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NON-UK DOMICILIARIES AND THE FINANCE ACT 2008

PRE 6 APRIL 2009 REVIEW

This is the latest in a series of news releases providing details on the remittance basis changes first announced in the Pre-Budget Report in November 2007, detailed in the Finance Bill in January 2008, and then further amended in March 2008. We are now approaching the end of the first tax year in which the Finance Act 2008 has been in effect and set out below various actions that individuals and offshore trustees may want to consider both before 6 April 2009 and in the coming year.

A detailed summary of the remittance basis changes entitled 'Remittance Basis Changes from 6 April 2008' and dated 28 March 2008. can be found at www.praxisfiduciaries.com Latest/News.

Claiming the Remittance Basis and Paying the £30,000 Remittance Basis User Charge

Individuals who are resident but not domiciled, or not ordinarily resident, in the UK are able to claim "remittance basis". Where they do, a liability to tax will only arise on their foreign income or gains if they are used in any manner or form in the UK by or for the benefit of a remittance basis taxpayer, their spouse, or minor children and grandchildren, or are brought to the UK by any structure for their benefit.

Individuals who have been UK resident during more than seven out of the past nine tax years (at 6 April 2008), will have to pay an annual charge of £30,000 in order to use the remittance basis.

Individuals will therefore need to decide whether or not to be a "remittance basis user" for the 2008/09 tax year. For some it will make commercial sense for others it will not, depending on the level of their unremitted foreign income and gains. The decision as to whether to pay the charge needs to be made no later than 31 January 2010 for the tax year 2008/2009.

Note that individuals have a choice to claim remittance basis in one year and pay the charge, and not claim in another year. Claiming or otherwise has no bearing on whether you are not domiciled in the UK for general law purposes.

Individuals should consider steps to mitigate the impact of the charge. For example, funds could be held by one family member thereby ensuring that only one member of the family needs to pay the charge. Such planning would be unlikely to be effective for the 2008/09 tax year but could be utilised for future years if implemented now.

Many commentators have promoted utilising Offshore Insurance Bonds which would trap the individual's income and gains thereby delaying the need to claim remittance basis until encashment of the bond is made. Further information regarding the use of bonds either in a personal capacity or as part of an existing structure in respect of future tax years is available on request.

Nominated Foreign Income and Gains

Individuals claiming remittance basis need to nominate the foreign income or gains that the charge will relate to as a "tax credit".

However, the legislation contains a "trap" which applies where an individual remits some part of his nominated income or gains, whilst leaving other income and gains unremitted. In such circumstances, *all* the individual's remittance basis income and gains are treated as a single mixed fund, and any remittance will be subject to the unfavourable mixed fund rules (as outlined

below). Any nominated income or gains will continue to be treated as remitted last. For those not seeking a credit in another jurisdiction, it may therefore be prudent to nominate a relatively small amount of income or gains. The nominated funds should be kept in a separate account and not remitted to the UK. Income or gains must be received into the nominated account by 5 April 2009.

There has still been no confirmation from the US Government that the £30,000 remittance charge will be allowed as a credit against US tax liabilities. If relief is permitted, US nationals will need to take particular care when claiming the remittance basis to nominate the correct amount of income or gains to be treated as bearing the £30,000 tax as an under-declaration could jeopardise their entitlement to a credit. Specialist advice should be sought as soon as possible.

Segregation of Income and Gains

The new wider remittance basis rules apply only to income and gains arising post 5 April 2008 and there remains some flexibility for remittance planning with those amounts of foreign income and gains that arose pre 6 April 2008. In order to take advantage of this, all pre 6 April 2008 income and gains should be maintained in separate accounts.

In particular, the payment of UK expenses out of post 5 April 2008 foreign income or gains by a relevant person (including trusts and companies from which the remittance basis taxpayer can benefit) will now give rise to a remittance unless the expenses relate wholly or mainly to property situated outside the UK and are made to a non UK bank account. Equally, investment in UK assets using foreign income by relevant trusts or companies will result in a remittance for the taxpayer. This can be avoided by utilising the segregated pre 6 April 2008 income and gains.

There are now statutory rules regarding the treatment of transfers from mixed funds (i.e. those containing more than one type of income or capital or income or capital for more than one year). These rules only apply

to income and gains which arose on or after 6 April 2008. The previous method of dealing with such transfers, based on case law, will continue to apply in relation to income arising prior to 6 April 2008. Under the new rules, the order of matching is unfavourable in that foreign income is taxed before foreign gains and untaxed foreign income and gains before taxed foreign income and gains. Any other types of income (including UK source income) or capital are treated as remitted last. This order of matching will apply to each year in turn starting with the year of the remittance and working backwards.

It should be noted that these rules only apply where a remittance is being made to the UK. Transfers not giving rise to a remittance will carry an element of each source of income and gains on a pro rata basis.

Non-UK domiciled individuals have always needed to keep separate their tax-free remittable capital from funds containing capital gains and income. This will continue to be important post 6 April 2008 to ensure that advantage can be taken of the lowest tax rates on remittances by avoiding the application of the mixed fund rules.

Foreign Losses

Individuals will also need to consider their position with regard to foreign capital losses. Before 6 April 2008 losses on foreign assets could not be used for set-off against gains on foreign assets which were taxable on the remittance basis. It is now possible for remittance basis taxpayers to elect for these losses to be made available. Once an election has been made, both foreign *and* UK losses must be used in a certain matching order – against unremitted gains, remitted gains, then finally, UK gains.

Whether or not to claim loss relief is a decision that needs to be taken in respect of the first tax year for which the remittance basis is claimed and once made it is irrevocable. The loss claim is governed by

the same rules as the claim for remittance basis and will therefore need to be made at the latest by 31 January 2010 in respect of the 2008/09 tax year. Detailed analysis will be required to ascertain whether a claim for foreign losses should be made or not.

Residence

The only statutory test for residence at present is in relation to an individual's physical presence in the UK for a period of 183 days or more in any one tax year. Although a comprehensive statutory test for residence was proposed during the Committee stage of the 2008 Finance Bill, it was rejected at the time. However it is understood that the Treasury is considering introducing such a test in the future in order to remove the current areas of uncertainty and is keen to receive views from professionals in this respect.

Pre 6 April 2008, days of arrival in and departure from the UK were not counted by concession. From 6 April 2008, a day is counted if the individual is present in the UK at midnight, unless he is a passenger in transit and leaves the UK the following day. Activities unrelated to the trip (attending meeting, visiting friends and family etc) should not be engaged in during the transit period.

The "91 day test" is dealt with in the HMRC guidance booklet, IR20, which was updated in July 2008 to reflect the new day counting rules, as outlined above. Under the 91 day test, if after 4 tax years an individual's visits to the UK average 91 days or more, he will only be treated as UK resident from 6 April of the 5th tax year, providing there was no earlier intention to make visits in excess of 90 days.

Should such an intention exist, the individual would be treated as UK resident from 6 April in the first tax year in which he makes visits to the UK or from 6 April in the tax year in which he decides to make such visits.

The above test also applies for establishing ordinary residence in the UK.

As the 91 day test is not statutory, it cannot be fully relied on in that HMRC will consider an individual's overall position. HMRC consider that the 91 day rule only applies to individuals who have clearly left the UK (i.e. made a distinct break) or to visitors to the UK. As the end of the 2008/09 tax year approaches, individuals should review the number of days spent in the UK to avoid becoming unintentionally resident for the year.

Offshore Trusts

Offshore Trusts remain a useful planning vehicle, providing capital gains tax deferral for both foreign and UK gains. As mentioned above, the use of Offshore Insurance Bonds can also be considered within trust structures.

However, the rules surrounding offshore trusts are very complex and this has been compounded by the new legislation. As such it is imperative to be fully advised in connection with such structures.

Trustee Investment Strategies

In view of the reduction in the rate of Capital Gains Tax to 18%, and the remittance protection for gains afforded to offshore trusts, trustees should consider investing for capital gains rather than income or deemed income or offshore income gains – all of which may be taxed at the maximum income tax rate of 40% (set to rise to 45% in 2011).

Rebasing Election for Trustees

As detailed in our earlier News Releases, the trustees of offshore trusts will be able to make a one-time election to treat all assets held as at 5 April 2008 in the trust (or held by any underlying company owned by the trust) as if they had been sold and reacquired at market value on 6 April 2008. The effect of the election is to remove the accrued gains at that point from liability to Capital Gains Tax if later matched to capital payments to UK resident, non-domiciled beneficiaries. As many asset classes have fallen in value since

April 2008 it would seem sensible for the trustees to look to make this election where there is a prospect of capital being required by the beneficiaries in the UK in the future.

The rebasing election has to be filed by 31 January 2010 if the trustees have made a capital payment to a UK resident beneficiary in the 2008/09 tax year, or if there has been a transfer between trusts in that year. If the rebasing election is not made by the 31 January deadline after the first tax year in which this "trigger point" occurs, the opportunity will be lost.

In view of this, the trustees need to monitor carefully whether any capital payments (which include capital benefits, such as loan benefits) have been made in 2008/09 to ensure the deadline is not missed.

The rebasing election requires confirmation of the name of the settlement, the date it was settled, and the names and addresses of the trustees. It is likely that HMRC will, having received an election, seek further details about the trust and thereafter wish to monitor the gains and capital payments. It will be necessary to agree 6 April 2008 valuations of assets and keep track of pre and post 6 April 2008 elements of gains.

Restructuring for Offshore Trusts

Even though the new legislation is already in effect, there are a number of further planning points that can be considered both for new settlements and existing structures with a view to further deferral of Capital Gains Tax liabilities. Such planning generally involves loan assets and the ring-fencing of trust gains and will depend on whether or not the settlor is non-deemed domiciled for IHT purposes. Further details are available on request.

To obtain maximum benefit for existing structures, this type of planning should ideally be reviewed as soon as possible.

Capital Gains Tax Planning for Offshore Trusts

In order to avoid any unexpected tax liabilities arising in 2008/09 as a result of the new capital payment matching rules, trustees should undertake a review of the trust's past history of gains and capital payments before the year end as these can be relevant to the post 5 April 2008 position.

In addition, if asset disposals are intended before the year end, consideration should be given to the timing and type of assets to be sold to ensure maximum tax efficiency. Depending on the requirements of any remittance basis user beneficiaries, trustees should also consider the ratio and timing of UK and offshore capital payments as correct planning can result in deferral of liability.

A further point to consider is in respect of offshore income gains (i.e. gains on funds without "distributor status"). Where such gains have been realised in 2008/09, effective capital payment planning before the year end can ensure that the benefit of the trustee rebasing election is available.

The complexity of the new rules is such that a detailed review of each case is strongly recommended.

Contact

If you wish to discuss these changes or require further information please contact your Client Engagement Director.

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