

UK TAX CHANGES FOR NON-DOMICILIARIES

DRAFT LEGISLATION

Draft legislation was published on 18 January 2008 to implement sweeping changes to the UK tax rules which apply to those who are resident in the UK but not UK domiciled (or ordinarily resident). Most of the changes were announced in the October 2007 Pre-Budget Report but some, such as the measures affecting offshore trusts, have only now been revealed.

The changes will take effect from 6 April 2008. That leaves clients and their advisors just a couple of months to interpret the proposed law and consider whether to alter their existing arrangements. A consultation period is open until 28 February and HMRC say that comments on the legislation itself will be welcomed after that date. Professional bodies are lobbying hard against the proposals and so it is not certain at this stage that the rules will be exactly as proposed in the first draft.

BACKGROUND:

THE CONCEPTS OF RESIDENCE, ORDINARY RESIDENCE AND DOMICILE

Residence: very broadly, a person is resident in the UK if they spend 183 days in the UK in a tax year or, for short-term visitors, if their visits to the UK average 91 days or more over four tax years.

Ordinary residence: arises if a person is UK resident from year to year.

Domicile: there are detailed rules but, generally, domicile is inherited at birth and, from age 16, a new domicile can be acquired which involves physical presence in a country with the intention to remain there permanently or indefinitely.

Under the tax rules to date, people who are both UK resident and domiciled are liable to UK tax on all worldwide income and gains, whereas those who are UK resident but not domiciled ("RNDs") are liable to UK tax on all income and gains arising in the UK, but only on income and gains arising outside the UK that is remitted (i.e. brought into) the UK.

"Remittance" has a very wide meaning and is not confined to transferring cash or receiving the money personally in the UK. Capital gains and employment income are "remitted" to the UK if brought into the country in any manner or form whereas other relevant foreign income must, at present, be brought into the UK as money or its commercial equivalent (i.e. a cheque).

THE NEW RULES IN OUTLINE ARE AS FOLLOWS:

Day Count for Residence Tests

- From 6 April 2008 days of arrival into and departure from the UK (other than as "transit" passengers e.g. at an airport) will be treated as days of full presence when computing the 183-day residence test. We are told that HMRC will also apply this practice to the non-statutory 91-day average test. The change will affect some visitors significantly, for example those who arrive on Monday and leave on Wednesday will now spend 3 days in the UK as opposed to 1 under current rules

Temporary non-residence

- A temporary non-residence rule, equivalent to the 5-year rule for CGT, is being introduced for income tax. The effect is that income remitted while non-resident will be taxed in the year of return unless the individual remains non-resident for 5 complete tax years

£30,000 'additional charge' and remittance basis changes

- o The meaning of "remittance" is being further widened and, in addition, there is to be a charge for those who wish to be taxed on the remittance basis
- o In future, the remittance basis will always have to be claimed for a particular tax year by submitting an appropriately completed Self Assessment Tax Return (subject to the *de minimis* rule mentioned below)
- o If the election is not made, RNDs will be liable to UK tax on their worldwide income and gains in the tax year in which they arise. This might not be as bad as it sounds if there is relief under a double tax treaty
- o It will be possible to switch, year by year, between the remittance basis and taxation of worldwide income and gains on an arising basis
- o RNDs who have been UK resident (whether continuously or sporadically) for at least 7 out of the previous 9 years will have to pay a charge of £30,000 to make this election
- o The £30,000 charge is in addition to the tax liability for the year in question. Whilst the charge is treated as UK income tax for the purposes of collection and administration, it is not in itself income tax and so whether relief will be available under a double tax treaty will depend on the rules of the other country concerned
- o If the £30,000 is generated by foreign income and/or gains and brought into the UK to pay the charge, this in itself is a "remittance" and will be taxed as such. It will therefore be necessary to remit the £30,000 plus tax payable on it in order to meet the liability
- o Those taxed on the remittance basis in future will lose various personal tax allowances, including their income tax personal allowance and CGT annual exempt amount
- o The changes will not apply for a particular tax year to those whose unremitted income and gains for the year are less than £1,000. Where this *de minimis* rule applies, the remittance basis will apply automatically without a claim and there will be no loss of personal allowances or requirement to pay the additional charge
- o The Pre-Budget Report mooted the possibility of a higher charge for non-domiciliaries who have been resident in the UK for longer than 10 years. This is not contained in the draft legislation although the consultation is still open on that aspect
- o The rules have not ostensibly been altered so as to affect remittances of pure capital, which should therefore continue to incur no UK tax charges. However, great care is always required in identifying 'clean' capital and segregating out income/gains

Loopholes closed and anti-avoidance

- o The **source-ceasing** rule will no longer apply. It used to be the case that foreign income remitted to the UK from a bank account that had been closed in a previous tax year could escape UK tax. From 6 April, that will no longer be the case
- o It will no longer be possible for income arising in one year to be remitted tax-free the following year by claiming the remittance basis in one year but not the next
- o The **"cash only"** loophole for relevant foreign income is also being closed so that, after 6 April 2008, if an individual receives foreign income in the UK in *any* form (such as by bringing in an asset purchased with foreign income abroad), or has the power to enjoy that income in the UK, the amount received or enjoyed in the UK is chargeable to tax
- o Foreign income and gains given outside the UK to a close relative or passed to a non-resident trust or company, so that they no longer appear to be the gains or income of the individual, will now be taxed on the remittance basis if that individual effectively has the use and enjoyment in the UK of amounts derived directly or indirectly from those gains or that income. The definition of "connected persons" is now very wide and includes "a man and woman living together as husband and wife"
- o The current rules which catch 'deemed' remittances, for example where a non-UK domiciliary uses foreign income outside the UK to satisfy a UK debt, are being widened. Current planning structures such as offshore mortgages may now be caught under the remittance rules

The CGT charging regime for non-resident trusts

- The **settlor charge** (under s86 TCGA) continues, under which gains realised by non-resident trustees of settlor-interested trusts (which are very widely defined) are taxable on an arising basis on UK resident and domiciled settlors. Hitherto, the charge has not applied if the settlor is UK resident but non-domiciled
- However, from 6 April, the settlor charge will extend to RND settlors, so that they too will be taxed on trust gains on an arising basis *unless* they elect for the remittance basis. Therefore, it is only if the settlor opts to be taxed on the remittance basis (which may now involve the payment of the £30,000 charge as mentioned earlier), that he can claim to be subject to UK tax on remittances from the trust. However, gains made before 5 April 2008 which are remitted after that date are not caught
- Another consequence of these changes seems to be that the remittance basis can not, by its nature, apply to gains made on the disposal of UK assets held in offshore trusts and so these will automatically be taxable on RND settlors after 6 April. This might prompt significant disposals of UK investments before the tax year end
- Relationship with beneficiary charge: Where the remittance basis does apply to the s86 settlor-charge, any unremitted gains will be liable to be taxed under the beneficiary charge under s87 TCGA
- The **beneficiary charge** provides that trust gains which are not subject to the s86 charge are attributed to beneficiaries who receive capital payments from the trust. Beneficiaries who are UK resident and domiciled are thereby liable to UK tax on those gains, although currently RND beneficiaries are not so liable. In future, RND beneficiaries will be taxed on trust gains to the extent of any capital payments made to them
- **Retrospective effect?** The beneficiary charge has always operated in such a way that, to the extent that trust gains are not 'matched' with a capital payment in the same tax year, those gains are rolled forwards (or "stockpiled") and matched against capital distributions in subsequent years. Similarly, beneficiaries who receive capital payments at a time when there are no current year or stockpiled gains, may have subsequent trust gains attributed to them. There may therefore be an element of retrospective taxation in the new rules, e.g. RND beneficiaries who receive capital payments after 6 April can be taxed on gains made in prior years which have not been 'franked' by earlier capital payments. Also, it seems that RND beneficiaries who received capital payments in the past at a time when the rules never applied to them, could now be attributed with gains made in the future. This is not spelt out in the legislation or the explanatory notes and papers which accompany it and there is much lobbying on the point
- Because of the matching rules, there has always been an opportunity to "wash out" gains of offshore trusts by making capital payments to non-domiciled beneficiaries; that will presumably now only be possible if those beneficiaries are also non-resident
- The reporting requirements are to be extended to dovetail with the new rules so that the Revenue will have to be notified of trusts (including those made before 6 April 2008) created by settlors who are or were UK resident but not domiciled

CGT and non-resident companies

- The s13 TCGA anti-avoidance rule, which attributes gains made by non-resident companies to UK resident 'participators', is being extended to RND participators on the remittance basis

Transfer of assets abroad

- The draft legislation contains provisions to "clarify and strengthen" these existing anti-avoidance rules in relation to non-domiciled individuals. Broadly, the aim is link in the new remittance basis rules to income treated as arising to a person under the transfer of assets abroad rules

Proposed changes to mainstream CGT legislation

- We still await draft legislation on the Pre-Budget Report proposals to introduce an 18% flat rate of CGT from 6 April and abolish taper relief and indexation. Although this was not covered in the material published last week, it will have a bearing on planning as those who are going to be subject to UK tax on gains under the above rules will pay tax at a different rate to that which applies currently

This note is intended to give a brief explanation of the key aspects of the new legislation and we will be giving further thought to detailed planning for our clients, on which we will report further in due course. In the meantime, anyone affected by the changes should take advice as soon as possible as to planning. Please contact your usual Boodle Hatfield contact or one of the lawyers below.

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PRIVATE CLIENT & TAX CONTACTS

This document is intended to provide a first point of reference for current developments in aspects of tax and financial planning law. It should not be relied on as a substitute for professional advice. If advice on a particular circumstance is required please contact your Boodle Hatfield lawyer or one of the partners listed below:

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