Mixed fund analysis for all remittance basis users: new and limited opportunity for cleansing funds

Tax Services
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Non-UK domiciled individuals who have made use of the remittance basis have until 6 April 2019 to segregate their mixed funds into the constituent parts, so that they can remit funds to the UK in a tax favourable order. The first important step is to identify the constituent parts in the mixed fund and EY have developed a tool (FILTA) which can assist with this. Please see below for further information on the opportunity and how we can help.

The remittance basis

Individuals who are regarded as resident in the UK are initially taxable on their worldwide income and capital gains. The remittance basis of taxation is available to individuals who are regarded as not domiciled and not deemed domiciled in the UK. Under the remittance basis, an individual is taxable on their UK source income and capital gains as they arise, but is only taxable on their overseas income and capital gains to the extent that the funds are remitted to the UK.

There are certain tax consequences for an individual claiming the remittance basis, including the potential loss of the personal allowance and an annual charge for longer term residents, and therefore it must be determined whether the claim would be worthwhile, prior to it being made. However, if a non-UK domiciled individual has unremitted overseas income and gains of less than £2,000 in the tax year, the remittance basis is applied automatically and a claim is not required.

If funds from outside of the UK are required in the UK, by an individual who has claimed the remittance basis in respect of those funds, there will generally be a tax charge at the time of the remittance. There are specific rules in place which deem the type of funds which are remitted from each overseas source if that source contains more than one type of income or capital (i.e., a mixed fund), which will generally mean that the proportion taxable at the highest rate is taxable first.

Opportunity to cleanse mixed funds

Mixed funds arise when the same fund (e.g., a bank account or a share holding) contains more than one of the following: untaxed unremitted income, capital gains or clean non-taxable funds. A mixed fund may arise from one transaction or a series of many such transactions and may cover one year or many years. Normally, a taxpayer cannot choose to remit specific funds from a mixed fund but instead there are strict rules for ordering what is regarded as remitted.

Linked with the changes to the taxation of non-UK domiciles from 6 April 2017, the Government has released a new opportunity for current or previous remittance basis users to cleanse mixed funds.

This opportunity will give all individuals who have made use of the remittance basis in either 2008-09 or a later tax year, apart from those born in the UK with a UK domicile of origin, a two-year window beginning on 6 April 2017 in which to separate their mixed funds into their constituent parts. This will only apply to mixed funds in the form of bank accounts or similar, not to assets derived from or representing mixed funds, although assets can be sold and the cash deposited in a bank account in order for segregation to be achieved.

This cleansing of mixed funds will only be available where an individual has sufficiently good records to determine the constituent parts. For this reason, it is advisable to begin reviewing these records now, analysing the funds in each account to identify the constituent income, capital gains and clean capital makeup, in order to allow individuals to take advantage of the two-year window.

This links into another opportunity which has been introduced, whereby rebasing assets to 5 April 2017 will be available to reduce chargeable gains for those deemed domiciled from 6 April 2017. In these cases, the funds used to purchase the asset will require analysis and potential cleansing. The two-year window allows individuals to remit funds in a more favourable order, e.g., clean capital first, realising only limited gains. There is no obligation to make such a remittance in the two-year window.

The opportunity for mixed fund cleansing is not restricted to individuals becoming deemed domiciled on 6 April 2017 although the rebasing opportunity is.
How we can help

HMRC has confirmed that cleansing will not be available where an individual is unable to determine the component parts of their mixed fund. It will therefore be important for individuals to understand the makeup in terms of income, capital gains and clean capital of their mixed funds.

We have developed a Foreign Income and Losses Transaction Analysis (FILTA) tool, which enables tracking and identification of constituent parts of a mixed fund. This has been developed using our own experience and proven methodology for analysing and segregating mixed funds.

We have previously used FILTA in agreeing taxpayer positions with HMRC under the pre-cleansing rules, including where full records have not been available. FILTA has provided our clients with opportunities to restructure their mixed funds so that remittances to the UK can be effected as efficiently as possible whilst taking full consideration of the strict ordering rules for mixed funds. The opportunity means that we can take the calculations generated by FILTA further to wholly segregate the constituent parts of the funds, such as original clean capital, so that, potentially, tax-free remittances can be made. For some, all offshore accounts might be analysed and segregated using FILTA but, for others, only one or a selection of accounts might be considered.

It is vital that transfers undertaken for cleansing are operated very carefully in line with the legislation and guidance, as if a condition is not met (e.g., overnominating or multiple transfers between accounts) then the transfer will fail and the normal ordering rules will be invoked on the whole transfer. We can also assist in confirming the steps to be taken to successfully operate mixed fund cleansing.

As an example an individual has £1 million held in an offshore bank account, which they require in the UK. This fund contains bank deposit interest on the offshore balance, dividends from Spanish and Luxembourg shares, proceeds from the disposal of a commercial property in Spain, proceeds from the disposal of Luxembourg company shares and capital which was already held by the individual prior to their taking up residence in the UK.

The first stage is to determine how much of each element is contained in the account and so, income and capital gains calculations and analysis of receipts and transfers out using our FILTA tool is required. Following this, it is determined that the mixed fund contains £50,000 of untaxed overseas bank interest, £50,000 of untaxed overseas dividends, £100,000 of untaxed foreign capital gains and £800,000 of clean capital. For the purpose of this example, we are assuming that the income and capital gains arose in the most recent tax year and also that no foreign tax has been paid as further complexity arises where multiple tax years are in question or tax credits are available.

Under current rules, the first £50,000 remitted is the savings income and chargeable to income tax at 45% and the next £50,000 is the dividend income, chargeable to income tax at 38.1%. The next £100,000 is the foreign capital gains and will be charged to capital gains tax at 20%. Note, we have assumed the individual would be an additional rate taxpayer. Once all of these taxable portions have been remitted, the remaining clean capital can then be remitted without a tax charge.

The new opportunity means that, following segregation, it will be possible to remit the clean capital first, keeping and spending the foreign income offshore without attracting a UK tax charge.

Even after the publication of the legislation in Finance (No 2) Act 2017, the precise details of how segregation will work remain unclear, we are anticipating guidance being provided in the coming weeks and months and we would expect them to apply in the above circumstances.
Fees
Our fees for mixed fund analysis are dependent on the individual’s circumstances and the information available in relation to the funds held. The fees can differ in scale and we would provide a fee estimate based on the following:

► The number of years that the individual has been resident in the UK
► Number of years the remittance basis has been used
► The number of accounts which require analysis
► The average number of transactions in the relevant accounts on a monthly basis

Each case must be assessed separately, based on the individual circumstances, and we would be happy to have a no-obligation discussion regarding our next steps and fees.

Further information
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