Remittance Basis Users - January 2010

REMITTANCE BASIS USERS: FOREIGN CAPITAL LOSS ELECTION

Overview

Individuals who are not domiciled in the UK are able to benefit from the remittance basis of taxation. So long as they claim the remittance basis, and pay the £30,000 charge for this if they are long-term residents, they are only subject to tax on their non-UK income and capital gains to the extent that these are remitted to the UK.

Whilst gains will be subject to tax in the UK, the previous position has always been that no relief was available to remittance basis users in respect of capital losses realised on their non-UK assets.

However, Finance Act 2008 introduced a one-off lifetime election which can be made by remittance basis users to unlock the availability of non-UK losses.

The decision to make this election is not simple and it has its drawbacks. The key issues which need to be considered when making the election are set out below.

Current position

If an individual claims the remittance basis, the current position in the absence of any election is that capital losses arising on the disposal of foreign assets are ignored for UK tax purposes, regardless of whether the proceeds are remitted. Capital losses arising on the disposal of UK situs assets are available to be offset against other gains, whether they are UK gains or remitted foreign gains, of the current and subsequent years.

To illustrate this, consider the following example. Assume that a remittance basis user disposes of two investments held in an offshore portfolio. Investment A is sold for £200,000 and realises a capital gain of £30,000 whilst investment B is sold for £100,000 and realises a capital loss of £80,000. Now assume that the entire proceeds from both disposals, being £300,000, are remitted.

The current tax position in the absence of any election is that by remitting the entire proceeds from both disposals capital gains tax would be payable on the gain arising from A of £30,000. However, no relief would be available for the loss arising from B of £80,000 and it is not possible to offset it against the other foreign capital gain from A. It is therefore ignored completely for UK tax purposes.

Importantly, if the remittance basis had not been claimed for the year in question it would have been possible to claim the £80,000 loss. This may be relevant if there is a specific year in which an individual has large offshore losses, and less significant offshore income and gains.

Election - Summary

Finance Act 2008 introduced an election that individuals subject to the remittance basis of taxation can make to address the perceived imbalance of being subject to tax on remitted foreign gains whilst allowing no relief for foreign losses.

The election, if made, would enable the use of capital losses arising on the disposal of foreign assets. However, there is a drawback. As an overview, if an election is made, capital losses (both UK and foreign) must first be offset against foreign gains, regardless of whether they are remitted, before being offset against UK gains.

This could mean in practice that an individual might not receive the full benefit of UK losses. The individual could end up paying more tax overall if the losses are fully applied against unremitted foreign gains if there are also UK or remitted foreign gains.

Election – Technical Details

If the election, which would be made in the white space of the individual's tax return, is made there are various technical implications. However, there are two main consequences.

Firstly, and most importantly, all losses (UK and foreign) will be available for relief. However, a strict order is set out for which the losses must be applied against the individual's worldwide gains and this may not necessarily result in a beneficial position overall.

The losses for a year will be applied in the following order:

1. "Promptly" remitted gains. These are capital gains that arise on foreign assets in the tax year and the proceeds are remitted to the UK in the same tax year.

2. Unremitted foreign gains. These are capital gains arising on foreign assets disposed of during the year but where the proceeds are not remitted to the UK. These would not normally be subject to tax in the UK and therefore, by making the election, any losses matched to these would only be beneficial if and when the gain is remitted in a subsequent year.

3. UK gains. These are any capital gains arising in the year on disposals of UK situs assets.

The important thing to note about this order is that, whilst it does unlock the availability of foreign losses that were previously ignored, these may be matched against foreign gains which the individual never intended to remit and therefore the losses, which would include UK losses that previously would have been benefitted from, could be wasted.

The second consequence of the election is a change to the tax treatment of foreign capital gains when they arise in one year but are not remitted to the UK until a later year, as opposed to "promptly" remitted gains defined at 1 above. In the year of such a remittance, no losses of that year or any year later than the year in which the gain originally arose are deductible from the remitted gain. Furthermore, the annual exemption of the year of remittance will not be available to offset such remitted gains.

Timing of election

Importantly, the election is irrevocable – once it has been made it will apply to all future tax years in which the individual claims the remittance basis in the UK.

The year ended 5 April 2009 is the first year for which the election may be made. Furthermore, the election must be made in respect of the first tax year for which the individual claims the remittance basis after 6 April 2008. In most cases this will be 2008/09 and therefore the election must be claimed in the individual's tax return which is due for submission by 31 January 2010.

Importantly, however, HM Revenue & Customs have confirmed that the election may subsequently be made with retrospective effect at any time prior to 5 April 2013.

Should the election be made?

There are a number of issues which need to be considered and some of these are outlined here.

Disclosure and administration

Currently, remittance basis users are not required to disclose in their UK tax return details of any foreign capital gains or losses that are not remitted to the UK. By making the election, disclosure would be required each year to HM Revenue & Customs of the individual's worldwide capital gains and losses. Furthermore, these would need to be calculated in accordance with UK tax principles and a record must be kept of the gains and losses (and the order in which they are utilised) which would increase the administrative burden.

Expectation of future gains and losses

The election cannot be reversed once made and will apply for the

rest of the individual's life as long as the remittance basis is claimed. Unfortunately it is very difficult to predict what gains and losses the individual will incur both in the UK and abroad in the future. Whilst the structure of an individual's assets currently may indicate an election may be beneficial in the short term, their position may be very different in, say, ten years. In particular, if it is expected over the long term that foreign unremitted capital gains will exceed foreign losses, an election will not be advantageous.

Who would benefit from the election?

Generally speaking, individuals who will benefit most from the election are those that hold the majority of their wealth in assets overseas and fund their UK expenditure by remitting proceeds from disposals of foreign assets. Individuals who are confident that they will not incur significant UK capital losses in the future will also benefit.

Conversely, an individual who expects to realise UK losses but not foreign losses should not make the election.

Conclusion

It is very difficult to make a fully informed decision now as to whether an election would be beneficial to an individual without the knowledge of their future gains and losses.

One option might be to make no election now but to wait and see what gains and losses are realised over the next three years. It may be that, with the benefit of hindsight, an election should have been made and the election can then be made retrospectively as long as it is done before 5 April 2013.

The question of making the election is clearly a complex one and one which will impact on the tax treatment of the individual's gains and losses for the rest of their life. Professional advice should be sought prior to making any decision.

David Mellor
Partner

020 7680 8100
davidmellor@dixonwilson.co.uk

Jon Sutton
Partner

020 7680 8100
jonsutton@dixonwilson.co.uk

Ben Grist
Manager

020 7680 8100
bengrist@dixonwilson.co.uk

This firm is not authorised under the Financial Services and Markets Act 2000 but we are able in certain circumstances to offer a limited range of investment services to clients because we are members of the Institute of Chartered Accountants in England and Wales. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide. The services described in this document may include investment services of this kind.

Dixon Wilson
22 Chancery Lane
London
WC2A 1LS

T: +44 (0)20 7680 8100
F: +44 (0)20 7680 8101

DX: 51 LDE

www.dixonwilson.co.uk
dw@dixonwilson.co.uk

DIXON WILSON

CHARTERED ACCOUNTANTS