Residence and non-domicile: Proposed UK tax changes

Proposed draft legislation was published on 18 January 2008, following October's Pre-Budget Statement, giving considerable detail on the Government's current intentions. The consultation period continues to 28 February, and the draft legislation is likely to be amended, and possibly extended.

The proposed changes to the taxation of non-domiciliaries are wide-ranging and, in some areas, more severe than anticipated

There is a window of opportunity for non-domiciled individuals to review how they will be taxed after 5 April 2008, and to consider what action to take before that date. However, in view of the fact that the proposals may be further amended, it is generally suggested that advice be sought and action considered, but not yet necessarily implemented.

The proposed changes to the taxation of non-domiciliaries are wide-ranging and, in some areas, more severe than anticipated, particularly for resident beneficiaries of offshore trusts. There is also a much wider definition of remittance, so, for example, even a remittance to the UK by the donee of a gift from a UK resident donor can give rise to a tax liability for the donor, if the two are connected. In this context, even a couple living together who are neither married nor in a civil partnership, may be regarded as connected.

Residence

As foreshadowed by the Pre-Budget Statement, for the purposes of counting the days of presence in the UK, the days of arrival in, and departure from, the UK after 5 April 2008 are to be treated as days of presence (but for earlier years are still regarded as days of absence). This is to apply for the purposes of both the 183 day and the 90 day tests. The only exceptions are that a day of transit in the UK can be ignored, provided that the individual remains in a part of an airport or port not accessible to members of the public, unless they are arriving in, or departing from, the UK. An individual in transit who has to move from one airport terminal to another, for example, is likely to be unable to satisfy this requirement.

Retaining the remittance basis of taxation

UK resident non-domiciliaries can currently use the remittance basis of taxation. While this is optional, it is generally favourable. It means that offshore investment income and capital gains (and in some cases offshore earned income) are only taxed if and when remitted to the UK.

From 6 April 2008, UK residents will be taxed on a worldwide arising basis for income and gains unless they are non-domiciled, and:

- their unremitted income and gains for that year are less than £1,000, in which case the remittance basis is automatic; or
- they make a claim on their Self Assessment Tax Return for the remittance basis to apply. The claim must state the individual is not domiciled in the UK for the tax year.

Further provisions apply to those individuals claiming the remittance basis for a tax year, i.e. those in the latter category above:

- claimants lose their entitlement to certain allowances for that year, primarily personal allowances against income and the capital gains tax annual exemption;
- for those who have been resident for more than 7 out of the previous 9 tax years there is an additional annual charge of £30,000.

Example

An individual is not domiciled in the UK and has been resident here since 2001/02 with the exception of 2004/05 when he was non-resident. As at 6 April 2008 he will have been resident for 6 out of the last 9 tax years so for 2008/09 he can claim the remittance basis without payment of the £30,000 levy. As at 6 April 2009 he will have been resident in at least 7 of the last 9 tax years and so if he wishes to maintain the remittance basis for 2009/10 (or later years) he must make a claim and pay £30,000. He loses his personal allowance and annual exemption for any year such a claim is made including 2008/09.

Regardless of domicile, individuals who are resident but not ordinarily resident in the UK can make a claim for the remittance basis, although the same provisions apply, (i.e. loss

A new wide meaning of "remitted to the UK" will apply to all foreign employment income, foreign investment income and foreign capital gains

of personal allowances and the annual capital gains exemption, and potentially the payment of the £30,000 levy although this would be an unusual circumstance).

It is also important to note that each individual (husband, wife and children) are separate taxpayers for these purposes.

Furthermore, it is possible to claim the remittance basis for one year but not another. However, unremitted foreign income and gains of a year of claim will still be taxed if remitted in a year in which no claim is made

The £30,000 additional charge

The £30,000 additional charge will be non-refundable and be treated as income tax for the purposes of payment, accounting, collection and recovery. However, HMRC has made it clear that it is not income tax and whether another country will give double tax relief in respect of it will be up to each individual country, though this is understood to be unlikely.

Example of payment

A non-domiciled individual has been resident in the UK for 10 years at 6 April 2008 and intends to pay the additional charge going forward. The additional charge for 2008/09 will be due on 31 January 2010. However, the 2008/09 liability also sets the payments on account for 2009/10 due in two equal installments on 31 January and 31 July 2010. Therefore, £45,000 will be due on 31 January 2010, with payments of £15,000 on each 31 July and 31 January thereafter.

Remittances

Currently, foreign-source income or gains of UK-resident individuals who are not domiciled in the UK or not ordinarily resident in the UK are chargeable to UK tax to the extent that such income or gains are "remitted" to the UK.

The term "remitted" means, broadly, "received in" the UK, but includes some instances of constructive remittances where income or gains are not physically received in the UK.

The draft legislation introduces a new wide meaning of "remitted to the UK" which will apply to all foreign employment income, foreign investment income and foreign capital gains, including those arising in offshore structures where the remittance basis applies.

The main areas affected are:

- Chattels: Currently, foreign investment income would not be remitted unless you received or remitted it to the UK as "money". You could use foreign investment income to purchase, say, a car or a painting outside the UK, and bringing the car or the painting into the UK would not be a remittance, unless you sold it and had the money in the UK. If you used foreign employment income or foreign capital gains, it would be a remittance if you brought it to the UK and "enjoyed" it here. Under the proposed legislation, bringing the car or painting into the UK will be a remittance of foreign income or gains used to purchase it.
- "Source-ceasing" will no longer avoid UK tax on foreign investment income remitted to the UK. Source-ceasing relied on the principle that investment income could only be subject to UK tax when remitted if the source was in existence in the year that the remittance took place. Hence, if a bank account was closed one year, the accumulated interest earned on the funds deposited could be remitted in a subsequent tax year, without being subject to tax. Income remitted from 2008/09 onwards will be taxable, even, it seems, if the source ceased to exist many years ago

  Hence, where offshore income is still retained outside the UK, which arose from sources which ceased in 2006/07 or earlier, consideration should be given to remitting such funds prior to 5 April 2008.
- "Mixed funds": Where a foreign account or fund comprises capital and/or income and/or gains, the income will be treated as remitted to the UK first (earned income before investment income), then the capital gains, then the non-taxable capital. This constitutes a potentially significant change. Currently, there is no statutory order of identification, although it is normal practice to regard income as being expended in priority to capital. However, it has also been normal practice that where a mixed fund contains income which has already been subject to UK tax, a remittance can be regarded as first coming from that taxed income, so that no further liability arises. The proposed legislation makes no mention of such practice being followed in future. Furthermore, it has been a long-established

From 6 April 2008, offshore trusts will cease to be a source of clean capital

principle that on the disposal of an asset, the gain and the original capital cannot be separated, so that if part of the proceeds were remitted to the UK the proportion of the gain that was regarded as remitted was calculated pro rata. For example, if an asset which cost £9,000 was sold for £10,000, and £2,000 was remitted to the UK, 10% of the remittance, £200, was regarded as the amount of the gain that was remitted/taxable. In future, it seems that, in the same situation, the full £1,000 gain would be regarded as having been remitted.

- "Alienation": Where a UK-resident or temporarily non-resident individual (see below) makes a gift outside the UK to a "related" person, any income or capital gain element will no longer escape UK tax where remitted to the UK directly or indirectly by the recipient of the gift. In this context "related" includes not only the individual himself, brothers, sisters, lineal descendants or ancestors and his and their spouses or civil partners but also someone who is living with the individual as husband or wife or civil partner. Hence, an individual who buys a present for his partner (whatever sex) whilst on holiday abroad is potentially liable to UK tax if the recipient of the gift brings it into the UK. Similarly, a father who gives his son some money outside the UK could be subject to UK tax if his son brings that money into the UK perhaps ten years later.

  This principle may be particularly relevant when considering offshore trusts, as an individual is "related" to the trustees of a trust of which he is settlor or beneficiary.

- Debts: The settlement of offshore debts or loans, the proceeds of which have been remitted to or enjoyed in the UK, can be regarded as the remittance of such offshore funds to the UK. The servicing of such offshore debts using offshore funds could similarly be regarded as a remittance of the latter to the UK. Up until now, the payment of interest using offshore funds on a properly arranged offshore mortgage for the purchase of a UK property has not been regarded as a remittance to the UK. In future, however, payment of such interest using offshore funds could be regarded as a remittance to the UK.

Employment income

The new provisions will also affect the taxation of overseas earnings for UK residents who are either non-domiciled or not ordinarily resident.

Generally taxable earnings are assessed on the arising basis (e.g. when paid) except for:

- earnings for duties performed abroad by an individual who is resident but not ordinarily resident in the UK, or
- earnings of a non-domiciled resident individual from an employment, the duties of which are performed wholly abroad, with a non-resident employer.

In both these cases, the remuneration is only taxable on the remittance basis.

It is proposed that, from 6 April 2008, individuals in either category would only continue to be taxable on the remittance basis in respect of such offshore income if they claim the remittance basis (thereby losing the benefit of their personal allowances etc and, if they have been resident for at least seven out of the last nine years, paying the £30,000 levy).

The taxation of non-resident individuals, who are only subject to UK tax on remuneration for duties performed in the UK, is unchanged.

Temporary non-residence

Currently, where an individual has been resident for more than 4 out of the preceding 7 tax years, there are anti-avoidance provisions that in certain circumstances can tax capital gains made in a period of temporary (less than 5 complete tax years) of non-residence. This is now extended to include the remitted income and capital gains of a temporarily non-resident non-domiciliary so that such amounts are taxed in the year residence is resumed.

Offshore structures: capital gains anti-avoidance

The Pre-Budget Statement in October announced significant changes to capital gains tax. Draft legislation is still awaited but is likely to impact on the tax rates applicable to gains of offshore structures.

Trusts

Trusts with non-resident trustees ("offshore trusts") are outside the scope of capital gains tax even in respect of UK assets, because they are non-resident. Currently, these gains can be

From 6 April 2008, UK resident non-domiciled beneficiaries are charged to tax on trust gains if they receive a capital payment or benefit from the trust inside or outside the UK.

taxed on resident domiciled settlors and beneficiaries in certain circumstances but not on resident non-domiciled settlors or beneficiaries. With careful planning this meant that offshore trusts could be a source of tax-free capital for non-domiciliaries. From 6 April 2008 this will no longer be the case as the intention is for a resident non-domiciled settlor of an offshore trust to be taxed as follows:

- gains on the disposal of UK situs assets in the trust structure on an arising basis;
- gains on the disposal of non-UK situs assets ("foreign deemed chargeable gains") in the trust structure on an arising basis unless the settlor makes a claim for the remittance basis to apply.

If the foreign deemed chargeable gains are not charged to UK tax on the settlor they are potentially charged to beneficiaries.

From 6 April 2008, UK resident non-domiciled beneficiaries are charged to tax on trust gains if they receive a capital payment or benefit from the trust inside or outside the UK. The remittance basis does not apply to this provision. A payment matches to historic gains on a £:£ basis and if there are no, or insufficient, historic gains the payment is matched to future gains at the time these gains arise.

There will be many different circumstances but trustees may need to consider whether to divest themselves of UK assets before 6 April 2008. Non-domiciled settlors and beneficiaries may need to consider whether to request from trustees a capital distribution (and possibly remit this) before 6 April 2008. Particular consideration will need to be given to trust-company-house structures.

Companies

A non-domiciled resident individual who is a 10% or more shareholder in an offshore "close" company is now chargeable on gains on UK assets made by the company on an arising basis, with gains on non-UK situs assets also on an arising basis subject to the shareholder claiming the remittance basis of taxation for the latter.

Offshore trusts: notification

The legislation seeks to ensure that an individual creating an offshore trust makes the relevant notification (date of settlement, settlor, trustees) to HMRC within 3 months of the date of settlement. A settlor becoming resident in the UK after 6 April 2008 with such a trust in existence has 12 months from arrival to make the notification.

HMRC has stated that these amendments take effect from 6 April 2008 but do not apply the reporting requirements to non-domiciled settlors who became resident in the UK before 6 April 2008 for periods before that date.

Summary

The full impact of these complex proposals will take some time to be fully appreciated and you should bear in mind that the proposals may well change.

We will be making representations to HMRC on the proposals. If you have comments on the draft legislation, please e-mail nondoms@moorestephens.com or write to your usual Moore Stephens contact by 15 February 2008.

This factsheet is a summary of the draft legislation only and you should seek professional advice before taking action.

This fact sheet is provided for information purposes only and does not constitute any form of financial or investment advice. Past performance is no guarantee of future investment returns and you should be aware that the value of your investments can go down as well as up.

We believe the information in this fact sheet to be correct at the time of going to press, but we cannot accept any responsibility for any loss accessioned to any person as a result of action or refraining from action as a result of any item herein.

Printed and published by © Moore Stephens LLP, a member firm of Moore Stephens International Limited, a worldwide network of independent firms. Moore Stephens LLP is registered by the Institute of Chartered Accountants in England and Wales to carry out company audit work. Authorised and regulated by the Financial Services Authority for investment business.

January 2008