

# **NON RESIDENTS AND NON DOMICILIARIES ... BREAKING UK NEWS**

## **NEW GOVERNMENT ANNOUNCEMENT**

**DECEMBER 2011**



## NON DOMS – PROPOSALS FOR CHANGE FROM APRIL 2012

### 1. Introduction

On Tuesday, 6 December 2011 HM Revenue & Customs issued draft legislation for the new tax regime for non doms applying from April 6 2012. There was also a summary of responses to the consultation process and the draft legislation largely followed the proposals set out in the Consultative Document of 17 June 2011.

There was useful clarification of the proposals to allow tax free remittances to invest in UK business and it was reassuring that investment not only to assist unquoted trading companies but also commercial property development and letting were to be permitted. Consideration is being given to investment in partnerships being also allowed, but only from April 2013. There is a welcome relaxation of the former “14 day” requirement. Now it is suggested that non doms will have 45 days (was 14 days) to take the proceeds of sale of investments out of the UK to prevent a tax clawback on the “tax free” remittance proposal.

For all taxpayers, whether non dom or not, there is welcome news that the proposal to take foreign currency gains and losses out of Capital Gains Tax is to apply not only to individuals but also to trustees and estates of deceased persons.

All non doms need to take account of the draft legislation and new proposals and there continue to be very large tax advantages for such individuals to come and settle in the UK. All the tax proposals refer to the need for incentivisation to encourage non doms to remain in the UK and invest here.

With our large non dom client base, we are setting out below some thoughts on the proposals although we should stress of course that these are only possibilities for change yet to be confirmed in law.

### 2. Current Regime

Since April 2008, non doms who are UK resident have generally had a choice as to whether to declare their worldwide income and gains or to adopt the remittance basis for overseas income and gains. For those who have been resident for seven years or less, claiming the remittance basis means they lose the benefit of the personal allowance and CGT annual exemption. For those who have been here more than seven years there is a choice each year but claiming the remittance basis has meant the need to pay a £30,000 levy.

Non doms also enjoy certain Inheritance Tax (IHT) benefits, namely that normally they will only be liable to IHT on their UK assets. However after being resident for all or part of 17 of the last 20 tax years, they will become deemed domiciled for IHT and hence liable to IHT on their worldwide assets. It should be noted that the proposals here have no impact on the IHT status of non doms.

### 3. The Proposals in Detail . . .

#### 3.1 Increase in Levy

As previously predicted, those who have been in the UK for 12 or more of the last 14 tax years will have to pay a £50,000 levy from April 2012 in order to get the benefits of the remittance basis for overseas income and gains. It is noted that 5,400 taxpayers account for the £30,000 levy each year. The opportunity will continue to exist each tax year for those in this position to choose whether to pay the levy or not.

*Example – Alison, is German domiciled and lives in London. She arrived here in March 1999 and hence will need to pay a £50,000 levy from April 2012 to get the benefits of the remittance basis rather than £30,000 as she has been here for 12 years or more. She will probably choose to do this as her offshore income and gains are usually around £200,000 each year and she does not need to make any remittances.*

**Planning Opportunities** – For some non doms it is a marginal decision each year as to whether to pay the £30,000 levy or declare worldwide income and gains. For some therefore it will not be appropriate to pay the higher £50,000 levy and they may care to accelerate the crystallisation of offshore income and gains where appropriate prior to April 2012 so as to pay less tax from April 2012. The scenario here is that perhaps from that date they will declare their worldwide income and gains as there is no benefit in paying the £50,000 levy.

#### 3.2 Tax Free Remittances to Invest in UK Business

This is perhaps the most interesting and exciting change that is proposed. Many non doms will have substantial unremitted overseas income and gains as they have been taxed on a remittance basis for most if not all past years. They therefore face substantial tax charges if they invest in the UK although there may be opportunities to do this in a more tax effective manner still using offshore trusts.

The proposal is that from April 2012 it will be possible for non doms to make tax free remittances of offshore income and gains to invest in UK businesses carrying on a trading activity or undertaking the development or letting of commercial property. There continues to be a specific exclusion for the holding and letting of residential property and for leasing.

It is confirmed that the following investments will *not* be permitted:

- AIM or fully listed companies
- Partnerships (although more thought is to be given to this and hence this may be allowed from April 2013)

The remittances may be made tax free either by UK residents who are non dom or by associated offshore trusts. The investment can be made in shares or loans to the appropriate businesses and it is confirmed that these will need to be limited companies as this will simplify matters and reduce the opportunities, in the Government's view, for tax avoidance. The businesses need not operate wholly or mainly in the UK but need to have a permanent establishment here.

The ability to make tax free remittances is therefore widely drawn and non doms in this position need to carefully look at their position and consider how they should invest in future. Many may still prefer to utilise offshore trusts as these certainly give opportunities for tax free gains to be made and there is nothing in the new proposals that enables gains subsequently made on the UK investments to be outside UK taxation.

As an anti-avoidance measure, it is proposed that once the UK investment in question is realised, the non dom must take the amount originally invested *out of* the UK within 45 days or reinvest within this short time scale to prevent a clawback of the relief.

*Example – Boris is Russian domiciled and has lived in the UK since 1999. He has annual offshore income of £500,000 and accumulated offshore savings of £3 million. He has been planning to invest in the UK in commercial property, a retail business operating as a LLP, UK quoted shares and a UK hotel company. He realises that if he invests after April 2012 he can safely remit tax free money to buy commercial property and the hotel company but quite possibly not to buy the UK quoted shares. It will not be possible for him to invest in the LLP operating the retail chain as this is not a limited company so that he cannot remit tax free to invest in it but that this may be possible from April 2013.*

As far as planning is concerned, it is clear that non doms in this position need to carefully consider the timing of future investments in the UK and whether to utilise these new provisions or perhaps continue to use offshore trusts. Quite possibly offshore trusts will still be beneficial and can make gains free of tax and then remit free of tax to the UK under these new provisions. It could be a useful means of offshore trusts with stockpiled gains to make investments on behalf of beneficiaries, taking advantage of these new provisions.

### 3.3 Foreign Currency Bank Accounts

A major change here is suggested which will embrace both non doms and UK doms and the proposals are now extended to trustees and estates of deceased persons. At present any gains made on foreign currency bank accounts through, for example, withdrawals or closures of the accounts are in principle subject to CGT. There is an

exclusion for this where the currency is held for personal expenditure outside the UK but the provision can mean expensive compliance costs and a need for detailed record keeping. The Document notes that non doms will often have foreign currency bank accounts and proposes that they are taken outside CGT from April 2012.

*Example – Brian put £100,000 in a US dollar account in 2014 giving a balance of \$160,000. He closes the account in 2015 and withdraws the balance which is now £87,000 as the pound has strengthened against the dollar.*

*Present position – A capital loss of £13,000 would arise which can be offset against current and future capital gains.*

*Future position – The loss will be outside Capital Gains Tax*

Planning opportunities would include crystallising any losses on foreign bank accounts prior to the change taking effect from April 2012.

### **3.4 Overseas Employment Income**

Non doms will continue to benefit from a remittance basis for certain overseas employment income where there is a separate contract with an overseas employer for duties wholly carried out wholly outside the UK. There is also a broadly similar relief for those who are not ordinarily resident and for them there is no need to have a separate contract – the element of the remuneration appropriate to non UK duties is taxed on a remittance basis. The proposal here is that the provisions contained in Statement of Practice 1/09 will be enacted in statute.

*Example – Cedric is UK resident but not ordinarily resident. He earns £200,000 remuneration each year as an employee and spends 25% on average throughout the tax year working overseas. This means that £50,000 (25% x £200,000) will be taxed on a remittance basis.*

Interestingly, there are proposals in the “Statutory Definition of Tax Residence” consultative document also issued on 17 June to narrow down the benefits of being not ordinarily resident in the UK.

### **3.5 Nominated Income**

The document recognises that there has been confusion and administrative complexity caused by the need for non dom taxpayers to “nominate” certain income in order that the £30,000 levy is recognised as a tax by certain overseas jurisdictions. One technical consequence of this is that there have been serious tax disadvantages for non doms where they remit income from a nominated account offshore. Proposals now allow them to remit up to £10 without any tax charge.

### **3.6 Taxation of Items Sold in the UK**

Hitherto a painting, for example, might have been bought out of some untaxed offshore income and brought into the UK to be sold. This might be to take advantage of the facilities operated by UK auction houses. It is proposed that where an item

bought out of offshore income is brought into the UK to be sold, that this will not be treated as a taxable remittance provided the proceeds are taken out of the UK within 45 days.

*Example – Derek is French domiciled and lives in the UK. He bought a painting in France in 2008 using untaxed offshore income for £200,000. He keeps the painting in his Paris house but wishes to bring it into the UK shortly for it to be sold at Christies.*

*Present position – the bringing of the painting into the UK will constitute a taxable remittance of £200,000 on which he will need to pay income tax.*

*Future position – there will be no taxable remittance when the painting is brought into the UK but the proceeds must be taken out of the UK within 45 days of the sale to prevent a remittance occurring.*

#### 4. Conclusions

The Consultative Document has a number of interesting technical changes but the opportunities for certain non doms to remit tax free will mean for certain purposes that the strategy for holding offshore wealth will need to be carefully considered. The provisions seem to be tightly drawn and do not shelter, for example, future gains made on these investments. It seems to us that many non doms will continue to invest through offshore trusts and then bring the money in to invest once tax free gains have been made.

Non doms who wish advice from us on this or any other aspect of the changes or their own taxation should contact us at any time.

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## UK STATUTORY DEFINITION OF TAX RESIDENCE ... BREAKING NEWS

### 1. Introduction

Somewhat disappointingly perhaps, a press release on 6 December 2011 tells us that the UK has decided to defer the introduction of a statutory definition of tax residence for individuals until 6 April 2013. It appears that unspecified issues have arisen in the course of consultation which require further review. The delay is unfortunate as recent tax cases such as *Gaines-Cooper* (see Appendix 1) and harsher HM Revenue & Customs practise has led to considerable confusion and uncertainty for people coming to and leaving the UK. Indeed the original June 2011 Consultative Document was forced to accept that the present “residence rules are vague, complicated and perceived to be subjective. In certain circumstances it is not possible for a person to be sure whether they are tax resident in the UK or to know what activities or circumstances could make them tax resident.”

The change were indeed welcome and would have given a degree of certainty and we very much hope that the proposals *are* brought in during April 2013. Although the original proposals have been deferred, there has been considerable interest from clients and contacts in them and hence we reiterate the main proposals below. Also in Appendix 2 we set out a summary of how these proposals will operate in practise.

### 2. Leaving the UK

Many recent tax cases have focused on whether a UK resident has truly left the UK for tax purposes and assumed non resident status. This of course can be crucial as if still UK resident, the individual will be liable to UK tax in principle on their worldwide income and gains. Thus in ascertaining tax residence it has been important to assess whether a “clean break” has been made and what continuing connections there have been with the UK.

The new proposals assert that someone will be *not* resident in the UK for a tax year if they fall under any of the following conditions:

- If they were not resident in the UK in all of the previous three years and they are present in the UK for fewer than 45 days in the current tax year; or
- Were resident in the UK in one or more of the previous three tax years and they are present in the UK for fewer than ten days in the current tax year; or
- Leave the UK to carry out full time work abroad provided they are present in the UK for fewer than 90 days in the tax year and no more than 20 days are spent working in the UK in the tax year.

There are proposed definitions for “full time work abroad” and “working day”. However the provisions can be regarded as being quite generous in that an individual will know exactly where they stand and may be able to plan their affairs carefully. There are anti-avoidance provisions if an individual leaves the UK and is not away for five complete tax years. In a measure similar to that adopted for capital gains, an individual who has assumed non resident status may still be liable to UK tax upon return on certain UK investment income, namely dividends paid by closely controlled companies that reflect profits that are built up during a past period of UK residence.

*Example – Alan leaves the UK in March 2014 and returns to the UK in May 2015. He takes care to be in the UK for less than ten days in the year to 5 April 2015 but receives a dividend of £1 million from his family company representing accumulated profits made prior to March 2014. Although not resident in the UK under the “ten day test” he will be taxed on the dividend in the year of return under this proposed five year rule.*

Where an individual is not conclusively non-resident due to the “day count” provision set out above, it will be important to look at other “connection” factors namely:

- Whether the individual’s spouse or civil partner or common law equivalent or minor children are still resident in the UK.
- Whether the individual has accessible accommodation in the UK and makes use of it during the tax year.
- Whether the individual does substantive work in the UK.
- Whether the individual spent 90 days or more in the UK in either of the previous two tax years.
- Whether the individual spends more days in the UK in a tax year than in any other single country.

There are quite complex provisions that mean that these “connection factors” need to be evaluated and compared with the number of days spent in the UK. For example if an individual is in the UK for between 45 and 89 days in a year, he will be resident if the individual has three or more connecting factors.

*Example – Brian leaves the UK in March 2014 and returns in May 2015, but comes back for 98 days in the year to 5 April 2015. He is single, does not work in the UK, has no UK accommodation and spends the remainder of his time equally between France and Belgium.*

*Present treatment – he almost certainly would be resident in the UK in 2014/15 due to level of return visits.*

*Proposed treatment – as he has been in the UK for between 90 and 119 days in the year to 5 April 2015, he needs only to have two connecting factors or more to be UK resident. His only connecting factor is that he was in the UK for 90 days or more in 2013/14 and hence he is non resident in the UK for 2014/15.*

### 3. Arriving in the UK

Again the law has been unclear as to when an individual became resident and again the “conclusive non residents” tests outlined in (2) above will be adopted to determine whether he or she has become resident in the UK. If none of these tests apply it will be important to look at certain connecting factors, namely:

- Whether they have a UK resident family.
- Whether they have substantive UK employment duties.
- Whether they have accessible accommodation in the UK.
- Whether they spent 90 days or more in the UK in either of the previous two tax years.

### 4. Conclusions

The new proposals seem to us to be admirably clear and therefore give considerable assistance to taxpayers. It has to be said that perhaps they give opportunities for tax avoidance, particularly for those leaving the UK. Although we need to be mindful of certain anti avoidance provisions, they do not apply, for example, to bonuses paid by captive UK companies.

Individuals need to consider their position carefully as there will need to be a gentle transition to the new rules which may need to be considered carefully in individual cases. Individuals leaving and coming to the UK will need to plan their tax affairs especially carefully to minimise their tax exposure both in the UK and any other jurisdiction.

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## NEW UK TAX RESIDENCE DECISION SENDS SHOCK WAVES THROUGH TAX PROFESSION . . .

The UK Supreme Court ruled on October 19 that Seychelles based entrepreneur, Robert Gaines-Cooper *did* remain resident in the UK throughout the period 1992 to 2004 and hence was liable to full UK tax on his worldwide income and gains... he claimed he merely followed UK tax authority published practice as set out in Booklet IR20 and hence was *not* resident. It is now open to the UK tax authorities to target a large number of mobile executives as well as high net wealth individuals. It is clearer than ever that someone leaving the UK for long periods needs to make a “clean break” in order to cease being tax resident.

Even to the five Lords in the Supreme Court, the position was not wholly clear as in a 4 to 1 verdict Lord Mance dissented and agreed with the taxpayer’s stance. Other Lords commented on the “very poorly drafted . . . and garbled” Revenue guidance. There is even reference by the Lords to a 1936 Commission which said the law on tax residence was “intolerable and should not be allowed to continue. . .”

Gaines Cooper, like many entrepreneurs, was highly mobile and in a typical year might spend as much as 150 days on flights. The Lords heard how he lived “an international existence” from 1976 to 2004. His days in the UK were well within the 90 day average prescribed in the (much maligned) Revenue booklet IR20. The Court however agreed with the Revenue that Gaines-Cooper had never actually left the UK and cited continuing connections with the UK such as a substantial UK house, race horses, car collection and his son being at school, wife living here, etc. This meant that the UK continued to be the “centre of gravity of his life and interests”.

Thankfully, proposals have been published for a statutory definition of tax residence for individuals and it is likely these will take effect from 6 April 2012. For the time being however and for periods to April 2012, advising on tax residence has become a high risk area for advisers (and their clients!) with large amounts of tax often at stake..

International Tax Partner at Creaseys, Richard Holme, commented: “Tax law in this area has not kept up to date with modern technology, travel and working practices and has created a huge degree of uncertainty for international business. Wealthy individuals may be wary of visiting the UK frequently or having UK connections as this may trigger substantial tax bills. We are advising a number of clients in this area at present but sometimes with a large degree of caution.

*“Take an example, Roger who left the UK in May 2010 to work in Dubai for 3 years. His wife Mary stays behind in the UK to look after their children. Roger visits for a weekend every month to see his family . . . and play golf! He also spends 4 weeks in the UK on holiday. He plans to encash a UK endowment policy at a large gain. Is he non UK resident? Could he still be liable to UK tax on his worldwide income?”*

We welcome the new statutory definition of tax residence but it will not take effect for another six months or so. We very much hope that the legislation to be published on December 6 will be clear and unambiguous. Massive tax planning opportunities continue for those arriving in the UK and being able to claim not ordinarily resident or non dom status.”

Creaseys are members of IGAF Polaris, a substantial international association of accountants and tax advisers with 843 offices in 89 countries and have several hundred non dom and non resident clients.

## PROPOSED STATUTORY RESIDENCY TEST FROM 6 APRIL 2013

A Consultative Document issued in June 2011 proposes certain tests to determine whether an individual is resident or not in the UK for tax purposes.

Part A of the test will conclusively determine that an individual is not resident in the UK for a tax year if they fall under any of the following conditions, namely they:

- were not resident in the UK in all of the previous three tax years and they are present in the UK for fewer than 45 days in the current tax year; or
- were resident in the UK in one or more of the previous three tax years and they are present in the UK for fewer than 10 days in the current tax year; or
- leave the UK to carry out full-time work abroad, provided they are present in the UK for fewer than 90 days in the tax year and no more than 20 days are spent working in the UK in the tax year.

Provided Part A of the test does *not* apply, an individual will be conclusively resident for the tax year under Part B if they meet any of the following conditions, namely they:

- are present in the UK for 183 days or more in a tax year; or
- have only one home and that home is in the UK (or have two or more homes and all of these are in the UK); or
- carry out full-time work in the UK.

If Part B does not determine the individual conclusively resident, then "connecting factors" should be considered to determine whether an individual is resident or not. The number of connecting factors required for an individual to be resident will depend on their number of days in the UK;

Days spent in UK	Impact of connection factors on residence status
Fewer than 45 days	Always non-resident
45 – 89 days	Resident if individual has 4 factors (otherwise not resident)
90 – 119 days	Resident if individual has 3 factors or more (otherwise not resident)
120 – 182 days	Resident if individual has 2 factors or more (otherwise not resident)
183 days or more	Always resident

The Government proposes that the following connection factors should be relevant to an individual's residence status, but only when linked to the amount of time the person spends in the UK:

- Family – the individual's spouse or civil partner or common law equivalent (provided the individual is not separated from them) or minor children are resident in the UK;
- Accommodation – the individual has accessible accommodation in the UK and makes use of it during the tax year (subject to exclusions for some types of accommodation);
- Substantive work in the UK – the individual does substantive work in the UK (but does not work in the UK full-time);
- UK presence in previous year – the individual spent 90 days or more in the UK in either of the previous two tax years;
- More re time in the UK than in other countries – the individual spends more days in the UK in the tax year than in any other single country.