

# The taxation of those resident but not domiciled in the UK

## 12 March 2008 Budget update

The Budget delivered on **12 March 2008** included many welcome changes to the January proposals which will apply to those resident but not domiciled in the UK from 6 April 2008 (any individual not domiciled in the UK is referred to as a 'non-dom' in this note). Previous announcements, including the publication of draft legislation in January 2008, appeared to leave many non-doms with long term UK tax problems.

This summary of the new rules is based on the notices published on Budget Day and their interpretation will be clarified by the publication of the draft legislation.

### The most important improvements include the following:

- A number of exemptions have been introduced which will prevent the remittance basis applying when certain assets purchased from offshore investment income are brought to the UK. These exemptions include personal effects (apparently defined as clothes, shoes, jewellery and watches), assets costing less than £1,000 and assets which are only brought to the UK for a short period. The detailed rules on these exemptions will need to be examined once the draft legislation is published.
- It will be possible to continue to make gifts offshore to individuals, other than to immediate family, which are subsequently remitted to the UK by the recipient without creating a remittance.
- The new rules relating to foreign trusts have been made less onerous, particularly in relation to non-dom settlors of foreign trusts.
- Changes to the effective rate at which foreign dividends will be taxed – those not claiming the remittance basis will be better off, whereas those claiming the remittance basis will be worse off.
- Capital losses arising on the sale of foreign assets after 5 April 2008 may now be available in the UK.
- Children under the age of 18 will not be required to pay the new £30,000 tax charge.
- Provided the £30,000 charge is paid directly from an offshore bank account (either by cheque or electronic transfer) it will not be treated as a taxable remittance.
- An attempt has been made to improve the position for US taxpayers so that double tax relief is intended to be available on the £30,000 charge.

The Government has stated that once the legislation for these new rules has been finalised there will be no further substantive changes either in the remainder of this parliament or in the next.

Whilst these changes are positive, there remains an urgent need to review your position before 6 April 2008. In many cases action may need to be taken before 6 April 2008 even though the legislation is not final and further changes may be introduced before, or even after, 5 April 2008.

### Residence rules

For the purposes of day counting, presence in the UK at midnight will count as a day of residence. Days when an individual is in transit in the UK and does not conduct any other activities will not count.

These new rules will mean that more non-doms will become resident in the UK and more will become dual resident, that is resident, for tax purposes, both in the UK, and in another country.

DIXON WILSON  
CHARTERED ACCOUNTANTS

Dixon Wilson, Rotherwick House, 3 Thomas More Street, London E1W 1YX

Telephone: +44 (0)20 7680 8100 Facsimile: +44 (0)20 7680 8101 E-mail: [dw@dixonwilson.co.uk](mailto:dw@dixonwilson.co.uk) DX 124404 London/City

Dixon Wilson, 19 avenue de l'Opéra, 75001 Paris, France

Telephone: +33 (0)1 47 03 12 90 Facsimile: +33 (0)1 47 03 12 85 E-mail: [dw@dixonwilson.fr](mailto:dw@dixonwilson.fr)

## Resident non-doms

If you are a resident non-dom you will fall into one of the following four categories:

- A. You have annual unremitted foreign income and gains of less than £2,000 (regardless of the length of time you have been in the UK). You will be able to claim the remittance basis, and will have access to the annual income tax allowances and capital gains tax annual exempt amount; or
- B. You have been resident in the UK for less than seven out of the previous nine tax years (years of residence prior to 5 April 2008 are taken into consideration for these purposes) and your unremitted foreign income and gains are more than £2,000. You will be able to claim the remittance basis, but will not have access to the annual income tax allowances and capital gains tax annual exempt amount; or
- C. You have been resident for more than seven out of the previous nine tax years and decide not to pay the £30,000 annual charge. You will be taxed on your worldwide income and gains (whether or not remitted), and will continue to have access to the annual income tax allowances and capital gains tax annual exempt amount; or
- D. You have been resident for more than seven out of the previous nine tax years and decide to pay the £30,000 annual charge. You will be taxable on the remittance basis but will not have access to the annual income tax allowances and capital gains tax annual exempt amount.

If you fall into categories C or D you will be able to decide each tax year whether or not you should pay the £30,000 charge and claim the remittance basis.

Children under the age of 18 will not be required to pay the £30,000 charge but will not have access to the annual income tax allowances and capital gains tax annual exempt amount if their annual unremitted income and gains exceed £2,000.

Where the £30,000 charge is paid it will be attributed to unremitted offshore income and gains nominated by the taxpayer, and as a result relief is intended to be available under most double tax treaties. Where the nominated income and gains are subsequently remitted to the UK no further UK tax will be payable. There will be complex rules which set out the order in which foreign income and gains are treated as being remitted to the UK for tax purposes. The income and gains nominated for the £30,000 charge will be deemed to be remitted to the UK only after all other foreign income and gains. Additional tax will continue to be paid on other remitted foreign income and gains.

## Extension of the remittance basis

In reading this note, a distinction needs to be made between the tax treatment when the remittance basis is claimed, and when it is not claimed.

Resident non-doms who do not claim the remittance basis will, in most cases, be taxed on the same basis as UK domiciliaries as well as being taxed on past foreign income and gains if these are remitted to the UK.

The concept of what constitutes a remittance has been extended. From 6 April 2008 the new rules will tax:

- assets brought into the UK or made available for use in the UK (including those owned by trusts or offshore companies) which represent, directly or indirectly, foreign income or gains. Assets which were owned by an individual on 11 March 2008 (whether or not they were in the UK at that time) are not included. In addition, assets which are in the UK on 5 April 2008 which are owned by offshore structures will not give rise to a remittance unless there is a change of ownership.
- certain gifts between connected parties. For example, where income is given to a connected party offshore and the recipient then remits the funds, the donor will still be taxed on the income as if it were his. The definition of connected parties has been changed and now includes spouses, civil partners and those living together as if they were married, or in a civil partnership, children and grandchildren under the age of 18. It remains unclear whether gifts to adult children are caught by these new rules.
- income which was previously converted into capital for tax purposes, using what is technically known as the 'source ceasing' mechanism, which is remitted after 5 April 2008. In many cases it will be appropriate to consider remitting funds falling into this category prior to 5 April 2008.
- payments made offshore for services received in the UK. It is not clear in some cases what services 'received in the UK' may include.
- the payment of interest on loans used to acquire property, or other assets, in the UK where the payment is made offshore unless the loan was in place on 12 March 2008 and there have been no subsequent advances or amendments. These 'grandfathering' provisions will continue for the earlier of the period of the loan and 5 April 2028. The repayment of the capital on such loans has always been taxed as a remittance.

Where offshore accounts hold a mixture of funds, including income, capital and capital gains the rules for identifying what a remittance from such an account represents are changing. In some cases it may be difficult to identify the correct tax treatment, and this may be a time consuming exercise.

Dual residents may be able to claim relief under existing double tax treaties in respect of foreign income or gains which are remitted to the UK.

### Offshore companies

Offshore companies tend to be used as intermediate holding companies for holding investments or property. In addition, many hedge funds and other publicly available investment vehicles use offshore companies.

Where non-doms (together with parties connected with them) hold more than 10% of the share capital of an offshore company, either directly or through a trust structure, and the company is controlled by a small group of investors (a 'close company'), the following rules will apply.

From 6 April 2008 when the remittance basis has been claimed:

- gains realised by the company on the sale of assets situated in the UK are immediately assessed on resident non-doms on a basis proportionate to their direct, or indirect, shareholding, regardless of whether or not the proceeds are remitted to the UK.
- gains realised on the sale of foreign assets are taxable when the proceeds, or derived assets, are, following a distribution by the company, remitted to the UK by the shareholder or any connected party.

When the remittance basis is not claimed resident non-doms who own more than 10% of the share capital of an offshore close company will be taxable on all gains realised by the company on an arising basis, regardless of the location of the asset and whether or not the proceeds are remitted.

In most cases, where an overseas company makes a distribution (e.g. a dividend or on liquidation) which is then remitted, a double charge to capital gains tax and income tax may arise unless the remittance is made shortly after the disposal by the company.

### Offshore settlements – where you are a beneficiary

Currently resident non-doms who are beneficiaries of offshore settlements do not pay UK capital gains tax on capital advanced to them by the trustees.

From 6 April 2008, capital distributions to non-doms from offshore settlements will be potentially taxable if remitted to the UK and will be matched firstly against any undistributed income, then against any offshore income gains and finally against any capital gains.

From 6 April 2008 the following rules will apply to those distributions which are remitted to the UK and are matched to capital gains:

- distributions made prior to 6 April 2008 will only give rise to a UK tax liability in very limited circumstances, but can have a major tax impact if the recipient subsequently becomes domiciled in the UK at a time when the trust still exists.
- gains realised by trustees prior to 6 April 2008 will not give rise to a UK tax liability regardless of the timing or size of distributions from the trust.
- beneficiaries will be taxed on capital distributions when these can be matched against gains of the trust (including those of any underlying company) which are realised after 5 April 2008, and if the distribution is received by them in the UK.
- gains of later years will be matched with distributions on a last in first out basis (currently a first in first out basis).
- tax liabilities are likely to arise where beneficiaries occupy property, situated in the UK, owned by the trust (or by an underlying company) on less than commercial terms or are in receipt of interest free or subsidised loans. These 'deemed capital payments' may result in capital gains tax being payable on future gains realised by the trustees.

For the purposes of calculating the capital gains on which resident non-doms will potentially be taxed, the trustees (rather than the beneficiaries or settlor) of offshore settlements will be able to submit an election to the UK tax authorities to rebase all of the assets held in the trust, together with any underlying companies, to their market value on 5 April 2008. The election will be irrevocable and will apply to all trust assets and must be made within specified time limits after a qualifying capital distribution. Gains arising from the sale of assets after 5 April 2008 will be calculated with reference to the increase in market value arising after this date.

**Offshore settlements – where you are the settlor**

In contrast to the rules contained in the draft legislation published in January, resident non-doms who are settlors of offshore settlements will not be taxed on the gains of offshore trusts, even when the gains arise from the sale of UK assets and the settlor does not pay the £30,000 charge. Charges will arise, as set out above, if the settlor receives distributions which are remitted to the UK.

**Offshore income gains realised by offshore trusts**

Offshore income gains (OIGs) arise when gains are realised on the sale of certain offshore funds. The rules for OIGs have been clarified. The double tax charges which can arise under the current rules should no longer apply.

**Action required prior to 6 April 2008**

Each individual's financial and family circumstances will be different and will need to be considered separately.

The following action should be considered, and action taken, before 6 April 2008:

- is it appropriate to remit funds to the UK to fund future UK spending? In many cases remittances made prior to 6 April will be tax free whereas post 5 April remittances will give rise to a tax liability.
- should one-off gifts be made between family members?
- is it appropriate to consider remitting funds to the UK (possibly as part of a gift) prior to 6 April to remove uncertainty regarding the tax status of the funds under the new rules?
- should chattels owned by offshore trusts or companies be brought to the UK prior to 6 April?
- are the tax costs and risks associated with benefits arising from the use of assets in the UK owned by offshore trusts and companies, or from loans provided by such entities, acceptable? In many cases, this type of offshore structure may need to be changed to minimise the impact of the new rules over the long term.

The time which remains before 6 April 2008 is very limited and decisions need to be taken as soon as possible so that, if appropriate, offshore companies can be liquidated, trusts wound up and distributions made.

This update is a summary of the main changes to the rules for the taxation of non-doms resident in the UK as presented in the Budget on 12 March 2008. The new rules are subject to the publication of the draft legislation and may still be subsequently be amended. This update is for information only and does not constitute professional advice. For further information, advice or assistance in relation to any of the matters raised please speak to your usual Dixon Wilson contact or to the authors.



**James Kidgell**

jameskidgell@dixonwilson.co.uk



**David Nelson**

davidnelson@dixonwilson.co.uk



**David Mellor**

davidmellor@dixonwilson.co.uk

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Dixon Wilson, 22 Chancery Lane, London, WC2A 1LS  
 Telephone: +44 (0)20 7680 8100 Facsimile: +44 (0)20 7680 8101 E-mail: dw@dixonwilson.co.uk DX 124404 London/City

Dixon Wilson, 19 avenue de l'Opéra, 75001 Paris, France  
 Telephone: +33 (0)1 47 03 12 90 Facsimile: +33 (0)1 47 03 12 85 E-mail: dw@dixonwilson.fr