



private client | non-domiciliaries proposed changes

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who will be affected?

The changes affect UK resident but non-domiciled: individuals; settlors of non-UK resident trust; beneficiaries of non-UK resident trust.

residents

The tax position of an individual depends on his domicile and residence. There is no comprehensive statutory test of residence but broadly:

1. An individual who is present in the UK for 183 days in a tax year will be resident here; and
2. An individual who on average spends more than 90 days a year in the UK over a period of time will be resident here.

At present, days of arrival in and departure from the UK are not counted. From 6 April days of arrival in and departure from the UK will count towards the 90/183 day limits. A day when the individual both arrives and leaves the UK will also count, unless he is merely a transit passenger. This is likely to lead to some odd results for example a Polish lorry driver making the following trips to the UK:

30 trips arriving/departing the same day and 31 trips arriving/departing the next day would if he continued this pattern for four years become UK resident.

This is clearly a nonsense and it is to be hoped that further clarification will be given on some of these situations.

the remittance basis

An individual who is UK resident but not domiciled pays income and capital gains tax on the remittance basis, i.e. he is taxed on UK arising income and capital gains made on UK assets but is taxed on non-UK arising income and gains made on non-UK assets only if they are remitted to the UK.

From 6 April a claim must be made for the remittance basis to apply unless the income and gains are less than £1,000. The effect of the claim is that individuals lose the rights

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to allowances such as the personal allowance, the married allowance, and the capital gains tax exemption.

The claim is to be made on an annual basis which means taxpayers can opt in or out of the remittance basis. If on the remittance basis, capital losses will not be allowed to offset capital gains.

Where an individual has been resident for 7 out of the previous 9 years, he must pay a fee of £30,000 to continue using the remittance basis. This additional remittance base charge is not a tax and at present is not expected to be available in other countries, particularly the US, as a credit.

The Revenue has however confirmed that if you remit £30,000 to pay the charge this will not be taxed as a remittance. This was set out in the Revenue's February letter where they stated that they had misunderstood ministers' intentions and a certain amount of back tracking was set out. In this letter it was stated that there would in fact now be no requirement to disclose details of offshore assets as had been set out in the legislation. It was also stated there would be no retrospection on the treatment of trusts, and the tax charge would not apply to accrued or realised gains prior to 6 April 2008.

meaning of remittance

Currently employment income and capital gains have been treated on a remittance basis and you have only had to elect in the tax return for foreign income to be treated on the remittance basis. From 6 April 2008 it will be necessary to claim all types of income and gains to be treated on the remittance basis.

so what is a remittance?

From 6 April all tax on income and gains are remitted if any money or other property is brought in or received or used in the UK. This also applies if the property derives from the income or gains. It is not clear what derives means and there is no definition in the legislation.

The big change is in the relevant person – where this now includes individual, spouse, civil partner, parents, grandparents, children, grandchildren, brothers and sisters and all their spouses. It also includes a person living with another individual as if they were the individual's spouse or civil partner.

Trusts created by the individual and companies controlled by the individual would also be connected. The definition also includes services where services are provided in the UK and the payment for the service is related directly or indirectly to offshore income or

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gains. If income or gains are used outside the UK to satisfy a debt which relates to property in the UK or a service provided in the UK, this will count as a remittance. It is unclear whether the payment of the interest on an offshore borrowing using offshore income and gains will be treated as a remittance, however.

Under the current rules, if an individual used investment income to buy an asset, for example, a car or painting abroad and brought the item to the UK there will be no income tax charge unless and until the item is sold in the UK. After 5 April, the imported item will be a remittance of the income. It also seems that assets purchased outside the UK and previously brought to the UK may become taxable if they are still in the UK on 6 April. It is worth noting that the amount remitted is limited to the amount of the income and gains. If the amount derived from the asset is less than the income or gains, then the amount treated as remitted will be more than the amount of the actual remittance.

sourced ceasing

It is a principle of income tax law that income is only taxable if the source of the income exists. Under current rules if an individual closes a source, for example, bank account which had generated interest then the income from that source ceases to have the character of income and it can be remitted to the UK in the following tax year, tax free. From 6 April 2008, this will not be the case and the new rules will apply to pre-April 2008 income if it is remitted after 5 April. So, if an individual has offshore income which arose from a source which was closed before 6 April 2007, he should remit it before 6 April 2008. If he remits it after 6 April it will be taxable no matter how long ago this source ceased.

time of remittance

Until now it was possible for an individual to claim the remittance basis in year 1, not claim it in year 2 and then remit the income of year 1 in year 2 when it would be tax free as it did not arise in that year. This will not be possible after 5 April.

If income or gains arise in the year for which the individual is taxable on a remittance basis, they will be taxed on remittance whatever the individual status in the year of remittance.

temporary non-residence

Under the current rules a UK resident non-domiciliary could leave the UK for a year or two and remit income which had arisen during his resident period to the UK while he was non-resident. This would not be taxable when remitted nor would it become taxable if he then becomes resident in the UK again.

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From 6 April, if an individual becomes non-resident for fewer than 5 complete tax years and remits offshore income which arose while he was resident during that period he will be treated as if he had remitted income in the year when he returns to the UK.

rebasing

Under current rules, if a resident but non-domiciled individual transfers by gift an offshore asset to a trust or another individual or company, he is treated as if he had sold the asset at market value. The deemed gain arising could never be remitted so could not be taxed. The recipient would acquire the asset at its then market value and only future gains would potentially be taxable.

From 6 April, the asset transferred would itself be treated as derived from the gain so that the remittance of the asset or its proceeds would be treated as a remittance of the deemed gain as well as any further gain. Where the remittance was by a person connected with the original donor the donor would be treated as making the remittance and will be taxable. It seems that these rules may apply to pre-6 April deemed gains although only a remittance to the donor himself would be taxable. There is an opportunity to rebase assets before 6 April to counter this problem. In future trustees and other recipients would need records of the donors deemed gains when he transfers assets to them. This could, of course, cause practical difficulties.

mixed funds

There are at present no rules to determine what is remitted from an account or proceeds of sale which includes different types of income and capital gains. Current practice is broadly to treat a remittance as being:

- 1) UK income which has already been taxed
- 2) Untaxed income
- 3) Untaxed capital gain
- 4) Pure capital

From 6 April, new rules will specify the exact order of remittances from mixed funds. The rules apply for determining whether there has been a remittance and what has been remitted. They do not apply generally so that other transfers out of the fund e.g. to another account which is kept offshore are still uncertain in their composition. One has to determine the categories of income and gains which are in the mixed fund for each tax year. Remittances are then matched for each tax year starting with the current year.

offshore companies

Capital gains made by non-UK resident close companies are attributed to the shareholders in proportion to their shareholdings. There is no attribution to the

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shareholder if he holds no more than 10% of the company. A company is close if broadly it is controlled by 5 or fewer shareholders. At present, a UK resident but non-domiciled individual will be exempt on any gains attributed to him under this provision even if the gains related to a UK asset and even if the asset or proceeds of sale were given to him in the UK. If the individual actually received the proceeds by way of dividend or on liquidation of the company the funds would be taxable on the remittance basis but a gift by the company would not be taxable. From 6 April, the company's gains that are attributed to a resident non-domiciled shareholder will be taxable. The shareholder would be taxable immediately on any UK assets but on a remittance basis on offshore assets.

Where the proceeds are actually paid out to the shareholder by way of dividend or on liquidation within 3 years any tax paid on the deemed gain can be offset against the tax payable on the actual receipt. If the distribution is more than 3 years after the deemed gain arises, the individual could suffer two charges to tax on the same value – one charge on the deemed gain and one on the dividend or gain arising on the liquidation.

offshore trust settlors

The advantage of a non-UK resident trust is that a UK resident non-domiciled settlor is not taxable on the gains made by the trustees even if the trustees make gains on UK assets and even if those funds are remitted to the UK. So effectively capital gains would be shelved completely.

From 6 April, future gains made by the trustees would be treated as if they were gains of the settlor and will be taxable on them on a remittance basis. The gains of the trustees include gains of an underlying company. This can lead to double taxation without any relief if the trustees subsequently receive a dividend from the company or liquidate it.

Trustees' gains on offshore assets will only be taxable if remitted to the UK (but remember this includes a payment to any person connected with the settlor). It would also include the trustees making a remittance to the UK for investment purposes and this could have quite serious implications for investments in the UK.

The settlor will be immediately taxed on any gains made on any UK assets within the structure whether the assets are actually sold or the subject of a gift.

Many offshore trusts use underlying companies to hold UK assets to protect them from inheritance tax for example UK residential property is often held that way. These structures need to be reviewed as a matter of urgency.

These charges will arise whether or not the settlor receives anything from the trust although the settlor is entitled to obtain reimbursement of the tax paid from the trustees under UK legislation. If he does not claim the reimbursement, he may be considered to have made an addition to the trust.

Trustees may want to consider disposing of UK investments in this tax year and reinvesting in offshore assets. Trustees can also consider washing out past capital gains and rebasing assets to current market value by distributing assets or even collapsing the trust/company structure and paying out all the funds to the settlor or other suitable beneficiaries. However, this may not be advisable for a number of reasons including inheritance tax if the trust is an excluded property settlement. Also, of course, there is a measure of asset protection in the event of a divorce, etc.

offshore trust beneficiaries

Resident but non-domiciled beneficiaries are effectively exempt from capital gains tax on capital they receive from a non-resident trust even if the trustees make gains on UK assets and even if a payment is made to the beneficiaries in the UK. If a beneficiary receives a payment of capital in the UK that payment can be matched with accumulated income in the trust. To the extent that the payment exceeds the accumulated income it will be matched with capital gains made by the trustees but no tax will be payable on the matched gains.

Under the new provisions payments of capital received by beneficiaries which are matched with gains made by the trustees are subject to capital gains tax even if a capital payment is made offshore and even if the gains arose on non-UK assets and the gains have not been remitted. It is worth noting that the STEP briefing on the clarification from the Revenue in early February stated that they thought there was a proposal for the beneficiary to be taxed on a remittance basis as with the settlors but that was not actually included in the letter.

Under the current rules if the trustees make a capital payment to a UK domiciled beneficiary who is subject to tax on the trustees gains, the rate of capital gains tax may be increased where the payment is matched with gains which arose in previous years. Where the payment is matched with gains more than 6 years old, the maximum rate of tax can be 64%. Assuming the flat rate 18% charge is introduced, the maximum rate would after 5 April be 28.8%.

Where a beneficiary receives the payment after 5 April which is matched with old gains, the non-domiciled beneficiary would also be subject to the surcharge at the 28.8% maximum rate.

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Offshore gains which are not taxed on the settlor will be brought into the s87 pool to be matched to payments to beneficiaries. However, such gains would not be subject to the surcharge.

Again, trustees may wish to consider rebasing investments, distributing assets or collapsing trust structures before 6 April in favour of non-resident or non-domiciled beneficiaries in order to extinguish past gains and match past payments.

about haysmacintyre

haysmacintyre, Chartered Accountants and tax advisers, comprises 24 partners and 150 staff based in Holborn, London. It provides high quality auditing and assurance, business and personal taxation, corporate finance, financial planning and other business support services.

Around 40% of the firm's business is within the corporate sector – small and medium sized enterprises, many of which are in the property, media and entertainment, technology, sports and business services sectors. The firm acts for a number of listed companies and assists new companies raise initial funds on the capital markets and through private equity. 25% of the firm's business is for charitable and not for profit organisations and the remainder is for professional practices and private individuals – whether senior executives, entrepreneurs or those with significant land or wealth at home or overseas.

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