GOVERNMENT CHANGE OF HEART ON NON-DOMICILIARIES

Briefing

February 2008

In what can only be described as a dramatic change of heart, the Government announced on 12 February significant changes to the draft legislation published on 18 January dealing with the taxation of foreign domiciliaries resident in the UK. While it is stated that these changes reflect the Government's original intention, this may be viewed as disingenuous. The Government has clearly been shaken by representations from the City and the professions (as well as from the foreign domiciled community), all of whom have pointed out forcefully the problems in much of the draft legislation, particularly as regards the taxation of gains in foreign trusts, and the retrospective aspects of some of the proposals.

This change of heart was confirmed in a letter written by Dave Hartnett, Acting Chairman of HM Revenue and Customs. This gives an assurance of the Government's intentions, which will go some way to allaying serious concerns in some areas. However it is unlikely that there will be complete clarity until the Finance Bill is published which may not be until after 6 April, when the proposals are to take effect. Some further details will doubtless be provided in the Budget Statement due on 12 March, but the legislation needed is of enormous complexity, as the draft proposals have demonstrated.

The letter gives guidance on four points:

a) those using the remittance basis will not be required to make any additional disclosures about their income and gains arising abroad. So long as they declare their remittances to the UK and pay UK tax on them, they will not be obliged to disclose information on the source of the remittances.

b) there will be no retrospection in the treatment of foreign trusts and the tax changes will not not apply to gains realised before 6 April 2008.

c) money brought to the UK to pay the £30,000 charge will not itself be taxable

d) it will continue to be possible to bring art work to the UK for public display without incurring a charge to tax.

Taking each of these points in turn:

Disclosure

Concern has been expressed about the requirement for UK resident settlors to disclose all overseas settlements made by them since 1991. The Revenue's assurance does not specifically state that this requirement will be removed. Instead, it suggests that there will be no need to disclose details of unremitted income and gains and that it will not require information as to the source of remittances on which UK tax is paid. It is difficult to reconcile this last statement with detailed provisions in the draft legislation for identifying remittances from mixed accounts, the enquiry provisions within the Self-Assessment regime, and a tax system which will continue to differentiate between income, income gains, capital gains and non-taxable capital. Perhaps they are saying that if all sums remitted are declared as income no further enquiry would be made, but a general exclusion of enquiry rights hardly seems likely.

Gains on Foreign Trusts

The draft legislation had originally failed to provide for an effective remittance basis for capital extractions from foreign trusts. It would also have resulted in a 40% charge on gains from most offshore funds realised by trustees whether extracted or remitted where the trust had a UK resident settlor.

Furthermore, it would have operated so as to tax gains long since realised within such trusts and attribute future gains to past capital distributions.

The letter seeks to give an assurance that trust gains already realised or inherent as at 5 April 2008 will not be taxed. Presumably, this will be achieved through a deemed re-basing of assets as at that date although details are not given. HMRC have also indicated that past capital payments will be ignored.

They have also confirmed that it is their intention to ensure that the remittance basis will apply to trust gains attributed either to the settlor or beneficiaries. Finally, they have acknowledged that the charge on offshore income gains arising within a settlor interested trust was a drafting error and such gains will be taxable on remittance basis.

The Additional Charge

The letter makes it clear that remittances made to pay the £30,000 additional charge will not themselves be taxable. Furthermore, it states that there will be continuing discussions with the US authorities to seek to achieve a credit for this charge against US liabilities.

Chattels and Works of Art

As a result of representations, works of art brought to the UK after 5 April 2008 for public exhibition will be exempted from being considered a remittance.

Additionally, the Revenue are proposing to make it clear that works of art and other chattels purchased out of mixed funds and already in the UK will not give rise to a tax charge if the original import would not have done so. However, if such items (or cash remittances from source ceased income made before 5 April 2008) are re-exported, any remittance of such funds or items after 5 April 2008 would be subject to the new rules.

There remain many questions and much detail to be clarified. While it would appear that there will be an automatic re-basing of assets held in foreign trusts, it is difficult to see how this will work where there are domiciled and non-domiciled beneficiaries receiving capital payments out of the same gains pool - or when a beneficiary ceases to elect for the remittance basis to apply. Furthermore, it still seems likely that distributions of capital after 5 April 2008 will be matched with post-6 April 2008 income and gains, so despite re-basing it may remain difficult to extract capital for remittance to the UK without a tax liability.

However, and despite the uncertainties which remain, the Government's change of heart is to be welcomed and tribute must be paid to the senior members of HM Revenue and Customs who took part in the process of consultation for their professionalism and willingness to engage with the profession in highly technical discussions. The speed in which they have reacted to the points put to them is commendable. Hopefully, this process of dialogue has been beneficial for both sides and will continue when changes are under consideration in the future.

Nevertheless, these areas are of immense complexity as the draft legislation demonstrated. While the assurances given are welcome, their implementation will involve further complex drafting. It would be preferable were the Government to acknowledge that this episode shows the need for such provisions to be properly considered and debated, and that this can only be achieved if the more complex anti-avoidance legislation is deferred until 6 April 2009.

In the meantime, it is to be hoped that the assurances given will be sufficient to prevent the predicted exodus of the non-domiciled community from the UK.

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This briefing is written in response to newly published material dealing with highly complex issues.

The information contained in this briefing does not constitute advice and is intended solely to provide the reader with an outline of the provisions. It is not a substitute for specialist advice in respect of individual situations.

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