



THE PROPOSED REFORM OF THE TAXATION OF NON-DOMICILED INDIVIDUALS – JUNE 2011

On 17 June 2011, the UK government issued two consultation papers. The papers outline its proposals for changes to the rules regarding tax residence in the UK and taxation of individuals (not companies) who are resident but not domiciled (“non-doms”) in the UK. This note concentrates on the reform of the taxation of non-doms.

Non-doms who are resident in the UK benefit from a favourable set of tax rules. Broadly, they can claim the remittance basis so that they only pay tax on their UK source income and capital gains and on those offshore income and capital gains which are remitted to the UK. These favourable rules were overhauled with effect from 6th April 2008 with the introduction of an annual remittance basis charge of £30,000 payable by non-doms who have been UK resident for 7 out of 9 tax years prior to the year of claim.

The proposed reforms set out in the June consultation paper will make further changes to the system in order to:

- (1) ensure that non-doms make a fairer UK tax contribution;
- (2) encourage non-doms to invest in the UK; and
- (3) simplify the rules.

If the proposed changes are enacted, the new rules would apply to tax years after 2011/2012.

Increasing the remittance basis charge

In order to make the system fairer, the Government is proposing that non-doms who claim the remittance basis and who have been resident in the UK for at least 12 out of the last 14 tax years should pay a higher remittance basis charge of £50,000. This proposed charge will apply from 6 April 2012. It will operate in the same way as the £30,000 charge with the same exemptions (e.g. for those with less than £2,000 of unremitted offshore income/capital gains) and with the accompanying loss of the income tax personal allowance and capital gains tax annual exemption.

The lower £30,000 charge will continue to apply for non-doms who have been UK resident between 7 and 11 tax years.

Non-doms who will be liable to pay the £50,000 remittance basis charge will need to take into account their offshore income and capital gains in deciding whether to claim for the remittance basis in a particular tax year. Broadly, they will need to have at least £100,000 of offshore income or approximately £180,000 of offshore capital gains to justify paying the higher remittance basis charge.

The Government confirmed in the consultation paper that they will not introduce any more stringent tax measures as this could risk forcing non-doms to leave the UK.

Encouraging investment in the UK

Currently non-doms are discouraged from remitting offshore funds to invest in the UK. In a welcome move the Government wants to attract non-doms to invest in the UK by exempting from UK tax offshore income/capital gains remitted to the UK for **commercial investment in UK business**. The relief will not be restricted to UK resident businesses and will include non-resident businesses which have a UK permanent establishment.

Provided the conditions are met, there is no maximum or minimum limit on the amount which can be remitted for the investment and the investment can take the form of shares and/or loan capital. Moreover, under the current proposals, there are no restrictions where non-doms invest in family businesses, businesses in which they have shareholding or work for and draw a commercial remuneration from.

It is proposed that the relief will be claimed through the self-assessment tax return. The current main proposals are set out below.

Qualifying businesses

In order to qualify for the exemption from UK tax on remitted funds, and subject to the exclusions below, the non-dom must invest those monies in:

- *businesses carrying out trading activity* – the trading activity must constitute a *substantial* proportion of the business's activities. Clarification is therefore required on the meaning of "substantial" (e.g. under the old taper relief rules "substantial" meant at least 80% whereas there is a 50% test under the inheritance tax rules for business property relief). Investment will be permitted in manufacturing, retail, technology, importing goods and also financial services provided that the business is trading.
- *businesses undertaking the development or letting of commercial property* – the development or letting of commercial property must constitute a substantial proportion of the business' activities and again clarification will be required on what "substantial" means.

Excluded businesses

Businesses will be excluded if they constitute:

- *Holding and letting residential property* – unless the business is engaged in a trade of building and developing residential property (although there is an exemption for nursing homes/hospitals in certain circumstances).
- *Leasing* - leasing of intangible moveable property e.g. yachts, cars, furniture, etc.
- *Provision of personal services* - e.g. nannies and other domestic help.

Form of business

The investment will only qualify for the exemption from UK tax if it is made into **companies**. Consequently, partnerships, trusts and sole traders will be excluded. The Government is concerned about the use of partnerships in tax avoidance, but given that partnerships are used widely in the

financial sector, it is to be hoped that this exclusion will be lifted or at least somewhat relaxed. The Government is consulting on whether companies listed on AIM and regulated stock exchanges should qualify.

Making the investment

The investment can be made direct or through offshore trusts or offshore companies. This is a welcome move given the widespread use of offshore trusts and companies by clients where remittance from such structures would otherwise generate a UK tax charge.

The investment can be made into a holding company provided it only holds shares in companies which carry on qualifying businesses and are UK resident or have a UK permanent establishment. Important points to note are that the holding company itself need not be UK resident and its shareholdings are not subject to any minimum, so private equity/venture capital companies could qualify.

Anti-avoidance provisions

- Overseas income/capital gains remitted to the UK must be taken out of the UK within two weeks of selling the qualifying investment or reinvested in another qualifying business otherwise the original investment will be a taxable remittance.
- Provisions will prevent non-arm's length loans or payments passing from the company to the non-dom.
- Provisions will prevent non-doms realising value from an existing business (e.g. by selling it to a company they own) where there is no new business investment in the UK.

Simplifying the remittance basis rules

There are three main areas which the Government proposes to simplify.

- *Nominated income* - the complex rules concerning nominating overseas income/capital gains for the remittance basis charge, particularly if the nominated funds are remitted, mean that non-doms typically nominate a minimal amount of £1 of overseas income/capital gains in an offshore account. The proposed simplifications will enable them to nominate up to £10 of their offshore income/capital gains, which they can remit tax free and without triggering the complicated mixed fund rules. This will reduce the administrative burden and compliance costs as ring-fenced nominated funds accounts will no longer be required.
- *Foreign currency bank accounts* – currently currency fluctuations in foreign currency bank accounts can give rise to a capital gains tax charge if funds are remitted. The proposed rules will remove all funds within such accounts from the scope of UK capital gains tax for both non-doms and UK resident and domiciled individuals.
- *Assets sold in the UK* – certain assets purchased with offshore income/capital gains can be brought into the UK free of any UK tax charge, e.g. works of art/antiques for public display, items brought to the UK temporarily or for repair, jewellery. In a move to help the art market, this exemption will now also apply where these items are sold (provided the sale proceeds are removed from the UK within two weeks) so more people will now be encouraged to sell art in the UK.

The Government is also going to put on a statutory footing a current statement of practice which applies to employees who are not ordinarily resident and work under a single employment contract with UK and overseas duties. Under the statement of practice (SP 1/09) such employees only pay tax on earnings relating to UK duties and the complex mixed fund rules do not apply to the single salary they receive. The Government will consult on several issues concerning this current practice.

What happens now?

The proposed changes to the taxation of non-doms is not yet law and you should not therefore make any plans based on it in its present form.

There will be a consultation period during which Berkeley Law and other professionals or entities or individuals who have knowledge and experience of this area will be able to make representations to the Treasury about areas of concern.

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