

Spring 2008

A real credit for non doms

We now know that UK resident individuals who are non-UK domiciled and have been resident in the UK for at least 7 years out of the preceding 9 years will have to pay £30,000 to claim the remittance basis of taxation on their foreign income and gains.

It has been confirmed that the £30,000 will now be a tax charge rather than a stand alone charge. This should mean that this will be creditable under Double Taxation Treaties, which was a major issue for the US and other jurisdictions.

It will be payable in respect of an individual's unremitted foreign income and gains and an individual can choose which unremitted income or gains the £30,000 is paid on. As such, it could be either income tax or capital gains tax or a mixture of both. When that particular foreign income or gain is later remitted, no further tax will be payable on the remittance. This is a very different treatment of the charge from that outlined in the original proposals as it represents a real tax credit.

The remitted funds

However, there will be rules to ensure that the foreign income and gains to which the £30,000 tax is attributed are remitted last of all. This means that an individual would have to remit all his other foreign income or gains before he will get any credit for the tax paid on the £30,000 charge. There is some uncertainty about this which we hope the Finance Bill will clear up.

To pay or not to pay?

Each individual case will need to be carefully considered taking into account the level of foreign income and gains and whether foreign tax has already been paid.

Exceptions to the legislation

This legislation will not apply to individuals whose total unremitted foreign income and gains in any UK tax year is less than £2,000 and individuals under the age of 18 at the end of the tax year will also not have to pay the charge.

Countdown to midnight for non residents

The Budget has relaxed the proposed rules for counting the days spent in the UK when determining whether an individual is resident in the UK for tax purposes. It had previously been announced that days of arrival in and departure from the UK would be counted towards the total number of days spent in the UK.

The latest revision now means that, on or after 6 April 2008, only days where the individual is present in the UK at midnight will be counted as a day spent in the UK. In addition, there will be an exemption for passengers who are in transit between two places outside the UK. This caters for people who have to change airports meaning that days spent travelling via the UK will not now count as a day of presence here. This exemption is more generous than the original proposals.

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All settled offshore?

We now have some much needed clarification on the tax treatment for UK resident and non-domiciled individuals with interests in non-UK trusts and companies. These details are, in respect of non-UK trusts in particular, a very welcome relaxation of the rules that had been included in the draft legislation published in January.

Settlor charge

A major amendment of the proposed new rules is that non-domiciled settlors of offshore trusts will remain outside the scope of a UK tax charge. It was expected that gains realised by offshore trustees could be taxed on a settlor even if the gains were not distributed to them.

The fact that the gain will not now be charged automatically on non-UK domiciled settlors means that non-UK trusts will remain tax efficient vehicles for such individuals for so long as the gains are retained in the trust. Any distributed gains will be taxed as set out below.

Gains charge on capital distributions

Capital gains of an offshore trust will be taxed on beneficiaries resident in the UK when capital is distributed to them. As previously announced, the charge is to be extended to non-UK domiciled beneficiaries from 6 April 2008. However, there have been a number of important concessions to the way in which these rules will apply to non-UK domiciled individuals.

The charge works by matching capital gains realised by trustees of non-UK trusts against capital payments made to beneficiaries. Beneficiaries resident and domiciled in the UK are then taxed on the trust gains matched with capital payments received by them.

The original proposals would have imposed retrospective taxation for non-UK domiciliaries but it is now confirmed that this will not be the case.

Broadly, the impact of the new rules for UK resident but not domiciled beneficiaries will be as follows:

- Capital gains arising to the trust before 6 April 2008 will not be taxable even where these are matched with capital payments made to them on or after that date. Neither will capital payments made before 6 April 2008 be matched with capital gains arising to the trust on or after that date.
- Non-domiciled beneficiaries will be potentially taxable on trust gains on or after 6 April 2008 only where:
 - The trust realises gains on or after 6 April 2008, and

- The beneficiary receives a capital payment that is matched with these gains on or after that date.
- Trust gains will be taxed only on remittance to the UK if the beneficiary claims the remittance basis for the year. This basis will apply even to UK assets that are disposed of by the trust, which is another surprise change to the proposed rules.

In addition to these features, trustees of non-UK trusts can also consider making a "rebasement election" for all assets held at 6 April 2008. The effect of the election is that for gains realised on or after 6 April 2008, the element of the gain that accrued before that date will not be taxed. This therefore wipes out retrospective taxation on unrealised as well as on realised gains.

The draft legislation included wide ranging requirements for the disclosure of information on offshore trusts to HM Revenue & Customs (HMRC). These have now been removed, but subject to important provisos:

- Information on offshore trusts can still be required by HMRC where enquiries are made into the tax affairs of a UK resident settlor or beneficiary, whether or not they are domiciled in the UK.
- It appears that where the 6 April 2008 rebasing election is made, an unspecified amount of information will need to be supplied to HMRC regarding the trust and its assets.

Offshore companies

As expected, the rules treating gains realised by non-UK 'close' companies as accruing to UK resident and domiciled shareholders with interests of greater than 10% in the company will be extended to non-UK domiciled individuals for gains realised on or after 6 April 2008.

In contrast to the revised rules for offshore trusts, it would appear that there will be a distinction between gains realised on UK assets, which will be taxed on an arising basis, and on non-UK assets where the remittance basis would apply if that basis of taxation is claimed. There will also be no facility to make a 6 April 2008 rebasing election for assets held by such companies.

Conclusion

The revised proposals take on board many of the concerns raised during the consultation process on the original draft legislation. The impact of the changes, and the options that should be considered, will depend on the specific circumstances of each case.

Lifeline for life interests

Radical reforms to the Inheritance Tax (IHT) regime were introduced by Finance Act 2006 for certain UK trusts. In particular, trusts with an existing beneficiary entitled to the income of the trust (a life interest) had until 5 April 2008 to consider the effects of the IHT reforms. By adjusting the terms of the trust the old IHT treatment could be preserved for longer. This is often achieved by passing the life interest to a younger beneficiary, a generation or two removed from the previous life tenant.

The termination of the original life interest is treated as a Potentially Exempt Transfer for IHT by that life tenant and goes on their own 7 year clock for IHT purposes. It is exempt if the new life interest is established in favour of their spouse/civil partner.

Just weeks before the period of grace runs out, the Treasury has given it a new breath of life, by a generous extension of the deadline from 5 April to 5 October 2008.

The extension does not affect the transitional provisions introduced by FA2006 in relation to other types of trust, nor additions to, or creations of, new Interest in Possession Trusts.

Having originally allowed the trustees a two year period to consider and implement a replacement life interest, the reason for this late extension is unclear. Those who are giving the matter their consideration only now have been thrown a lifeline, which will enable them to get their legal documentation completed in good time. It will also be welcomed by solicitors in estate planning who have been energetically drafting paperwork before the 5 April deadline!



Last chance to stock up on Indexation!

You will no doubt be aware that, for individuals and trustees, assets held between March 1982 and April 1998 attracted an addition to tax base cost for the effects of inflation (indexation relief). This relief is being abolished from April 2008.

However, the Revenue announced (by way of their frequently asked questions) that a transfer of an asset before 6 April 2008 between spouses will capture accumulated indexation relief. Obviously the effect of this transfers on other areas, such as Entrepreneurs' Relief, will also have to be considered. It is not a blanket solution but may be of use in planning.

Nothing to tax you this year...

Two of the important pre-announced proposals have been deferred for a year:

- **Income shifting** - the government has expressed the view that too much tax is lost where a business is structured in such a way that dividends or partnership profits are shifted from higher rate taxpayers to lower rate taxpayers. The common, although not exclusive, scenario is the husband and wife business. Draft legislation was published more than 3 months ago to "correct" this situation although the very wide-ranging provisions produced could have affected virtually every private business. The overwhelming opinion was that the application of the current proposals was just not practical to implement.

The government states that it remains committed to change as avoiding tax by shifting income has to stop but has nonetheless bowed to pressure on the current proposed legislation. The changes have been deferred to the Finance Bill 2009.

- **Capital allowances on cars are at the moment unchanged** - at least until April 2009 when it is expected that the allowances on cars will change to an emissions based approach. Expenditure on cars with CO2 emissions of 160g/km or lower will attract a writing down allowance of 20%; on all other expenditure on cars the rate will be 10%. On some expensive cars this will actually improve the position, but wait for it!

Capital Gains Tax - what relief for Entrepreneurs

Under the major changes to capital gains tax from April this year many people will benefit from the reduction to a flat rate of 18%. There are, however, also many losers, mainly those people who would have benefited from the current 10% rate on business assets.

Following intensive lobbying, the Chancellor announced a new Entrepreneurs' Relief. A detailed review of the proposals shows that the relief is more complicated and less attractive than hoped for:

1. As the relief applies only on the first £1 million of lifetime gains after 5 April 2008, it is therefore unlikely to be of great benefit to the serial entrepreneur. The previous taper relief regime had no upper limit on gains.
2. The relief is available to individuals making gains on the disposal of an unincorporated business (or their partnership share), certain business assets, or shares in their "personal" trading company. The problem is that this means the individual has to hold at least 5% of the ordinary shares, carrying at least 5% of the votes and must also be a director or employee of the company. This means very small employee shareholdings will not qualify.
3. The shares or business must have been owned for at least one year.
4. Trustees will be able to claim relief on certain disposals, broadly where a beneficiary has both a life interest and is involved in the business being sold.
5. The relief will only be available where there is a disposal of a business. Sales of assets without an associated business sale will not qualify. Another group who will miss out on the relief are the owners of commercial property which has been let to third party traders. Where the property has not been used within their own trade, or by their own personal company, the gain on the property will now be taxable at 18%.

Company share sales are often made for a combination of cash and shares or loan notes in the acquiring company. Where shares or loan notes have been received a proportion of the gain is deferred until those assets are disposed of. On such disposals after April 2008 the position on Entrepreneurs' Relief is:

- A sale of the new shares qualifies if the holder is an employee or director and owns the requisite 5%.
- Where the loan notes are "qualifying corporate bonds" (broadly normal commercial loans) the deferred gain will qualify if the original shares would have qualified (assuming the relief had been available).
- Where the loan notes are "non-qualifying corporate bonds", the relief will only apply if the holder is an employee or director and also holds the requisite 5% of the shares.

The new relief is an improvement over the original proposals, but still leaves many investors facing substantially increased liabilities in the future.



For further information please call your normal contact at any of the offices below.

St. Albans

Gloucester House
72 London Road
St. Albans
Hertfordshire
AL1 1NS

Tel: (01727) 869141
Fax: (01727) 869149
stalbans@mercerhole.co.uk
DX: 6121 St. Albans

London

International Press Centre
76 Shoe Lane
London
EC4A 3JB

Tel: (020) 7353 1597
Fax: (020) 7353 1748
london@mercerhole.co.uk
DX: 469 London/Chancery Lane

Milton Keynes

Silbury Court
420 Silbury Boulevard
Central Milton Keynes
MK9 2AF

Tel: (01908) 605552
Fax: (01908) 677433
miltonkeynes@mercerhole.co.uk
DX: 54467 Milton Keynes

Northampton

300 Pavilion Drive
Northampton Business Park
Northampton
NN4 7YE

Tel: (01604) 669330
Fax: (01604) 702000
northampton@mercerhole.co.uk

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