

Two years on

How has the revamped regime for non domiciliaries settled in?

RICHARD HOLME and
PAULA BASLEIGH find out.

Practitioners dealing with the complex tax changes to the non-domiciliary regime, introduced by the 2008 Finance Bill, will have found the period from the initial announcement in October 2007 through to the passing of the bill in July 2008 extremely testing.

As the proposals went through Parliament there were some fairly dramatic changes of direction. Some advisers may have informed clients as each amendment was announced, but then been disappointed when further alterations were made, often negating the advice previously given.

The good news for the non-dom clients was the continuation of the non attribution of TCGA 1992, s 86 gains to non-dom settlors and the rebasing election permitted for offshore trusts by FA 2008, Sch 7 para 126.

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Throughout that period we saw non-dom clients becoming confused and often angry at the new proposals. Several chose to leave the UK to benefit from more straightforward and less onerous tax regimes. It has been reported that about 25% fewer non doms have applied to move to Britain since the introduction of the new rules.

KEY POINTS

- The new non-dom regime was not all bad news.
- Deciding whether or not to pay the £30,000 levy.
- Greater use could be made of offshore trusts.
- The £30,000 levy should not be remitted to the UK.
- Confusion caused by mixed funds.



These factors suggest that hardening non-dom rules had the opposite effect from that intended, i.e. to raise additional funds for the Treasury (£3.5 billion was the 2007 pre-Budget report's wildly optimistic projection of this). Several feared that more measures might be introduced to add greater complications to the new non-dom regime. However assurances were given by the then Chancellor of the Exchequer, Alistair Darling, that further changes would not take place.

The new regime has perhaps inevitably given rise to several misconceptions, and we discuss some of these below.

The £30,000 charge

It is not the case that all non doms must pay the £30,000 levy. Furthermore, non doms may opt for the remittance basis in their first seven tax years of residence in the UK at the expense of sacrificing their personal allowance and capital gains tax annual exemption; although with the tapered personal allowance now in force, no loss will be suffered by many on higher incomes.

In a very few cases, long-term residents thought that non-dom status had no real tax benefit and felt that they should no longer be categorised as such. This was not wholly satisfactory and could lead to HMRC enquiries into earlier years. In our practice, many non-dom clients are declaring tax on their worldwide income and gains, while considering their options each year.

Another misconception has been that it is not possible to choose between declaration of worldwide income and gains and the £30,000 tax charge each tax year for those who have

been in the UK for at least seven of the last nine tax years – this is not the case.

Offshore trusts

It is far from true that offshore trusts are no longer tax effective. The potential benefits to non doms of setting up offshore trusts and sheltering capital gains tax, even on disposals of UK assets, will only have increased following the announcement recently of the new Government's proposals to raise capital gains tax rates on non-business assets.

A late amendment to the Finance Bill 2008 meant that the gains of non-resident trusts continued not to be attributed to non-dom settlors, thus allowing such trusts to make tax free gains and defer any capital gains tax liability until distributions were made to UK-resident beneficiaries who would then be liable under TCGA 1992, s 87. This removes the need for the potential beneficiaries to consider making remittance basis elections until the year of distribution.

Advantages and disadvantages

Settlor-interested offshore trusts are therefore still often useful. Such entities might make gains for a number of years and then look to make a capital payment offshore to the settlor or a member of his immediate family, who might then pay the £30,000 levy to avoid capital gains tax or have left the UK permanently by this time.

Alternatively, assets and gains might be retained within the trust and consideration might be given to advancing capital to family beneficiaries by way of a loan. Offshore trusts still have their benefits as a shelter from inheritance tax for non-UK assets, and even if the settlor becomes UK domiciled after setting up the trust, the trust will still constitute 'excluded property' for inheritance tax purposes.

Loans to beneficiaries may cause adverse tax consequences and care will need to be taken that they are not regarded as a taxable remittance of the loan principal. Provided they are constituted as speciality debts, they are likely to be outside the scope of any ten-year charges for the trust for inheritance

tax purposes, as they are not regarded as UK assets. When the family beneficiary dies, the debt to the trust should normally be deductible from their estate for inheritance tax purposes.

Settlor-interested offshore trusts

Non-dom clients declaring their worldwide income and gains or considering the use of the remittance basis have sometimes been reluctant to accept that offshore income of settlor-interested offshore trusts will be taxed on them by virtue of ITTOIA 2005, s 624 if they (or their spouse or minor children) have an interest in the trust. Unfortunately in this scenario, s 624 will apply whether or not the income is distributed, and – all other things being equal – trustees should distribute the income.

Nominated accounts

Some clients have become confused between the ability to pay the £30,000 levy (tax charge) direct to HMRC in the UK without this being a taxable remittance, and the need to nominate on their tax return a particular bank account or source of income.

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The two concepts are completely different. It may be beneficial to pay the £30,000 levy out of income potentially taxed at higher rates if remitted. The remittance needs to be made direct to HMRC, not remitted to the UK and then paid. In some situations non-dom clients have found that even if they are not paying the £30,000 levy, they have considerable UK tax to pay on non-UK income and gains and the only means to discharge this has been to make a taxable remittance.

Bruce Sutherland & Co

B W Sutherland CBE FCA FTII Miss J A Nelder BA FCA FTII David Bowes FTII
 Moreton House, Moreton in Marsh, Gloucestershire GL56 0LH
 Tel: 01608 651091 Fax: 01608 651973
 DX 11484 Moreton in Marsh

bruce.sutherland@bruce-sutherland.com jenny.nelder@bruce-sutherland.com david.bowes@bruce-sutherland.com

THE SHARE VALUATION SPECIALISTS

Remittances from mixed funds

Perhaps one of the most daunting tasks is to establish whether a taxable remittance has been made from mixed funds in a year during which the client has been taxed on the arising basis. Broadly, non-dom taxpayers who choose to be taxed on an arising basis are also taxed on remittances of foreign income and gains that arose in earlier years, if the remittance basis was claimed in those earlier years. This means that if an individual was taxed on the arising basis in 2008/09 and 2009/10 and made a remittance to the UK from a mixed fund in 2009/10, this would only be a taxable remittance to the extent that it represents income earned and gains realised prior to 6 April 2008.

In order to establish the taxable element of the remittance, one needs to analyse the mixed fund immediately before the transfer and match the remittance with funds within the account in the order specified in ITA 2007, s 809Q. This analysis is first carried out for the year in which the transfer takes place (to the day before the remittance); only if the remittance is greater than

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the combined amounts credited in the year to date is it necessary to look at income, gains and capital credited in preceding years (on a year by year basis, starting with the latest year).

The effect of the ordering and identification rules is that all the income and capital of a later tax year will be treated as remitted before any of the income and capital of an earlier year. One should bear in mind that a mixed fund does not exist just because the individual has a number of accounts with the same bank. There is further guidance on this topic in Section 3 of HMRC's *Residence, Domicile & Remittances Manual* which runs to 302 pages.

Offshore insurance bonds

Offshore insurance bonds have their tax benefits in permitting, very broadly, tax free roll-up (subject to withholding taxes) and the ability to take 5% withdrawals of capital which are often

marketed as being 'tax free'. With a clean pool of capital such a bond may be appropriate and permit remittances to be made to the UK in order to fund living expenses etc. However, in our experience these bonds have been over-sold for non-dom clients, who have often placed into the bonds tainted funds which contain an element of income. Thus when the 5% return of capital is remitted to the UK, part of this will be a taxable remittance.

Domicile switching

On looking at the domicile section of the 'Residence, remittance basis etc' pages to the tax return, taxpayers could be forgiven for assuming that they can easily change their domicile by answering the questions in the right manner. They should be made aware that this is a tricky process and it can be difficult to persuade HMRC that a change has taken place, as evidenced by the landmark *Gaines Cooper v CRC* case.

Tax returns

The preparation of tax returns for non-dom clients for the year to 5 April 2009 proved in many cases to be a complex process. There was the need for many clients to declare their worldwide income and gains for the first time and for a minority to compare carefully the benefits of paying on a remittance basis or a worldwide arising basis. From 2009/10 our software provider is including the facility to run two computations, one on the arising basis and one on the remittance basis, so that it will be simpler to choose the most beneficial option for the client on a year-by-year basis.

It is a shame that the ability to seek a domicile ruling was withdrawn from April 2008, but perhaps it was surprising that this facility lasted as long as it did. The self-assessment process *prima facie* requires the taxpayer to decide for himself his particular status on a particular issue.

The future

Unfortunately, now that most of us have become familiar with the practical effect of the rules surrounding non doms, it is likely that the system will be reformed once again – there was a brief mention in the Government announcement of 20 May. It is clear that, in the face of controversy and press speculation on certain high profile figures, both parties are in favour of a less generous tax regime for non doms.

The Conservatives' manifesto proposed to impose a flat rate levy on all non doms to fund the increase in the inheritance tax nil rate band. However, the Liberal Democrats had planned to reform the system allowing people to hold non-dom status for no more than seven years before they are subject to tax on all offshore income in the same way as domiciled British citizens ... watch this space! ■

Richard Holme and **Paula Basleigh** can be contacted at Creaseys LLP, www.creaseys.co.uk.

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