

# The new regime for offshore trusts and non-UK domiciliaries

*“There are things that non-UK domiciliaries need to do now.”*

The new regime has seen many old planning strategies brought to an end. As a non-UK domiciliary you will need to review your affairs to decide how you are going to meet your income and capital needs in the future, if you cannot meet them from UK source income and gains.

The changes are effective from 6 April 2008. The legislation is still in draft form, but nevertheless there are things that non-UK domiciliaries need to do now to put them in the best position to protect themselves from the new regime, both to take advantage of grandfathering provisions if available, and to avoid falling foul of the new rules.

Grandfathering provisions are rules that preserve the effect of the old, more generous regime, so it is worth taking time and effort to make sure that you fall within them where possible.

This document outlines some of the most important features of the new regime, with some suggestions as to what actions you should be considering. Even when the legislation is final, it will take some time for the new rules to 'bed down' and for sensible, workable practices to develop. This means that it is important to stay in contact with us, so that we can provide you with the best and most up to date advice possible.

**Please note, this document is intended solely for non-UK domiciliaries.**

Moore Stephens LLP  
St Paul's House  
Warwick Lane  
London EC4M 7BP  
Tel: +44 (0)20 7334 9191  
Fax: +44 (0)20 7248 3408  
www.moorestephens.co.uk

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### **Change to day counting rules for residency test**

- A day will count for these purposes if you are in the UK at midnight.
- A day in transit is excluded if you are merely passing through and have no activities in the UK.

If you are claiming to be non-resident, it is important to keep a diary showing the days you are present in the UK, with times of arrival and departure. In the case of days of transit, it is also important to record why you were passing through the UK to make it clear that you were not engaging in activities unrelated to travel.

### **Availability of the remittance basis**

- There is an automatic remittance basis for those with less than £2,000 offshore income and gains in a tax year.
- For everyone else claiming the remittance basis, there will be a loss of personal allowances and the capital gains tax exemption whether paying the £30,000 levy or not.
- The £30,000 levy applies to adults (i.e. in any tax year in which they are 18 or over) who have been UK resident for at least seven of the previous nine tax years immediately preceding the tax year in question.
- The levy will not be treated as a remittance if paid out of offshore income/gains directly to HMRC.
- The decision to make the claim or not can be made every year, meaning you can opt in or out of the remittance basis depending on the amount of offshore income/gains arising in a year.

It may not be worthwhile paying the levy every year. For example, careful management of the timing of trust distributions or investments reaching maturity could mean that the levy could be paid, say, every three or four years. It might also be worth concentrating family assets held offshore in the hands of one individual, who would pay the levy, rather than spreading them between husband and wife.

### **Closing 'loopholes'**

- Assets brought into the UK could trigger a remittance under both the old and new remittance rules, depending on the type of funds used to purchase them. However, there are new exemptions for imported assets. A remittance will not occur where the asset brought into the UK is a chattel for personal use, or an asset costing less than £1,000. Assets brought to the UK for repair will also not be treated as remitted. It is also possible to import assets temporarily (for less than 275 days) without charge. Art, to which the public has access, is also exempt from charge.
- Assets purchased out of offshore investment income and brought to the UK were not treated as remitted until they were sold in the UK. Bringing such assets into the UK will now be treated as an immediate remittance.
- However, there are grandfathering provisions for assets purchased on or before 11 March 2008. Assets purchased after that date but before 6 April 2008 must have been brought into the UK by that date to be within these provisions. In either case, there will not be a tax charge on their remittance, even if they are taken out of the UK and brought back later.

An inventory should be taken of all assets that are within the grandfathering provisions, together with any evidence regarding their acquisition.

### Offshore mortgages

- Previously, it was possible to pay interest on an offshore mortgage outside the UK from offshore investment income without creating a remittance. This is no longer the case for new mortgages taken out from 12 March 2008.
- However, existing offshore mortgages have been grandfathered provided certain conditions are met, and the mortgage is not varied in any way in the future. In essence, the funds must have been applied in buying the property in the UK before 12 March 2008, and the borrowings must have been secured on that property and not on any other assets.
- The grandfathering provisions above will still apply where you re-mortgaged the property after the original purchase, provided this occurred before 12 March 2008 and the new mortgage satisfies the conditions referred to previously.
- HMRC have issued guidance on what they consider to be a subsequent variation of a mortgage, particularly in respect of borrowings that move from a variable to a fixed rate. Where that change is part of the terms of the mortgage, and not a re-mortgage, then that will not be a variation. However, if you were not happy with the new, fixed rate and shopped around for another mortgage, that would be a variation.

We suspect HMRC are going to be quite pedantic when applying the grandfathering provisions and any deviation, no matter how slight, could cause problems. Therefore, it should not be assumed that a re-mortgage automatically qualifies. Furthermore, any future variation, even something as seemingly harmless as a prepayment or increasing monthly payments, should not be actioned before taking advice.

### Meaning of remittance expanded

- It is no longer possible to 'clean' offshore income and gains by making a gift offshore to a 'related person' and for them to bring those funds into the UK to enjoy. A 'related person' is defined as a spouse, a minor child, a minor grandchild, the trustees of a settlement from which any of those people can benefit or a company in which those people are participators (broadly more than a 10% shareholder).
- However, there are grandfathering provisions that preserve the ability to make such transfers where income and gains arose offshore pre-6 April 2008. Gifts can still be made to related persons (or others) and then brought into the UK by the recipient, and the donor will not be treated as making a remittance provided no benefit accrues to them.

The grandfathering only applies to pre-6 April 2008 offshore income and gains. Therefore, depending on your individual circumstances, consideration should be given to segregating such income and gains from post-6 April 2008 income and gains, in order to maximise the potential advantage of the grandfathering opportunities.

It is still possible to make gifts out of any offshore income or capital gain to adult children, provided the person making the gift cannot benefit from it in any way. This is an important planning tool for many families aiming to pass wealth down generations.

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### **Mixed funds**

- A mixed fund is not defined in the legislation. Broadly, it is an account or fund that holds a mixture of types of income and/or capital and capital gains, whether offshore or UK source.
- We will now have legislative rules for determining the order in which different types of income and gain will come out of a mixed fund. It is clear the new rules will differ from previously established practice.
- The old mixed fund practice treated UK taxed income as coming out of a mixed account in priority to other types of income; now it will come out last.
- The old practice treated gains as coming out as a proportion of proceeds remitted to the UK; now the whole gain will be treated as coming out in priority to capital.
- The old practice should continue to apply to income and gains arising pre-6 April 2008, but the new rules will apply to income and gains arising from that date.

Arrangements should be put in place to prevent income and gains of different types from becoming mixed. Separate bank accounts should be set up to hold different types of income and also to hold sale proceeds from any capital assets separate from income. Income should be segregated according to source, whether onshore or offshore, employment income or investment income. In particular, income or gains that have suffered tax in another jurisdiction and have an associated tax credit should be held separately. These different accounts should be operated very carefully and very strictly. There is a much greater need for discipline in tracking types of income and sources of capital gain from 6 April 2008.

Again, depending on your individual circumstances, consideration should be given to keeping pre- and post-6 April 2008 funds separate in any event.

### **Personal capital loss regime**

- Offshore capital losses can now be claimed if an election is made. However, the rules on their allowability are more complex and restrictive than for a UK domiciled individual, so that losses may be wasted offshore on gains that will never be remitted.
- The election is irrevocable, has to be made for the first year that the remittance basis is claimed whether the £30,000 levy is payable or not and, once made, applies to all years going forward.
- Another major disadvantage is that the election involves disclosing all offshore assets to HMRC.

It is unlikely that the capital loss regime will prove attractive to most non-UK domiciled individuals, bearing in mind the increased disclosure requirements and the fact that it is irrevocable.

### Offshore trusts

- Prior to 6 April 2008 a non-UK domiciliary could never be charged to capital gains tax in respect of capital gains made by offshore trustees, even if received in the UK. In many cases this will no longer be the position. Trust gains realised from 6 April 2008 will be within the charge to tax where they are matched to capital benefits, whether cash or in kind, conferred on UK resident beneficiaries. If you claim the remittance basis, benefits are not taxable provided they are not enjoyed in the UK.
- Benefits received before 6 April 2008 should remain free of capital gains tax even when matched with gains arising after that date. Benefits received in the UK after that date should remain tax free when matched with gains made before that date. However, whilst this is potentially good news, many offshore trustees, particularly of older and/or complex trusts, are unlikely to have the necessary records to take advantage of these provisions.
- Trustees have the option of making an election that will rebase the cost of assets to 5 April 2008 values, thus 'shifting' more gains into the non-chargeable pre-6 April 2008 pool. It applies to all assets in the trust, even if held in underlying companies, and it is not possible to pick and choose individual assets to rebase. The deadline for this election is likely to be 31 January 2010 if benefits were received anywhere in the world in the tax year 2008-2009.
- Previously, there had been arguments that realised gains on offshore non-qualifying distributor funds such as hedge funds and roll-up funds were tax free when held by offshore trusts and paid out to non-UK domiciled beneficiaries. Gains on such funds arising after 5 April 2008 will now definitely be taxable as income. Furthermore, due to anti-avoidance provisions, such holdings can considerably complicate the tax position of an offshore trust.
- There will be an increased compliance burden for the trustees.

Although the treatment of offshore trust gains is a major change, new rules matching distributions to gains and a flat capital gains tax rate of 18%, means the situation may be manageable.

Careful management of distributions going forward is essential, and offshore trustees should consider taking advice on this issue. Trustees should obtain valuations of trust assets, and consider whether the rebasing election is a worthwhile exercise. The election is particularly likely to be beneficial if UK property is held through an underlying company.

*“Careful management of distributions going forward is essential.”*

## Who to contact

If you would like further information please contact:

Rod Gautrey  
Valerie Watson  
Gill Smith  
Simon Baylis

**Email:** [firstname.lastname@moorestephens.com](mailto:firstname.lastname@moorestephens.com)

### Offshore companies not held through a trust

- Previously, gains arising to an offshore company could not be attributed to a non-UK domiciled individual resident in the UK, no matter where the gain arose.
- From 6 April 2008, gains made in the UK by such a company will be attributed to and taxed on a non-UK domiciled shareholder resident in the UK (who broadly has more than a 10% interest in the company). This will occur in the year in which the gain is made.
- The remittance basis will be available, where the claim is made, on gains realised outside the UK. If the gains are not brought into the UK, they will remain outside the charge to tax. The new, extended remittance rules will apply when determining whether a remittance has been made.
- It is not possible to make a rebasing election in respect of companies that are held directly rather than through a trust.
- However, the rate of capital gains tax on disposals is now at the lower rate of 18% rather than a previous potential maximum rate of 40%.

Generally, direct investment by the company in UK assets would not appear to be tax effective, though this will depend on the facts of each case.

It might be possible to make a future disposal of non-UK assets at the company level in a year when the shareholder is claiming the remittance basis and keeps the proceeds offshore. Relief might also be available under double tax treaties or under EU legislation.

The company's distribution policy requires care as in certain circumstances there can be a double charge to tax on both the attributed gain, and a related dividend.

### Caveats

It is important to note that the full extent of the new regime is not known with certainty. The legislation is still being finalised and, as stated will take time to bed down. HMRC are providing their interpretation from time to time. We will continue to monitor the position and more detail will shortly be on our website.

**MOORE STEPHENS**  
CHARTERED ACCOUNTANTS

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St Paul's House, Warwick Lane, London EC4M 7BP  
Tel: +44 (0)20 7334 9191 Fax: +44 (0)20 7248 3408  
[www.moorestephens.co.uk](http://www.moorestephens.co.uk)