

Tax Law Rewrite
Response to Paper CC/SC (08) 12

Bill 7: UK representatives of non-UK residents

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10 October 2008

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Introduction

1. We published committee paper CC/SC (08) 12 on 15 April 2008 on the HMRC internet website www.hmrc.gov.uk/rewrite. The closing date for responses was 11 July 2008. The draft clause and Schedule rewrite sections 126 and 127 of, and Schedule 23 to, FA 1995 providing for the liabilities and obligations of a person who in accordance with those provisions is a UK representative of a non-UK resident in respect of the assessment, collection and recovery of income tax and capital gains tax chargeable on the non-UK resident.

2. The purpose of this response document is to provide details of the substantive points made and to explain our analysis and proposals in respect of them. Minor points such as suggestions to improve punctuation are not covered, but all comments received have been carefully considered.

3. We received written responses from the following:

- the Institute of Chartered Accountants in England and Wales and
- the CBI.

4. We are very grateful for all the comments made, many of which were detailed and we appreciate the time and effort that went into them. We are sending each respondent a copy of this response document.

5. The following abbreviations are used:

- FA 1995 Finance Act 1995 (and similarly for other Finance Acts)
- HMRC Her Majesty's Revenue and Customs
- ITA the Income Tax Act 2007
- ITTOIA the Income Tax (Trading and Other Income) Act 2005
- TCGA the Taxation of Chargeable Gains Act 1992
- TMA the Taxes Management Act 1970.

Clause 1 and Schedule 1: UK representatives of non-UK residents

Q1. We welcome comments on the proposal to rewrite these provisions of FA 1995 in ITA so far as they relate to income tax and in TCGA so far as they relate to capital gains tax.

Both respondents agreed that these provisions should be rewritten in ITA and TCGA rather than in TMA.

One respondent was content with the structure proposed including the duplication of certain provisions of Chapter 1 in Chapter 1A.

But the other respondent considered that the way in which substantially the same rules are used in the definition of a UK representative and in setting the limits on liability (which itself depends in part on whether there is a UK representative) is confusing.

The respondent considered that repeating these rules in consecutive chapters, with a considerable amount of duplication, is cumbersome and does nothing to illuminate the relationship between the two purposes for which they are being used. In the respondent's view, it would be most logical to put the definition of UK representatives first, with the rules set out in full, followed by the chapter dealing with limits on liability in which the rules on independent brokers and investment managers would be expressed by cross-reference. The respondent proposes that the material from paper CC/SC(08)14 should be inserted into Part 14 of ITA before the existing Chapter 1, but most of the definitions in Chapter 1 should then be replaced by cross-references. The respondent did not see it as being a major disadvantage that the cross-references would apply the definitions in question with (very minor) modifications. If anything, in the respondent's view, highlighting the necessary modifications would help to show the relationship between the different contexts in which the definitions are used.

6. We considered carefully at the initial drafting stage whether we should set out the definitions in full or could apply those in Chapter 1 by cross-reference. We concluded that we should follow what respondents had in other cases considered to be more helpful, namely repeating the definitions in full.

7. We acknowledge the respondent's countervailing argument that in this case cross-referencing with modification may help to show the relationship between the different contexts in which the definitions are used. But the respondent's suggestion also proposes that not only does the material rewritten in these new sections precede Chapter 1 of Part 14 of ITA but that the existing Chapter 1 is also amended to apply the definitions in the new sections by cross-reference.

8. Chapter 1 brings together in one set of provisions the limits on liability to income tax of non-UK resident companies based on section 151 of, and Schedule 26 to, FA 2003 and the similar limits on the liability of other non-UK residents based on

sections 127 and 128 of FA 1995. The provisions of FA 2003 differ in many details from those of FA 1995 and this is reflected in Chapter 1 where some definitions have alternative forms for their application to non-UK resident companies and for their application to other non-UK residents.

9. Accordingly, the respondent's suggestion would require that, in addition to being amended to include cross-references to the definitions of terms applicable to non-UK residents other than companies, Chapter 1 would also need to retain in full the definitions of the equivalent but slightly different terms, based on FA 2003, which apply in relation to non-UK resident companies.

10. We do not think that this radical rewriting of material recently rewritten in ITA is justified or, because of the need also to apply definitions from FA 2003, helpful to users. We accordingly maintain our view that it is better for the new Chapter 1A to be drafted as an integrated whole and to include its own definitions in full based on the provisions of FA 1995 alone.

11. In those circumstances, we do not consider that there is any case for placing these new sections before the existing Chapter 1, where, following the insertion of Chapter A1 (remittance basis) by FA 2008, they would form Chapters A2 and A3 and, in accordance with the normal convention, would be numbered as sections 809Z8 to 809Z30.

12. *We do not propose to adopt the respondent's suggestion either by placing the new Chapters between the existing Chapters A1 and 1 of Part 14 of ITA or by substantially redrafting Chapter 1.*

Part 1: New Chapters 1A and 1B of Part 14 of ITA 2007

Chapter 1A: UK representative of non-UK resident

Section 828A: Overview

A respondent questioned whether the words "for the purposes of this Chapter" in subsection (1) should be "for the purposes of Chapter 1B" on the basis that a definition cannot be said to be for the purposes of a Chapter which contains nothing but the definition itself. The respondent stated that this comment applied also to section 828C(2).

13. We consider that the drafting works correctly but appreciate that the inclusion of the words "for the purposes of this Chapter" in section 828A(1) (and elsewhere in Chapter 1A) may cause readers some difficulty.

14. On further consideration, we do not consider those words to be necessary. It is sufficient for Chapter 1A to provide the rules for when a branch or agency is a UK representative without any express statement of particular purposes. Section 828A(2) makes clear at an early point in Chapter 1A that Chapter 1B provides for the effect of the application of the rules in Chapter 1A.

15. *We propose to omit the words “for the purposes of this Chapter”, not only from the new sections 828A(1) and 828C(2) of ITA but also from new sections 828E(2), 828F(2), 828G(2), 828H(2) and 828I(2) of that Act and from new sections 271A(1) and 271B(2) of TCGA, and in new sections 828R(2) of ITA and 271B(1)(b) and 271E(2) of TCGA for “for the purposes of” to substitute “under”.*

Section 828F: Brokers

A respondent considered that the repeated use of "amount" and "amounts" in this section makes it difficult to follow. The respondent was concerned at the requirement to identify something which is at the same time "an amount within section 828C(2)" and "included in the 'taxable amounts' in relation to a transaction", which takes one to a further definition in section 828F(3).

The respondent also considered that it is also not helpful that subsection (3) uses, in slightly modified form, the cumbersome expression "where the income arises from ... so much of any business as relates to transactions carried out through a broker", from section 127(1)(b) FA 1995. The respondent observed that in its original context this phrase looks as though it was deliberately constructed so as to avoid referring to amounts of income from individual transactions, recognising that income is generally computed for a business or part of a business as a whole, rather than transaction by transaction. But the respondent noted that the rewrite adopts a different approach, starting in section 828F(3) with the "taxable amounts" relating to a single transaction, rather than with the income from all transactions carried on through the broker as in section 127(1)(b). In the respondent's view, as under the rewrite approach one is necessarily being directed to the income from a specific transaction, the roundabout reference to "so much of any business as relates to" the transaction serves no purpose.

16. We agree that this is cumbersome and that it can be simplified.

17. *We propose for “included in the taxable amounts” in section 828F(2)(a) to substitute “transaction income” and for section 828F(3) to substitute a provision defining “transaction income” by cross-reference to section 814(5).*

Section 828G: Investment managers

The respondent's comments on section 828F apply to this section as well.

18. *We propose to make amendments to this section to similar effect as the amendments to section 828F.*

Section 828H: Persons acting under alternative finance arrangements

A respondent commented as follows. In the original form of the source legislation it is reasonably clear that the reference to "the other party to the arrangements falling within [section 47 FA 2005]" means, specifically, the counterparty to the arrangements which generate income attributable to the non-resident's UK branch or agency. Similarly with the "other person acting for the non-resident in relation to the arrangements". However the rewritten version says in effect that the counterparty in any alternative finance arrangements entered into by the non-resident is excluded from being his UK representative. This may make no practical difference, since the counterparty in arrangements not conducted through the branch or agency would not (at least in that capacity) be his UK representative anyway, but expressing the exclusion in these unnecessarily wide terms tends to obscure the logic of the legislation.

19. We do not believe that this section widens the scope of the provision or obscures its effect. This section applies if "an amount within section 828C(2)" arising to a non-UK resident consists of alternative finance return or profit share return. Amounts within section 828C(2) are limited to amounts attributable to the non-UK resident's United Kingdom branch or agency.

20. *We do not propose to amend this section.*

Section 828K: The independent investment manager conditions

A respondent commented that the words "independent businesses dealing with each other at arm's length" in subsection (4) did not have quite the same meaning as the words "independent businesses that deal with each other at arm's length" in the source legislation. The respondent expressed the view that the wording used in the source legislation can only refer to the general course of dealing between the parties, whereas the rewritten version seems to be referring to the terms of the particular transaction under consideration. The respondent considered that it may be more sensible to express this test by reference to the terms of the particular transaction, rather than some wider relationship between the parties, but did not consider that it is clear which is meant.

21. We do not consider that the words used in section 828K, which are also used in section 818(4), have any different effect to those in the source legislation, section 127(18) of FA 1995 and also in the case of section 818(4) of ITA paragraph 7(2) of Schedule 26 to FA 2003.

The respondent also considered that it is not clear from the wording as it stands (either in the source legislation or in the rewritten version) whether the requirement is –

(a) that when the investment manager acts on behalf of the non-UK resident in relation to the transaction in question they actually are independent businesses dealing with each other at arm's length; or

(b) that when the investment manager acts on behalf of the non-UK resident in relation to the transaction he does so on terms such as would have applied between (hypothetical) independent businesses dealing with each other at arm's length.

The respondent observed that the latter seems more closely to represent the approach of SP1/01 and that, in particular, version (a) would appear to be inconsistent with paragraph 22 of the statement.

22. We do not consider that there is any distinction. If when the investment manager acts on behalf of the non-UK resident in relation to the transaction the investment manager does so on terms such as would have applied between (hypothetical) independent businesses dealing with each other at arm's length, then in relation to the transaction in question the investment manager and the non-UK resident are in fact independent businesses dealing with each other at arm's length.

23. Among other things, SP1/01 gives guidance on the circumstances in which HMRC will consider the independent capacity test in section 127(3)(c) of FA 1995 to be met. SP1/01 was re-issued in substantially revised form in July 2007. The guidance is now to be found in paragraphs 35 to 44.

24. ***We do not propose to amend section 828K(4).***

Section 828L: Investment managers: the 20% rule

Q2. We welcome comments on the inclusion of section 828L notwithstanding that it is in identical terms to section 819(1) to (3).

The respondent that was content with the proposed structure of the new Chapters of Part 14 of ITA supported the inclusion of this section. The other respondent did not for the reasons given above.

25. ***We intend to retain section 828L.***

Section 828M: Meaning of “qualifying period”, “relevant disregarded income” and “beneficial entitlement”

Q3. We welcome comments on the inclusion of the definitions in full in section 828M rather than applying, with modification, the definitions in sections 820, 821 and 822 by cross reference.

The respondent that was content with the proposed structure of the new Chapters of Part 14 of ITA supported the inclusion of this section. The other respondent did not for the reasons given above.

26. We intend to retain section 828M.

Q4. We welcome comments on the use of “the total of the non-UK resident’s income” in section 828M(3).

One respondent supported this use. The other did not comment.

27. We intend to retain these words.

A respondent commented that the words "in relation to which the independent investment manager conditions are met, ignoring the requirements of the 20% rule" in subsection (3)(b) do not appear to have exactly the same effect as the existing cross-reference in section 127(5)(b) FA 1995, as paragraph 56 of the commentary says they do. The existing cross-reference requires the income in question to be such as would be treated as disregarded income for the purposes of section 813 of ITA, disregarding the 20% rule. To meet that test it would have to come within the definition of "disregarded transaction income", which in turn means that it would have to be "transaction income" in relation to which the investment manager conditions are met. However the rewritten version does not reproduce the requirement for the income to be transaction income. This appears to mean that it could include income from transactions effected by the manager wholly outside the UK.

28. The words substituted in section 828M(3)(b) of ITA for those in section 127(5)(b) of FA 1995 are the same as those substituted in section 821(4)(b) of ITA. The substitution was the subject of a question in the explanatory notes to the draft clauses published under committee paper CC/SC (05) 14: Bill 4: Limits on liability to income tax of non-UK residents. The respondent raised the same issue in relation to what became section 821(4)(b) of ITA.

29. In the response document to committee paper CC/SC (05) 14 we replied that we were satisfied that this substituted wording did not change the law for the reasons which are set out in the Explanatory Notes to section 821 of ITA:

2430. The substituted words do not change the law relating to the limit on the liability of a non-UK resident other than a company in section 811. Only income deriving from investment transactions is measured for the purposes of the 20% rule in section 127(4) of FA 1995. Income arising from any other type of transaction is irrelevant.

2431. Income is only “relevant excluded income” under section 127(5) of FA 1995 if it derives from investment transactions carried out by the manager while acting on the non-resident’s behalf (see section 127(5)(a) where the word “transactions” refers back to “investment transactions” in section 127(1)(c)). Under section 127(5)(b) of FA 1995, it also has to be treated as “excluded income” under section 128(3) of that Act. The only way that income arising from so much of a business as

relates to investment transactions can be “excluded income” is if the conditions in section 127(3) of FA 1995 (the investment manager conditions) are met.

30. The priority rule in section 366(1) of ITTOIA is also relevant to this analysis. That rule provides that any income which falls within any Chapter of Part 4 of ITTOIA (Savings and investment income) and also within Chapter 2 of Part 2 of ITTOIA (receipts of a trade, profession or vocation) is dealt with under Part 2.

31. Neither income within section 126(2)(a) or (b) of FA 1995 deriving from investment transactions carried out through an investment manager in the United Kingdom nor “transaction income” within the meaning of section 814(5) of ITA is limited to United Kingdom source income.

32. ***We do not propose to amend section 828M(3)(b).***

Section 828N: Treatment of transactions where requirements of 20% rule not met

Q5. We welcome comments on the inclusion of section 828N rather than applying section 823, with modification, by cross reference.

The respondent that was content with the proposed structure of the new Chapters of Part 14 of ITA supported the inclusion of this section. The other respondent did not for the reasons given above.

33. ***We intend to retain section 828N.***

Section 828O: Application of 20% rule to collective investment schemes

Q6. We welcome comments on the inclusion of section 828O rather than applying section 824, with modification, by cross reference.

The respondent that was content with the proposed structure of the new Chapters of Part 14 of ITA supported the inclusion of this section. The other respondent did not for the reasons given above.

34. ***We intend to retain section 828O.***

One respondent questioned whether it needs to be made clearer that the amounts in subsection (1) arise or accrue from the transaction referred to in subsection (2), as is the case in the source legislation, section 127(9) of FA 1995.

35. ***We will amend not only this section but also section 824 of ITA, which is in the same terms, to make the connection clearer by substituting for subsections (1) and (2) something closer to the source legislation.***

Section 828Q: Interpretation of Chapter

A respondent, although in favour of the proposal to define "investment transaction" by cross-reference to section 827, considered it rather unclear whether it would be theoretically possible (as it seems to be at present) for the Treasury to designate different transactions for each of the two purposes to which the definition applies.

36. The definitions of "investment transaction" in section 127(12) and (13) of FA 1995 and section 827(2) and (3) of ITA have been replaced by Schedule 16 to FA 2008 with a definition in the following terms:

"investment transaction" means any transaction of a description specified for the purposes of this section in regulations made by the Commissioners for Her Majesty's Revenue and Customs.

37. The similar definition of "investment transaction" in paragraph 3(3) and (4) of Schedule 26 to FA 2003 (non-resident companies: transactions through broker, investment manager or Lloyd's agent) has also been replaced by Schedule 16 to FA 2008 with a provision in the like terms.

38. While it is unlikely that in practice these three powers will be exercised by HMRC except at the same time and to the same effect, it is theoretically possible.

39. *We propose to maintain this theoretical possibility by amending section 828Q so that it contains a stand alone definition of "investment transaction" based on section 127(12) and (13) of FA 1995 as substituted by FA 2008 and thus continues to give a separate power to HMRC to designate investment transactions for the purposes of Chapter 1A.*

Part 2: New Part 7A of TCGA 1992

Part 7A: UK representatives of non-UK residents

Chapter 1: Treatment of branch or agency as UK representative of non-UK resident

Section 271B: Branch or agency treated as UK representative

Q7. We welcome comments on the proposal to provide that a non UK resident's UK representative for capital gains tax purposes is the same person as is the non UK resident's UK representative for income tax purposes.

Both respondents agreed with this proposal.

Chapter 2: Capital gains tax obligations and liabilities imposed on UK representatives

Section 271F: Obligations and liabilities of UK representative

One respondent noted that subsections (1) and (4) were drafted differently from the counterpart income tax provisions in section 828S(1) and (4) of ITA, although based on the same source legislation.

40. *We will conform the wording of section 271F(1) and (4) of TCGA with that of section 828S(1) and (4) of ITA.*