

TAXATION

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Squeezing the pips

The new non-domicile tax regime has been cobbled together and will be bad for UK plc, says **SIMON MCKIE**.

Mike Truman in his article, 'So Long, Farewell', *Taxation*, 21 February 2008, page 159, concluded that 'some non-domiciles have expressed the fear that this [the remittance basis changes announced in the Pre-Budget Report] may just be the start of a process which will lead to a removal of all their tax privileges; all I can say is that I hope their fears are realised.' He seems to have based this rather unsympathetic view on two independent arguments.

First, on an economic argument, the number of non-domiciliaries who will leave the UK due to the new charge has been greatly exaggerated, and that the departure of those who will go will not significantly damage the UK economy. Secondly, on a moral argument, it is morally right that non-domiciliaries should be taxed in the same way as UK domiciliaries.

Economic argument

Mike attempts to demonstrate that non-domiciliaries are not particularly important to the economic welfare of the country and, even if they are, it is unlikely that many would leave if UK taxation becomes less favourable to them. Mike's judgment of the economic effect of taxing non-domiciliaries on the same basis as UK domiciliaries is clearly not shared by the Government.

During my professional lifetime, governments of whatever political complexion have regularly examined the taxation of non-UK domiciliaries and, after making initial noises about reform have, until November of last year, always backed off from making any changes.

In opposition, Gordon Brown identified the remittance basis for non-domiciliaries as a tax loophole. But once he got into Government he spent the next ten years trying to avoid closing it until wrong-footed by the Conservative Party. He did not do so until then because of an ideological commitment to the welfare of the rich.

In support of his economic argument, Mike cites data which he concedes is limited. For example, he cites the total number of individual non-domiciliaries who pay tax on remitted income as 111,000, and he regards 'the ones who might decide to leave ...' as a subset of this figure.

That number, however, does not include those who make no returns because they pay no tax having no taxable income at all. By the nature of things, that group

KEY POINTS

- The presence of non-domiciles in the UK benefits the economy.
- The moral argument does not outweigh the economic risk of non-domiciles leaving the UK.
- Internationally mobile taxpayers truly are HMRC's 'customers'.
- A tax designed for a specific group of taxpayers could be to the advantage of the UK.
- The current reform is disappointing.

is likely to include a large proportion of the richest non-domiciliaries, because those will be the non-domiciliaries who are sufficiently rich to live off accumulated capital and to accumulate their income overseas.

Mike's economic argument seems to be predicated on the proposition that the measure of the economic loss to this country of non-domiciles moving overseas is the excess of 'the extra tax that would be paid by the non-domiciles that stay, against the tax lost with those who leave'.

The economic benefit of the residence of non-domiciliaries in the UK, however, is not just the tax which they pay into the UK Exchequer. It is also the employment and business income which they generate, the business and financial expertise which they bring to this country, the businesses which their presence attracts to the UK, their involvement in charities and the charitable donations which they make while they are here.

Charitable involvement

The significance of their charitable involvement in the provision of artworks for public display, for example, became obvious when lobbyists alerted the Government to the threat posed by its original proposals to heritage charities, which resulted in one of the Chancellor's many u-turns.



STEP research showed that over half of the UK's super wealthy had either decided to leave the country or were making contingency plans to do so.

Perhaps Mike's conclusion on this matter stems from the fact that he views what others would call serious economic damage as mere inconvenience. For example, he contemplates the relocation of 100 family-owned Greek shipping companies to Greece and the loss of £10 billion of revenue from the UK with apparent equanimity. Or perhaps it is because the article does not take account of the research published by STEP on 1 February 2008. It

certainly does not refer to that research, which showed that over half of the UK's super wealthy had either decided to leave the country or were making contingency plans to do so or to sell their UK investments. The survey revealed that UK resident non-domiciled individuals pay £7.16 billion in tax, that the UK business investments of non-domiciliaries are estimated at £125 billion and that non-domiciliaries spend £16.6 billion in the UK every year.

So it is clear that the Government takes seriously the economic benefits of attracting non-domiciliaries to the UK and the risk that changes to their taxation may result in significant numbers of them leaving. STEP's research provides evidence that, far from overestimating that net benefit and those risks, the Government has seriously underestimated them.

The moral argument

Mike's article, however, does not really rest on his economic argument. He is mainly concerned with a moral argument that it is unfair that non-domiciliaries should have special tax privileges. He does not see the questions as simply one of balancing the benefits of the increased tax revenues from those who remain against the economic losses resulting from the departure of those who do not, for he sees this approach as being based on:

'... the assertion ... that the richer you are, and the more mobile you are, the lower your average rate of tax should be.'

To this supposed underlying principle he opposes two equitable principles:

'There are two principles which are generally accepted as being fundamental to a fair tax system – horizontal equity and vertical equity. Horizontal equity says that people who are in the same position should face the same tax liability; vertical equity says that the greater your income, the greater your average rate of tax.'

But if Mike's moral argument is independent of his economic argument, then his view amounts to no more than the old view that it is better for everyone to be

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poorer provided they are less unequal; a belief in the virtue of equality of misery. I can see no virtue in equalising the taxation of domiciliaries and non-domiciliaries if the result is to make the general body of citizens poorer.

So I do not think that Mike's two principles are generally accepted at all. I see no reason why two people should be forced to pay the same price for the privilege of residing in a place, whether it is a country or a hotel room, simply because they have the same income or why one person should be forced to pay more for something simply because he has a higher income. Rather, it is appropriate that the price set by the market should be allowed best to match willing suppliers with willing buyers.

Global taxpayers

I have argued ('Towards a better tax system: Tax competition – liberation or a flaming liberty', Tax Faculty May 2000) that in a global economy where individuals are free to move between countries, tax becomes the price which a country places upon its amenities. Where taxpayers are internationally mobile, they truly become HMRC's 'customers' and not its victims. In relation to the amenities of a country or of a hotel, the market place best maximises the utility of buyers and sellers.

The principle which one hopes is generally accepted is that the Government's duty is to protect and advance the interests of the Queen and her subjects. That requires the Government to extract the largest possible advantage for the general body of citizens from allowing the privilege of

residence in this country. If we accept for a moment the rather dubious proposition that an increase in Government revenue benefits the general body of citizens, then taxation can be regarded as the balancing charge by which the Government maximises that benefit.

Mike suggests that the end result of ignoring his twin equitable principles is:

'... that the rich end up negotiating a flat amount of tax that they are prepared to pay in order that the UK can be graced by the favour of their presence, in which case you might as well go the whole hog and apply to become the twenty seventh canton of Switzerland.'

Mike obviously regards this suggestion as in some way absurd and, as a general approach to taxation, it is. The reason for that, however, is not because such an approach would be unfair but because it would be impractical. Pricing strategies which have too many variations are administratively more expensive than the additional revenues which they raise. Equally, pricing strategies which are too inflexible fail to maximise income either because they depress demand or fail to charge enough for what is on offer. Individually negotiated prices only make sense for particularly large or valuable customers.

HMRC used to set individual prices for particularly valuable taxpayers, in the form of 'forward tax agreements'. Unfortunately in *Fayed & Others v Advocate General for Scotland and CIR 77 TC 273*, it was held to be acting ultra vires in doing so.

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It will only be in small numbers of cases that it would be worthwhile concluding individual agreements. That situation is common to most large suppliers whatever they are supplying. But it often makes commercial sense to identify a group of 'customers', the common characteristics of which suit a particular pricing structure. The remittance basis rules are an example of exactly that. They identify a group of individuals who may be expected to move jurisdictions quite easily and recognises that if the UK's tax pricing structure does not recognise that mobility, it will lose those 'customers' to foreign competitors.

Blunt instrument

The remittance rules, however, have always been a blunt instrument. Mike very sensibly points out that American expatriates on five-year secondments will have weaker ties to this country than those who have been resident in the UK for a long time. He feels that the tax system should recognise the difference on grounds of fairness which are difficult to follow but there is a perfectly sensible, commercial justification for doing so. The longer a person remains here, the more likely it is that he will be settled here and therefore the more likely that he will be willing to pay a higher price for the privilege of continuing to reside here. That is precisely the approach which the Government has adopted in applying the remittance basis charge to those who have been resident here for seven of the preceding nine fiscal years.

Poorly designed pricing structure

So providing a special tax price on residence for a group of individuals defined by reference to the absence of a strong connecting factor with the UK (such as domicile) is not only rational, but it correctly fulfils the function of Government in maximising the general benefit of the Queen's subjects. It has to be said, however, that the actual system by which that is achieved, which has been developed by historical accident, is in many ways a highly irrational one.

First of all, one might argue that the concept of domicile itself is a poor identifier of mobility. There are many individuals with non-domiciled status who are highly unlikely to move from the UK. A test based on citizenship and long term residence might provide a closer correlation with the benefits which this country has to offer and might better identify the internationally mobile. Perhaps, though, the real problem lies with HMRC's policing of claims to non-domicile status.

Secondly, the remittance basis encourages non-domiciliaries to hold their wealth outside the UK rather than in it, thus providing a disincentive to the creation of UK jobs and businesses.

Thirdly, although the best pricing strategies are simple and transparent, the changes contained in the Finance Bill 2008, Sch 7 create a regime which is complex and

opaque. If a customer does not know what he has to pay for something or suspects that there are hidden costs, he will deduct a risk discount from the price which he is willing to pay for it. It would be much more sensible to provide a maximum limit on the income tax and capital gains tax liabilities of non-domiciliaries rather as is done in the Isle of Man in relation to all taxpayers.

Fourthly, the system proposed by the Government is also remarkably inflexible in creating a single point from which one moves from no charge at all to a quite significant charge. It would surely make more sense to impose a small maximum tax liability on non-domiciliaries after they have been resident for a relatively short period (say, three years) which increases year by year.

Rational tax pricing system

So, a more rational tax system for those with a weak connection with the UK would restrict the maximum tax liability of non-domiciliaries (or perhaps foreign citizens) to a modest amount (say, £5,000) and, after they have been resident for a short minimum period (say, three years,) provide that that liability would increase in smallish increments (say, £5,000) for each additional year of residence. Such a system would recognise the fact that the longer a person lives in a country, the less likely it becomes that he will move elsewhere.

It would impose a price on UK residence for those without a strong connecting factor to the UK which was clear, simple, predictable and was strongly correlated to the elasticity of demand for the privilege of residence here.

Need for accurate forecasts

The price which the Government sets on residence is important and should be based on proper evidence. If it is set too low, we shall sell the privilege of residence in this country too cheaply. If we set it too high, we shall choke off demand and fail to maximise the benefits to the UK. So the price set should have been based on a proper assessment of likely market demand. In fact, although the Government started consulting on possible changes to the domicile rules in 2002, the consultation document entitled 'Paying a Fairer Share: a consultation on residence and domicile' published in December 2007 revealed that the Government had made no reliable estimates of the effects of its proposals at all. Indeed, one suspects that the level of the remittance basis charge was set simply on the basis that it was slightly more than that proposed by the Conservative Party.

How was it for you?

How disappointing this 'reform' has been. After six years of consultation we have a hastily cobbled together system which fails virtually every test for rational tax reform, introduced in response to little more than the irrational whine of 'it isn't fair'.

Was it too much to ask for a rational and simple system based on relevant evidence? It appears that it was. ■

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