Non-domiciliaries' income and gains

The Finance Act 2015 brings further changes to those resident in the UK but not domiciled.

Before 6 April 2008 UK residents not domiciled in the UK were only subject to tax on overseas income and gains when this was remitted to the UK [the 'remittance basis']. Furthermore, those not domiciled in the UK were not liable to capital gains tax on the gains of a non-resident trust or company, wherever those gains arose. The Finance Act 2008 changed all that.

Claiming the remittance basis

Now (unless their unremitted income and gains total less than £2,000 in the tax year), those who claim the remittance basis on overseas income and/or gains because they are not domiciled in the UK are not entitled to income tax personal allowances or the annual exemption for capital gains tax. Overseas income for this purpose includes income arising in the Republic of Ireland. Before 6 April 2008 the remittance basis did not extend to such income.

The remittance basis charge

Save where that de minimis applies, if the claimant has been resident in the UK for at least seven out of the preceding tax years, and is aged 18 or more, he or she will only be entitled to claim the remittance basis for a tax year on payment of a 'remittance basis charge' (RBC).

- If the claimant has been UK resident for 7 out of the preceding 9 tax years the RBC is £30,000; but
- if the claimant has been UK resident for 12 out of the preceding 14 tax years the RBC is £60,000 [£50,000 for 2012/13 to 2014/15] and
- (but only from 2015/16 onwards) if the claimant has been UK resident for 17 out of the preceding 20 tax years the RBC is £90,000.

The RBC is treated as tax (income tax or capital gains tax as the individual chooses) on unremitted overseas income or gains. It is collected at the usual tax due date, with interest and surcharges for late payment. If characterised as payment of income tax in respect of unremitted overseas income, it will form part of the liability which determines the level of interim income tax payments for the following year. The unremitted income or gains on which the RBC has been paid will not be taxed again if it is eventually remitted

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to the UK. However, all untaxed unremitted overseas income and gains will be treated as remitted before income or gains on which the RBC has been paid.

As the RBC will be either income tax or capital gains tax, it should be treated as such under double taxation agreements.

If each member of a family is non-domiciled, each parent and each adult child therefore has a choice to make.

Where unremitted income and gains are expected to be under £2,000 (so no claim is required in order that the remittance basis may apply), but it is later found that the unremitted income gains are too much, the arising basis would apply automatically unless the individual is still in time to claim the remittance basis.

Remittances

The definition of remittances which represent overseas income or gains (including any from a 'ceased source', even one which ceased years earlier) includes cash or property brought into the UK, and services used in the UK, by or for the benefit of the individual or his immediate family. The 'immediate family' includes spouses, civil partners (and those living together as husband and wife or as civil partners) and their children and grandchildren under 18.

There are exemptions for personal effects (clothes, shoes, jewellery and watches), assets costing less than £1,000, assets brought into the UK for repair and restoration and assets in the UK for less than nine months, but only when 'purchased from 'relevant foreign income' Note that this does not apply to such items that represent otherwise unremitted overseas employment earnings and capital gains.

Although ostensibly only applying from 6 April 2008, this definition of remittances would have meant that events many years earlier could result in a tax liability in 2008/09 or later. However, any asset bought out of untaxed overseas income that an individual owned on 11 March 2008 will be exempt from charge under the remittance basis, whether the asset is in the UK or overseas. Furthermore, any asset in the UK on 5 April 2008 escapes the remittance charge for so long as the current owner owns it, even if it is later exported and re-imported. But, as was the case before 6 April 2008, a charge will arise if an asset bought from untaxed overseas income is turned into cash after import into the UK.

A separate exemption applies where a work of art is bought from unremitted overseas income or gains and brought into the UK for public display. Unremitted income or gains given offshore before 6 April 2008 to one's spouse, for example, will be taxed as a remittance if first brought into the UK after 5 April 2008.

As to identifying unremitted income and gains, remittances from a 'mixed source' (e.g. employment income, investment income, capital gains, original monies) are to be attributed on a 'just and reasonable' basis. A pre-existing division of bank accounts between 'capital' and 'income' holds good after 5 April 2008, so that remittances from the 'capital' account may be made tax-free.

Before 6 April 2008 interest on loans raised offshore to buy property in the UK might be paid from unremitted overseas income without a tax charge. Now such interest payments will be remittances save in the case of those paid on debts existing at 12 March 2008 that were used to buy residential property in the UK for the life of the loan or until 5 April 2028 if sooner, unless the terms of the loan are varied or any further advances are made after 12 March 2008.

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HMRC now also consider as a remittance a loan raised to acquire property in the UK if the loan is secured on otherwise unremitted overseas income or gains. Before 4 August 2014, by concession, this was not applied to loans on a commercial basis that were regularly serviced from overseas income or gains. In such cases only the interest was treated as a remittance. Such arrangements are only protected if either the loan is repaid before 5 April 2016 or a written undertaking is given by 31 December 2015 (which is subsequently honoured) that the overseas 'security' is replaced by 'onshore' security before 5 April 2016.

An individual is currently able to choose for each tax year whether or not to adopt the remittance basis. Of course income and gains arising in a year when that choice is made remain taxable in any year that they are remitted, even though the individual may by then be taxable on the arising basis. HMRC are consulting on a proposal that, from 2016/17 the choice will have to be for three years at a time.

If the RBC is paid directly to HMRC by cheque or electronic transfer from overseas sources it will not be taxed as a remittance.

From 6 April 2012 a remittance of overseas income or gains is exempt if, within 45 days, it is used to make a 'qualifying investment'. That is, in shares issued to the investor in, or a loan made by the investor to, a private limited company carrying on a trade or investing in real estate, or a company which exists to make investments in such companies.

Temporary non-residence

If an individual resumes UK residence after fewer than 5 tax years of non-residence, and he or she was UK resident for at least 4 out of the 7 tax years immediately before the year of departure, any overseas income remitted to the UK in those intervening years that arose while UK resident but was not taxed as it arose is to be taxed as if it had been remitted to the UK in the tax year of return. A similar rule is to apply to overseas gains remitted to the UK in the intervening years, but only if the remittance basis applies to the individual for the year of return. Under the existing law gains realised during a period of temporary non-residence are already chargeable in the year of return where the 'arising' basis applies, save where the asset was acquired during that period.

Non-resident companies

A major change affects gains realised by non-resident companies that would be 'close' if they were resident. Gains realised by non-resident companies that would be 'close' if they were resident are attributed to UK resident participators even if non-domiciled (if their 'participation' - including that of their 'associates' - exceeds 10%). Those non-domiciled UK residents who are on the remittance basis will be chargeable only on remittances of gains on overseas assets.

Where the non-resident company's shares are held by a non-resident trust, the gains are attributed to the trustees. The re-basing election referred to below will then extend to the company's assets held at 6 April 2008.

There is no exemption for a gain realised on disposal of a residence owned by a company, even if it is the main residence of a participator. So the common situation of a UK residence owned by an offshore company (to avoid UK inheritance tax), and in the case of 'expensive' dwellings now exposed to the annual tax on enveloped dwellings has become less tax-efficient. And it is worth noting that the benefit of living in a house in the UK may represent a 'capital payment' from a non-resident trust (in the common situation where the company is owned by such a trust), and it is clearly remitted to the UK.

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Non-resident trusts

Settlors - A UK resident domiciled settlor remains exempt from charge on gains arising in a non-resident trust (even if the trust might benefit the settlor, the settlor's spouse, etc) This applies regardless of whether the settlor is taxed on the remittance basis. He or she is of course still potentially liable to tax on gains attributed to capital payment received, as with other beneficiaries.

Beneficiaries - A UK domiciled resident who receives a capital payment from a non-resident trust is deemed to have a capital gain to the extent of the capital gains of the trust ('trust gains') not previously attributed to earlier capital payments. If the capital payment exceeds the unattributed trust gains to date the excess capital payment is carried forward to be attributed to any later trust gains. A gain would then be deemed to arise in that later year.

This now also applies to non-domiciled UK residents.

Before 6 April 2008 the linkage between trust gains and capital payments was first in, first out (or FIFO); the trust gain was linked with the earliest previously unattributed capital payment. Now it is last in, first out (LIFO) for all beneficiaries in receipt of capital payments.

Trust gains arising after 5 April 2008 that are linked with capital payments prior to 6 April 2008 escape tax if the beneficiary is non-domiciled (even if he is not on the remittance basis) in the year the gain arises in the trust.

Furthermore, trust gains arising before 6 April 2008 that are matched with capital payments made after 5 April 2008 will escape tax if the beneficiary is not domiciled in the year the capital payment is received.

Capital payments to non-UK domiciled beneficiaries in the period 12 March to 5 April 2008 are never to be linked with trust gains arising after 5 April 2008, thus increasing the chance that a subsequent trust gain will be matched with a post-5.4.08 capital payment.

Trustees of non-resident trusts are able to make an irrevocable re-basing election, which will have the effect of excluding from tax for non-domiciled beneficiaries such part of the gain on a disposal made after 5 April 2008 as had accrued by that date. The election has to cover gains on all assets held on 6 April 2008 by the trust and on the trustees' participation in all assets held by non-resident companies that would be 'close' if they were resident, if the trustees' 'participation' - including that of their 'associates' - exceeds 10%.

The election must be made by the 31 January next following the first year after 5 April 2008 that a capital payment is made to a UK resident.

Finally, where a trust gain does arise to a UK resident non-domiciled beneficiary, and he is on the remittance basis, he is only taxable to the extent that the capital payment that gives rise to the attributed gain is remitted to the UK. This applies whether the trust gain arose on an offshore asset or a UK asset.

The supplemental charge (which increases the beneficiary's capital gains tax liability by reference to the delay between the trust gain arising and receipt of the capital payment) is based on the year the capital payment is received, not when it is remitted to the UK by a non-UK domiciled beneficiary.

In essence UK resident non-domiciliaries are taxable on trust gains to the extent that both the trust gains and the capital payments relate to the period after 5 April 2008.

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Losses on the disposal of overseas assets

It is important to realise that one's domicile is not affected by the decision not to apply for or accept remittance basis of taxation. Non-domiciled individuals taxed on the arising basis will have relief for losses on overseas assets. Those non-domiciled who *do* claim the remittance basis for any year may elect (but only with effect from the first year) into a regime

that enables them to get relief for such losses in the UK in the years they are taxed on the arising basis. The election will be irrevocable and will require disclosure of details of unremitted capital gains.

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