THE CHANGES TO THE REMITTANCE BASIS AND NEW STRUCTURES

by Patrick C Soares

The new provisions dealing with the remittance basis of assessment for individuals who are resident in the UK but not domiciled therein are contained in Schedule 7 to the Finance Bill 2008 (ordered to be printed on 18/3/08) and this contains 143 paragraphs.

They are a much watered down version of the pugnacious drafts originally put out.

The New Remittance Basis

Under a new s.809B of ITA 2007, an individual who is resident in the United Kingdom but not domiciled in the United Kingdom may make a claim to be on the remittance basis.

If he is, what the legislation calls, a long-term UK resident, then to have the privilege of the remittance basis he must pay the £30,000 for each year of assessment that he wants to be on this basis.

Monies are remitted to the United Kingdom under s.809K if, broadly, investment income or chargeable gains which arose overseas one brought to the United Kingdom or property derived from them are brought to the United Kingdom (s.809K(1) – (3)(b)).

If the income or chargeable gains are used outside the United Kingdom as security, for example, for monies borrowed outside the United Kingdom which (borrowed monies) are brought to the United Kingdom then there is a deemed remittance of the income and gains (s.809K(3)(c)). Note there are important transitional provisions in paragraph 85 which are available if the debt arrangement were set up before the 12th March 2008 and the loan was made for the purpose of enabling the taxpayer to acquire an interest in residential property in the United Kingdom.

Under the new remittance rules the taxpayer is treated as remitting income or gains to the United Kingdom if he or a “relevant person” remits the same to the United Kingdom.

A relevant person is the taxpayer and his spouse or civil partner, his minor grandchildren or children and certain close companies under s.809L(2)(f) and the trustees of a settlement under which the taxpayer or his spouse, etc., is a settlor or a beneficiary (s.809L(2)(g)).

There are new anti-avoidance provisions in s.809K(4) and (5) which seek to ensure that their can still be a taxable remittance even though property is given to the person who is not a relevant person and also where there are gifts to persons who enter into connected transactions designed to ensure that relevant persons receive benefits in the UK.

Mixed Funds

Section 809P deals with transfers out from mixed funds: broadly the income is treated as coming out first. One can avoid these provisions by ensuring that one does not mix one’s funds. In particular, one should ensure that interest on a foreign account accrues to a separate account.

Foreign income

In order to apply the new remittance basis rules to relevant foreign income – offshore investment income etc. – s.832 ITA 2007 is to be amended by paragraph 49 of the new Schedule. The key point to note in this amendment is that there is a charge to tax on a remittance of overseas income "whether or not the source of the income exists when the income is remitted".

Five Year Residence Rule

The remittance rules require the taxpayer to be resident in the United Kingdom in the year the funds are remitted to the UK but there is a temporary non-residence anti-avoidance provision in s.832 (para 49) which sets out a five-year period which effectively prevents the taxpayer from breaking his residence in year 1 and remitting the funds to the United Kingdom and then coming back to the UK in year 2 and claiming the funds are tax-free: he broadly has to be outside the United Kingdom for a five-year period.

Foreign Chargeable Gains

Paragraph 56 sets out the appropriate capital gains tax amendments to TCGA 1992 s.12 ensuring that gains made on the disposal of foreign assets (called "foreign chargeable gains" in the new s.12(4)) are taxable on a remittance basis.

Attribution of gains to shareholdings in non-resident companies

Changes made to TCGA 1992 s.13(2) ensure that one does not escape the application of TCGA 1992 s.13 (which apportions capital gains made by overseas company to UK based shareholders in the overseas company) by being non-domiciled in the United Kingdom, i.e. a shareholder who is resident or ordinarily resident in the United Kingdom regardless of his place of domicile can have a gain apportioned to him. If the company, however, makes a foreign chargeable gain then the remittance basis applies with regard thereto. These provisions apply with regard to chargeable gains made on or after the 6th April 2008.

There is no rebasing election (see below) available in such situations.

There is no relief on the disposal of UK-located assets by the overseas company.

Offshore settlements and capital gains tax

TCGA 1992 s.86 (settlor interested offshore settlement) is untouched by the new changes.

Paragraph 97 contains new provisions, however, which can tax beneficiaries (recipients) under offshore settlements to the extent that they receive capital payments. The general rules matching capital payments with capital gains are contained in a new s.87A.

A new s.87B states that chargeable gains treated as accruing to an individual by virtue of a capital payment are foreign chargeable gains within the meaning of TCGA 1992 s.12. *This provision enables one to apply the remittance basis to the capital payment even though the payment may relate to a gain made on the disposal of an asset located in the United Kingdom.*

Paragraph 108 of the new Schedule ensures that *trust gains realised in the year 2007/08 (and earlier years)* effectively fall out of charge under the matching process.

Paragraph 110 ensures that if gains are made in 2008/09 and subsequent years and these gains are matched with capital payments of a person not domiciled in the United Kingdom then no charge arises with regard to any capital payments to which the gains are matched *if the capital payments were made before the 6th April 2008*.

Paragraph 112 of the new schedule deals with the new re-basing provisions. These enable the trustees to elect that the assets of the settlement and certain underlying companies have new base costs for CGT purposes equal to the market value of the assets on 6th April 2008. This is very attractive. An election to rebase is irrevocable. An election may only be made on or before the 31st January which occurs after the end of the first tax year (beginning with the tax year 2008/9) in which an event within either of the following paragraphs occurs:-

(a) a capital payment (including living in a house) is received (or treated as received) by a beneficiary of the settlement, and the beneficiary is resident in the United Kingdom in the tax year in which it is received; and

(b) the trustees transfer part (but not all) of the settled property to another offshore settlement.

Transfers of assets abroad

ITA 2007 s.720 (the old TA 1988 s.739) remains more or less intact. Income arising to the settlement is deemed to be the income of the settlor if he or his spouse can benefit from the same. The remittance basis applies to foreign source income using the new definitions of remittance in sections 809K to 809Q. The settlor is charged to tax if any of the foreign income which is deemed to be his under s.721 is remitted to the United Kingdom and he is taxed on the full amount of the income so remitted (the new s.726(4)).

Necessary amendments are also made to ITA 2007 s.731 (the old TA 1988 s.740). Here there is a tax charge on beneficiaries who receive benefits from overseas settlements and structures: they are taxed on those benefits under general principles to the extent that there is income arising in the overseas structure. If the beneficiary is not domiciled in the United Kingdom then the benefit which comes out of the structure to him is treated under the new definition of remittance as deriving from the foreign deemed income which arose within the structure: the benefit is thus taxable on a remittance basis. Note that the remittance basis can only apply to the extent that there is foreign income arising in the offshore structure caught by s.731. If there is UK source income then this can give rise to a tax on the benefit whether or not the benefit is remitted to the United Kingdom (new s.735A).

Optimum Structures under the New Remittance Basis

Property Holdings

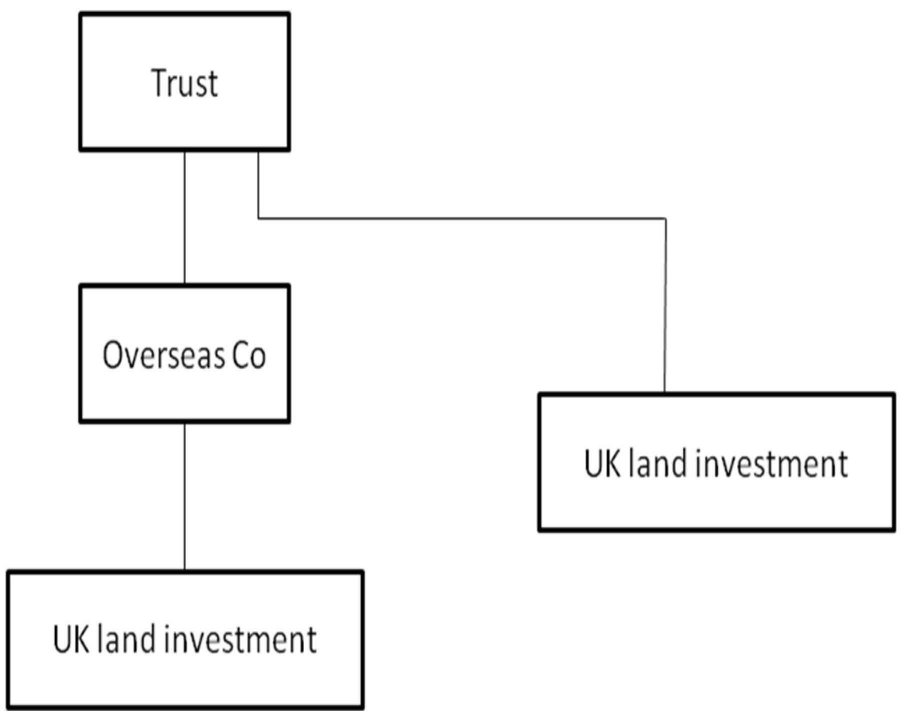
One attractive structure is for the taxpayer who is resident and ordinarily resident but not domiciled in the UK to set up an overseas settlement, usually with an offshore underlying company, which in turn owns a UK investment property.

When the investment property is sold there is only a tax charge upon the UK resident and ordinary resident but not domiciled beneficiary if the proceeds are made over to him in the form of a capital payment *and the same is remitted to the United Kingdom*.

Settlor Excluded Settlement

It will be noted that another new golden structure under the new legislation is if there is a settlement under which the settlor and the spouse of the settlor (who are not domiciled in the UK) are excluded from all benefit and this overseas settlement or an overseas company owned by such an overseas settlement makes capital gains and receives income whether in the United Kingdom or outside the United Kingdom. There can only be a tax charge in this case on the beneficiaries to the extent that they receive benefits but there can be no charge if what is made over to the beneficiaries, even in the United Kingdom, is on full commercial terms. Thus the issue of a deeply discounted security (DDS) on full commercial terms by a beneficiary avoids all income or capital gains tax charges.

Property Holdings – Golden Structure Under the New Regime



Settlor (Non-UK Domiciled) Excluded Settlement – Golden Structure Under the New Regime