



Consultation into the taxation of non-domiciled individuals

On Friday 17 June the Coalition Government published the long-awaited consultation document into the taxation of Non-UK domiciled individuals. A separate consultation on a statutory residence test has also been published today and is the subject of a separate note. The consultation was announced at the time of the Budget and it was promised that the remittance basis of taxation would be amended to increase simplification and to encourage non-domiciled individuals to invest into the UK. Now that we can finally see the detail of what is being considered, to what extent have these aims been achieved?

What is the remittance basis?

The remittance basis of taxation applies, following a claim, to non-UK domiciled individuals and, broadly speaking, means that while being taxed on all their UK income and capital gains as they arise, they are only taxed on their non-UK income and gains to the extent that they are brought to the UK. Finance Act 2008 considerably widened the circumstances in which individuals will be treated as having brought funds to the UK. It introduced the concept of a 'relevant person' such that a spouse, minor child or grandchild or certain companies or trusts brought funds to the UK, this may be treated as a remittance by the individual. It also introduced complex 'mixed fund' rules which laid out the order in which income, capital gains and clean capital are treated as leaving a bank account or other mixed pot.

Proposed changes to encourage investment

Under the proposals set out in the consultation document, non-UK domiciled individuals will be able to bring funds to the UK in limited circumstances in order to invest in 'qualifying businesses'

The Government is consulting on what should be included in the term, 'qualifying business' but it is proposed that it will include any investment into a UK company carrying out a trade or a business of developing or letting commercial property. Holding and letting UK residential property is excluded, except where that property is used for commercial purposes

(eg. nursing homes). Companies leasing tangible moveable property (eg. yachts) and provided personal services (eg. nannies) are also to be excluded. A UK company appears to include any company which is resident in the UK or has a permanent establishment in the UK so non-UK incorporated companies appear to be included. This may have other tax benefits.

Investment into holding companies will also be permitted where those companies hold shares in UK companies which carry out qualifying activities and do not carry out excluded activities. There will be no restrictions over the degree of ownership which the holding company must have in its underlying companies. The consultation document suggests that this will allow Private Equity investments to qualify. However, it is possible that the restrictions on investing in partnerships outlined below may cause some difficulty here. It appears that where the holding company also holds shares in non-UK companies with no connection with the UK, no relief will be available.

It is proposed that investments must be made into companies and cannot be made into any other form of business, including partnerships.

There will be no minimum or maximum investment levels in order to qualify for the relief, and it appears that investment into the company can take any form - ie. shares and securities or loans. There is equally no restriction on individuals investing in companies by which they or their family are employed, provided they only draw commercial remuneration from the company. However, anti-avoidance provisions will prevent 'non-commercial' payments to the individual from the company.

The Government is consulting on whether the relief should extend only to investments in unquoted trading companies, or whether it may be possible to extend the relief to quoted shares.

Who can make the investment?

The relief will apply to all amounts remitted in order to make qualifying investments by any relevant person (including companies and trusts) and will not be limited to investments by individuals directly.

How will the relief work?

Amounts brought to the UK to purchase qualifying investments will be treated as not remitted to the UK for as long as the qualifying investment is held. However, amounts received on the sale of shares or securities must be reinvested or removed from the UK within two weeks to avoid a remittance of the original funds being triggered. In our view, this may often prove too short a period and it is hoped that this can be extended as part of the consultation.

It is envisaged that the first amounts received by an individual in respect of an investment will be treated as the funds originally invested. This may cause difficulties for individuals as, for example, if only half a shareholding is sold, the amount received may be treated as representing all original seed capital for the purpose of the remittance basis, but may in reality also include a UK taxable capital gain. If the whole amount must be removed from the UK within 14 days, this may leave individuals unable to meet a capital gains tax charge in respect of

this gain. It is to be hoped that a more practical solution to this problem will be found before the proposed rules become law. Amounts received for this purpose will not include 'permitted commercial payments' which is not specifically defined but appears to be intended to include commercial levels of remuneration, dividends and interest.

In order to benefit from the relief, the individual will be required to make a claim in his tax return stating whether he has remitted income or capital gains, the amount remitted and the business in which he has invested.

An increase in the remittance basis charge (RBC)

At present, those who have been resident in the UK for any part of 7 out of the previous nine years and who wish to claim the remittance basis must pay an additional £30,000 of tax, known as the remittance basis charge. Under the proposals included in the publication, individuals resident in the UK for 12 out of the previous 14 years must now pay an increased RBC of £50,000.

Simplification of the remittance basis

The proposed simplifications to the remittance basis are very narrow in scope and essentially focus on four areas, nominated income, foreign currency bank accounts, the sale of certain assets in the UK and bank accounts for non-ordinarily resident employees with both UK and non-UK work days.

Nominated income - the current rules

At present, if an individual pays the RBC, the charge is treated as attaching to specific income or gains of the individual which the individual must nominate when he makes his claim for the remittance basis (referred to here as 'nominated income'). If his nominated income is less than that necessary to produce the tax charge, then the remainder of the tax charge is treated as attaching to a fictional amount of income treated as arising to that individual.

To prevent individuals from being able to claim credit in the UK for the £30,000 by remitting that income, special deeming rules apply if the individual makes a remittance of their nominated income. These rules essentially apply to treat all of an individual's overseas income and gains as one big mixed fund. Once a remittance of nominated income has been made, every remittance by the individual will be re-characterised such that income and gains are then treated as remitted in the order laid down (essentially with the income and gains attracting the highest tax charges being treated as remitted first) until all the individual's overseas income and gains have been remitted.

As a result of these punitive rules, many individuals choose to nominate just £1 of income in a clearly marked bank account so that this amount cannot be accidentally brought to the UK. This can prove tricky as an individual must ensure that he has a bank account with just £1 of income arising in each tax year which can be nominated, this is especially difficult to achieve in these times of low interest rates.

For those wishing to claim a credit for the £30,000 in the US, or another regime, this approach of minimal nomination would not be sufficient; a nomination of sufficient income or gains to attract a £30,000 tax charge must be made.

Nominated income - the simplification

It is proposed that individuals will be able to remit the first £10 of nominated income to the UK free of tax and without triggering the complicated anti-avoidance rules related to nominated income. For individuals who choose only to nominate £1 of income, this will remove the need to create a separate bank account to hold nominated income.

For those who wish to claim credit for the remittance basis charge (of either £30,000 or £50,000), there will remain a need to nominate the full amount of income or gains needed to give rise to the charge and these individuals will still need to maintain separate bank accounts to hold these amounts and be careful with remittances.

Foreign currency bank accounts - the current rules

At present a bank account held in a currency other than Sterling is treated as a capital asset for the purpose of capital gains tax. As such, every deposit into the account is treated as enhancement expenditure (or effectively a purchase) and every withdrawal is treated as a part disposal. HMRC has previously allowed gains and losses to be calculated on a simplified basis and there are various concessions in this area.

Even so, for individuals with several foreign currency bank accounts, calculating the gains and losses in respect of their accounts has proved an onerous task, usually resulting in many time consuming calculations giving rise to minimal amounts of capital gains tax.

Foreign currency bank accounts - the simplification

The consultation proposes that all amounts within an individual's foreign currency bank account will be removed from the scope of capital gains tax. This will remove the need to complete onerous calculations in respect of such accounts and would be a very welcome change. Foreign currency gains would still need to be calculated in respect of other assets.

Assets sold in the UK

Under the current rules certain assets which can currently be brought to the UK under an exemption, eg. works of art, jewellery, assets worth less than £10,000. However, if such assets are sold in the UK this is treated as a taxable remittance. Under proposals set out in the consultation document it will be possible to sell such assets in the UK without triggering a remittance, provided the proceeds from the sale are removed from the UK within two weeks.

However, selling such assets in the UK would be likely to give rise to a UK chargeable gain (which would not arise if they were sold overseas)

and it is not clear whether all the proceeds would need to leave the UK (thus leaving no funds to meet the UK capital gains tax charge).

Employees with UK and non-UK work days

It is intended that the special treatment for bank accounts of individuals who are UK resident but not ordinarily resident and receive employment income in respect of both UK and non-UK work days, currently contained in statement of practice 1/09, will be included in statute. In addition, the consultation asks some specific and narrow questions regarding additional areas which might be included in the statutory version of this practice.

When will all these changes take place?

The changes proposed are intended to take effect from 6 April 2012. However, the detail of the changes are still the subject of consultation and may change before they become law.

What happens now?

Ernst and Young wrote to the Government when the consultation was first announced setting out the changes we would like to see. It is encouraging to see that some of these proposals have been considered, but there have been many missed opportunities. The consultation period runs until 9 September and we will be writing to HMRC with our detailed comments as well as attending meetings with HM Treasury and HMRC. If you feel you would like to contribute to this process, please speak to your usual Ernst and Young contact or one of the names below.

In the meantime, if you are thinking of making an investment in the UK please speak to us about how best to structure the investment in the light of the proposed changes.

Further information

For further information, please contact one of the following or your usual Ernst & Young contact:

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