

## NEW TAX RULES FOR NON-DOMICILED INDIVIDUALS RESIDENT IN THE UK

The Pre-Budget Report on 9 October 2007 made reference to changes to the remittance basis of taxation for non-UK domiciled individuals who are resident in the UK, and also to a change in the way that the days test for determining an individual's residence status in the UK would be applied. Although an outline of the new provisions was set out in press notices at the time, we have only now received the specific detail.

Draft legislation was finally published on 18 January 2008. Although this is the subject of a consultation process running to the end of February 2008, and therefore may be subject to amendment, the extent and workings of the changes are now apparent. **As the new rules are due to become effective from 6 April 2008, all individuals affected need to review their affairs before that date.**

An important point to note is that the draft legislation does not make any change to the way in which an individual's domicile status is determined. It is only the income tax and capital gains tax consequences of UK resident but not domiciled status that are affected.

### Residence tests

In determining whether an individual is resident in the UK for a tax year a mixture of statutory provisions and HM Revenue & Customs practice have historically been applied. Specific day tests of presence in the UK of 183 days or more in any one tax year, or of 91 days or more on average over a period of up to four years, are at the core of these rules. It has been accepted practice that for the purposes of counting days of presence in the UK, days of arrival and departure here are ignored.

From 6 April 2008 days of arrival and departure in the UK will be counted as days of presence in the UK for the purposes of these tests. Individuals "in transit" through UK airports or ports will not be treated as present in the UK on those days, provided they remain "airside" at all times.

### ACTION POINTS

- **This new rule could have a significant impact for individuals making frequent, short visits to the UK, or for those asserting that they have relinquished UK residence because of the amount of time that they spend overseas. These individuals will need to re-consider their travel schedules from 6 April 2008 to take the changes into account.**

### Remittance basis

An individual resident but not domiciled in the UK is currently entitled to claim that their non-UK investment income is taxable here only on the remittance basis, rather than as it arises. Non-UK employment income and capital gains of such individuals are automatically taxed on the remittance basis.

From 6 April 2008, such individuals will need to make a specific claim each year that all non-UK income and capital gains for that year is to be taxed on the remittance basis. The claim will be made in the individual's annual tax return.

The claim for the remittance basis is made on a stand alone basis for each tax year and therefore it is possible to claim in one tax year, and not in the next, and so on.

Where no such claim is made for a tax year, all of the individual's non-UK income and capital gains for that year will need to be declared and taxed on the arising basis.

No claim will be required for a year in which an individual's total non-UK income and capital gains are less than £1,000. The remittance basis will apply automatically in those circumstances.

### ***Tax costs of claiming the remittance basis***

The making of a claim for the remittance basis for a tax year will from 6 April 2008 have the following new tax consequences.

- The individual will not be able to claim the personal income tax allowance or the capital gains tax annual exemption for that year, even to set against UK income and gains.
- The individual will be required to pay a £30,000 levy for that tax year, over and above any other tax calculated on amounts that are remitted to the UK in the year.  
**HOWEVER it should be noted that the £30,000 levy will only apply to individuals who have been resident in the UK in 7 out of the 9 tax years preceding the tax year in question.** Residence in the UK for any part of a tax year will count for these purposes.

A point to note is that these new tax consequences will be triggered by the making of a claim for the remittance basis for a tax year. Therefore, where a claim is not required because the individual's non-UK income and capital gains are less than £1,000 for a year, these new tax consequences will NOT apply for that year.

The effects of the loss of personal allowances and the £30,000 levy will be calculated as part of the individual's self assessment, and will be payable in the same way as any other tax due for the year, in other words on 31 January following the end of the tax year.

### **ACTION POINTS**

- **As the claim for the remittance basis can be made after the end of the tax year, no action is strictly required before 6 April 2008. However, as forward planning individuals should consider –**
- **Whether or when they exceed the 7 out of 9 year residence condition**
- **Whether the tax saved through claiming the remittance basis for unremitted income and capital gains for that year would be likely to exceed the £30,000 levy and the loss of the personal allowance. As a very rough guide, a higher rate taxpayer would require unremitted non-UK income and gains in the order of £80,000 for a tax year to be better off claiming the remittance basis. However, other issues may need to be taken into account, particularly where the individual has interests in non-UK companies and trusts (see below).**

### ***Changes to the definition of remittances of income and capital gains***

Existing law and practice can produce some often surprisingly generous definitions of what constitutes a remittance of income or capital gains to the UK, and these have facilitated the management of remittances of funds to the UK on a tax free basis.

From 6 April 2008, there is to be an extensive revision of these rules, and new statutory provisions to replace current practice. In outline, the key changes will be:

- Income arising in one tax year cannot be remitted tax free in a later tax year where the remittance basis is not claimed.

- It will no longer be possible to remit income tax free in a tax year when the source of that income had ceased before the start of the year. This will put an end to, for instance, the "carousel" planning of offshore bank accounts.
- The bringing assets into the UK, or the use of services in the UK, that have been funded out of non-UK income or capital gains will be taxed as a remittance.
- It will no longer be possible to gift non-UK income or capital gains to a connected person outside of the UK, and for them to subsequently remit this without a tax charge on the individual receiving the original income or gains. Connected persons are widely defined for these purposes as spouses or civil partners, or persons lived with in such a way; parents; children and remoter issue; siblings; and aunts and uncles.
- It may no longer be possible to fund the interest on debts secured on property in the UK non-UK income or capital gains on a tax free basis.

### ***Remittances from mixed funds***

A specific statutory basis will be applied from 6 April 2008 where remittances are made from offshore accounts that contain a mixture of sources. It will now be necessary to match remittances from such accounts by allocating transfers from these in the following order:

- UK employment income
- Non-UK employment income
- Non-UK investment income
- Non-UK capital gains
- UK investment income, or capital

This order is to be applied on an annual basis. When all of the transfers from an account for a year have been so matched, the matching is then undertaken in the same way for earlier years in reverse chronological order.

These rules will also apply to remittances from non-UK trusts and companies.

The above method, whilst giving greater certainty than the previous practice, will often mean a less favourable outcome, particularly in respect of capital gains. It also means a great deal of record keeping will be necessary.

### **Gains arising to offshore companies and trusts**

It is in this area in particular that the extent of the draft legislation goes beyond what was anticipated in the original announcement. **Urgent consideration needs to be given to the consequences of these changes to the rules and any action that might need to be taken before 6 April 2008.**

### ***Offshore companies***

There are existing provisions that treat gains realised through closely held non-UK companies as accruing to UK resident and domiciled shareholders with interests of greater than 10% in the company.

From 6 April 2008, these rules will be extended to UK resident and non-domiciled individuals. This means that such individuals will be taxed on their proportionate share of any gains realised by such companies on or after that date.

If the individual claims the remittance basis of taxation for the year in which the gain arises to the non-UK company, then they will be taxed on gains arising in respect of assets in the UK. Gains on non-UK assets will be taxed on a remittance basis.

There is no credit for the tax paid in this way if a gain is realised on the ultimate disposal of the company so this could be expensive.

Many non-UK domiciliaries own their home through an offshore company. As the company is not an individual no principal private residence relief is available but the attribution rules will mean that the gain on the sale of the property will be taxable in the UK.

## **ACTION POINTS**

- Consider winding up the structure before 5 April 2008.

### ***Offshore trusts***

There are similar provisions that treat gains realised by non-UK trusts as accruing to UK resident and domiciled settlors who retain an interest in such trusts. The definition of a retained interest is very wide and includes spouses, children and grandchildren even if the settlor himself cannot benefit directly.

From 6 April 2008, the rules will be extended to UK resident but not domiciled settlors. The gains arising to the trust in a tax year will be treated as accruing to the settlor.

If the individual claims the remittance basis for a tax year, he will be taxed on gains arising in respect of UK assets. Gains on non-UK assets will be taxed on the remittance basis.

The gains attributed in such a way will need to be taken into account in any consideration of the relative merit of a claim for the remittance basis for a particular tax year and the costs of the annual £30,000 levy.

### ***Non-settlor beneficiaries***

There are further rules that attribute gains of offshore trusts to beneficiaries who receive capital payments. These have only applied to UK resident and domiciled beneficiaries. The rules will be extended to include non-UK domiciled beneficiaries from 6 April 2008. The impact of this rule change is particularly far reaching and unexpected:

- The remittance basis will not apply, so gains will be taxed whether or not the capital payment is received in the UK.
- Capital payments received on or after 6 April 2008 can be matched with any unmatched capital gains arising before that date.
- Similarly, any capital gains realised on or after 6 April 2008 can be matched with any unmatched capital payments received before that date.
- Settlor can be taxed in this way on any unremitted capital payments.

## **ACTION POINTS**

The effects of these rules in respect of offshore trusts and companies will require an urgent review before 6 April 2008 to determine:

- Whether gains should be realised, and possibly distributed, before 6 April 2008.
- Whether action needs to be taken to clear past capital gains or capital payments on a tax free basis before 6 April 2008.
- Whether consideration should be given to winding up the trust or company before 6 April 2008.

### ***Income of offshore trusts and companies***

From 6 April 2008, individuals will be taxed on all of the income of such structures if they retain an interest in them. If the remittance basis is claimed for a year, non UK income will be taxed only on the remittance basis.

## ***New information powers***

Trusts established by UK resident and domiciled settlors must be notified to HM Revenue & Customs within prescribed time limits. From 6 April 2008 these rules will be extended to UK resident but not domiciled settlors.

- Existing trusts need to be notified to HM Revenue & Customs by 5 April 2009.
- New trusts need to be notified to HM Revenue & Customs within three months of establishment.
- Existing trusts where the settlor becomes UK resident on or after 6 April 2008 need to be notified to HM Revenue & Customs within 12 months of them becoming so resident.

## **Conclusion**

There may be changes to the proposed legislation before final enactment and there are many other points of detail that are not covered here. However it is clear that all UK resident but not domiciled individuals need to consider the potential impact of the proposed changes before 6 April 2008 and to identify any planning steps that they should undertake. Obviously time is short where action is required and we would ask you to contact us without delay if you are affected by these changes.

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