

FOREIGN DOMICILIARIES COMING TO THE UNITED KINGDOM: AN UPDATE ON PRACTICAL TAX PLANNING

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The favourable tax regime in the UK for foreign domiciliaries has encouraged many foreigners in recent decades to make the UK their temporary home. For many such individuals the remittance basis of taxation, the exemption from Capital Gains Tax (CGT) on gains of non-resident settlements under s.86 TCGA 1992 and the Inheritance Tax (IHT) excluded property settlement rules at s.48(3) IHTA 1984 have rendered the payment of UK tax optional. It is unsurprising that the UK should have become a popular choice of residence for wealthy foreigners, with the obvious tax advantages supplemented by relative political and social stability and a rich cultural heritage. Nevertheless, when the OECD published its list of ‘harmful tax practices’² in 2000, the tax regime in the UK for foreign domiciliaries was not included on it.

In April 2002, goaded into action by a persistent campaign in the broad sheet press in the run-up to the 2002 Budget, the Chancellor announced a review of residence and domicile as it affects UK taxation. Many within the profession assumed that this announcement presaged reform which would result either in the withdrawal of the benefits of the regime or, at the very least, a substantial limitation in their scope and duration. There is no doubt that this announcement, and the uncertainty which it created, led to a reduction in the influx of wealthy foreigners. Some postponed their plans to relocate, preferring to await the outcome of the Government’s review. Others have chosen an alternative location, Switzerland with its lump sum (‘forfait’) basis of taxation proving an attractive choice.

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² Towards Global Tax Co-operation (the 2000 Report) - OECD June 2000

Although this uncertainty still prevails more than three years later, there are now more foreigners who are prepared to commit themselves and their families to a move to the UK if an increase in client activity in this area is a reasonable basis on which to form a judgment. Undoubtedly, the failure of the review thus far to translate into reform has provided encouragement and greater confidence, although only time will tell whether this is misplaced. In the meantime, we are now having to look again at the tax planning which can be undertaken for these individuals in the period leading up to their arrival in the UK. Many of the considerations remain unchanged and are familiar territory for advisers practising in this area. There are also new issues to tackle, such as the EU Savings Tax Directive and, of course, the pre-owned assets tax regime which could affect planning for foreign domiciliaries. An increasing number of clients are insisting upon the inclusion of hedge funds within an investment portfolio and, in some cases, upon the adoption of an absolute return strategy made up exclusively of offshore funds without 'distributor status'. This creates challenges for effective tax structuring, particularly where the investments are held by non-resident trustees.

The purpose of this article is to 'dust-off' the subject of pre-arrival tax planning for foreign domiciliaries and take a practical look at some of these issues, particularly those which are new or which need to be regarded from a slightly different perspective.

Timing of pre-arrival planning

Pre-arrival tax planning is best undertaken prior to the tax year in which the foreign domiciliary establishes residence in the UK. Any cash which the individual has on 5 April prior to the tax year in which residence commences is regarded as capital which can be brought to the UK without a UK tax charge. It therefore makes sense to anticipate cash requirements for major expenditure in the UK and set it aside. If the individual is coming to the UK under the investor category of immigration, he will need to bring £1,000,000 into the UK and this needs to be planned with great care so that, wherever possible, the cash is raised and set aside for the purpose in the tax year preceding the year of arrival. It should always be borne in mind that currencies other than sterling are potentially chargeable assets for CGT purposes. Cash capital reserved for use in the UK should therefore be maintained in sterling.

The luxury of planning in the tax year preceding arrival is not always available. Where this is not possible, it is necessary to consider how investment income and gains in the year of arrival are subject to tax. Guidance is given in H M Revenue & Customs ('the Revenue') booklet IR20.

Overseas investment income

If untaxed overseas investment income is received in the tax year of arrival, it is clear from IR20 (Chapter 6.20) that if the source of the income is closed before the individual arrives in the UK, the Revenue accepts that the income may be remitted to the UK after arrival without a charge to UK tax. It is therefore worth reviewing overseas income sources pre-arrival to consider whether it is appropriate to terminate sources of income if it is intended to use this cash to fund UK expenditure.

Capital Gains

Extra Statutory Concession D2 sets out the basis for exemption from CGT for pre-arrival gains where the taxpayer has been neither resident nor ordinarily resident in the UK in the five tax years preceding arrival. Reliance on this concession needs to be regarded in the context of the Revenue's statement on use generally of concessions:

'A concession will not be given in any case where an attempt is made to use it for tax avoidance'³.

This is not the place to analyse the meaning of 'tax avoidance'. Wherever the boundary between 'tax avoidance' and 'tax mitigation' lies, the simple realisation pre-arrival of an investment asset for cash, and the remittance of that cash to the UK either pre or post-arrival, should not be regarded as an exercise in tax avoidance which ought to disturb application of the concessionary treatment. A more extensive exercise, such as the rebasing of an entire investment portfolio in the pre-arrival period, would be more vulnerable to withdrawal of the concession. Settlement of a foreign investment portfolio on trust may be a more effective method of achieving a rebasing without having to rely on ESC D2.

In the context of the timing of pre-arrival planning, it is essential to have full regard to the tax status of the individual prior to establishing UK residence, and indeed afterwards in some instances. This will normally require the UK tax adviser to work closely with foreign tax professionals to ensure that execution of effective UK tax planning is not creating foreign tax liabilities. Inheritance laws will also need to be considered, and if establishing a trust for an individual from a civil law jurisdiction, care will need to be taken to avoid difficulties with non-recognition of trusts and forced heirship provisions. If transfers of foreign real estate assets to a trust or company are being contemplated, local advice is essential since some jurisdictions place restrictions on property ownership where failure to comply could result in confiscation.

³ Inland Revenue booklet IR1 'Extra-Statutory Concessions'

Even after establishing residence in the UK, UK tax is unlikely to be the only fiscal exposure which the individual has. US citizens and Green Card holders are liable to US tax on worldwide income and gains even if resident outside the US, subject to Double Taxation Agreements. Other jurisdictions, such as Germany, have 'tax shadows' which bring gifts within charge to local tax within a fixed period following departure. It is crucial to appreciate that for this type of international client, one cannot advise on UK tax in isolation.

Foreign domiciliaries and trusts

There are two principal tax benefits which make trust structuring an important feature of conventional pre-arrival tax planning for foreign domiciliaries:-

- (i) S.48(3) IHTA 1984 provides that where a settlor was not domiciled in the UK when the property was added to the trust, the trust assets will be excluded property, outside the scope of UK Inheritance Tax (IHT), as long as they are situated outside the UK. Put simply, the trust will be an IHT free pot as long as it owns no UK situated assets. There now exists a degree of uncertainty as to whether this continues to apply where the transfer to the trust would otherwise fall within the Gift with Reservation (GWR) provisions and the settlor subsequently becomes UK domiciled, either under general principles or under the IHT deeming provisions at s.267 IHTA 1984. This apparent conflict between an exemption and an anti-avoidance provision was thought to have been resolved at an early stage by the publication in December 1986 of correspondence with the Controller of the Capital Taxes Office⁴ which confirmed the Revenue view that the excluded property exemption at s.48(3) superseded the GWR provisions. Within the last three years, the Revenue has made it clear in correspondence that they now regard this originally published view to have been more generous than the legislation warrants. No formal reinterpretation has been published but it can be anticipated that this permanent exemption would be one of the areas tackled as part of a general reform of the foreign domiciliaries tax regime, should this happen.
- (ii) S.86 TCGA 1992 (attribution of gains to settlors) and s.87 TCGA 1992 (attribution of gains to beneficiaries) form the main thrust of the legislative code to prevent avoidance of CGT by UK taxpayers through the use of non-resident trusts. Neither section applies where the individual to whom the gain might otherwise be attributed is not domiciled in the UK. A non-resident trust therefore confers two CGT

⁴ Law Society's Gazette, 10 December 1986

advantages on the foreign domiciliary, by comparison with the taxing provisions which apply to personally owned assets:

- The trustees may realise capital gains and then distribute capital to the UK resident foreign domiciliary without a charge to CGT, even if the cash distributed is received in the UK.
- The trustees may realise capital gains on UK situated assets, which can be distributed to the foreign domiciled beneficiary without CGT. If held personally, capital gains on UK assets would be subject to CGT on an arising basis, with no protection of the remittance basis.

A trust can therefore provide a combination of long term IHT protection (for non UK situated assets retained on trust) and an absolute CGT saving, even where capital is paid to the foreign domiciled beneficiary in the UK.

Type of Trust

The type of trust will be determined by the individual's circumstances. A discretionary trust will often provide the greatest flexibility for the individual and his family, and will also ensure that an initial life interest for the settlor or his spouse will be avoided. This is important, since s.80 IHTA 1984 provides that where the settlor or his spouse is entitled to an immediate interest in possession, a separate trust is treated as commencing on expiry of that interest in possession or, if the trust provides for successive interests for the spouses, on expiry of the second interest in possession. The deemed settlor of this separate trust is the individual whose interest in possession expired, either the original settlor or his spouse, as the case may be. S.82 IHTA 1984 then provides that the excluded property exemption at s.48(3) IHTA 1984 will only apply to the 'separate' trust if both the actual settlor was foreign domiciled when the original trust was created and the deemed settlor of the separate trust was foreign domiciled when the separate trust came into being.

It should be noted that these provisions apply only for the purposes of 'this chapter', being Chapter III of IHTA 1984 which deals exclusively with the IHT charging provisions for settlements without interests in possession. S.82 IHTA 1984 will not apply for as long as the trust continues to be held subject to interests in possession, so the original excluded property benefits conferred by s.48(3) IHTA 1984 can be preserved, even with an initial life interest for the settlor or his wife, if the trust provides for successive life interests for the spouse,

the children, the grandchildren etc. This approach does, however, lack flexibility.

The more conventional approach is therefore to establish a discretionary trust, provided that the assets to be settled are non-UK situated. Shortly afterwards, the trustees may appoint an interest in possession without invoking the s.80 provisions, since this interest in possession over the property will not have been in effect *immediately* after the property becomes comprised in the settlement. A trust subject to an interest in possession will often be a more appropriate structure for a foreign domiciliary if it is to be used to fund UK expenditure. Income subject to an interest in possession belongs to the beneficiary and, as such, cannot be 'relevant income' for the purposes of s.740 TA 1988 or 'available income' under s.633 ITTOIA 2005 (formerly s.677 TA 1988).

Segregation of income from capital within the trust

The trust established for the benefit of the foreign domiciliary arriving in the UK will in most circumstances be a trust where the settlor retains an interest for the purposes of s.624 ITTOIA 2005 (formerly s.660A TA 1988). Furthermore, the transfer of assets to the trust will generate income over which the transferor will in all likelihood be regarded as retaining 'power to enjoy', and s.739 TA 1988 will thus be in point. These two provisions have the same effect of treating the income as being the income of the settlor/transferor, although the Revenue has confirmed that it will not in practice invoke both provisions in relation to the same income⁵. To preserve the ability of the trustees to pay out capital to the foreign domiciliary which cannot be regarded as including any element of income deemed to be his under s.624 ITTOIA 2005 or s.739 TA 1988, it is crucial that the trustees segregate income from capital within the trust. This is straightforward enough to do where the income is bank interest, dividends or rent. However, there can be difficulties with income segregation in two areas in particular:

- (i) Where fixed interest securities are sold other than on an interest payment date, the accrued income scheme will operate to deem the proceeds on sale as containing an element of accrued income. Note that a foreign domiciliary is not subject to the accrued income scheme on personally held non-UK investments by virtue of s.715(1)(j) TA 1988, but this exemption does not appear to extend to securities held by trustees which are subject to an interest in possession in favour of a foreign domiciliary. The trustees must instruct the investment manager to segregate the accrued

⁵ Inland Revenue Tax Bulletin 40 (April 1999)

income element within the brokerage account and pay it directly to the portfolio income account, with the capital balance being paid to the portfolio dealing account. If this segregation cannot be achieved within the brokerage account, then instructions must be given to debit the portfolio dealing account immediately with a sum equal to the accrued income element which will be transferred to the portfolio income account.

- (ii) The disposal of certain types of investment gives rise to an income gain rather than a capital gain. The burgeoning popularity of hedge funds has brought this issue to the fore in recent years, since nearly all hedge funds are 'non-qualifying offshore funds' within the definition of s.760 TA 1988. Gains on the realisation of such investments are deemed to be offshore income gains. It is clearly not possible to separate out the income gain element from the capital proceeds of realisation.

S.762 TA 1988 modifies the taxation of offshore income gains where they arise to non-resident trusts. In effect, s.762 provides for the establishment of a pool of offshore income gains and then imports the s.87 TCGA 1992 charging provisions so that beneficiaries receiving capital payments are charged to income tax by way of attribution. Fortunately for the foreign domiciled beneficiary, the exemption from CGT on attribution of capital gains under s.87 TCGA 1992 applies equally to the attribution of offshore income gains under s.762 TA 1988. Therefore, as long as the s.762 provisions apply to the offshore income gain, the foreign domiciled beneficiary has nothing to fear.

However, offshore income gains remain income for the purposes of s.624 ITTOIA 2005 and s.739 TA 1988. S.762(6) TA 1988 clarifies that neither s.624 ITTOIA 2005 nor s.739 TA 1988 will apply 'to the extent that' an offshore income gain is treated (by way of attribution) as having accrued to a UK resident individual, even if, having accrued to the individual, it is then exempt by virtue of his foreign domicile status. It is thus crucial to ensure that once the offshore income gain is realised by the trustees, it is then treated as accruing to the foreign domiciled beneficiary so as to preclude a charge under s.624 ITTOIA 2005 or s.739 TA 1988. There is more than one interpretation as to what needs to be done to secure this treatment. The 'safe' view is that provided the offshore income gain has been identified and a capital payment made which 'franks' the gain by 5 April in the tax year of realisation, this will be sufficient to ensure that the s.762 TA 1988 charging provision applies in priority either to s.624 ITTOIA 2005 or s.739 TA 1988.

The trust remains an essential feature of pre-arrival tax planning for the foreign domiciliary, but it is important to avoid restricting the IHT benefits by overlooking the s.80 IHTA 1984 pitfalls described above. It is also important to ensure that, once established, the trust is administered rigorously, particularly as regards the segregation of income from capital so that its tax efficiency is not eroded. It is generally to be recommended that the UK tax adviser provides the trustees with a detailed set of guidelines setting out any investment restrictions which may be required, together with a *modus operandi* explaining how segregation should be achieved across the accounts operated within the trust.

Establishing the banking arrangements

Many foreign domiciliaries will have a requirement for banking facilities outside the UK. The extent and complexity of their requirements will depend on their personal circumstances and will be different in each case. In terms of tax planning, this is a well trodden path which does not warrant extensive coverage here, other than to highlight a few points of good housekeeping:

- If it is intended to ‘capitalise’ an offshore income account by using the ceasing source principle, ensure that the only income on the account derives from the source which is to be closed. The classic example is capital and income accounts held at the bank where the income account includes not just interest mandated from the capital account but assorted other income besides.
- In establishing income accounts, consider whether income itself should be segregated so that interest and foreign dividends which have suffered withholding tax are held separately from income which has not suffered tax at source. Credit against UK tax will be available for foreign taxes on a remittance, and it will invariably be cheaper to remit from taxed income than untaxed income.
- Where an income account contains a mixture of income taxable on the arising basis (principally, UK or Eire source income) and foreign income taxable on the remittance basis, the Revenue will accept that remittances come out of the former first⁶.
- Detailed instructions should be provided to the bank for operating the accounts. If a mistake is then made and funds are credited to the wrong

account, it may be possible to rectify the error by relying upon the ‘banking error concession’⁷. However, this will only be possible if the error is identified swiftly and appropriate action taken as soon as it is discovered. The bank must be made aware of this.

- If the foreign domiciliary requires the offshore bank to issue him with a credit card, he must be instructed in its correct usage. If he uses this credit card for UK expenditure, the settlement of the credit card bill using a non-UK income account would be a constructive remittance to the UK. It is of course crucial that the credit card company is not itself a UK entity. If it is, the use of the card will create a contractual obligation between the foreign domiciliary and a UK company, and subsequent settlement of the bill using offshore funds will constitute a remittance. It is a relatively common error for an offshore bank to issue what is effectively a UK credit card. This is an area which the Revenue currently appears to be reviewing with increasing regularity in the context of self-assessment enquiry activity.

Effect of the EU Savings Tax Directive

A further factor to consider which is of current topical interest is the effect of the EU Savings Tax Directive, implemented from 1 July 2005. The Crown Dependencies of Jersey, Guernsey and the Isle of Man along with the British Virgin Islands have decided to follow the EU member states Austria, Luxembourg, and Belgium in applying a withholding tax to interest arising within their territories during a seemingly open-ended ‘transitional period’, rather than opting for automatic reporting of interest to the member state of the individual’s residence. If it is the individual’s preference, the withholding tax can be avoided if he elects for reporting of the interest or obtains a certificate from his tax authority confirming that reporting is not required. Switzerland has made the same choice, although others, including Cayman, have opted for automatic exchange of information. The rate of withholding tax will start at 15% for the first three years rising to 20% for the next three years and 35% thereafter.

The directive applies to an individual resident in an EU Member State who is beneficially entitled to the interest. The withholding tax or the reporting requirement therefore affects not just interest arising on a personal bank account, but also interest of a trust where a resident of an EU Member State has an interest in possession.

⁷ *Roxburghe’s (Duke of) Executors v CIR*, CS 1936, 20 TC 711

At the time of writing this article, there is a lack of clarity and also a lack of consistency in how the territories and Member States are intending to implement the directive, and even a lack of consistency in the way in which financial institutions in each territory are dealing with it. Many foreign domiciliaries have banking arrangements in one of the territories which have chosen to apply the withholding tax. Although the directive itself makes no specific reference either to foreign domiciliaries or to the remittance basis of taxation, industry guidance issued in the Crown Dependencies and also in Switzerland suggests that paying agents in those territories will not apply the withholding tax where they are satisfied that no tax liability arises in the Member state. This may be because the interest is exempt or because the individual is subject to tax only on the remittance basis and has no intention of remitting the interest to the member state. Paying agents in these territories are now in many cases writing to UK tax advisers for information which supports their clients' foreign domicile status. It therefore does seem possible that the foreign domiciliary may, by careful selection of the location for his banking arrangements, be able to arrange his affairs so that neither the withholding tax nor automatic reporting will apply to unremitted interest.

It should be observed that any benefit from this relaxed approach may be transitory, since it has not been endorsed by the Revenue. On the contrary, updated guidance notes were published on 20 June 2005 which included the following 'Frequently Asked Question' and answer:

I am resident but not domiciled in the UK. Am I within the scope of the Directive if I do not remit savings income to the UK from abroad?

The Directive makes no mention of domicile or remittance. If you are resident in the UK and you receive savings income from a territory covered by the Directive (or a related agreement) then details of the payment should be reported to the UK, or it should be subject to withholding tax. You may apply for a certificate from HMRC for the income to be paid gross. Alternatively, if tax is withheld, you may claim credit for the tax on your Self Assessment tax return.

Evidently, there is a fundamental divergence of views on this issue and it will be interesting to see if, and if so how, they are reconciled in the coming months.

Residential Property in the UK

The foreign domiciliary coming to the UK will have residential property requirements. In cases where the UK property will qualify for Principal Private

Residence exemption on a later sale, there is no CGT advantage in using a trust structure as a holding vehicle for such a property. A trust may, however, be appropriate either where the individual has retained a residence in his country of origin or where he is buying two residences in the UK, typically one in London and the other in the country. Where a trust is used to hold UK residential property occupied by the non-domiciled settlor and his family, it is preferable that the trust be used exclusively for this purpose rather than holding income producing assets as well. This will preclude the possibility that the beneficiaries might pay income tax on the benefit of rent-free occupation by virtue of s.633 ITTOIA 2005 or s.740 TA 1988.

The IHT problems associated with UK property ownership are now less easily dealt with. Following the House of Lords' decision in *Dimsey and Allen*⁸, it is now generally accepted that in all but rare cases, the risk of a substantial income tax liability based on the accommodation benefit at s.106 ITEPA 2003 rules out the use of a non-resident company as an ownership structure. The most pragmatic approaches now appear to be one of the following:

1. Accept the risk of the IHT charge, but insure against it. If the foreign domiciliary is in the UK for a predictable and relatively short period, term assurance can be taken out to cover the IHT liability which would arise in the event of his death whilst still owning the property. If the length of his stay is less clear, whole life insurance can be used. In either case, the policy would be written in trust to ensure that in the event of a pay out, the policy proceeds would remain outside his estate. The risk can be reduced with married couples by ensuring that on the first death, the inter-spousal exemption applies on transfer of the property to the survivor.
2. Seek to reduce the value of the UK property by using debt. This can be achieved by raising loan finance from an offshore lender which will reduce the value of the UK property for IHT purposes provided that it is secured against it (s.162 IHTA 1984). This method has the further advantage that 'relevant foreign income' (s.830 ITTOIA 2005) arising to the foreign domiciliary which is taxable on the remittance basis can be used to pay the interest on such a loan without resulting in a remittance. In contrast, any use of this income to repay the capital of the loan would be regarded as a remittance.

It may still be possible to achieve an IHT efficient holding structure using internally created debt rather than external loan finance, which has the obvious advantage of not requiring the payment of interest to a third

⁸ *R v Allen*, HL (2001) STC 1537

party. Barry McCutcheon in his article entitled 'Foreign Domiciliaries: the impact of the Pre-Owned Assets Regime' ([2005] PCB, Jan/Feb) reviews the two trust structure. In this arrangement, the property is acquired by an interest in possession trust (the house trust) funded by a loan from a foreign company owned by a second trust (the debt trust). Both trusts are created by the foreign domiciliary. For IHT purposes, the value of the UK property owned by the house trust which falls within the foreign domiciliary's estate is reduced by the borrowings from the debt trust, so that it is only value in excess of the debt which is subject to IHT. The debt trust itself will own only excluded property, being the shares in the underlying company. McCutcheon's view is that provided that the debt trust is itself an interest in possession trust, the arrangement will not, in overall terms, have reduced the value of the foreign domiciliary's estate for the purposes of the Pre-Owned Assets regime. This is on the basis that the value of the debt, as reflected in the share capital of the company making the loan, and the corresponding reduction in value of the property are equal. Therefore, the debt would fall outside the excluded liability provisions at FA2004, Schedule 15 para 11(6). Certainly, this is the most logical interpretation of the way in which para 11(6) was intended to operate although it may not be the only interpretation, as explained below.

Pre-Owned Assets Regime

It is encouraging generally that the regime contains a series of reliefs and exemptions which, in most circumstances, will mean that for one reason or another the UK resident foreign domiciliary will not be caught. Although the subject is far too wide to deal with at any length (anyone interested in this subject should read the McCutcheon article referred to above), it is worth running through the exemptions and reliefs in brief and highlighting the way in which they affect foreign domiciliaries:

- Where the individual is non-UK domiciled (meaning neither actually domiciled nor deemed domiciled under s.267 IHTA 1984), the regime does not apply to property situated outside the UK.
- Where property is settled on trust and the individual was not domiciled (or deemed domiciled) at that time, the regime does not apply to that individual in relation to non-UK situated assets on trust, even if he has subsequently become UK domiciled.

- Where the property falls within the individual's estate, the regime does not apply. This exemption includes property on trust which is subject to an interest in possession, even if it is excluded property. The rationale is that this property falls within the individual's estate until immediately before death, and only at that time does the excluded property exemption apply. This is known as the ownership exemption.
- Where the property is not a part of the estate but other property is within the estate which derives its value from it, then the regime does not apply. This is known as the derivative ownership exemption. It would apply to assets, including UK assets, held by a non-resident company which is in turn owned by an interest in possession trust. The value of the assets is reflected in the value of the company's shares, and the company's shares are included in the individual's estate by virtue of the interest in possession.
- Where the property is subject to the GWR provisions, the regime does not apply. Property owned by a discretionary trust which is excluded property under s.48(3) IHTA 1984 is nevertheless deemed for the purposes of this

regime to be subject to the GWR rules, even though there is no IHT charge in respect of it. This is known as the reserved benefit exemption.

- Where the property is not subject to the GWR provisions but its value is reflected in property which is, the regime does not apply. This is known as the derivative reserved benefit exemption. It covers the position where assets of a discretionary trust are held by an underlying non-resident company. Although the assets themselves are outside the GWR provisions, the shares of the company which reflect the value of those assets are within the provisions and so the exemption applies.

The application of one or more of these reliefs and exemptions will ensure that most trust and corporate structures devised as part of the planning process for foreign domiciliaries will not result in a charge to income tax under this regime. There remain areas of uncertainty for foreign domiciliaries, caused by difficulties in interpreting unclear legislation. These are:

1. Many trusts will have funded underlying non-resident companies using loan rather than share capital. This approach preserves flexibility to extract value from the company back up to trust level by repayment of the debt. The trustees' loan to the company, along with the company's share capital, would clearly qualify either for the ownership exemption or the

reserved benefit exemption, depending on whether the trust was on interest in possession or discretionary terms. However, would the value of assets owned by the company be regarded as reflected in the trustees' loan to the company in the same way that it clearly is reflected in the value of the share capital? Common sense dictates that it would be. However, it may be arguable that the value of the loan derives from the company's contractual obligation to repay it, not from the company's underlying assets. If the Revenue were to adopt this interpretation, then neither the derivative ownership exemption nor the derivative reserved benefit exemption would apply to the underlying assets of the company, save to the extent that their value is reflected in the company's share capital.

2. There is lingering uncertainty as to the scope and extent of the excluded liability provisions contained at Sch 15 para 11(6) FA 2004. An excluded liability is one where the creation of the debt and the transaction whereby the asset came to be included in the estate were associated operations. Such is the breadth of the associated operations definition (s.268 IHTA 1984) that an excluded liability could be as simple as a loan from a bank taken out by an interest in possession trust to purchase a residential property. The provisions operate to disapply the ownership exemption to the extent of value covered by an excluded liability. However, it is only invoked at all '*where at any time the value of a person's estate for the purposes of IHTA 1984 is reduced by an excluded liability...*'. It seems logical to review whether the transaction involving the excluded liability has resulted in a net reduction in the individual's estate. In the simple scenario set out above, the value of the estate before the transaction would be whatever cash the trustees had to put towards the purchase of the property, and the value immediately after the transaction would be the gross value of the property, less the excluded liability. Since the two would be the same, the provision would not apply.

However, does the legislation require one to judge whether there has been a net reduction in the estate as a result of the excluded liability only at the time of the transaction itself? The provisions apply where *at any time* the value of a person's estate is reduced by an excluded liability. If one were to review the estate, say, a week following the transaction, could it at that time be said that the value of the estate, in the form of the gross value of the property, was subject to a continuing reduction in the form of an excluded liability? If this interpretation were adopted, the scope of the provision could be considerably greater than currently envisaged and, surely, intended. It would then be necessary to revert to the formula set out in paragraph 4 and judge whether the land value exposed by the

excluded liability can ‘reasonably be attributed to’ the contribution provided by the individual. Although one would hope and expect that no charge would arise, it is rather unsatisfactory to have to rely on the somewhat subjective test of what is ‘reasonable’.

Guidance in both of these areas would greatly assist in dispelling concerns of those advising foreign domiciliaries.

Agreeing domicile status with the Revenue

When a foreign domiciliary establishes residence in the UK, it is usually desirable to agree his domicile status with the Revenue in the interests of achieving certainty for him and his family. Under current Revenue practice, there is a relatively short window in which this can be done. This practice is set out in Tax Bulletin 29 which was issued on 29 June 1997. The Revenue no longer regards itself as competent to give a domicile ‘ruling’ as such. This is a matter of law and it is for the taxpayer himself to take advice on this, draw his own conclusions and self-assess accordingly. On arrival in the UK, a claim to be non-domiciled in the UK may be made on form DOM1 or form P86. The Revenue will then undertake to advise whether they accept this claim, provided that it is made before the Revenue receives the self-assessment tax return for the tax year to which the claim relates.

This does not amount to a formal ruling, but is an acceptance by the Revenue that they will for the time being proceed on the basis that the taxpayer has a foreign domicile. This claim, once agreed, has to be renewed annually by indicating continuing non-domicile status on the self-assessment tax return. The Revenue’s method of challenging this status in the future is by way of enquiry into his claim under s.9A TMA 1970.

If the first self-assessment tax return post-arrival is submitted to the Revenue without having previously made a claim to be non-domiciled, the opportunity to achieve this degree of certainty will have been lost.

Change in the wind?

It is too early to know whether the guarded optimism of those foreign domiciliaries now coming to these shores is justified. The review process was initiated in April 2002, less than 12 months into the term of a new Government, when the political will to carry through reform might have been expected to be strong. A new term in office might now lend fresh momentum to the initiative,

but the focus most recently seems to have been not on the bigger picture but on specific areas of detail. For instance, a new Revenue interpretation was published on 21 April 2005 announcing a 'change of emphasis' in the Revenue's approach to the review of dual employment contract arrangements of foreign domiciliaries. Finance [No 3] Bill 2005 contains provisions (inter alia) targeted specifically at non-domiciliaries, ensuring that bearer shares and securities issued by companies incorporated in the UK are regarded as situated in the UK. Maintaining the status quo but targeting particular perceived 'abuses' has much to recommend it, but more general reform, be it partial or wholesale, remains an option which cannot be discounted. The case for reform on economic grounds is not proven and an exodus of influential wealth creators may be an expensive price to pay for what would be perceived generally to be a fairer system of taxation. One senses that the decision may ultimately rest on political considerations.