Another example is the IHT exemption for OEICs and AUTs:

> "Overseas investors are in theory liable to inheritance tax on their OEIC and AUT holdings, because they are regarded as being situated in the UK for tax purposes on the investors' death. Competing centres do not charge tax in parallel circumstances. Removing the potential inheritance tax charge will help UK managers compete on an equal footing with overseas fund providers."

Press Release 16 October 2002 (OEICs and AUTs) para 6. The text continues (inaccurately):

> "This very rarely generates any significant yield, because UK assets still have to exceed the inheritance tax threshold ... before any tax is due. But it is a deterrent in marketing terms".

I suspect that the true reason that the old IHT rule raised little IHT was rather different, namely that no-one (if properly advised and wishing to comply with UK

The present coalition government seems well aware of the point, at least in relation to companies:

> In recent years too many businesses have left the UK amid concerns over tax competitiveness. It's time to reverse this trend.[20]

Similarly the budget 2011 stated the Government's aim to create:

> the most competitive tax system in the G20.[21]

Those opposed to the consequences of this line of argument deride it as a "fiscal race to the bottom" but most sober commentators recognise that the UK could not act alone, as if there were no such thing as international tax competition.

Devolution raises the possibility of tax competition within the UK. So far, debate has focused on the possibility of Northern Ireland and Scotland having a lower corporation tax rate than England:

> a lower headline rate of corporation tax could encourage greater investment by Scottish and UK firms in both physical and human capital and in research and development (R&D) within Scotland.
> At the same time, it could make the country more attractive as a location

---

tax rules) would invest more than the IHT threshold in AUTs or OEICs. Undetectable non-compliance must also be reckoned with. But that does not affect the point made here.

Another example:

> "The location of ownership, flagging (registration) and management activities is very 'footloose', since it can easily be transferred from one country to another. This makes it vital to have regard to the fiscal regimes in other countries if we want to maintain a successful shipping industry in the UK. The modern armoury in the battle for success invariably includes a virtually tax-exempt fiscal regime." (Independent Enquiry into a Tonnage Tax, Lord Alexander, HM Treasury 1999.)

Another example is the exemptions granted to sports performers: see s.68 FA 2006 (Olympic Games 2012); sch. 20 FA 2010 (Champions League 2011). These events would not be held in the UK in the absence of a tax exemption.

20 HM Treasury, "Corporate Tax Reform: delivering a more competitive system", November 2010.

21 The phrase occurs seven times in Budget 2011: this was described as an "ambition"; presumably the word "intention" was thought to be too strong. *http://cdn.hm-treasury.gov.uk/2011budget_complete.pdf*

> for multi-national investment. It could also act as an important signal to global companies and investors as to Scotland's ambition to be a location for competitive business.[22]

Perhaps at some point it may occur to politicians and commentators that similar arguments apply to taxation of individuals.

Unfortunately, it is almost always hard to predict what will be the overall economic effect of any reform, and predictions tend to reflect the views and wishes of those who make them.[23] Ascertaining the effect of reforms after they are made is scarcely less difficult.

1.2.3 *EU and international law aspects*

The freedom of the UK to enter into tax competition against other countries is subject to certain constraints of EU and international law and politics. International fiscal co-operation in this area at present operates only to a limited extent, but it has made some progress in a (non-binding) EU code of conduct on business taxation[24] and may in the future become a more important aspect of tax policy.

The EC has expressed disapproval of the remittance basis:

> The Commission does not advocate remittance base taxation, as it may

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22 The consultation paper does not consider the possibility that England might match the Scottish lower rate and does not address the question of what constitutes a scottish company for the purpose of the lower rate. Likewise in Northern Ireland: HM Treasury, "Rebalancing the Northern Ireland economy" (March 2011) accessible *www.hm-treasury.gov.uk/d/rebalancing_the_northern_ireland_economy_consultation.pdf*. Wales would also like to join in:

> "If Northern Ireland is allowed to cut corporation tax, it would be outrageous if Welsh politicians did not have the option of doing the same" Gerald Holtham, chair of the Holtham Commission for Wales

(Cited in the Scottish consultation paper below)

So we may have no shortage of tax competition with the UK.

23 See HMRC's estimate that a reduction in the rate Corporation Tax in Scotland to 12.5% would cost £2.6bn, but the Scottish Parliament say the impact will be positive: "Corporation Tax: Discussion Paper Options for Reform" (August 2011) p.43, accessible *www.scotland.gov.uk/Resource/Doc/919/0120786.pdf*.

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24 *http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm*

> lead to double non-taxation.[25]

That expression of disapproval does not seem to have had any effect on UK domestic politics.

Since tax competition extends beyond the EU, and there is (to say the least) limited enthusiasm for increasing EU powers in relation to tax, those hoping for a body to curb international tax competition tend to look to the OECD.[26]

1.2.4 *"Customers" of HMRC*

It does not seem to me to be wholly coincidental that the change of terminology from taxpayers to "customers" of HMRC has come at a time which has seen a substantial increase in HMRC's powers and in its desire to use them to impose civil and criminal penalties.[27]

In the 2010/11 edition of this work I concluded:

> Where there is tax competition, the term "customer", which HMRC have (controversially) applied to taxpayers since 2001[28] is slightly less inapt. UK resident foreign domiciliaries are in principle more free than other taxpayers to take their "custom" elsewhere.

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25 László Kovács (EU Taxation and Customs Commissioner) IP/07/445 (30 March 2007).

26 Eg Jeffrey Sachs "Stop this race to the bottom on corporate tax" Financial Times, March 28 2011.

27 "The Department expects the new [civil] penalty regime to result in higher penalties as the minimum penalty for deliberate evasion and concealment is 50%. The Department should track the level of penalties imposed to ensure that it is applying the new regime rigorously." "We're going to significantly increase the number of criminal investigators and the number of prosecutions we're going to carry forward". House of Commons Committee of Public Accounts, "HM Revenue & Customs: Managing civil tax investigations" (March 2011)
www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/765/765.pdf.

28 A press release at the time provided: (14/06/01) "M and C Saatchi, a leading advertising agency, has been appointed by the IR to rebrand the department. Branding and design consultants, Corporate Edge, will also be working with the IR and M and C Saatchi to 'create a customer driven department.'"
In 2003 Sir Nicholas Montagu (then Chairman of the Board of Inland Revenue) said that the reason for the change was to remind Revenue staff that the needs of the consumer of public services should be considered first: see "The Customer is always right" Tax Advisor February 2003.

As far as I am aware, no other Revenue department in the world has adopted this terminology. It will not cease to give rise to derision as long as the current generation of tax practitioners remain in practice.[29] It is conceivable that the terminology will last until a future generation sees nothing to laugh at in expressions such as *"penalties designed to change customer behaviour"*[30] but I think that unlikely.

The Archbishop of Canterbury sees the issue in a wider context, and his objections to the terminology are more profound:

> The language of customer and provider has wormed its way into practically all areas of our social life, even education and healthcare, and we forget that it is a metaphor when we call a student, a patient or a traveller a "customer". The implication is that the most basic relation between one human being and another or one group and another is that of the carefully calibrated exchange of material resources; the most basic kind of assessment we can make about the actions of another, from the trader to the nurse to the politician, is the evaluation of how much they can increase my liberty to negotiate favorable deals and maximize my resources.[31]

1.3 Fairness

The other consideration in the assessment of foreign domicile taxation is fairness.

1.3.1 *What is fairness?*

The starting point for any serious discussion of fairness in tax is

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29 See eg Cameron, "Customer Service?" *Taxation* 10 Apr 2008, p.361: "It never ceases to amaze me that HMRC have adopted the word 'customer' to describe the taxpaying public. A customer is someone who chooses to patronise a business." Andy Wells agrees: "I will never be a "customer" of HMRC. This disregard for the English language irks just about every tax professional I come across..." *Taxation* 4 June 2009, p.549. Similarly Anthony Thomas, president of CIOT: "HMRC now refer to taxpayers as customers, but they do not treat them as customers"; "We need Trust", Taxation (2 June 2011) p.7.

30 *www.hmrc.gov.uk/e-learning/New_Penalties_Awareness/Inaccuracy_Pen_ext/HTML/Inaccuracy_Pen_ext_106.html*

31 Williams, "Knowing our Limits" in Williams and Elliott (ed), *Crisis and Recovery* 2010, p.20.

economists terminology:

(1) horizontal equity, the view that people who are relevantly equal should pay the same amount of tax.

(2) vertical equity, the view that people who are relevantly different should pay different amounts of tax, which leads to the (more or less) accepted view that fair taxation should be progressive rather than regressive.

Economists have developed these concepts with considerable sophistication[32] but their limitations are painfully exposed when one tries to apply them in a real life context, such as an assessment of the fairness of the taxation of foreign domiciliaries. The concept of horizontal equity is not so much a definition of fairness as an approach to identifying the issues in any serious discussion of fairness. In deciding whether one group (foreign domiciliaries, say) is fairly taxed, one needs to identify another group by way of comparison (UK domiciliaries, say) and ask if they are relevantly equal.

1.3.2 *Is a distinction between UK and foreign domiciliaries fair?*

In the author's view, domicile is in general a useful and practical measure of UK linkage, and to regard UK and foreign domiciled residents as completely equivalent is facile. Or put the other way, foreign domicile does constitute a significantly weaker UK link than UK domicile. Accordingly conferring a lighter UK tax regime on foreign domiciliaries, such as a remittance basis, is indeed fair. This is especially so bearing in mind that mere residence does not require a very close connection to the UK – merely passing the 183 or 91 day tests or (under HMRC 6) having vaguer and more remote connections.

Further, a foreign domiciliary may not have had a fair opportunity to arrange their affairs with UK tax in mind; for instance creating settlements from which they were excluded.

32 For a starting point, see Kaplow,"Horizontal Equity: Measures in Search of a Principle" National Tax Journal 42, no. 2 (1989): 139-55 accessible *http://ntj.tax.org/wwtax/ntjrec.nsf/A4CE18763C5BB9608525686C00686DAC/$FILE/v42n2139.pdf*
Musgrave "Horizontal Equity Once More" National Tax Journal 43, no. 2 (1990): 113-23 accessible *http://ntj.tax.org/wwtax/ntjrec.nsf/0/a42168feab9541ff8525686c00686dca/$FILE/v43n2113.pdf*

Another consideration is the impracticality (both for taxpayers and HMRC) of untangling ownership of assets, especially in family ownership arrangements which are common in third world countries.

This view is not universally held. Some maintain that any distinction (for IT or CGT) between UK residents based on domicile is unfair. The two are relevantly equal.

It is difficult to see how the dispute between the rival views can be judged, or what either side could do or say to convince the other. The concept of fairness is insufficiently precise to resolve the dispute. Or one might say that it comes down to a matter of impression, which is to say the same thing.

Many of those who advocate this view most strongly are not tax practitioners, and I think would be surprised to find how little is required to be UK resident: their views may based on a paradigm of a foreign domiciliary who is a very long-term UK resident.

It also has to be said that in political debate, much depth of analysis is not to be expected; assessment of fairness is visceral, and sensitive ears might sometimes detect elements of class or wealth hostility and xenophobia.

1.3.3 *Is a remittance basis fair?*

Of course, even if it is accepted that it is fair to tax foreign domiciliaries less than UK domiciliaries, the question of what constitutes a fair reduction is a separate issue. The 2008 reforms accepted the principle of a distinction (which is why they did not go far enough for some commentators) but significantly reduced the extent of the tax reduction by making the remittance basis less attractive.

The remittance basis of taxation is in effect a form of qualified non-taxation. In assessing its fairness it is relevant to compare different groups of foreign domiciliaries:

(1) *Short-term residents* who are:
- (a) wealthy individuals, who can elect for the remittance basis and are able to retain significant foreign income/gains abroad, and
- (b) less wealthy individuals for whom the remittance basis is not attractive since they cannot afford to retain foreign income/gains abroad.

(2) *Long-term residents*
- (a) ultra-wealthy individuals, who can elect for the remittance basis and are able to retain significant foreign income/gains abroad, and

(b) less wealthy individuals for whom the remittance basis does not justify the £30k.

The effective rate of tax under the remittance basis approximately declines with income and in that sense it can be described as regressive taxation. If one accepts that taxation ought in principle to be progressive, which has been a broad feature of UK taxation then there is the basis for an argument that the remittance basis is unfair.

What effect have the 2008 reforms had in this area? So far as they have decreased the attractiveness of the remittance basis by withdrawal of personal reliefs as a cost of the remittance basis they have decreased the unfairness.

So far as they have introduced the remittance basis claim charge, the reforms have targeted the benefit of the remittance basis at a small number of ultra-wealthy individuals. That may make some sense under the economic argument, but from a fairness point of view it is difficult to justify.

1.4 Suitability of domicile as a fiscal test

The domicile concept is not ideally framed to identify the "footloose" individuals, whose UK links are less, and for whom a lighter tax regime is appropriate on fairness or economic arguments. The adhesive quality of a domicile of origin, and the restrictive rules for the acquisition of a domicile of choice, allow some fortunate individuals to enjoy foreign domicile tax treatment, despite very close UK links and only tenuous, historical and fortuitous links to their domicile of origin. To the extent that they do so the current tax system fails both on economic and fairness criteria.

In considering this objection to domicile, however, one should bear in mind that no perfect criteria exists: the question is not whether domicile always produces the right answer, but whether one can do significantly better with other concepts.

Other concepts are sometimes used:

(1) Long term residence, of which UK tax uses a variety of tests:
  - (a) IHT deemed domicile rule: 17 years residence.
  - (b) Long-term residence rules: 8 years residence.
  - (c) Temporary non-residence rules: 4/7 years residence and 5 years absence.
  - (d) Ordinary residence (vague but like a 3 year residence test)

(2) Citizenship (not much used in UK domestic tax law but used in some IHT DTAs and in the OECD model treaty.

These are all alternative ways to make the distinction between UK residents with strong and weaker UK links; whether they would serve better than a domicile test is very doubtful.

1.5 Approaches to reform of foreign domiciliary taxation

It is helpful to distinguish different ways of altering the tax system for foreign domiciliaries:

(1) Alter the definition of domicile for general purposes and so restrict the class who qualify for foreign domicile tax treatment.
(2) Alter the definition of foreign domicile for some or all tax purposes.
(3) Alter tax laws applying to all foreign domiciliaries.
(4) Identify subclasses of foreign domiciliaries with close UK links so as to tax them more heavily.

One can of course achieve the same end result by more than one technique. There is a lot to be said for approach (4) both on economic and fairness grounds.

1.6 History of reform of foreign domicile taxation[33]

1.6.1 *1974-2002*

The 1974 Finance Bill included a provision (clause 18) that an individual ordinarily resident in the UK for five out of the preceding six years of assessment should be deemed UK domiciled for IT and CGT purposes. This was withdrawn from the Bill.[34]

In 1987 the Law Commission published recommendations for minor reforms of the general law of domicile[35] but despite initial acceptance by the Government, there was no change in the law. In 1996 the proposals

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33 See too 9.4 (History of the remittance basis).

34 For an account of the lobbying behind this, see Barnett, *Inside The Treasury* (1982) p.28–9.

35 Law Com. No. 168 *The Law of Domicile*, accessible *www.scotlawcom.gov.uk/download_file/view/228/*

were formally abandoned.[36]

The 1988 Consultative Document (Residence in the UK) made radical proposals. The remittance basis would be abolished. Those resident here for less than seven out of 14 years (and, perhaps, who are also not UK domiciled) would qualify for a new "intermediate basis" of taxation. This would require disclosure of worldwide income in order to tax it at an effective rate of 2% or less. This almost unworkable proposal was sensibly abandoned.

In the first edition of this work (2001) I said:

> It seems more likely than not that, apart from tinkering changes, the present regime will continue for the foreseeable future. But "the major distinguishing feature of the British tax system is its instability".[37] There is also the possibility of EU pressure for reform. If what has been a backwater acquires political prominence, perhaps due to no more than a campaign by a single newspaper, there will certainly be major changes.

1.6.2 *2003 background paper on residence and domicile*

In 2002 a newspaper campaign emerged[38] which pressed the Blair Government into action, or at least into the appearance of action. The Budget of April 2003 delivered a "background paper" called "Reviewing the Residence and Domicile Rules as they affect Taxation".[39] This was a

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36 According to Hansard HC, 16 Jan 1996 Col 487:
"The Government have decided not to take forward these reforms on the basis that, although they are desirable in themselves, they do not contain sufficient practical benefit to outweigh the risks of proceeding with them and to justify disturbing the present long established body of case law on this subject."
This was the right reason for the right decision. However, the true reason for the decision may well have been pressure of the foreign domicile lobby: see "Rules for Determining Domicile", Law Reform Commission of Hong Kong (2005) para 4.28 accessible *www.hkreform.gov.hk*.

37 This was noted in Steinmo, *Taxation and Democracy*, (1993) p.44 but the instability has markedly increased since then.

38 See for instance, *The Sunday Times*, 1 March 2002; *The Guardian*, 11 and 12 April 2002.

39 See *www.kessler.co.uk*

facile document[40] but it may be unfair to criticise its (unnamed) authors. Their instructions may have been to be uncontroversial; by saying nothing, there was nothing in the document to which anyone of any political view could object.

Nothing then happened from 2003 to 2008 except an often repeated statement that:

> The review of the residence and domicile rules ... is ongoing.[41]

It is clear that the review of foreign domicile tax did not follow the normal course of consultation, decision and implementation. In the absence of a frank explanation of what went on, it is tempting to speculate. The likely explanation is that the Blair Government wanted to do nothing, but prevaricated to avoid an announcement which would have lead to a furore from those in favour of reform.[42] Blair resigned in June 2007. A change of power led to an unannounced U-turn from that unannounced policy.

1.7 2008 reforms: assessment

The 2003 background paper on domicile recited the principles that taxation of foreign domiciliaries:

> [1] should be fair;
> [2] should support the competitiveness of the UK economy; and
> [3] should be clear and easy to operate.[43]

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40 It contained an outline of the law (a rehash of IR20) and one paragraph summaries of the law of 29 other countries (of insufficient detail to be of any use and generally said to be misleading). The paper did not consider any proposals or their possible impact. It (consciously?) ignored every earlier discussion of reform: the Royal Commissions of 1920 and 1955, the 1936 Codification Committee, the 1974 Finance Bill, the 1987 Law Commission Report and the 1988 Consultation Paper. For an account of the decline in quality of Government white and green papers, see Forster, *British Government in Crisis* (2005), p.134.

41 The history is set out in more detail in the 9th edition of this work para 1.3.2. The last outing of (by then extremely tired) statement was Hansard 12 July 2007 Col 1605 by which time almost no-one believed it, but by then it was possibly true.

42 See Oborne, *The Rise of Political Lying* (2005).

43 The paper might have cited Adam Smith *The Wealth of Nations* (1776) Book 5 chapter 2, accessible *www.bibliomania.com/2/1/65/112/frameset.html*
The paper did not point out (though Adam Smith did) that these objectives are to a

It seems reasonable to assess the 2008 reforms by these criteria.

The 2008 reforms increased the tax burden on foreign domiciliaries in three main ways:

(1) The remittance basis claim charge for long-term residents
(2) The withdrawal of personal allowances for all remittance basis claimants
(3) The extension of anti-avoidance provisions to remittance basis taxpayers (in particular, the ITA remittance basis, the s.720, s.13 and s.87 remittance bases, and the AIP remittance basis).

1.7.1 *Clear and easy to operate*

It will be evident to anyone who skims this book that by this criteria the 2008 rules are an abject failure. The rules are unclear, often difficult and sometimes impossible to operate. In these respects they are unquestionably worse than the pre-2008 rules. The terms of the 2012 review suggest that this is tacitly accepted.

Government policy normally requires an impact assessment.[44] None was carried out in relation to any of the 2008 reforms. Many features of the reforms could not have survived if it had been.

1.7.2 *Competitiveness of the UK economy*

On one side of the account is the gain of more tax paid by foreign domiciliaries. On the other is:

(1) Tax and investment lost from individuals who leave the UK, and those who (because of the reforms) decide not to come.
(2) The loss to the economy that the new rules in many cases prevent investment in the UK and prevent use of UK services (to a much greater extent that is necessary from the concept of a remittance basis).

In the 2008/09 edition of this work my initial assessment was as follows:

> Overall it seems to me implausible that the reforms will make a positive contribution to the UK economy. One can test the matter this way. If a wealthy individual, a beneficiary of offshore trusts created by himself or his

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substantial extent irreconcilable.

44 *www.berr.gov.uk/files/file44544.pdf*

> family, asked for advice on the desirability of choosing the UK as a residence, what would one say? Even now the individual could still do worse; and if enough advance planning and restructuring is possible, the problems may be ameliorated, at an administrative cost. Thus tax may still not prevent an individual from coming to the UK if he wants to sufficiently. Also, the old cliché about the tax tail and the commercial dog still holds good. But all this is a far cry from the pre-2008 position, where one would simply respond that the UK was clearly a desirable place to reside.

This view is now supported by a number of surveys.

A KPMG survey found that as a result of the 2008 changes, 24% of foreign domiciliaries were planning to leave the UK within two years, with an additional 24% hoping that the rules will be changed and looking to review their position in the medium term. More than nine out of ten said that the changes had damaged the UK's competitiveness.[45]

A Knight Frank survey found that up to 7% of foreign domiciliaries left UK in the months following the tax announcements and a further 31% were planning or actively considering departure.[46]

Stonehage research suggests that the changes will produce an initial tax gain diminishing to a tax loss beginning from a date between 2014 and 2018.[47]

My own anecdotal experience - consistent with the above - is of a number of individuals who decide - I think wisely - not to come to the UK because of the uncertainties relating to taxation.

It is of course difficult if not impossible to disentangle the 2008 reforms from other disincentives to coming to the UK, such as the increase in income tax rates to 50%, the enormous uncertainties caused by the transfer of asset abroad changes in 2005, and corporation tax changes.

Corporate departures from the UK have been widely publicised; they include WPP, Shire, Regus, Henderson, Charter, Beazley, Brit Insurance, UBM, Shore Capital, Informa and Aureos Capital. Individual departures from the UK are not readily identifiable, and losses from those who decide not to come are almost totally unmeasurable.

HMRC offer the following statistics:

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45 March 2009, accessible *www.kpmg.co.uk/news/docs/NomDoms_FinanceAct2008_Access3.pdf*

46 *www.knightfrank.com* Press Release, 20 June 2009.

47 "Non Doms and the UK Economy", March 2010, accessible *www.stonehage.com*.

	Non-doms	Tax paid	RBC payers		total RBC paid
	Total no	*total £billion*	*average per person*		
2004-05	110,000	3.3	£30,000		
2005-06	111,000	4	£36,036		
2006-07	117,000	5	£42,735		
2007-08	140,000	6.9	£49,286		
2008-09	123,000	5.9	£47,967	5400	£162m

The figures are interesting but it is impossible to draw any economic conclusions from them.

1.7.3 *Fairness of 2008 reforms*

The FA 2008 contained a wide ranging package of reforms and any short assessment of its fairness must necessarily be limited to its main features.

The remittance basis claim charge distinguishes between short term and long-term residents, and taxes the latter more heavily, the connecting factor here being an 8/10 year residence test. One cannot categorise that distinction as unfair.

On the other hand, among long-term foreign domiciliaries, the charge distinguishes between the extremely wealthy (to whom the remittance basis is still attractive) and others (to whom it is not). This offends against the principle of vertical equity, which suggests that people with higher incomes should pay more tax. That is not fair, though it is an unfairness arising directly out of a decision to maximise the economic advantage by targeting the remittance basis to the wealthiest.

The withdrawal of personal allowances as a quid pro quo of a remittance basis is not unfair (though it comes at a cost in terms of complexity).

Of perhaps greater importance is the other aspects of a package of reforms which affect all foreign domiciliaries, not just long-term residents.

The new and wider ITA remittance basis is not unfair, except for the wilder reaches of the relevant person definition and the supposed rule (probably ignored in practice) that the taxable amount remitted may exceed the value of the asset remitted.

The extended 2008 anti-avoidance rules can work unfairly but complete fairness is impossible to achieve in this area.

The transitional rules are another matter. The rules are retroactive in that their impact on individuals depends on income and gains arising before

2008, and unfair in that they impose tax on those income/gains in a manner that no-one before 2008 would have anticipated. These rules are unquestionably and grievously unfair.

All in all, the 2008 reform may be given some limited marks for fairness. This is not to say that the pre-2008 rules should be regarded as unfair: the concept of fairness (especially if viewed through the lense of practicality) is so vague that a very wide range of tax policies may all be categorised as "fair".

Some of the hardest hit are long-term UK resident US citizens, who pay
(1) US tax on a citizenship basis and
(2) substantially greater UK tax liabilities under the 2008 regime.
with only treaty relief to mitigate double taxation, as far as it goes.
That is unfair, but the reason is not that UK unfairly taxes its long-term residents, but that the US (I think, uniquely in the world) imposes US tax on non-resident citizens, so all its non-residents face the burden of double taxation: US tax and tax in their country of residence (subject in part to treaty relief).

1.7.4 *Process of implementation*

The manner in which the FA 2008 was introduced deserves to be recorded.

On 18 January 2008, 26 pages of draft clauses were published whose unwritten message to wealthy non-residents was broadly: *do not come to the UK if possible; if you must, do not under any circumstances invest any money here*. The clauses were officially described as work in progress, but this was unfit for publication.

HMRC presumably agreed. On 27 March the Finance Bill was published, containing 54 pages of legislation. The FB clauses bore almost no resemblance to the January draft. One consequence is that the professional time and clients' money spent considering the old clauses was almost entirely wasted. That certainly cost many £millions. Another consequence was that the profession had nine frantic days to scramble around before the end of the tax year. Because of the absence of sensible transitional reliefs, large amounts of tax depended on decisions and actions taken in those days. Sensible consideration of difficult and important matters was rendered impossible.

On the date of publication the Treasury announced that the Finance Bill was incomplete and amendments covering almost every aspect of the rules[48] would be made in the course of progress of the Finance Bill.[49] Thirty pages of amendments duly emerged in mid June – far too late in the Finance Bill timetable to give them any serious consideration. Forty eight more Report Stage amendments were published on 26 June. The report stage and third reading (after which no further amendments could be made) were held on 1 and 2 July 2008. John Avery Jones notes that "Report Stage amendments are usually a disaster."[50]

As a result, the final legislation poses problems which will occupy practitioners and HMRC for many years, but it is also noteworthy that during the first three months of 2008/09 taxpayers could not know what laws governed transactions which they might wish to carry out, or what record keeping would be required of them.

The former editor of *Taxation* is blunt:

> The standard of strategic policy making at the Treasury has been unacceptably poor in recent years, but this must surely have been one of its lowest ebbs ever.[51]

The CIOT say:

> when corners are cut, especially under time pressures, there can be serious deficiencies.

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48 Explanatory notes to Schedule 7, para 36 (mixed funds); para 47 (s.87 charge); para 52 (non-resident trusts); para 74 (Schedule 4C); para 91 (TAA provisions; para 106 (works of art); para 107 (employment related securities).

49 In the 2008/09 edition I said:
"This is a new development in tax legislation. While from time to time inadequately drafted clauses have always been found in Finance Bills, this is as far as I am aware the first time that the Government has had to announce that fact at the time of publication of the Finance Bill."
It seems however to be a trend as there are similar examples in the FA 2009.

50 See "Taxing Foreign Income from Pitt to the Tax Law Rewrite—The Decline of the Remittance Basis", John Avery Jones in *Studies in the History of Tax Law* (Vol 1 2004) accessible on *www.kessler.co.uk*.

51 *Taxation* 12 June 2008 Vol 161 No. 4160 p.627 (Malcolm Gunn).

and their example to illustrate the point is the non-domicile rules in the FA 2008.[52]

The House of Lords Economic Affairs Committee comment in measured language:

> Our private sector witnesses would not have used words like "a real shambles" if they did not feel strongly about this. ...
> 176. We recommend that, if they have not already done so, HMT and HMRC should carry out a full review of the reasons why there were so many difficulties in the development of this policy initiative. They should ensure that the lessons are learned so that these problems do not emerge in other initiatives.
> 177. We also recommend that if another policy initiative gets to the point where the legislation cannot be finalised for inclusion in the Finance Bill, that initiative should not be included in the Bill, or, if feasible, the part which is not finalised should not be included. We cannot support the approach of the Finance Bill's still being subject to much amendment at the time it is published, particularly when the proposals come into effect from the beginning of the tax year, as in this case. [53]

No review has been carried out.

Does it now matter? Readers may think it pointless to cry "foul" in a game which has no referee, and whose result has now been declared. But I think the story deserves to be recorded as what a working party lead by Lord Howe described as "an object lesson in how not to legislate".[54]

The charity tax reforms of the F(No.1)A 2010 suggests that no lesson has been learned. There are some signs that the present coalition government would like to be less cavalier in enacting tax legislation. Whether the government can ensure that this happens remains to be seen.

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52 The Making of Tax Law, para 3.2, CIOT, June 2010 *www.tax.org.uk/resources/CIOT/Documents/2010/09/themakingoftaxlaw.pdf*

53 Select Committee on Economic Affairs, 2nd Report of Session 2007–08, The Finance Bill 2008 *www.publications.parliament.uk/pa/ld200708/ldselect/ldeconaf/117/117i.pdf.*

54 Making Taxes Simpler - The final report of a Working Party chaired by Lord Howe of Aberavon (July 2008) *www.tax-news.com/asp/res/makingtaxessimpler.pdf.*

1.8 The future

The announcement of policy changes a year ahead of implementation, to allow for consultation, is a welcome development. The 2011 Budget contains two such announcements which affect the themes of this book.

The June 2010 budget provided:

> 1.98 As announced in the Coalition Agreement, the Government will review the taxation of non-domiciled individuals. This will assess whether changes can be made to the current rules to ensure that nondomiciled individuals make a fair contribution to reducing the deficit, in return for greater certainty and stability for those bringing skills and investment to the UK.

Of course just as in the review over period 2003-2008, the outcome of any review will turn primarily on the views and political power of those carrying out and ultimately implementing the review. The result of this review appears in the 2011 budget:

> **3.7 Review of non-domicile taxation —** At the June Budget 2010, the Government confirmed that it would review the taxation of non-domiciled individuals. There is currently a beneficial tax regime for non-domiciles regardless of how long they have been resident in the UK. However, the rules mean that foreign income and gains are taxed if they are brought to the UK and this is a disincentive to inward investment. The Government will introduce the following reforms:
> • remove the tax charge when non-domiciles remit foreign income or capital gains to the UK for the purpose of commercial investment in UK businesses;
> • simplify some aspects of the current tax rules for non-domiciles to remove undue administrative burdens; and
> • increase the existing £30,000 annual charge to £50,000 for non-domiciles who have been UK resident for 12 or more years and who wish to retain access to the beneficial tax regime (the remittance basis). The £30,000 charge will be retained for those who have been resident for at least seven of the past nine years and fewer than 12 years.
> The Government will be consulting on the detail of this measure. It will issue a consultation document in June. The Government intends to

implement these reforms from April 2012.[55]

The other important change on the horizon is a statutory residence test.

1.9 Stability?

Alistair Darling (then Chancellor of the Exchequer) said in his budget speech 2008:

> There will be no further changes to this regime [for foreign domiciliaries] for the rest of this Parliament or the next.[56]

This was only lip-service to the desideratum of stability and no-one seriously believed it.[57] In the 2008/09 edition of this work I said:

> The statement is constitutionally wrong, as Parliament cannot bind its successor. But leaving aside (if one can) constitutional fundamentals, it would be rash to rely on it. On the contrary, I predict that further tinkering (at least) is likely as the effect of the present rules gradually becomes evident.

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55 HMRC "Overview of Tax Legislation and Rates" (23 March 2011).
The Budget 2011 predicts that these reforms will have the following effect:

Year	2011/12	2012/3	2013/14	2014/15	2015/16
Yield	£0	£0	£110m	£70m	£50m

I find it difficult to see how these figures could be derived and doubt if they should be taken seriously.

56 *www.hm-treasury.gov.uk/budget/budget_08/bud_bud08_speech.cfm*.

57 The House of Lords Economic Affairs Committee said:
"227. In his Budget Statement, the Chancellor promised that the rules in this area would not be substantially revised for the rest of this or the next Parliament. We do not take this to mean that there will not be legislation in coming Finance Bills to address defects in the current legislation. We think it inevitable that, given the evident pressure under which this legislation was produced, there will be such defects." 2nd Report of Session 2007–08, The Finance Bill 2008 *www.publications.parliament.uk/pa/ld200708/ldselect/ldeconaf/117/117i.pdf*.
In the Consultation Document "Modernising Powers, Deterrents and Safeguards: Tackling Offshore Tax Evasion" 9 December 2009 para 4.43 HMRC tactfully misquoted the then Chancellor, saying "At Budget 2008, the Chancellor of the Exchequer gave a commitment that there would be no *significant* changes to the *policy underlying* the remittance basis for the lifetime of that Parliament and the next."

The FA 2009 did just that, with more tinkering in the F(no.1) A 2010 and a rewrite of the offshore fund rules.

The 2011 budget has another promise of stability:

> There will be no other substantive changes to these rules for the remainder of this Parliament.[58]

The coalition government (correctly) does not promise to bind the next Parliament. The promised period of stability is therefore for three years, from 2012 (assuming the proposed 2012 changes are enacted on schedule) until 2015 (assuming Parliament lasts the full 5 year period).

58 HMRC "Overview of Tax Legislation and Rates" (23 March 2011) para 3.7.