



Residence and Domicile Changes - draft legislation published

January 2008

Nearly a month after it was first promised, HM Revenue & Customs ("HMRC") have finally published draft legislation in relation to the proposed changes to the residence and domicile rules. If enacted in their current form the new rules will apply from 6 April 2008 and will remove many of the tax benefits currently enjoyed by non-UK domiciliaries. They also make some changes to the test of whether a person is UK resident.

Despite extensive lobbying, the draft legislation makes virtually no concessions and enacts all the changes originally announced. Indeed in certain respects the legislation will be worse than originally feared.

In this briefing we look in more detail at the proposed changes and their likely impact. We conclude by outlining some planning ideas which non-domiciliaries or their trustees may wish to consider.

Outline of proposals

Our previous briefing issued in October 2007 gave details of the original proposals. The draft legislation seeks to enact these virtually unchanged. In summary:

- Days of arrival and departure will, from 6 April 2008, count towards whether a person is resident in the UK. Strictly the legislation only applies to the 183 days test, although HMRC have said that they will apply a similar practice to the 91 days test too.
- Non-domiciliaries who have been resident in the UK for at least 7 of the previous 9 tax years must pay a £30,000 per annum charge if they wish to retain the remittance basis. If so they will also lose their personal allowances and annual exemptions. It appears that residence in the UK for as little as 6 years and 2 days, if a person arrives towards the end of a tax year, could trigger the liability.
- A new definition of what it means to remit funds to the UK has been drafted, eliminating a number of the so-called loopholes which previously existed.
- The rules for income and gains of offshore trusts and companies have been brought broadly into line with those for personal ownership. In particular gains made

on UK real estate or other UK assets within an offshore structure will be taxable on an arising basis.

- As expected the rules apply to offshore income gains in the same way as to capital gains.
- The remittance basis must be positively claimed.

The good news

Trying to find good news in the draft legislation is not easy, but the proposals do alleviate a few concerns:

- No proposals have been made to change the inheritance tax position of non-domiciliaries or of trusts set up by them.
- Those with unremitted income of less than £1,000 p.a. do not need to pay the £30,000 and will not lose their personal allowances
- It appears possible to break the 7 out of 9 year test by 3 years of non-residence
- There appear to be some opportunities to restructure prior to 6 April 2008.
- Income and gains of 2007/08 or earlier years still appear capable of being alienated (e.g. by transfer to spouse) and potentially remitted after 6 April 2008.

The bad news

That the government have not listened to the many representations made to them is disappointing. In particular:

- No overall statutory residence test has been introduced, leaving taxpayers with even greater uncertainty than at present. Residence remains a matter of "fact and degree to be judged under all the circumstances"
- The £30,000 charge is not income tax (although it is treated as such for various purposes) meaning that there is still some doubt as to whether it will be creditable under double tax treaties. It is thought to represent a real cost to US citizens, in particular.
- The £30,000 charge does not offset the tax charge on remitted funds. And grossing-up is required if offshore

funds are brought into the UK with which to pay it.

- A number of "loopholes" in the remittance basis have been closed as expected, but the new definition also removes other possibilities not previously mentioned. One example of this is paying for UK services into the offshore bank account of the service-provider.
- Despite intensive lobbying, the rules on offshore companies and trusts have been broadly brought into line with those for personal ownership.
- A new 5 year rule has been introduced to prevent remittances in a period of temporary non-residence.

The very bad news

- The source-ceasing rules appear to be retroactive. Any historic income whose source has ceased appears to become taxable again if remitted after 6 April 2008.
- S87 TCGA 1992 (which imputes capital gains made by offshore trustees to recipients of capital payments) will apply to non-domiciliaries from 6 April and will do so with no remittance basis at all. This puts such trusts in a worse position than personal ownership of the same assets.
- S87 is also retroactive meaning that any capital gains realised at any time in the past may still be on the clock and charged if beneficiaries receive capital payments after 6 April 2008. This may somewhat limit the scope to rebase assets prior to the end of the tax year.
- Losses realised by non-domiciliaries on non-UK assets will continue to be unallowable even if the non-domiciliary opts for full UK taxation.
- Tax paid by non-domiciliaries when capital gains are imputed to them from offshore close companies will not be capable of being offset against subsequent gains made on the sale of shares in that company (s13(7) TCGA). This applies irrespective of whether the non-domiciliary has opted into UK taxation.
- The final two points above both appear to be clear cases of discrimination and might potentially be challenged under European law.

What does "remittance" mean?

Many of the changes for non-domiciliaries hinge on the new statutory definition of "remittance" in ss809H-K ITA 2007.

These sections introduce a new order of precedence for remittances from mixed funds. They otherwise define remittance as occurring where money, property or services are enjoyed in the UK which, in turn, derive in some direct or indirect way from offshore income or gains. The enjoyment in the UK can be by the individual or any connected person.

However, the particular interest here arises in the case of imputed

gains from offshore trusts and companies. Queries had been raised as to what "remittance" would mean in the context not of actual income or gains, but of imputed income or gains.

The drafting is slightly unclear, but the result appears to be that such remittances will only be taxed where:

- There is an individual in the UK who enjoys the money, property or services. Simply having the offshore trust or company bring the money into its own UK bank account will not be a remittance.
- Not only must the individual be in the UK, so must the enjoyment. So if a payment is made to a non-UK bank account the remittance basis can still apply (subject to paying the £30k as appropriate); and
- The benefit enjoyed must derive directly or indirectly from the offshore income or proceeds of sale. So, if the company or trust provides a benefit out of other identifiable assets, the new rules may not treat this as a remittance.

Planning ahead of 6 April 2008

It seems likely that the exact method of planning will depend very much on each person's own circumstances. However, some generic planning ideas might include:

- Rebasing assets prior to 6 April 2008, either by triggering actual or artificial disposals (for instance to a new company). However, the retroactive effect of s87 (see above) would need to be watched
- Winding-up trusts. This would not only rebase assets, but also appear to prevent the retroactive effect of s87 provided it is done before 6 April.
- Resettling. Those who are not yet deemed domiciled might consider resettling any trusts which have been wound-up.
- Trust lends assets back to beneficiaries. This could trigger a rebasing, while keeping the IHT status of the trust intact.
- Alienation of offshore income and gains would be sensible ahead of 6 April 2008, although may remain possible afterwards.

Planning after 6 April 2008

A number of planning opportunities will remain for non-domiciliaries although there will be significantly fewer than at present. More ideas will undoubtedly emerge in due course, but initial thoughts would appear to include:

- Proper income and capital segregation would still appear to allow pure capital to be remitted to the UK tax free
- The £30,000 charge is assessed each year. By investing for capital growth rather than income, it may be possible to pay the charge only in years when gains are realised.
- Spouses may wish to amalgamate assets so that only one of

them pays the £30,000 charge

- Wrappers such as offshore bonds may be attractive in some situations to enable tax deferral without the £30,000 charge.
- Those who can become non-resident before encashing a bond may wish to consider this more actively.
- For trusts which are not settlor-interested, there will be an interesting debate as to whether to invest for income or for capital growth. Currently income is preferable as when benefits are received by beneficiaries they are taxed at 40% rather than rates up to 64%. However, with the general reduction in the CGT rate, the comparison will become between 40% (income tax) and 28.8% (CGT). The latter, however, will not benefit from any remittance rules, whereas income will.
- Capital payments to non-resident beneficiaries will, as at present, still wash out capital gains within offshore trusts.
- Stand-alone offshore companies are likely to become more popular than offshore trusts as the imputation provisions under s13 are less stringent in a number of respects. The remittance basis will more clearly apply; those with less than

a 10% interest will not be charged at all; the gains may get indexation relief; and the company can pay the tax charge (and arguably even the £30k) without this being treated as a remittance (s13(11)).

- Protected cell companies designed to get round the s13 rules may prove to become more popular.
- Double-trust structures, with a "dry" trust from which remittances are made, may be possible.
- Distributions out of offshore trusts as income rather than capital should continue to benefit from the remittance basis.

Conclusion

With less than 3 months to 6 April, non-domiciliaries need urgently to review their affairs in the light of these changes. We have suggested some outline ideas in this briefing but, as always, a great deal will depend upon the exact circumstances of each individual.

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