Statutory residence test and remittance basis changes

Outcome of the consultations

December 2011

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On 6 December, as promised, the UK Government published draft legislation for its proposed changes to the remittance basis of taxation applicable to UK resident non-domiciliaries. The draft legislation was accompanied by a summary of responses to a consultation on the proposed changes, published in June 2011, which ended in September 2011.

At the same time, the Government announced in a Written Ministerial Statement that the Statutory Residence Test, originally proposed for 6 April 2012, is to be delayed until 6 April 2013 to allow time for further consideration and consultation.

This will no doubt be a disappointment for many international individuals who were looking forward to a degree of certainty in relation to their UK tax residence status. However, it is hoped that the additional period of reflection will ensure that the test which is introduced is as fair and workable as possible.

Changes to the remittance basis

All the changes originally proposed are to be introduced, in some cases with amendments taking into account points raised in the responses to the consultation. The changes are as follows:

- increased remittance basis charge – an annual charge of £50,000 for individuals resident in the UK in 12 of the preceding 14 tax years;
- encouraging business investment – tax-free remittance of income or gains to be permitted for the purpose of certain 'qualifying investments'; and
- simplification of the remittance basis rules – adjustments to be made to the current remittance basis rules for:

  – nominating income and gains;

  – foreign currency bank accounts;

  – taxation on the sale of exempt assets in the UK; and

  – Statement of Practice 1/09 in relation to employees with duties in the UK and overseas (legislation to be delayed until 6 April 2013).

Increased remittance basis charge

As originally announced, from 6 April 2012, an individual who has been resident in the UK in 12 of the preceding 14 tax years will pay an annual charge of £50,000 in order to claim the remittance basis of taxation. Individuals who have been resident in the UK in seven of the preceding nine tax years will continue to pay £30,000.

Encouraging business investment

To encourage non-domiciliaries to invest in UK businesses, the consultation proposed to allow tax-free remittances of overseas income and gains for this purpose. Whilst the idea was generally welcomed by the internationally wealthy and the private client industry, the original proposals were quite restrictive. Having

reviewed the responses it received on this issue, the Government has made a number of changes to its proposals for 'qualifying investments'.

As originally proposed, there will be no upper or lower limit to the amount which can be remitted for investment. A 'qualifying investment' will include a loan as well as an investment in shares and can be made by anyone who qualifies as a 'relevant person' under the general remittance basis rules. This would include non-domiciled individuals, specified members of their family and related trustees and companies.

The exemption is to be limited to investment in a 'target company', which is either to be an 'eligible trading company' ('ETC'), or an 'eligible stakeholder company' ('ESC'). As the names suggest, these will be private limited companies which either carry on commercial trades (as all or substantially all of their business) or invest in companies which do. They will also include companies preparing to do either activity in the next two years.

Companies listed on a recognised stock exchange will not be included but, according to the summary of responses, those listed on AIM and PLUS quoted will be able to qualify. Limited liability partnerships will not qualify, but the Government has indicated it will look at this further with a view to extending the relief to partnerships (but not sole traders) in 2013.

The proposal that non-UK companies would need a permanent establishment in the UK to qualify has been dropped, as have the proposed specific exclusions for residential property and businesses leasing tangible moveable property and providing personal services. Such businesses will instead have to bring themselves within the conditions for ETCs and ESCs and the Government's concerns will be dealt with by exclusions for the provision of personal benefit and anti-avoidance rules.

The exemption will not apply if the 'remittance' or subsequent investment is made as part of a scheme or arrangement of which tax avoidance is the, or one of the, main purposes.

The time limits for making the investment after bringing foreign income or gains to the UK, or for taking them offshore or re-investing them after a 'potentially chargeable event', in order to avoid giving rise to a taxable remittance, have been extended from 14 days to 45 days.

A 'potentially chargeable event' includes a disposal of all or part of the investment holding, the target company ceasing to be an ETC or ESC, or the relevant person making the investment ceasing to be a relevant person. It also includes a breach of the 'extraction of value rule' (whereby value is received by or for the benefit of the investor or a relevant person otherwise than by way of a disposal), or of the 2 year start-up rule (if the ETC or ESC fails to start trading or investing, as relevant, within 2 years of the investment being made).

The 45 day 'grace period' begins on the day proceeds are paid to a relevant person where all or part of the holding is disposed of, or, if the extraction of value rule is breached, the day on which the value is received. Otherwise, it begins on the day on which a relevant person becomes aware or ought reasonably to have become aware of the potentially chargeable event. (HMRC may agree to extend the grace period in a particular case in exceptional circumstances). There is also a suggestion in the summary of responses, which is not as yet reflected in the draft legislation, that where a target company ceases to meet the qualifying conditions, an investor will have an additional 45 days to dispose of the investment before the grace period begins.

A disposal of an investment may give rise to a chargeable gain. To avoid the need for a taxable remittance to be made in order for an investor to meet the capital gains tax charge in circumstances where this is necessary, the Government has indicated it will bring forward draft legislation dealing with this for consultation in early 2012 with a view to including it in Finance Bill 2012.

Simplification of the remittance basis rules

In addition to the qualifying investment exemption, the consultation also proposed a number of minor provisions intended to simplify the remittance basis rules. Having considered the responses to the consultation, the Government is introducing these on the following basis:

- **nominated income –** as originally proposed, with effect from 6 April 2012, the first £10 of income or gains nominated by a taxpayer electing to pay the remittance basis charge may

be remitted to the UK free of tax and without triggering complex identification rules;

- **foreign currency bank accounts –** to avoid the administrative burden of calculating gains and losses on foreign currency bank accounts, which often ultimately balance out, with effect from 6 April 2012, all sums in foreign currency bank accounts held by individuals, trustees and personal representatives, will no longer be within the scope of capital gains tax. This will apply regardless of domicile.

  The extension of this proposed exemption to include trustees and personal representatives was made having taken account of responses to the consultation;

- **taxation of exempt assets sold in the UK –** assets which are otherwise exempt from tax as remittances when brought to the UK (works of art or antiques brought here to be displayed in public, items of personal clothing, footwear or jewellery, items brought here temporarily for up to 275 days in total or for repair, or items worth less than £1,000) are currently liable to tax if sold in the UK.

  This tax charge is to be removed for a sale made by a 'relevant person' (non-domiciled individuals, specified members of their family and related trustees and companies) at arm's length to someone who is not a relevant person, in circumstances where no relevant person has any interest in or benefit from the item.

  The sale proceeds must be paid to the seller (whether in instalments or otherwise) within 95 days from the date of sale and, less any legitimate sale costs, must be taken out of the UK or invested in a qualifying investment under the new rules within a further 45 days. If payment is made in instalments, the 45 day period starts with the date of the final instalment (HMRC may agree to extend this period if this is requested by the individual whose income or gains would otherwise be treated as having been remitted to the UK).

  The exemption will not apply if the sale was part of a scheme or arrangement of which tax avoidance was the, or one of the, main purposes.

  In the summary of responses, the Government indicated that it will introduce legislation in Finance Bill 2012 to treat gains made on such a sale as foreign chargeable gains, which will be subject to the remittance basis. This should make selling such assets in the UK more attractive. Draft legislation is to be published early next year.

  In relation to the provisions on exempt assets generally, the Government is going to consider whether the rules can be extended to cover situations in which assets are lost, stolen or destroyed or if other aspects of the rules can be simplified. Any legislation resulting from these considerations will be included in Finance Bill 2013; and

- **Statement of Practice 1/09: employees with duties in the UK and overseas –** the consultation proposed that this statement of practice should be put on a statutory footing. Following the consultation, this is to be taken forward in Finance Bill 2013 to take effect in April 2013. This is to allow further consideration of issues raised by those responding and will also tie in with any changes the Government decides to make to the rules on ordinary residence. The statement of practice will continue to apply in the meantime.

  SP1/09 applies to employees who are resident but not ordinarily resident in the UK, who are taxed on the remittance basis on their overseas earnings and who carry out duties both in the UK and overseas under a single contract of employment. Typically, such earnings are paid into a single bank account which, as it holds a mixture of UK and overseas earnings, becomes a 'mixed fund'. Without SP1/09, employees would have to apportion each individual salary payment over a tax year between UK and overseas earnings in order to establish their UK tax liability.

  SP1/09 simplifies this exercise by allowing them to apportion their income over a tax year on the basis of the number of days worked in the UK compared with those worked overseas and to calculate their tax liability by reference to the total amount transferred out of the account during the whole tax year rather than by reference to individual transfers.

Other simplifications of the remittance basis rules

The consultation asked for suggestions for additional areas in which the remittance basis rules might be simplified. Of the suggestions made, the Government has indicated it will consider excluding minor grandchildren from the definition of a 'relevant person' and removing the charge to tax on inadvertent remittances, with a view to implementing any changes in April 2013.

Conclusion

Although it is disappointing that we will have wait another year for the statutory residence test, the changes to the remittance basis being introduced in April 2012 are welcome. It is also positive that the Government has taken notice of the comments of respondents on board.

The exemption for qualifying investments, particularly, has been broadened in scope, enabling investment in residential property and other businesses which were restricted in the original proposals. The lengthening of time limits from 14 days to 45 days for a qualifying investment to take place, or for funds to be moved offshore or re-invested when circumstances change is welcome, as are the provisions enabling investment in companies which have not yet begun to trade.

With regard to the provision for sales of exempt assets, again the time limits have been relaxed and the proposal to treat gains on sales as foreign gains should make this exemption significantly more valuable.

Likewise, the extension of the exemption from capital gains tax for foreign currency bank accounts to include trustees and personal representatives will increase the value of this concession.

There is no doubt that there remains significant scope for improving the remittance basis rules, but these provisions are a promising start.

The draft legislation is subject to consultation until 10 February 2012. Whilst the detailed clauses may be amended to take account of any comments, the broad provisions are unlikely to change. As such, anyone who has a qualifying investment in mind, or may wish to utilise any of the other exemptions on or shortly after 6 April 2012, should consider taking professional advice now.

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