Supported by

__TAXguide 06/18__

Rebasing and the changes to the CGT foreign capital losses election - professional bodies Q&As

Version 1 (without HMRC comments – see foreword - published 27 March 2018

CONTENTS

FOREWORD

Introduction

Finance (No 2) Act 2017 introduced very significant changes to the taxation of foreign domiciliaries.

Part 1 of these FAQs covers Capital Gains Tax rebasing a transitional measure only available to foreign domiciliaries who become deemed domiciled in 2017/18 and meet specified conditions. The rebasing legislation is found at Finance (No 2) Act 2017, Sch 8, Part 3 (reproduced in Appendix 1).

Part 2 looks at the interactions between Capital Gains Tax rebasing and mixed fund cleansing (a transitional relief introduced for the period from 6 April 2017 to 5 April 2019 where specified conditions are met). Those interested in cleansing should refer to our separate FAQs on cleansing.

Part 3 considers the consequential changes to the foreign capital losses election. The amended TCGA 1992 legislation and the Finance (No 2) 2017, Sch 8 amendments are reproduced in Appendix 2.

Initial HMRC Guidance was issued on 31 January 2018 and reissued on 2 February 2018 (reproduced in Appendix 3 for rebasing and Appendix 4 for the foreign losses election). This initial HMRC Guidance is aimed primarily at ordinary taxpayers.

These professional body Questions and Answers are intended to assist professional advisers.

Questions and draft suggested answers have been prepared by committee members of ICAEW, STEP, CIOT and LSEW to highlight and consider areas of uncertainty in the statutory provisions for:

- rebasing and the changes to the CGT foreign capital losses election (this TAXGuide)
- cleansing of mixed funds (TAXGuide 05/18)
- trust protections and other trust issues (TAXGuide 07/18)
- the extension of IHT to overseas property representing UK property interests (not finalised yet)

as introduced by Finance Act (No 2) Act 2017 with effect from 6 April 2017. The questions and the draft suggested answers have been sent to HMRC for comment.

Caveat

<u>The draft suggested answers have not been agreed by or commented upon by HMRC at this stage and should not be taken as representing HMRC's views.</u> We will update this TAXGuide when HMRC's comments have been received.

The draft suggested answers reflect the views of the committee members of the professional bodies involved in their preparation on the generic issues addressed in the questions and draft suggested answers. The questions and draft suggested answers are intended to assist professional advisers in considering the issues, do not constitute advice and are not a substitute for professional consideration of the issues by such a professional adviser in each client's specific context.

PART 1 – CAPITAL GAINS TAX REBASING

Question 1

Which of the following does rebasing apply to:

a) chargeable assets;

b) non-reporting funds;

c) deeply discounted securities;

d) life policies?

Suggested Answer

(a) and (b).

Rebasing relief enables individuals to calculate gains on qualifying foreign assets held by reference to the market value of the chargeable asset as at 5 April 2017.

Since the actual gain is computed using Capital Gains Tax rules rebasing applies to non-reporting funds (where income tax is payable on the gain) as well as chargeable assets.

Rebasing does not apply to deeply discounted securities or life policy gains (since the chargeable amounts are not computed as chargeable gains).

It should be noted that special rules apply when computing carried interest gains. Only "permitted deductions" can be subtracted from the proceeds figure (TCGA 1992, s 103KA). Thought is being given as to whether rebasing interacts with TCGA 1992, s 103KA such that market value consideration can be deemed to have been paid to the carried interest scheme on 5 April 2017, so that the deemed consideration is a "permitted deduction" in accordance with s 103KA(6)(a). This will be dealt with separately.

Question 2

Do partnership assets qualify for rebasing?

Suggested Answer

Yes, the legislation is wide enough that it applies to:

- the qualifying individual's share of qualifying foreign assets belonging to a UK partnership (including LLPs); and
- the qualifying individual's share of qualifying foreign assets belonging to a transparent foreign situs partnership (including LLPs).

Prior to the passing of the legislation advice was taken by HMRC as to whether it was necessary to incorporate TCGA 1992, s 59 (Partnerships) and TCGA 1992, s 59A (Limited Liability Partnerships) into the rebasing legislation. It was decided that it was not, as they are both general provisions about how the taxation of chargeable gains works and, therefore, automatically apply in the context of rebasing. Statement of Practice D12 refers to partnerships normally being transparent for taxation purposes (assets held by a transparent partnership being held by the partners) such that dealings of the partnership (including disposals) are seen as dealings by the partners, and this is consistent with the legislation.

For foreign partnerships the question of whether they are transparent or not will come down to establishing the facts and then determining whether the entity should be seen as transparent for UK tax purposes. Where a foreign entity is listed in the HMRC International Manual (at INTM180030) as being transparent for UK tax purposes it will be accepted that a qualifying individual's share of qualifying foreign situs partnership assets will be rebased.

Question 3

Which one or more of the following would prevent an individual from qualifying for rebasing?

a) the individual was born in the UK with a UK domicile of origin;

b) the individual is not deemed domiciled until 2019/20;

c) the individual becomes domiciled in the UK prior to the disposal of the asset;

d) the foreign domiciliary leaves the UK for six years, returns having shed his deemed domiciled status and then disposes of the asset

Suggested Answer

All of (a) to (d) above would prevent an individual from qualifying for rebasing.

Going through each in turn:

a) Individuals born in the UK with a UK domicile of origin cannot benefit from rebasing or cleansing. For UK CGT purposes they are subject to tax as if they are a UK domiciliary.

b) To benefit from rebasing an individual must be deemed domiciled in 2017/18 (the first tax year that the legislation is effective from).

c) Retaining a foreign domicile remains important for tax purposes even when an individual is deemed domiciled. If an individual's domicile changes under common law to being within the UK prior to the sale of assets that would otherwise qualify for rebasing no rebasing will be due.

d) Where an individual qualifies for rebasing and wants to leave the UK to re-start the deemed domicile clock consideration should be given to either: (i) selling assets that can benefit from rebasing prior to leaving the UK; or (ii) selling the assets prior to returning to the UK (the individual will have to be non-resident for six years to re-start the domicile clock, so the temporary non-residence anti-avoidance legislation will not be in point).

Question 4

The published guidance includes the following as example 5:

Mr D acquires a non-UK situs asset on 5/3/14 and transfers it to his wife Mrs D on 30/6/17. For Mr D, his transfer is subject to the no gain/no loss provisions as normal. On a later disposal by Mrs D rebasing would not be available as her acquisition of the asset is after 5/4/17.

The example does not make it clear, but we assume that Mr D cannot qualify for rebasing. If Mr D could qualify for rebasing then it would be the rebased cost that Mrs D took over (see Finance (No 2) Act 2017, Sch 8, para 41(5) and para 41(6)). Is this agreed?

Suggested Answer

Yes, the above is agreed. Where rebasing applies a spouse disposal does not cause it to be lost. This is made clear by Finance (No 2) Act 2017, Sch 8, para 41(5) and para 41(6).

Example 5 in the HMRC Guidance can only be correct if Mr D does <u>not</u> qualify for rebasing. If Mr D does not qualify for rebasing then Mrs D cannot benefit either as she does not own the asset prior to 6 April 2017.

If Mr D had qualified for rebasing the transfer to Mrs D would mean that she would have taken over the 5 April 2017 rebased cost of the asset.

<u>Question 5</u>

Katya is a UK resident foreign domiciliary who qualifies for rebasing.

She acquired a painting in February 2011 using £750,000 of Remittance Basis relevant foreign income (2008/09 to 2009/10) and a £500,000 inheritance received in 2010/11. The painting is kept out of the UK. It is worth £4.5 million on 5 April 2017. Katya retains her foreign domicile under common law and is still UK resident when she comes to sell the painting in 2020/21. She receives £4.75 million.

The funds are paid into a separate bank account. What is the composition of the mixed fund account?

Suggested Answer

Tax Year	**Type of Funds**	**Amount**
2008/09 and 2009/10	Remittance Basis relevant foreign income	£750,000
2010/11	Inheritance – clean capital	£500,000
2020/21	Gain that disappears as a result of rebasing – other income or capital not subject to UK tax	£3,250,000
2020/21	Arising Basis Gain	£250,000
		£4,750,000

Since the mixed fund rules match per tax year on a last in, first out basis the £4 million can be brought to the UK without a tax liability (without the need to cleanse first) as it will be matched to:

- the 2020/21 Arising Basis gain of £250,000;
- the gain that disappears due to rebasing of £3,250,000 (deemed to arise in 2020/21, the tax year of disposal) and;

- the 2010/11 inheritance of £500,000.

SECTION B - INTERACTION BETWEEN REBASING AND CLEANSING

Question 6

How does Finance (No 2) Act 2017, Part 3 (Capital Gains Tax rebasing) interact with, Part 4 (cleansing)?

Suggested Answer

It is possible to benefit from both rebasing and cleansing. However, to do so an individual has to meet the conditions in both sets of legislation. Assuming they do the asset would need to be sold so as to leave enough time for the cleansing transaction prior to 6 April 2019 (the cleansing deadline).

It is only necessary to cleanse where rebasing has been carried out if the acquisition costs were tainted (in whole or in part) with Remittance Basis income or chargeable gains. Where they are not the proceeds can be brought into the UK without any resulting tax liability since:

- the acquisition costs are clean capital;
- rebasing wipes out the gain up to 5 April 2017; and
- any post 5 April 2017 gain is taxed on the Arising Basis (since the individual must be deemed domiciled to qualify for rebasing).

Cleansing will be necessary where in whole or in part the acquisition cost traces to Remittance Basis income or chargeable gains and the individual wants to bring the clean capital to the UK. This can be done either by:

- transferring out the Remittance Basis income and/or chargeable gains; or
- Transferring out: (i) the clean capital (if any); (ii) the gain that disappears as a result of rebasing; and (iii) the Arising Basis gain (if any).

Example

An individual is deemed domiciled in 2017/18 and qualifies for rebasing. A valuable painting (qualifying for rebasing) is sold on 19 April 2018. The painting was:

- acquired for £11 million using £7 million of clean capital and £4 million of Remittance Basis relevant foreign income without a foreign tax credit;
- worth £15.2 million on 5 April 2017; and
- sold for £15.4 million.

The £15.4 million is paid into a new offshore bank account (account C). The rebasing means that only £200,000 is subject to tax on the Arising Basis in 2018/19.

Funds representing the £7 million of clean capital, the £4.2 million gain benefitting from rebasing and the £200,000 chargeable gain taxed on the Arising Basis can all be brought into the UK free from additional tax if the £4 million of Remittance Basis relevant foreign income is cleansed from account C. To do this the following would happen:

- New offshore account D is opened and a £4 million cleansing transfer from account C to account D takes place. An appropriate nomination with respect to the ITA 2007, s 809Q(4)(d) Remittance Basis relevant foreign income is made.
- The £11.4 million remaining within account C is brought into the UK (no tax is payable as a result of this remittance).

Note that if it was decided to do the cleansing the other way around, with the £4 million of Remittance Basis relevant foreign income without a foreign tax credit remaining in account C the nomination for the £4.2 million gain benefitting from rebasing would not refer to ITA 2007, s 809Q(4)(e) as the rebasing means that the £4.2 million is not a foreign chargeable gain. Rather it would be within ITA 2007, s 809Q(4)(i) (income or capital not within another paragraph of s 809Q(4)). This is important when documenting the cleansing nomination (incorrect documentation could lead to the nomination being invalid).

Question 7

Kiki is deemed domiciled in 2017/18 and qualifies for rebasing. She has a mixed fund investment portfolio that contains a significant amount of clean capital which she wants to cleanse. Kiki does not, however, want to be out of the market for long or acquire different investments. As such:

- a new investment portfolio is opened for the clean capital;
- all the investments are sold on 19 June 2018;
- a cautious cleansing transfer (and nomination) to the new clean capital investment portfolio takes place;
- on 20 June 2018 acquisitions are made such that, once all the acquisitions are made, across the two portfolios Kiki is left with exactly the same investments and in the same quantities as she held on 19 June 2018.

What is the tax analysis?

Suggested answer

From a CGT perspective because there has been a re-acquisition within the period of 30 days after the disposal the base cost for the disposal is the acquisition cost of the new shares (that is the “bed and breakfasting” rule applies).

The base cost for the shares Kiki has in her portfolios as at 20 June 2018 is the rebased 5 April 2017 amount.

As explained in Question 14 of the Cleansing of Mixed Funds FAQs, holding the same shares/securities of the same class in more than one portfolio should be avoided to prevent significant mixed fund analysis difficulties.

Question 8

HMRC's view, as expressed in the manuals, is that if a taxpayer receives $1,000 of foreign income when it is worth £500 but brings it to the UK when it is worth £700 (due to forex movements) then he is considered to have made a taxable remittance of £700. (Equally if the funds are worth £300 when brought to the UK there is a taxable remittance of £300.)

The HMRC view led to double taxation issues for foreign currency within bank accounts and the law was changed. There is still, however, an issue for other assets if the view expressed in HMRC's Manual is followed. It should be noted that we think that the HMRC view is not the better technical interpretation so, it is our view that, provided disclosure is made there are good grounds for not filing on that basis.

This issue was discussed with HMRC in 2012 and 2013. The conclusion of these discussions was an agreement to differ in our technical opinions. The issue is, however, thrown into sharp focus by rebasing since the HMRC view does not result in the results one would expect given the Chancellor's announcement

Consider the following example:

Example

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) has $1 million of 2014/15 income which was worth £500,000 when received. It is then invested in an asset. At 5 April 2017 it is was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017. The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

<u>HMRC's interpretation</u> is that the $1.2 million represents:

- the $1 million of original income, worth £750,000 at the date of remittance; and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

Under this HMRC approach, since the entire mixed fund has been brought into the UK (so the remittance is not limited to the sterling value of the amount brought into the UK) the taxable remittance is £750,000 notwithstanding that the taxpayer has only remitted £900,000 of cash and expected to benefit from £400,000 rebasing relief.

In contrast, taking <u>the alternative approach (as agreed by the professional bodies)</u> with the same figures the $1.2 million represents:

- the $1 million of original income (£500,000); and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

That is £900,000 is brought in per the mixed fund analysis, which agrees to the value of the sterling amount transferred. Only £500,000 is taxable meaning the taxpayer benefits in full from the £400,000 rebasing relief.

Given this issue what should be done in these circumstances?

Suggested Answer

Provided a consistent year on year approach is taken for each individual mixed fund bank account analysis the conversion of Remittance Basis foreign income to sterling can take place either on the date the income arises or when the income is remitted.

Question 9

Whilst HMRC in its manuals states that income in a foreign currency should be translated to sterling using the foreign exchange spot rate on remittance this is not the case for gains as there is clear case law to the contrary (*Bentley v Pike [1981] STC 360, Capcount Trading v Evans [1993] STC 11*). As such, HMRC and practitioners agree on the position for gains.

How will rebasing work where just foreign chargeable gains were used wholly (or in part) to fund the acquisition?

Suggested Answer

This is best explained by way of an example.

Example

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) had $1 million within a bank account (this traced to the sale of an investment in 2009/10 and represented clean capital of £400,000 and Remittance Basis foreign chargeable gains of £200,000). The $1 million was re-invested in an asset. At 5 April 2017 the new foreign asset was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017. The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

The $1.2 million represents:

- the $1 million of original funds (£400,000 clean capital and £200,000 Remittance Basis foreign chargeable gains); and
- the £300,000 capital gain (that is £900,000 less £600,000).

That is £900,000 is brought to the UK per the mixed fund analysis, which agrees to the value of the sterling amount transferred.

PART 3 - THE CGT FOREIGN CAPITAL LOSSES ELECTION

Question 10

Do surplus losses which arise while a capital loss election is in force remain available to offset gains accruing once deemed domiciled?

Suggested Answer

Section 16ZA TCGA provides for an election, the consequence of which is to confirm foreign losses as allowable losses. While the election has effect, s16ZB, s16ZC and s16ZD also have effect (subject to other specific criteria) and provide for special ordering rules on how to offset foreign losses.

Once an individual becomes deemed domiciled, s16ZA(2A) disapplies the election for that, and subsequent, tax years and consequently s16ZB, s16ZC and s16ZD are also turned off. Surplus foreign losses which arose while the election was in place remain as allowable losses under s16 once the individual becomes deemed domiciled. And since the special ordering rules at s16ZB, s16ZC and s16ZD no longer apply, the surplus losses may be offset against both UK and foreign gains which arise once the individual is deemed domiciled.

For individuals who did not make the foreign capital loss election, any losses which accrued prior to becoming deemed domiciled are not allowable losses and remain so.

Question 11

Can capital losses which are realised while deemed domiciled be offset against Remittance Basis foreign chargeable gains that are remitted to the UK during the deemed domiciled period?

Suggested answer:

S16ZB operates to stop allowable losses being offset against earlier foreign chargeable gains remitted at a later date (i.e. to prevent the effective carry back of losses). Loss relief is instead provided by the special ordering rules in s16ZC.

However, once an individual becomes deemed domiciled, s16ZA(2A) disapplies the election under s16ZA for that, and subsequent, tax years and consequently s16ZB, s16ZC and s16ZD are also turned off. Thus, allowable loses which are realised while the individual is deemed domiciled can be offset against Remittance Basis foreign chargeable gains remitted while the individual is deemed domiciled.

It should be noted that the same result applies where the individual did not make the foreign capital losses election (that is a loss realised after an individual is deemed UK domiciled can be set against a gain that: (i) was realised when an individual was not deemed UK domiciled; and (ii) is remitted when the individual is deemed UK domiciled).

APPENDIX 1 – THE CAPITAL GAINS TAX REBASING LEGISLATION

FINANCE (NO 2) ACT 2017, SCH 8, PART 3

41

(1) This paragraph applies to the disposal of an asset by an individual ("P") where--

(*a*) the asset was held by P on 5 April 2017,

(*b*) the disposal is made on or after 6 April 2017,

(*c*) the asset was not situated in the United Kingdom at any time in the relevant period, and

(*d*) P is a qualifying individual.

(2) The relevant period is the period which--

(*a*) begins with 16 March 2016 or, if later, the date on which P acquired the asset, and

(*b*) ends with 5 April 2017.

(3) P is a qualifying individual if--

(*a*) section 809H of ITA 2007 (claim for remittance basis by long-term UK resident: charge) applied in relation to P for any tax year before the tax year 2017-18,

(*b*) P is not an individual--

(i) who was born in the United Kingdom, and

(ii) whose domicile of origin was in the United Kingdom,

(*c*) P was not domiciled in the United Kingdom at any time in a relevant tax year, and

(*d*) P met condition B in section 835BA of ITA 2007 in relation to each relevant tax year.

(4) The relevant tax years are--

(*a*) the tax year 2017-18, and

(*b*) if the disposal was made after that tax year, all subsequent tax years up to and including that in which the disposal was made.

(5) In computing, for the purpose of TCGA 1992, the gain or loss accruing on the disposal, it is to be assumed that P acquired the asset on 5 April 2017 for a consideration equal to its market value on that date.

(6) Sub-paragraph (5) applies notwithstanding section 58(1) of TCGA 1992 (disposals between spouses).

(7) Where under section 127 of TCGA 1992 (including that section as applied by sections 132, 135 and 136 of that Act) an original and a new holding of shares or other securities are treated as the same asset, the condition in sub-paragraph (1)(*c*) applies to both the original and the new holding.

(8) This Part of this Schedule has effect as if it were included in TCGA 1992.

42

(1) This paragraph applies for the purposes of paragraph 41(1)(*c*) in the case of an asset which, having been situated outside the United Kingdom, becomes situated in the United Kingdom before the end of the relevant period.

(2) The asset is to be regarded as not situated in the United Kingdom at a time in the relevant period when--

(*a*) it meets the condition in section 809Z(3)(*a*), (*b*) or (*c*) of ITA 2007 (public access),

(*b*) it meets the condition in section 809Z3(3)(*a*), (*b*) or (*c*) of ITA 2007 (repairs),

(*c*) the sole or principal purpose of its being situated in the United Kingdom is to sell it or put it up for sale, or

(*d*) in the case of clothing, footwear, jewellery or a watch, it is for the personal use of--

(i) P or a husband, wife or civil partner of P, or

(ii) a child or grandchild of a person within sub-paragraph (i), if the child or grandchild has not reached the age of 18.

(3) The asset is to be regarded as not situated in the United Kingdom at any time in the relevant period if it is brought to, or received or used in, the United Kingdom in circumstances in which section 809L(2)(*a*) of ITA 2007 applies but--

(*a*) by virtue of section 809X(5)(*c*) of ITA 2007 (notional remitted amount less than £1000) it is treated as not remitted to the United Kingdom, or

(*b*) by the end of the relevant period it has not failed to meet the temporary importation rule in section 809Z4 of ITA 2007.

(4) Section 809M(3)(*a*) and (*b*) of ITA 2007 (persons living together) apply for the purposes of sub-paragraph (2)(*d*)(i).

43

(1) An individual may make an election for paragraph 41 not to apply to a disposal made by the individual.

(2) Sections 42 and 43 of TMA 1970 (procedure and time limit for claims), except section 42(1A) of that Act, apply in relation to an election under this paragraph as they apply in relation to a claim for relief.

(3) An election under this paragraph is irrevocable.

(4) All such adjustments are to be made, whether by way of discharge or repayment of tax, the making of assessments or otherwise, as are required to give effect to an election under this paragraph.

APPENDIX 2 - UK RESIDENT FOREIGN DOMICILIARIES - THE FOREIGN CAPITAL LOSS ELECTION LEGISLATION

TCGA 1992

[16ZA Losses: non-UK domiciled individuals

[(1) An individual may make an election under this section in respect of--

(*a*) the first tax year in which section 809B of ITA 2007 (claim for remittance basis) applies to the individual, or

(*b*) the first tax year in which that section applies to the individual following a period in which the individual has been domiciled in the United Kingdom.

(2) Where an individual makes an election under this section in respect of a tax year, the election has effect in relation to the individual for--

(*a*) that tax year, and

(*b*) all subsequent tax years.

(2A) But if after making an election under this section an individual becomes domiciled in the United Kingdom at any time in a tax year, the election does not have effect in relation to the individual for--

(*a*) that tax year, or

(*b*) any subsequent tax year.

(2B) Where an election made by an individual under this section in respect of a tax year ceases to have effect by virtue of subsection (2A), the fact that it has ceased to have effect does not prevent the individual from making another election under this section in respect of a later tax year.

(3) If an individual does not make an election under this section in respect of a year referred to in subsection (1)(*a*) or (*b*), foreign losses accruing to the individual in--

(*a*) that tax year, or

(*b*) any subsequent tax year except one in which the individual is domiciled in the United Kingdom,

are not allowable losses.][2]

(4) Sections 42 and 43 of the Management Act (procedure and time limit for making claims), except section 42(1A) of that Act, apply in relation to an election under this section as they apply in relation to a claim for relief.

(5) An election under this section is irrevocable.

(6) In this section "foreign loss" means a loss accruing from the disposal of an asset situated outside the United Kingdom.][1]

[(7) Section 835BA of ITA 2007 (deemed domicile) applies for the purposes of this section.][2]

Amendments--

[1] Sections 16ZA-16ZD inserted by FA 2008 s 25, Sch 7 paras 55, 62 with effect for the tax year 2008-09 and subsequent tax years.
[2] Sub-ss (1)-(3) substituted, and sub-s (7) inserted, by F(No 2)A 2017 s 29(2), Sch 8 paras 2, 3(1)-(3) with effect in relation to the tax year 2017-18 and subsequent tax years. Sub-ss (1)-(3) previously read as follows--
"(1) In this section "the relevant tax year", in relation to an individual, means the first tax year for which--

(*a*) section 809B of ITA 2007 (claim for remittance basis) applies to the individual, and
(*b*) the individual is not domiciled in the United Kingdom.

(2) An individual may make an election under this section for the relevant tax year (in which case sections 16ZB and 16ZC have effect in relation to the individual for the relevant tax year and all subsequent tax years).
(3) If an individual does not make such an election, foreign losses accruing to the individual in--

(*a*) the relevant tax year, or
(*b*) any subsequent tax year except one in which the individual is domiciled in the United Kingdom,

are not allowable losses.".

[16ZB Individual who has made election under section 16ZA: foreign chargeable gains remitted in tax year after tax year in which accrue

(1) This section applies to an individual for a tax year ("the applicable tax year") if--

[(*a*) the individual has made an election under section 16ZA in respect of a tax year before the applicable year,

(*aa*) the election has effect in relation to the individual for the applicable year,

(*b*) foreign chargeable gains accrued to the individual in or after the tax year in respect of which the election was made but before the applicable year, and][3]

(*c*) by reason of the remission of any of the foreign chargeable gains to the United Kingdom, chargeable gains are treated under section 12 as accruing to the individual in the applicable tax year [or a part of the applicable tax year][2] ("the relevant gains").

(2) Section 2(2) or (4) has effect for the applicable tax year as if the relevant gains had not accrued.

(3) The amount on which the individual is charged to capital gains tax for the applicable tax year is (instead of the amount given by section 2(2) or (4)(*b*), as reduced under section 3) the sum of--

(*a*) the adjusted taxable amount, and

(*b*) the amount of the relevant gains.

(4) "The adjusted taxable amount" is--

(*a*) if section 3(1) (annual exempt amount) does not apply to the individual for the applicable tax year, the amount given by section 2(2) or (4)(*b*) as it has effect by virtue of subsection (2), and

(*b*) otherwise, so much of that amount as exceeds the exempt amount for the applicable tax year (within the meaning of section 3).

(5) In subsection (1) "foreign chargeable gains" has the meaning given by section 12(4).

(6) For the purposes of subsection (1)(*c*) foreign chargeable gains are remitted to the United Kingdom if they are regarded as so remitted for the purposes of section 12.][1]

Cross-references--

F(No 2)A 2017 Sch 8 paras 5, 6 (disapplication of this section in connection with elections made under s 16ZA).

Amendments--

1 Sections 16ZA-16ZD inserted by FA 2008 s 25, Sch 7 paras 55, 62 with effect for the tax year 2008-09 and subsequent tax years.
2 Words in sub-s (1)(*c*) inserted by FA 2013 s 218, Sch 45 paras 92, 98 with effect in calculating an individual's liability to income tax or capital gains tax for the tax year 2013-14 or any subsequent tax year, subject to transitional provisions and savings in FA 2013 Sch 45 paras 154-158.
3 Sub-s (1)(*a*)-(*b*) substituted for sub-s (1)(*a*), (*b*) by F(No 2)A 2017 s 29(2), Sch 8 paras 2, 4 with effect in relation to the tax year 2017-18 and subsequent tax years. Sub-s (1)(*a*), (*b*) previously read as follows--
"(*a*) the individual has made an election under section 16ZA,
(*b*) foreign chargeable gains accrued to the individual in or after the relevant tax year (within the meaning of section 16ZA) but before the applicable tax year, and"

[16ZC Individual who has made election under section 16ZA and to whom remittance basis applies

(1) This section applies to an individual for a tax year if--

[(*a*) the individual has made an election under section 16ZA in respect of the tax year or any earlier tax year,

(*b*) the election has effect in relation to the individual for the tax year, and (*c*) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for the tax year.][3]

(2) The following steps apply for the purpose of calculating the amount on which the individual is to be charged to capital gains tax for the tax year.

Step 1 Deduct any relevant allowable losses from the chargeable gains referred to in subsection (3) in the order in which they appear there (starting with paragraph (*a*) of that subsection).

If allowable losses are deductible from the chargeable gains referred to in subsection (3)(*b*) but are not enough to exhaust them all--

(*a*) those chargeable gains are to be ordered according to the day on which they accrued,

(*b*) the losses are to be deducted from those gains in reverse chronological order (starting with the last chargeable gain to accrue), and

(*c*) if allowable losses are deductible from chargeable gains that accrued on a particular day but are not enough to exhaust all of the chargeable gains that accrued on that day, the amount deducted from each of those chargeable gains is the appropriate proportion of the losses.

In paragraph (*c*) "the appropriate proportion", in relation to a chargeable gain, is the amount of that gain divided by the total amount of the chargeable gains that accrued on the day in question.

Step 2 Treat the amount referred to in section 2(2) or (4)(*a*) or 16ZB(3)(*a*) as being equal to--

(*a*) the amount it would be if there were no relevant allowable losses, minus

(*b*) the total amount deducted under Step 1 from chargeable gains within subsection (3)(*a*) or (*c*).

(3) The chargeable gains are--

(*a*) foreign chargeable gains accruing to the individual in the tax year, to the extent that they are remitted to the United Kingdom in that year [or, if that year is a split year as respects the individual, in the UK part of that year][2],

(*b*) foreign chargeable gains accruing to the individual in that year, to the extent that they are not so remitted in that year [or they are so remitted in that year but it is a split year as respects the individual and they are so remitted in the overseas part of the year][2], and

(*c*) chargeable gains accruing to the individual in that year (other than foreign chargeable gains).

(4) Chargeable gains treated as accruing under section 87 or 89(2) (read, where appropriate, with section 10A) are not within any paragraph of subsection (3).

(5) Chargeable gains treated as accruing under section 12 are not within subsection (3)(*c*).

(6) For the purposes of subsection (3) foreign chargeable gains are remitted to the United Kingdom if they are regarded as so remitted for the purposes of section 12.

(7) In this section--

"relevant allowable losses" means the allowable losses that section 2(2) provides may be deducted from chargeable gains accruing to the individual in the tax year [or a part of the tax year][2], and

"foreign chargeable gains" has the meaning given by section 12(4).][1]

Cross-references--

F(No 2)A 2017 Sch 8 paras 5, 6 (disapplication of this section in connection with elections made under s 16ZA).

Amendments--

[1] Sections 16ZA-16ZD inserted by FA 2008 s 25, Sch 7 paras 55, 62 with effect for the tax year 2008-09 and subsequent tax years.
[2] Words in sub-ss (3)(*a*), (*b*), (7) inserted by FA 2013 s 218, Sch 45 paras 92, 99 with effect in calculating an individual's liability to income tax or capital gains tax for the tax year 2013-14 or any subsequent tax year, subject to transitional provisions and savings in FA 2013 Sch 45 paras 154-158.
[3] Sub-s (1)(*a*)-(*c*) substituted by F(No 2)A 2017 s 29(2), Sch 8 paras 2, 5 with effect in relation to the tax year 2017-18 and subsequent tax years. Sub-s (1)(*a*)-(*c*) previously read as follows--
"(*a*) the individual has made an election under section 16ZA for the tax year or any earlier tax year,
(*b*) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for the tax year, and
(*c*) the individual is not domiciled in the United Kingdom in the tax year.".

[16ZD Section 16ZC: supplementary

(1) This section applies if section 16ZC applies to an individual for a tax year.

(2) Any allowable loss deducted under step 1 of section 16ZC(2) is to be regarded (for the purposes of section 2(2)(*b*)) as allowed as a deduction from chargeable gains accruing to the individual in the tax year.

(3) If a deduction is made under step 1 of section 16ZC(2) from a foreign chargeable gain within section 16ZC(3)(*b*), the amount of the foreign chargeable gain is reduced by the amount deducted.][1]

Amendments--

[1] Sections 16ZA-16ZD inserted by FA 2008 s 25, Sch 7 paras 55, 62 with effect for the tax year 2008-09 and subsequent tax years.

Changes Introduced made to the foreign capital loss election legislation by Finance (No 2) Act 2017), Sch 8, Part 1 paragraphs 2 to 5

2

TCGA 1992 is amended as follows.

3

(1) Section 16ZA (losses: non-UK domiciled individuals) is amended as follows.

(2) For subsections (1) to (3) substitute--

"(1) An individual may make an election under this section in respect of--

(*a*) the first tax year in which section 809B of ITA 2007 (claim for remittance basis) applies to the individual, or

(*b*) the first tax year in which that section applies to the individual following a period in which the individual has been domiciled in the United Kingdom.

(2) Where an individual makes an election under this section in respect of a tax year, the election has effect in relation to the individual for--

(*a*) that tax year, and

(*b*) all subsequent tax years.

(2A) But if after making an election under this section an individual becomes domiciled in the United Kingdom at any time in a tax year, the election does not have effect in relation to the individual for--

(*a*) that tax year, or

(*b*) any subsequent tax year.

(2B) Where an election made by an individual under this section in respect of a tax year ceases to have effect by virtue of subsection (2A), the fact that it has ceased to have effect does not prevent the individual from making another election under this section in respect of a later tax year.

(3) If an individual does not make an election under this section in respect of a year referred to in subsection (1)(*a*) or (*b*), foreign losses accruing to the individual in--

(*a*) that tax year, or

(*b*) any subsequent tax year except one in which the individual is domiciled in the United Kingdom,

are not allowable losses."

(3) After subsection (6) insert--

"(7) Section 835BA of ITA 2007 (deemed domicile) applies for the purposes of this section."

(4) The amendments made by this paragraph have effect in relation to the tax year 2017-18 and subsequent tax years.

(5) Where--

(*a*) an individual makes an election under section 16ZA of TCGA 1992 as originally enacted for a tax year before the tax year 2017-18, but

(*b*) after making the election the individual becomes domiciled in the United Kingdom at any time in a tax year,

sections 16ZB and 16ZC of that Act do not have effect in relation to the individual by virtue of that election for that tax year or any subsequent tax year.

(6) Section 835BA of ITA 2007 (deemed domicile) applies for the purposes of sub-paragraph (5).

4

(1) In section 16ZB (election under section 16ZA: foreign chargeable gains remitted in the tax year after that in which they accrue), in subsection (1), for paragraphs (*a*) and (*b*) substitute--

"(*a*) the individual has made an election under section 16ZA in respect of a tax year before the applicable year,

(*aa*) the election has effect in relation to the individual for the applicable year,

(*b*) foreign chargeable gains accrued to the individual in or after the tax year in respect of which the election was made but before the applicable year, and".

(2) The amendment made by this paragraph has effect in relation to the tax year 2017-18 and subsequent tax years.

5

(1) In section 16ZC (election under section 16ZA by individual to whom remittance basis applies), in subsection (1), for paragraphs (*a*) to (*c*) substitute--

"(*a*) the individual has made an election under section 16ZA in respect of the tax year or any earlier tax year,

(*b*) the election has effect in relation to the individual for the tax year, and

(*c*) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for the tax year."

(2) The amendment made by this paragraph has effect in relation to the tax year 2017-18 and subsequent tax years.

APPENDIX 3 – HMRC CAPITAL GAINS TAX REBASING GUIDANCE

Revised 2 February 2018

An individual that becomes deemed domiciled under condition B of s835BA ITA2007 on 6 April 2017 will be entitled to rebase certain foreign assets to their market value at 5 April 2017 for the purposes of calculating the gain or loss on the disposal of that asset. This is subject to a number of conditions.

For the individual:

i. Section s809H (claim for remittance basis and a charge applies) applied to the individual in relation to 2016/17 or an earlier year
ii. The individual was resident in the UK for 2017/18
iii. For 2017/18 and each year up to and including the year in which the disposal is made condition B of s835BA is met (i.e. he is deemed domiciled under the 15 out of 20 rule) and the individual has not become domiciled in the UK
iv. Condition A of s835BA ITA2007 does not apply to the individual e.g. rebasing is not available where the individual is born in the UK with a domicile of origin in the UK
v. For the year of disposal the individual is not domiciled in the UK at any time in the year under common law

For the asset:

a) The asset was held on 5/4/17
b) The disposal is made on or after 6/4/17
c) The asset was not situated in the UK at any time in the period from 16/3/16 (or acquisition if later) to 5/4/17

Additional points:

- On disposal of an asset an election can be made for the rebasing not to apply to that asset. An election is irrevocable and can be made within normal time limits.
- For a) additional considerations apply where s127 TCGA 1992 applies
- For c) certain periods when an asset was brought into the UK for repair or public access will be discounted when considering whether an asset was UK Situs. In addition certain personal items may not be considered UK situs. The detail of these rules is outside the scope of this material.
- Rebasing of an asset only affects its base cost for the purposes of calculating the amount of the gain (or loss) arising on disposal. It does not act to remove any previously rolled over gains from the calculation of the gain arising.
- Rebasing is available for units held personally in a non-reporting status offshore fund
- Rebasing can apply where assets are held under nominee arrangements or in a partnership that is transparent for capital gains tax purposes.

Examples

1) Mr A first becomes deemed domiciled under condition B of s835BA ITA2007 for 2018/19. Rebasing is not available for Mr A.
2) Mrs B is the settlor of a non UK resident trust that holds non-UK assets. Rebasing is not available for the trust assets.
3) Non UK situs assets are held by a nominee for Mr C. Subject to the other conditions being met, the assets are within the scope of the rebasing rules.

4) Mr D acquires a non UK situs asset on 20/5/15 and transfers it to his wife Mrs D on 21/3/17. She disposes of the asset on 20/12/17. Subject to the other conditions being met Mrs D would be entitled to rebasing for the asset transferred, rather than her acquisition cost being the amount provided by the no gain/no loss provisions for transfers to a spouse. (For Mr D, his transfer to Mrs D is subject to the no gain/no loss provisions as normal.)
5) Mr D acquires a non UK situs asset on 5/3/14 and transfers it to his wife Mrs D on 30/6/17. For Mr D, his transfer is subject to the no gain/no loss provisions as normal. On a later disposal by Mrs D rebasing would not be available as her acquisition of the asset is after 5/4/17.
6) Mr E becomes deemed domiciled under condition B of s835BA ITA2007 for 2017/18 but has not previously made any claims to the remittance basis and s809H has not applied in any year. Rebasing is not available to Mr E.
7) Ms F becomes deemed domiciled under condition B of s835BA ITA 2007 and has owned a UK property for many years. Rebasing is not available for UK situs assets.

APPENDIX 4 HMRC GUIDANCE
FOREIGN CAPITAL LOSS ELECTIONS – TCGA1992 s 16ZA to 16ZC

Revised 2 February 2018

The rules governing foreign loss elections have been amended.

From 2017/18 losses on the disposal of foreign situs assets in a year will be allowable losses if the individual is deemed domiciled for the year. Losses that accrued while a foreign loss election was in place which have not been used (i.e. losses realised but not offset against gains under the special ordering rules) will be available to offset against gains once the taxpayer becomes deemed domiciled.

An individual who was born in the UK with a UK domicile of origin will be UK deemed domiciled on his or her return to the UK regardless of how many years they spend outside of the UK. Deemed domicile can only be lost by an individual who acquires that status only by virtue of being UK resident in 15 of the immediately preceding 20 tax years. If such an individual loses his deemed domicile status by being non-UK resident for six years or more and later becomes UK resident but not domiciled, then a foreign loss election can again be made. The normal rules apply so this is triggered by the first year in this later period to which s809B ITA 2007 applies. The election is irrevocable but only applies to the later period. See example 1 and 2.

For the years when the election was in force the special rules concerning the allocation of allowable losses are unaffected.

Example 1

Mr A is a non-domiciled individual that has claimed the remittance basis since 2008/09. He made a foreign loss election for 2008/9 onwards. The effect of the foreign loss election will continue up to 2016/17. A is deemed domiciled in the UK from 6/4/17 (only as a result of being a long term UK resident).

In 20019/20 he leaves the UK returning in 2026/27. He is not deemed domiciled from 6/4/26 and he claims the remittance basis for 2026/27. If Mr A wants to be able to claim foreign capital losses he will need to make a foreign loss election. The normal time limit applies. That is four years from the end of 5 April 2027 (so prior to 6 April 2031).

Example 2

Mr B. Facts are the same as A except B didn’t make a foreign loss election in 2008/09. B will have an opportunity to make a foreign loss election for 2026/27 and subsequent years.

TAXguide 05/18

Cleansing of mixed funds – professional bodies Q&As

Version 1 without HMRC comments – see foreword - published 27 March 2018

CONTENTS

FOREWORD

Introduction

Finance (No 2) Act 2017 introduced very significant changes to the taxation of foreign domiciliaries.

An interim measure, introduced to assist foreign domiciliaries, with mixed fund accounts, who have been Remittance Basis users (whether automatic or as a result of making a claim) at least once between 2008/09 and 2016/17 inclusive, is cleansing. There is a two year window (6 April 2017 to 5 April 2019) during which cleansing transfers and the associated nomination can take place. The actual remittance of cleansed funds can happen at any time (so well outside of the two year window).

The legislation (found at Finance (No 2) Act 2017, Sch 8, Part 4 (reproduced in Appendix 1 to this legislation) is brief.

Initial HMRC Guidance was issued on 31 January 2018 (last updated 9 March 2018, reproduced in Appendix 2). This HMRC Guidance is aimed primarily at ordinary taxpayers.

These professional body Questions and Answers are intended to assist professional advisers.

Questions and draft suggested answers have been prepared by committee members of ICAEW, STEP CIOT and LSEW to highlight and consider areas of uncertainty in the statutory provisions for:

- cleansing of mixed funds (this TAXGuide);
- rebasing and the changes to the CGT foreign capital losses election (TAXGuide 06/18)
- trust protections and other trust issues (TAXGuide 07/18)
- the extension of IHT to overseas property representing UK property interests (not finalised yet)

as introduced by Finance Act (No 2) Act 2017 with effect from 6 April 2017. The questions and the draft suggested answers have been sent to HMRC for comment.

Caveat

<u>The draft suggested answers have not been agreed by or commented upon by HMRC at this stage and should not be taken as representing HMRC's views</u>. We will update this TAXGuide when HMRC's comments have been received.

The draft suggested answers reflect the views of the committee members of the professional bodies involved in their preparation on the generic issues addressed in the questions and draft suggested answers. The questions and draft suggested answers are intended to assist professional advisers in considering the issues, do not constitute advice and are not a substitute for professional consideration of the issues by such a professional adviser in each client's specific context.

SECTION A – FOREIGN CURRENCY ISSUES

Question 1 deals with mixed fund analysis work where there are foreign currency accounts and questions 2 and 3 cover foreign currency and rebasing issues.

Question 50 below considers cleansing transfers and making a nomination from a foreign currency bank account.

Question 1

Foreign domiciliaries will often have foreign currency bank accounts. As such, mixed fund analysis of foreign currency accounts will often need to be carried out. The HMRC Manuals deal will some very simplified examples and suggest that the analysis should take place in the foreign currency with the conversion to sterling only occurring when the remittance takes place.

There is no legislation covering the issue and no specific case law.

Case law is definitive about the need for chargeable gains to be computed in sterling. In addition, from a practical perspective it is difficult to see how anything other than a sterling analysis can (without extreme complexity) work where there are multiple transfers (in some cases hundreds if not thousands) between accounts in multiple currencies. To add to the difficulties in such situations you can have numerous instances of investments acquired using funds from one currency, where the investment is denominated in a separate currency and the sale proceeds go into a third account in another currency.

Since the area is not covered by any legislation there should be a pragmatic position taken. Provided the individual is consistent year on year when the analysis is prepared for a foreign currency account he or she should be able to carry out the mixed fund analysis in either the foreign currency or in sterling. Does HMRC agree?

Suggested answer

Provided a consistent year on year approach is taken for each specific foreign currency account a mixed fund analysis can be carried out in either the foreign currency or in sterling.

Example

Clara is a UK resident foreign domiciliary. She meets the criteria such that she can cleanse her mixed fund accounts. She has:

- a Swiss franc account with QRS Offshore Bank; and
- five different foreign currency accounts with LMS Offshore Bank (Swiss francs, US dollars, Euros, Australian dollars and Canadian dollars) as well as a sterling account and an active trading portfolio (buying and selling investments in various different currencies often with the currency used for the purchase not being the same as the currency the investment is denominated in and with the sale proceeds being in a different currency and going to a different account). Various transfers are made between the different currency accounts.

The account with QRS Offshore bank is analysed in Swiss francs.

The complexity of the issues with respect to the accounts with LMS Offshore Bank means that all those foreign currency accounts are analysed in sterling.

In both cases a consistent year on year approach is taken with respect to the mixed fund analysis, so both the analysis for the QRS Offshore bank and the accounts with LMS Offshore Bank are acceptable.

Question 2

HMRC's view, as expressed in the manuals, is that if a taxpayer receives $1,000 of foreign income when it is worth £500 but brings it to the UK when it is worth £700 (due to forex movements) then he is considered to have made a taxable remittance of £700. (Equally if the funds are worth £300 when brought to the UK there is a taxable remittance of £300.)

The HMRC view led to double taxation issues for foreign currency within bank accounts and the law was changed. There is still, however, an issue for other assets if the view expressed in HMRC's Manual is followed. It should be noted that we think that the HMRC view is not the better technical interpretation so, it is our view that, provided disclosure is made there are good grounds for not filing on that basis. This issue was discussed with HMRC in 2012 and 2013. The conclusion of these discussions was an agreement to differ in our technical opinions. The issue is, however, thrown into sharp focus by rebasing since the HMRC view does not result in the results one would expect given the Chancellor's announcement

Consider the following example:

Example

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) has $1 million of 2014/15 income which was worth £500,000 when received. It is then invested in an asset. At 5 April 2017 it is was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017. The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

HMRC's interpretation is that the $1.2 million represents:

- the $1 million of original income, worth £750,000 at the date of remittance; and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

Under this HMRC approach, since the entire mixed fund has been brought into the UK (so the remittance is not limited to the sterling value of the amount brought into the UK) the taxable remittance is £750,000 notwithstanding that the taxpayer has only remitted £900,000 of cash and expected to benefit from £400,000 rebasing relief.

In contrast, taking the alternative approach (as agreed by the professional bodies) with the same figures the $1.2 million represents:

- the $1 million of original income (£500,000); and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

That is £900,000 is brought in per the mixed fund analysis, which agrees to the value of the sterling amount transferred. Only £500,000 is taxable meaning the taxpayer benefits in full from the £400,000 rebasing relief.

Given this issue what should be done in these circumstances?

Suggested Answer

Provided a consistent year on year approach is taken for each individual mixed fund bank account analysis the conversion of Remittance Basis foreign income to sterling can take place either on the date the income arises or when the income is remitted.

Question 3

Whilst HMRC in its manuals states that income in a foreign currency should be translated to sterling using the foreign exchange spot rate on remittance this is not the case for gains as there is clear case law to the contrary (*Bentley v Pike [1981] STC 360, Capcount Trading v Evans [1993] STC 11*). As such, HMRC and practitioners agree on the position for gains.

How will rebasing work where just foreign chargeable gains were used wholly (or in part) to fund the acquisition?

Suggested Answer

This is best explained by way of an example.

Example

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) had $1 million within a bank account (this traced to the sale of an investment in 2009/10 and represented clean capital of £400,000 and Remittance Basis foreign chargeable gains of £200,000). The $1 million was re-invested in an asset. At 5 April 2017 the new foreign asset was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017. The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

The $1.2 million represents:

- the $1 million of original funds (£400,000 clean capital and £200,000 Remittance Basis foreign chargeable gains); and
- the £300,000 capital gain (that is £900,000 less £600,000).

That is £900,000 is brought to the UK per the mixed fund analysis, which agrees to the value of the sterling amount transferred.

SECTION B– THE OVER NOMINATION TRAP

Question 4

The way the legislation is worded (ITA 2007, Sch 8, Part 4, para 44 (5) for transfers of post 5 April 2008 funds and para 45(5) for transfers of pre-6 April 2008 funds) any over nomination (even as little as £1) can mean that a cleansing transfer fails, and the offshore transfer rules apply. As such, even an error that, for the purposes of tax return remittance computations would not be an issue, is disastrous for cleansing.

Getting a lengthy and complex mixed fund analysis completely correct is unlikely since there will be:

- hundreds/thousands of entries;
- remittances;

- offshore transfers between accounts;
- multiple share/security acquisitions and disposals; and
- various foreign currency transactions (multiple transfers between different foreign currency accounts and the potential for investments to be acquired in one currency, denominated in another and the proceeds paid into an account in a third currency).

The comments in the HMRC guidance, about what can be done where there has been an over nomination such that a cleansing transaction fails, are not helpful in this context.

In theory, where there is a failed transfer such that the original mixed fund and the new account are both mixed, both accounts can be cleansed if there is time prior to 6 April 2019. The problem is that the mixed fund analysis will have been prepared using best efforts and a realisation that there has been an over nomination is unlikely to happen in time for this second successful cleansing exercise.

What can be practically done to try to avoid this over nomination problem?

Suggested Answer

Practically, with the legislation being as unhelpful as it is, where there is a complex mixed fund analysis (meaning significant risk of an error, however small, having crept in) the only practical way forward is a conscious under nomination. For example, where clean capital is to be cleansed and the mixed fund analysis says that there is £3.45 million clean capital, deliberately reducing the amount transferred so the nomination is not too high.

[WOULD HMRC USE ITS CARE AND MANAGEMENT POWERS TO ALLOW A CLEANSING TRANSFER WHERE THE OVER NOMINATION IS LOWER THAN A CERTAIN AMOUNT – SAY £5,000?]

Question 5

A qualifying individual has a mixed fund account (account C) containing Remittance Basis income with no foreign tax credit, Remittance Basis gains with no foreign tax credit and clean capital. On 14 April 2018 she gives instructions to her bank to make the following cleansing transactions (the instructions for both transfers being given at the same time):

- £1 million of Remittance Basis income with no foreign tax credit to offshore account D; and
- £2 million of Remittance Basis gains with no foreign tax credit to offshore account E.

Whilst one transfer will be shown as going through first on the bank statement for account C this is purely due to the vagaries of the banking system.

What is the position if it subsequently turns out that the nominated amount of Remittance Basis income with no foreign tax credit was less than the actual amount of income in account C and the nominated amount of Remittance Basis gains with no foreign tax credit was more than the amount of gains in account C?

Suggested answer:

If the transfers are made on the same day with the transfer instruction being provided to the bank (or financial institution) at the same time, the transfer of the understated amount (here Remittance Basis income with no foreign tax credit) will be treated as made first (and will be a valid cleansing transaction). The transfer of the overstated amount (here Remittance

Basis gains with no foreign tax credit) will be treated as an offshore transfer (and not a valid cleansing transaction).
If the mistake is picked up, account C (the original account) and account E could be reanalysed and further cleansing transactions to further accounts could be made within the time limit.

<u>Question 6</u>

As stated above any over nomination (even just a £1 excess) is sufficient to mean that a cleansing transfer will fail. As such, where the rules are understood, nominations will be cautious. This will particularly be the case in lengthy and complex mixed fund analysis situations where, even when all reasonable care has been taken, the risk of errors is high due to the onerous and voluminous nature of the analysis work. This will mean that the original mixed fund account will remain mixed even when all the cleansing transfers have taken place.

Please confirm that cleansing transaction(s) and nomination(s) are valid where there have been <u>under</u> nominations and the original mixed fund account remains mixed when all the transfers have taken place?

Suggested answer

In such circumstances the cleansing transaction(s) and nomination(s) will be valid.

There is nothing in the legislation that states that for the cleansing transactions to be valid the original mixed fund account must be fully cleansed such that after the cleansing transactions it is no longer a mixed account.

Example

An individual has a mixed fund offshore account (account C). The individual knows that the account was opened initially with £10 million of clean capital but is not sure about other receipts. The mixed fund analysis is, therefore, carried out on the basis that all the other receipts are Remittance Basis income with no foreign tax credit. Having carried out the analysis on this basis there is £7.8 million of clean capital as at 29 July 2018. To be cautious £7.5 million is transferred out to newly established offshore account D and the appropriate nomination made for the clean capital (ITA 2007, s 809Q(4)(i)). The remaining contents of account C are unknown. This is not an issue.

Example

An individual has a mixed fund account (account C) and analysis breaks it down as:

- £1.2 million Remittance Basis relevant foreign income not subject to a foreign tax;
- £2.7 million Remittance Basis foreign gains not subject to a foreign tax; and
- £3.3 million clean capital (inheritances and gifts).

All funds arising <u>after</u> 5 April 2008.

The analysis goes back 8 years with thousands of transfers out or between accounts. The individual, therefore, wants to be cautious with cleansing transfers to avoid any risk of over nominations. Three new accounts are opened (accounts B, C and D) and the following cleansing transfers and nominations are made in 2018/19:

- £1 million to account D - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £1 million transferred to account D representing income within ITA 2007, s 809Q(4)(d) (that is relevant foreign income other than income within paragraph (g)).
- £2.5 million to account E - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £2.5 million transferred to account E representing gains within ITA 2007, s 809Q(4)(e) (that is foreign gains other than gains within paragraph (h)).
- £3 million to account F - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £3 million transferred to account F representing income within ITA 2007, s 809Q(4)(i).

The three nominations are valid. Account C remains mixed containing (in accordance with the analysis):

- £200K of relevant foreign income not subject to a foreign tax;
- £200K foreign gains not subject to a foreign tax; and
- £300K clean capital (inheritances and gifts).

SECTION C – ACCOUNTS WITH PRE-6 APRIL 2008 FUNDS

Para 89 Schedule 7 of FA 2008 states: "Sections 809Q to 809S of ITA 2007 (transfers from mixed funds) do not apply for the purposes of determining whether income or chargeable gains for the tax year 2007-08 or any earlier tax year are remitted to the United Kingdom (or the amount of any such income or chargeable gains so remitted)." There are some common law matching rules in place for mixed funds pre-6 April 2008 (such as for remittances from a mixed fund account). These are drawn from case law. There is, however, no case law that deals with offshore transfers.

For the purposes of the cleansing legislation, Finance (No 2) Act 2017, sch 8 para 46 provides two prescriptive mixed fund analysis rules as follows:

1) There has been a transfer of money before 6 April 2008 from <u>the mixed fund</u> to another overseas account (para 46(2)).
2) A transfer of money is made before 6 April 2008 from another overseas account to <u>the mixed fund</u> and there is insufficient evidence to determine the composition of the transfer (para 46(6)).

<u>Question 7</u>

Advisers had no way of knowing about the Finance (No 2) Act 2017, sch 8, para 46 rules prior to March 2017 (when the rules were published in the Finance Bill, although the Snap General Election caused them to be dropped and re-introduced such that they were enacted in November 2017 in Finance (No 2) Act 2017).

Where there are accounts dating back to pre-6 April 2008 and mixed fund analysis was performed prior to March 2017 it is very likely that a different methodology would have been used for the analysis and may have been agreed with HMRC (for example as part of a LDF settlement).

The mixed fund analysis performed, which is likely to be extremely complex and onerous (not to mention expensive in terms of professional time) if not impossible to re-do (as the records may no longer be available), will not be in line with the cleansing legislation. This issue is fundamental since (as discussed in section B above) an over-nomination invalidates the cleansing transactions.

What are taxpayers and advisers supposed to do in these circumstances?

Suggested answer

The statutory rules introduced in Finance (No 2) Act 2017, sch 8 para 46 were enacted to assist taxpayers and advisers where no mixed fund analysis had been performed prior to 20 March 2017 (when the rules were published).

Where no mixed fund analysis was performed prior to 20 March 2017, the statutory rules need to be followed.

There was, however, no intention to inconvenience taxpayers where a mixed fund analysis was carried out prior to 20 March 2017. Such individuals <u>do not</u> have to re-do their mixed fund analysis. Where the mixed fund analysis has been agreed by HMRC the taxpayer can have confidence that the methodology used for pre-6 April 2008 offshore transfers will not be challenged. In all other cases there will not be an issue provided what has been done is reasonable and followed consistently.

<u>Question 8</u>

Does the reference in the legislation to "the mixed fund" in para 46(2) purely refer to the account being cleansed such that the legislative rules above do not apply for pre-6 April 2008 offshore transfers between two mixed funds i.e. does the reference to "another overseas account" in para 46(2) include a mixed fund account or not?

Suggested Answer

There is nothing in the legislation that suggests that the reference to "another overseas account" must be a reference to an account which is not a mixed fund. Indeed, the second rule specifically suggests that the transfer from the other overseas account to the mixed fund is a transfer between different mixed fund accounts since para 46(7-9) suggests there could be income and gains in the other account.

<u>Question 9</u>

As mentioned above, for the purposes of the cleansing legislation, Finance (No 2) Act 2017 para 46 provides prescriptive mixed fund analysis rules in the following situations:

- there has been a transfer from the mixed fund to an overseas account before 6 April 2008 (para 46(2)); and
- there has been a transfer from an overseas account to a mixed fund before 6 April 2008, but only where you did not know the composition of the funds transferred (para 46(6)).

The rules only deal with situations prior to 6 April 2008. It is not clear what should happen where there are offshore transfers of pre-6 April 2008 funds after 5 April 2008.

Suggested Answer

The statutory mixed fund rules only apply to post 5 April 2008 funds. As such, one would look to apply the common law rules in this situation. However, as mentioned there are none.

For consistency, where a mixed fund analysis has been carried out prior to 20 March 2017, whatever non-statutory pre-6 April 2008 methodology has been used for pre-6 April 2008 offshore transfers should continue to be followed for post 5 April 2008 offshore transfers of pre-6 April 2008 funds.

Where a mixed fund analysis has not been carried out prior to 20 March 2017 such that the statutory rules are followed for pre-6 April 2008 offshore transfers either of the following approaches should be followed consistently where there are post 5 April 2008 offshore transfers relating to pre-6 April 2008 funds:

- the statutory rules should continue to be followed for consistency; or
- since there is a lacuna in the legislation it would be reasonable to carry out the analysis on the basis that each transfer takes across a proportionate amount of the various different categories of pre-6 April 2008 funds within the mixed fund account.

Question 10

Where a mixed fund analysis for cleansing purposes involving pre-6 April 2008 funds is carried out what how should the analysis be performed:

a) where an analysis was carried out prior to 20 March 2017; and
b) where no analysis has been performed prior to 20 March 2017?

Suggested Answer

a) Where an analysis was carried out prior to 20 March 2017:

- for pre-6 April 2008 funds the common law rules for remittances and onshore transfers;
- for pre-6 April 2008 offshore transfers there are no common law rules provided the methodology used to deal with offshore transfers is reasonable and followed consistency it will not be challenged (see questions 7 and 9) and
- for post 5 April 2008 funds the statutory rules within ITA 2007, ss 809Q and 809R.

b) Where no analysis has been performed prior to 20 March 2017:

- for pre-6 April 2008 remittances and onshore transfers the common law rules and the Finance (No 2) Act 2017, sch 8, para 46 rules for offshore transfers;
- for transfers (remittances or offshore transfers) of pre-6 April 2008 funds after 5 April 2008 the common law rules should be followed for remittances. For offshore transfers either of the approaches outlined in the answer to question 9 should be followed consistently; and
- for post 5 April 2008 funds the statutory rules within ITA 2007, ss 809Q and 809R.

See FAQ 16 for a question on cleansing and the Finance Act 2008, Sch 7, para 86 transitional provisions with respect to relevant foreign income.

SECTION D- MEANING OF ACCOUNT

Question 11

The legislation specifies that for cleansing to take place there must be a transfer from one offshore account (referred to as account A) to another offshore account (referred to as account B).

Many offshore banks establish a portfolio for a client with a number of different sub-accounts within one portfolio. For mixed fund purposes sub-accounts count as different bank accounts. It is, therefore, possible for one sub-account to be the mixed fund transferor account for cleansing purposes (sub-account C) with another sub-account being the transferee account (sub-account D). Can this be confirmed?

Suggested Answer

Yes, cleansing can take place between sub-accounts either within the same portfolio reference or within different portfolio references.

Question 12

Where an individual has an investment portfolio it is common that it is linked to various accounts (capital and income accounts in various relevant currencies).

Assuming the mixed fund definition at ITA 2007, s 809R(4) is met, there are two ways of going about the mixed fund analysis:

First approach

- each account (or sub-account) is treated as a separate mixed fund; and
- each individual asset held within the investment portfolio is treated as a separate mixed fund.

Second approach

An investment portfolio and the associated accounts (or sub-accounts) are treated as a single mixed fund.

Strictly the legal nature of the relationship with the bank /fund manager determines the approach to use.

a) In practise is it accepted that, provided the approach is followed consistently with respect to the investment portfolio and all linked accounts, either of the two approaches set down above will be valid for mixed fund analysis and cleansing purposes?
b) Assuming the above is accepted, how does cleansing differ between the two approaches?

Suggested Answer

a) Provided the approach is followed consistently with respect to the investment portfolio and all linked accounts either analysis will be valid for mixed fund and cleansing purposes.
b) Where the first approach is taken, there are multiple mixed funds as:

    - each account (or sub-account) is treated as a separate mixed fund; and
    - each individual asset held within the investment portfolio is treated as a separate mixed fund.

    The accounts (or sub-accounts) can be cleansed separately. To cleanse individual investments the investments would have to be sold. Cleansing all the investments would necessitate the disposal of all the investments.

The position is different where the second approach is taken since the investment portfolio and the associated accounts (or sub-accounts) are treated as a single mixed fund. The cleansing legislation is clear that cleansing transfers have to be transfers of cash. However, it does not say anything about the offshore mixed fund account having to be entirely in cash. As such, if the mixed fund analysis established that there is £2.67 million of clean capital, disposals could occur so as to realise £2.6 million for a prudent cash transfer to a new unconnected account. Everything else could remain invested.

Example

Chuck is a UK resident foreign domiciliary who meets the cleansing conditions.

He has a substantial investment portfolio (all offshore assets) with linked offshore accounts. There is no segregation of income and income and gains are constantly reinvested.

His mixed fund analysis is carried out on the basis that

- each account (or sub-account) is treated as a separate mixed fund; and
- each individual asset held within the investment portfolio is treated as a separate mixed fund.

He wants to cleanse his Microsoft, Apple and Facebook shares as they contain significant levels of clean capital (£5.4 million). As such he sells the shares, pays the proceeds into new account C and then carries out the cleansing transaction.

It would be different if the mixed fund analysis had been carried out on the basis that the investment portfolio and the associated accounts (or sub-accounts) were treated as a single mixed fund. In this case there might be £5.65 million of clean capital in total. Being prudent Chuck may decide to transfer out £5.5 million and would consider what the best way (from an investment perspective) of realising the necessary cash would be. The £5.5 million realised would be paid into an empty linked account and then transferred to a new offshore account with no connection to the portfolio or the linked accounts.

SECTION E – MIXED FUND ANALYSIS AND CLEANSING

<u>Question 13</u>

The derivation rules mean that the total of the various kinds of income and capital can be more than the value of the mixed fund. This can occur for various reasons such as:

- how the derivation rules work, for example where £1 million of Remittance Basis relevant foreign income, £1 million of Remittance Basis relevant foreign earnings and £0.5 million of clean capital are used to acquire) an offshore property (total cost £2.5 million) and that property is then sold at a loss for £2 million;
- the interaction with anti-avoidance rules like s13 TCGA.

How do the mixed fund rules and cleansing work in such a situation?

Suggested Answer

The various issues surrounding mixed funds and losses are considered in detail in the FAQs in section G, which consider various possible situations.

In the example in the question the funds used to acquire the property break down into Remittance Basis income and clean capital, as follows:

	Amount	%
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£1.0 million	40%
Relevant foreign earnings - – ITA 2007, s 809Q(4)(b)	£1.0 million	40%
Clean capital – ITA 2007, s 809Q(4)(i)	£0.5 million	20%
	£2.5 million	

The property is sold for £2 million, so we have a loss of £0.5 million and nothing in the legislation to assist in terms of how this loss should be treated. Applying just and reasonable methodology one would proportionally reduce each category of income and capital as follows:

	Acquisition Cost	Reductions	Proceeds
Relevant foreign income	£1.0 million	£0.2 million	£0.8 million*
Relevant foreign earnings	£1.0 million	£0.2 million	£0.8 million*
Clean capital	**£0.5 million**	**£0.1 million**	**£0.4 million**
	£2.5 million	£0.5 million	£2 million

*Whilst the above is a necessary first step as it deals with the loss, the allocation above cannot be the final position. This is because it is not in accordance with the derivation rules for income and chargeable gains in ITA 2007, Part 14, Chapter A1, which make it clear that such amounts cannot be reduced. This means that for mixed fund analysis purposes there is:

	Amount
Relevant foreign income	£1.0 million
Relevant foreign earnings	£1.0 million
Clean capital	**£0.4 million**
	£2.4 million

That is, the aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.4 million higher than the actual £2 million proceeds figure.

The £0.4 million of clean capital can be cleansed.

More complex example

Initially a painting is acquired for £4.8 million:

	Amount	%
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£1.2 million	25%
Foreign gains – ITA 2007, s 809Q(4)(e)	£1.2 million	25%
Clean capital – ITA 2007, s 809Q(4)(i)	£2.4 million	50%
	£4.8 million	

The painting is sold for £3.6 million realising a loss of £1.2 million.

Step 1 – proportionally allocate out the £1.2 million loss.

	Acquisition Cost	Reductions	Proceeds
Relevant foreign income	£1.2 million	£0.3 million	£0.9 million
Foreign gains	£1.2 million	£0.3 million	£0.9 million
Clean capital	**£2.4 million**	**£0.6 million**	**£1.8 million**
	£4.8 million	£1.2 million	£3.6 million

Step 2 – adjust the step 1 result as the derivation rules mean that the income and gains figures cannot be reduced.

	Amount
Relevant foreign income	£1.2 million
Relevant foreign earnings	£1.2 million
Clean capital	**£1.8 million**
	£4.2 million

That is, the aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.6 million higher than the actual proceeds figure.

The proceeds are paid into a new offshore account (C) and then reinvested in shares. The shares are sold on 19 May 2018 for £4.4 million and the proceeds paid into account C (which contains no other funds). A Remittance Basis gain of £0.8 million is realised on the sale (£4.4 million less £3.6 million). As such, for mixed fund analysis purposes there is:

	Funds Re-invested	Remittance Basis Gain	Amount
Relevant foreign income	£1.2 million		£1.2 million
Foreign gains	£1.2 million	£0.8 million	£2.0 million
Clean capital	**£1.8 million**		**£1.8 million**
	£4.2 million	£0.8 million	£5 million

That is, again as a result of the derivation rules, the mixed fund analysis aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.6 million higher than the actual proceeds figure paid into account C.

The £1.8 million of clean capital can be cleansed.

The £2 million of foreign gains could also be cleansed (since the current CGT rates are much lower than the Income Tax rates this might be felt to be worthwhile).

Question 14

How do you carry out a mixed fund analysis where an individual has shares/securities of the same class in more than one portfolio?

Suggested Answer

Unless the portfolios mirror each other such that the amount taken from each account to acquire the investments is the same as the CGT base cost amount (TCGA 1992, s 104), there are significant mixed fund issues where shares/securities of the same class are held in more than one portfolio. This is because the TCGA 1992, s 104 legislation provides that all shares/securities of the same class that were acquired by an individual in the same capacity are pooled for base cost purposes (provided the 30 day or same day rules do not apply). As such, the base costs used for the CGT computations will be different (possibly significantly so) to the amount used to acquire the shares/securities.

We would strongly suggest that to avoid complexity, shares/securities of the same class are <u>not</u> held in more than one portfolio.

However, it is likely that not realising the issues, a number of taxpayers will have shares/securities of the same class in more than one investment portfolio. If the client wants to cleanse it will be necessary to carry out a mixed fund analysis taking this issue into account. This additional problem will make a mixed fund analysis in a real example extremely complex and even more time consuming. Depending on the numbers the divergence between the base cost and the amount used from the mixed fund account to make the purchases could result in significant additions to or depletions from the ITA 2007, s 809Q(4)(i) "other" category. In basic terms clean capital could either be created or depleted.

The following is a simplified example to illustrate the point (the acquisition and sales proceeds figures have been specifically chosen such that large gains and losses result in order to show what a significant difference this issue can make to the mixed fund analysis).

Example

Kurt is a UK resident foreign domiciliary.

<u>On 15 June 2011</u> he paid a £5 million inheritance (received in 2011/12) into account C with XYZ Offshore Bank. He used this £5 million to acquire £1 million shares in Raven Inc (£5 per share). These shares were kept within an investment portfolio with XYZ Offshore Bank with a linked sterling account.

Kurt already held shares in Raven Inc in a mixed fund portfolio with LMN Offshore Fund Manager. The 2 million shares <u>had been acquired in 2008/2009</u> for £3.50 per share using £7 million of funds representing Kurt's 2008/09 Remittance Basis relevant foreign earnings.

Raven Inc operates in a volatile sector, but Kurt feels he has specialist knowledge of the sector and that he can make a profit from investing in the shares despite the volatility.

<u>On 19 October 2014</u> Kurt sold 1 million of the Raven Inc shares in his LMN Offshore Fund Manager portfolio for £8 per share.

His base cost per share must take both portfolio holdings into account so is £4 ((£5 million + £7 million) / 3 million).

Kurt is a Remittance Basis User in 2014/15. Proceeds of £8 million are received. This breaks down as:

- £3.5 million traceable to Kurt's 2008/09 Remittance Basis relevant foreign earnings (that is 50% of the original £7 million used to acquire the holding of which half has been sold);

- £4 million 2014/15 Remittance Basis chargeable gain (proceeds of £8 million less base cost of £4 million); and
- £0.5 million – 2014/15 "other" ITA 2007, s 809Q(4)(i) - arisen as the operation of TCGA 1992, s 104 results in a £4 million Remittance Basis Chargeable Gain rather than the £4.5 million gain that would have arisen if pooling was not necessary and the actual amount used from LMN Offshore Fund had been the base cost. As the amount falls into s 809Q(4)(i) it is effectively an addition to clean capital.

Just over a year later, on 24 November 2015 Kurt acquired a further 1 million shares in Raven Inc in his LMN Offshore Fund Manager portfolio paying £2 per share (this was a low price for the shares and Kurt was confident that they would recover).

Kurt reinvested £2 million of the £8 million he received. This is an offshore transfer:
(i) investment 25%; and (ii) kept in cash 75%.

24 November 2015 acquisition	**New Investment - 1 million holding Raven Inc shares - 25% offshore transfer**	**Bank account 75%**
2008/09 Remittance Basis relevant foreign earnings	£875,000	£2,625,000
2014/15 Remittance Basis chargeable gain	£1 million	£3 million
2014/15 "other" ITA 2007, s 809Q(4)(i)	£125,000	£375,000

The original unsold 1 million Raven Inc shares in his LMN Offshore Fund Manager portfolio represented £3.5 million of 2008/09 Remittance Basis relevant foreign earnings.

On 5 October 2017 Kurt sold his entire 1 million Raven Inc shares holding in his XYZ Offshore Bank portfolio for £4.50 per share.

Again, Kurt's base cost per share must take both portfolio holdings into account, so is £3.50 ((£5 million + £3.5 million + £2 million) / 3 million). The base cost of the 1 million shares sold is, therefore, £3.5 million.

Kurt is a Remittance Basis User in 2017/18. Proceeds of £4.5 million are received, the base cost for the £1 million shares is £3.5 million (as calculated above). From a CGT perspective, because of the operation of TCGA 1992, s 104, a £1 million gain has been realised (Remittance Basis no foreign tax credit).

If pooling were not necessary and the actual amount used from XYZ Investment Bank had been used as the base cost there would have been a £0.5 million loss. There is, therefore, a mixed fund analysis issue, since the funds within the bank account are £1.5 million less than the funds used to acquire the shares and the chargeable gain.

The situation here is different to that in question 13 but again we have a situation where there is £1.5 million less in the mixed fund and nothing in the legislation to assist in terms of how this diminution should be treated. Applying the same just and reasonable methodology as in question 13:

Step 1 – proportionately allocate out the £1.5 million across the original clean capital used to acquire the shares and the Remittance Basis gain on the sale of the shares:

	Amounts Per Category	%	Reduction	Proceeds
Clean Capital	£5 million	83.33%	£1.25 million	£3.75 million
Remittance Basis Gain	£1 million	16.67%	£0.25 million	£0.75 million
	£6 million		£1.5 million	£4.5 million

Step 2 – adjust the step 1 result as the derivation rules mean that the gains figure cannot be reduced.

	Amounts Per Category
Clean Capital ITA 2007, s 809Q(4)(i)	£3.75 million
Remittance Basis Gain ITA 2007, s 809Q(4)(e)	£1.00 million
	£4.75 million

That is, again as a result of the derivation rules, the mixed fund analysis aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is higher (in this case £0.25 million higher) than the actual proceeds figure.

<u>On 19 February 2018</u> Kurt uses £4.25 million of the £4.5 million within his XYZ Offshore Bank account to acquire 600,000 shares in Raven Inc. This is an offshore transfer: (i) investment 94.4%; and (ii) kept in cash 5.6%.

<u>On 31 May 2018</u> Kurt sells the 2 million shares in Raven Inc within his LMN Offshore Fund Manager portfolio for £11 per share.

His base cost per share must take both portfolio holdings into account, so is £3.75 ((£4.25 million + £3.5 million + £2 million) / 2.6 million). The base cost of the 2 million shares sold is, therefore, £7.5 million.

Kurt is a Remittance Basis User in 2018/19. Proceeds of £22 million are received and paid into the same LMN Offshore Fund Manager account as the funds not reinvested from the first sale. The £22 million proceeds breaks down as:

- £ 4,375,000 (£875,000 + £3.5 million) traceable to Kurt's 2008/09 Remittance Basis relevant foreign earnings;
- £1,000,000 2014/15 Remittance Basis chargeable gain;
- £125,000 2014/15 "other" ITA 2007, s 809Q(4)(i);
- £14.5 million (£22 million less £7.5 million) 2018/19 Remittance Basis chargeable gain;
- £2 million 2018/19 "other" ITA 2007, s 809Q(4)(i) - arisen as the operation of TCGA 1992, s 104 results in a £14.5 million Remittance Basis Chargeable Gain rather than the £16.5 million gain that would have arisen if pooling was not necessary and the actual amount used from the LMN Offshore Fund Portfolio account had been the base cost. As the amount falls into s 809Q(4)(i) it is effectively an addition to clean capital.

Note that the LMN Offshore Fund Portfolio account could be cleansed prior to 6 April 2019 and the total £2.5 million ITA 2007, s 809Q(4)(i) "other" (the £375,000 kept in the account and the £125,000 and £2 million above) transferred to a new "clean capital account".

Question 15

The legislation at ITA 2007, s 809Q(4) sets out the following types of income, gains and (in the last category) capital. These are:

a) employment income (other than income within paragraph (*b*), (*c*) or (*f*)),

b) relevant foreign earnings (other than income within paragraph (*f*)),

c) foreign specific employment income (other than income within paragraph (*f*)),

d) relevant foreign income (other than income within paragraph (*g*))

e) foreign chargeable gains (other than chargeable gains within paragraph (*h*)),

f) employment income subject to a foreign tax,

g) relevant foreign income subject to a foreign tax,

h) foreign chargeable gains subject to a foreign tax, and

i) income or capital not within another paragraph of this subsection

A number of these categories can include different types of income or gains some of which are more favourable to remit than others, for example:

- employment income subject to different levels of foreign tax (say a Swiss employment and a German employment);
- relevant foreign income relating to different jurisdictions, so subject to different levels of foreign tax;
- Remittance Basis foreign chargeable gains that have been offset by foreign losses (TCGA 1992, 16ZC(2))
- foreign chargeable gains subject to different levels of foreign tax (either because they relate to property in different jurisdictions or because the jurisdiction has special rules such that no all disposals are taxed at the same level);
- foreign chargeable gains that can benefit from Entrepreneurs' Relief;
- foreign chargeable gains on a second residential property and/or carried interest (taxed in the UK at 18%/28%) and all other chargeable gains (taxed in the UK at 10%/20%);
- gains attributed to beneficiaries from offshore trusts with different levels of supplementary charge; and
- gains attributable to a foreign domiciled beneficiary from an offshore trust where the Finance Act 2008 transitional provisions are in point (matching to pre-6 April 2008 gains or pre-6 April 2008 capital payments).

Assuming there is a mixed fund, in addition to cleansing with respect to the different categories of income, gains and capital within s 809Q(4) is it possible to cleanse within the actual (a) to (i) categories?

Suggested Answer

Cleansing specific categories of s 809Q(4) income or gains according to tax year is allowed. As such if the different types of funds within any individual category relate to different tax years they could be cleansed because of this.

The cleansing legislation does not specifically deal with circumstances where the different types of funds within any individual category relate to the same tax year. However, the mixed fund rules do acknowledge that there can be different type of income or gains within the same category (ITA 2007, s 809Q(1) Step 2:

Step 2 Find the earliest paragraph for which the amount determined under step 1 is not nil.

If that amount does not exceed the amount of the transfer, treat the transfer as containing the amount of income or capital within that paragraph (and for that tax year):

Otherwise, treat the transfer as containing the relevant proportion of each kind of income or capital within that paragraph (and for that tax year).

"The relevant proportion is the amount of the transfer divided by the amount determined under step 1 for that paragraph.

Given that the mixed fund rules do deal with different kinds of income or capital within a category[1] cleansing within specific ITA 2007, s 809Q(4)(a) to (i) categories is allowed.

Example

Yvette is a UK resident foreign domiciliary. She has an offshore account (account C) that she uses for the proceeds from foreign gains. The original funding came from clean capital and she has then reinvested proceeds into other assets (property and shares).

Yvette also paid into the account a carried interest gain and the gain on the sale of her 100% owned French company (again initial clean capital funding and sufficient profits were made after that to not need any further injections of cash from her).

Yvette qualifies for cleansing and she decides that she would like to cleanse her mixed fund account as fully as possible (though she does not want to sell any property as she does not feel it is the right time). Immediately prior to the cleansing the fund contains:

- £11.33 million clean capital - ITA 2007, s 809Q(4)(i);
- £4.2 million Remittance Basis foreign chargeable gains with no foreign tax credit on the sale of various residential properties that she had let out - ITA 2007, s 809Q(4)(e);
- £0.5 million exempt gain with respect to one of the properties she let out that qualifies for some principal private residence relief and also letting relief as it was her only residence immediately prior to her coming to the UK - ITA 2007, s 809Q(4)(i);
- £1.67 million Remittance Basis foreign carried interest gain with no foreign tax credit - ITA 2007, s 809Q(4)(e);
- £1.85 million Remittance Basis foreign gains on share disposals with no foreign tax credit - ITA 2007, s 809Q(4)(e); and
- £3.75 million Remittance Basis foreign gain on the sale of her trading company where the gain qualifies for Entrepreneurs' Relief (ER) - ITA 2007, s 809Q(4)(e).

[1] The legislation uses paragraph as it is specifically referencing ITA 2007, s 809Q(4)(a) to (i).

Yvette is an additional rate taxpayer. She arranges for three new offshore accounts to be set up:

- Account D – for the ITA 2007, s 809Q(4)(i) clean capital (that is the £11.33 million within the account which traces back to the original funding and the £0.5 million exempt gain resulting from principal private residence and letting relief).
- Account E – for the ER gain
- Account F – for the share disposal gains that, since she is an additional rate taxpayer, will be taxed at 20%.

She makes prudent cleansing transfers to each account leaving a buffer in account C to protect against the over-nomination risk.

The gains that will be taxed at 28%:

- the £1.67 million carried interest gain; and
- the £4.2 million Remittance Basis foreign chargeable gains with no foreign tax credit on the sale of various residential properties that she had let out

are left within account C together with the buffer amounts discussed above.

Example

Franco is a UK resident foreign domiciliary. He has an offshore account (account C) that contains a mixture of clean capital, Remittance Basis relevant foreign income with no tax credit and Remittance Basis relevant foreign income with a 15% tax credit.

Franco qualifies for cleansing and he decides that he would like to cleanse his mixed fund account as fully as possible. Immediately prior to the cleansing the fund contains:

- £1.67 of million clean capital - ITA 2007, s 809Q(4)(i);
- £320,000 of Remittance Basis relevant foreign income with no tax credit - ITA 2007, s 809Q(4)(d); and
- £165,000 of Remittance Basis relevant foreign income with a 15% tax credit - ITA 2007, s 809Q(4)(g).

Franco arranges for two new offshore accounts to be set up:

- Account D for the clean capital; and
- Account E for the Remittance Basis relevant foreign income with a 15% tax credit.

He makes prudent transfers to each account leaving a buffer in account C to protect against the over-nomination risk. Account C is left with the Remittance Basis relevant foreign income with no foreign tax credit and the buffer funds.

Note that in all the cases above there are different categories of gains and clean capital over various years, that is: there is a mixed fund as defined in the ITA 2007, s 809Q legislation. It is highly unlikely that there will ever be an account with just one ITA 2007, s 809Q(4) category of funds all relating to the same tax year. <u>*If this were the case there would not be a mixed fund so cleansing of different types of funds within the same category could not take place.*</u> *To cleanse such an account, a practical solution would be to transfer the funds in the account into another account where the composition was such that there was already or would be a mixed fund and cleansing could then happen.*

Question 16

Finance Act 2008, Sch 7 made fundamental changes to the regime for taxing foreign domiciliaries. The following transitional provisions with respect to relevant foreign income were introduced by para 86:

- *Section 809L of ITA 2007 (meaning of "remitted to the United Kingdom") has effect subject to this paragraph.*

- *If, before 6 April 2008, property (including money) consisting of or deriving from an individual's relevant foreign income was brought to or received or used in the United Kingdom by or for the benefit of a relevant person, treat the relevant foreign income as not remitted to the United Kingdom on or after that date (if it otherwise would be regarded as so remitted).*

- *If, before 12 March 2008, property (other than money) consisting of or deriving from an individual's relevant foreign income was acquired by a relevant person, treat the relevant foreign income as not remitted to the United Kingdom on or after 6 April 2008 (if it otherwise would be regarded as so remitted).*

- *Subject to sub-paragraphs (2) and (3), in relation to an individual's income and chargeable gains for the tax year 2007-08 or any earlier tax year, section 809L has effect as if the references to a relevant person were to the individual.*

[(4A) For the purposes of sub-paragraph (4), section 648(2) to (5) of ITTOIA 2005 (and corresponding earlier enactments) do not apply (so that relevant foreign income which arose under a settlement in the tax year 2007-08 or any earlier tax year is to be treated as income for the tax year in which it arose).][1]

- *"Money" has the same meaning as in section 809Y of ITA 2007.*

Amendments--

[1] Sub-s (4A) inserted by FA 2009 s 51, Sch 27 para 14 with effect for the tax year 2008-09 and subsequent tax years.

What is the position when carrying out a mixed fund analysis if either Finance Act 2008, sch 7, para 86 (2) or para 86(3) applies to funds?

What would such funds be characterised as for nomination purposes?

Suggested Answer

The transitional provisions effectively re-characterise the relevant foreign income such that it becomes clean capital.

For nomination purposes the funds are characterised as pre-6 April 2008 income or capital not subject to tax on remittance.

Example

Ivan is a UK resident foreign domiciliary. He came to the UK in 2000. He had a significant offshore share portfolio when he came and all income and proceeds from sales were invested in shares. As such, prior to 12 March 2008 almost all the relevant income within the portfolio had been invested (and is so within para 86(3)).

Ivan continues in the same vein after 12 March 2008. In 2018 he requires additional funds as he needs to acquire a larger property. He qualifies for cleansing and decides to carry out a cleansing exercise on 5 November 2018.

Ivan decides that he wants to remit to the UK all the funds he can where there will be no additional tax charge (though leaving a buffer to safeguard against any inadvertent mistakes in the lengthy and complex mixed fund analysis) and that he will leave everything else in the mixed fund account and invest as before. He, therefore, liquidates his portfolio and all his funds are within the one mixed fund offshore account (account C). The account consists of:

- £8.3 million pre-arrival clean capital (pre-6 April 2008 funds as he arrived in the UK in 2000) – pre-6 April 2008 income or capital not subject to tax on remittance
- £3.7 million of relevant foreign income that had been invested in shares prior to 12 March 2008 - pre-6 April 2008 income or capital not subject to tax on remittance;
- £2.1 million of post 5 April 2008 Remittance Basis relevant foreign income (no foreign tax credit) - ITA 2007, s 809Q(4)(d);
- £2.4 million of Remittance Basis chargeable gains (no foreign tax credit) - pre-6 April 2008 foreign chargeable gains no foreign tax credit
- £3.6 million of post 5 April 2008 Remittance Basis chargeable gains (no foreign tax credit) - ITA 2007, s 809Q(4)(e).

If Ivan were to transfer all the funds that per the analysis fall into clean capital he would transfer £12 million (the £8.3 million pre-arrival clean capital plus the £3.7 million of relevant foreign income that had been invested in shares prior to 12 March 2008). He decides to transfer £11.75 million to new offshore account D (leaving a £250,000 buffer).

For nomination purposes the entire transfer relates to pre-6 April 2008 income or capital not subject to tax on remittance. There is no need to refer to the different nature of the funds though this can be done if desired.

<u>Question 17</u>

How should Arising Basis foreign income and gains be included in a mixed fund analysis and how does this feed into cleansing?

Suggested Answer

There is no specific category within ITA 2007, s 809Q(4) for either foreign income or foreign gains taxed on the Arising Basis.

Going through the categories that are within ITA 2007, s 809Q(4) strictly foreign income or foreign gains taxed on the Arising Basis should be characterised in the same way as Remittance Basis foreign income or gains for the purposes of a mixed fund analysis, as the categories are not limited to Remittance Basis income and gains. However, since these funds can be remitted to the UK without additional tax, where mixed fund analysis work has been carried out it is highly likely that Arising Basis foreign income and/or gains would have been classified along with clean capital under the ITA 2007, s 809Q(4)(i) category. This pragmatic method of classification made no difference to the analysis and it is, therefore, accepted that provided the methodology is followed consistently in the mixed fund analysis nominations can be made grouping together both clean capital and Arising Basis foreign income and gains under the 809Q(4)(i) category.

__Example – mixed fund analysis carried out on the strict basis__

For cleansing purposes it is possible to cleanse s 809Q(4) kinds of income and capital per tax year. As such, where a mixed fund contains Remittance Basis and Arising Basis income and gains the income and gains in the Arising Basis year can be cleansed as per the following example.

Account C contains the following:

- £1 million of 2012/13 Remittance Basis relevant foreign earnings (not subject to a foreign tax);
- £400,000 of 2012/13 Remittance Basis foreign chargeable gains (not subject to a foreign tax);
- £225,000 of 2012/13 Remittance Basis relevant foreign income (not subject to a foreign tax)
- £100,000 of 2013/14 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2013/14 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £150,000 of 2014/15 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £60,000 of 2014/15 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £100,000 of 2015/16 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2015/16 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £2.5 million of 2016/17 Remittance Basis foreign chargeable gains (not subject to a foreign tax);
- £750,000 of 2016/17 Remittance Basis relevant foreign income (not subject to a foreign tax).

The decision is made to cleanse the Arising Basis income and gains. That is to cleanse:

- £100,000 of 2013/14 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2013/14 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £150,000 of 2014/15 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £60,000 of 2014/15 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £100,000 of 2015/16 Remittance Basis foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2015/16 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;

A new offshore bank account (account D) is opened and £510,000 transferred across from account C to account D. The following nominations are made:

- £100,000 of 2013/14 of ITA 2007, s 809Q(4)(e) funds;
- £50,000 of 2013/14 of ITA 2007, s 809Q(4)(d) funds;

- £150,000 of 2014/15 of ITA 2007, s 809Q(4)(e) funds;
- £60,000 of 2014/15 of ITA 2007, s 809Q(4)(d) funds;
- £100,000 of 2015/16 of ITA 2007, s 809Q(4)(e) funds; and
- £50,000 of 2015/16 of ITA 2007, s 809Q(4)(d) funds.

Example – mixed fund analysis carried out on the pragmatic basis

Mixed offshore account C has been in existence for many years and there have been many entries. It was decided to cleanse the account.

Just prior to the cleansing, the account contained the following:

- £3.6 million of Remittance Basis relevant foreign earnings (not subject to a foreign tax);
- £0.4 million of Remittance Basis foreign chargeable gains (not subject to a foreign tax);
- £2.4 million of Remittance Basis relevant foreign income;
- £5.75 million inheritance;
- £1.3 million Arising Basis relevant foreign income; and
- £0.5 million of Arising Basis gains.

It was decided to remove most of the funds that could be brought into the UK tax free from the mixed fund account into a new account (a buffer was left in the mixed fund account in case there were any issues with the analysis since it was so long). A £7 million (being £5.75m + £1.3m + £0.5m less a buffer from each) transfer occurred with the nomination referring to ITA 2007, s 809Q(4)(i) funds.

Question 18

How should the following be recorded for mixed fund and cleansing purposes?

- the part of the gain that is not taxable as a result of Finance (No 2) Act 2017, Sch 8, Part 3 rebasing relief; and
- foreign non-chargeable gains such as:
    - the non-taxable gain on the sale of a residential property as a result of principal private residence relief (and possibly also letting relief; and
    - foreign currency gains realised on withdrawals from accounts post 5 April 2012 (the legislation changed such that these gains were no longer taxable.

Suggested Answer

Such amounts do not fall into any of ITA 2007, s 809Q(4)(a) to (h) categories. As such, they fall within ITA 2007, s 809Q(4)(i), income or capital not within any other paragraph of ITA 2007, s 809Q(4).

Example

Bernadette is a UK resident foreign domiciliary. She became deemed domiciled in 2017/18. On 15 April 2018 she sold a set of five valuable vases and an antique table. Bernadette met all the conditions to qualify for rebasing. The proceeds were paid into a newly opened offshore account. She had acquired the vases and table in 2010 using £600,000 of Remittance Basis relevant foreign income. The part of the gain that was not taxable as a result of Finance (No 2) Act, Sch 8, Part 3 rebasing relief was £1.1 million. The Arising Basis gain post 6 April 2017 was £50,000.

Bernadette transferred the £1.1 million (exempt as a result of rebasing) and the £50,000 (Arising Basis gain) to a new account to be used for UK expenditure (since the funds could be brought to the UK free from tax. For cleansing purposes, the £1.1 million exempt as a result of rebasing relief is within ITA 2007, s 809Q(4)(i). The treatment of the £50,000 Arising Basis gain is discussed in question 17 above.

<u>Question 19</u>

How should Remittance Basis foreign income and/or gains (FIG) be recorded for mixed funds and cleansing purposes where it is deemed to have been remitted to the UK as a result of, for example, being used as collateral for a UK loan?

Suggested Answer

A taxable remittance can only occur once. As such, since the funds have already been taxed in the UK, the funds used as collateral should be treated as coming within ITA 2007, s 809Q(4)(i) for the purposes of mixed fund analysis work and resulting cleansing transfers.

Example

In June 2016 £1 million of 2012/13 relevant foreign income (no foreign tax credit) was used as collateral for a £900,000 loan. The £900,000 loan was brought into the UK in August 2016. Under the current HMRC interpretation with respect to FIG used as collateral for a relevant debt £900,000 of the £1 million collateral is deemed to be remitted.

The loan is re-paid from UK funds in 2018.

In January 2019 the £1 million that was used as collateral is transferred to a mixed fund account. For cleansing purposes:

- £900,000 of this £1 million is seen as clean capital (so within ITA 2007, s 809Q(4)(i)); and
- since the remaining £100,000 has not suffered UK tax it is still Remittance Basis relevant foreign income and within ITA 2007, s 809Q(4)(d).

The £900, 000 and any other clean capital in the mixed fund account can be cleansed.

SECTION F – RELEVANT PERSONS AND CLEANSING

<u>Question 20</u>

Can cleansing transfers be carried out by an individual (P) where the funds belong to someone else (another relevant person in connection with the individual) but trace to the individual's income, gains and/or capital, such that there would be a taxable consequence if the Remittance Basis income or gains came to the UK?

Suggested Answer

Post 5 April 2008 income and capital

The cleansing rules for post 5 April 2008 income and capital do not require the nominated funds to be held by the individual (P). The funds can be in the account of a relevant person. For cleansing to be effective all that is necessary is that the cleansing transfers must relate to income, gains and/or capital traceable to P. It is P that must make the nomination rather than the person the mixed fund account is in the name of.

Pre-6 April 2008 income and capital

The position is different for pre-6 April 2008 income and capital as the relevant person rules did not apply pre-6 April 2008. As such, for pre-6 April 2008 funds cleansing can only be carried out where the funds are in a mixed fund account in the name of P.

Example

Gérard and Clara are both UK resident foreign domiciliaries (having come to the UK in 2008/09). Gérard gifted his wife Clara a valuable painting for her birthday in February 2010. The painting was a mixed fund comprised of £6 million 2009/10 clean capital and £5 million 2009/10 Remittance Basis relevant foreign income not subject to a foreign tax.

The gift took place in France and the painting has stayed in their flat in Paris. Clara sells the painting in January 2019 realising a gain of £3.5 million (sheltered by the Remittance Basis).

Clara had the proceeds from the painting paid into a new offshore account (account C). Two further new offshore accounts (account D and account E) are opened).

Gerard was a Remittance Basis user from 2008/09 to 2016/17, thereby meeting the cleansing conditions. The decision is made to cleanse account C of the funds traceable to the acquisition cost of the painting.

The following cleansing transfers are made:

- £5 million transferred from account C to account D; and

- £6 million transferred from account C to account E.

Gérard makes the following nominations:

- the £5 million 2009/10 Remittance Basis relevant foreign income coming within ITA 2007, s 809Q(4)(d); and

- the £6 million 2009/10 clean capital coming within ITA 2007, s 809Q(4)(i).

The Remittance Basis foreign chargeable gain is left within account C. That was Clara's gain so could not have been part of a cleansing nomination made by Gérard.

After the transfers Clara can bring funds from account E to the UK without Gérard being subject to tax.

Any remittances from account C would result in a taxable remittance on Clara but only at the (currently) lower Capital Gains Tax rates.

Example

On 29 August 2014 Gérard settled The Gérard Family Interest in Possession Offshore Trust (of which he is the life tenant and main capital beneficiary) using:

- £16 million of his Remittance Basis relevant foreign earnings (with no foreign tax credit) relating to 2012/13, 2013/14 and 2014/15; and
- £8 million of clean capital (a family inheritance from 2013/14).

The settled funds were not initially segregated as it was not envisaged that Gérard would require capital distributions for remittance to the UK.

The income arising within the trust is kept strictly segregated from the funds Gérard settled. The trust income (less income expenses) is paid out to Gérard each quarter for his offshore expenses.

Trust gains and losses are realised regularly and proceeds from the disposal of investments are reinvested.

As at 31 January 2018 the trust, therefore, had an income account (account C) for trust income and a second account (account D) for the mixed funds settled by Gérard and gains/losses realised as a result of the sale of investments.

It was decided that Gérard might require significant UK funds from the trust and that use should be made of the cleansing provisions to segregate the original clean capital (with no foreign tax credit) from the Remittance Basis relevant foreign earnings. The investment portfolio was liquidated so a thorough cleansing could occur. A remittance analysis from 29 August 2014 (when the trust was constituted) was carried out and it was established that on 13 April 2018 account D was comprised of:

- £15.9 million tracing back to the original Remittance Basis relevant foreign earnings (with no foreign tax credit) settled;
- £7.95 million tracing back to the original clean capital settled; and
- £1.5 million of gains realised on disposals within the trust. Trust gains are not attributed to the settlor so, for cleansing purposes are not seen as the settlor's gains. This means that they cannot be cleansed.

New offshore account E with a different bank and investment manager is established. To be cautious (to avoid the over nomination trap discussed in section B) a cleansing transfer of £7.9 million to account E takes place. Gérard nominates £7.9 million of 2013/14 clean capital coming within s 809Q(4)(i).

After the transfer the trustee can make a capital distribution to Gérard from account E. Should Gérard remit he will only be subject to tax on the TCGA 1992, s 87 gains attributed. The settled funds tracing back to Remittance Basis relevant foreign earnings will, however, have been left behind in account D.

Example

On 29 August 2010 Gérard funded The Gérard Family Discretionary Offshore Trust using £11 million of clean capital (a family inheritance from 2009/10). This broke down as a £2 million settlement and a £9 million loan. During his lifetime Gérard was to be the main beneficiary of the trust.

There was no segregation of income and gains as it was not envisaged that Gérard would need to extract funds (even by way of loan repayment) for remittance to the UK.

Gérard's UK needs changed, and it became clear that loan repayments for remittance to the UK would be helpful. The trustees considered the position. Whilst the provisions for settlors of non-UK resident trusts changed from 2017/18 the transitional settlement's provisions are insufficiently wide (see footnote 2) to allow repayment of the loan to Gérard from the mixed fund and remittance of the repayment without a tax liability.

As such, a mixed fund analysis was carried out to enable cleansing to take place.

At 19 April 2018 the account was found to contain:

- £10.95 million tracing back to the original settled funds (Gérard's clean capital).
- £4.75 million[2] of pre-6 April 2017 Remittance Basis foreign income that arose within the trust (deemed to be Gérard's income under ITA 2007, s 720).
- £135,000 of 2017/18 income. As a result of the Finance (No 2) Act 2017 changes this income is Protected Foreign Source Income not income arising to Gérard, so it cannot be cleansed.
- £3.5 million of gains realised on disposals within the trust. Trust gains are not attributed to the settlor so, for cleansing purposes are not seen as the settlor's gains. This means that they also cannot be cleansed.

New offshore account C with a different bank and investment manager is established. To be cautious (that is to avoid the over nomination trap discussed in section B) a cleansing transfer of £10.9 million to account C takes place.

Gérard makes the following nomination the £10.9 million 2009/10 clean capital coming within s 809Q(4)(i).

After the transfer the trustee can make loan repayments to Gérard from account C and he can remit these funds to the UK without any tax consequences.

Example

Heidi is a UK resident foreign domiciliary who came to the UK in May 1995. She has always been a Remittance Basis user, so is eligible for cleansing.

In July 2000 Heidi used £3.5 million of her Remittance Basis relevant foreign income (no foreign tax credit) to buy a property in New York.

She also invested £3 million of Remittance Basis relevant foreign income (no foreign tax credit) in a portfolio of shares in 2000.

In April 2010 she established The Heidi Offshore Discretionary Trust of which she was the main beneficiary transferring £1 million of Remittance Basis relevant foreign earnings. She also loaned £3 million of clean capital to the trust. The loan was originally repayable on demand and interest free but a new loan was put in place in July 2017 that was still repayable upon demand but with interest set at the official rate of interest (since Heidi was deemed domiciled from 2017/18 the change was necessary to avoid tainting the trust).

[2] Note that the £4.75 million of pre- 6 April 2017 Remittance Basis foreign income that arose within the trust is not caught by the settlements' regime unless and until it is remitted (ITTOIA 2005, s 648). If a remittance occurred there would be a tax liability if Gérard (or any relevant person other than the trustee) benefits as the transitional rule for pre-6 April 2017 income under the settlements' regime is narrower than that under the transfer of assets abroad legislation).

In June 2010 Heidi transferred:

- The New York property to The Heidi Offshore Discretionary Trust. Her gain on the deemed disposal was £1.25 million.
- The share portfolio and associated broker account to the trust. At the time of the transfer £4 million represented clean capital (as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision), £75,000 post 5 April 2008 Remittance Basis relevant foreign income, £1.3 million Remittance Basis capital gains with no foreign tax credit (£1 million pre-6 April 2008 and £300,000 post 5 April 2008) and there was a gain on the deemed disposal of the share portfolio on the transfer into trust of £875,000.

In May 2017 Heidi asked the trustees to repay £750,000 of the loan. She wanted to be able to bring the funds into the UK.

Even though the loan had come from Heidi's clean capital the trustees realised that care had to be taken as to what funds to use for the loan repayment as, if the funds used to make the partial loan repayment traced to any of the Remittance Basis income and/or gains that Heidi had settled, there would be a taxable remittance when the funds were brought into the UK.

The share portfolio and associated broker account was worth £6.4 million and a significant amount was clean as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision. However, pre-6 April 2008 funds cannot be cleansed and, as mentioned the £4 million of funds that represented clean capital (as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision) were mixed in with £1 million of Heidi's pre-6 April 2008 Remittance Basis chargeable gains. As such, it was not possible to access the clean funds by way of cleansing within the trust.

The trustees, therefore, considered the New York property, which was not required any longer and had risen in value considerably. The property was sold in July 2017 for the US dollar equivalent of £7.25 million (realising a gain of £2.5 million within the trust). The proceeds from the sale were paid into new offshore account (account D). The funds within account D broke down as follows:

- £3.5 million of clean capital (as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision). This could not form part of a cleansing transfer as the funds were pre-6 April 2008.
- The £1.25 million deemed gain on the transfer in of the New York property to the trust in 2009/10. This is Heidi's gain (within ITA 2007, s 809Q(4)(e)) and can be cleansed by her as it accrued after 5 April 2008.
- The £2.5 million trust gain on the disposal of the New York property. Note that (from 6 April 2017) trust gains are not attributed to a foreign domiciled settlor unless either the individual is deemed domiciled as a result of being born in the UK with a UK domicile of origin or deemed domicile and the trust protections have been forfeited. Heidi was born in Zurich with a Zurich domicile of origin and had not forfeited protection so, for cleansing purposes this £2.5 million is not seen as her gain.)

Cleansing of account D occurred in August 2017 with the £1.25 million Remittance Basis chargeable gain being transferred to a new offshore account (account E) and the appropriate nomination being made by Heidi.

The £750,000 loan repayment was made from the £6 million in the account D and could be brought into the UK by Heidi without any UK tax being due.

Question 21

Where a UK resident foreign domiciliary has made a loan to a relevant person (the loan funds having been kept offshore up to now in a capital account) and the funds loaned represent a mix of clean capital, Remittance Basis income and Remittance Basis chargeable gains, is cleansing the cash sufficient or does the loan have to be repaid?

Suggested Answer

The loan is an asset in the hands of the UK resident foreign domiciliary. As such, if the loan were not to a relevant person it would have to be repaid in order for the funds to be cleansed.

The fact that the loan is to a relevant person changes the analysis as the mixed funds are in two places:

1) within the cash held offshore by the relevant person; and
2) the loan asset in the hands of the UK resident foreign domiciliary.

The loan funds (clean capital, Remittance Basis income and Remittance Basis chargeable gains), can be cleansed in the hands of the borrower by appropriate offshore transfers provided the UK resident foreign domiciliary qualifies for cleansing and makes the nominations. As such, if the relevant person wants to bring the clean capital portion of the loan funds into the UK then cleansing will make this possible.

However, as stated the mixed funds are in two places and the loan itself has not been cleansed. If the UK resident foreign domiciliary wants to cleanse his loan it will need to be repaid offshore and the cash then cleansed.

SECTION G - MIXED FUND ANALYSIS AND FOREIGN CAPITAL LOSSES

As set down in question 13, the mixed fund legislation does not deal with how losses should be treated. We have, therefore, suggested that for mixed fund analysis purposes a two-step approach should be adopted:

1) proportionally allocate out the loss amongst the different categories of funds used to acquire the property sold at a loss;
2) adjust the step 1 result where either income or gains were used to acquire the property since the derivation rules mean that for mixed fund analysis purposes these categories cannot be reduced.

<u>In terms of utilising the losses one follows the normal loss set-off rules.</u>

Question 22

Where an individual, who has previously made a Remittance Basis claim and made the foreign capital losses election within the deadline, is taxed on the Arising Basis[3] for a tax year how are foreign losses accounted for in the mixed fund analysis?

[3] Allocating out losses using the two step process set down will be time consuming where the property has been acquired using more than one category of income and capital. A quicker pragmatic approach would be to say that losses and gains cancel each other out in the mixed fund analysis. (Where Arising Basis income and gains are characterised as being within ITA s 809Q(4)(i) – see question 17 – the quicker approach would be a reduction of clean capital.)

Suggested Answer

The steps set down in the introduction to this section are followed, as shown in the following examples.

Example

Phoenix Guernsey Ltd shares are acquired using £75,000 of 2015/16 Remittance Basis relevant foreign income (not subject to a foreign tax). A foreign loss election has been made. The shares are sold in 2017/18 for £50,000, with the proceeds being paid into account C a pre-existing mixed fund account.

The taxpayer is taxed on the Arising Basis for 2017/18.

Since only Remittance Basis relevant foreign income was used for the acquisition of the shares the entire loss is set against this income in step 1.

Step 2 - adjust the step 1 result since income was used to acquire the property and the derivation rules mean that for mixed fund analysis purposes income cannot be reduced.

This means that whilst only £50,000 is added to account C £75,000 of Remittance Basis relevant foreign income is added for the purposes of the mixed fund analysis.

The £25,000 Arising Basis loss is available to set against any gains in the year.

Example

A taxpayer (who has made a foreign loss election) has two mixed fund accounts:

- Account C; and
- Account D.

The taxpayer is taxed on the Arising Basis for 2017/18 and two chargeable disposals were made in the tax year:

- Pineapple Tropical Ltd shares (acquired using £100,000 of 2015/16 Remittance Basis relevant foreign income (not subject to a foreign tax) and £75,000 of 2014/15 clean capital) were sold for £250,000, thereby realising a gain of £75,000. The proceeds are paid into account C.
- Grapefruit Florida Inc shares (acquired using £50,000 of 2014/15 Remittance Basis relevant foreign income (not subject to a foreign tax) and £100,000 of clean capital) were sold for £50,000, thereby realising a loss of £100,000. The proceeds are paid into account D.

These were the only two disposals that the taxpayer made in the year.

Provided it is followed consistently either the method set down in the suggested answer of the method set down in this footnote would be acceptable.

Pineapple Tropical Ltd

For the mixed fund analysis purposes, the £250,000 of proceeds paid into Account C breaks down as follows:

	Amount
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£100,000
Clean capital – ITA 2007, s 809Q(4)(i)	£75,000
Foreign gains – ITA 2007, s 809Q(4)(e) taxed on the Arising Basis	£75,000
	£250,000

Grapefruit Florida Inc

As a loss has been realised on the share disposal the two step process is followed.

Step 1 - proportionally allocate out the £100,000 loss

	Amount	%
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£50,000	33.33%
Clean capital – ITA 2007, s 809Q(4)(i)	£100,000	66.67%
	£150,000	

	Acquisition Cost	Reductions	Proceeds
Relevant foreign income	£50,000	£33,333	£16,667
Clean capital	**£100,000**	**£66,667**	**£33,333**
	£150,000	£100,000	£50,000

Step 2 - adjust the step 1 result since income was used in part to acquire the shares and the derivation rules mean that for mixed fund analysis purposes income cannot be reduced.

For mixed fund analysis purposes only the following is added into Account D as a result of the receipt of the proceeds from the sale of the Grapefruit Florida Inc shares:

	Amount
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£50,000
Clean capital – ITA 2007, s 809Q(4)(i)	**£33,333**
	£83,333

Normal loss relief rules apply, so there will be no tax to pay on the £75,000 gain on the sale of the Pineapple Tropical Ltd shares.

A new account (account E) could be opened with cleansing transactions as follows:

- from account C the £75,000 clean capital;

- from account C the £75,000 Arising Basis gain (offset by the current year annual exemption and the loss on the Grapefruit Florida Inc shares);
- from account D the £33,333 remaining clean capital.

Question 23

Where an individual, who has previously made a Remittance Basis claim and made the foreign capital losses election within the deadline, is taxed on the Remittance Basis[4] for a tax year how are foreign losses accounted for in the mixed fund analysis?

Suggested Answer

The steps set down in the introduction to this section are followed, as shown in the following example.

Example

Ginger Guernsey Ltd shares are acquired using £250,000 of 2015/16 Remittance Basis foreign chargeable gains (not subject to a foreign tax) and £150,000 of 2014/15 clean capital. A foreign loss election has been made. The shares are sold in 2017/18 for £275,000. As such, a loss of £125,000 has been realised.

The taxpayer is taxed on the Remittance Basis for 2017/18.

The taxpayer has only one offshore account (account C), so all gains in the year are paid into the account (£300,000 of gains are realised with this being the only loss). There are no remittances in the year.

Step 1 - proportionally allocate out the £125,000 loss

	Amount	%
Foreign chargeable gains – ITA 2007, s 809Q(4)(e)	£250,000	62.5%
Clean capital – ITA 2007, s 809Q(4)(i)	£150,000	37.5%
	£400,000	

[4] Again, allocating out losses using the two step process set down will be time consuming where the property has been acquired using more than one category of income and capital. A quicker pragmatic approach would be to say that in such a situation, foreign capital losses have to be allocated in accordance with the specific legislative rules:

- they cannot be automatically set against foreign gains of the same year in the mixed fund account;
- where the legislation provides that the losses can reduce the gains within the mixed fund then the foreign chargeable losses can go in as negative entries in the s 809Q(4)(e) fund category. If the gains are greater than the total losses and there are remittances it is important to remember that the losses must go against remitted gains first and the analysis must be prepared accordingly; and
- the losses will be disregarded in a mixed fund analysis where they cannot be used against gains in the account. In such a situation the bank account balance will be lower than the total of the different kinds of income and capital.

Provided it is followed consistently either the method set down in the suggested answer of the method set down in this footnote would be acceptable.

	Acquisition Cost	Reductions	Proceeds
Foreign gains	£250,000	£78,125	£171,875
Clean capital	**£150,000**	**£46,875**	**£103,125**
	£400,000	£125,000	£275,000

Step 2 - adjust the step 1 result since gains were used in part to acquire the shares and the derivation rules mean that for mixed fund analysis purposes gains cannot be reduced.

For mixed fund analysis purposes only, the following is added into Account C as a result of the receipt:

	Amount
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£250,000
Clean capital – ITA 2007, s 809Q(4)(i)	**£103,125**
	£353,125

The TCGA 1992, s 16ZC loss relief rules apply, so the £125,000 loss can be set off against the £300,000 unremitted gains. Since the £125,000 is less than £300,000, and none of the gains are remitted, the losses are deducted against gains in reverse chronological order as per TCGA 1992, s 16ZC(2) step 1.

Cleansing transactions could:

- Remove the £103,125 clean capital and any other clean capital in the account.
- Remove the Remittance Basis Chargeable gains offset by the £125,000 loss (see question 15).

Question 24

Where a Remittance Basis user has not made a foreign capital loss election and cannot, therefore, claim foreign losses, what is the analysis where there is a foreign disposal and a loss is realised?

For example, shares in XYZ Jersey Ltd are:

- acquired using £375,000 of Remittance Basis relevant foreign earnings and £550,000 of clean capital; and
- sold in 2017/18 for £750,000 realising a capital loss of £175,000.

Suggested Answer

The steps set down in the introduction to this section are followed.

Step 1 - proportionally allocate out the £175,000 loss

	Amount	%
Relevant foreign earnings – ITA 2007, s 809Q(4)(b)	£375,000	40.54%
Clean capital – ITA 2007, s 809Q(4)(i)	£550,000	59.46%
	£925,000	

	Acquisition Cost	Reductions	Proceeds
Relevant foreign earnings	£375,000	£70,945	£304,055
Clean capital	**£550,000**	**£104,055**	**£445,945**
	£925,000	£175,000	£750,000

Step 2 - adjust the step 1 result since income was used in part to acquire the shares and the derivation rules mean that for mixed fund analysis purposes income cannot be reduced.

For mixed fund analysis purposes only the following is added into Account C as a result of the receipt:

	Amount
Relevant foreign earnings – ITA 2007, s 809Q(4)(b)	£375,000
Clean capital – ITA 2007, s 809Q(4)(i)	**£445,945**
	£820,945

Question 25

Would the analysis be the same, as in question 24, if the individual (a foreign domiciliary who previously made a Remittance Basis Claim and has not made a foreign capital loss election) were taxed on the Arising Basis for the tax year (assuming they are not deemed domiciled and, therefore, entitled to claim foreign chargeable losses)?

Suggested Answer

Yes, again the same process must be followed. If the property is acquired purely out of clean capital the clean capital is reduced by the loss. If the loss is acquired using income, gains and clean capital the derivation principle comes in and the income and gains cannot be reduced, so the two stage process illustrated in question 24 must be utilised.

SECTION H - CLEANSING & THE OFFSHORE ANTI-AVOIDANCE LEGISLATION

Question 26

Individuals may wish to cleanse amounts of cash which they have received as a capital distribution from an offshore trust of which they are a beneficiary.

Where such distributions are made in circumstances where the anti-avoidance rules in ITA 2007, s 731 and TCGA 1992, s 87 apply, it is technically not possible to determine the precise amount of income or gains arising to the beneficiary as a result of the distribution until after the end of the tax year of receipt, since the relevant matching rules for both provisions require consideration of events covering the entire tax year.

In such circumstances, any cleansing transaction must necessarily be based on estimates of how the payment will ultimately be matched and taxed. There is, therefore, the inherent risk of an over-nomination.

Will the taxpayer be able to carry out a valid cleansing transaction in respect of the income/gains treated as arising under the above provisions before the end of the tax year in which the income/gains will be treated as arising?

This will of course be a particular problem in 2018/19 since the cleansing deadline is 5 April 2019.

Suggested Answer

Whilst the determination of what the sum distributed represents can only take place after the end of the relevant tax year, the determination applies back to the date of the distribution (in other words, the analysis after the end of the tax year only confirms what the sum is and always has been).

A valid cleansing transfer as envisaged above could, therefore, be made during the tax year of the distribution. However, as mentioned in the question there is the risk of an over-nomination.

It is suggested that the calculations are carried out using the best information at the time, that is:

- the current pools (either for ITA 2007, s 731 relevant income or TCGA 1992, s 87 gains purposes);
- best estimates of future gains and relevant income;
- capital payments made to date; and
- any future capital payments the trustee(s) expect to make in the year.

Once this has been done rather than make the transfer in accordance with the figures calculated, a buffer should be kept behind in the mixed fund account (that is, caution is required) with a view to mitigating the risk of an over nomination.

If at all possible where the distribution occurs in 2018/19 waiting until March 2019 and having the work done to calculate the pools on an ongoing basis would give the best chance of avoiding an over-nomination issue.

Where distributions happen in 2018/19 the trustees could try to refrain from making any capital disposals or further distributions until after 5 April 2019. Income is more difficult since the only way of avoiding further income may be to make distributions after having adjusted the trust investment strategy (which would involve disposals and may not be commercial) to avoid it arising until after 5 April 2019.

Example

Jean-Luc is a UK resident foreign domiciliary. He has no clean capital and is an additional rate tax payer.

An offshore trust was set up by Jean-Luc's grandfather (a foreign domiciliary who was never UK resident and has died). Jean-Luc's uncle is the life tenant (initially the life tenant was his father who has died). As such, there is no relevant income within the structure. Jean-Luc can benefit from capital payments.

A capital payment of £3 million (paid into account C) was made to Jean-Luc on 17 November 2018. He needed £2 million to complete on a house purchase in the UK and £1 million for urgent renovations to his French chateau (the urgency meant that it was not possible to wait until later in the tax year).

Jean-Luc wants to mitigate his tax liability on the £2 million remittance by cleansing the £3 million. He meets the criteria such that he can cleanse.

In the year the trustee had already made a capital distribution of £500,000 to Jean-Luc's uncle and knew that later in the tax year they would make a capital distribution of £200,000 to Jean-Luc's sister. There were no unmatched capital payments brought forward.

To enable them to have the best picture of the s 87 gains pool at the year end the trustee made the necessary disposals of assets not just to finance Jean-Luc's distribution but also so that there will be sufficient cash for the distribution to his sister. The trustee decides to wait until after 5 April 2019 to make any further asset disposals or further distributions unless something exceptional happens.

The trustee has its tax advisers carry out the TCGA 1992, s 87 pool calculations and it is established that £0.7 of the £3 million will not be matched to gains and the remainder will be matched as follows:

- £0.5 million to 2017/18 gains;
- £0.7 million to 2016/17 gains;
- £0.5 million to 2015/16 gains; and
- £0.6 million to 2006/07 gains.

To create a mixed fund (a prerequisite for cleansing as discussed above), Jean-Luc has the £3 million paid into an offshore account with Remittance Basis relevant foreign income (account C). Jean-Luc then opens five new offshore accounts and makes the following transfers:

- Account D – for the unmatched capital payment. Note that since it has not yet been matched this must come within ITA 2007, s 809Q(4)(i) for nomination purposes even though it may be matched to gains in future tax years.
- Account E – for the 2017/18 gains.
- Account F – for the 2016/17 gains.
- Account G – for the 2015/16 gains.
- Account H - for the 2006/07 gains

Jean-Luc makes prudent transfers to each account leaving a buffer in account C to protect against the over-nomination risk. Account C is left with the Remittance Basis relevant foreign income with no foreign tax credit and the buffer funds.

So he has the £2 million for the UK house purchase Jean-Luc remits:

- the whole of accounts H (no tax charge due to the Finance Act 2008 supplementary provisions for gains realised prior to 6 April 2008);
- the whole of account D (no tax charge since not currently matched. The capital payment will be carried forward and may be matched in the future depending on subsequent trust gains, other capital payments made and whether Jean-Luc remains UK resident);
- the whole of account E (no supplementary charge as 2017/18 is the tax year preceding the year the capital payment is made); and
- what is required from account F to make up the shortfall (supplementary charge but at the lowest level).

Since he may need to make further remittances to the UK and the CGT tax rates are currently lower (even taking the supplementary charge he would pay) than the 45% tax rate on remitting the relevant foreign income he uses the contents of account C for the chateau repairs and makes up the shortfall from account G (since the supplementary charge would be higher on account G remittances than account F).

SECTION I – OVERSEAS WORKDAY RELIEF

Question 27

Anne-Marie, a UK resident foreign domiciliary had a foreign employment but performed duties in the UK that were more than incidental. She benefitted from overseas workday relief in her first three years of UK residence (2013/14, 2014/15 and 2015/16).

In 2013/14 Anne-Marie's overseas workdays were low and she was taxed on the Arising Basis on 75% of her foreign employment income. In 2014/15 her overseas days were much higher and she was only taxed on the Arising Basis on 45% of her foreign income. Finally, in 2015/16 she was taxed on the Arising Basis on 55% of her foreign income.

From 2016/17 Anne-Marie was taxed on the Arising Basis on her entire salary as she continued to perform more than just incidental UK duties. In 2017/18 the nature of her employment changed and she did not perform any UK duties in that year or in 2018/19 (she was also not within the ITEPA 2003, s 24A provisions). As such, all of her income in 2017/18 and 2018/19 was taxed on the Remittance Basis.

Anne-Marie received a bonus in 2017/18 related to her 2014/15 duties so this was taxed in the same way as her basic 2014/15 employment income was (55% Remittance Basis and 45% Arising Basis).

The foreign employment income was all paid into one offshore account. There were no transfers out and no other income was added to the account. However, the account was previously used as a clean capital account and at the time the first month's employment income was paid in there was £1,235 of clean capital in the account. As such, the special mixed fund rules for certain employment cases (ITA 2007, s 809RA to s 809RD) are not in point.

Towards the end of 2018 Anne-Marie decided that she wanted to remit funds to the UK.

How would she use cleansing to enable her to do this as tax efficiently as possible?

Suggested Answer

Anne-Marie should open a new account (account C). She can then transfer to account C:

- the £1,235 of clean capital
- the 2013/14, 2014/15 and 2015/16 UK portion of Arising Basis employment income;
- the UK portion of the 2014/15 Arising Basis employment income that was paid in 2017/18 (this bonus being taxed in the way 2014/15 income was taxed since it relates to 2014/15 duties); and
- her entire salary for 2016/17 duties since this was all taxed on the Arising Basis

The original mixed fund account will after these transfers be left with Remittance Basis relevant foreign earnings. There is no need to cleanse further unless there are tax credit issues (for example a change in tax rates) such that one or more year has a better tax credit than other years.

Note that if Anne-Marie had initially opened a new account for the employment income and made the necessary nomination the special mixed fund rules for certain employment cases (ITA 2007, s 809RA to s 809RD) would apply. The cleansing legislation applies to all mixed funds, so nominated mixed funds accounts can be cleansed in just the same way as any other mixed fund (the only difference being that if the mixed fund has not breached the special rules it does not have the potential to have as many different categories of income and gains as general mixed fund account).

In the case of Anne-Marie, apart from the fact that the £1,235 of clean capital would not be in the special nominated account the cleansing would be the same as set out above.

SECTION J - FIG AND COLLATERAL

<u>Question 28</u>

Where does Remittance Basis foreign income or gains (FIG) used as collateral "sit" when it comes to cleansing (i.e. does it "sit" in the bank account that is collateralised or does it "sit" in the loan/asset acquired with the loan funds)?

Suggested Answer

FIG held in a bank account used as collateral, remains in the bank account for the purpose of cleansing.

Where the loan funds were brought into the UK, but the loan dates back to before the August 2014 change in HMRC stance on FIG used as collateral such that grandfathering is in place and the FIG is not treated as having been remitted, the individual might want to make use of cleansing to adjust the collateral as the loan terms might be about to change such that the grandfathering will be lost - see example (a).

Where the loan funds have to date been kept outside of the UK the individual might want to make use of cleansing so that the funds can be brought to the UK without a negative tax consequence - see example (b).

Example (a)

There is a £1 million loan and the bank requires £1.5 million collateral. Currently the collateral mixed fund account contains £1 million of clean capital and £500,000 of FIG. The individual recently received a £750,000 inheritance.

The loan was for a fixed term ending in May 2019 and a new loan must be re-negotiated. As such, grandfathering will be lost.

On the basis that the loan is still required and there is insufficient alternative clean capital for the new loan it will be necessary to cleanse the collateral mixed fund account of the £500,000 FIG prior to 6 April 2019. The necessary additional clean capital can be transferred into the clean collateral account as required.

Example (b)

If the collateral mixed fund account contains £500,000 of FIG and £600,000 of clean capital, a loan of £550,000 is likely to be considered to represent £500,000 of FIG and £50,000 of clean capital – the loan cannot be brought to the UK without triggering a taxable remittance. If the account is cleansed and the capital account used as the collateral, then the loan automatically becomes capital and so can be brought to the UK without triggering a taxable remittance.

Question 29

Loan funds are treated as capital within a mixed fund (account C) and can, therefore, be cleansed out as capital (into account D). If the loan is subsequently repaid using a mixture of capital and FIG, however, does this then (almost retroactively) taint the cleansed capital?

Suggested Account

In circumstances where the debt is cleared using a mixture of capital and FIG then this will taint the cleansed account. The account will then become (upon repayment of the loan) a mixed fund representing the capital and FIG. If there is time prior to 6 April 2019 account D can be cleansed.

SECTION K - INTERACTION BETWEEN MIXED FUND CLEANSING AND REBASING

Question 30

How does Finance (No 2) Act 2017, Part 3 (Capital Gains Tax rebasing) interact with, Part 4 (cleansing)?

Suggested Answer

It is possible to benefit from both rebasing and cleansing. However, to do so an individual has to meet the conditions in both sets of legislation. Assuming they do the asset would need to be sold so as to leave enough time for the cleansing transaction prior to 6 April 2019 (the cleansing deadline).

It is only necessary to cleanse where rebasing has been carried out if the acquisition costs were tainted (in whole or in part) with Remittance Basis income or chargeable gains. Where they are not the proceeds can be brought into the UK without any resulting tax liability since:

- the acquisition costs are clean capital;
- rebasing wipes out the gain up to 5 April 2017; and
- any post 5 April 2017 gain is taxed on the Arising Basis (since the individual must be deemed domiciled to qualify for rebasing).

Cleansing will be necessary where in whole or in part the acquisition cost traces to Remittance Basis income or chargeable gains and the individual wants to bring the clean capital to the UK. This can be done either by:

- transferring out the Remittance Basis income and/or chargeable gains; or
- Transferring out: (i) the clean capital (if any); (ii) the gain that disappears as a result of rebasing; and (iii) the Arising Basis gain (if any).

Example

An individual is deemed domiciled in 2017/18 and qualifies for rebasing. A valuable painting (qualifying for rebasing) is sold on 19 April 2018. The painting was:

- acquired for £11 million using £7 million of clean capital and £4 million of Remittance Basis relevant foreign income without a foreign tax credit;

- worth £15.2 million on 5 April 2017; and
- sold for £15.4 million.

The £15.4 million is paid into a new offshore bank account (account C). The rebasing means that only £200,000 is subject to tax on the Arising Basis in 2018/19.

Funds representing the £7 million of clean capital, the £4.2 million gain benefitting from rebasing and the £200,000 chargeable gain taxed on the Arising Basis can all be brought into the UK free from additional tax if the £4 million of Remittance Basis relevant foreign income is cleansed from account C. To do this the following would happen:

- New offshore account D is opened and a £4 million cleansing transfer from account C to account D takes place. An appropriate nomination with respect to the ITA 2007, s 809Q(4)(d) Remittance Basis relevant foreign income is made.
- The £11.4 million remaining within account C is brought into the UK (no tax is payable as a result of this remittance).

Note that if it was decided to do the cleansing the other way around, with the £4 million of Remittance Basis relevant foreign income without a foreign tax credit remaining in account C the nomination for the £4.2 million gain benefitting from rebasing would not refer to ITA 2007, s 809Q(4)(e) as the rebasing means that the £4.2 million is not a foreign chargeable gain. Rather it would be within ITA 2007, s 809Q(4)(i) (income or capital not within another paragraph of s 809Q(4)). This is important when documenting the cleansing nomination (incorrect documentation could lead to the nomination being invalid).

Question 31

Kiki is deemed domiciled in 2017/18 and qualifies for rebasing. She has a mixed fund investment portfolio that contains a significant amount of clean capital which she wants to cleanse. Kiki does not, however, want to be out of the market for long or acquire different investments. As such:

- a new investment portfolio is opened for the clean capital;
- all the investments are sold on 19 June 2018;
- a cautious cleansing transfer (and nomination) to the new clean capital investment portfolio takes place;
- on 20 June 2018 acquisitions are made such that, once all the acquisitions are made, across the two portfolios Kiki is left with exactly the same investments and in the same quantities as she held on 19 June 2018.

What is the tax analysis?

Suggested answer

From a CGT perspective because there has been a re-acquisition within the period of 30 days after the disposal the base cost for the disposal is the acquisition cost of the new shares (that is the "bed and breakfasting" rule applies).

The base cost for the shares Kiki has in her portfolios as at 20 June 2018 is the rebased 5 April 2017 amount.

As explained in Question 14 above holding the same shares/securities of the same class in more than one portfolio should be avoided to prevent significant mixed fund analysis difficulties going forward

SECTION L – INTERACTION WITH (ITA 2007, S 809I TO S 809J)

Question 32

Is there any benefit to cleansing where the provisions at ITA 2007, s 809I have been triggered?

Suggested Answer

Only if an individual has one or more mixed funds containing clean capital. The clean capital can be cleansed and brought to the UK without ITA 2007, s 809J changing its classification.

There is no benefit to cleansing for Remittance Basis income and chargeable gains as the ITA 2007, s 809J rules take the total remittances of nominated income and chargeable gains and Remittance Basis income and chargeable gains and, following the steps set down in ITA 2007, s 809J(1), match this figure in the order set down in s 809J(2) regardless of what has actually been remitted.

Question 33

Where either:

- pre-6 April 2012 nominated income or gains; or
- post 5 April 2012 nominated income or gains in excess of £10 for a tax year

are paid into an account with other income or capital is it possible to cleanse the account so as to remove the other income or capital?

Suggested Answer

Cleansing is possible but great caution should be exercised as one would not want to trigger the ITA 2007, s 809I and s 809J rules. There should be no attempt to remove income or gains of the same type and of the same year as what was nominated.

Provided a sufficient buffer is left to guard against the dangers of an over nomination, the following can be cleansed:

- clean capital within the mixed fund account;
- income or gains other than that which has been nominated and paid into the mixed fund account; and
- income or gains of the same type but a different year to that which has been nominated and paid into the mixed fund account.

Where there is even the slightest doubt as to the accuracy of the mixed fund analysis cleansing should not be attempted as the risk of an over-nomination and triggering the ITA 2007, s 809I and s 809J rules on remittance would be too great.

SECTION M – NON-RESIDENTS & CLEANSING

Question 34

The employment earnings rules mean that income paid out in a tax year is subject to tax on the basis of the individual's circumstances in the tax year that the duties arose. Where as a result of this issue a mixed fund is created can a non-UK resident individual cleanse the account?

Suggested Answer

There is nothing in the legislation that prohibits a non-resident from cleansing. They must, however meet all the conditions so they must have been UK resident in at least one year between 2008/09 and 2016/17 (inclusive) and been a Remittance Basis user.

Example

Anastasia meets the cleansing qualifying conditions. In 2017/18 she receives a £1 million bonus relating to duties performed in 2016/17 (when she was UK resident and qualified for overseas workday relief). This means that if she remits the foreign duties part of the bonus (even though she is non-UK resident) it will be taxable. She is entitled to 50% overseas workday relief as a result of the split between UK and foreign workdays. As such, £500,000 relates to UK duties and £500,000 to foreign duties.

Anastasia paid the bonus into the same offshore account (account C) that contained an inheritance of £5 million.

Anastasia wants to cleanse the account because she wants to bring funds to the UK for various reasons (she wants to acquire a London flat for when she is in the UK on business and she also wants to acquire some quoted UK investments).

In this situation the easiest thing for Anastasia would be to open a new offshore account (account D) and transfer the portion of the bonus relating to foreign duties (£500,000) to the account. She will then be left with £5.5 million in account C that she can bring into the UK and can use the £500,000 in account D for offshore expenditure,

SECTION N - TRANSFER OF MONEY

Question 35

What is meant in the legislation by "a transfer of money"?

Suggested Answer

The legislation states that for a cleansing transfer to be valid it must be a transfer of money. That is money only NOT money or money's worth.

Funds within a saving account qualify as money. Similarly, funds within a money market deposit account qualify as money. However, holdings within money market investment funds or any other liquid investments do not qualify as money.

Generally, for cleansing to occur property (other than money) will have to be liquidated so the cleansing transfer can occur.

See question 12 for a consideration of the issues where there is an investment portfolio linked to various accounts.

SECTION O– JOINT ACCOUNTS

It should be noted that due to the complexities it is recommended that Remittance Basis users do not use joint accounts.

Question 36

Can you cleanse funds within a joint account and if so how?

Suggested Answer

Funds within a joint account can be cleansed (as stated in the HMRC Guidance). However, before cleansing can be carried out the mixed fund analysis must be carried out.

Mixed fund analysis where there are joint accounts is extremely complex because of the problem in determining the nature of the funds in the account. It is even more complex where there are accounts in the names of more than two people.

A separate mixed fund analysis has to be carried out for each individual whose name the account is in. However, the analysis cannot be carried out just on the basis of the source of the funds and who the expenses relate to. Even the intentions of the parties when the funds are paid into and taken out of the account is not necessary sufficient[5]. It will be necessary to look at the legal documentation with respect to the account such as the terms and conditions, the documents that have been signed and in particular the bank mandate.

SECTION P - CLEANSING TRANSFERS

<u>Question 37</u>

Cleansing is carried out with the express intention of either freeing up clean funds (possibly leaving other funds behind in the mixed fund account) or funds that can be remitted at a lower tax cost (Remittance Basis foreign income and/or gains with foreign tax credits, entrepreneurs' relief gains, normal gains taxed at 10%/20% or even gains taxed at 18%/28% where the taxpayer has a high marginal Income Tax rate that would apply to remittances of income). As such, whilst a remittance to the UK may not occur in the tax year cleansing takes place there is the intention to remit at some point.

Can it be confirmed that this is not an issue given that the legislative wording refers to the cleansing transfer as an offshore transfer and links that to the ITA 2007, s 809R(4) "offshore transfer" definition?

Our concern is that s 809R(4) links in to s 809R(5) and (6) and 809R(6) deems any transfer to be an offshore transfer if remittance does not occur before the end of the tax year in which the transfer occurs and is not then expected to occur thereafter. Put another way the transfer is <u>only an offshore transfer if the funds are not brought into the UK in the year and there is no intention that they will be bought to the UK</u>. With cleansing even if the funds are not brought to the UK in the year the transfer occurs there is an intention that they will be.

Suggested Answer

HMRC took legal advice on this point prior to the legislation being passed. The advice was that the legislation worked as intended and cleansing transfers would be valid where the funds are brought to the UK in the tax year or the intention is that they will be brought to the UK in future tax years.

---

[5] The Privy Council recently decided in Whitlock and another (Appellants) v Moree (Respondent)(Bahamas**)** [2017] UKPC 44 that, even if there may not have been an intention to make a gift, the terms of the bank mandate (which clearly showed that the account was, both legally and beneficially, owned jointly) took precedence.

Example

Fatima is a UK resident foreign domiciliary. She has a mixed fund account (account C).

Fatima requires funds in the UK and knows that the account C contains significant clean capital. She decides to cleanse but only removing the clean capital. Just prior to cleansing the analysis shows £5.67 million clean capital in account C. She opens a new offshore account (account D). To be prudent (mitigating the risk of an over nomination) on 19 January 2019 she transfers £5.5 million to account D and makes the appropriate nomination. She immediately remits the funds to the UK.

Assuming there is no over nomination, Fatima has made a valid cleansing transfer and the £5.5 remitted to the UK is free from UK tax.

Question 38

Opening offshore accounts is very difficult and from a practical perspective where a mixed fund account has been fully cleansed such that there are no funds within the account it will often be helpful to re-use the account for cleansing transactions with other accounts. It is also helpful to cleanse the same categories of funds from different mixed fund transferor accounts to the same transferee account)

Suggested Answer

Provided cleansing transfers take place in the two-year window the only prohibition put in place by the legislation is on making more than one nomination going the same way between the same two accounts.

Example

An individual has a mixed fund account (account C) and analysis breaks it down as:

- £1.5 million Remittance Basis relevant foreign income not subject to a foreign tax; and
- £3.5 million clean capital (inheritances and gifts).

The individual already has the following other offshore accounts:

- an account (account D) just containing Remittance Basis relevant foreign income not subject to a foreign tax; and
- a clean capital account (account E).

The individual makes the following cleansing transfers and nominations:

- the £1.5 million Remittance Basis relevant foreign income not subject to a foreign tax is transferred from account C to account D; and
- the £3.5 million clean capital (inheritances and gifts) is transferred from account C to account D.

Account C has a nil balance. The individual also wants to cleanse offshore account F which contains:

- £1 million Remittance Basis foreign chargeable gains not subject to a foreign tax; and
- £1.5 million clean capital (inheritances and gifts).

The individual intends to make the following cleansing transfers and nominations:

- a transfer of the £1 million Remittance Basis relevant chargeable gains not subject to a foreign tax is transferred from account F to account C; and
- a transfer of the £1.5 million clean capital (inheritances and gifts) from account F to account D.

Example

An individual has a mixed fund account (account C) containing Remittance Basis relevant foreign income not subject to a foreign tax, Remittance Basis foreign chargeable gains not subject to a foreign tax and clean capital. Cleansing transfers occur on 18 June 2018 such that the three different categories of funds go to new offshore accounts D (clean capital), E (Remittance Basis relevant foreign income not subject to a foreign tax) and F (Remittance Basis foreign chargeable gains not subject to a foreign tax) with account C having a nil balance.

On 29 September 2018, a valuable painting is sold for £25 million. The acquisition cost of £19 million is pre-UK arrival capital. The £6 million gain represents Remittance Basis foreign chargeable gains not subject to a foreign tax. The £25 million is paid into account C. The £6 million gain can be cleansed by way of a cleansing transfer and nomination provided the transfer is <u>not</u> to any of accounts D to F.

<u>Question 39</u>

Provided the transfer occurs before 6 April 2019 can further cleansing take place if a mixed fund account that does not have a nil balance receives additional funds after cleansing transfers have occurred?

Suggested Answer

Yes. As mentioned above, the legislation does not place any restrictions on the number of cleansing transactions that can take place from a mixed fund account or when in the two-year cleansing period the transactions have to take place. The only prohibition is on making more than one nomination going the <u>same way</u> between the same two accounts.

Example

An individual has a mixed fund account (account C) containing Remittance Basis relevant foreign income not subject to a foreign tax, Remittance Basis foreign chargeable gains not subject to a foreign tax and clean capital. Cleansing transactions are made as follows:

- 17 January 2018 to transfer the clean capital to new offshore account D; and
- 25 April 2018 to transfer the foreign chargeable gains to new offshore account E.

The Remittance Basis relevant foreign income not subject to a foreign tax remains within account C.

On 4 March 2019 the individual's non-UK resident mother mistakenly transfers a £1 million birthday gift to account C rather than account D. Realising her mother's error the individual quickly opens a new clean capital offshore account (account F) and makes a £1 million cleansing transfer on 7 March 2019 to account F (no other transactions having happened with respect to account C between 4 March 2019 and 7 March 2019, so there is no over nomination concern). The transfer cannot be to account D as that would be the second transfer from accounts C to account D and would not, therefore, be valid for cleansing purposes.

The three cleansing transfers to accounts D, E and F are all valid.

SECTION Q – CLEANSING SPECIFICS

Question 40

Can an individual who was foreign domiciled and a Remittance Basis user in one or more of the tax year(s) between 2008/09 and 2016/17 and has acquired a UK domicile of choice qualify for cleansing?

Suggested Answer

Yes, in contrast to rebasing, the acquisition of an actual UK domicile will not prevent an individual from cleansing a mixed fund account provided he or she was a Remittance Basis user at least once between 2008/09 and 2016/17 and the other cleansing conditions are met.

Question 41

Due to the risk of over nominating (see section B) and the nomination then being invalid (with the transfer being treated as an offshore transfer), will HMRC enter into correspondence with taxpayers, so they can obtain certainty that HMRC agrees the figures prior to the cleansing transaction(s) taking place?

Suggested Answer

HMRC will review a taxpayer’s figures where the taxpayer has a Customer Compliance Manager (previously a Customer Relationship Manager). The approach should be made to the Customer Compliance Manager who will obtain guidance from HMRC technical. The approach will need to be made so as to give HMRC sufficient time to look through the analysis work. Common sense needs to be used as the time HMRC will take will depend on the length and complexity of the analysis.

HMRC cannot review figures where a taxpayer does not have a CRM. However, where there is uncertainty as to the law the non-statutory clearance process is available (see https://www.gov.uk/guidance/non-statutory-clearance-service-guidance).

SECTION R – NOMINATIONS AND RECORD KEEPING

It is clear from the legislation that the nomination is crucial in order for the cleansing transfer to be valid. The legislation does not, however, say anything about what is required for the nomination. In the HMRC guidance it states that there is no need for a formal nomination process. Given the importance of the nomination additional guidance is required, so we consider nomination issues and record keeping requirements below.

We include a potential cleansing nomination template in the Appendix 3.

Question 42

a) For post 5 April 2008 funds one nominates the appropriate category of income or capital within the ITA 2007, s 809Q(4) categories. Since these categories of income and capital set only apply for post 5 April 2008 funds how should nominations be made for pre-6 April 2008 funds?
b) Regardless of whether the funds are post 5 April 2008 or pre-6 April 2008, how should a nomination be made where a sub-category of funds (see question 15) is being cleansed?

Suggested Answer

a) The same categories of income and capital as set down in ITA 2007, s 809Q(4) should be used only that legislation should not be referred to (as it does not apply to ore-6 April 2008 funds). The fact that the funds are pre-6 April 2008 should be stated. Appendix 3 provides examples.
b) Where there is a situation, such as is envisaged in question 15, and the transfer is to cleanse a specific sub-category of income or gains the nomination should clearly describe the sub-category in question. Again appendix 3 provides examples.

Question 43

When does the nomination need to be made?

Suggested Answer

Making the nomination and documenting the making of the nomination are two different things.

It is the making of the nomination that is crucial. The actual documentation of the nomination can occur after the nomination.

In the HMRC Guidance (see Appendix 2) it states that the nomination should be made prior to 6 April 2019. To be prudent the nomination should also be recorded in writing prior to that date. From a practical perspective, it would make sense for the documentation of the making of the nomination to take place at the same time as the nomination or soon after to ensure that it is not forgotten about.

Whilst in, theory, there is nothing to prevent a random transfer being made and a nomination at a later stage (when a mixed fund analysis has been carried out) the risk of such a transfer not agreeing to any mixed fund analysis such that the amount transferred is either an over-nomination for all purposes (such that it falls to be treated as an offshore transfer) of a significant under nomination is high. Waiting until after the mixed fund analysis has been performed is always going to be the better route.

The one exception to the above will be where an individual has left things too late to carry out the necessary detailed mixed fund analysis by the deadline. In such cases a best (very prudent) guesses for cleansing may be made with appropriate transfers and nominations (the aim will be to under nominate so the cleansing transfers will be valid). Prior to any remittances the mixed fund analysis would then need to be carried out to see check whether the transfers are valid for cleansing purposes (that is whether they are under of over nominations).

Question 44

What should be put in the nomination document?

Suggested Answer

The nomination document can either be a separate document (an e-mail would suffice) or the information can be put on the face of the electronic transfer document that the bank provides (this might be a downloaded document if internet banking is used).

The following details should be recorded on the nomination document (see Appendix 3):

- the transferor account;
- the transferee account;
- the amount that is being cleansed; and
- the kind of income or capital being cleansed. See question 42 and Appendix 3 for how to provide these details.

There is no specific requirement to record the tax year with respect to which the foreign income or gains arise/accrue. However, it is possible to separately nominate foreign income or gains for specific tax years and where this is done the tax year should be recorded.

Question 45

What records/evidence must be kept with respect to nominations?

Suggested Answer

The mixed fund analysis on which the nomination(s) are based, the electronic transfer document(s) and (if it is not made on the face of electronic transfer document) the document containing the nomination details.

Question 46

How long must the records/evidence with respect to the nomination be kept?

Suggested Answer

The cleansing transaction itself cannot result in tax liabilities so in itself is not of interest to HMRC. It is the remittance to the UK of cleansed funds that HMRC might enquire into. As such, records/evidence in connection with the nomination should be kept until all cleansed funds have been remitted and the enquiry window has elapsed for the last remittance. To be cautious it would be sensible to retain records/evidence until the period of time for a discovery assessment has elapsed.

Question 47

Whilst a minor does not pay the Remittance Basis Charge, a minor can be a Remittance Basis user, such that cleansing can be in point where the minor has a mixed fund. It is appreciated that cleansing can only occur where the account beneficially belongs to the minor and the minor will be absolutely entitled to the funds on reaching 18. Where this is the case who should make the nomination? A tax return submitted for a minor is approved by a parent (or guardian where appropriate)? Would this also be the case for a cleansing nomination? Presumably the name of the nominee on the account (which could be a grandparent) is disregarded?

Suggested Answer

The position for the approval of a cleansing nomination with respect to an account held absolutely for a minor, which the minor will be absolutely entitled to on reaching the age of 18, is the same as for the signing of a tax return for the minor. The name of the nominee on the account that is being cleansed (or the transferee account) is irrelevant.

Similarly, an individual who has lost mental capacity does not sign their tax return and would not sign a nomination. Where a mixed fund account beneficially belongs to the incapacitated individual the Court appointed deputy or the person who has the necessary power of attorney will be able to make the decision about the cleansing transfer and will make the nomination

Note that the nomination template wording in Appendix 3 should be slightly adapted where the taxpayer is a minor or does not have the mental capacity necessary to approve the nomination. For example:

For a minor

I am the parent/guardian [DELETE AS APPROPRIATE] of [INSERT CHILD'S NAME] who is a minor. He/she [DELETE AS APPROPRIATE] was a Remittance Basis user at least once between 2008/09 and 2016/17 inclusive.

In cases of mental incapacity

I act as [INSERT CAPACITY IN WHICH PERSON IS ENTITLED TO ACT FOR THE INDIVIDUAL WITH RESPECT TO THEIR FINANCIAL AFFAIRS] for [INSERT NAME] who was a Remittance Basis user at least once between 2008/09 and 2016/17 inclusive.

<u>Question 48</u>

If a mistake has been made with a cleansing transfer to a new offshore account (account D) and this is appreciated prior to 6 April 2019 can the funds be transferred back from account D to the original mixed fund account (account C) and the account cleansed correctly?

Suggested Answer

Yes. Further mixed fund analysis may need to be carried out depending on whether there have other transfers from account C.

It is also possible to analyse account C and account D and cleanse those accounts without transferring the funds from account D back. This is likely to be the easier approach where account D was an existing account that was made into a mixed account by the failed cleansing transaction.

Example

Renée makes a cleansing transfer to a new account (account S) on 17 July 2018 of £9.75 million of what he thinks is clean capital. When he sends the paperwork to his tax adviser his tax adviser realised that Renée made a transposition error as the transfer should have been of £9.57 million clean capital. The transfer is not, therefore, valid. Reneé transfers the funds back to the original account. This was the only cleansing transfer, so he can open a new offshore account and make the £9.57 million transfer.

<u>Question 49</u>

Can cleansing transfers be made from account C to account D and, at a later date (but prior to 6 April 2019), from account D to account C?

Suggested Answer

It seems unlikely that this would happen. The answer is, however, yes. This is because the transfer is going the other way to the first transfer. The legislation allows for one transfer each way between accounts.

Example

Sabrina is a UK resident foreign domiciliary who meets the cleansing criteria. She has no clean capital other than that within her mixed fund account (account C).

Sabrina wants to cleanse account C so she has funds she can bring to the UK without a tax charge. She decides to remove all the Remittance Basis income and gains from account C transferring the funds to new offshore account D and leaving the clean capital within account C. Her mixed fund analysis is straightforward, so she is happy to use the precise figures for the cleansing hence removing the other funds rather than transferring out a cautious estimate of the clean capital.

Once the first cleansing is carried out she brings the clean funds in account C to the UK.

She realises that she will need further funds in the UK. Within account D she has a significant level of Remittance Basis foreign capital gains (none of which are chargeable at the higher 18%/28% rates or have foreign tax credits). She decides that a 20% tax rate is acceptable and that she will cleanse account D to remove these gains. Rather than open another bank account she uses account C. This is a valid cleansing transfer as it is the first time that a nomination from account D to account C will have been made.

Question 50

How should the nomination be made where the mixed fund bank account is in a foreign currency?

Suggested Answer

As with any other nomination the nomination does not need to be signed and could be in an e-mail.

Where the mixed fund analysis has been carried out in a foreign currency and the cleansing transfer is also in the foreign currency the nomination can be in that foreign currency.

Where the mixed fund analysis has been carried out in sterling the nomination should also be made in sterling.

1. Mixed fund analysis carried out in the foreign currency

Example nominations

From and to accounts in the same foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

L US$ Account

- *$5 million transferred from L USD Mixed Account to J Capital USD Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *$5 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in a different foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

P AUS$ Account

- *AUS$ 6 million transferred from P USD Mixed Account to Q Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *AUS$ 6 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in sterling

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

J Euro Account

- *Euro 4 million transferred from J Euro Mixed Account to K Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *Euro 4 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

2. Mixed fund analysis carried out in sterling

Where the mixed fund analysis has been prepared in sterling the cleansing transfer must not be higher than the sterling mixed fund analysis figure for the ITA 2007, s 809Q(4) category of funds being transferred. That is the foreign currency transfer must equate to the appropriate sterling amount using an appropriate foreign exchange spot rate on the date of the cleansing transaction. For example, where the analysis shows a US$ account has £11 million clean capital the US$ figure transferred cannot be higher than the US$ equivalent of £11 million on the date of the transfer.

Example nominations

From and to accounts in the same foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

L US$ Account

- *The US$ equivalent, at the date of the cleansing transfer, of £4 million (that is $5.6 million) was transferred from L USD Mixed Account to J Capital USD Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *£4 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in a different foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

P AUS$ Account

- *The AUS$ equivalent, at the date of the cleansing transfer, of £6 million (that is AUD$ 10.62 million) was transferred from P USD Mixed Account to Q Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d*) £6 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in sterling

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

J Euro Account

- *The Euro equivalent, at the date of the cleansing transfer, of £4 million (that is Euro 6.72 million) was transferred from J Euro Mixed Account to K Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) £4 million was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

SECTION S – TAX RETURN DISCLOSURE

<u>Question 51</u>

What disclosure is required on self-assessment tax returns?

Suggested Answer

It is not necessary to make any disclosure on self-assessment tax returns. It is, however, appreciated that disclosure may be felt to be desirable.

Disclosure in the year that cleansing takes place – there is no merit in making disclosure in the year that cleansing takes place <u>unless</u> remittance also occurs in this year. This is because it is only once remittance has occurred that there could be any UK tax issue.

In the year that a remittance of cleansed funds occurs the following disclosure might be made on the tax return.

"On 24 March 2020 I remitted [INSERT AMOUNT] that following a cleansing transaction, which occurred on[INSERT DATE], is deemed to trace to clean capital."

Additional detail should be given if any assumptions were made with respect to the mixed fund analysis that underpins the cleansing.

[WHAT WOULD HMRC CONSIDER TO BE SUFFICIENT DISCLOSURE TO PROTECT AGAINST A DISCLOVERY ASSESSMENT? IS IT POSSIBLE TO PROVIDE SUFFICIENT DISCLOSURE SHORT OF ACTUALLY ADDING THE MIXED FUND ANALYSIS AS AN ATTACHMENT? WOULD EVEN THAT BE ENOUGH WITHOUT THE SUPPORTING BANK STATEMENTS? IN MANY CASES THE ON-LINE SYSTEM WILL NOT BE CAPABLE OF TAKING SUCH LARGE FILES]

SECTION T – INTERACTION WITH REQUIREMENT TO CORRECT

<u>Question 52</u>

How could cleansing work interact with the requirement to correct (introduced by Finance (No 2) Act 2017, Sch 18)?

Suggested Answer

The requirement to correct (RTC) legislation establishes a new legal obligation on taxpayers to disclose to HMRC undeclared UK tax liabilities, as at 5 April 2017, with respect to offshore matters or transfers. The RTC period runs from 16 November 2017 (Royal Assent) to 30 September 2018 after which far tougher penalties come into force (the failure to correct penalty (FTC) being 200%, of the offshore unpaid tax, which can be reduced but not below 100%).

As will have become clear from the questions above a cleansing transaction occurs after a mixed fund analysis has determined the composition of the fund. It is possible that the analysis will uncover inadvertent unreported taxable remittances that fall within the RTC legislation. If this happens a disclosure of the unreported liability will need to be made as soon as possible to meet the 30 September 2018 deadline.

APPENDIX 1 – THE LEGISLATION

FINANCE (NO 2) ACT 2017 SCHEDULE 8, PART 4 - DEEMED DOMICILE: INCOME TAX AND CAPITAL GAINS TAX/PART 4 CLEANSING OF MIXED FUNDS

44

(1) This paragraph applies for the purposes of the application of section 809Q(3) of ITA 2007 in relation to an individual ("P").

(2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where--

(a) the transfer is made in the tax year 2017-18 or the tax year 2018-19,

(b) the transfer is a transfer of money,

(c) the mixed fund from which the transfer is made is an account (account A) and the transfer is made to another account (account B),

(d) the transfer is nominated by P for the purposes of this sub-paragraph,

(e) at the time of the nomination no other transfer from account A to account B has been so nominated, and

(f) P is a qualifying individual.

(3) P is a qualifying individual if--

(a) section 809B, 809D or 809E of ITA 2007 (Remittance Basis) applied in relation to P for any tax year before the tax year 2017-18, and

(b) P is not an individual--

(i) who was born in the United Kingdom, and

(ii) whose domicile of origin was in the United Kingdom.

(4) An offshore transfer to which sub-paragraph (2) applies is to be treated as containing such amount of such kind or kinds of income and capital in the mixed fund immediately before the transfer as may be specified in the nomination under sub-paragraph (2)(d).

(5) An amount of a kind of income or capital specified under sub-paragraph (4) may not exceed the amount of that kind which is in the mixed fund immediately before the transfer.

(6) In this paragraph "mixed fund" and "offshore transfer" have the same meanings as in section 809R(4) of ITA 2007.

45

(1) This paragraph applies to a transfer made by a person ("P") from a mixed fund where--

(a) the transfer is made in the tax year 2017-18 or the tax year 2018-19,

(b) the transfer is a transfer of money,

(c) the mixed fund from which the transfer is made is an overseas account (account A) containing pre-6 April 2008 income or chargeable gains,

(d) the transfer is made to another overseas account (account B),

(e) the transfer is nominated by the person for the purposes of this sub-paragraph,

(f) at the time of the nomination no other transfer from account A to account B has been so nominated, and

(g) P is a qualifying individual.

(2) P is a qualifying individual if--

(a) section 809B, 809D or 809E of ITA 2007 (Remittance Basis) applied in relation to P for any tax year before the tax year 2017-18, and

(b) P is not an individual--

(i) who was born in the United Kingdom, and

(ii) whose domicile of origin was in the United Kingdom.

(3) A transfer to which this paragraph applies is to be treated as containing such amount of such kind or kinds of income or capital in the mixed fund immediately before the transfer (for example, income or chargeable gains for a particular tax year) as may be specified in the nomination under sub-paragraph (1)(e).

(4) An amount of a kind of income or capital specified under sub-paragraph (3) may not exceed the amount of that kind which is in the mixed fund immediately before the transfer.

(5) In this paragraph and paragraph 46--

"mixed fund" has the same meaning as in section 809R(4) of ITA 2007;

"overseas account" means an account situated outside the United Kingdom;

"pre-6 April 2008 income or chargeable gains" means income or chargeable gains for the tax year 2007-8 or any earlier tax year.

46

(1) This paragraph applies to determine, for the purposes of paragraph 45, the composition of the mixed fund referred to in paragraph 45(1).

(2) Sub-paragraphs (3) to (5) apply where a transfer of money is made before 6 April 2008 from the mixed fund to another overseas account.

(3) Take the following Steps--

Step 1. Calculate the total amount of income and chargeable gains in the mixed fund immediately before the transfer ("the total income and gains").

Step 2. Calculate what proportion of the total income and gains is income and what proportion is chargeable gains.

(4) If the amount transferred does not exceed the total income and gains, the transfer is to be treated as if it consisted of income and chargeable gains in the proportions found under Step 2 in sub-paragraph (3).

(5) If the amount transferred exceeds the total income and gains, the transfer is to be treated as if it consisted of--

(a) all the income and chargeable gains that were in the mixed fund immediately before the transfer, and

(b) in respect of the balance, other capital from the mixed fund.

(6) Sub-paragraphs (7) and (8) apply where--

(a) a transfer of money is made before 6 April 2008 from another overseas account to the mixed fund, and

(b) there is insufficient evidence to determine the composition of the transfer.

(7) Take the following Steps--

Step 1. Calculate the total amount of income and chargeable gains in the other overseas account immediately before the transfer ("the total income and gains").

Step 2. Calculate what proportion of the total income and gains is income and what proportion is chargeable gains.

(8) The transfer is to be presumed to consist of income and chargeable gains in the proportions found under Step 2 in sub-paragraph (7).

(9) For the purposes of Steps 1 and 2 in sub-paragraph (7), if there is insufficient evidence to say that an amount is income or that it is chargeable gains, treat it as income.

APPENDIX 2 – HMRC GUIDANCE RELEASED 31 JANUARY 2018 (LAST UPDATED 9 MARCH 2018)

CLEANSING MIXED FUNDS

Contents

A mixed fund is an overseas fund of money, which contains:

- more than one type of income, gains and capital, or
- income, gains or capital from more than one tax year

You can cleanse mixed funds by transferring money from one offshore account to another if you:

- are non-UK domiciled
- can identify the make-up of your mixed funds
- have been taxed on the Remittance Basis in any year from 6 April 2008 to 5 April 2017
- meet the conditions in section 809B of the Income Tax Act 2007
- meet the conditions in section 809D of the Income Tax Act 2007 (your unremitted foreign income and gains are less than £2,000)
- meet the conditions in section 809E of the Income Tax Act 2007 (without making a claim, other cases)

You can't cleanse mixed funds if you were born in the UK with a UK domicile of origin.

Cleansing conditions from April 2017

From 6 April 2017 to cleanse your mixed fund accounts you must:

- nominate the transfer
- make the transfer between 6 April 2017 and 5 April 2019
- only cleanse money
- transfer from one overseas account to another
- specify the amount for each category
- not have nominated a transfer from account A to account B before
- be a qualifying individual at the time of transfer
- make sure the transfer is for income, gains and capital, can be the whole or part of what is in the account and doesn't exceed the amounts in the account immediately before the transfer
- be able to identify the source of the funds

If you can't identify all the sources of the amounts in each of your mixed fund accounts, you'll only be able to apply the cleansing provisions to the amounts you can identify.

You don't have to cleanse all overseas mixed fund accounts at the same time, as long as each account is cleansed within the 2 year window, ending 5 April 2019.

You also don't need to completely empty the original mixed fund account, but once a nominated transfer from an account has happened it can't be nominated again into that same account.

Nominations

You must nominate all transfers of income, gains and capital from the mixed fund you want to cleanse and:

- keep records of all nominations
- make the nomination between 6 April 2017 to 5 April 2019

Any nominations made outside this 2 year window won't be valid for cleansing purposes.

The normal mixed fund rules still apply (sections 809Q and 809R Income Tax Act 2007), to transfers in or out of an uncleansed or partially cleansed mixed fund, if these transfers aren't nominated for the purposes of the cleansing provisions.

If nominated transfers exceed the amount of that kind of income held in the mixed fund account immediately before the transfer then the normal mixed fund rules will apply. Such a nomination would be invalid and would have the potential to affect all subsequent nominations possibly invalidating them too.

If you can't identify the make-up of the transfer, because you don't have enough evidence of what is in the other account, then the transfer will be treated as income.

Examples 1 and 2 show mixed fund nominations.
Example 7 shows multiple account nominations.

Joint Accounts

Joint mixed fund accounts can be cleansed even if only one person qualifies.

Each qualifying person can cleanse their share of the joint account by identifying:

- the funds which are theirs

- what those funds are, income, capital or chargeable gains

Before 6 April 2008

The statutory rules for mixed funds didn't apply before 6 April 2008.

You can cleanse an account that contains funds from before 2008, after 6 April 2008 or both, if you meet the cleansing and qualifying conditions.

Transfers made from a mixed fund before 6 April 2008

Step 1
Calculate the total amounts of income and chargeable gains in the mixed fund immediately before the transfer took place.

Step 2
Work out the proportion of income and gains contained within the account.

If the amount transferred is less than the total amount of income and gains, treat that transfer as comprising of the proportions of income and gains contained within the account.

If the amount transferred exceeds the total amount of income and gains you don't need to proceed further than step 1 – the initial identification of the total amounts of income and gains contained within the account before the transfer took place.

Examples 3 and 4 show transfers from mixed fund account before 6 April 2008.
Transfer made into a mixed fund before 6 April 2008

Step 1
Calculate the total amount of income and chargeable gains in the other overseas account immediately before the transfer took place.

Step 2
Work out what proportion of the total income and chargeable gains is income and chargeable gains.

The transfer to the mixed fund account will consist of income and chargeable gains in the proportions as worked out at step 2.

Examples 5 and 6 show transfers into mixed fund account before 6 April 2008.

Examples

Example 1

Natasha has a mixed fund containing:

- 2012 to 2013 foreign income £1 million
- 2013 to 2014 foreign income £2.3 million
- 2014 to 2015 foreign income £1.5 million

Total £4.8 million

- 2010 to 2011 foreign gain £500,000
- 2011 to 2012 foreign gain £750,000
- 2012 to 2013 foreign gain £2.5 million
- 2013 to 2014 foreign gain £1.5 million

Total £5.25 million

On 10 January 2018 Natasha nominates and transfers to an already existing account (containing only foreign gains) £4.5 million. She keeps sufficient evidence which shows the transfer consisted of:

- £1.5 million 2013 to 2014 foreign gain
- £2.5 million 2012 to 2013 foreign gain
- £500,000 2010 to 2011 foreign gain

The £750,000 foreign gain from 2011 to 2012 remains in the original mixed fund for the time being.

Example 2

Flavia has a mixed fund account which contains the following funds immediately before she nominates transfers under the cleansing provisions:

- 2014 to 2015 overseas capital gain £200,000
- 2014 to 2015 clean capital £150,000
- 2013 to 2014 foreign income £110,000
- 2013 to 2014 overseas capital gain £600,000
- 2010 to 2011 foreign income £850,000

Flavia nominates £1 million foreign income, transferring it to a new account (B) on 17 July 2018. Flavia leaves the balance of her funds in the original account (A).

The total amount of foreign income immediately before the transfer to account B was £960,000, Flavia's transfer exceeds the total amount of foreign income contained in the account by £40,000.

This error means that Flavia has breached one of the cleansing conditions, instead of successfully cleansing the original account Flavia has engaged the mixed fund rules at section 809Q and 809R (that is the entire £1 million is taken to be an offshore transfer), creating another mixed fund. She will need to work out by applying these rules the proportion of income, gains and capital that this account contains.

Flavia can if she wished subsequently cleanse this account (B) by correctly applying the cleansing provisions so long as she is within the 2 year window.

Example 3

Brad has a pre-2008 mixed fund account. On 30 October 2007 a transfer of £100,000 was made from that account to another of Brad's accounts. Immediately before this transfer the account contained:

- capital £200,000
- income £300,000
- chargeable gains £500,000

Totals £800,000

Proportionally this means:

Income is 37.5% and gains are 62.5% of the total income and gains held within the account.

Applying these proportions against the £100,000 transfer means that:

£37,500 income, and £62,500 gains were transferred from this account on 30 October 2007.

This leaves the balance remaining in the account after the transfer:

- capital £200,000
- income £262,500
- gains £437,500

If Brad meets the qualifying individual and cleansing conditions, he can if he so wishes cleanse this account.

Example 4

The facts are identical to example 3, but instead Brad makes a transfer from the account on the 30 October 2007 of £850,000.

The total amount of income and chargeable gains in the account immediately before the transfer was £800,000. The balance of £200,000 being capital.

This means that Brad transferred all the income and gains plus £50,000 of his capital, leaving a balance of £150,000 capital.

As this account now only contains one source of funds, the £150,000 capital, there is no need for Brad to apply the cleansing provisions to it.

Example 5

Sanjeev has 2 accounts which contain funds that arose before 6 April 2008. On 16 January 2007 a transfer was made from his British Virgin islands (BVI) account (the other account) of £2 million to his Jersey account (the mixed fund account).

After the transfer the Jersey account contains £7.8 million.

Sanjeev knew that prior to the transfer the Jersey account contained:

- capital £1.2 million
- income £4 million
- chargeable gains £600,000

Total £5.8 million

Sanjeev needs to follow steps 1 and 2 on his BVI account to work out what the £2 million transfer was.

The BVI account before the transfer contained:

- capital £450,000
- income £2.25 million
- chargeable gains £1.75 million

Total £4.45 million

Step 1 the total income and gains in the BVI account was:

- income £2.25 million
- chargeable gains £1.75 million

Total £4 million

Step 2 the proportions are:

- income 56.25%
- chargeable gains 43.75%

Applying these proportions to the £2 million transfer means that Sanjeev transferred:

- income £1.125 million
- chargeable gains £875,000

to his Jersey account

The Jersey account after the transfer contains:

- capital £1.2 million
- income £5.125 million
- chargeable gains £1.475 million

Total £7.8 million

Provided all the conditions are met Sanjeev can if he wishes cleanse his Jersey account.

Example 6

The facts are identical to example 5, except that Sanjeev doesn't know what was in his BVI account before the transfer.

He can't complete steps 1 and 2, so the whole £2 million transfer to his Jersey account will be treated as income.

This means that after the transfer his Jersey account will contain:

- capital 1.2 million
- income £6 million

- chargeable gains £600,000

Total £7.8 million

Provided all the conditions are met Sanjeev can if he wishes cleanse his Jersey account.

Example 7 - Multiple account nominations

Hamid is a qualifying individual. He has been continually resident in the UK since the tax year 2001 to 2002 and has always assessed himself on the remittance basis. Hamid has 4 offshore bank accounts:

- Isle of Man (IOM)
- Jersey
- Switzerland
- BVI

All these accounts are mixed fund accounts and are made up as below:

IOM account

- 1999 to 2000 £900,000 foreign earnings
- 2003 to 2004 £100,000 foreign income
- 2003 to 2004 £500,000 inheritance
- 2007 to 2008 £200,000 foreign gain

Jersey account

- 2008 to 2009 £500,000 inheritance
- 2010 to 2011 £600,000 foreign gain
- 2011 to 2012 £500,000 foreign income
- 2014 to 2015 £500,000 UK employment income

Switzerland account

- 2009 to 2010 £300,000 foreign earnings
- 2013 to 2014 £900,000 foreign gain
- 2015 to 2016 £100,000 foreign income
- 2015 to 2016 £400,000 UK employment income

BVI Account

- 2009 to 2010 £100,000 foreign gain
- 2009 to 2010 £50,000 foreign income
- 2010 to 2011 £2 million inheritance

Hamid wants to buy a new house in London in the near future and thinks he may need to remit some of his offshore funds for this purchase. He decides to take advantage of the cleansing provisions to simplify his finances going forward.

He decides to set up 3 new receiving accounts and nominates the following transfers into them on 2 October 2017:

- account 1 - £900,000 (total UK employment income from the Jersey and Swiss accounts)
- account 2 - £650,000 (total foreign income from the 3 accounts, Jersey, BVI and Swiss)
- account 3 - £1.6 million (total foreign gain from the 3 accounts, Jersey, BVI and Swiss)

Hamid leaves his £500,000 inheritance in the original Jersey account, the £2 million inheritance in the original BVI account and the £300,000 foreign earnings in the original Swiss account. These accounts have been cleansed.

On 12 December 2018 Hamid cleanses his IOM account. He transfers the 2003 to 2004 £100,000 foreign income into the existing account – account 2. Due to banking procedures the 2007 to 2008 foreign gain doesn't transfer to the receiving account – account 3 until 14 December 2018.

Hamid transfers the 2003 to 2004 inheritance into his original Jersey account, leaving the balance of £900,000 foreign earnings in the original IOM account. As Hamid has nominated all these transfers under the cleansing provisions he has successfully cleansed his IOM account.

If he wants to safeguard the 3 new accounts and his other 4 cleansed accounts from becoming mixed fund accounts in the future, Hamid will have to ensure that any funds accruing in each account (for example, interest) are paid into a separate account to prevent 'tainting' of the funds.

APPENDIX 3 – CLEANSING NOMINATION TEMPLATE[6]

This document could be an e-mail in which case there will be no wet signature.

I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [BETWEEN 6 APRIL 2017 AND 5 APRIL 2019 INCLUSIVE] I gave instructions to [BANK NAME] Bank to carry out various electronic transfers pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8 Part 4 nominations made.

T GBP Account

- £3 million transferred from T GBP Account to C Capital GBP Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 45 (2)(d) this £3 million was nominated as being pre-6 April 2008 clean capital
- £1.6 transferred from T GBP Account to D GBP Remittance Basis Income Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 45 (2)(d) this £1.6 million was nominated as being pre-6 April 2008 Remittance Basis relevant foreign income without a foreign tax credit.
- £800,000 transferred from T GBP Account to E GBP Remittance Basis Standard Rates Gains Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 45 (2)(d) this £800,000 was nominated as being pre-6 April 2008 Remittance Basis chargeable gains taxable at the standard 10%/20% UK Capital Gains Tax rates and without a foreign tax credit.
- £1.9 million transferred from T GBP Account to F GBP Remittance Basis FTC Gains Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 45 (2)(d) this £1.9 million was nominated as being pre-6 April 2008 Remittance Basis chargeable gains taxable at the standard 10%/20% UK Capital Gains Tax rates with a foreign tax credit.
- £5 million transferred from T GBP Account to C Capital GBP Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £5 million was nominated as being funds within ITA 2007, s 809Q(4)(i).
- £750,000 transferred from T GBP Account to D GBP Remittance Basis Income Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this transfer was nominated as being £750,000 of income within ITA 2007, s 809Q(4)(d).
- £250,000 transferred from T GBP Account to E GBP Remittance Basis Standard Rates Gains Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £250,000 was nominated as being £250,000 of gains taxable at the standard 10%/20% UK Capital Gains Tax rates within ITA 2007, s 809Q(4)(e).
- £1.7 million transferred from T GBP Account to G GBP Remittance Basis ER Gains Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £1.7 million was nominated as being a £1.7 million of gain within ITA 2007, s 809Q(4)(e) that benefits from entrepreneurs' relief.

U GBP Account

- £500,000 transferred from U GBP Account to C Capital GBP account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £500,000 was nominated as being income within ITA 2007, s 809Q(4)(d)[7] from the tax year [INSERT YEAR] which has already borne UK tax (on the Arising Basis).

[6] If cleansing an account in the name of a relevant person this should be disclosed when giving details of the accounts. It should be noted that, since the concept was only introduced in Finance Act 2008, only post 5 April 2008 income and capital can be cleansed from accounts in the names of relevant persons.

[7] As mentioned in question 17, if Arising Basis income and gains are allocated to s 809Q(4)(i) in the mixed fund analysis this classification should be used for the nomination.

- £1,244,000 transferred from U GBP Account to C Capital GBP account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £1,244,000 was nominated as being funds within ITA 2007, s 809Q(4)(i), which were exempt from Capital Gains Tax as a result of private residence relief and letting relief.
- £375,000 transferred from T GBP Account to H GBP Remittance Basis Higher Rates Gains Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £375,000 was nominated as being £375,000 of gains within ITA 2007, s 809Q(4)(e) that was subject to the higher 18%/28% Capital Gains Tax rates as a result of being the part of the sale of a residential property not benefitting from private residence relief.

V GBP Account

- £2 million transferred from V GBP Account to C Capital GBP account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £2 million was nominated as being funds within ITA 2007, s 809Q(4)(i).

W GBP Account

- £80,000 transferred from W GBP Account to C Capital GBP account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £80,000 was nominated as being funds within ITA 2007, s 809Q(4)(i).

X GBP Account

- £40,000 transferred from X GBP Account to C Capital GBP account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) this £40,000 was nominated as being funds within ITA 2007, s 809Q(4)(i).

Signed Date: [PRIOR TO 6 APRIL 2019]

See question 47 for the slight modifications to paragraph 1 where the taxpayer lacks the legal capacity to sign the nomination (as a result of being a minor or loss of mental capacity.

See question 50 for suggested wording for foreign currency account nominations.

Supported by

DEEMED DOMICILE CHANGES - TRUST PROTECTIONS

These questions and draft suggested answers have been prepared by committee members of STEP, ICAEW, the CIOT and the Law Society to highlight and consider areas of uncertainty in the statutory provisions for trust protections as introduced by F(No) A 2017 with effect from 6 April 2017. The questions and the draft suggested answers have been sent to HMRC for comment.

The draft suggested answers have not been agreed by or commented upon by HMRC at this stage and should not be taken as representing HMRC's views.

The draft suggested answers reflect the views of the committee members of the professional bodies involved in their preparation on the generic issues addressed in the questions and draft suggested answers. The questions and draft suggested answers are intended to assist professional advisers in considering the issues, do not constitute advice and are not a substitute for professional consideration of the issues by such a professional adviser in each client's specific context.

SECTION A PROTECTED FOREIGN-SOURCE INCOME AND TAINTING

The description of what constitutes a protected trust and therefore what is protected foreign source income (PFSI) is set out in largely identical terms in TCGA 1992 Schedule 5 paragraphs 5A and 5B, ITTOIA 2005 sections 628A and 628B, ITA 2007 sections 721A, 721B and section 729A.

For the sake of brevity and convenience, the questions below refer to the TCGA provisions in Schedule 5 paragraphs 5A and 5B (unless otherwise specified in the question) but the same clarification should be regarded as asked and given in respect of the other provisions.

References to 'HMRC's guidance' in the questions below are to the guidance published by HMRC on GOV.UK on 31 January 2018, as updated on 2 February 2018 at the following link:

https://www.gov.uk/government/publications/trust-protections-and-capital-gains-tax-changes

Question 1 – the point at which a settlement is created

The point at which a settlement is created by the settlor is important because in order to access the trust protections the settlement must have been created when the settlor was not deemed domiciled in the UK. How is the date of creation established?

Suggested answer: There are no special rules for these purposes; the position under general law will establish the date of creation of the settlement. In general terms, assuming there is already certainty of objects and intentions, a validly constituted express settlement is created when property first becomes comprised in it. Until the settlement contains funds or other property it is not created. Mere execution of a document is not sufficient. It is necessary for the settlement to be properly constituted.

Question 2 – inadvertent additions

Can inadvertent additions of property or income taint a protected settlement?

Suggested answer: Condition D is that 'no property or income is provided directly or indirectly for the purposes of the settlement by the settlor…' Property or income provided inadvertently would not by definition appear to be provided 'for the purposes of the settlement'. In addition an inadvertent addition of property or income would often also fall within the exemption in paragraph 5B(2)(b) for transactions without gratuitous intent.

Question 3 – de minimis disregard

It is unclear whether HMRC will be willing to apply a de minimis disregard but it would obviate the administrative burden of establishing evidence of intent or inadvertency. Such an approach would seem to be within HMRC's care and management powers and consistent with the limit that used to apply for foreign currency remittances (see CG78325).

Suggested answer: HMRC would accept that where there is a de minimis amount , that amount is disregarded for Condition D unless it is part of an arrangement to provide property or income to the settlement in excess of the de minimis limit The disregard HMRC will accept is the higher of £500 and 1% of the net value of the trust property.

Question 4 – settlement of which the settlor is a beneficiary – meaning of beneficiary

Condition D applies to property or income provided directly or indirectly …by the trustees of another settlement of which the settlor is the settlor or a beneficiary. Is 'beneficiary' in this context restricted to an actual beneficiary or does it include any person capable of being added as a beneficiary?

In the latter case most settlements will have a wide power of addition so virtually any settlement from which the settlor is not specifically excluded could fall foul of this condition. As a matter of trust law unless and until someone is added they are not actually a beneficiary at all and the trustees do not need to consider whether to confer any benefits on them.

Suggested answer: A 'beneficiary' in this context means an actual beneficiary of the settlement. HMRC accept that until a person is added as a member of the class of beneficiaries they are not a beneficiary.

Question 5 – meaning of 'provided'

For property or income to be 'provided' for the purposes of the settlement in Condition D, does there have to be an intention on the part of the provider to confer some bounty on the settlement or its beneficiaries (see *IRC v Leiner (1964) 41 TC 589*)?

Suggested answer: Yes, although the same point is made by the exclusions for arm's length transactions and transactions not intended to produce a gratuitous benefit.

Question 6 – does ongoing employment by the settlor taint a protected settlement

For the purposes of Condition D, the addition of value to property comprised in the settlement is to be treated as the direct provision of property for the purposes of the settlement (Schedule 5 paragraph 5A(7)). Assume that a protected settlement owns shares of a company in which the settlor is a senior employee. The shares contain the usual good-leaver / bad-leaver provisions, such that if the settlor leaves employment with the company then the shares are lost (either through forfeiture, conversion into deferred shares, change in share rights, sale back to the company, compulsory sale to other shareholders or some other similar mechanism). If the settlor is a 'bad-leaver' then the shares will be lost on disadvantageous terms (eg they may have to be sold back to the company for only £1).

Does the settlor remaining in employment – thereby preserving the value of the shares for the trustees – constitute an 'addition of value' to the settlement thereby causing the settlement to lose protected status?

Suggested answer: No. The settlor remaining in employment merely preserves the value of the shares rather than adding to their value. However, even if there were some enhancement of the value of the shares, the use of the term 'provided' in Condition D indicates, as in other tax contexts, that there must be some element of bounty or gratuitous intent on the part of the settlor (see *IRC v Leiner (1964) 41 TC 589)*. Typically, the settlor will wish to remain in employment for other reasons unconnected to the shares. Except in extreme cases (for instance where the employment is contrived and the overall terms of employment are not undertaken on a commercially justifiable basis), it is not thought that this would constitute the direct or indirect provision of property or income within Condition D.

Question 6a – share options or deferred shares

As above, save that the settlement owns shares under an American-style deferred shares plan (or alternatively owns options under a European-style option-scheme). Under the deferred shares plan, restrictions on the shares fall away as the shares 'vest'. Typically, this will be because the settlor remains in employment with the company in question. This more clearly 'enhances' the value of the shares. Does the answer to this question differ from the question above?

Suggested answer: No. Although the settlor remaining in employment may enhance the value of the shares or options, as long as the overall terms of employment are undertaken on a commercially justifiable basis), this would not be considered to be the provision of property or income or the addition of value which disapplied Condition D. Only in extreme cases, where the settlor deliberately acted solely with the objective of enhancing the value of the shares or the share-option scheme was otherwise contrived to achieve this result, would this taint the settlement.

Question 7 – retention of income due to life tenant – does this constitute an addition?

What is the position where trustees of a life interest settlement simply retain income due to the life tenant who is the settlor? In such cases the trustees hold the income as nominee for the life tenant and there would not appear to be any question of property or income being provided within Condition D unless there is some positive act on the part of the life tenant which permits the trustees to retain the income.

Suggested answer: Condition D is that no property or income is provided 'for the purposes of the settlement'. Income due to a life tenant who is the settlor will invariably leave 'the settlement' and become held on bare trusts or nomineeship under TCGA section 60. So in a typical case where the trustees simply have not got round to making the distribution but they fully intend to, then the life tenant can be taken to have no gratuitous intent towards the settlement. However, where there is evidence that the life tenant has deliberately left income in the hands of the trustees with a view to the additional investment return enhancing the value of the property comprised in the settlement, Condition D may be in point.

Question 8 – guarantees and other transactions which do not add absolute value to a trust

Does an addition of value mean an addition of value in absolute terms, not relative terms i.e. the relevant question is not whether the transaction was beneficial to the settlement compared to some hypothetical commercial transaction, but whether the transaction itself resulted in an actual and identifiable increase in the value of the trust fund.

For example, assume trustees borrow commercially from a bank and pay an arm's length rate of interest. As is common, the bank requires the settlor to guarantee the loan. The bank does not require collateral for the guarantee. No payment is made by the trustees to the settlor for giving the guarantee as there is no realistic risk that the trustees will not be able to repay the loan.

Suggested answer: Arguably there is no gratuitous intent on the part of the settlor in giving the guarantee as the settlor does not consider that there is any significant risk that the guarantee will be called (and even if it were the loan would be subrogated to the settlor assuming he has the right to recover any amounts he has paid under the guarantee from the trust fund).

SP5/92 takes the position on a generic basis that the giving of a guarantee is to be treated as the provision of property/income for the purposes of the settlement. However, in these particular circumstances, there is no provision of property or income to the trustees by the settlor merely by the giving of the guarantee. The trustees have borrowed money but they have the obligation to repay the money along with an arm's length rate of interest. There is no risk in reality that they will default on their obligations. Whilst a third party might have charged the trustees for giving a guarantee in similar circumstances, the guarantee does not itself increase the value of any of the trust assets. The transaction does not therefore fall foul of Condition D. Unless the guarantee resulted in the trust paying a rate of interest that was demonstrably uncommercial or there was a real risk of the trustees being unable to meet their obligations, HMRC would not regard the trust as tainted.

Question 9 – preserving the value of trust property rather than increasing it

A protected settlement owns a UK residential property in which the settlor lives. The settlor lives there rent-free by virtue of a licence granted by the trustees. The settlor generally keeps the property in good order and repair. Does this constitute an 'addition of value'?

Suggested answer: No. Incurring expenditure of a revenue nature to maintain the property in good order and repair merely preserves the value of the property rather than enhancing it. Whilst it is not necessary, a requirement to keep the property in good order and repair could be included in the licence.

Question 9a – improvements to a property but with compensation

As above, but the settlor carries out significant improvements that would be categorised as capital in nature. However, the settlor is compensated for these improvements, either immediately or through some form of 'tenant-right' clause in the licence (entitling the settlor to compensation for improvements at the termination of the licence). Does this constitute an addition of value? Does the same apply if the tenant-right clause depreciates any improvements (for instance if the settlor spends £100,000 on improvements, the amount repayable under tenant-right will be written-off over the useful life of the improvement, say 10 years).

Suggested answer: No. As long as the settlor is properly compensated for the improvements, then there is no addition of value to the settlement. A tenant-right clause, so long as structured on the same terms that would have applied with an arm's length tenant, can be sufficient to achieve this. Provided that any depreciation is on terms equivalent to arm's length terms it should not constitute an addition of value to the settlement. In the above example the settlor will enjoy the improved property while he or she still lives there. If however, the licence enabled the trustees to bring the settlor's occupation to an end at any time and they did so shortly after the improvements were made then HMRC would expect the settlor to be adequately compensated for such improvements.

Question 9b – saving the trustees an expense

As above, but the property is a block of flats (or other nearby properties). The settlor lives in one of the flats, but the others are let on arm's length terms to third party tenants. As the settlor lives nearby, he assists the trustees with certain practical day-to-day matters such as interviewing new tenants, assisting with rent collection and generally in answering practical queries and passing these onto the trustees. But he does not do so on an overly regular basis, such as to make him a dependent agent of the trustees.

Does the position differ if the settlor lives nowhere near the property or properties, but fulfils the role which a managing agent would otherwise have fulfilled?

Suggested answer: It is natural for a settlor or beneficiary to seek to assist the trustees to maintain the value of settlement property. Helping to maintain the value of the existing settlement is not the same as an addition of property, income or value (which contemplates value coming into the settlement 'from outside' it). Even if the trustees are thereby saved an expense, so long as this is through the settlor's own efforts, this would not appear to be an addition of value. The position would be different if the settlor met an expense which the trustees should properly have met (e.g. the settlor paid professional managing agents to save the trustees from doing so).

Question 10 – investment suggestions from settlor – addition of value?

The trustees of a protected settlement invest the settlement fund in a portfolio of financial investments. The portfolio is regularly reviewed both with professional investment advisers and with the beneficiaries (which may include the settlor). The settlor herself works in the finance industry (say a hedge-fund manager) and offers helpful advice to the trustees about the investment of the portfolio. The trustees accept this advice which results in a better return than would have been the case had the settlor not been consulted. Does this amount to an addition of property?

Suggested answer: No. Trustees are typically under a duty to take into account the wishes and views of the settlor and other beneficiaries as part of the proper exercise of their role. So long as the investments are purchased at market value or otherwise on arm's length terms, the value added to the settlement is not by the settlor, even though the settlor may have recommended a good investment.

Question 10a – investment advice to trustees with additional features

As in question 10 above, but with one or more of the following additional features:

(a) the settlor is a financial professional and routinely provides free advice, such that the trustees save on the fees which would otherwise have had to be paid to an independent financial adviser;

(b) the settlor introduces the trustees to bespoke opportunities which would not have been available to the general public (but nonetheless the price paid by the trustees is market value or otherwise on arm's length terms);

(c) The trust deed specifically reserves the role of "investment advisor" or "investment director" to the settlor and the trustees are obliged by the settlement deed either to consult the settlor or, in some cases, the trustees have no investment discretion at all and must follow the views of the settlor.

Suggested answer: As in question 10, as long as all the investments are acquired at market value or otherwise on arm's length terms, there is no addition of property, income or value here. Any addition of value comes from the settlement fund being invested well, not from the settlor adding 'external' value. Introducing an 'opportunity' of itself should not amount to an addition of property. That the trustees are saved an expense by virtue of the settlor doing what any beneficiary or settlor would naturally do (namely aiming to work with the trustees to improve the investment of the trust fund) is not something that should be considered to be an addition of value. (By contrast, if the trustees are saved an expense for which they are liable, because the settlor pays that expense for them that would constitute an addition of value– see question 9b above).

Question 11 - reduced management fees or other preferential terms due to wider relationship with settlor

The trustees of a protected settlement invest the settlement fund in a professionally managed investment fund. The settlor is an employee or partner in the fund along with others and is unlikely to control the fund terms and conditions. It is common in private equity and private investment funds to provide that as long as the settlor is an employee or partner management fees are not charged or are set at a lower amount for the settlor, his family and related trusts than would be the case for a third party investor. If the settlor's employment or work relationship with the fund ceases this benefit also ceases. The settlor would not receive any additional salary or benefit if the trust did not take advantage of this benefit.

Alternatively lower fees are charged (or perhaps a higher return is given) because the settlor, in parallel, has his or her own funds with the same institution – and because both the settlor and the trustees are co-invested, the total investment moves into a higher tier.

A similar point arises where the investment fund is willing to charge reduced fees where the investment into the fund is made by an individual or an entity associated with that individual that the fund wishes to attract because of that person's 'name' in the market.

Suggested answer: There is no provision of property or income, or addition of value to the settlement by the settlor. Whilst another investor might have been charged a higher fee in similar circumstances, the settlor has not provided any income or added value to the settlement. Condition D is not engaged.

Question 12 – addition of value by inaction – e.g. allowing an option to lapse

HMRC's published guidance includes the following example between paragraphs 5.4 and 5.5.

Example: Raphael is domiciled under common law in British Columbia, where he was born and has his domicile of origin. He is the settlor of the Raphael 2007 Discretionary Trust. He is also a beneficiary of the trust. The settlement was made in March 2007 and the trustees are resident in the British Virgin Islands. The trust receives income that would be relevant foreign income if received by an individual resident in the UK. Raphael has been resident in the UK since July 2010. Raphael becomes deemed domiciled in the UK by virtue of his long-term residence in the UK with effect from 6 April 2025. Raphael holds an option to purchase a majority of the shares in a Canadian company, which are currently owned by the trustees of the Raphael 2007 Discretionary Trust, at a substantial discount to their present value. In June 2027 Raphael releases the option. At that time the exercise of the option would have allowed Raphael to acquire the shares at substantially below their market value. By forgoing the exercise of the option Raphael has increased the value of the shareholding of the settlement. Conditions A to E are met, but it is necessary to determine whether or not the provision of property in June 2027 is to be ignored for the purposes of condition F. The release of the option by Raphael plainly does not fall within categories (c) to (g). It is not a transaction entered into on arm's length terms and Raphael does not offer any evidence that he had no intention to confer a gratuitous benefit on any other person. Neither category (a) nor category (b) allows the release to be ignored. Condition F is not met and the settlement is 'tainted'.

Would the outcome be the same if Raphael had merely let the options lapse?

Suggested answer: Unless the lapse was caused by a non-tax related circumstance, eg the sudden ill health of Raphael which prevented him exercising the option thereby allowing it to lapse, the same outcome would flow. By analogy with IHTA 1984 section 3 where a transfer of value may be made by way of omission, an omission which results in the lapse of the option would be regarded as an addition of value.

Question 13 – property provided pursuant to a liability – timing.

If property is provided in pursuance of a liability incurred after 6 April 2017 but before an individual becomes deemed domiciled, it would be expected that Condition D would not apply as property would be treated as being provided when the liability to deliver is incurred. However, the disregard in paragraph 5B(2)(f) might indicate that property is provided when delivered not when the liability to deliver is incurred. How binding does the liability incurred prior to becoming deemed domiciled have to be? The example in the guidance does not make it clear.

Suggested answer: Property is treated as being provided when the liability to deliver is incurred. The purpose of the specific disregard in Schedule 5 paragraph 5B(2)(f) is for the avoidance of doubt. The liability must be legally binding prior to becoming deemed domiciled even if it is conditional on certain events occurring.

Question 14 – income of intermediate companies in a chain – whether PFSI

For the purposes of ITA 2007 sections 721A and 729A income of an underlying company can be PFSI where either:

a) The trustees are participators in the company to which the income arises; or
b) The company to which the income arises is the last company in a chain of companies and the trustees are participators in the top company in the chain.

Read literally, this could mean income arising to intermediate companies in the chain cannot be PFSI. However, a purposive construction avoids this result, if ‘the last company in the chain’ is taken to be the company which has received the income, even if that company may have direct or indirect subsidiaries. Could it be confirmed that if the conditions of ITA 2007 sections 721A and 729A are otherwise met, income of all companies in the chain is PFSI.

Suggested answer: It is agreed that the provisions in section 721A and section 729A regarding chains of companies must logically be construed so as to allow income received by companies at all levels in a chain to qualify as PFSI if the various other conditions in these sections are met.

Question 15 – capital sum provisions ITA 2007 sections 727-730 ITA – whether PFSI

Income arising within a company owned by a settlement is PFSI for the purposes of the ‘capital sum’ provisions in the transfer of assets abroad rules (ITA 2007 sections 727 – 730) if the trustees become participators in the company (or the top company of a chain) as a result of a relevant transaction and the relevant income becomes the income of the company as a result of <u>that</u> relevant transaction.

Read literally, this could mean that there are many circumstances where the income of such a company would not be PFSI for the purposes of the capital sum rules.

For example, if a settlor establishes an overseas investment company and transfers £10 million to that company before subsequently transferring the shares in the company to a trust, the trustees become participators as a result of the transfer of the shares to the trustees but the income arises in the company as a result of the original transfer of the £10 million to the company – these are different relevant transactions.

Is it accepted that, in these circumstances, the income of the company is PFSI within ITA 2007 section 729A(4) (assuming the other conditions are satisfied)?

Suggested answer: the intention is that the income of an underlying company in these circumstances should be PFSI for the purposes of the capital sum rules to the extent of the trustees' interest in the company as a participator.

Therefore, if the company is wholly owned by the trustees and there are no external interests, it is accepted that the income qualifies as PFSI. This is on the basis of a purposive construction of section 729A(4)(e) so that the condition is treated as being satisfied as long as the income arises as a result of any 'relevant transaction' rather than the income having to arise as a result of exactly the same relevant transaction by which the trustees became participators in the company.

The position would however be different if, for example, the settlor had made a loan to the company as a result of which income arose to the company and the settlor retained the benefit of the loan. In these circumstances, the income of the company which was attributable to the loan would not be PFSI for the purposes of the capital sum rules.

This is because the series of 'relevant transactions' giving rise to the trustees' participation in the company is completely separate to the chain of 'relevant transactions' which results in income from the proceeds of the loan being received by the company. There is therefore no link between the relevant transaction resulting in the trustees becoming participators in the company and the relevant transaction giving rise to the income.

Question 16 – can existing loans be amended rather than replaced

A repayable on demand loan which was made directly or indirectly to a relevant settlement prior to 6 April 2017 on non-arm's length terms and which remains outstanding on that date will be regarded as a provision of property for the purposes of the settlement and therefore the trust protections will not apply if the settlor has become deemed domiciled. The transitional grace period alleviates the position, where the deemed domicile date is 6 April 2017 and the loan is either repaid in full together with any outstanding interest before 6 April 2018 or made subject to arm's length terms, and arm's length interest is paid to the lender for the period from 6 April 2017 to 5 April 2018 and continues to be payable in subsequent years.

In the interests of clarity, could it be confirmed that the existing on demand loan by the settlor that was not on arm's length terms need not be repaid and replaced with a new loan on arm's length terms, but that it is sufficient to satisfy the transitional provision if the existing loan becomes on arm's length terms by the introduction of new arm's length terms to the loan agreement?

Suggested answer: There is no requirement to repay the loan and replace it with a new loan as long as the existing loan becomes a loan on arm's length terms as defined.

Question 16a

What is the position if a loan for a fixed term of say ten years repayable in 2026 was made before 6 April 2017 on non-arm's length terms by the settlor? There is no tainting as the liability was incurred before 6 April 2017. However, if at the end of the ten year period the loan is not as such repaid (see paragraph 5.8 of HMRC's guidance) but put on arm's length terms as an on demand loan and the official rate of interest is paid going forward does HMRC accept that no tainting arises? On one construction, TCGA 1992 Schedule 5 para 5B(5)(d) might suggest that if the loan becomes repayable after the deemed domicile date there is tainting even if it is immediately placed on arm's length terms.

Suggested answer – As long as the loan is put on arms length terms at the end of the fixed term within the statutory definition then there is no tainting even if it is documented as a continuation of the existing loan rather than the making of a new loan.

Question 17 - loan terms backdated so interest-bearing at the official rate from the date on which it was made

Assume that a loan is made to the trustees of a settlement settled by a foreign domiciliary, either by the settlor or by another settlement of which he/she is a settlor or beneficiary, and the loan is made after the settlor has become deemed domiciled, and the loan is initially made on interest-free terms (or at a rate of interest which is lower than the official rate). This is likely to be due to ignorance of the draconian consequences of a loan being made on these terms. If, having been made aware of the issue, the parties agree that the loan should be treated as interest-bearing at the official rate from the date on which it was made, such that interest accrues from that date as if the loan had been interest-bearing at the official rate, and such interest is actually paid by the trustees at least annually, do HMRC accept that tainting will be avoided?

Suggested answer: HMRC consider that if the loan terms are amended <u>within the first year</u> to make the loan interest-bearing at the official rate (or a higher rate), and interest is paid under the loan at least annually, and as a result of the amendment the amount of interest received by the lender in the year from the making of the loan is at least equal to the amount which would have been received in that period if the loan had been subject to interest at the official rate from the outset, then the loan should be treated as having been made to the trustees on arm's length terms.

Question 18 – payment of interest from trust to trust

Schedule 5 paragraph 5B (7) precludes an interest free loan left outstanding on 6 April 2017 from tainting inter alia if interest at the official rate is paid before 6 April 2018 in respect of the period from 6 April 2017 to 5 April 2018. In many cases the lender will be another trust. It is assumed that payment of such interest will not taint the lending trust.

Suggested answer: In the circumstances described the lending trust will not be tainted.

Question 19 – loans to underlying companies - whether arm's length rules can apply.

It is not clear from the legislation that the requirement that no property or income is provided directly or indirectly for the purposes of the settlement extends to property or income so provided to companies owned by the non-UK resident trustees either wholly or in part.

However HMRC's published guidance (at 5.2) indicates that

'*When considering the tainting provisions it is also important to consider whether any property has been provided directly or indirectly by the settlor….to any underlying entities owned by the settlement at any time during the relevant period.'*

Does it therefore follow from HMRC's view above that in the case of a loan to a company in which the settlement is a direct or indirect participator

- Schedule 5 paragraph 5B(2)(c) and 5B(2)(d) will preclude tainting where interest on such a loan at the official rate is payable and paid at least annually.
- Schedule 5B paragraph 5B(7) will preclude tainting where the loan is varied or repaid before 5 April 2018 if the conditions of paragraph 5B(7) are otherwise met.

Suggested answer : HMRC's view is that that a loan to a company in which the trust is a direct or indirect participator can in principle constitute tainting in the same way that loans to trustees can. However, HMRC considers that the provisions of Schedule 5 paragraphs 5B(2)(c), 5B(2)(d), 5B(2)(e) and 5B(7) apply equally to loans made to companies as to loans made to trustees.

Question 20 – loans to companies whether arm's length terms are only those in paragraph 5B(8) or whether other ways in which such loans can be arm's length

Paragraph 5B (8) sets out what is necessary for a loan to be on arm's length terms if it is made by or to the trustees. Unfortunately, this paragraph does not, on the face of it, apply where a loan is made by or to a company which is owned by a settlement. On this basis, it seems open to a taxpayer to argue that any given loan is on arm's length terms as long as evidence can be produced to support this. For example, if it could be shown that a bank would have lent on similar terms.

However, this leaves settlors and trustees in a difficult position as, in many circumstances, it is very difficult to obtain evidence as to exactly the terms on which a bank may be prepared to lend and it would be much simpler both for taxpayers and for HMRC if it could be accepted that, in the absence of any such evidence, the statutory arm's length provisions in paragraph 5B (8) would apply to loans to or from a company owned by a trust as well as loans to or from the trustees.

Suggested answer: It is accepted that, for the purposes of Condition D in paragraph 5A (and the equivalent income tax provisions), a loan by or to a company or other entity owned by a trust will be treated as being on arm's length terms if it complies with the provisions of paragraph 5B (8). It is also accepted that a loan which does not satisfy these conditions is on arm's length terms if HMRC are satisfied that this is the case based on any evidence provided.

Question 20a

If a loan or other transaction is entered into between the trustees and a company wholly owned by the trust or vice versa, is Condition D in point?

Suggested answer: No, Condition D is not contravened by a loan or other transaction between entities within a wholly owned structure even if value passes from one entity to another.

Question 21 – change in official rate of interest

HMRC's guidance indicates that a loan is on arm's length terms if the interest rate is equal to the official rate at the date the loan is entered into (see the examples under category (c) and category (d) in paragraph 5.5 of the guidance). It is not however clear whether:

a. it makes any difference whether the loans are for a fixed term or whether they are repayable on demand; or

b. HMRC will also accept that the loans are on arm's length terms if, in fact, the terms of the loans provided for the interest rate to be varied so as to track the official rate from time to time.

Suggested answer: Provided that the interest rate is equal to the official rate at the date of the loan, it makes no difference whether the loan is for a fixed term or repayable on demand. HMRC also accepts that the loan is on arm's length terms if the interest rate is at the official rate at the date the loan is entered into and the loan agreement provides that thereafter the interest rate will track the official rate from time to time.

Question 22 – Swiss Franc and Japanese Yen loans

There are different official rates for loans denominated in Swiss francs and Japanese yen (see EIM26106) subject to certain conditions. Will the use of these separate rates be accepted as on arm's length terms in respect of loans denominated in these currencies ?

Suggested answer: Regardless of whether it is higher or lower, the use of the special rates for Japanese yen and Swiss francs is an alternative to the official rate that parties to a loan in those currencies will be free to adopt without the trust being tainted. However, in these circumstances the normal official rate can also be used.

Question 23 – inability to vary terms of loan due to external shareholders

There are situations where trustees own an interest in a company, but do not have full control either because the interest is a minority issue or the interest is a majority one but the level of control is affected by the existence of significant minority shareholders. In such cases, shareholders' agreements (either entered into when investors put funds into a business, or sometimes imposed by the courts in divorce cases) may require the consent of the other shareholders if the terms of loans from the settlor to the company are amended. In such cases, consent may not always be forthcoming – in particular where the arrangement has resulted from acrimonious divorce proceedings, or where the company's business does not have the cash to pay the interest.

How will the tainting rules apply in such cases , where it has not been possible to amend the terms of the loan, due to circumstances outside the control of the settlor, so that it is on arm's length terms by 5 April 2018.

Suggested answer: There is no gratuitous intent on the part of the settlor if a pre-existing shareholders' agreement or other arrangement which is binding on the shareholders prevents any change to the terms of a loan (absent a breach) without shareholder consent where such consent is sought in accordance with the terms of the agreement and denied on valid grounds, provided that that the shareholders are not otherwise connected. The lack of gratuitous intent in these particular circumstances means that no property or income is provided for the purposes of the settlement by the settlor and Condition D does not apply. An extension of the loan beyond its fixed term on non-arm's length terms would fall within Condition D.

Question 24 – use of funding bonds to pay interest; receipt and re-lending of interest

In some cases, companies which are controlled by a settlement may not have funds available to fund interest payments. In cases where the company has a portfolio of liquid investments, it should be possible to realise some of those investments to pay the interest on loans from the settlor (or a connected trust) on arm's length terms. However, where the underlying company has a more active business, or has a portfolio of illiquid investments, it may not be possible for the company to find sufficient cash to fund the interest payments.

Assuming that the settlement will be tainted if interest remains unpaid in these circumstances:

- Would the issue of a funding bond[1] (even if this is not foreseen in the loan documentation) be regarded as payment for these purposes, and so avoid the trust being tainted. The issue of the funding bond in this case should mean that the interest is treated as paid, and so is taxable on the settlor.

- Will the interest be treated as paid in a case where it is paid and then immediately loaned back to the company on arm's length terms, and the settlor treats the interest as having been received by them and taxed accordingly.

Suggested answer: Provided that the arrangements for payment of interest on arm's length terms result in the settlor as lender being in receipt of interest income for UK tax purposes, the arrangements described will not fall foul of Condition D. Loans from persons other than the settlor (other than a trust where he is the settlor or beneficiary) would not taint the trust as such although may, depending on their particular terms, raise other tax issues in relation to that lender.

Question 25 – indirect provision of property/income or addition by a company owned by the settlor

Would the indirect provision of property or income or an addition of value by a company owned by the settlor mean that Condition D is not met ?

Suggested answer: Yes, the indirect provision by a company owned by the settlor will be treated as the provision of property or income by the settlor in the same way as a settlor transaction. Therefore a loan by a company owned by the settlor will taint the trust unless made on arm's length terms.

[1] A funding bond is defined in ITTOIA 2005 section 380(3) as including 'any bonds, stocks, shares, securities or certificates of indebtedness (but does not include any instrument providing for payment in the form of goods or services or a voucher'. It will usually be a loan note (although it can be shares). It would be possible either for a funding bond to be issued under the terms of the original loan instrument or as part of a separate side agreement between the parties. Under section 380 (2) the issue treated for income tax purposes as if it were the payment of so much of that interest as equals the market value of the bonds at their issue.

Question 26 – failure to reclaim tax

The published guidance indicates at the end of 5.5 that :

A failure by a settlor to reclaim tax from the trustees could taint a trust, but provided that the settlor claims reimbursement within a reasonable time the trust will not be regarded by HMRC as tainted.

What is the position if the recoverable tax was paid before 6 April 2017, in some cases many years before ?

Suggested answer: If, prior to 6 April 2017, a reasonable time has passed since the right of reimbursement first arose Condition D will not apply. This is because any addition would have taken place when the right had not been exercised within a reasonable time after it has arisen. There is no further addition if the settlor continues to fail to exercise the right.

Question 27 – inheritance tax implications of loan interest payable at the official rate

Paragraph 5B(8) sets out the circumstances where a loan is considered to be on 'arm's length terms'. These provisions are repeated in the equivalent income tax provisions. However, there are no comparable inheritance tax provisions, which may produce uncertainties in some circumstances. For example, assume that trustees make a ten year fixed term loan to a UK resident settlor at a rate that does not exceed the official rate of interest. Further assume that a bank would charge interest at a rate that exceeds the official rate of interest in such circumstances. The settlor cannot pay a higher rate without tainting the settlement. In such circumstances is it accepted that the provisions of IHTA 1984 section 10 would apply because paying interest at no more than the official rate is not intended to confer a benefit on any person and is required under the capital gains tax and income tax rules for the purpose of ensuring that the loan is deemed to be on arm's length terms. As a result there will be no possibility of an exit charge under IHTA 1984 section 65.

Suggested answer: HMRC does not intend to trigger inheritance tax liabilities and reporting requirements as a result of settlors and trustees complying with the statutory provisions under the anti-tainting provisions that treat the provision of loans and payment of interest as being under arm's length terms under those rules.

SECTION B BENEFITS CHARGE ITA 2007 SECTIONS 731 AND 732; TCGA 1992 ss97B and 97C and equivalent income tax provisions

These sections charge benefits to income tax and have since 6 April 2017 been extended to the transferor unless he is domiciled in the UK under general law or is deemed UK domiciled as a returner.

Question 28 – reimbursement of tax – benefit for transfer of assets (ToAA) abroad code ?

ITTOIA 2005 section 646 specifically gives the settlor the right to reclaim from the trustees tax payable by the settlor under ITTOIA 2005, sections 624 or 629. Where the settlor does not do so HMRC consider that this could be a transfer of value for IHT purposes on the part of the settlor (see SP5(92)) and unless a genuine attempt to enforce the right to reclaim has been made that it could taint the trust (see 5.3 and 5.5 of HMRC's guidance). As such, it is assumed that HMRC would agree that the reimbursement to the settlor of the tax suffered should not be seen as a benefit under the new transfer of assets abroad benefits charge.

To take an example:

If a UK resident foreign domiciled settlor establishes a family trust mainly for the benefit of children but being cautious is amongst the beneficiaries (just in case she needs to request funds) then ITTOIA 2005, section 624 is in point. Tax for 2015/16 and 2016/17 is suffered by the settlor on the trust income and, in line with ITTOIA 2005, section 646, reimbursed to her by the trustees in 2017/18. Does HMRC accept that this is not a benefit under the new transfer of assets abroad (ToAA) ITA 2007, section 731 charge?

It is assumed that HMRC does accept that the reimbursement does not give rise to negative income tax or CGT consequences, since:

- Firstly, including a right to reimbursement of the tax in the legislation and then making it taxable would be odd.

- Secondly, since HMRC consider that there will be a transfer of value where the settlor makes no effort to be reimbursed it suggests that HMRC must see the reimbursement as the satisfaction of a right of the settlor and not the obtaining of a benefit (or a capital payment). It would not be fair to, on the one hand, subject the settlor to IHT if the tax suffered is not reimbursed and on the other, if it is reimbursed look to impose an income tax or CGT liability.

- Thirdly, in the HMRC Capital Gains Tax Manual at CG38625 https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg38625 it states at the end that for CGT purposes there will be no capital payment where a beneficiary or settlor receives an amount under a statutory right for reimbursement (such as ITTOIA 2005, section 646). Taking a different approach for the adjusted ToAA benefits charge would not make sense.

Suggested answer: HMRC accepts that where a beneficiary or settlor receives an amount under a statutory right of reimbursement (such as ITTOIA 2005, section 646) that it will not be seen as a benefit for the purposes of the ToAA benefits charge legislation, so there will be no negative income tax consequences.

Question 29 – meaning of ITA 2007 section 731(1A)

Section 731(1A) prevents a charge where the recipient is non-resident when he/she receives the benefit. On a literal reading this does not apply where the person abroad is a settlement or underlying company and the recipient of the benefit is the settlor. At a purposive level section 731(1A) is plainly intended to be read with section 733A and ensure the settlor can be charged on a benefit received by the settlor's non-resident spouse or minor child but not if the non-resident is the settlor. Could it be confirmed that section 731(1A) will only be applied to tax the settlor if payments are made to the settlor's non-resident close family member and the settlor is UK resident, not where the settlor himself is non-resident and payments are made to him (or a close family member)? An alternative reading would put the settlor in a worse position than a UK domiciliary becoming non-UK resident particularly as the remittance basis could not apply.

Suggested answer: It is not the intention to widen the scope of the transfer of assets provisions by visiting charges on non-resident transferors/settlors (or indeed on non-resident family members themselves). The policy intent of this provision is to ensure the charge under section 733A on the settlor/transferor is not frustrated by the fact that the actual recipient of the benefit is non-resident. HMRC's view is that the non-resident individual cannot themselves be subject to tax whilst non-UK resident. More particularly, if payments are made to the settlor after that settlor has become non-resident it is not intended to charge the settlor.

Question 30 – further territorial issues with the change to the ToAA provisions

As a consequence of the amendments to ITA 2007, sections 731,732 and 733 ITA, it appears that a benefit, provided to a non-UK resident under a power to distribute capital, may be matched and treated as income under section 732. However, due to the restrictions in section 731(1A), only a certain narrow class of non-UK resident individuals may actually be subject to UK tax on that income (none if the purposive approach in the answer to the question above is applied).

The concern is that whilst most non-residents are clearly not taxed on the matched income, the fact that the benefit appears to be matched under section 733 (even though the recipients are non-UK resident) could be taken to mean that capital payments that are thought to be matched to TCGA 1992, section 87 trust gains in the run up to 6 April 2018 will not be so matched.

The reason for the concern is TCGA 1992, section 97(1):

(1) In sections [86A][1] to 96 [and Schedule 4C][2] and this section "capital payment"—

(*a*) means any payment which is not chargeable to income tax on the recipient or, in the case of a recipient who is [not resident][5] in the United Kingdom, any payment received otherwise than as income, but

(*b*) …

Section 97(3) goes on to state:

The fact that the whole or part of a benefit is by virtue of [section 733 of ITA 2007][4] treated as the recipient's income for a year of assessment after that in which it is received—

(*a*) shall not prevent the benefit or that part of it being treated for the purposes of sections [86A][1] to 96 [and Schedule 4C][2] as a capital payment in relation to any year of assessment earlier than that in which it is treated as his income; but

(*b*) shall preclude its being treated for those purposes as a capital payment in relation to that or any later year of assessment.

It could be inferred that a benefit received by a non-UK resident which is matched to income under ToAA is not a 'payment received otherwise than as income' for the purposes of section 97(1). In which case, the benefit would not be a capital payment for section 97 purposes and so would not be matched to stockpiled gains.

This does not however appear to be right. Where a capital payment is made to a non-resident, the question is whether the payment is of an income or capital nature under normal trust law principles. This is confirmed in HMRC's manual (CG 38625). The reference in TCGA section 97(3) to income being treated as arising under ITA section 733 must therefore be read as only applying where that income is taxable (or potentially taxable) – i.e. where the beneficiary is UK resident or is a close family member of a UK resident settlor.

This is relevant only for the 2017/18 tax year since the current Finance (No. 2) Bill will when enacted as Finance Act 2018 change the rules such that capital payments to non-UK residents cannot be matched post 5 April 2018.

Suggested answer: The purpose of section 97(3) is to prevent a CGT charge where a capital payment is subject to income tax under the transfer of assets abroad benefits charge. For the purposes of section 97(1) HMRC agree that a benefit paid to a non-UK resident which is matched to income under ToAA is a payment otherwise than as income for 2017/18 and so is a capital payment and can be matched to gains unless the beneficiary is a close family member of a UK resident settlor.

Question 31 – ITA 2007 section 731(1A) – FIFO and income before 5 April 2017

The charge under section 731(1A) is only made if the relevant income matched to the benefit is PFSI (see section 721(3BA)). Two points arise:

i) In determining which relevant income is matched to the benefit is it correct that FIFO must be used by virtue of ITA 2007 section 735A ?

ii) Is it the case that relevant income cannot be PFSI unless it arose after 5 April 2017 ?

Suggested answer:In relation to i) it is clear from section 731(1A) that section 735A is applied and therefore FIFO is to be used. For (ii) as the changes only apply for the tax year 2017/18 onwards income before that date cannot be PFSI. The amendments made to section 726 introducing sub-sections (6) and (7) refer specifically to PFSI and earlier years thereby providing further confirmation.

Question 32 [text to follow]

Question 33 – valuation of benefits on movable property

The new rules contained in Schedule 9 of F(No 2) A 2017 on valuation of benefits raise some practical issues. The valuation of benefits on movable assets in TCGA section 97B (and equivalent income tax provisions) are reasonably clear in relation to art but are more difficult in relation to items such as planes and yachts. The issues apply not just in relation to settlors but beneficiaries more generally.

Example

X as beneficiary has exclusive free use all year of a private plane owned by the trust. The cost of the plane to the trust was £25 million. The annual taxable benefit is therefore currently £625,000 ignoring 'T' in the legislation. The trustees (or underlying company) require X to reimburse them in full for the crew of the plane who include an air hostess as well as two pilots. X also pays all repairs, insurance and storage charges but no other payments. The total cost of this is £700,000 pa. In these circumstances does HMRC accept that there is no taxable benefit on X and furthermore that if the payments for the plane do not exceed an arm's length amount no tainting occurs if X is the settlor and the trust is a protected trust?

Suggested answer: As X has exclusive use of the plane, any costs or exprenses reimbursed to the trustees, whether they relate to crew or other costs, are in respect of the availability of the plane . Therefore there is no benefits charge and no tainting if the payments are no more than would be paid on arm's length terms.

Question 34 – methodology of valuation

In some cases the arm's length payment for use of a particular asset or house may be more or less than the deemed value of the benefit set out in TCGA 1992 sections 97B and 97C. For example, a beneficiary may occupy a house on a ten year lease at full market rent and as a condition of the lease has to pay for all improvements and maintenance. The arrangement reached is fully commercial with independent valuations.

In these circumstances the market rent due may often be less than that paid under an assured shorthold tenancy where the tenant is not generally liable to pay for improvements and the tenancies are shorter. It is assumed that in these circumstances the provisions in Schedule 9 are intended to displace any actual arm's length arrangements. Therefore if the rent being paid on a commercial basis under a ten year repairing lease is less than the rental value as defined in section 97C(3) (which assumes that the landlord bears the cost of repairs) a taxable benefit will still arise.

Suggested answer: This is correct. However, the beneficiary will be able to deduct from the taxable benefit any sums actually paid in rent for the availability of the land (see section 97C(1)(b)(i)) and any costs of repair, insurance or maintenance (but not improvement). (section 97C(1)(b)(ii)).