

Tax Alert

March 29, 2018

Key Points

- Individuals that are UK tax resident and non-UK domiciled have the ability until 5 April 2019 to cleanse their mixed overseas funds and accounts.
- Affected individuals should act now to review their position and assess what steps may be taken.
- There are a number of formalities that must be met, and traps to watch out for, so careful planning and implementation is needed.



Mixed Funds – Limited Window for Cleansing Until 5 April 2019

Introduction

Individuals that are UK tax resident and non-UK domiciled currently have a limited window until the end of tax year 2018/19 during which they can reorganize (or ‘cleanse’) their mixed overseas funds into separate accounts, to enable remittances to the UK to be made in a more tax efficient way than might otherwise be the case. Updated guidance on these rules has recently been published by HM Revenue & Customs (HMRC). The guidance stresses the importance of complying with the notification formalities and keeping relevant records, as well as providing a number of worked examples.

Background

Individuals who are UK tax resident and non-UK domiciled are subject to tax on their worldwide income and gains, unless the remittance basis applies. Where the remittance basis is available and the individual elects for it to apply, UK tax is applied only to such of the individual's non-UK income and capital gains that are remitted to the UK. Making such an election can involve paying an annual charge depending on the number of years of UK residence (broadly, £30,000 after year 7 and £60,000 after year 12).

Recent wide-ranging changes to the UK's tax regime concerning non-UK domiciled individuals have included the introduction of ‘deemed domicile’ status, whereby broadly non-UK domiciled individuals who are UK resident for 15 out of 20 years will be deemed to be UK domiciled for income tax, capital gains tax, and inheritance tax purposes. This means that, effectively, the remittance basis is not available to long-term resident individuals that satisfy deemed domicile status.

In respect of non-UK accounts containing more than one source of funds, the general position (subject to the limited window discussed below) is that where a non-UK domiciled individual claiming the remittance basis chooses to remit funds from such a mixed fund to the UK, deemed ordering rules will apply. These broadly require that foreign income/gains that would be subject to UK tax on their remittance (so-called

unclean capital) will be deemed remitted before clean capital (i.e., amounts that would not be subject to UK tax on their remittance to the UK - such as amounts that have already been subject to UK tax, certain gifts, or amounts that arose in respect of non-UK income/gains before the individual became UK resident), and that taxable income will be deemed remitted before (lower rate) taxable gains.

Cleansing window

Finance (No.2) Act 2017 has introduced a limited window - closing 5 April 2019 - during which mixed funds may be cleansed (or 'unmixed'), which ultimately can enable remittances to the UK to be made in a more tax efficient manner than would otherwise be the case under the general rules. Different sources of funds contained in a mixed offshore account can be separated out into different accounts, allowing particular funds to be isolated and subsequently remitted without application of the deemed ordering rules that would otherwise apply.

This will be relevant, for example, to UK resident non-UK domiciled fund managers, performing activities both in the UK and overseas, and receiving a non-UK source performance return that is attributable to management services performed outside the UK, where the return has been paid into a single account and 'mixed' together with UK taxed returns. Under the general rules, on a remittance to the UK the non-UK return would be deemed to be remitted to the UK (and therefore become subject to UK tax) before the UK taxed return. However, during the limited window it will be possible to separate the mixed fund into separate accounts, following which only the UK taxed return may be remitted to the UK, and the non-UK return may remain outside the UK.

Where fund managers have reinvested both their unclean and clean capital into the overseas investment funds that they manage, in order to be able to take advantage of the current window and cleanse such capital they would first need to redeem their interests in the relevant funds into their overseas bank accounts before the cleansing transactions could be effected.

The window will also be relevant to UK resident non-UK domiciled individuals with a non-UK bank account containing, for example, a mixture of pre-UK residence income or gains and post-UK residence income or gains, who wish to remit some of the funds to the UK (for example, to purchase a property).

Practicalities and Next Steps

There are a number of formalities that must be met in relation to any cleansing transaction, and certain traps to watch out for, including the following:

- Certain criteria must be met in order for an individual to qualify. The individual must have claimed the remittance basis in any year between 6 April 2008 and 5 April 2017, and must not be a person who was born in the UK and whose domicile of origin was in the UK.
- The cleansing transaction must involve a transfer of money from one non-UK account to another non-UK account.

- The transfer need not be formally notified, but must be nominated. The nomination and transfer must be made by 5 April 2019, and the amount of the transfer must be specified.
- It must be possible to identify the sources of the mixed funds, otherwise the cleansing may only apply to the amounts that can be identified.
- It is important to document the relevant transfers and retain the records.
- There can be only one transfer from a particular mixed account to another specific account.
- Inaccuracies could render the purported cleansing transfer ineffective. HMRC considers that a purported transfer of an amount of foreign income that exceeds the actual amount of foreign income in the mixed fund would mean that the entirety of that transfer (not just the excess) is not treated as cleansed.
- Interest accruing on funds in a cleansed account may need to be paid into a separate account so as not to taint the clean funds.

It would be prudent for any UK resident non-UK domiciled individuals that currently have mixed funds to review their position. A detailed review of the nature and source of funds in the mixed account, together with the individual's future plans, will be necessary to determine the most suitable course of action in respect of any cleansing of the mixed fund while this possibility is available.

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