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Seven-year ditch for non-domiciliaries!

We have long been promised changes in how non-domiciled individuals are taxed. Now we know; the remittance basis will still apply but anyone claiming it will have to pay an additional £30,000 a year for the privilege regardless of the size of their remittances or tax bills. This is just one of the far-reaching proposals due to come into force on 6 April 2008. We await the publication of a consultative document due at the end of the year but this leaves very little time to consult before the new legislation impacts.

Importantly, the proposals will not apply to non-domiciled individuals unless they have been resident in the UK for 7 tax years. All periods of residence before 6 April 2008 are included in the 7 year count. This means that individuals who have been resident for 7 years or more before 6 April 2008 will automatically have to pay the charge to claim the remittance basis after that date. Equally, if an individual has been resident for 5 years by 6 April 2008, he will have only two further years to go before the levy applies.

After the 7th year the remittance basis can only be claimed if the taxpayer pays the flat charge of £30,000. If he does not pay the £30,000 charge, he will be taxed on his worldwide income and gains arising in the tax year. Even if he does pay the charge, he will still have to pay tax on his remitted income or gains as well.

The question is - is it worth paying the levy? An individual would need £75,000 of non-UK income in the year or approximately £1,500,000 capital to make it worthwhile. Some non domiciliaries do have such levels of wealth, but under these levels the levy will bite hard and getting it right before 6 April 2008 is going to be vitally important. There may be some ways to improve the position:

- If an individual has sources of unremitted income and gains then remitting some or all of these before 6 April 2008 should be considered before the annual charge kicks in.
- Depending on the numbers involved, it may be beneficial to remit funds after 5 April 2008 and pay tax on an arising basis.
- If non-UK income and gains have arisen before 2007/08, it may be possible to bring funds to the UK in 2007/08 without attracting a charge to UK tax. For this to work, an individual would not claim the remittance basis on his 2007/08 tax return. We are awaiting the detail of the anti-avoidance legislation to see if this is a realistic option.

Where individuals benefit from claiming the remittance basis, the proposals alter the availability of personal allowances in a punitive way. Further attacks on benefits previously enjoyed by non-domiciled UK residents have been threatened, including removing the opportunity to carry out source-ceasing planning, curtailing the benefits of offshore structures, and extending the definition of remittance in relation to relevant foreign income. We will have to wait for the consultation paper to find out exactly what the Revenue has up its sleeve.

Overall, this is a challenging package of measures which is clearly aimed at putting the resident non domiciled individual into the same taxation bracket as those domiciled here.

In this issue

- Seven-year ditch for non-domiciliaries!
- All change - a gain!
- What a difference a day makes?
- Oh Darling - pass me that nil rate band!

All change - a gain!

Just when you thought you knew where you were, along comes a major shake-up of the basic principles of Capital Gains Tax (CGT). This does not apply to gains made by companies, which is important! The headline changes are:

- A flat rate of CGT of 18%.
- Withdrawal of taper relief that currently applies to reduce a gain based on the length of ownership and the nature of the asset. Today, for non-business assets held for more than 10 years the effective rate of tax is 24% and for business assets held for more than 2 years is 10%.
- Withdrawal of the indexation relief that currently applies between March 1982 and April 1998. This relief had increased the tax base cost of an asset by amounts up to a maximum of 104%.
- From 6 April 2008 all shares of the same class will be "pooled" for tax purposes and treated as a single asset. Regrettably though the drive for simplification did not produce any removal of the complex rules on preventing bed and breakfasting.

On the basis that taper relief was originally introduced to encourage long-term investment, the very short holding period for business assets of only 2 years seemed a little bizarre when it was first introduced. However, the effective 10% rate has been a great incentive for entrepreneurs to "have a go" and reap a good net-of-tax reward.

What do these changes achieve then?

The new 18% rate will surely encourage short-term investment. Most business owners will pay more tax if they sell after 5 April 2008. This is because the type of asset and length of holding period will be irrelevant thereafter. This is likely either to encourage some very rash decisions in the short-term; or give some great scope for creative thinking in terms of crystallising "uncommercial" gains in this tax year.

There will be winners and losers, but in principle, the changes can probably best be digested by way of examples. Whilst all of these refer to company shares the same principles apply to all assets. The impact is significant.

First look at an individual with shares in an investment company, say a property letting company, who has held his shares since the late 1970's. At March 1982 the shares were worth £1.5 million and now are worth £4 million.

The impact of the CGT changes is huge:

Example 1	**2007/08 £000**	**2008/09 £000**
Sale proceeds	4,000	4,000
Less		
Tax cost	(1,500)	(1,500)
Indexation	(1,560)	0
Gain	940	2,500
Less		
Taper relief at 40%	(376)	0
Taxable gain	564	2,500
Tax at 40% 2007/08 vs 18% 2008/09	**226**	**450**

For this individual the advice is clear - if a disposal is planned at all, it needs to be in this tax year under the current regime rather than the next.

If the same individual had held his shares for rather less time, say for 10 years, the tax movement is again significant but swings the other way:

Example 2	**2007/08 £000**	**2008/09 £000**
Sale proceeds	4,000	4,000
Less		
Tax cost	(1,500)	(1,500)
Gain	2,500	2,500
Less		
Taper relief at 40%	(1,000)	0
Taxable gain	1,500	2,500
Tax at 40% 2007/08 vs 18% 2008/09	**600**	**450**

...continued

All change - a gain!

Staying with the same investor having held his shares for significantly less time the tax saving is even more noticeable under the new regime:

Example 3	**2007/08 £000**	**2008/09 £000**
Sale proceeds	4,000	4,000
Less		
Tax cost	(1,500)	(1,500)
Gain	2,500	2,500
Less		
Taper relief at 0%	0	0
Taxable gain	2,500	2,500
Tax at 40% 2007/08 vs 18% 2008/09	**1,000**	**450**

A clear demonstration of the benefits to a short term investor!

The position for business owners or even investors in shares of trading companies is significantly worsened as the following example shows:

Example 4	**2007/08 £000**	**2008/09 £000**
Sale proceeds	4,000	4,000
Less		
Tax cost	(1,500)	(1,500)
Gain	2,500	2,500
Less		
Taper relief at 75%	(1,875)	0
Taxable gain	625	2,500
Tax at 40% 2007/08 vs 18% 2008/09	**250**	**450**

So what should you do?

Realistically tax should never drive commercial decisions. That said, however, the tax implications are such that if you do envisage a sale at some stage in the near future we need to talk - you have to decide whether it is better for you to crystallise a gain now to make use of available reliefs and lower rates and so reduce future gains - or not!

Happy planning!

What a difference a day makes?

Alongside the changes affecting non-domiciled individuals, the government has taken the opportunity to make changes to UK residence rules. The issue was raised in a tax case in October 2006 and, despite the Revenue's assertion at the time that its practice would not change, the concession which allows individuals to leave out days of arrival and departure in calculating the total number of days spent in the UK has been withdrawn.

In determining whether an individual is tax resident in the UK for 2008/09 onwards the days of arrival and departure will be treated as days of UK presence bringing the UK more into line with the practice of most other jurisdictions. This will have implications for frequent visitors to the UK who are trying to remain non-resident: the Monday to Friday trip will now account for 5 days instead of the 3 days under the present rules. The international commuter will have to consider the number and duration of his visits even more carefully if he is not to infringe the 90 day rule. To ensure less than 90 days in the UK means 18 working weeks rather than the 30 that could previously have been spent here.

Oh Darling - pass me that nil rate band!

Although the biggest headline grabber of Alistair Darling's PBR certainly spoke of inheritance tax cuts for couples, the existing total relief for both spouses/civil partners remains unchanged and is merely wrapped in a slightly different manner, representing no extra overall tax savings.

Any assets passing on death to a spouse or civil partner normally qualify for spouse exemption and no inheritance tax is payable. However, each individual is entitled to a nil rate band allowance (currently £300,000) and, essentially in this scenario, the nil rate band on the first death goes unused. With the use of tax planning Wills, there have been various ways in which the first nil rate band could be rescued.

The proposal is that the unused amount of the individual nil rate band will now pass to the survivor spouse. This provides a real opportunity for the family in considering the estate of anyone who dies after 9 October 2007 and who was widowed after 18 March 1986. It is possible that there will be up to two nil rate bands to set against the estate. This is retrospective and is likely to be helpful in both lifetime and post-death planning.

One quirk of the draft legislation is that if someone has survived more than one spouse then on their death, within a two year time limit, their personal representatives can claim the unused relief. The maximum proportion they can claim is capped at 100% of the current rate. Consider the following illustrations including potential planning as detailed below.

Example 1

Jenny dies on 31 July 1997 and leaves all of her estate to her husband Donald - thereby leaving 100% of her inheritance tax nil rate band unused. Donald dies on 31 December 2007 with an estate of £600,000 leaving all assets to his son Harry. The executors warn Harry that the potential inheritance tax payable is £120,000. However, they make a claim for an additional 100% nil rate band as a result of the new rules. This means that the whole of the estate passes free of inheritance tax.

Example 2

Alan dies on 5 April 1996 with an estate of £500,000, leaving £77,000 under the terms of his Will to his daughter and the remainder to his spouse Barbara absolutely. The nil rate band when Alan dies is £154,000 so 50% of his nil rate band is unused.

Barbara then marries Charles, but she dies on 5 April 2008 leaving £700,000 to Charles. The nil rate band when Barbara dies is £300,000, but her executors can claim exemption for the 50% of Alan's nil rate band previously unused (represented by £150,000).

This means Charles can enter into a deed of variation to effect a gift under the terms of Barbara's Will to, say her daughter, passing £150,000 free of inheritance tax. Barbara's entire estate is still exempt and they have made use of the brought forward unused nil rate band (from Alan) which would otherwise be wasted. The full 100% of her nil rate band passes to her surviving spouse.

Charles dies on 10 April 2009, leaving an estate of £1,000,000 to his new girlfriend. The nil rate band when Charles dies is £325,000 and, in addition to this nil rate band, his executors can also claim exemption for Barbara's unused nil rate band (an additional 100%).

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