

Non-Domiciliaries Face Harsh Tax Regime

The long awaited draft legislation in respect of the taxation of non-domiciliaries claiming the remittance basis was published early in January and it has proved to be much more tightly drawn than was expected. All non-domiciliaries with significant overseas assets, and particularly those with interests in overseas trusts, will need to review their affairs urgently. In response to representations made since the draft legislation became available various amendments have been outlined by H M Revenue & Customs, presumably with Ministerial authority, although the true scope of some of these amendments is rather unclear.

Unless a non-domiciliary has relatively little foreign income and gains, a claim to the remittance basis of taxation after 5 April next can only be made each year on payment of a fee of £30,000 for the year to HM Revenue and Customs. This fee is not tax of any sort, although it is recoverable as if it were tax. As a result it is unlikely to be allowed for credit against foreign tax payable overseas. In time, as sources of available capital become exhausted the non-domiciliary may well have to bring in foreign income in order to pay the fee, but one of the recent amendments states that such funds will not count as a taxable remittance.

HM Revenue and Customs is taking the opportunity to close many well known tax planning techniques with the remittance basis. For example, it will no longer be possible to transmit foreign income or gains by gift to a family member overseas who can then bring that money into the United Kingdom without liability. Closing this opportunity has the most pernicious effect. For example, if a non-domiciliary gives an asset standing at a large capital gain to his brother outside the United Kingdom who many years later sells the asset and brings the proceeds to the United Kingdom, this will give rise to capital gains tax liability on the non-domiciliary who gave the asset away in the first place. It will not matter that the money is not used for the benefit of the brother who originally gave it to the other; in fact, he or she may have no clue what the other brother is doing and could unwittingly have tax liability as a result of his actions many years later. What is worse, there is no requirement that the original gift takes place after 5 April 2008 and so tax liability could now be attracted at some future date because of a gift many years ago. In some cases the funds could pass between several relatives before finding their way to the UK, but this will still result in a remittance by the original donor. The extreme unfairness of this rule has been pointed out to HMRC and as a result they have promised to reconsider it, perhaps limiting it to cases where the original donor benefits from the remittance..

If all this seems inordinately harsh, then the provisions relating to offshore trusts as originally published had worse traps in them. A non-domiciliary may have received capital payments from an existing trust some years ago and if these have not already been matched with capital gains within the trust, he would have tax liability in a future year when gains are actually realised. Even more surprising was that capital payments to beneficiaries of offshore trusts were not to have any remittance basis rules at all and so a capital distribution overseas to a resident non-domiciled beneficiary could have taxable capital gains attributed to it. Fortunately HMRC have now back-tracked on many of these proposals and have promised redrafted legislation in due course.

As a further twist of the knife, the draft legislation sets out new reporting requirements for offshore trusts. Any newly established offshore trust set up after 6 April 2008 by a person resident in the United Kingdom must be reported to HM

Revenue and Customs within 3 months of the date on which it is created. Where a person comes to the United Kingdom for the first time and takes up residence here, having already created one or more offshore trusts, he or she must report those to HM Revenue and Customs within 12 months of becoming resident. Once again it is understood that these proposals are likely to be watered down but to what degree still remains to be seen.

In short, non-domiciliaries will switch from enjoying a relaxed and flexible tax regime up to 5 April next, to suffering a particularly harsh regime from 6 April 2008 onwards. It is becoming of increasing concern that the standard of strategic thinking at the Treasury is in a state of decline. This was probably first noticeable when the nil rate band of corporation tax was introduced for small companies, a measure which was widely recognised as opening the way for a considerable amount of tax planning, such that eventually it led to a humiliating climb-down by the Government. Another fiendish tax recently introduced is pre owned asset tax which, in practice, is far beyond the capability of the ordinary person to understand and operate, produces minimal tax and, quite perversely, it largely attacks elderly people on low incomes. This year has seen introduction of sweeping capital gains tax changes with ill thought out effects and yet little has been done to ameliorate these. As regards the changes for non-domiciliaries, it may well be the case that the existing regime for them is unduly lenient, but switching overnight to a very harsh regime does seem to be inappropriate.

Nevertheless we can advise non-domiciliaries fully about the forthcoming regime, together with important actions to be taken before 5 April next to mitigate future liabilities.

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