Redo from start

The new remittance basis legislation contains a fundamental flaw which could give rise to double taxation, warns SIMON MCKIE.

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EXTENSIVE REVISIONS ARE to be made to the draft legislation on the remittance basis which was published on 18 January 2008. The revisions, announced in the 2008 Budget notes, do not, however, seem to correct a fundamental flaw in the draft legislation which, on a literal reading, would result in extensive retrospective tax charges on many taxpayers. This article examines this structural flaw by reference to the simple ***Example*** below.

Under the current rules (that is before the new Schedule on remittances is enacted) one would analyse the tax consequences of these transactions as follows.

Three rules

In the House of Lords decision in *National Providence Institution v Brown* 8 TC 57, three rules were stated as applying to determine whether a remittance of income was taxable (see the illuminating discussion in *Taxation of Foreign Domicilaries* 6th Edition, by James Kessler, at pages 271).

First, income tax is not a tax on income of every kind but a tax on income from various specified sources. So if there is not a source of the type specified in the legislation, there is no charge. Secondly, income tax is an annual tax. One should therefore treat each income tax year as a separate independent matter and one must ask in respect of each year whether, *in that year*, the conditions of the charge to tax are satisfied. Thirdly, income tax is *charged* on income arising in any year from specified sources in that year, but it is *computed* by references to the sums received in the UK.

The result of applying these three principles to Mr A's transactions is that he was charged to income tax on the whole interest arising in 2005-06, but the amount of that income was computed as nil because none of it was remitted. In 2007-08 he was not charged on the interest because, in that year, it did not have a source.

KEY POINTS

- Nature of income tax according to the House of Lords.
- The new remittance basis rules appear to have retrospective effect.
- Would a purposive construction of the new Schedule prevent retrospection?
- Income could be remitted and charged several times.
- The rules should be amended so that double taxation cannot occur.

New rules

How does the new Schedule affect this? Para 53 of the new Schedule provides that:

> 'The amendments made by … [Part 1 of the new Schedule which contains all of the relevant provisions] … shall have effect for the tax year 2008-09 and subsequent tax years.'

At first sight it might be thought that the effect of this is that these amendments are not to have effect for 2007-08 and before. But para 53 does not say that. It simply says that they shall have effect for 2008-09 onwards. In the absence of any other provision, they would not have effect for previous years, but paras 54 and 55 contain provisions governing their application in 2007-08 and previous years. Paragraph 55 subsections 1 and 2 provide that:

'(1) This paragraph applies to an individual's relevant foreign income for the tax year 2007-08 or any earlier tax year ("the relevant tax year") if:

'(a) the individual made a claim under ITTOIA 2005, s 831 for the relevant tax year; or

'(b)TA 1988, s 65(5) (or any earlier superseded enactment corresponding to that provision) applied in relation to the individual for the relevant tax year.

'(2) ITTOIA 2005, s 832 (as amended by this Part of this Schedule) applies in relation to the relevant foreign income as if ITA 2007, s 809B (claim for remittance basis to apply) applied to the individual for the relevant tax year.'

The conditions of para 55(1) are satisfied in relation to Mr A for all years in which he has been resident in the

UK. This is because he has made claims under ITTOIA 2005, s 831 for the tax years 2005-06 onwards and, in previous years, was taxed on the remittance basis under TA 1988, s 65(5).

The result of para 55 applying is, under subpara 2 ibid, that ITTOIA 2005, s 832 (as amended by Part 12 of the new Schedule) applies in relation to the relevant foreign income as if ITA 2007, s 809B (Claims for remittance basis to apply) applied to Mr A for the relevant tax year.

Subsection 2 then has the result that 'ITTOIA, s 832 (as amended by Part 1 of the new Schedule) applies in relation to the relevant foreign income as if ITA 2007, s 809B … applied to the individual for the relevant tax year'. It is clear that the 'relevant foreign income' referred to must be 'the relevant foreign income for the tax year 2007-08 or any earlier year' referred to at the beginning of the paragraph.

One then turns to new ITA 2007, s 832:

> 'Relevant foreign income charged on remittance basis
>
> '(1) This section applies to an individual's relevant foreign income for a tax year ("the relevant foreign income") if ITA 2007, s 809B or 809C (remittance basis) applies to the individual for that year.
> '(2) For any tax year in which:
>
> '(a) the individual is UK resident; and
> '(b) any of the relevant foreign income is remitted to the UK, income tax is charged on the full amount of the relevant foreign income so remitted in that year.
>
> '(3) Subsection (2) applies whether or not the source of the income exists when the income is remitted.
> '(4) See ITA 2007, ss 809H to 809L of for the meaning of "remitted to the UK" etc.'

One follows the other

Because para 55(2) deems new ITA 2007, s 809B to have applied to Mr A's income for all years up to and including 2007-08, new ITA 2007, s 832 applies because the condition for its application in subsection (1) ibid is satisfied in respect of all of those years. Subsection (3) ibid then has the result that the source closing rule does not apply in determining the charge on Mr A's relevant foreign income in any of those years. Subsection (4) ibid then tells you to apply the new rules to determining whether there has been a remittance of income.

New Schedule para 57, however, provides that the meaning of 'relevant person' in the rules for determining a remittance in new ITA 2007, s 809H is to be restricted to the individual taxpayer concerned for the years 2007-08 and before. New Schedule para 58 then provides that, for those years, the special provisions relating to 'mixed funds' in new ITA 2007, ss 809J and 809K are not to apply. Otherwise, however, the complex and broad provisions for determining whether there has been a remittance and how much has been remitted in new ITA 2007, ss 809G and 809H are not disapplied.

Retrospective result

The result of that is that one is called upon to perform a new computation of Mr A's remittances of income for 2007-08 and all preceding years for the purposes of computing the charge to income tax on that income.

That seems to be the literal result of the new provisions. It creates a series of retrospective income tax charges.

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One might argue that a purposive construction of the new Schedule would prevent it creating charges in prior years. It is well established, however, that the purpose of legislation is to be determined from the actual words used by Parliament and there is nothing in the draft legislation which indicates that those charges are not part of its purpose.

Perhaps a general presumption against retrospective taxation would allow the courts to conclude that such charges were not intended.

Predicting how the courts will apply a purposive construction to ignore the literal meaning of legislation, however, is always a highly uncertain activity. One is left with the fact that the legislation read literally imposes such charges and the hope that the courts would modify its literal meaning.

The retrospective charges might be limited by the fact that the enquiry period has now closed in relation to 2005-

06 and previous years, so that only two fiscal years are within the enquiry window. That assumes, however, that the taxpayer will have supplied sufficient information about his income on his return to have allowed the Inspector to have assessed the income on the correct basis (*Veltema v Langham* [2004] STC 544). It is very unlikely that he will have done so because at the time he made his return he would not have known that the information was relevant.

Confused interpretation

The Society of Trust and Estate Practitioners and the Chartered Institute of Taxation have released a note of various issues discussed at meetings with HMRC and HM Treasury which took place in the week beginning 11 February 2008.

In it the following statement is made:

> 'Para 32: the proceeds of source closing can be remitted to the UK before 6 April 2008 without a tax charge. However, if those funds, or assets representing them, are later removed from the UK and subsequently brought back into the UK, for example for investment, HMRC's view is that there would be a remittance charge on this second remittance.'

> *"Worryingly, the opinion recorded in the note also seems to assume that the same income can be remitted many times.*

It is not clear whether this amounts to a statement of an intention that this will be achieved by amending the draft legislation, or an assertion by HMRC that this is the way that the current draft legislation works. If it is the latter, it may indicate that their view is that the legislation cannot create a tax charge for years before 2008-09 although, as we have seen, that contradicts a literal construction of the legislation.

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Helpful revision?

Budget note 2008 BN104 states that:

> 'Any asset purchased out of untaxed relevant foreign income which an individual owned on 11 March 2008 will be exempt from a charge under the remittance basis, for so long as that individual owns it, even if that asset is currently outside the UK and later imported. Any asset in the UK on 5 April 2008 will also be exempt from a charge under the remittance basis, for so long as the current owner owns it, even if that asset is later exported and then [sic] re-imported. The existing charge that arises if such an asset is sold in the UK will remain.'

This revision to the new Schedule may help in some circumstances in which the importation of an asset would be a remittance under the new Schedule as originally published. It does not, however, address the problem of assets which are situated outside the UK on 5 April 2008 and which have not been purchased (such as money) or of assets which are purchased after 11 March 2008.

If HMRC's view is correct, a subsequent remittance of income which had already been remitted before 2008-09 could result in a charge under the new rules. Indeed, it would appear that the same income could be charged several times under the new rules in each year in which it was remitted.

Applying the principles in *National Provident Institution v Brown* 8 TC 57, one would compute in each year the amount of the income which had been remitted in that year and, under new ITA 2007, s 832(2), that computed amount would be charged in that year.

Double taxation

Of course, that would offend against the strong presumption against double taxation in construing legislation. It may be, therefore, that the courts would construe the legislation in accordance with that presumption by doing some violence to the words used. But until a case is heard, it again appears that taxpayers would be in the position, in making self assessments, of having to anticipate how a court would modify the literal construction of legislation.

To avoid imposing such difficult matters of judgment on taxpayers, it is clear that, before it is enacted, the legislation should be amended to state clearly that nothing in the new Schedule can give rise to an assessment in respect of 2007-08 and prior years, and that once income has been remitted it cannot be remitted again. Whether the Government will do so, or not, we must wait and see. ■

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Example

Mr A is a non-domiciled individual who has been resident in the UK since 1988-89. In every fiscal year in which he has been UK resident, the remittance basis has applied to him. In 2005-06 he had an offshore bank account (Account 1) into which only foreign interest income had been paid and which then had a balance of one million pounds. In that year he closed Account 1 and transferred the money to a new account (Account 2), also offshore, with another bank. In 2007-08 he transferred the balance of Account 2 to a UK bank account (Account 3).