

Silver lining in non-dom reforms?

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For those who will become UK deemed domiciled for income and gains tax purposes on 6 April 2017 under the 15/20 test ¹, the Consultation Document of 19 August 2016 contained some welcome good news. Not only will there be an opportunity to rebase assets that are held directly to their 5 April 2017 market value but such individuals can also take advantage of the opportunity to 'cleans' accounts that constitute a mixture of capital, income and gains in order to increase the funds that can be remitted to the UK tax-free.

Rebasing

The opportunity to rebase is only available if the following conditions are met:

- The assets were foreign situs (so, non-UK assets) on 8 July 2015;
- The assets were held directly on 8 July 2015; and
- The individual paid the remittance basis charge in any tax year before the 2017/2018 tax year.

The last condition may present an issue for US taxpayers who would normally choose not to pay the remittance basis charge. However, it may be worthwhile paying the £60,000 or £90,000 charge for tax year 2015/16 or 2016/17 in order to take advantage of the rebasing opportunity, if latent gains are large enough.

For those who claimed the remittance basis in the past, it should be noted that rebasing does not necessarily mean that sale proceeds can be brought to the UK tax-free. The source of funds used to purchase an asset needs to be considered. It is only if the asset was purchased using funds already taxed in the UK or 'clean capital' that the proceeds can be brought to the UK without triggering a taxable remittance. However, if foreign income or gains were used as part or all of the purchase monies, then the usual remittance rules would apply to determine to what extent a tax charge would be triggered on bringing the proceeds of sale to the UK. However, the opportunity to cleanse mixed funds during 2017/18, as discussed further below, can be used to separate the proceeds into constituent parts to enable the capital part to be brought to the UK tax free.

The draft legislation which will hopefully clarify the mechanics of the rebasing is promised on 5 December 2016. The Consultation Document does, however, describe it as applying on an 'asset by asset' basis. For those who have assets that can benefit from rebasing, it may be beneficial to hold on to those assets until 6 April 2017 depending of course on investment considerations.

Cleansing

To encourage repatriation of funds to the UK, the Government has decided that during tax year 6 April 2017 – 5 April 2018 there will be a one-time window to separate mixed funds (funds that contain a mix of one or more of capital, gains and income) into their different constituent parts. This effective suspension of the mixed fund rules allows individuals to move the part of a mixed fund that represents clean capital to a separate account, giving them the opportunity to remit funds from this account to the UK tax-free not only in 2017/18 but in future tax years. This is a great opportunity to increase the pot of funds that can be remitted to the UK tax-free, provided that the relevant records are available.

This opportunity is not restricted to those who become deemed domiciled on 6 April 2017 and appears to be available to any 'non-dom' whether UK resident or not (except those born in the UK with a UK domicile of origin). If any mistakes have been made in the past in relation to keeping income separate from capital in periods of UK residence, then these can be rectified by taking the opportunity to transfer the income to a separate account in 2017/18. The provisos on the ability to cleanse are:

- Cleansing will not be allowed if an individual is unable to determine the component parts of the mixed fund. The exact extent of records that would be needed is not yet known but it would be contrary to the aim of the cleansing opportunity for HMRC to be too draconian with record requirements. It is likely to be sufficient for an individual to be able to identify the source of the mixed funds in order to give a credible explanation of the rationale for the break-down of the mixed funds into its constituent parts.
- Cleansing will only apply to bank deposits or similar. It will not apply to an asset that represents a mixed fund, although if that asset is sold, the cleansing opportunity can be used to separate the proceeds into constituent parts.

Conclusion

Taken together the rebasing and cleansing opportunities could be very useful to lessen the impact of the prospect of being subject to UK tax on an arising basis for the first time on 6 April 2017 and/or for those who are considering establishing a UK tax resident investment holding company in order to benefit from the relatively² low UK corporation tax rate (20% currently due to fall to 17% in 2020). For the investment holding company, given that a check-the-box election would need to be made to make the company transparent for US income tax purposes (in order to avoid tax issues associated with the company being a PFIC), the tax issues arising from the underlying investments would need to be carefully considered, as they would for directly owned investments. However, the ability to rebase assets prior to the transfer to the company and/or to fund the company with funds that are clean for UK tax purposes post cleansing, increases the attractiveness of the proposal.

[1] resident in the UK in 15 out of the past 20 years

[2] as compared to the higher personal tax rates

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