CLEAN CAPITAL THE STRUCTURING & PITFALLS

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The remittance basis (RB) is a preferential basis of taxation in the UK, which is available to taxpayers that are non-domiciled under UK general law and not yet deemed UK domicile under tax law. A taxpayer claiming the RB is subject to UK tax on any UK sourced income/gains, or any income/gains remitted to the UK.

There have been various changes over the last 15 years since the Finance Act 2008 where major reforms were made to the RB rules. Since then, the Finance Act 2013 and later in 2017 have brought around further change to determining UK tax residency and UK deemed domicile for long-term residents (the 15/20 rule).

These rules can create tax efficient investment opportunities, but there are complexities that need to be managed in real time as part of any wealth planning for a UK client. Without professional help it is easy for clients to trip up on the rules with what they may see as basic day-to-day decisions.

The Structuring

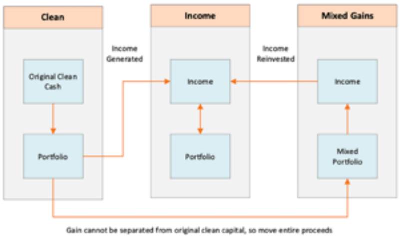
Keeping it Clean

Clean capital – the term used for any funds that can be brought to the UK without being subject to additional UK tax charges (for a client that is claiming or has previously claimed the RB). This will usually be already UK taxed capital or income / gains that have arisen prior to becoming UK resident. This concept is important as once capital has been identified as 'clean' it needs to be preserved and remain easily accessible in the UK.

Achieving this whilst investing clean capital can be difficult as without knowledge of these rules, clean capital can easily become trapped with other mixed funds.

How do we structure?

This would be a basic structure for a client that is investing a pot of clean capital with a non-UK custodian and whilst still claiming the RB:



Within an individual's main clean portfolio there will be three distinct sub portfolios:

1. **Clean –** The clean pot contains the original clean (as defined above) funds being invested; these can be brought into the UK without a charge. This pot can be invested into a portfolio of direct stocks and bonds, which are preferably non-UK situs for tax efficiency, but this will depend on the UK cash flow needs of the client.

2. **Income –** Any income generated on the non-UK situs clean portfolio is not subject to UK tax and therefore needs to be segregated out from the clean pot, this would go into pot 2. Segregation of this income is fundamental, given a remittance of this would be subject to full UK tax. This income should be ringfenced for non-UK spending in priority.

3. **Mixed Gains –** There are anti-avoidance rules for offshore-to-offshore transfers, which means it is not possible to split a capital gain from the original clean proceeds on the disposal of an asset. This means when an asset is sold at a profit, the entire proceeds need to be moved to the mixed gains account. By putting the gain into the "Mixed Gains" sub portfolio this is not tainted with the "Income" portfolio and can be remitted to the UK at a lower cost, 20% capital gains vs 45% income tax.

Often clients have other funds that are not deemed clean capital for UK tax purposes. This could broadly include mixed funds but may also include things such as non-UK employment earnings and overseas workday relief claims.

A similar structure as the above will need to be operated for these amounts and importantly must always be kept separate from any identified clean capital.

I claimed the remittance basis but now am on the arising basis, how does this change?

A common mistake here is thinking that everything can be unwound and used in the UK without any issues, which unfortunately is not the case. As a rule of thumb, if you have income which has benefitted from the remittance basis (pot 2 or 3 in our example above), this cannot be transferred to the UK without paying the corresponding UK tax.

It is imperative to understand the full tax history of a client at the fact find process, which should at least date back to when they arrived in the UK and any activity since.

If you have switched to the arising basis of taxation, you will be generating clean income from all pots (including the mixed funds). The structuring should be adjusted at this point to ensure this additional clean capital can be segregated for use in the UK.

Common Pitfalls

This article is meant to give you a flavour of how you can structure your assets and is by no means a comprehensive guide. If any of the below apply to you, we strongly recommend speaking to someone:

UK situs - Have you purchased UK situs assets in an offshore account? This can give rise to a remittance. Therefore, it is important to allocate exposure to UK markets in a clean capital portfolio.

UK Service Fees - How do you pay for UK professional service fees? This can give rise to a remittance and structuring the payment of professional fees offshore should be considered.

Loans - Loans can also give rise to indirect remittances if not collateralised or serviced using clean capital and so this should always be managed. It is important to know where the loan proceeds are being used and repaid from.

Relevant Persons - Not understanding who is a 'relevant person' for UK tax purposes. For example, transfers of funds offshore to a spouse or a minor child that are then transferred by them to the UK can still give rise to taxable remittances.

Mixed marriages - Is your spouse a non-dom? Shifting assets from a UK domiciled individual to a non-dom could shift them outside of UK taxation.

Intentions - Not considering how long you intend to live in the UK and if you will eventually require offshore funds for UK spending. Structuring prudently and as early as possible can give you flexibility if these intentions change.

Deemed Domicile - Are you coming up to 15 years residency in the UK? Now may be the time to take advantage of the remittance basis one last time and realise some of the gains on your portfolio. Also, if you are deemed domicile for income tax, inheritance tax will also be a consideration.