

## **RESIDENCE AND DOMICILE**

### **PROPOSED AMENDMENTS TO THE TAX RULES**

On 25 January 2008 HM Revenue & Customs published draft legislation which will be incorporated into the 2008 Finance Bill. From 6 April 2008 and subject to the new provisions being adopted by Parliament, the proposals will make significant changes to the current rules, and in particular:-

- The residence rules will be amended so that days of arrival in and departure from the UK will count towards establishing residence.
- Individuals who are resident but not domiciled, or not ordinarily resident, in the UK will be required to make a claim in order to access the remittance basis of taxation for income and chargeable gains, unless their unremitted foreign income and gains are less than £1,000. Individuals who opt for the remittance basis will lose their entitlement to personal allowances and the capital gains tax annual exemption.
- Individuals who have been resident but not domiciled, or not ordinarily resident, during at least seven of the nine tax years immediately preceding the year in question and wish to claim the remittance basis must pay an annual charge of £30,000.
- The current rules will be amended to close loopholes which allow individuals using the remittance basis to avoid paying tax on foreign income and gains.
- Non domiciled and ordinarily resident settlors of offshore trusts with underlying capital gains who remit capital payments to the UK will be liable to capital gains tax. Non-domiciled and ordinarily resident beneficiaries of offshore trusts with underlying capital gains will be liable to capital gains tax on capital payments even if they are not remitted to the UK
- Capital gains tax will be payable by non domiciled and ordinarily resident settlors on the sale of trust owned UK assets such as a private residence.

### **Residence - Day Counting**

From 2008/9 the days of arrival and departure will count in determining whether an individual has stayed 183 days or more in the UK in a tax year so as to make him resident. HMRC say that this will also be applied to the 90-day residence test over four years, although this is HMRC practice and not law. Transit passengers in the UK who remain airside will not be treated as having spent a day in the UK.

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## **Remittance Basis**

Many changes have been made to the remittance basis with a view to closing long established loopholes and making it more difficult to make tax-free remittances, including remittances through trusts.

- Source closing will no longer be possible. This converted foreign bank interest into remittable capital in a subsequent year by closing the original bank account.
- It is no longer possible to purchase an item with income, pay for it abroad and subsequently bring the item into the UK.
- A common and much broader definition of “remittance” is introduced for all types of offshore income and gains, and applies when:
  - a) any money or other property is brought to, or received or used in, the UK by or for the benefit of a “relevant person” (see below); or
  - b) any service is provided in the UK to or for the benefit of a “relevant person”

and the money or property is or derives from foreign income or chargeable gains, or in the case of a provision of a service it is paid for out of foreign income or chargeable gains or anything deriving from such income or gains. Additionally, if such income or gains are used to repay a debt which is directly or indirectly incurred in respect of such money, property or service, that repayment is deemed to be a remittance into the UK.

“Relevant person” in this context is very widely defined and includes the individual himself, together with his spouse/civil partner, his siblings, ancestors, descendants (together with the spouses/civil partners and also trusts established by the donor or any of the above). Additionally, persons living together as if they are married or in a civil partnership are treated for these purposes as spouses or civil partners.

- Formerly, it was possible for an individual to make a gift outside the UK of foreign income and gain-laden capital to another person, and he could bring the funds into the UK as clean capital in his hands, as long as the funds were not used to benefit the original donor (and amounted therefore to an indirect remittance by him). This applied to spouses and children as well as remoter persons.

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From 6 April, the effect of this wider concept of remittance is that if such gifts are made to a relevant person and the relevant person remits the funds into the UK (which would include for example trustees (being themselves relevant persons) bringing funds into the UK to invest, even if the donor himself does not benefit), that remittance will be taxed on the donor as a remittance by him.

- Detailed rules are introduced to identify what is remitted where the remittance is from a fund which contains different types of income and/or gains. Broadly, income is remitted first, followed by capital gains in priority to the original clean capital.
- As the law currently stands a foreign asset settled on an overseas trust is treated as being received by the trustees at market value. The new rule is that the notional capital gain on the transfer of the asset to the trust is treated as being comprised in the asset gifted, so that if the proceeds of sale are remitted to the UK from the trust to the original donor or to a "relevant person" the original donor is liable to tax on the remittance.
- A specific rule has been introduced to prevent individuals remitting foreign income into the UK during a period of non-UK residence consisting of less than five complete tax years. In such circumstances, the income is deemed to be remitted in the tax year of return.

### **Mixed Funds**

Specific rules are being introduced to clarify the analysis of remittances from mixed funds. Remittances from mixed funds will from 6 April 2008 be deemed to have been made in the following order - UK employment income, relevant foreign earnings, relevant foreign income, foreign chargeable gains, and any other income or capital, taking one tax year at a time and working backwards.

There is a significant change of policy on the treatment of remitted gains in that the gain is treated as remitted first, and the proceeds are no longer pro-rata'd between the original investment and the gain.

### **Planning Opportunities and Traps – Including Changes that Apply Semi-Retroactively**

- Any foreign investment income whose source was closed in the tax year ended 5 April 2007 or earlier tax years can be remitted tax-free if remitted before 6 April 2008.
- It is still possible to remit pure capital to the UK with no tax charge, by proper segregation of income and capital.

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- When an individual has transferred a foreign asset to another individual or to foreign trustees by way of gift, and a chargeable gain was notionally realised on the gift of the asset, consideration should be given to remitting the asset to the UK before 6 April 2008. If remitted afterwards to the individual or to a “relevant person” the gain will be taxable on the individual.
- An individual who has foreign income or gains should consider making gifts to his family outside the UK which they can remit as clean capital to the UK before 6 April 2008. The benefit of these funds should not be shared with the individual. Individuals with foreign assets standing at a gain might consider transferring them into trust, and for the trustees to make a distribution to the individual before 6 April 2008.
- Equally, individuals with offshore accounts containing the proceeds of sale of assets sold at the gain should consider remitting a proportion of the funds to the UK before 6 April 2008 to take advantage of the current pro rata'd treatment of the gain and capital element. This needs to be balanced against the new lower rate of CGT at 18% from 6 April 2008.
- In some cases offshore bonds or similar investments may be attractive to enable tax deferral without the £30,000 charge. A gain on disposal is however charged to income tax at 40% unless the remittance basis is elected, which will probably be more expensive than the 18% rate of CGT on other investments.
- Spouses/civil partners could consider amalgamating assets so that only one of them pays the £30,000 charge.

### **Attribution of Gains to Settlers Of Settlor-Interested Non-Resident Trusts**

A significant advantage of an offshore trust was that capital gains realised by the trust could be distributed to the non-domiciled settlor in the UK without attracting a liability to CGT. Under the new rules, trust gains realised after 5 April 2008 will be attributed to the settlor so that gains on the disposal of foreign assets by the trustees will be subject to CGT on the remittance basis. Gains on the disposal of UK assets will be attributable to the settlor and taxed on the arising basis. This includes gains realised by companies owning UK private residences, see below.

As a result of this change a capital gains tax liability may arise in the following circumstances:

- a capital distribution or other capital benefit is received after 5 April 2008 where the trust has realised gains in the past or does so in future; and
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- a UK resident non-domiciled beneficiary has already received a capital distribution or other capital benefit at a time when it was thought to be tax-free in his hands, and the trust realises gains after 5 April 2008.

### **Attribution of Gains to Beneficiaries of Settlor - Interested Non-Resident Trusts**

From 6 April 2008 resident and non-domiciled beneficiaries will be taxed on underlying trust gains in respect of capital distributions received by them anywhere in the world.

For this reason it is important that trust gains are matched by distributions to beneficiaries prior to 6 April 2008.

### **Planning Suggestions**

Where the trust has realised gains:

- Trustees should consider transferring all the assets of the trust to the settlor, who could then consider transferring all the assets into a new trust. This will eliminate all historic gains as well as the gains realised on the distribution to the settlor, and the assets in the trust remain excluded property for IHT purposes.
- If the value of capital payments to the settlor and other beneficiaries exceeds trust gains realised to date “excess capital payments” will be carried forward to the new regime and the beneficiary of the capital payments will be subject to CGT on gains realised by the trustees after 5 April 2008. Before 6 April 2008 the trustees should consider realising gains sufficient to match the excess capital payments, to the extent that such unmatched gains exist.
- If an individual has assets in his own name which are situated outside the UK and standing at a gain he should consider transferring them to an offshore trust and distributed to him by the trustees before 6 April 2008. The assets can then be remitted to the UK tax-free.
- Deemed-domiciled settlors cannot crystallise gains by distributing trust assets and re-settling them on a new trust as the assets would have lost their IHT excluded status.
- If the trust was settled with UK taxes in mind, before 6 April 2008 distribute separate and identifiable trust income to the settlor or beneficiary offshore who could then make a gift to his spouse who could then make the remittance tax free.

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### **Attribution Of Gains To Members of Non-UK Resident Companies**

A non-domiciled individual who has an interest of more than 10% in a non-UK resident company which has five or fewer participators (shareholders), and the company has made a capital gain, the individual will be charged to CGT on his proportion of the gain on the remittance basis. If the gain is in respect of a UK asset the gain is taxed on the arising basis.

### **Ownership of UK Homes**

There are significant implications if a UK home is owned through a non-UK company, with or without a trust, where the non-UK domiciled occupant is UK resident.

From 6 April 2008 any gains realised in the trust, including gains realised before 6 April 2008, will be matched against rent-free occupation by a beneficiary or settlor and charged to CGT on an arising basis irrespective of whether the occupant pays the £30,000 levy.

No principal private residence relief from CGT will be available on the sale of the property (as it is owned by a company) and the gain will be taxable on an arising basis on the settlor of the trust or the individual owner of the company if UK resident.

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6 February 2008

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