

TAXATION OF UK RESIDENT, NON-UK DOMICILED INDIVIDUALS

Our July 2008 newsletter summarised the changes to the taxation of UK-resident, non-UK domiciled individuals (“RNDs”) which were introduced in the 2008 Budget. At the time our newsletter was published, Finance Act 2008 had not received Royal Assent, although the legislation took effect from 6th April 2008. The legislation has now had some time to settle and we have been able to assess the consequences. The purpose of this article is to set out some practical points for individuals and their overseas trustees.

THE £30,000 REMITTANCE BASIS CHARGE

RNDs are entitled to claim the remittance basis of taxation. Subject to the exception referred to below, if a RND chooses not to make a claim to be taxed under the remittance basis, all of their worldwide income and gains, wherever arising and whether brought into the UK or not, will be taxed in the UK (subject to the provisions of any double tax treaty). Therefore, it will be important for RNDs to decide whether or not to claim the remittance basis.

RNDs who have been resident in the UK for at least 7 out of 9 tax years will have to pay the £30,000 charge if they elect to be taxed on the remittance basis.

RNDs with unremitted foreign income and gains of less than £2,000 will automatically be subject to the remittance basis of taxation and will continue to benefit from their personal allowances and capital gains tax exemption. The RND will not have to pay the £30,000 charge. Therefore RNDs with relatively modest amounts of foreign income or gains should consider now whether to remit all of their worldwide income and gains apart from £2,000.

If an RND decides to claim the remittance basis for the tax year 2008/09, the claim must be made by 31 October 2009 if completing a paper tax return, or by 31 January 2010 if completing a return on-line. The RND will have to make a payment by 31 January 2010 of £45,000, being the £30,000 charge plus £15,000 as a payment on account for the tax year 2009/10, assuming they anticipate that they will be UK resident in that tax year and claim the remittance basis. During the tax year that the RND has made the claim, he or she will not be entitled to the UK personal tax allowances, or the annual exemption for capital gains. It will therefore be necessary to calculate whether an election is appropriate.

RNDs will be required to “nominate” the source of unremitted foreign income or gains on which the charge will be paid. At present, we do not know how much information will have to be given to HMRC. However, once the source has been nominated, it will be important to ensure that none of the monies from that source are remitted to the UK, either deliberately or inadvertently. If the nominated income or gains are remitted, it appears that no tax charge arises. The practical reality, however, is different; the remittance of the nominated amount will be deemed to be a remittance of the RND’s other foreign income or gains. Further, ordering rules will apply to determine what is remitted in a tax year which, it appears, will affect the present tax year and all future tax years as well. The ordering rules apply to the extent of the actual remittances of income or gains and they operate on a “worst first” basis, treating income as being remitted prior to capital gains and capital.

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Due to the uncertainty of the ramifications of remitting the nominated amount (in full or in part) we recommend that:

A separate, interest-bearing account is set up outside the UK to provide the RND with a source of income which will never be remitted. If the amount in this account is relatively small this should not create any inconvenience. All that is necessary is that the relevant account should generate some interest; £1 by the end of the tax year will be sufficient. The legislation provides that where the source of income or gains is insufficient to create a tax charge of £30,000, the charge is nonetheless increased to £30,000.

Provided the RND pays the £30,000 charge direct to HMRC from a foreign bank account (not being the nominated source), the payment will not itself be treated as a remittance.

Clarification is still awaited from the IRS as to whether or not the £30,000 payment will be available as a credit against US tax. US persons are taxable on their worldwide income and gains in the US. Therefore, claiming the remittance basis in the UK will only be beneficial to the extent that the UK effective rate of tax that would have been paid is higher than the US effective rate.

Where more than one member of a family is potentially subject to the remittance basis charge, it will be worth considering whether the family's affairs can be restructured to limit the payment of the charge to one family member.

CAPITAL LOSSES

There are new rules relating to capital losses. Before the new regime, losses on foreign assets were not available. From 6 April 2008 RNDs can make an election so that their foreign losses are available to them. The election has to be made in the first year that the RND elects to be taxed on the remittance basis and, once made, it is irrevocable. Losses are then set against chargeable gains in a specified order: first against unremitted gains, then remitted gains and finally UK gains. The ordering rules apply to both foreign and UK losses. Previously UK losses could only be set against UK gains. Careful consideration of the RND's UK and foreign loss position will need to be undertaken before deciding whether an election is likely to be beneficial.

MIXED FUNDS

There are ordering rules if RNDs remit monies from mixed accounts – broadly monies giving rise to the highest rate of tax are deemed to be remitted first. RNDs should therefore consider opening a number of different bank accounts in order to segregate different types of income (i.e. income which carries tax credits from that which does not) and the proceeds of sale of investments sold at a loss, no gain or a gain. This will enable them to choose in which order they remit monies to the UK to give themselves the most favourable tax result.

THE NEW REGIME AND TRUSTS

RND beneficiaries (including the settlor) who receive a capital distribution from an off-shore trust will be subject to UK tax on capital payments received in the UK which are matched with trust gains. However, capital payments which are kept out of the UK will not be taxed on a RND beneficiary who elects to be taxed on the remittance basis, even if matched with UK gains.

The reduction in the capital gains tax rate to 18% is clearly significant. With the proposal announced in the 2008 Pre-Budget Report to increase the top rate of income tax to 45% from 6 April 2011, it appears there is a clear benefit in investing for capital gains over income. Therefore, trustees will need to consider the impact of the new tax regime on investment policy, although, as always, any decisions regarding investments should not be driven solely by tax.

As we noted in our July newsletter, trustees are able to make an irrevocable election to rebase trust assets held on 6 April 2008. Where an election is made, any trust gains that had accrued, but had not been realised before 6 April 2008 will not be taken into account for the purposes of matching post-5 April 2008 capital gains to capital payments made to RND beneficiaries. The election effectively revalues trust assets to their market values as at 5 April 2008.

If the trustees decide it is appropriate to make the election, it must be made by 31 January following the tax year in which a capital payment is made to a UK resident beneficiary or when part of the trust fund is transferred to a new settlement. If the election is not made on either of these occasions, the rebasing election opportunity will be lost.

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Therefore, prior to making a capital payment or transferring trust assets to a new settlement, trustees will need to consider whether or not it is appropriate to make the rebasing elections. It is important to remember that the election will not be made on an asset by asset basis but will apply to all assets of the trust and its underlying companies.

HMRC have now published a form on which trustees can make the election. (<http://www.hmrc.gov.uk/cnr/rbe1.pdf>) The trustees will be required to provide the name and date of the settlement together with their full names and addresses. It remains to be seen what, if any, further use HMRC will make of this information.

Originally, the payment of fees and commissions to professional advisers would have resulted in a remittance of foreign income and gains if the fees related to services provided from the UK and were paid out of foreign income and gains. This has now been relaxed and, provided the services provided in the UK relate wholly or mainly to property situated outside the UK, and provided the payment is made to a non-UK bank account, the fees paid will not constitute a remittance. HMRC have confirmed that “wholly or mainly” means in excess of 50% and whether the condition is met will be judged by reference to work done (normally time spent). It does seem extraordinary that, as a result of this legislation, HMRC have required UK professionals who advise overseas trustees to open foreign bank accounts.

This article offers general guidance only. It reflects the law as at March 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

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