



# Non-domiciliaries

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## Tax residency: day counting test

From 6 April 2008 the way in which an individual's presence in the UK will be calculated for tax purposes will change. The new rules mean that any day where the individual is present in the UK at midnight will be counted as a day of presence in the UK. Therefore if an individual arrives in the UK on a Monday and leaves on the Tuesday they will be considered to be present in the UK for one day. Under current rules both the day of arrival and that of departure would have been ignored and therefore no days of presence would have been recorded in relation to that visit.

There is an exemption to the rules outlined above that relates to transit passengers (ie someone who is in transit between two places outside the UK). This exemption allows individuals who are genuinely in transit (even if this involves them being in the UK at the midnight hour) not to have to count the time in transit as a day in the UK for tax purposes. The exemption will not cover those who try and fit in business meetings while 'in transit'.

### Our first reaction

The clarification is helpful and allows individuals who genuinely use the UK as a transport hub not to clock up extra days presence in the UK when they are in transit.

## The £30,000 annual charge

Where an adult has been resident in the UK in more than seven of the past 10 tax years they will be subject to UK tax on their worldwide income on an arising basis unless they pay a £30,000 annual charge and elect for the remittance basis of taxation to apply. There is a £2,000 de minimis limit whereby non-UK domiciled individuals, who have unremitted offshore income and gains in the tax year, will automatically qualify for the remittance basis of taxation with no election having to be made (and no annual charge being paid).

Where an individual has been resident for less than seven out of 10 tax years they will be able to elect for the remittance basis of taxation to apply without paying the £30,000 annual charge.

It will be possible for individuals to elect in and out of the remittance basis (and therefore the annual charge) on a year-by-year basis. This will give taxpayers the opportunity to review their position at the end of a tax year and decide whether they will pay the charge.

The annual charge will now only apply to adults (ie individuals under 18 will not have to pay the charge to claim the remittance basis until the year in which they turn 18).

It should be noted that the personal allowance for income tax purposes and the annual exemption for capital gains tax will not be available if the remittance basis of taxation is claimed (unless the de minimis limit applies).

There is also a change to the nature of the annual charge – it will now be treated as a tax charge on unremitted income and gains. The result of this is that the £30,000 should be creditable against tax under the terms of applicable double tax treaties. The unremitted income/gains on which the charge has effectively been paid will not be taxed if and when it is remitted to the UK. However, there will be particular ordering rules so that the income/gains on which the charge has been paid will effectively be treated as the last offshore income/gains to be remitted.

If an individual pays the £30,000 direct from an offshore bank account to HMRC by cheque or electronic transfer the £30,000 itself will not be taxed as a remittance.

### Our first reaction

The £30,000 annual charge is as expected following previous announcements. It is helpful that the payment will now be treated as a payment of tax resulting in it being potentially creditable against tax in other countries. Also restricting the charge to adults is helpful to family groups.

## Remittance of income

The Chancellor has confirmed changes to the remittance basis for non UK domiciled individuals who are living in the UK. Such individuals pay UK tax on UK source income and gains and foreign income and gains that are 'remitted' to the UK. There are, under current rules, a number of loopholes whereby offshore income and gains can be used in the UK without a taxable remittance arising. The changes below have been confirmed:

## Cessation of source

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Under the existing law it is possible for a non domiciled individual, who is UK resident, to remit income to the UK, in a tax year when the source of the income no longer exists, without creating a charge to UK income tax.

Under the new legislation due to take effect from 6 April 2008 this is no longer possible and income will be taxed when remitted to the UK, even if the source of that income no longer exists.

## Remittance in kind

At the moment it is possible for non domiciled individuals, who are resident in the UK, to use offshore investment income to purchase assets outside of the UK and subsequently enjoy those assets in the UK without triggering a taxable remittance.

This 'remittance in kind' loophole has now been closed so that foreign income will be treated as remitted if, in the future, the income is remitted to the UK in any form. Therefore if an individual brings property (eg a car or jewellery) into the UK that was purchased outside the UK with foreign income this will be treated as a taxable remittance from 6 April 2008.

There are a number of exemptions to these new provisions. Personal effects (such as clothes, shoes, jewellery and watches) and assets costing less than £1,000 will not be taxed. Further, assets brought into the UK for repair or restoration will be exempt as will assets brought to the UK for less than a total of nine months.

In addition to the exemptions outlined above legislation will be introduced from 6 April 2008 to exempt works of art from being taxed under the remittance basis of taxation if they are brought to the UK for the purposes of public display.

Any asset purchased out of offshore income, that was owned on 11 March 2008, can continue to be enjoyed in the UK after 6 April 2008. This is the case even if that asset has not yet been imported to the UK. Further if the asset is exported and later imported back to the UK after 5 April 2008 then no taxable remittance will arise.

If the asset is sold and cash is realised in the UK then at the point of realisation it will become taxable.

## Claims mechanism

There is a flaw in the current legislation that allows an individual to opt out of the remittance basis for foreign income only, not capital gains, and remit all previously accrued investment income to the UK without triggering a charge to tax.

The Budget confirms that this 'loophole' will be closed as from 6 April 2008. As such the last opportunity for planning with this method will be the current tax year (2007/08).

### Our first reaction

The closure of the loopholes was previously announced. However, further exemptions have been introduced in relation to remittances in kind which softens the blow.

## Remittance basis and foreign dividend income

Following the tax law rewrite in 2005 higher rate taxpayers that remitted foreign dividend income were liable to tax at the rate of 32.5 per cent. Previously it had been 40 per cent. HMRC have indicated that the changes introduced by the tax law rewrite were as a result of a drafting error and they will be reversing this such that the higher rate, currently 40 per cent, will apply to remittances of foreign dividends after 6 April 2008.

## Gifts offshore

It is currently possible for a resident non UK domiciliary to gift offshore income and gains to a close relative who then remits the funds without incurring a charge to tax (on the basis that there are no reciprocal arrangements created as a result of the gift whereby the funds work their way back to the donor).

From 6 April 2008 a taxable remittance will occur if such a gift is made to a close family member who subsequently remits the funds to the UK.

The definition of a close family member for these purposes includes spouses, civil partners, individuals living together as spouses or civil partners, and their children and grandchildren under 18. It will also cover companies with which the donor is connected and trusts settled by the donor.

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## Our first reaction

The definition of who the donor is connected to has been significantly reduced which is a welcome amendment.

## Remittance from mixed accounts

To date there has never been any statutory guidance on how remittances from accounts which have mixed funds, consisting of various sources of income and capital gains, are treated. The HMRC have taken the view that income comes out of the account first, followed by capital gains (as an apportionment of sales proceeds) and then finally pure capital.

Draft legislation issued in January stated that the order of remittance from a mixed fund should be UK taxed employment income, foreign employment income, foreign savings, foreign chargeable gains and finally income and capital not previously mentioned. The Budget announces that the final legislation will be more comprehensive than this but does not elaborate further.

## Our first reaction

These changes bring statutory certainty to a position that previously lacked clarity. However the final form of the changes are yet to be published.

## Offshore mortgages

Individuals who borrow funds from overseas have been able to remit the funds borrowed to the UK and service the interest on the borrowings from untaxed foreign income without giving rise to a tax charge.

The draft legislation indicated that the tax benefits afforded by this structuring would no longer be available for new or existing loans. The Budget announced certain grandfathering provisions that would apply until the loan is repaid or 5 April 2028, whichever is the earlier. However these would only apply where the loan is already in existence and is secured against a residential property provided there are no changes to the terms of the loan after 12 March 2008.

## Our first reaction

While the grandfathering provisions are welcome, it seems that where individuals have mortgages in which the terms will change after the expiry of a fixed term, they will become taxable earlier than might otherwise have been anticipated.

## Offshore capital losses

Non UK domiciled individuals currently do not get relief for losses arising offshore. From 6 April 2008 those non domiciled individuals that elect to pay tax on the arising basis will be able to get relief for foreign losses.

## Our first reaction

This is a welcome change. If non domiciled individuals elect into the UK taxation system they should be afforded the same treatment as UK domiciled individuals.

## CGT treatment for non-resident trusts: non-domiciliaries

Under the current law UK resident but non-UK domiciled individuals are specifically excluded from a capital gains tax charge in respect of capital gains realised by and capital payments received from non-resident trusts.

The suggested charge on a non-domiciled settlor of a non resident trust when gains are realised by offshore trustees has been dropped. However, any non-domiciled individual who receives a capital payment from a non-resident trust will be taxable to the extent (if there are realised gains within the trust) that funds are remitted to the UK. It should be noted that this treatment applies to all gains realised by the trustees – whether or not they are realised on UK or non-UK situs assets. Those non-domiciled individuals that have not elected for the remittance basis of taxation will be subject to tax whether or not the payment is remitted to the UK.

Complex computational provisions will be adopted to calculate the timing and the level of the tax charge. There will be an ability to elect to disregard gains that have accrued or arisen prior to 6 April 2008 but the use of this election will be coupled with the need to provide

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more detailed information concerning the trust to HMRC.

## **Our first reaction**

These latest proposals represent a real relaxation for beneficiaries of non resident trusts. Following the publishing of earlier draft legislation there were fears that the regime would be significantly worse. Whether the watering down of the original provisions is sufficient to placate the non domiciled community remains to be seen.

## **Tax treatment of non-resident companies**

The anti-avoidance legislation currently allows UK resident but non-UK domiciled individuals to hold assets via a non-UK resident company such that the chargeable gains realised through the holding company can be realised free of tax for the individual concerned. The legislation will be changed so that gains on UK situs assets realised by offshore companies will be taxable on the shareholder on the arising basis and gains on non-UK situs assets will be taxable on the remittance basis (providing the remittance basis of taxation has been claimed by the shareholder).

## **Our first reaction**

This change was announced in the Pre Budget report and was therefore to be expected. We are still awaiting final details of how the changes will operate in practice.

