Proposed UK Legislation Will Institute Yearly £30,000 Charge to Remittance-based, Non-Domiciled Taxpayers.

The £30,000 charge is in addition to any tax liability for the year in question that may arise due to making taxable remittances. The draft legislation confirms that those eligible can choose – from one tax year to another – whether they wish to be taxed on the remittance basis, so analyze your situation and choose wisely. At present, it appears that the new charge is not creditable against US tax liabilities because it is not characterized as an income tax but merely a charge. This aspect of the ruling is not final and could change before the draft legislation passes into law. In fact, the UK government announced earlier this week that they are working with the US authorities to determine how the £30,000 charge can become creditable against US tax liabilities.

Details

The draft legislation for the PBR (Pre Budget Report) changes on residence and domicile in the UK was published on January 18, 2008. The publication confirms that sweeping changes are ahead for non-UK-domiciled individuals from April 6, 2008, leaving little time for those individuals to reorganize their affairs. This legislation represents the most substantive change made to the rules, in 90 years.

What do we know now?

The legislation covers the areas highlighted in the pre-budget report and subsequent consultation paper. An overview of some of the issues raised follows.

Amendment to the residence rules

- The existing statutory legislation, outlining that an individual who spends 183 days in the UK in a tax year is a resident, will be amended so that days of arrival and departure will be included when counting the days.
- However, there is still no wider statutory definition of residence introduced by the legislation. Instead, HMRC will alter its practice from April 6, 2008, in relation to the non-statutory 91-day average test so that the days of arrival and departure will be included when that practice is applied.
- An exception will be provided for transit passengers travelling via the UK, provided that they remain in a part of an airport or port that is not accessible to members of the public (i.e., they remain "airside" in an airport terminal).
- Up until this new legislation a UK resident, non domiciled taxpayer could break UK residence (for example by leaving the UK and spending less than 183 days in the tax year in the UK) remit funds and not incur a UK tax liability. A new temporary non-residence rule has been introduced so that remittance basis users must be non-residents for five complete tax years (April 6th to April 5th); if not, any relevant foreign income remitted to the UK in the years following departure and before return to the UK will be taxed in the UK in the year of return. The position regarding non-residence by virtue of full-time contract of employment abroad is unclear.

Making a claim for the remittance basis to apply

- From April 6, 2008, a claim for the remittance basis will need to be made by all UK residents who are eligible to claim and who wish to be taxed on that basis in relation to employment income, investment income and capital gains. Currently a claim only needs to be made in respect to investment income.
- The personal self assessment tax return for 2008/2009 will include a check-box to make the claim.
- The remittance basis will apply automatically to relevant individuals who have unremitted income and gains in a tax year of less than £1,000.
- The draft legislation confirms that those eligible will be able to choose each year whether or not they wish to be taxed on the remittance basis.
- If an individual elects for the remittance basis they will not be required to disclose their worldwide income on their UK tax return – the only non-UK income and gains to report will be those which are remitted to the UK.
- If an individual chooses not to claim the remittance basis for any given tax year, he or she will be taxed on a worldwide basis for that year. However, if funds that arose in an earlier year to which remittance basis was applied, are remitted during the year, the individual will also be taxed on the remitted funds. This is an amendment to the existing rules, which do not currently tax the remitted income in a year of worldwide taxation basis.

Additional costs for individuals claiming the remittance basis

- Individuals entitled to claim the remittance basis due to their non-UK-domiciled, or non-UK ordinarily resident status and who have been a UK resident for at least 8 of the past 10 years, up to and including the year in which a remittance basis claim is made, will be liable to pay a charge of £30,000.
- Therefore, if an individual has been resident since 2001/2002, that individual will be liable for the £30,000 charge if he or she wishes to claim the remittance basis from April 6, 2008.
- This charge is in addition to any tax liability for the year in question that may arise from making taxable remittances. The charge will be payable by January 31 following the end of the tax year in question. For example, the first year that the £30,000 charge can apply is ended April 5, 2009. The £30,000 charge will be payable when the tax return is due January 31, 2010.
- Those eligible individuals who choose to be taxed under the remittance basis will not be entitled to claim various personal tax allowances, including the income tax personal allowance and the capital gains tax annual exempt amount. This applies for all income and gains (including UK source) for any year in which the remittance basis is claimed, even in the first seven years of residence, when the £30,000 is not payable.
- The government has previously indicated that it was considering a charge higher than £30,000 for individuals who have been in the UK more than 10 years. The legislation however, does not provide for any additional charge for relevant individuals who have been UK residents for more than 10 years.
- The £30,000 charge is per individual. In the UK, spouses are taxed separately, so care needs to be taken if one spouse has a small amount of investment income that exceeds £1,000. Normally when investments are jointly held, HMRC will regard any revenue as arising equally.
- Amounts brought in to the UK to pay the £30,000 charge will not be regarded as taxable remittances.

Will tax credit relief be available for the £30,000 charge?

- Each overseas tax authority will need to review the final legislation in the context of its foreign tax credit regulations to confirm the position.
- Based on our consideration of the US position, our preliminary analysis of the draft legislation suggests that the **£30,000 charge will not be creditable** against partners' US tax liabilities because it is not characterized as an income tax. This position may change depending on whether any changes are made to the draft legislation before the changes pass into law.
- We understand that the UK government are currently in discussions with tthe US authorities on how to enable the 30,000 charge to qualify as a credit for US tax purposes.

Removal of "flaws and anomalies" from the remittance basis

- The longstanding HMRC practice of accepting that no tax liability can apply to remitted amounts if the source of the funds remitted does not exist in the year of remittance has been overturned by the proposed legislation.
- On the basis of case law, if non-UK investment income is currently used to purchase an asset outside the UK that is then brought to the UK, no tax is applied under the remittance basis. The draft legislation will introduce statutory rules so that this transaction will be considered a taxable remittance of the non-UK investment income used to purchase the asset.
- Statutory rules have also been introduced in order to identify remittances from mixed funds. Although the legislation confirms existing practice that remittances from mixed funds should be treated as taxable income in the first instance (to the extent there is any), it also introduces less favorable rules regarding the remittance of capital gains.
- Under existing practice, the sale of a non-UK asset might realize net proceeds of £1,000, of which £500 represents the capital gain. A remittance of £500 would therefore be taxed on a pro-rate basis, such that £250 would be taxed as a remitted capital gain. Under the draft legislation, the remittance would be treated as capital gain in the first instance, meaning £500 would be taxed as a remitted capital gain. The default position is that jointly held property is regarded as being owned 50/50 by the co-owners. In certain circumstances, it is possible to elect for a different basis to apply. Each case needs to be considered individually.
- Another longstanding practice established by case law and accepted by HMRC is the ability for a UK resident, non-domiciled individual, to gift non-UK income to a relative outside of the UK and for that individual to remit that gift without incurring a tax charge. Legislation has been introduced to prevent this practice, meaning that from April 6, 2008, a tax charge will arise to the donor on remittance by the connected party. This will not apply to gifts between unconnected parties.

Conclusion

It is now clearer than ever that HM Treasury intends to press ahead with these far reaching changes. As the new rules come into force on April 6, 2008, the window of opportunity for those affected to reorganize their affairs is short.

Therefore, it is critical that people give urgent attention to their positions.

We have a number of structuring routes to mitigate the impact of these changes and maintain many of the benefits of the current regime.

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