

## Year End Tax Insight for Expatriates

Now that we have come to the end of UK tax return preparation for the first year affected by the new rules, it is a good time to reflect back on some of the issues that our clients faced. It is also useful to remind people of pitfalls to avoid under the new regime and make sure that advantage is taken of the reliefs that remain available.

As a result of the new non-dom rules changing from 6 April 2008, clients who have been resident in the UK since 2001/02 would have seen their 2008/09 UK tax returns become a lot more complex compared to previous years and in many cases their liabilities would have increased. For those that arrived after April 2003, the new regime is imminent and so planning ahead can help improve the situation for everyone.

Clients will also be aware of further tax changes coming into force from 6 April 2010, namely the new 50% income tax rate and 42.5% dividend income tax rate for taxpayers with over £150,000 of taxable income and the phase-out of the personal allowance by £1 for every £2 of income for taxpayers with over £100,000 of income. These will particularly hurt those clients that have been resident here since the 2003/04 UK tax year. There are other significant changes such as the restriction to relief for pension contributions.

It will therefore be important for clients to maximise any tax planning opportunities that are available to them, in order to minimise their UK tax

liabilities going forward and we highlight some of these opportunities below. This is meant to be general guidance and should not be acted on without taking specific tax advice.

Turning first to the new rules that now apply to non domiciled people, there remain tax benefits to being not domiciled in the UK.

### Who pays the Remittance Basis Charge (RBC)?

For the first seven years of UK residence the remittance basis is widely available, meaning only UK source income/gains and income and gains brought to the UK are subject to tax. However, the "cost" of the favourable regime can be the loss of the UK personal allowance and UK Capital Gains Tax annual exemption. We have advised clients on whether there is an advantage to paying arising basis tax or indeed bringing small amounts of offshore income to the UK to protect the UK personal allowance. After 7 years of UK residence an annual RBC of £30,000 can apply to those who wish to remain subject to tax on their UK income only. Once the RBC applies it may not be necessary to pay it every year or indeed for both spouses to pay! We have been looking at this on a bespoke basis to get the best possible result for our clients.

### What has changed?

The rules have generally reduced the scope to make remittances to the UK

in two key areas that had previously been popular. With limited exception, (in relation to some offshore mortgages that existed pre 6 April 2008), the payment of interest on an offshore mortgage with offshore funds is no longer outside the scope of UK tax, if the loan was used in the UK. The other areas that have been curtailed are the use of gifting and purchase of assets offshore subsequently brought to the UK.

Another key area of change is in relation to a remittance from a "mixed fund" where HMRC now prescribe the order in which different types of income are considered brought in.

It is a common mistake to believe that if you forgo the remittance basis and report worldwide income you can bring all offshore funds to the UK. This is not the case. Only the income and gains that you have paid tax on since 6 April 2008 can be brought to the UK. Care should be taken to ensure previous years' income and gains are not remitted unless advice has been sought - the cost of doing so could be significant!

### So what can be remitted to the UK?

Having sufficient funds in the UK was always an issue for non UK domiciliaries wishing to maximise their tax position. For a client not yet subject to the RBC it is important to structure offshore investments and accounts to maintain maximum flexibility for bringing funds to the UK tax efficiently. This planning will stand you in good stead if you

remain in the UK beyond 7 years and will restrict the application of the new HMRC "Mixed Fund" rules (mentioned above) that otherwise determine what income is treated as brought to the UK if a remittance is made.

Once subject to the RBC, careful selection of the "nominated" account is required and the funds in this account should be ring fenced and not brought here. One bonus is that funds can be remitted from offshore tax free to pay the RBC itself as long as they are paid directly to HMRC. Note this does not apply to non domiciled people subject to the remittance basis in their first 7 years or to those who now report worldwide income. Special consideration is required for those people over how to pay the UK tax bill.

Arising basis taxpayers can bring in that interest/dividend income and proceeds relating to capital gains on which they have paid UK tax. This does give more flexibility than has been the case in the past.

## Lessons learned?

In the past where our clients invested outside the UK they did not have to take UK tax considerations into account. In many cases this is no longer the case and it may be appropriate to review offshore assets (including trust assets) whether or not you are fully subject to UK tax yet. For many people it will make sense to do so before the end of the tax year. The impact of currency on the UK tax situation is a common concern, as is the tax treatment of investment funds that are not "reporting funds" for UK tax purposes. The structure of a foreign company or partnership can also give rise to an unexpected UK tax outcome.

## Good news?

There are two reliefs that can improve the tax situation. In almost all cases it will be beneficial from a tax point of view for the trustees of a foreign trust with UK resident beneficiaries to make a Capital Gains Tax (CGT) rebasing election in respect of the trust assets as at 6 April 2008. However if there have been distributions to UK beneficiaries during 2008/09 this election was required to have been made by 31 January 2010.

In addition people who claim the remittance basis can elect to allow losses realised on foreign assets to be offset against UK and foreign gains. It is not so clear-cut whether this loss claim will be beneficial in all circumstances because of the order in which the loss has to be offset. Therefore care needs to be taken in deciding whether or not to make this election.

Both elections are irrevocable and apply to all future years.

## How can I reduce my tax liability still further?

In addition to ensuring full advantage is taken of non domiciled status under the new rules, our clients are increasingly taking a closer look at UK planning as a way of reducing tax. Here are some of the ideas we are suggesting:

### Transfer of assets between spouses

If your spouse is not working or is a basic rate (20%) taxpayer in the UK, consider transferring investments in your name to your spouse to save you paying tax of up to 50% on investment income and the disposal of Offshore Income Gains. Anyone UK domiciled who is transferring assets to a spouse who is not UK domiciled should always seek advice before doing this.

## Utilising your Capital Gains Tax Annual Exemption

Those clients entitled to the CGT annual exemption can realise gains either side of 5 April using their and their spouse's allowances of up to £40,400 tax-free (£10,000 for each spouse for 2009/10 and 2010/11). Clients will need to take account of exchange rate fluctuations if they wish to sell offshore assets denominated in a foreign currency and note that the disposal of "Offshore Income Gains" will give rise to an Income Tax charge rather than a Capital Gains Tax charge of 18%. If you have capital gains on shares which you wish to continue holding, you could consider using this year's annual exemption by realising the gains to uplift the costs of your shares using a "bed and spouse" transaction. This is where the shareholder sells the shares on the open market and the spouse buys it back on the same or following day.

## Using your ISA Allowances

Contributing to an ISA allows an individual, who is over the age of 18 and who is resident and ordinarily resident in the UK, to invest up to a maximum of £7,200 for 2009/10 (£10,200 if you are 50 or over as at 6 April 2010) and pay no UK tax on income or capital gains. This allowance increases to £10,200 from 6 April 2010 regardless of whether you are aged 50 or not. Half of the allowance can be invested in cash or the whole allowance can be invested in shares. US citizens will pay tax on interest (up to 35%) and dividends (15% if the dividends are qualifying, 35% if not), however UK tax can be saved of up to 50% on interest and 42.5% on dividends. US taxpayers should hold direct stock in companies rather than unit trusts if they do not wish to fall foul of the US PFIC rules.

## Pension Planning

Clients with 'relevant income' of less than £130,000 should consider maximising their pension contributions to UK registered schemes before 5 April 2010 to obtain 40% tax relief. Clients with 'relevant income' of £130,000 and over in either the 2007/08, 2008/09 and 2009/10 UK tax years should take professional advice as they will need to determine whether they fall foul of the anti-forestalling provisions announced in the 2009 Budget if they wish to contribute more than £20,000 in the 2009/10 UK tax year. US taxpayers will need to ensure that they have sufficient excess foreign tax credits when making such contributions and will need to be aware of the additional US reporting requirements if they wish to contribute to UK SIPPs.

## Making donations to Dual Qualified Charities

Contributing to charities that are dual qualified for both UK and US tax purposes will allow you to claim tax relief on your donation in both jurisdictions. Make sure you tick the box to make the donation under Gift Aid, as this is beneficial for you and the charity and ensure you retain evidence of your donation (e.g. acknowledgement of your gift from the charity). Non-UK taxpayers cannot benefit from Gift Aid so the taxpaying spouse, and preferably the higher earner, should make all the household's charity donations. Gifts made after 6 April 2010 may attract tax relief at a higher rate.

## IRS Circular 230 disclosure

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## Enterprise Investment Schemes (EIS)

A government scheme which provides a range of UK tax relief for investors. Provided that the shares are held for three years, 20% income tax relief can be claimed on an investment up to £500,000. Individuals may elect to treat their investment as if made in the previous UK tax year, thereby carrying income tax relief back one year. No UK Capital Gains Tax is payable on disposal of shares after three years.

## Venture Capital Trust Schemes (VCT)

Another government scheme which provides a range of UK tax relief for investors. They differ from EIS as these schemes tend to invest in a number of different small companies. Provided that the shares are held for five years, 30% income tax relief can be claimed on an investment up to £200,000. No UK Capital Gains Tax is payable on disposal of the shares, regardless of how long they are held.

US taxpayers will need to ensure that they have sufficient excess foreign tax credits when making such a contribution and should be aware that US tax will apply on the sale of the shares. US taxpayers will also need to be aware that VCTs will be considered to be PFICs and should seek professional advice before making an investment.

Both EIS and VCT schemes encourage investments in higher risk companies so you need to consider your attitude to risk and not let tax reliefs outweigh

the consideration of your investment strategy. Buzzacott Financial Planning give independent advice and can help clients who are considering pension planning, ISAs or EIS/VCT investment.

## Self employed/Partnerships

If you have a business and are able to influence the timing of payments and your taxable income is more than £150,000, consider paying compensation and dividends before 6 April 2010 to take advantage of the lower UK tax rates in force for the remainder of 2009/10. Some businesses are changing their accounting date to bring more profits to charge in the current tax year, before the higher rates take effect.

## Deemed Domiciled For UK Inheritance Tax

If you have been here for any part of 17 of the last 20 UK tax years, you will be deemed domiciled for UK Inheritance Tax purposes and therefore liable to UK Inheritance Tax on your worldwide estate. Clients that have been resident in the UK since the 1994/95 UK tax year will be deemed domiciled from 6 April 2010 and may wish to consider establishing Excluded Property Trusts before 6 April 2010 to shield their overseas assets from UK Inheritance Tax going forwards.