



## Non-residents and non-domiciliaries – the draft new rules

January 2008

The new rules for taxing UK resident non-domiciled individuals and for calculating periods of UK residence have finally been released (in draft) more than three months after their announcement in the Pre-Budget Report. The proposed provisions are even broader and more draconian than was anticipated and, to the extent that planning to mitigate their effects is possible, there is little more than two months available to do so.

In context, however, there continue to be significant benefits for UK resident non-domiciliaries for inheritance tax purposes, and in respect of untaxed remittances to the UK.

This note does not seek to cover all the provisions included in the draft legislation, but discusses the principal measures likely to be relevant to individuals, including settlors and beneficiaries, and trustees, as follows:

- A **£30,000 annual charge** to claim the remittance basis for a non-UK domiciled individual who has been resident in the UK in at least 7 of the preceding 9 tax years and who has £1,000 or more of unremitted foreign income and capital gains arising in a tax year.
- A claim for the remittance basis treatment in any tax year will result in the withdrawal of certain allowances and reliefs for that tax year. These include income tax personal allowances and the capital gains tax ('CGT') annual exempt amount.
- Methods of converting income and/or gains into capital will no longer be available; for example, "source ceasing" for income, and making gifts offshore to connected persons, such as relatives and into trusts.
- The requirement to **notify HMRC of the creation of offshore settlements** will be extended to UK resident or ordinarily resident non-domiciled settlors.
- The rules in relation to the **attribution of gains to participators in offshore close companies** are being extended to UK resident non-domiciliaries so that gains on UK assets treated as accruing to the individual will be charged on an arising basis. The remittance basis is available in relation to gains on non-UK assets in these circumstances.
- Gains arising on **UK assets** in an offshore trust which is "settlor-interested" will be taxable on a UK resident non-domiciled settlor on an arising basis.
- Gains arising on **non-UK assets** in a settlor-interested offshore trust will also be taxable on a UK resident non-domiciled settlor on an arising basis unless the settlor claims the remittance basis. If such a gain is not subsequently remitted, it may subsequently be taxed on a UK resident beneficiary who receives a capital payment from the trust.
- UK resident non-domiciled beneficiaries (including settlors) of an offshore trust will be taxed on trust gains on receipt of capital payments

(wherever they are received) in the same way as UK domiciled beneficiaries. The remittance basis will not be available in this situation.

- The **income tax anti-avoidance rules**, which currently apply either to tax transferors (broadly, settlors) or beneficiaries of offshore trusts in respect of income accumulated in the offshore structure, depending on circumstances, are amended to incorporate the new remittance rules.
- **Days of arrival and departure**, including a day of both arrival and departure, unless spent in transit, will be counted as days of presence in the UK for the purpose of determining residence status.

The UK CGT regime is being overhauled so that the standard CGT rate will be 18% for gains realised after 5 April 2008. In certain limited circumstances, "entrepreneurs' relief" will apply to tax the first £1 million of gains at 10% on disposal of interests in certain trading companies or other trading businesses. Taper relief and indexation allowance are being withdrawn. The change in the rate of CGT likely to be payable after 5 April will be relevant to people reviewing their offshore assets and structures in the light of the new residence and domicile regime.

## Current position

An individual who is resident but not domiciled in the UK pays tax on their own UK income and capital gains as it arises (the "**arising basis**"), in the same way as a UK domiciled individual.

For income and capital gains arising outside the UK, eg on a foreign bank account or other offshore asset, a UK resident non-domiciled individual is entitled to pay UK tax on the "**remittance basis**", whereby they pay only when they bring in or "remit" the income or gains to the UK. Such an individual does not have to pay UK tax on "clean" foreign capital which they bring to the UK.

Assets, for example, works of art purchased offshore with foreign income or gains, may be brought into the UK without giving rise to a UK tax charge. Gifts to relatives or trustees can, in certain circumstances, convert capital gains and income into pure capital in the hands of the recipient.

If a source of income is terminated in one tax year, the income from it can be brought to the UK in a subsequent tax year UK tax-free as capital.

UK resident non-domiciled individuals who are settlors or beneficiaries of offshore trusts, or have interests in certain offshore companies, have also been in a privileged position for CGT purposes compared with UK domiciliaries. The anti-avoidance rules which apply to attribute capital gains to UK resident domiciliaries with interests in offshore trusts do not apply to them at all.

## New rules - individuals

### Annual charge

From 6 April 2008, there will be an **annual charge of £30,000** to claim the remittance basis. This will apply to any UK resident non-domiciled individual who has been resident in the UK in 7 of the preceding 9 tax years, if he has £1,000 or more of unremitted foreign income or gains in a tax year. Years of residence prior to 6 April 2008 will count for this purpose, so a non-domiciled individual who became UK resident in tax year 2001/2 (potentially feasible for someone who arrived in the UK at the beginning of April 2002), will be liable to pay the charge from 6 April 2008.

The charge will be in addition to any other tax liability and it will not be possible to set it off against another UK liability. If the individual remits funds to the UK to pay the charge he will be liable to tax on the remittance (effectively, the charge will be grossed up to £50,000).

It will be possible to **elect in and out of the remittance basis** in different tax years, and an individual will have until he files his tax return for a tax year to decide whether his foreign income and gains for that year are sufficient to justify claiming the remittance basis. In any year that he claims the remittance basis, however, he will lose his entitlement to a number of reliefs and allowances including personal income tax allowances and the annual CGT exempt amount. This will be the case whether or not the £30,000 annual charge is payable.

It may not be possible to set off the annual charge against tax paid in another jurisdiction under a double tax treaty. The UK Government has confirmed that they are making no provision for this and it will be for individual countries to determine how they will deal with the charge. There

is even a risk of all income and gains not being allowable under a treaty as tax is only payable "voluntarily".

The remittance basis will apply without claim, and without loss of personal reliefs and allowances, to anyone who has less than £1,000 unremitted foreign income and gains in any tax year.

*An individual who is currently taxed on the remittance basis and who chooses not to claim it after 5 April 2008 should bear in mind that then existing unremitted foreign income and gains will be treated as if the remittance basis applied if they are subsequently remitted to the UK, even though the taxpayer is otherwise taxed on the arising basis. Such taxpayers should, therefore, seek to capitalise existing unremitted income and gains prior to 6 April 2008 to the extent it is possible to do so.*

*Generally, UK resident non-domiciled individuals should consider whether any other remittance planning can and should be done in the current tax year.*

## Meaning of remittance

Under the new rules, if property purchased abroad using foreign income or gains, for example, a work of art, is subsequently brought to the UK, it will constitute a remittance. If foreign income or gains are applied offshore in payment for services in the UK or to satisfy a debt in the UK, that will also constitute a remittance.

It will not be necessary for the property or service to benefit the non-domiciled individual. A remittance will occur if the property or service may benefit a "relevant person". Relevant persons would include the individual and people "connected" with him, including (amongst others) his spouse or civil partner, siblings, ancestors and descendants. Trustees of trusts of which the individual is settlor and certain related companies would also be included. As a result, it will no longer be possible to alienate income and gains by transferring them to a connected person, who could subsequently bring them into the UK tax free, whether in the form of cash or another asset. The class of "relevant persons" has also been extended to include couples living together as if married or in a civil partnership.

Many structures in which **offshore loans** are or have been taken out to fund the acquisition of property in the UK may now be caught under the new rules. The use

of offshore income or gains to pay interest on a mortgage on a UK property is also likely to constitute a remittance.

*The changes as they relate to connected persons will not apply where income and gains arose prior to 6 April 2008.*

*Therefore, it should still be possible to make gifts of such income and gains to connected persons before that date without UK tax consequences, even if the property is brought into the UK after 6 April 2008.*

*Where a UK resident non-domiciled individual has unremitted foreign income and gains which have arisen to him prior to 6 April 2008, the new rules will apply to determine whether a remittance occurs on or after 6 April 2008. For that reason, if it is possible to alienate foreign income and gains which have arisen before 6 April in order that they may be remitted UK tax free in the future, this should be considered.*

*It has been suggested that property previously purchased abroad using foreign income or gains, and brought to the UK prior to 6 April 2008, could give rise to a remittance if it is still in the UK on or after 6 April 2008. To mitigate any such risk, UK based assets purchased using foreign income and gains from earlier years could be exported before 6 April. However, we think this risk is small.*

*Offshore mortgages and other loan structures used to finance UK property should be reviewed carefully and consideration given to unwinding such arrangements, if appropriate.*

## Income source ceasing

Income "source ceasing" will no longer be available from 6 April 2008. This means that if a source of income has been terminated since 5 April 2007, perhaps by closing a bank account, it will no longer be possible to remit the income without incurring a UK tax liability.

*Individuals who are holding foreign income whose source was terminated prior to 6 April 2007 should consider remitting the income to the UK in this tax year in order to avoid being caught by the new rules.*

## Temporary non-residence

The CGT rules, which prevent those who become non-UK resident on a temporary basis from realising gains free of UK tax during a non-resident period of less than

5 years are being extended to income. For an individual who has been UK resident for at least 4 of the 7 tax years immediately preceding the year in which he leaves the UK, foreign income for the year of departure or any earlier year, which is remitted to the UK during the individual's absence will be chargeable as if it was remitted in his year of return unless he has been non-resident for at least 5 tax years before he returns.

*It is worth noting that income which arises during a period of absence from the UK may be remitted tax-free even if an individual does not remain non-resident for the full 5 years. There may also be other planning options available using the non-residence provisions in appropriate circumstances.*

## New rules - offshore companies

Currently, rules which attribute the gains of certain offshore companies (broadly those under the control of five or fewer "participants" - persons with a share or interest in the capital or income of the company) to UK resident participants whose interest in the company exceeds 10%, do not apply to non-UK domiciled individuals. From 6 April, however, this will change and the **attribution rules** will apply to UK resident non-domiciliaries where either the underlying assets are UK situated or there is a remittance of gains on non-UK assets, if the remittance basis is claimed. Otherwise, all gains will be taxed on an arising basis.

Similarly, where gains are made by offshore companies held by non-UK trusts, they will be treated as if made by the trustees and will be taxable under new rules attributing trust gains to UK resident non-domiciled settlors and beneficiaries.

Provisions are included to deal with situations where **assets are disposed of for less than full consideration**. Further provisions prevent tax paid on the remittance basis under these rules on an attributed foreign gain being available as a deduction against a subsequent disposal by the participator of an interest in the company, which may give rise to an effective double charge.

*Where UK property is held through an offshore company, whether in trust or otherwise, it may be advisable to collapse the structure in some circumstances, for example, to take advantage of principal private residence relief in the future, where this is available.*

## New rules - offshore trusts

### Attribution of gains to settlors with an interest in an offshore settlement

Currently, non-UK domiciled settlors are specifically excluded from rules which tax the gains of offshore trusts on settlors with an interest in a settlement. A settlor has an "interest" for these purposes not only if he can benefit from the settlement, but also if one or more of several classes of family members and/or companies associated with them can do so. From 6 April, however, these rules will be extended to UK resident non-domiciled settlors. If the settlor claims the remittance basis, he will be taxed on gains on UK assets as they are realised by the trustees or an underlying company and on gains on offshore assets treated as remitted to the UK by him or the trustees or other connected person.

To the extent that foreign gains which are attributed to the settlor are not remitted to the UK, they may be attributed to capital payments made to beneficiaries (including the settlor).

### Attribution of gains to beneficiaries of an offshore settlement

Under the present rules, gains made within foreign trusts, which are not attributed to the settlor, may be attributed to beneficiaries who receive capital payments from the trust. In this case, a CGT charge is imposed when a UK resident and domiciled beneficiary receives a capital payment. A supplementary charge also applies to increase the tax payable where time has elapsed between the gain being realised and being distributed. Currently, this may give rise to a maximum tax rate of 64%. As the rate of CGT will change to 18% with effect from 6 April 2008, the application of the maximum supplementary charge should result in a rate of 28.8%.

Under the new rules, a charge may also be imposed on a UK resident non-domiciled beneficiary (including a settlor) who **receives a capital payment**, whether the gains have arisen on UK assets or otherwise and whether the benefit is received or enjoyed in the UK or elsewhere (subject to the charges on gains attributed to settlors).

These notes are for general information only and are not intended to provide legal advice.

Lawrence Graham LLP.  
All rights reserved.

Where foreign gains, attributed to a settlor of a settlor-interested offshore trust who has claimed the remittance basis, are not remitted to the UK, provisions apply to attribute them instead to capital payments made to beneficiaries (including the settlor) and tax them accordingly.

Trust gains for tax year 2007/8 and earlier which have not already been matched to a capital payment will give rise to a CGT charge on a capital payment made to a UK resident beneficiary after 6 April 2008 (as would be the case currently for a UK domiciled and resident beneficiary). Equally, trust gains which arise after 6 April 2008 may be attributed to capital payments made to non-domiciled beneficiaries before 6 April 2008, which have not been fully matched against earlier gains.

*These rules are draconian. To the extent it is possible to do so, capital payments should be made before 6 April 2008 to non-UK domiciled beneficiaries sufficient to match any trust gains already realised but not distributed. Unrealised gains should be realised where possible and distributed to non-domiciled beneficiaries in order to ensure that on 6 April 2008 there are no unmatched gains in the trust and no existing capital payments which have not been matched with gains.*

*Going forward, unless there are non-resident beneficiaries to whom capital payments may be made to "wash out" trust gains, it will be almost impossible to make distributions to non-domiciled beneficiaries which do not give rise to UK CGT. Subject to considerations of income tax (anti-avoidance provisions for which are not so penal) and more significantly, UK inheritance tax ('IHT'), it may be advisable to make significant distributions from many offshore trusts and, in some cases, consider winding them up before the end of the tax year, to hold assets personally, if appropriate.*

*Situations where UK resident non-domiciliaries gifted assets to a trust or a person, thus triggering a "deemed gain", should also be reviewed. These may become chargeable in the future.*

*Where there are good non-CGT reasons to retain an existing offshore trust, some comfort may be taken from the fact that after 5 April this year, gains should be taxed at a maximum rate of 28.8%; 18% if they are distributed in the tax year in which they arise. This is a considerable improvement from the current trust rate of 40%, or 64% if the maximum supplementary charge applies. Capital*

*gains will be taxed at a much lower rate than income, on which trustees and higher rate taxpayers are currently taxed at 40%.*

## **Transfer of assets abroad – income tax anti-avoidance provisions**

Where assets have been transferred abroad and are held through offshore entities, including a trust, there are provisions which apply to tax income arising in the offshore structure. If the "transferor" (broadly the settlor) is ordinarily resident in the UK and can benefit from the settlement, the rules treat such income as his. Otherwise, beneficiaries are taxed on income treated as theirs when they receive capital payments or other benefits.

The rules are extended to incorporate the new remittance rules. Where the remittance basis is claimed, it can apply to both transferor and beneficiary charges, unlike the equivalent CGT provisions. As the new broader definition of remittance will apply, payments by the trustees for services in the UK may be caught by the rules.

*Where possible, any accumulated income within the trust structure, whether at the level of the trust or in an underlying company, should be paid out before 6 April 2008. Going forward, if it will be difficult to avoid remitting funds to the UK under the new rules without UK tax charges arising, it may be preferable for the trustees to invest for capital growth, to take advantage of the new lower rates of UK CGT.*

## **Requirement to notify HMRC of offshore trusts**

UK-domiciled settlors are required to notify HMRC within 3 months of creating an offshore trust if they are resident or ordinarily resident in the UK at the time, or within 12 months of subsequently becoming resident or ordinarily resident. From 6 April, this requirement will be extended to non-UK domiciliaries (with an initial deadline of 1 September 2008 if notification would otherwise be due earlier). There will be a 12-month deadline for notification of offshore trusts created between 19 March 1991 and 6 April 2008, calculated from the later of 6 April or the date on which the settlor becomes UK resident or ordinarily resident.

The details required by HMRC are the date on which the settlement was created, the names and addresses of the person delivering the return and of the trustees immediately before the return is delivered.

*These rules represent a significant extension of HMRC's information gathering powers, seemingly without justification to the extent that they will apply to trusts set up many years ago, when the settlor may have had no UK connection. Such a trust may still have no UK beneficiaries or other existing UK connection, apart from the settlor.*

## UK residence – the day counting rules

Until now, for the purpose of determining if a person is resident in the UK, it was HMRC's stated practice in their publication IR20 not to count days of arrival in and departure from the UK, although there was no statutory basis for this practice.

The new rules introduce legislation which provides that, for the purposes of the 183 day rule, days of arrival and departure will count as days of presence. The only exception will be someone in transit who does not leave the restricted part of the port or airport. HMRC have indicated they will amend IR20 to introduce these provisions in the 90 day rule, but this will still not be on a statutory basis. It is unclear whether it is intended that the existing exception for days spent in the UK due to exceptional circumstances, such as the illness of the individual or a member of their family, will continue to apply.

*Visitors to the UK, who wish to ensure that they do not inadvertently become UK resident, will need to keep detailed records of the times and dates of their visits in the future. This will be of increasing importance to non-UK domiciled visitors, particularly beneficiaries of offshore trusts, who, even if they never bring any funds into the UK, may find themselves liable to UK CGT on trust distributions made to them, even if such payments are at no time remitted to the UK.*

## And finally...

The new measures will not remove all the tax advantages of UK resident non-domiciliaries and those who continue to claim the remittance basis will still be in a relatively privileged position for UK tax

purposes (subject to the £30,000 annual charge where this applies). However, from 6 April 2008 it will be significantly more difficult or even impossible to convert income or gains into capital which can be remitted to the UK tax-free. Equally, the income tax and CGT benefits to UK resident non-domiciliaries of holding assets via an offshore trust or company structure, whilst they still exist, will be eroded. **The IHT benefits still remain**, however.

The CGT changes, coming into effect at the same time as the residence and domicile measures, are likely to be an important factor in a decision as to how to proceed pre-6 April 2008 for both personal asset holdings and trust and company structures. In some cases, it may be beneficial to realise gains in advance of the deadline to take advantage of taper relief and indexation allowance whilst it is still available. Where these reliefs are of less significance or do not apply, it may be preferable to delay disposals until the new tax year.

At the same time, 6 April 2008 also sees the end of the transitional period for the IHT measures which were introduced for life interest and accumulation and maintenance trusts in 2006. For any trust for which IHT is a potential issue (because it holds UK assets directly; the settlor was domiciled or treated as domiciled for IHT purposes when funds were added to it; or he or his spouse or civil partner are domiciled or treated as domiciled when the later of their respective life interests comes to an end) it will be necessary to consider whether action should be taken to reorganise the trust prior to the end of the transitional period.

6 April 2008 is fast approaching. UK resident non-domiciled individuals and settlors and trustees of offshore trusts with UK resident settlors and/or beneficiaries should give immediate consideration to the extent to which the new measures will affect them and what actions may be taken to mitigate their effects as far as possible. It should be borne in mind that the measures may be subject to change before they come into effect, and even afterwards, until the Finance Bill in which they will be introduced is made law, probably during the summer.

*For further information, please get in touch with your usual LG contact on +44 (0)20 7379 0000 or by e-mail.*

These notes are for general information only and are not intended to provide legal advice.

Lawrence Graham LLP.  
All rights reserved.