

REFORM OF THE TAXATION OF NON-DOMICILED INDIVIDUALS



OVERVIEW

In the 2011 Budget statement the Chancellor announced:

- that there is to be a statutory residence test (SRT); and
- reforms to the taxation of foreign domiciliaries.

Separate Consultation Documents on the two topics were issued jointly by HM Treasury/HMRC on 17 June 2011 with the deadline for comments set at 9 September 2011. The level of responses received for both Consultations was unusually high. The Government's response came on 6 December 2011 in the form of a Written Ministerial Statement which addressed both issues, and a Response Document and draft legislation in connection with the reforms to the taxation of foreign domiciliaries.

The Government's proposals for reforms to the taxation of foreign domiciliaries will be enacted in two stages with the main reforms being included in Finance Bill 2012 and effective from tax year 2012/13 onwards. The published draft legislation covers the majority of the changes intended to be incorporated into the 2012 Finance Bill.

To allow time for appropriate consideration of the various issues raised in the many responses received to the SRT consultation, the test will not now be introduced until 2013/14. The SRT is the subject of a separate briefing.

1. REFORMS TO THE TAXATION OF FOREIGN DOMICILIARIES

The Government does not intend to change the broad principles underlying the Remittance Basis. However, as announced in the 2011 Budget, it intends to introduce reforms which it believes strike a balance between increasing the tax contribution from foreign domiciliaries who are long-term UK residents and encouraging inward investment in the UK.

We know from the Response Document issued on 6 December that most of the legislation will be enacted in Finance Act 2012 and take effect from 6 April 2012. There will, however, be some further reforms enacted in Finance Act 2013. Generally these further reforms will be additional simplification measures (see section 10).

The Response Document reiterates the commitment (first made by the Chancellor in the 2011 Budget), that following these reforms there will be no other substantive changes to the taxation of foreign domiciliaries for the remainder of this Parliament.

2. THE PROPOSALS AT A GLANCE

The reforms proposed comprise:

- An increase in the Remittance Basis Charge to £50,000 for adult longer term UK residents.
- A new exemption for commercial investment in UK qualifying businesses.
- A new exemption where pre-eminent objects are gifted to the nation under the new Cultural Gifts Scheme
- The simplification of the existing Remittance Basis rules in respect of:
 - Nominated income
 - Foreign currency bank accounts
 - The taxation of assets remitted to and sold in the UK
 - The enactment of the existing practice in relation to foreign employment duties of non-ordinarily resident taxpayers.

The last mentioned is the only one of the reforms above which is not being incorporated in Finance Act 2012. It will instead be enacted in Finance Act 2013 with the existing Statement of Practice remaining in force for 2012/13.

The main legislation for the new exemption for commercial investment in UK qualifying businesses will be enacted in Finance Act 2012, and effective for investments in companies where that investment occurs on or after 6 April 2012. The Response Document holds out the possibility that the Government may be persuaded to extend the exemption to investments in certain partnerships in Finance Act 2013.

The Response Document also commits the Government to consider introducing legislation in Finance Act 2013 to simplify the meaning of remittance in relation to:

- The exempt asset rules in general.
- Exempt assets that are lost, stolen or destroyed.
- Excluding minor grandchildren from the definition of “relevant person”.
- Removing the charge to tax on inadvertent remittances.

The Government may consider limited further simplification measures in 2013 (but see section 10 for areas where change has been ruled out).

In addition, we know that legislation will be included in Finance Bill 2013 to amend the following anti-avoidance provisions:

- The transfer of assets abroad regime; and
- gains on assets held by foreign companies closely controlled by UK participators.

This legislation impacts on all taxpayers but is especially relevant to foreign domiciliaries. Details of proposed changes are expected to be announced around the time of the 2012 Budget, with the Government also intending to publish a Consultation Document, which will include draft legislation and draft explanatory notes.

3. THE £50,000 HIGHER REMITTANCE BASIS CHARGE

One of the principles underpinning the Finance Act 2008 was that, with limited exceptions, those who claim the Remittance Basis should suffer a financial penalty. From 2008/09 onwards automatic access to the Remittance Basis is limited (mainly where foreign income and/or gains are less than £2,000 in aggregate) and claiming the Remittance Basis generally involves a loss of the personal allowance and the Capital Gains Tax annual exemption. In addition, adult foreign domiciliaries, resident in at least seven of the preceding nine tax years, have had to pay a fixed charge of £30,000 to claim the Remittance Basis. This is referred to as the Remittance Basis Charge (RBC).

From tax year 2012/13 there will be two levels of RBC:

- The standard £30,000 charge (as now), payable by individuals who have been UK resident in at least seven out of the nine preceding tax years.
- A higher £50,000 charge, payable by individuals who have been UK resident in at least 12 out of the 14 preceding tax years.

The draft legislation confirms that the mechanics of the higher RBC will be identical to the current £30,000 charge.

Whether the standard or higher charge applies, taxpayers – provided they remain domiciled outside the UK - will continue to be free to choose year by year whether to be taxed on the Remittance or the Arising Basis for the relevant tax year.

Adult UK resident foreign domiciliaries who have been continuously UK resident from or before the tax year 2000/01 will have to pay the higher charge to claim the Remittance Basis (unless their aggregate unremitted foreign income and/or gains for the tax year are less than £2,000). For those who have not been continuously resident since 2000/01, the look back period in relation to 2012/13 is from the tax year 1998/99.

The current exemption for Remittance Basis income or gains used to pay the RBC is extended. This means that a Remittance Basis user can, with respect to a tax year for which the £50,000 RBC is payable, make a payment of £50,000 (or aggregate payments of £50,000 or less) direct to HMRC from offshore income and gains without there being a taxable remittance.

For both the basic £30,000 and the higher £50,000 RBC, a period of non-UK residence of three complete tax years is required to re-set the clock; after that a person can return and claim the Remittance Basis without immediately having to pay the charge.

Foreign domiciliaries may be concerned that this rise could be a prelude to further increases. This concern was raised during the consultation process and is addressed within the Response Document, which at 2.2 states that: *“The Chancellor made a commitment at Budget 2011 that there would be no further substantive changes to non-domicile taxation for the rest of this Parliament. This commitment applies to the level of the RBC. The Government believes this will provide certainty and stability for non-domiciles.”*

4. EXEMPTION FOR COMMERCIAL INVESTMENTS IN UK BUSINESS

Overview

Recognising that the current Remittance Basis rules discourage UK resident foreign domiciliaries from investing in the UK, a special exemption is to be introduced. This will have effect where the qualifying investment occurs on or after 6 April 2012. The exemption will:

- Disapply the remittance rules with respect to remittances of foreign income or gains used to invest in a qualifying business.
- Be available in respect of any Remittance Basis income or gains, regardless of whether the Remittance Basis is claimed for the year in question. In other words, electing for the arising basis in a particular tax year will not preclude relief being claimed if the individual makes a qualifying investment using prior years' Remittance Basis income and/or gains.
- Be relevant to individuals caught, in the year of returning to the UK, by the CGT, offshore income gains or relevant foreign income anti-avoidance rules for temporary non-residents, who will be able to use the investment relief in the same way as other Remittance Basis taxpayers.
- Apply not only to direct investment by the taxpayer, but also to investment by any other relevant person.

Provided the conditions are met, there will be no upper or lower limit on the amount of Remittance Basis income and gains that can be invested. In addition, a claim to relief under these provisions will not affect entitlement to other UK reliefs. This means that an individual who brings Remittance Basis income and/or gains to the UK and claims this exemption will also be able to claim other tax reliefs, such as EIS or VCT, where appropriate.

Unfortunately, and despite representations advocating the extension of the relief to include investments in partnerships, the present proposals apply only to private limited companies (bodies corporate whose liability is limited and whose shares are not listed on a recognised stock exchange). As noted in section 2, the Government is prepared to consider the issue of partnerships further, but this would be a matter for Finance Act 2013.

Concerns were expressed as to whether the proposals are compatible with EU law and the State Aid rules. The Response Document makes it clear that the issue has been considered, stating at 2.90 that: “the Government is satisfied that the draft legislation to be published in Finance Bill 2012 is compatible with EU law and the State Aid rules”.

The qualifying conditions

For the exemption to be due, a “relevant event” must occur and the individual must claim the relief.

A relevant event will occur where money or other property.

- is used by a relevant person to make a qualifying investment; or
- is brought to or received in the United Kingdom in order to be used by a relevant person to make a qualifying investment.

This means that, to qualify, it is not necessary to transfer funds from abroad directly to the qualifying company’s bank account.

It is clear that the exemption will always be available where the other conditions are met and a cash investment is made. There is, however, a restriction where the investment is in specie. The exemption will only be available where the property is brought to or received in the United Kingdom in order to be used by a relevant person to make a qualifying investment. For reasons which are unclear the draft legislation specifically disapplies the exemption in cases where:

- the property was not brought to the UK for the purpose of making the investment; and
- since the actual remittance, liability to tax on Remittance Basis income and gains from which the property is derived has been avoided as a result of one of the other exemptions.

The other exemptions referred to are: the exemption for notional remitted value below £1,000, the personal use exemption, the repairs exemption, the public access exemption and the temporary importation exemption.

The definition of “relevant person” is the same as in the current legislation and includes: (a) the individual; (b) the individual’s spouse/civil partner or co-habitee; (c) minor children of the individual and/ or their spouse/civil partner or co-habitee; (d) minor children of the individual and/ or their spouse/civil partner or co-habitee; (e) connected companies (including subsidiaries) and trusts.

The relevant person has 45 days, from the time the money or other property enters the UK, to make the qualifying investment. Where a loan is made to a company, and can be drawn down over time the draft legislation specifies that the

loan is treated as being made when the first amount is drawn down. It is presumed that this is not meant to be read so as to allow the balance remaining undrawn after the 45 days expires to qualify for the exemption.

The qualifying investment definition

For an investment to be a qualifying investment the following conditions must be met:

- the relevant person must either subscribe for shares/securities in a company or make a loan (secured or unsecured) to a company;
- the company must be either an “eligible trading company” or an “eligible stakeholder company”; and
- no relevant person may receive a benefit:
 - as the result of either making the investment or the commitment to do so (it does not matter whether the benefit is received before or after the investment is made); or
 - where it is reasonable to assume that the benefit is only provided as a result of the investment.

In a restriction to the proposal outlined in the June Consultation Document, it will be necessary for any investment in shares/securities to be effected through subscription rather than by purchase from a third party. Thus the exemption will apply only to **new** capital introduced into a qualifying company. However, there is no requirement that the company be resident in the UK, or have a permanent establishment here.

An “eligible trading company” is defined as a private limited company which:

- carries on one or more commercial trades or is preparing to do so within the next 2 years; and
- “all or substantially all” that the company does is to carry on commercial trades (or that is what it is reasonably expected to do once it begins business).

To qualify, none of the company’s shares may be listed on a recognised stock exchange. The relief is confined to companies which are unlisted or are quoted on an exchange -regulated market such as AIM or PLUS quoted (the Government decided against introducing a wider relief which would apply to listed companies).

It is understood that “all or substantially all” will be taken to mean that non-qualifying activities should constitute 20% or less of the company’s overall activities.

A trade is commercial provided it is carried on a commercial basis and with a view to the

realisation of profits. Trade has a wider definition for the purposes of this exemption, it includes:

- anything that is treated for corporation tax purposes as if it were a trade;
- a business carried on for generating income from land; and
- research and development from which it is intended that a commercial trade will be derived, or will benefit (note that merely preparing to carry out such activities is not sufficient).

An eligible stakeholder company is defined as a company which:

- is a private limited company,
- exists wholly for the purpose of making investments in eligible trading companies (ignoring any minor or incidental purposes), and
- holds one or more such investments or is preparing to do so within the next 2 years.

A relevant person will be viewed as having received a benefit where, as the result of an arrangement entered into, he or she is provided (whether temporarily or permanently) with anything (thus embracing money or money's worth, including property, capital, goods or services of any kind) that would not be provided to him or her in the ordinary course of business, at least on the same terms. Anything provided to a relevant person, in the ordinary course of business and on arm's length terms, will not be deemed to be a benefit.

Claiming the exemption

The exemption has to be specifically claimed by the taxpayer. The deadline for making a claim is the first anniversary of 31 January following the tax year in which the investment is made. As such, since the exemption will apply to investments made in 2012/13 onwards, the first deadline is 31 January 2015.

It is understood that the claim will have to be made through a specific entry on their UK self-assessment tax return, and someone who would not otherwise file a return will have to do so if they wish to claim this relief. Claimants, who have remitted foreign income or gains for investment in a qualifying company will be required to state:

- how much has been invested in total (but without a requirement to show the constituent elements of the funds invested); and
- the names of the companies in which they have invested.

Clearance procedure

The Government accepts that it would be helpful to have a pre transaction clearance procedure in order to provide investors with certainty that an investment will qualify for relief. HMRC is understood to be exploring this.

Loss of exemption

The exemption will be withdrawn, and the income and gains invested will come into charge, if a potentially chargeable event occurs and appropriate mitigating action is not taken within the 45 day grace period. HMRC officers have the power to extend the grace period in exceptional circumstances.

Potentially chargeable events occur where:

- The investor disposes of all or part of the investment (see below). There is no relief for inter-spouse transfers.
- The company in which the investment is made ceases to be either an eligible trading company or an eligible stakeholder company. Note that this will happen if a company becomes listed on a recognised stock exchange.
- The investor ceases to be a relevant person in relation to the taxpayer. This could lead to problems on death as well as divorce or where gifted funds are invested by or for minor children or grandchildren who then attain majority. In the case of minor grandchildren there will be a particular issues, if the Finance Act 2013 amends the definition of "relevant person" so as to exclude them (see section 10) without also including appropriate transitional provisions.
- Value is extracted (explained below).
- The two year start-up rule is breached (explained below).

Liquidation resulting from insolvency will not itself be a chargeable event but any value received will potentially give rise to a charge.

Disposing of all or part of the investment

Where the disposal consideration is received in instalments each instalment is treated as a separate event.

The Government recognises that in some cases (most notably where there is a part disposal), the requirement to export an amount equal to the original Remittance Basis income and gains from the UK in order to prevent the tax avoided coming into charge, may cause difficulties in funding the CGT on the gain. Whilst draft legislation has not yet been produced, the Response Document states that the Government intend to allow CGT due on a gain to be paid without loss of the exemption.

The extraction of value rule

If value is extracted, this will be a chargeable event, and there will be a 45 day period in which mitigating action can be taken to avoid any income or gains used to make the investment falling into charge.

Value will be held to have been extracted if received (in money or money's worth) by or for the benefit of the investor or any other relevant person.

The rule will be breached if a benefit is received from:

- An "involved company". This term includes (i) the company which received the original investment; (ii) where the investee company is an eligible stakeholder company, all eligible trading companies in which it has or intends to make an investment and (iii) any connected companies.
- Anyone else where the circumstances are directly or indirectly attributable to the investment, or to any other investment made by a relevant person in an involved company.

The extraction of value rule is not breached merely because a relevant person receives value that:

- is treated for income tax or corporation tax purposes as the receipt of income, or would be so treated if that person were liable to such tax, and
- is paid or provided to the person in the ordinary course of business and on arm's length terms.

As such, this rule will not prevent a relevant person from receiving commercial remuneration, dividends, interest or other income in respect of their rights as a shareholder or lender, provided that, where appropriate, tax is paid on such payments.

The two year start-up rule

As with the extraction of value rule, if the two year start up rule is broken there will be a potentially chargeable event and a 45 day period in which mitigating action can be taken to avoid a tax charge on the Remittance Basis income and gains used to make the investment.

The rule can only apply in situations where:

- investment was into a company which was not trading at the time but was eligible because it intended to carry on a qualifying business; or
- investment was made into a prospective stakeholder company at a time when either it had no investments in any eligible trading companies, or none of the companies in which it had invested had started to carry on their intended trades.

Where investment is made in a company which has yet to commence trading it must start to do so within two years of the investment being made.

Where the company is an eligible stakeholder company, then within two years of the investment taking place:

- it needs to have acquired investments in at least one eligible trading company; or
- at least one of the eligible trading companies in which it has held investments must have carried on a commercial trade.

This appears to imply that only a small portion of the funds invested in an eligible stakeholder company needs to be used to acquire shares/securities in, or to make loans to, eligible trading companies. It is thought that this is unintended and that it will be necessary for all funds invested to be used within the two year period.

Avoiding a chargeable event

As noted above, a potentially chargeable event will not in itself mean that the exempted income or gains fall into charge. Rather, the chargeable event is the trigger for the commencement of a "grace period". If mitigating action is taken during this period the tax charge can be avoided.

The grace period is the period of 45 days beginning:

- in a case where all or part of the holding is disposed of, with the day on which the proceeds are paid to a relevant person;
- in a case where the extraction of value rule is breached, with the day on which the value is received, and
- in any other case, with the day on which a relevant person became aware or ought reasonably to have become aware of the potentially chargeable event.

The grace period can be extended by an HMRC officer in exceptional circumstances.

Broadly, the mitigating action that has to be taken is (as described below) either to remove the designated proceeds from the UK or to re-invest in a qualifying investment.

Appropriate mitigation steps

If the event is a disposal of all or part of the holding, the appropriate mitigation steps require the "designated proceeds" (as defined) to have been exported or re-invested in a qualifying investment.

For any other potentially chargeable event (the investee company ceasing to be an eligible company, the investor ceasing to be a relevant person in connection with the taxpayer, or breaches of either the extraction of value rule or the two year rule) it will be necessary to dispose of the

investment and then either export the designated proceeds offshore or re-invest them in another qualifying investment. A qualifying re-investment can be in the same or a different company. Under the draft legislation, where the event is something other than a disposal for full consideration, it is not possible to avoid a tax liability by exporting or re-investing a sum equivalent to the “deemed proceeds”, and retaining the investment itself.

“Proceeds” means the consideration for the disposal but where this is provided in the form of anything other than money, the consideration is taken to be the market value of the investment at the time of the disposal. If the disposal is not made by way of a bargain at arm’s length, the proceeds are also deemed to be equal to market value. Disposals between relevant persons are always deemed to be at market value. Proceeds will be taken as being net of agency fees reasonably incurred. Agency fees are defined as fees and other incidental costs of the disposal that are charged to the seller by any person by or through whom the disposal is effected, but excluding any such fees or costs that are charged by a relevant person, or are to be passed on to or otherwise applied for the benefit of a relevant person.

The “designated proceeds” are limited to the amount of Remittance Basis income or gains previously exempted less:

- amounts already exported; and
- amounts previously re-invested.

For these purposes the designated proceeds are only accepted as being exported if:

- they are taken outside the UK (in the form in which they are received); and
- on leaving the UK, they cease to be available to be used or enjoyed in the UK by or for the benefit of a relevant person.

Where designated proceeds are taken offshore, an immediate chargeable event is avoided. However, if these proceeds are subsequently remitted to the UK, then tax will of course be payable, in the absence of further exemptions. The draft legislation provides that where there is a mixed fund, the acquisition of a qualifying investment and any funds re-exported on sale will be identified under the offshore transfer rules (in other words, will be identified proportionately with all component elements of the mixed account from which they derived).

Failing to take appropriate mitigation steps

If appropriate mitigation steps are not taken in the grace period the Remittance Basis income or gains exempted as a result of the qualifying investment (or the appropriate portion where the chargeable event does not relate to the entire investment) are treated as having been remitted to the UK immediately after the end of that period.

There are specific ordering rules where there is more than one qualifying investment made in the same target company, or qualifying investments made in the same target company either as a result of:

- multiple investments into the same, eligible trading company; or
- investments made both into an eligible trading company directly and into that same company via an eligible stakeholder company.

The rules will identify which Remittance Basis income, and/or gains have come into charge. Regardless of which relevant person made the investment, disposals of all or part of the holdings are assumed to affect the investments in the order in which the investments were made (that is to say, on a first in, first out basis).

Anti-avoidance

The draft legislation contains an anti-avoidance provision which disapplies the exemption where the investment is made as part of or as a result of a scheme or arrangement the main purpose or one of the main purposes of which is to avoid tax. The context in which the Government thinks this provision will be applied is unclear.

Rawlinson & Hunter comments

We are disappointed that the Government has not extended the qualifying investment exemption to partnerships, although we are hopeful that this will happen in Finance Act 2013.

The draft legislation provides significantly more detail than the June Consultation Document and some of the policy decisions taken are welcome as they have broadened the relief. We particularly welcome the fact that:

- *there is no general exclusion for residential property or leasing;*
- *companies undertaking Research and Development will be treated as carrying on a commercial trade and will be eligible for relief; and*
- *there will be no requirement for a qualifying company to be UK resident or to have a UK Permanent Establishment.*

However, the requirement that any investment in shares/securities must be made by way of a subscription or the introduction of new capital, rather than a purchase from a third party is, we feel, regrettable and may cause problems in situations where additional investment is required but it is first necessary to buy out certain existing shareholders. We hope that representations will at least see some easing in this restriction and allow arm’s length third party sales to come within the exemption where the investor is acquiring a stake of 20% or more in the company.

We are unclear as to why the exemption is not allowed in cases where there is an investment in specie and the property has previously qualified as "exempt" under one of the existing exemptions. We appreciate that cases where this is an issue may not be so common as cash investments but see no justification for the restriction.

We understand why it was not felt appropriate to extend the relief to companies that are quoted on a recognised stock exchange. We do not, however, feel that it is appropriate for a listing to constitute a potentially chargeable event, which could force a disposal to avoid a tax charge on the Remittance Basis income and gains originally invested.

We do not think it is appropriate that ceasing to be a relevant person should be a potentially chargeable event. This could prove a significant disincentive, as it could discourage UK investment of gifted funds on behalf of minor children and grandchildren and cause considerable additional tax issues in the event of divorce. The absence of a hold over relief which would defer a chargeable event where transactions occur between relevant persons may reduce the attractions of the new exemption.

The extension to 45 days of the period of grace is welcome but given the range of potentially chargeable events it would be possible for one to occur without the knowledge of the investor and hope that HMRC will be generous in its interpretation of "ought reasonably to have been aware" when considering the start of the period of grace.

We welcome the proposed legislation to enable an individual disposing of a qualifying investment to meet the CGT due on a gain from the investment without this constituting a taxable remittance.

We cannot see what positive purpose the anti-avoidance provision will achieve. Interpreted literally it would mean that the legislation would be inoperable, as the whole point of it is to provide a tax advantage, and we cannot see what a purposive interpretation would catch that the other provisions do not already cover. We hope that representations will lead to this provision being removed as it seems to us that it can only cause confusion and waste resources through unnecessary clearance applications.

5. SALES OF EXEMPT PROPERTY

Overview

Under the current legislation there are a number of exemptions that apply where tangible non-monetary assets purchased outside the UK with

Remittance Basis income and/or gains are subsequently brought to the UK. These are:

- the public access rule (relating, for example, to works of art);
- the personal use rule (applicable only to clothing, footwear and jewellery);
- the repair rule;
- the temporary importation rule (the property must not have been in the UK for more than 275 days in aggregate) and
- the de minimis provision where the notional remitted amount is less than £1,000.

However, if the asset is sold in the UK:

- the Remittance Basis income or gains used to acquire the asset will fall into charge; and
- any gain on the disposal will be subject to Capital Gains Tax on the arising basis (unless the proceeds are less than £6,000 such that the chattels exemption applies).

This makes the UK unattractive as a place for the sale of assets owned by UK resident foreign domiciliaries. A new exemption will, therefore, be enacted in Finance Act 2012 to extend the current importation reliefs, with effect for disposals occurring on or after 6 April 2012. This new exemption will enable UK resident foreign domiciliaries to sell assets, falling within the above exemptions, in the UK without crystallising a charge on any Remittance Basis income and gains used in their acquisition or (where the sale takes place during a tax year for which the seller is a Remittance Basis user) to Capital Gains Tax on any chargeable gain on disposal.

The conditions

Provided that five specified conditions are met there will be an exemption from any tax charge that would otherwise have been attributable to the remittance effected by the individual or any other relevant person. The five conditions are as follows:

1. The sale is to a person other than a relevant person.
2. The sale is by way of a bargain made at arm's length.
3. Once the property is sold no relevant person:
 - a. has any interest in the property;
 - b. is able or entitled to benefit from the property by virtue of any interest, right or arrangement; or
 - c. has any right (whether conditional or unconditional) to acquire any interest mentioned in paragraph (a) or ability or entitlement mentioned in paragraph (b).

4. The whole of the sale proceeds are paid to the seller (whether as one payment or by way of instalment payments) within 95 days of the date on which the property is sold. Payment to any other person made on behalf of or at the discretion of the seller will for the purposes of this condition be accepted as being payment to the seller.
5. The whole of the proceeds are taken offshore or used to make a qualifying business investment (see section 4) within the period of 45 days from the date the proceeds are paid to the seller. Where the proceeds are paid by instalments the 45 days runs from the date on which the last of the instalments are paid to the seller. The draft legislation gives HMRC officers the discretion to extend the 45 day period in exceptional circumstances, if a request is made by an individual who, without the extension, would suffer a tax charge on Remittance Basis income or gains.

Sales proceeds are specifically defined as the consideration for the sale less any agency fees deducted from the consideration received by the seller. Agency fees are defined in the same way as for the qualifying business investment exemption (see section 4).

“Taken offshore” means that the sales proceeds are taken outside of the UK in the same form as they were paid to the seller. This means that they are no longer available to be used or enjoyed in the UK by or for the benefit of the individual or any other relevant person in connection with the individual. What happens to the actual asset itself after the sale is irrelevant to the operation of the exemption (assuming that a genuine third party sale has taken place).

Deeming gains realised on sale to be foreign chargeable gains

Whilst we do not yet have the draft legislation, the Response Document states that the Government accepts that the effectiveness of the policy would be significantly enhanced by a corresponding relaxation of the charge to Capital Gain Tax on any gain realised on the sale. Draft legislation on this aspect will be made available for comment early in 2012. Where the conditions set down above are met the gain, if realised in a tax year for which the individual is a Remittance Basis user and re-exported (presumably in line with the requirements set out above), will be deemed to be a foreign chargeable gain and only liable to UK tax if subsequently remitted to the UK.

Subsequent remittance of the proceeds

Any subsequent remittance of the proceeds from the sale or any property derived from these proceeds will be taxable (unless one of the

exemptions applies). The draft legislation provides that where the asset was acquired from a mixed fund, the special offshore transfer rules will apply to both the sale of the property and the re-exported funds.

Anti-avoidance

The draft legislation contains an similar anti-avoidance provision to that used for the new exemption for commercial investments in UK business (see section 4). In this case the provision disapplies the exemption where the sale is made as part of or as a result of a scheme or arrangement the main purpose or one of the main purposes of which is to avoid tax. Again the context in which the Government thinks this provision will be applied is unclear.

Practicalities

In practical terms these new provisions will allow for any asset to be imported and sold in the UK by a foreign domiciliary free from all UK tax provided (i) the total time the asset has been in the UK when the sale takes place is less than 275 days; and (ii) the individual is a Remittance Basis user in the year that the sale takes place. If the individual is taxed on the arising basis in the sale year then provided the conditions are met there will not be tax on the Remittance Basis income and gains used to acquire the asset but there will be tax on any chargeable gain realised.

Rawlinson & Hunter comments

Whilst the extension of the exemption on sales of exempt property to include the capital gain arising on disposal is welcome and may, in particular, greatly assist the UK arts market, the requirement that the whole of the sales proceeds be paid within 95 days is unhelpful. Many sales take place on deferred terms, particularly in the case of more valuable works of art. Most auction houses will release funds to the seller only after they have been paid. It is not understood why it was not provided that the grace period starts from the date the proceeds become freely available.

For the most part, our comments about the anti-avoidance provision are the same as for the similar provision found within the draft legislation for the new exemption for commercial investments in UK business (see section 4). There is, however, the additional concern that there is no clearance procedure proposed for this exemption. This means that the damage this provision may cause to confidence placed in the exemption may be all the greater. Again we hope the representations will lead to this unhelpful (and in our view unnecessary) provision being withdrawn.

6. GIFTS OF WORKS OF ART TO THE NATION

Foreign domiciliaries can benefit from the Cultural Gift Scheme provisions. Discussed in greater detail in our Charity and Philanthropy Briefing, the Cultural Gift Scheme is a scheme which seeks to encourage the gifting of objects (or collections of objects), which are either considered to be pre-eminent or associated with an historic building in public ownership, to the nation through the incentive of tax reductions (30% of the value of the object for individuals with the possibility of spreading this over five tax years).

Total funding of £30 million is available annually to cover the cost to the Exchequer of both the tax relief under this scheme and Inheritance Tax taken as offset in the Acceptance in Lieu scheme. To secure the tax relief the individual has to make a formal offer to donate the object to the nation and a Panel will assess whether the object is suitably pre-eminent (assessments being carried out on a first come, first served basis). As well as the tax reduction available under the Cultural Gift Scheme provisions, if the application is accepted then:

- Where the object is within the UK and tax on the Remittance Basis income and gains it derives from has, up until the point that the gift to the nation is made, been deferred as a result of one of the existing exemptions - the gift will not trigger the deferred charge meaning that the tax is avoided permanently.
- Where the object is brought into the UK specifically to be gifted to the nation there will be no liability to tax in connection with Remittance Basis foreign income or gains used to acquire the object.

7. NOMINATED INCOME

The provisions with respect to the RBC, and the requirement to make an actual nomination of foreign income or gains, are highly complex. The penal rules which apply if nominated income or gains are remitted are particularly onerous. The rules have led to the creation of specific accounts to ring-fence the funds nominated and much professional time has been spent explaining and supervising this process.

Recognising that the lengths to which the legislation is making taxpayers go are excessive and unnecessary, the rules are to be amended for tax year 2012/13 onwards so that the penal matching provisions will not apply to up to £10 of nominated income or gains. In simple terms, provided that for each tax year from 2012/13

onwards, the nominated amount is less than or equal to £10, the penal matching rules can never apply and even if the nominated funds are in whole or part remitted there will be no tax charge.

The amount is so small that the tax impact is not significant. The important point is that for 2012/13 onwards the ring-fencing requirements can fall away. We are still left with the ring-fencing requirements for the current and prior relevant years back to 2008/09.

Rawlinson & Hunter comments

This simplification is good news for taxpayers who have to pay the RBC. Particularly in the light of the announcement by the IRS, allowing credit against US tax for the RBC (even where only a token nomination is made), the draft legislation appears to us to be effective in:

- *removing most of the administrative burden which the RBC provisions impose currently on affected taxpayers; and*
- *maintaining the basis for claiming credit for the charge in foreign jurisdictions.*

8. FOREIGN CURRENCY BANK ACCOUNTS

Whilst this modification is introduced as part of the reforms to the taxation of foreign domiciliaries, it is important to note that, it applies to all individuals, trustees and personal representatives regardless of their domicile status.

Under the current Capital Gains Tax rules, foreign (non-sterling) currency held in a bank account is a chargeable asset for individuals, trustees and personal representatives (though not for companies). There is an exemption where the currency is acquired and used for personal expenditure outside the UK but this is of limited value. For foreign domiciliaries and trusts the administrative burden of computing gains on foreign currency transactions is particularly onerous. The operation of a foreign currency bank account can potentially give rise to numerous disposals which, under the current rules need to be taken into account.

For disposals occurring on or after 6 April 2012 the limited exemption for personal expenditure is replaced by a comprehensive exemption which removes sums held in foreign currency bank accounts from the scope of Capital Gains Tax. In the June Consultation Document, this exemption was only to apply to individuals. The Government has, however, taken notice of the representations made and the draft legislation introduces a comprehensive exemption for individuals, trustees and personal representatives.

It should be stressed that the exemption applies only to foreign currency bank accounts, and will not, therefore, cover investment in structured cash products such as money market funds.

The June Consultation Document stated that additional anti-avoidance provisions would be required to counter schemes which are devised artificially to generate an allowable loss equivalent to an exempt foreign currency bank account gain. The Response Document indicates that the Government no longer feels that this is necessary. This, it is suggested, is because it has been realised that further legislation would be superfluous as the existing Capital Gains Tax loss anti-avoidance rule is sufficient to disallow any such manufactured losses.

In the run up to 5 April 2012, depending on the latent gain/loss position with respect to foreign currency held, it may or may not make sense (from a tax perspective), to consider delaying or expediting withdrawals or transfers from foreign currency accounts. As ever each situation requires consideration on its merits and the commercial position should be considered carefully before any action is taken.

Rawlinson & Hunter comments

The proposed Capital Gains Tax exemption is a valuable simplification, and we particularly welcome the fact that the Government has listened to representations and extended the exemption to trustees and personal representatives of deceased persons. However, we feel that the opportunity should be taken to address the issues with respect to foreign income received in a foreign currency. This is currently a very difficult area with no agreement as to the correct treatment.

9. STATEMENT OF PRACTICE 1/09: EMPLOYEES WITH DUTIES IN THE UK AND OVERSEAS

Where an individual is a Remittance Basis user and ordinarily resident in the UK, the Remittance Basis in respect of earnings is available only where the foreign employment is with an overseas employer, and the duties are wholly performed abroad (with an exception for incidental UK duties). By contrast, in the case of a Remittance Basis user who is not ordinarily resident in the UK, a single contract can cover UK and foreign duties, with the earnings relating to foreign duties being taxed on the Remittance Basis provided the salary

is paid initially into an offshore account. Statement of Practice 1/09 deals with the operation of this special offshore account. Provided the conditions are met, it disapplies the standard mixed fund rules and allows for pragmatic and more beneficial matching rules to apply.

Since the Statement of Practice has a concessionary element, it was recognised that it had to be enacted at some point. The Government announced in the June Consultation Document that it was taking the opportunity to do so, and to consult on some of the more complicated issues that can arise with these special accounts, such as share scheme transactions.

Suggestions and concerns raised during the consultation process indicated the need for further consultation and anxiety that the legislation enacted might depart significantly from the way in which the Statements of Practice currently works. The Response Document states that the legislation will be delayed until 2013 to give time for further consideration and makes it clear that the Government agrees that it is important to ensure that the legislation will fully implement the Statement of Practice. This delay may also be sensible, as it will mean that the legislation is enacted at the same time, and will be effective from the same date, as the legislation on ordinary residence.

10. SIMPLIFICATIONS WHICH WILL BE CONSIDERED FOR ENACTMENT IN FINANCE ACT 2013

The Remittance Basis has never been a simple regime, but there is widespread feeling that the 2008 Finance Act raised the levels of complexity to such an extent that it is impossible for some to be fully compliant.

Whilst stating that a certain level of complexity is inherent in the regime, the June Consultation Document recognised the need for simplification where possible. In addition to the Government's simplifying proposals (the changes with respect to nominated income, foreign currency bank accounts, sales of exempt property and the enactment of the existing practice in relation to foreign employment duties of non-ordinarily resident taxpayers), a commitment was given to consider simplifications suggested by respondents to the consultation process.

In the December Response Document the Government undertook to consider further

simplification in the following areas:

- Exempt asset rules in general.
- Exempt assets that are lost, stolen or destroyed.
- Excluding minor grandchildren from the 'relevant person' definition.
- Removing the charge to tax on inadvertent remittances.

On a less positive note we also know from the Response Document that the Government has ruled out simplifications in the following areas:

- Reviewing and simplifying the mixed fund rules.
- Definition of a remittance and the derivation rules.
- Increasing the £2,000 de minimis limit to align with the income tax personal allowance.

11. CONCLUSION

We have draft legislation for all the Finance Bill 2012 changes apart from the provisions to:

- enable an individual disposing of a qualifying investment to meet the CGT due on a gain from the investment without this constituting a taxable remittance;
- relax the charge to CGT on any gain realised on the sale of an exempt (tangible) asset so as to treat it as a foreign chargeable gain.

Draft legislation on these amendments is expected in early 2012.

The published draft legislation is being consulted on (the terms being the same as the other Draft Finance Bill 2012 legislation. The deadline for comments is 10 February 2012 so as to give sufficient time for changes to be made to the Finance Bill legislation. There will then be the usual scrutiny as part of the Finance Bill process.

It is expected that there will be consultation of the Finance Bill 2013 changes over the summer.

We will continue to take a full part in the consultation process.

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