Not quite the same

KEVIN SLEVIN explains why advisers should be aware of a tax planning opportunity for non-domiciled parliamentarians.

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Tax practitioners worried about being sued for failing to provide proper and timely advice should be aware that there is yet another pitfall lying in wait for the unsuspecting adviser. The question is this. Have you overlooked the tax provisions contained in the Constitutional Reform and Governance Act 2010 (CRGA 2010)?

In passing this statute, Parliament decided that there should be a one-off opportunity for each member of a small group of individuals to ring fence some or all of their assets and exclude them from the charge to inheritance tax in the UK. The people in question are those MPs and members of the House of Lords whose place of domicile (ignoring CRGA 2010) is outside the UK. These non-domiciliaries, if they take steps at the right time, can still achieve substantial tax savings.

When these matters were being deliberated upon it must have been felt that, while the national press coverage was suggesting the changes introduced in the spring of 2010 would result in all those sitting in the Houses of Parliament having to pay the same taxes as the rest of the UK resident and domiciled population, those not domiciled in the UK (ignoring CRGA 2010) should be given the choice as to which of their assets, if any, should attract inheritance tax – as explained below. The national press coverage helped create the outward appearance of a more onerous regime, when what was actually happening still left all non-domiciliaries with attractive tax planning options. This is so despite the fact that the Government's notes published with the CRGA 2010 refer to a statement made on 16 December 2009 by the Leader of the House of Commons in which it was announced that the Government intended to 'bring forward legislation to provide that MPs and members of the House of Lords should pay UK tax in the same way as the vast majority of taxpayers in the UK'.

As the constitutional reform legislation was progressing through Parliament it could be argued that there was a clear conflict of interest. However, this article is not about the rights or wrongs of our parliamentarians deciding to perpetuate a particular tax avoidance opportunity for non-domiciliaries. Rather, it is about highlighting the need for practitioners to be alert to the issues enabling them to timeously advise their clients as to the options open to them – options which cease to apply once CRGA 2010 becomes relevant.

KEY POINTS

- Would-be parliamentarians who are non-domiciled can set up excluded property settlements.
- IHTA 1984, s 48 is not affected by CRGA 2010.
- Transfers between spouses need to be considered carefully.
- Double tax agreements may grant exemption from inheritance tax entirely, e.g. India and Pakistan.

What CRGA 2010 does

It is not unheard of for a tax measure to be introduced in legislation other than one of the many finance acts. In this instance, as a consequence of CRGA 2010, for the tax year 2010/11 and subsequent tax years, any person who is an MP or a member of the House of Lords for any part of a tax year is to be regarded as resident, ordinarily resident and domiciled in the United Kingdom for the whole of that year for income tax, capital gains tax, and inheritance tax purposes. In the event of an individual ceasing to be an MP or a member of the House of Lords this deemed taxed status ceases to apply with effect from 6 April following cessation (unless, say, an MP is elevated to the House of Lords). Transitional provisions operated in April 2010 for existing members of the House of Lords at the point when the act came into force.

In my article 'Pulling the wool over our eyes' (see *Taxation*, 29 April 2010, page 6) I explained, in very brief terms, how timely use of the valuable relief found in IHTA 1984, s 48 operates to assist UK residents about to lose their overseas domicile. This is a valuable relief for non-domiciliaries facing the prospect of their domicile becoming situated in the UK, either as a matter of fact or (the more likely situation) where the individual is reaching the point of being deemed to be domiciled in the UK under the so-called 17-year rule found in IHTA 1984, s 267. Tax practitioners need to be alert to the tax planning opportunities afforded by s 48.

What the CRGA 2010 provisions referred to above do is create another situation in which an individual will be deemed to have a domicile situated in the UK. Those joining the House of Lords or standing for election to the House of Commons face exactly the same issues as those approaching a deadline under the 17-year rule. They can exploit s 48 in the same way.

Excluded property settlement

So what is s 48 about? Broadly, IHTA 1984, s 5(1) defines a person's taxable estate on death. It states in particular that 'the estate of a person . . . does not include excluded property'. Accordingly, the value of the excluded property is not added to the value of the remainder of the deceased's property for IHT purposes.

Inheritance Tax Act 1984, s 48 defines 'excluded property' and, in particular, subsection 3 states:

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

Therefore, s 48 continues what is arguably the major tax planning advantage to be enjoyed by non-domiciliaries, namely the ability to establish a non-resident settlement comprising assets which can properly be regarded as 'excluded property' for IHT purposes – and, therefore, exempt from IHT. It will be noted that under s 48 the test is to be applied to the settlor at the date the settlement was established. It does not matter that the settlor has subsequently become domiciled in the UK (whether actually or under a deeming provision such as IHTA 1984, s 267 or under CRGA 2010).

Accordingly, the IHT tax planning involves establishing – before the change in domicile status – a non-resident settlement owning assets situated outside the UK (but see below regarding ownership of UK assets too).

Gifts with reservation of benefit

Matters involving individuals with a place of domicile situated outside the UK are seldom as simple as the previous paragraph may suggest and advisers must look at many issues, including gifts with reservation of benefit (GWR) under FA 1986, s 102. The good news here for non-domiciliaries is that HMRC appears still to accept the view that s 102 will not normally apply to foreign situs assets. Just what is a foreign asset needs to be viewed in the light of the particular structure engineered for the settlor on a case-by-case basis. For example, a non-domiciliary settlor may place £1 million cash into an offshore trust fund which the trustees invest by acquiring shares in a non-resident company established outside the UK. The directors of the company may then invest the funds by acquiring a property in the UK. The asset held by the non-resident trustees will be the shares in the overseas company, not the underlying asset, and will therefore be excluded property.

Nothing should be taken at face value here and input from an experienced barrister is normally called for to make sure no problems arise with GWRs or the pre-owned assets regime.

Tax engineering

This use of s 48 is well-known. If the necessary steps are complied with, a non-domiciliary can effectively select which assets, if any, he or she will expose to UK inheritance tax. This article is written to highlight the fact that the application of the CRGA 2010 presents another occasion when – providing the appropriate steps are taken at the right time – matters can be engineered to good effect for the client. It is all a matter of the individuals being in a position to engineer the desired outcome. Tax engineering somehow sounds more sinister than

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'tax avoidance' but the clear intention of Parliament, when introducing IHTA 1984, s 48 and CRGA 2010, s 41 to s 42, was to present non-domiciliaries with a special tax break. It is the task of tax practitioners to ensure that their relevant clients are made aware of the situation so that they may take full advantage of what Parliament has offered them.

Double tax treaties

The UK has double tax treaties addressing IHT issues with a limited number of countries. Their impact varies but readers should in particular be aware of both the Indian and Pakistan agreements. The effect of these is that the UK deemed domicile rules of IHTA 1984, s 267 referred to above cannot be applied to tax in the UK the worldwide assets of someone who dies with an Indian or Pakistani domicile as determined under local law. This appears to be so even though it is understood that there is no tax charge corresponding to IHT in either of these countries!

Indeed, while HMRC's view on this is not known, it does appear that all the double tax treaties will have the potential to override the effect of CRGA 2010 for inheritance tax purposes.

Whether it will prove to be prudent to rely on the continuation of a double tax treaty is a matter only time will tell but, as things stand, in a case involving an MP domiciled in, say, India, the UK inheritance tax impact of CRGA 2010 could well be totally overridden by a relevant double tax treaty.

What is more, a treaty covering UK income tax and capital gains tax, in relation to overseas income and capital gains on overseas assets, could well override the effect of CRGA 2010 as regards these taxes. For example, a Lord or Lady able to demonstrate that his or her 'centre of vital interests' is situated in Canada rather than in the UK under Article 4(2) of the Double Tax Treaty or that Article 4(2)(c) operates to determine how he or she shall be treated as resident in Canada.

Spouse transfers

It is well know that there is a difficulty within the inheritance tax provisions covering the treatment of transfers of assets between spouses (and civil partners) where the party wishing to make such a transfer is considered to be domiciled in the UK while the recipient spouse is not.

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Broadly speaking, where a spouse or civil partner considered to be domiciled in the UK wishes to make a transfer to his or her non-domiciled spouse/civil partner, only the first £55,000 of such a transfer is exempt under IHTA 1984, s 18. There is no such restriction where the transferor is domiciled outside the UK or both spouses are domiciled abroad. For this purpose, the deemed domicile provisions of either IHTA 1984, s 267 or CRGA 2010 are taken into account.

Therefore, where it is thought that the provisions of CRGA 2010 will operate to deem one spouse as domiciled in the UK while the other remains domiciled elsewhere, careful attention to the timing of intra-spouse transfers is essential. For example, if, before becoming an MP, Fred and his wife are both domiciled outside the UK but it is anticipated that Fred will soon be deemed to be domiciled here under CRGA 2010 (i.e. if he wins the election in which he is standing), it will clearly make sense for any transfers by Fred to his wife to be made before the beginning of the tax year in which the election is held. After the start of the tax year in which he is elected, any gift made by Fred to his non-domiciled wife will only be exempt to the extent of £55,000 (this is a cumulative lifetime figure). In the event of the gift becoming a failed potentially exempt transfer due to Fred's death within seven years, the gift will attract IHT. Clearly, early consideration of the possibility of, say, equalisation of assets is something which should be addressed (as well as possibly establishing an offshore trust). Contemplation of increased life insurance cover should also be on the agenda. The good thing is that, assuming Fred loses his seat at the next election, his non-domicile status will revert, unless by that point the 17-year rule referred to above applies. Despite this, any gift by Fred to his wife during the period in which he is deemed to be domiciled in the UK under CRGA 2010 will not be an exempt transfer within s 18, though no problem arises unless the donor dies before seven years has elapsed following the making of the gift.

If we now assume that Tom is wealthy and domiciled here and that it is his non-domiciled wife who is expected to win an election to become an MP, CRGA 2010 may operate to allow Tom to make exempt gifts to his wife during the period in which she has a deemed domicile in the UK.

However, it is important not to forget that a double taxation treaty operating so as to override CRGA 2010 (discussed above) will apply equally to the restriction in IHTA 1984 s 18.

Conclusion

Practitioners acting for budding members of both the House of Lords and the House of Commons need to make themselves aware of CRGA 2010 and its possible implications for their clients. Consideration of the possible establishment of an excluded property non-resident settlement should take place in advance of the start of tax year in which the new status is expected to be brought about by CRGA 2010. With proper care and attention – and ideally the support of a specialist tax barrister – it should be possible to prevent non-domiciliaries taking their place in the Houses of Parliament from also becoming voluntary taxpayers.

Reverting to the 16 December 2009 statement by the then Leader of the House of Commons referred to in the introduction above, readers might not think, having read this article, that the new legislation really does provide for non-domiciled MPs and members of the House of Lords 'to pay UK tax in the same way as the vast majority of taxpayers in the UK'. As the fictional politician Francis Urquhart might say, 'you might think so, but I could not possibly comment'.

Kevin Slevin is an independent taxation consultant, author and tax lecturer. He can be contacted by email at: kevin@slevinassociates.co.uk.
Kevin's publications include *Entrepreneurs' Relief: A Guide for Accountants* and *The Enterprise Investment Scheme*.