KPMG

Tax Newsletter: KPMG Isle of Man

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We hope you will enjoy this issue of our Tax Newsletter. Our purpose is to try to keep you abreast of topical UK tax issues which may affect you, your business, and/or your clients.

In this issue:

Beneficial ownership registers: Jersey, Guernsey & Isle of Man

On 19 June 2019, the governments of Jersey, Guernsey and the Isle of Man jointly announced (click here)

"a series of steps regarding each jurisdiction's central register of beneficial ownership information of companies and how they will move towards developing international standards of accessibility and transparency in the coming years…

The commitment … sets out three clear stages which are consistent with the EU's approach to transparency of beneficial ownership data of companies under the EU's Fifth Money Laundering Directive ('the EU Directive') within a deliverable timeframe.

The stages are:

- *the interconnection of the Islands' registers of beneficial ownership of companies with those within the EU for access by law enforcement authorities and Financial Intelligence Units; then*
- *access for financial service businesses and certain other prescribed businesses for corporate due diligence purposes; then*
- *public access aligned to the approach taken in the EU Directive".*

'Staleness' and discovery

The concept of 'staleness' means that an assessment will not be valid unless the discovery which underlines it is sufficiently new or fresh. Once HMRC has 'discovered' a loss of tax it must act within a 'reasonable' amount of time to issue an assessment.

It is interesting to note that there are a number of cases progressing through the courts on staleness which include:

- *Hargreaves v HMRC [2019] UKFTT 0244 (TC);*
- *Gordon and others v HMRC [2018] UKFTT 307;*
- *Beagles v HMRC [2018] UKUT 380 (TCC);*
- *Charman v HMRC [2018] UKFTT 765 (TC); and most recently*
- *HMRC v Tooth [2019] EWCA Civ 826.*

The case of *Hargreaves v HMRC [2019]* relates to both residence and domicile and includes interesting comments around 'when' a discovery is made in the circumstances of an HMRC challenge of a taxpayer who initially argued he was non-UK resident. Although this case is fact specific, it is hoped this decision may help incentivise HMRC to avoid repeated requests for further information.

The case of *HMRC v Tooth [2019]* was recently decided by the Court of Appeal and, although staleness was not formally an issue, there is implicit acceptance that the requirement of a discovery carries a need for newness and an inability for someone within HMRC to discover something another officer already knew.

The case of *Beagles v HMRC [2018]* is listed for October 2019 in the Court of Appeal, and will be the first case at that level to consider staleness.

Profit fragmentation: HMRC guidance

HMRC has published guidance in their internal international manual ("INTM") here on the new Profit fragmentation ("PF") rules. These rules apply to transfers of value that take place on or after 1 April 2019 for corporation tax and 6 April 2019 for income tax.

The new rules work by applying a number of tests which consider whether non-arm's length arrangements have resulted in profits arising outside the UK at a nil or very low tax rate, and may thereafter accrue to persons that have economic links to a UK individual.

This extensive guidance is set out in 30 different sections and includes at:

- INTM 610020 confirmation that the PF legislation reinforces existing tax legislation. It will only apply after other existing provisions and only to the extent that the existing provisions have not fully counteracted any tax advantages arising from the arrangements;

- INTM 610250 the interaction of the new PF rules with the transfer of assets abroad ("ToAA") and settlor interested trusts (s624 ITTOIA 2005) rules. This sets out that ToAA/s624 should take precedence, but if these rules do not fully counteract the potential PF charge then the balance will be subject to PF;

- INTM 610260 guidance on the interaction of PF and s731 ITA 2007 and the Trust Protections. If income is matched to a benefit under s731 and that income is later subject to the PF rules, there are no provisions that would give credit to the recipient of the benefit taxed under s731. The profit fragmentation rules don't affect the Trust Protections as income subject to the profit fragmentation rules is not PFSI; and

- INTM 610270 specific guidance on carried interest and disguised investment management fees suggests that the PF rules will not apply in practice to such fees.

HMRC confirms that the documentation that taxpayers need to prepare and retain to self-assess under the PF rules should be reasonable and proportionate given the nature, size and complexity (or otherwise) of their business or of the relevant transaction (or series of transactions). HMRC would expect taxpayers to be able to demonstrate the "arm's length" result of their arrangements (see INTM 610100).

HMRC also confirms that should taxpayers wish to make a claim for double taxation relief … they should contact HMRC quoting INTM 610240.

Resolve domicile status without need to quantify potential tax due

The First Tier Tribunal has ordered HMRC to issue a partial closure notice in respect of its finding that an individual was domiciled in the UK, even though it was not yet possible to quantify the total tax due on this basis.

James Kessler represented the taxpayer, who filed his returns on the basis he is non-UK domiciled (claiming the remittance basis) and argued that the taxpayer's domicile was a separate 'matter' within the meaning of section 28A Taxes Management Act 1970. Therefore the individual was not required to identify and provide the information requested by HMRC about his offshore income and gains.

The outcome of this case is interesting as it enables the taxpayer to appeal against HMRC's finding that he was domiciled in the UK and resolve this issue without being required to provide HMRC with any further

information about his offshore income and gains. This latter information would only be reasonably required in the event that it turns out that that the taxpayer is UK domiciled at the relevant time. We await to see if HMRC appeal.

HM Treasury 5MLD consultation

HM Treasury has published a consultation on the implementation of the 5th EU Money Laundering Directive (5MLD) (click here).

This consultation sets out how implementation of 5MLD will expand the scope of the Trust Registration Service (TRS) by requiring all UK and some non-EU resident express trusts to register on the TRS, whether or not the trust has a UK tax consequence. It also requires the Government to share data from the register with a range of persons under certain circumstances

A further more detailed HMRC consultation is expected in the upcoming months. It is anticipated that this will include additional information on the proposals for data collection, data sharing and penalties, taking into account responses to the HMT consultation.

Legislation to enact 5MLD has to be in place by 10 January 2020. Trusts in existence on 10 March 2020 will need to consider making their first TRS submission under 5MLD.

Chapter 9 of this 88 page consultation document sets out issues in relation to the expansion of the TRS, covering:

- the increased scope of the non-taxpaying express trusts that are required to register;
- the type of data that will need to be provided by trusts within 5MLD; and
- how the Government will deal with data sharing requests from relevant entities.

Increased scope of trust register

The 5MLD is to expand the TRS (see para 9.7) to include:

i) All UK resident 'express trusts'

The description of an 'express trust' is very wide (para 9.10 – 9.16). The document states that 'many types of bare trust' will be included (para 9.12). UK resident for this purpose is where (a) all trustees are UK resident or (b) where there is a mixture of UK and non-UK trustees and the settlor is a UK resident

ii) Non-EU resident express trusts that acquire UK land or property

iii) Non-EU resident express trusts that enter into a new business relationship with an obliged entity.

Information to be provided by trusts and timing

Trusts that will be required to register on the TRS under 5MLD will not have to provide the same information as trusts that currently have to register under 4MLD, i.e. trusts that have a UK tax liability have to provide more information than trusts that don't have a UK tax liability.

Para 9.21 onwards explains what information is required under 5MLD. It is noted for example that this doesn't include the assets settled into trust and their value.

The TRS is therefore going to have to have different registration forms depending on whether a trust registering has a tax liability or not. Due to the expanded scope of the TRS, the deadlines for filing on the TRS are going to change (para 9.27-9.33).

Data sharing

5MLD introduces new data sharing requirements which mean information on the register may be disclosed to others in addition to the current obligation HMRC has to share data with other law enforcement authorities.

a) Trustees will have to prove their registration on TRS to obliged entities (i.e. those with whom a trust enters into a new business relationship) performing 'know your client' checks.

b) As a separate matter, HMRC will share TRS data with those who can prove they have a 'legitimate interest' in seeing it for anti-money laundering purposes (Para 9.40-9.48).

   Para 9.45 notes the proposal for what is a 'legitimate interest'. Speculative enquiries will not be legitimate as the requestor needs to have evidence underpinning a suspicion that the trust is involved in money laundering/terrorist financing in order to access information on the TRS.

   Personal data on vulnerable individuals associated with any trust that is the subject of such a request will receive 'special consideration'. In particular, the Treasury expects that information on any minors associated with a trust will be withheld, even if

other data relating to that trust is released. (para 9.48).

c) For those requesting information on trusts that hold a controlling interest in a non-EEA company there are very wide data sharing requirements.

Anyone can request data held on the TRS in respect of a trust that controls a corporate structure outside the EEA. There is no requirement for an anti-money laundering/counter terrorist financing aspect to the request (para 9.49-9.57)

Update: Public register of foreign owners of UK land

In July 2018, the Government published the Draft Registration of Overseas Entities Bill (the Bill). Broadly this Bill sets out that overseas entities that wish to hold land in the UK will have to register with Companies House and identify their beneficial owners (i.e. there will be a public register of beneficial ownership).

On 20 May 2019, the House of Commons and House of Lords Joint Committee published a report following its pre-legislative scrutiny of this draft Bill. On 22 May 2019, in response to this report the Department for Business, Energy and Industrial Strategy made a written statement in the House of Lords. The statement confirmed that the Government is considering the recommendations of the joint committee and will publish a response in due course. Following Royal Assent and the making of secondary legislation, the Government intends that this register will be operational in 2021.

Points of interest from the Joint Committee report on the Bill include the following.

1) Trusts

Trusts are currently outside the scope of the definition of 'Overseas Entities' in draft Bill.

However, HM Treasury has published a consultation on the implementation of the 5th EU Money Laundering Directive (5MLD) (see above) which contains proposals to expand the scope of the Trust Registration Service to 'all UK resident express trusts' and to 'Non-EU resident express trusts that acquire UK land or property'.

Given the similarities between the proposals in Bill and the 5MLD the joint committee advocates simultaneous implementation to prevent duplicative registration regimes.

2) Other recommendations of the joint committee:

- clarification of the scope of the definition of 'overseas entities' (e.g. expressly providing that individuals are outside the scope of the Bill);
- introducing a pre-clearance mechanism for confirming in advance of transactions whether legal entities are registrable;
- lowering the 25% ownership and voting thresholds (plus extending these thresholds to the existing PSC regime), to address concerns that the thresholds could be exploited to circumvent the registration regime;
- in addition to the proposed obligation on overseas entities to update or confirm their beneficial ownership annually, including a specific requirement to update the register before making any disposition of UK land;
- introducing workable verification mechanisms to deter the submission of false information to the register; and
- introducing civil penalties for overseas entities that breach their obligations under the draft Bill, which could be backed up by criminal sanctions for non-payment.

Where will the future of tax lead us?

Digitalisation is often coupled with terms like 'disruption' and 'revolution'. Real digitalisation is both and its impact on tax is no exception. In line with many other areas tax is undergoing its own revolution as governments assess and respond to the impact of digitalisation. The implications are game changing for collection and policy, fundamentally redrawing lines for both the 'how' and the 'what' of tax.

Digitalisation provides opportunities to improve compliance exponentially, allowing tax authorities to close the tax gap. At the same time many governments increasingly view digitalised business models as a threat to the tax base because value can be derived from a market remotely with little physical presence (and therefore no ability to tax it).

Digitalisation: Simplification and compliance

As transactions become increasingly digital they also become increasingly traceable. Technological developments have opened the door to international co-operation and automatic exchange of information. This increased access to information, together with new technologies, allows tax authorities to super-charge their analysis capabilities enabling them to better identify fraudulent activities. For jurisdictions with high levels of fraud and corruption, digitalisation has become a game changer for the tax authorities in improving compliance and increasing tax yields.

Most tax administrations are gradually digitalising. Changes range from providing a set of on-line tools and portals to let taxpayers file returns on-line to introducing 'bridging' between the financial systems of the tax authority and the taxpayer allowing real time data analysis, liability calculation and (ultimately) collection.

It is easy to see the case for digitalising the administration of a tax system. As tax compliance becomes more automated this should produce a more efficient tax authority. Anything that narrows the tax gap, whether it be due to mistake, negligence or fraud, has to be a good thing. Efficiencies and reductions in compliance burdens for both taxpayer and the administration are there for the seizing.

Inevitably the increasing digitalisation of tax administration will raise philosophical concerns over the power and reach of the state and the safeguards and remedies available to taxpayers. It will rely on a healthy dose of public trust both in the capability of tax authorities to develop systems that are reliable and secure, and in the way in which the resulting data is used.

Digitalisation will also have wide ranging implications for in-house tax departments. It will transform the finance systems that are needed but it will also change the skills required within the department. Gone are the days where members of the tax department will do a line-by-line analysis of spend to determine what is tax-deductible.

But caution will be needed. Technology may take care of business as usual transactions but this does not remove the need for tax expertise. There will always be some transactions that need human intervention, both by the taxpayer and the tax authority. Getting the mix right between systems experts and tax technicians will take time and diligence.

Inevitably there are huge gains and a few downsides in digitalising tax administration. The highest barrier to progress may be communication and trust. Governments need to ensure that they bring taxpayers with them in terms of embracing the agenda for change.

Moving from analogue to digital tax

Taxing international business is essentially an exercise in carving up the profit pie. It involves attributing value creation across the global supply chain and allocating that 'value' to specific jurisdictions so that it can be taxed.

Until the 21st century the accepted wisdom for taxing international businesses was to allocate an equivalent 'arm's length price' to a cross-border service or activity. However, there also needed to be a physical presence or nexus in a jurisdiction for taxing rights to arise. These rules made sense (and broadly worked) when business was physical. But as transactions become digital and less reliant on a physical presence the rules have come under increasing strain. We essentially have an analogue tax system trying to cater to a digital world and it is no wonder that the system is fraying.

Often the discussion of how to tax an increasingly digitalised economy focusses on the tax affairs of tech giants. But the tendrils of digitalisation infiltrate all business models and limiting the discussion to this sector fundamentally misses the point. The issue is not how to tax the US tech giants of today but how to tax all business models of tomorrow. And in this fast moving area getting to the solution is becoming increasingly urgent.

There has for some time been a consensus that the international tax system needs to evolve but that is where the consensus ends. To make any meaningful changes to international tax systems it is essential to have wide-spread agreement across jurisdictions. As governments vie for tax revenues whilst also keeping control over their tax policies, the agenda for change becomes highly politicised.

FOMO (Fear Of Missing Out)

The idea of a business operating within your borders, making profits from your citizens, without contributing to the economy in terms of jobs or tax revenues, is anathema to governments (regardless of whether that business is at the same time benefitting from local taxpayer-funded infrastructure).

Frustrated at the slow pace of international reform jurisdictions are turning to unilateral measures. We have

seen numerous countries introducing new measures designed to protect their own tax base from increasing digitalisation. Whilst this is understandable it is, from the perspective of maintaining a cohesive international tax system, the worst possible answer. We are already seeing these unilateral measures collide.

Not only will the risk of double (or more) taxation increase, driving very real additional cost into supply chains, but compliance burdens will build as businesses struggle to meet numerous different, and possibly conflicting, requirements.

In existing international frameworks tax treaties will do a lot of the heavy lifting in terms of relieving instances of double taxation. Where gaps remain these are filled by some form of dispute resolution process. But increasingly we are seeing governments introduce taxes that fall outside of the reach of the treaty network.

For governments this may make sense. If they know their tax proposal may lead to double taxation then drafting a measure that falls within the treaty network can only dilute the effect of the tax whilst ensuring it falls outside of existing treaties maximises government revenues. But such an approach leaves business struggling as their only recourse to relieve double taxation is to go through an international dispute resolution process, which can be both costly and time-consuming.

The issue should not be underestimated. Double taxation problems of this type are already being seen as a result of the recent US tax reform. Unrelieved double taxation is leading to high effective tax rates, in some cases of over 100%. Many businesses are assessing the impact of new and proposed digital taxes and concluding that they may be facing triple (or more) taxation.

The solution

As a basic principle, tax should not distort the market to the extent that it becomes a barrier to trade. Where it does it will not be long before businesses are forced to make very real market choices.

The answer lies in an international consensus solution that has broad agreement and consistency in terms of interpretation, application and enforcement.

Progress is being made. International bodies such as the OECD and the EU are to be commended for their work to date as they attempt to bring options to the table that seek to build consensus. As new solutions are presented they necessarily flush out new concerns – the process is very much two steps forward one step back – but it is important that these efforts continue.

In the meantime, the danger will be that governments will become wedded to their unilateral measures and the tax revenues they bring. This is a zero sum game and inevitably there will be winners and losers. Critical to the success of a new international framework will be governments' willingness to sacrifice their own measures on the altar of an international solution.

Despite this uncertainty, solutions still need to be pursued. The alternative is a network of tax rules that hugely distort economic behaviour and may threaten the very integrity of how we tax international business. We may not be able to see the answer clearly at this stage, but some shapes are beginning to appear through the mist and fog. Hopefully through discussion and debate they will become more defined as building blocks for a new framework are developed.

This is work we should all be invested in whether we represent governments, tax administrations, businesses or the tax profession. Yes, digitalisation is revolutionary and, yes, it will be an uphill battle. But building a tax system for the digital age is pioneering activity and it was never going to be easy.

Private Residence Relief, lettings reliefs, final period exemption, spouse transfers consultation

The Government published a consultation entitled 'Capital Gains Tax: Private Residence Relief: changes to the ancillary reliefs' on 1 April 2019 (click here), which is now closed. This sets out more details of the proposals announced in Autumn Budget 2018 that will:

- restrict lettings reliefs to only apply where an owner is in shared occupancy with a tenant (it is noted that individuals may still be able to claim relief under another provision e.g. work related absences); and
- reduce the final period exemption from 18 to 9 months.

These changes will come into effect from April 2020.

The reforms mean that from April 2020 lettings relief will not be available for periods where an owner has moved out of the property and therefore no longer shares occupation with tenants. This effectively abolishes it for buy-to-let purposes. The impact on a landlord will be to increase the chargeable gain on disposal by up to £40,000. The final period exemption

was initially 36 months and introduced during a property market slump, as a concession for people who were unable to sell their former home after moving to another.

Some key areas of interest in the consultation are as follows:

1) Spouse transfers

The current rules allow, in certain circumstances, a person to claim full Private Residence Relief (PRR) on the disposal of a house that their spouse had previously owned and let out.

However, the consultation sought comments on whether this legislation should be reformed, in particular, whether the receiving spouse should always inherit the transferring spouse's period of ownership and the use to which the property was put during that time.

More details on this and a second spouse transfer example are contained within this consultation.

2) Enactment of two extra-statutory concessions (ESC)

The Government is to legislate two ESC:

- D49. Private residence relief: Short delay by owner-occupier in taking up residence; and
- D21. Private residence exemption: late claims in dual residence cases.

ESC D49 applies where a person is unable to occupy a new home which they will use as their only or main residence because:

- they are completing the sale of their old home;
- they are altering or redecorating it; or
- land is bought and a house is constructed on it.

In such cases up to the first 12 months is treated as if the house had been the person's only or main residence in that period. In some circumstances a longer period may be allowed.

ESC D21 applies where an individual has more than one residence, but only one of those residences has any real capital value. Strictly the individual should nominate one of these homes as their main residence, but this is often overlooked. This ESC extends the time period for nominating one of those residences as the individual's main residence.

3) Military service personnel

Changes to extend the benefits of job-related accommodation to service personnel who rent privately under the MOD Future Accommodation Model, to ensure they will continue to receive job-related accommodation relief on their only or main residence that they own elsewhere in the UK.