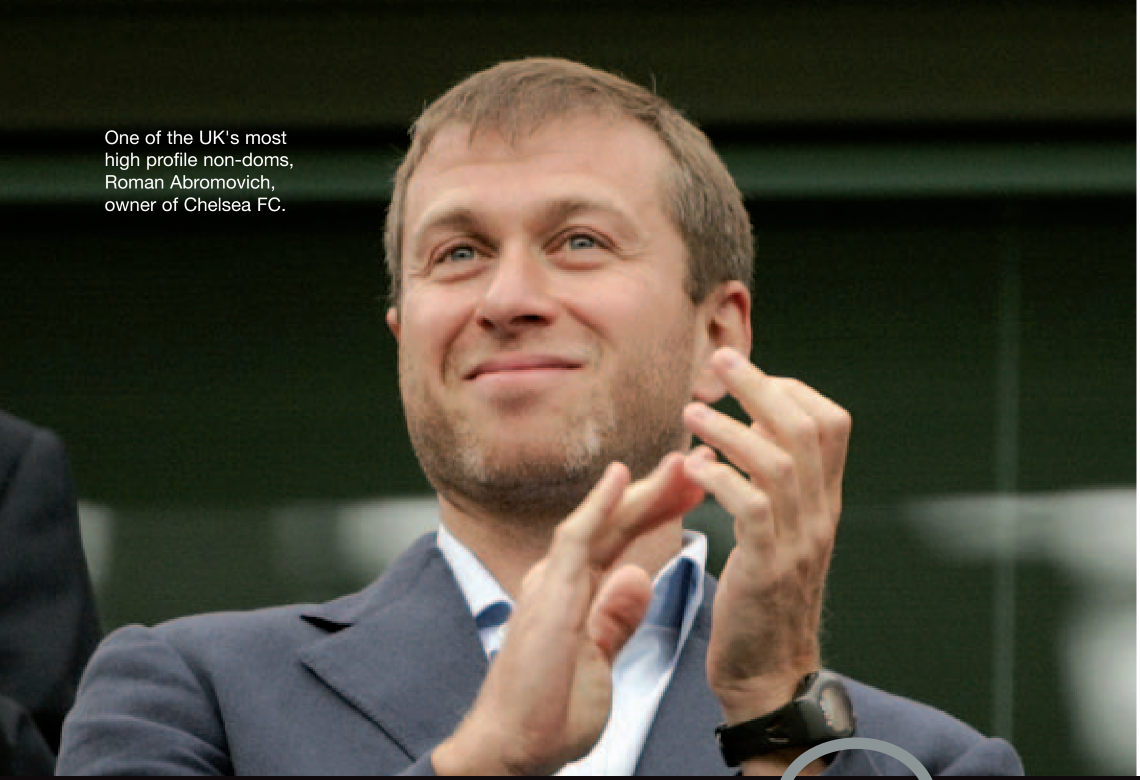

One of the UK's most high profile non-doms, Roman Abromovich, owner of Chelsea FC.

REUTERS/Peter MacDiarmid

The law of domicile has an important bearing on the way that individuals are subject to UK tax on their overseas income and capital gains. But the rules are changing, as Patricia Mock from Deloitte explains.

Home & away

People who are not domiciled in the UK have benefited from many advantages under the UK tax system by structuring their tax affairs in a certain way.

Non UK domiciled individuals who are UK resident are only subject to UK tax on any overseas income and gains to the extent that they are remitted to the UK, albeit in the case of certain categories of foreign income an election is also required. But new rules are being introduced that represent a major change in the position of non UK domiciled taxpayers.

Such taxpayers will need to calculate whether they are better off paying a new £30,000 annual charge or giving up the benefits of their status in relation to their foreign income and gains.

For the so-called 'super-rich', that will be an easy decision as they will prefer to pay the annual charge. For the less wealthy, it will sometimes be a marginal decision, particularly when the loss of the personal allowances is factored in.

For many high net worth individuals, the crucial detail lies in changes to the rules around offshore structures, such as trusts and companies. These structures have been widely used by non domiciles for many years, and the new legislation is likely to have a radical effect on their tax affairs.

The path to change

A review of the taxation of non UK domiciled individuals has been underway since 2003. In his Pre-Budget Report in October 2007, the Chancellor Alistair Darling announced some major changes to the taxation of UK-resident non UK domiciled individuals. This was followed by a consultation document issued in December 2007 called Paying a Fairer Share: A Consultation on Residence and Domicile.

While the consultation document contained a little more detail than the announcements made in October, it did not contain the draft legislation, which was finally issued in January 2008. The new rules take effect from 6 April 2008, following the responses to the consultation document and the draft legislation.

Although the overall position has become a little clearer since the issue of the draft legislation, this is still likely to change as part of the consultation process; indeed the UK government refers to it as a 'work in progress'. One clarification has already been issued in February 2008 and others are possible. The final rules will not be clear until the legislation has been finalised as part of the Finance Bill procedure.

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Both the announcements at the time of the pre-budget report and the consultation document put much emphasis on the Government's stated objectives of maintaining the UK's competitiveness, ensuring that the taxation rules operate fairly and deliver a modern tax system which takes accounts of greater and faster mobility of individuals in the global economy. The main changes which have been proposed for non domiciled UK residents are as follows:

- Changes are being proposed to counter the alienation of income and gains through offshore vehicles or closely connected persons. Currently, funds can be passed in various ways which enable the recipient to bring them into the UK tax free. In some circumstances, the original owner might have use or enjoyment of those funds once they are in the UK. This will be restricted, and gifts made offshore to relatives, including spouses and those living together as a couple will no longer be able to be imported tax free. The legislation will counter the tax free remittance, by non domiciles, of capital gains realised by offshore structures such as trust and companies.

- An 'additional tax charge' of £30,000 will be introduced for individuals who have been resident in the UK for more than seven years out of nine and want to continue to use the remittance basis of taxation. This regime will mean a flat rate charge of £30,000 in addition to income and gains being taxable when remitted. The seven-year time limit runs from the first year of residence in the UK and so the new rules will apply immediately to those who have been UK resident for seven years at 5 April 2008. Where an individual decides not to use the remittance basis (and not to pay the additional tax charge) he or she will be taxed on their worldwide income and gains regardless of whether they are remitted to the UK.

- There will be no entitlement to the personal allowance for UK resident individuals who are using the remittance basis, subject to a de minimis level of unremitted foreign income of less than £1,000. Similarly, the annual exemption for capital gains tax will not be available to these individuals. This will also apply to those who have been in the UK for seven years or less if they claim the remittance basis.

- The rules on counting days of presence in the UK in order to decide if an individual is UK resident will be changed. The intention is to include all days of arrival and departure, regardless of the time here in a day. The view is that this will bring the UK rules into line with international practice.

- In addition, a number of alterations will be made to the remittance basis of taxation, which are designed to 'remove flaws and anomalies' in the current rules. In particular:

- The 'source ceasing' rule is to be removed with effect from 6 April 2008. This means it will no longer be possible to cease a source of income in one tax year and remit funds tax-free in the following tax year.

- It will no longer be possible to remit income arising in one year tax-free by claiming the remittance basis in the first year but not the second.

- The cash basis of taxation will no longer apply. At present, foreign investment income is only taxable on remittance in the form of cash; the purchase and importation of an asset purchased from foreign income is not currently a remittance until the asset is sold in the UK.

- New rules will apply to remittances from 'mixed funds'. The proposal is to introduce statutory rules on how to tax funds remitted from mixed overseas accounts. Remittances will be matched on a year-by-year basis, firstly to employment income, then foreign earnings, foreign investment income, foreign chargeable gains, and any other foreign income or capital.

REUTERS/Stringer France

The UK's richest man Lakshmi Mittal moved to London in 1995 and has non-dom status.

'THE CASH BASIS OF TAXATION WILL NO LONGER APPLY.'

As well as the proposals set out above, which apply from 6 April 2008, the consultation document also requests views on whether further changes to the rules for non domiciles should be considered. The document contains examples of possible issues for debate, for example:

- A flat rate charge of £25,000 without a seven year grace period.

- A higher charge on those who have been here after 10 of the previous 12 years, of say £50,000.

- Setting an upper time limit on access to the remittance basis for non domiciles. This is envisaged as following the current inheritance tax rule whereby a non domicile is deemed domiciled when he has been resident in the UK for 17 out of the previous 20 tax years.

All non domiciles, and particularly those who have set up offshore structures, will need to consider whether there is any planning to be done that will assist their position. Given that the new rules apply from 6 April 2008, the time to consider this has been very limited and early action is essential. ■