

Cleansing and Rebasing

12 December 2017

INTRODUCTION

The latest reforms to the UK tax regime for foreign domiciliaries (“non-doms”) came into effect as expected on 6 April 2017.

The new rules introduce two opportunities: to “cleanse” overseas mixed funds, and to “rebase” assets to their 5 April 2017 market value for capital gains tax purposes.

Now that the second Finance Bill of 2017 has received Royal Assent, the rules are in their final form and those wishing to take advantage of these opportunities can proceed with more certainty.

MIXED FUND CLEANSING OPPORTUNITY

One of the challenges faced by non-UK domiciled individuals is identifying money that can be brought to the UK without triggering a UK tax liability.

A welcome feature of the new rules is the opportunity for individuals to “cleanse” their overseas mixed funds. In many cases, this will enable non-doms to unlock clean capital to fund their onshore spending free of UK tax.

The cleansing opportunity is open to all non-doms who have used the remittance basis prior to 6 April 2017 (apart from those born in the UK with a UK domicile of origin). However, there is only a temporary window for cleansing to take place between now and **5 April 2019**.

WHAT IS A MIXED FUND?

A non-UK bank account containing a mixture of clean capital, foreign income and/or foreign gains is considered to be a “mixed fund”.

Funds derived from certain sources, e.g. gifts from family members, or foreign income and gains generated prior to UK arrival, represent “clean capital” which can, in theory, be remitted to the UK free of tax.

However, once clean capital becomes mixed with foreign income or gains arising whilst the individual is UK resident, it has been virtually impossible (up until now) to separate income and gains from capital – so clean capital could rarely be split out and remitted to the UK.

The mixed fund rules work against the taxpayer. Remittances to the UK from a mixed fund account are deemed to represent foreign income and gains in priority to clean capital. In effect, elements taxable at the highest rates are remitted first.

HOW DOES CLEANSING WORK?

Non-doms will be able to split out overseas mixed funds into their constituent parts.

Where an amount of clean capital can be identified within a mixed account, it will be possible to nominate the clean capital and separate it from the mixed fund by transferring it into a separate overseas account containing nothing else. The clean capital can then be remitted to the UK free of tax.

It is necessary to quantify the amount of capital in the mixed fund first, and to be able to substantiate this to HM Revenue & Customs. Depending on the history of the mixed account, detailed calculations may be needed.

Cleansing only applies to non-UK bank accounts containing mixed funds. If the individual owns an asset representing a mixed fund, the asset must first be sold so that the sale proceeds can be cleansed.

REBASING RELIEF

The cleansing rules can prove to be even more beneficial when combined with the 5 April 2017 rebasing relief.

Rebasing relief potentially applies to individuals who are deemed domiciled from 6 April 2017 under the new 15 / 20 years test and have previously paid the remittance basis charge at least once. Provided the conditions are met, the base cost of foreign assets may be uplifted to 5 April 2017 market value for the purposes of calculating the gain subject to tax.

Where rebasing applies to a particular asset, only the growth in value after 5 April 2017 is subject to tax when the asset is eventually sold. In effect, the gain accruing before 5 April 2017 represents clean capital. This may present an opportunity for an individual who has already exhausted their other sources of clean capital to generate remittable funds now by rebasing.

EXAMPLE

Peter has lived in the UK for number of years and became deemed domiciled on 6 April 2017. He has used the remittance basis in the past, and paid the remittance basis charge.

Several years ago, he purchased shares in a Swedish company for £700 using untaxed foreign income. On 5 April 2017 his shares had increased in value to £900, and they are currently worth £1,000.

Peter decides it is a good time to sell his shares. The sale proceeds of £1,000 are paid into his bank account in Sweden.

Peter would like to use £200 in the UK and will spend the rest of the money when he visits Sweden.

- Without the benefit of rebasing, the capital gain would have been £300.
- Peter qualifies for rebasing, so the gain is £100 instead (i.e. £1,000 minus the uplifted 5 April 2017 market value of £900).
- Peter is subject to CGT on the £100 gain, at a rate of 20%. He pays CGT of £20.
- The sale proceeds of £1,000 in his Swedish account represent a mixed fund.
- £700 - untaxed foreign income (used to buy the shares)
- £100 - taxed capital gain (post 5 April 2017 gain)
- £200 - clean capital (pre 5 April 2017 gain)

If Peter cleanses the mixed fund by nominating to transfer the £200 of clean capital to a separate bank account outside the UK, he is then able to bring the £200 to the UK tax-free. The taxed gain of £100 could also be cleansed and remitted with no further UK tax consequence if Peter needed more funds in the UK.

WHO WILL BENEFIT?

We expect that cleansing will be of particular value to long-term resident non-doms who have used up their clean capital over time. However, cleansing is a one-off opportunity, and it is sensible planning for all non-doms with mixed funds to consider cleansing well before 5 April 2019 in order to maximise their clean capital. Mixed funds often arise where:

- an asset is purchased with clean capital and then sold at a gain;
- a non-UK clean capital account becomes tainted by transfers from other mixed accounts or income being paid into the wrong account; or

a distribution is received overseas from a non-UK trust.

CONTACT US

If you would like to discuss these topics in more detail, please contact your usual Dixon Wilson partner.

Step 1 Identifying a potential mixed fund

If you believe you may have a mixed fund or qualify for rebasing and cleansing, you should contact us to discuss your specific requirements as soon as possible – although cleansing is possible until 5 April 2019, the overall process may be time consuming.

Step 2 Calculation and analysis

Where historic analysis is required, the necessary banking records will need to be gathered and, in some cases, the calculations may be complex. The exercise should be undertaken well in advance of clean funds being required in the UK, leaving plenty of time before 5 April 2019.

Step 3 Cleansing

Once the analysis is complete and an amount of clean capital has been quantified, we can advise you on the cleansing process; including opening new bank accounts, transferring funds and making the required nominations. The legislation contains pitfalls and professional advice is essential.

Step 4 Bringing funds to the UK

The final stage will involve remitting the money to the UK, and this is where we can advise you on how the remittance should be made and assist with any associated UK tax reporting obligations.

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