AVOIDING THE ORDER OF REMITTANCE RULES BY HAVING A "GOLDEN" BANK ACCOUNT

by Patrick Soares

In order to use the remittance basis, an adult who is domiciled outside the UK but who has been resident in the UK for at least 7 out of the prior 9 years *must* nominate overseas income or gains which are to be taxed on an arising basis (ITA 2007 s.809C). There are tax trap provisions in ITA 2007 s.809I and s.809J, which apply if the taxpayer remits to the UK some or all of his nominated income or gains and leaves overseas other income or gains of his which are taxable on a remittance basis. The problem can be overcome by having a separate "golden" bank account.

An individual may have an offshore bank account A with the nominated income of (say) £75,000 therein. He may have bank account B with income of £1m and bank account C with capital gains of £2m. If he only brings to the United Kingdom the monies in bank account C (which means he pays capital gains tax at 18%), these provisions are wholly irrelevant. Also if he only brings to the United Kingdom the monies in accounts B and C, these provisions are wholly irrelevant. If he brings any part of the monies in the nominated account A to the UK without bringing also the whole of the overseas income and gains of his to the United Kingdom, then these provisions will be relevant. Once these provisions apply section 809I(2) states that the liabilities to income tax and capital gains tax shall be determined as if the overseas income and gains had been remitted to the United Kingdom in the order set out in s.809J(2) and *one must ignore totally the actual sources from which the remitted monies came.*

One can see that this can be particularly serious if a taxpayer remits capital gains to the United Kingdom thinking he will only be liable for an 18% tax charge: it will be seen that the result of the re-ordering is his overseas foreign income will be deemed to have come to the United Kingdom first. The reordering rules are in s.809(J). One must first (<u>step 1</u>) find the total amount of the individual's nominated income and gains and also the individual's "remittance basis income and gains" (remittance basis income and gains are the foreign income and gains of the individual taxable on a remittance basis *for all the tax years up to and including "the relevant tax year"*) ignoring of course the nominated income and gains. The relevant tax year is the year in which the remittance to the United Kingdom takes place.

<u>Step 2</u> requires one to find the amount of the foreign income and gains of the individual <u>for</u> *the relevant tax year* (ignoring once again the nominated income and gains): one then puts those gains and income into each of the relevant paragraphs (a) to (h) in s.809J(2). *The nominated income and gains is not attributed to any of the paragraphs.*

<u>Step 3</u> requires one to find the *earliest* paragraph where the amount determined under step 2 is *not* nil. If the amount in the first such paragraph does not exceed the *"relevant amount", ie, the amount remitted to the United Kingdom*, then the taxpayer is treated as having remitted the income and gains within that paragraph and for that tax year. If the amount within the paragraph is more than the relevant amount then the amount remitted is treated as the relevant proportion of each kind (category) of income or gain within *the paragraph* for that tax year. (There may for example be more than one type (category) of income falling within s.809J(2) paragraph (c).)

The relevant amount, i.e. the amount which is remitted to the United Kingdom and which is taxed accordingly as above, is (as one would expect) reduced to the extent that it is brought into charge to income tax or capital gains tax applying the above (step 4). However, if it has not been reduced to nil then step 5 operates and it states that one must go further down the list of paragraphs in s.809J(2): this may mean, for example, going down from s.809J(2)(c) (being the relevant foreign income paragraph) to s.809J(2)(d) (being the foreign chargeable gains paragraph). Finally if having gone through all the paragraphs with regard to income and gains *which arose in the year of remittance*, the relevant amount has still not been reduced to nil then one goes to step 6. One then has to look at any income and gains which arose to the individual *in tax years prior to the year of remittance*: one goes down the list in s.809J(2) to see what income or gains have arisen in what the legislation calls "the appropriate tax year": the appropriate tax year is the latest tax year which is before the tax year when the monies were remitted to the United Kingdom, being a year when the taxpayer was on the remittance basis.

The list of paragraphs in s.809J(2) is as follows:-

(a) relevant foreign earnings (other than those subject to foreign tax);

(b) foreign specific employment income (other than income subject to foreign tax);

(c) relevant foreign income (other than income subject to foreign tax);

(d) foreign chargeable gains (other than gains subject to foreign tax);

(e) relevant foreign earnings subject to foreign tax;

(f) foreign specific employment income subject to a foreign tax;

(g) relevant foreign income subject to a foreign tax;

(h) foreign chargeable gains subject to foreign tax.

Example

The taxpayer in 2008/09 has a bank account with £3m of investment income which has not borne any foreign tax. (It thus falls within s.809J(2)(c).) He also, in that year, has a bank account which has £1m of foreign chargeable gains which have not been subject to foreign tax. (Section 809J(2)(d) is the relevant head.) In year 2009/10 he has a third account which has investment income which accrued in 2009/10 of £0.5m. Finally he has a fourth account in 2009/10 which has a capital gain of £416,666 which was realised in 2009/10. He nominates gains in the sum of £166,666 (which produces the tax bill required of £30,000, the £166,666 being taxed at 18%) in his fourth account to be his nominated gains (£0.25m being thus left un-nominated in this account). In the year 2009/10 he remits £1m to the United Kingdom.

The rules in s.809I and s.809J apply because the taxpayer remits to the United Kingdom the nominated gains. Although he has remitted all his income and gains for the year 2009/10 to the United Kingdom he has not remitted all the earlier income and gains which arose or were realised in 2008/9. The situation therefore satisfies the conditions of ITA 2007 s.809I(1) and one must read on.

<table>
<tr><td colspan="2">2008/09</td><td colspan="2">2009/10</td></tr>
<tr><td>Income/Gains</td><td>Actual Remittances</td><td>Income/Gains</td><td>Actual Remittances</td></tr>
<tr><td>£3m investment income (para c)</td><td rowspan="2">Nil</td><td>£0.5m Investment income (para c)</td><td rowspan="2">£1m (“the relevant amount”)</td></tr>
<tr><td>£1m chargeable gains (para d)</td><td>£0.25m chargeable gains (para d) and £166,666 chargeable gains (nominated amount)</td></tr>
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The first thing to do (step 1) is to find “the relevant amount”: the relevant amount is £1m (s.809J(1)).

Step 2 requires one to determine how much income or gains (*other than the nominated gains of £166,666*) fall within the particular paragraphs in s.809J(2), and it will be seen that for the year 2009/10, the s.807J(2)(c) relevant foreign income is £0.5m and s.807J(2)(d) relevant chargeable gains is £0.25m.

Looking at step 3 the *earliest* paragraph where the amount in the paragraph is not nil is paragraph (c) (ITA 2007 s.809J(2)(c)), namely relevant foreign income: this is the sum of £0.5m. £0.5m does not exceed the £1m (being the relevant amount) so the taxpayer is treated as having remitted the £0.5m by virtue of step 3 and potentially 40% tax is payable thereon. The relevant amount has now been reduced from £1m to £0.5m – that is step 4.

Step 5 states that if the relevant amount is not nil (and it is not nil: it is £0.5m), one must then go to the next paragraph in the list, and if the amount in that paragraph is less than what remains of the relevant amount (and it *is* less because it is £0.25m worth of gain compared to £0.5m worth of relevant amount left to be attributed to any income or gains), then one treats the £0.25m as having been remitted to the United Kingdom and the taxpayer pays potentially 18% tax thereon.

£0.25m remains unattributed so it is necessary to go to step 6.

This requires one to go back to the immediately prior year which for these purposes is the appropriate tax year, and one matches the £0.25m (so carried back) with, first, the relevant foreign income, and if there is any leftover unmatched amount, then with the foreign chargeable gains. As the relevant foreign income for the year 2008/9 is £1m the whole of the 0.25m is matched with the same so the taxpayer is treated as having remitted £0.75m worth of income to the United Kingdom and £0.25m worth of gains in 2009/10.

Note that if the taxpayer in 2009/10 had remitted only £0.25m to the United Kingdom and this was out of his nominated gain these “order of remittance rules” would still apply, and the taxpayer would be treated as having remitted £0.25m worth of income and be chargeable to tax thereon at potentially 40%. This is because in the order of paragraphs relevant foreign income in s.809J(2)(c) comes before foreign chargeable gains in s.809J(2)(d).

The critical points to note are as follows.

(1) The remittance basis income and gains comprising all the offshore income and gains accruing over the years is clearly reduced by the relevant amount so there should be no double charge to tax. There is nothing, however, in the legislation which states that the remittance basis income and gains are reduced because monies have been spent offshore or given away. The aim behind these provisions is to prevent the taxpayer nominating particular income and then bringing that to the United Kingdom tax free (claiming the same is tax free because the same has already been taxed on an arising basis).

(2) For these provisions to apply some nominated income or gains must be remitted to the United Kingdom: thus one may accidentally fall within these provisions if £1 is remitted to the United Kingdom from nominated income or gains.

(3) There is nothing in the legislation to indicate that if the nominated income is less than the amount which gives rise to a tax charge of £30,000, so that there is an increase in the income under ITA 2007 s.809H(4) that notional increase can be looked upon as being nominated income. It is difficult to see how any notional figure can be remitted to the United Kingdom. Thus if a taxpayer has an overseas account with £1,000 in it and interest of £100 arises therefrom (this is the "golden" bank account) and he nominates that income and he brings no part of those monies to the United Kingdom then these *order of remittance rules in s.809I and J are wholly irrelevant*. Thus the need for a golden bank account.