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PLANNING OPPORTUNITIES USING OVERSEAS BONDS FOR UK RESIDENT BUT NON-DOMICILED INDIVIDUALS

Individuals that are both UK resident and UK domiciled are liable to UK income tax and capital gains tax on their worldwide income and gains (notwithstanding there may be double taxation treaties in place to avoid double taxation of their non-UK income and gains).

The situation is different for those who are UK resident but not UK domiciled (or deemed UK domiciled), in that they have a choice as to how they are taxed on their non-UK income and gains. The choice is to be taxed on either the arising basis or remittance basis.

Under the arising basis the non-UK domiciled individual is taxed in the same way as a UK domiciled individual, which means they are liable to tax on their non-UK income and gains in the tax year they arise.

Under the remittance basis the individual pays tax on their non-UK income and gains in the tax year that they bring the income or gains into the UK; when they "remit" the income or gains. This is summarised in the tables below.

	UK INCOME	FOREIGN INCOME
RESIDENT & DOMICILED	Arising	Arising
RESIDENT BUT NON-DOMICILED	Arising	Arising or, Remittance Basis
NON-RESIDENT	Arising	Not Taxable

	UK GAINS	FOREIGN GAINS
RESIDENT & DOMICILED	Arising	Arising
RESIDENT BUT NON-DOMICILED	Arising	Arising or, Remittance Basis
NON-RESIDENT	Not liable but **care** with regards to temporary non-residence & disposal of UK residential property after 5 April 2015	Not liable but **care** with regards to temporary non-residence & disposal of UK residential property after 5 April 2015

This information is based on our understanding of current law and taxation practice in the Isle of Man, the UK and Ireland as at 1 July 2020. This could change in the future. Tax treatment is subject to individual circumstances and your client should always seek independent and individual tax advice.

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WEALTH SOLUTIONS

LONG TERM RESIDENTS

For people who are non-domiciled and who remain UK resident for longer periods, there is now a charge for the benefit of using the remittance basis of taxation (where unremitted overseas income and/or gains are above £2,000). This charge is known as the remittance basis charge (RBC) and for 2020/21 is as follows:

› Resident for 7 out of the last 9 years - £30,000

› Resident for 12 out of the last 14 years - £60,000.

The effect of the remittance basis charge is to apply an additional tax charge for the individual in that tax year, i.e. the £30,000 and £60,000 will be added to their total tax bill.

Further, people who claim the remittance basis of taxation do not receive a UK income tax personal allowance or capital gains tax (CGT) annual exemption for the tax year in question. This may mean that, where the remittance basis charge would apply, it may not be beneficial to elect for remittance basis. It may only be beneficial to make the election if they have significant overseas income and gains, the UK tax on which would outweigh the cost of the remittance basis charge and the loss of the personal allowance and CGT annual exemption.

It is important to note that the remittance basis of taxation is not available once the individual becomes deemed domicile under the new '15 out of 20 years' rule. Once deemed domicile the individual is liable to income tax and CGT on worldwide income and gains on an arising basis. This is a significant change as the deemed domicile provisions previously only applied to inheritance tax (IHT).

SO HOW MIGHT AN OVERSEAS INVESTMENT BOND HELP?

An overseas investment bond can offer a wide range of investment options ranging from cash deposits to collective investment funds. The investment bond could meet the investment objectives of many clients within a single product, even those with sophisticated investment needs and objectives.

An overseas bond, if correctly structured, can be an internationally mobile investment product recognised by many tax jurisdictions across the globe. This may make it a suitable investment for those that are internationally mobile.

In addition, as an investment bond is a non-income producing asset it may simplify the tax administration of non-UK domiciled individuals who may otherwise need to consider whether to opt for the arising or remittance basis of taxation.

Selling assets, or re-balancing portfolios within an investment bond, does not give rise to any tax liabilities within the fund nor does it give rise to any capital gains tax liabilities on the policyholder. This again may offer some significant administrative and tax planning opportunities.

The following fictional case studies outline some of the planning opportunities that are available using an overseas bond.

CASE STUDY – UK RESIDENT NON-DOMICILED (RND)

Jean is a French national, living and working in London. He has been resident in the UK for 8 years and has been paying the remittance basis charge of £30,000 to avoid paying income and capital gains tax on a worldwide basis. He earns £250,000 p.a. in the UK and is an additional rate taxpayer.

Aside from his assets in the UK, Jean has £5m equivalent in a Swiss bank account generating interest. The £5m is made up of "tainted" or mixed funds, meaning that if any of this money is brought to the UK, Jean will be unable to directly access his original clean capital, having to work through any unremitted income and gains first. Jean plans to leave the UK in four years' time to live and work in Portugal.

He is looking for a suitable vehicle that offers a wide range of investments, is tax efficient and has flexibility to meet his needs depending on his residency at the time of encashment.

HOW CAN AN OVERSEAS INVESTMENT BOND HELP?

Finance (No. 2) Act 2017 allows Jean to cleanse his foreign assets on the basis he has good records of any capital, income or gains accrued. He had until 5th April 2020 for this cleansing to take place.

Records allowing, he could have segregated his clean capital into a separate account and invested it in an overseas investment bond. He could have then used these funds to remit 'income' to the UK without an immediate tax charge using the 5% annual tax-deferred entitlement.

- If Jean re-invested the proceeds from this account within an overseas investment bond it could provide some effective tax planning opportunities
- The investment bond is non-income producing asset. This could potentially mean that he no longer needed to pay the remittance basis charge as overseas investment bonds are taxed on the arising basis
- The bond can access a wide range of investment options including within the UK, without generating a taxable remittance
- There would be no need to account for UK tax in respect of savings interest or dividend income arising within the investment bond
- If he uses an Irish-based overseas investment bond this could provide further VAT savings when utilising discretionary management services
- He could also consider investing monies from his tainted account in a separate overseas investment bond and make withdrawals within the 5% entitlement from this for use when abroad. Such withdrawals would not create a chargeable event and, providing the proceeds are not remitted to the UK, they would not be subject to UK tax.

  When Jean leaves the UK to live and work in Portugal, it may be possible to amend the policy terms to ensure that it is fit for purpose should he wish to encash it when resident in a different EU country.

CASE STUDY – EXCLUDED PROPERTY TRUST

Sophia is a UK resident and non-domiciled Spanish national who has been living in the UK since she married her husband Nick ten years ago. Sophia is a successful investment banker. Sophia and Nick hope to retire early to Spain but have not yet set a target date for doing so. They have two children.

Sophia and Nick have saved and invested for years as they aspire to a comfortable early retirement and have property, cash and investments worth circa £2.5m in the UK.

In addition, Sophia has deposited her annual bonuses into overseas bank accounts with these being worth £2m. Good records have been kept with original capital and income/interest being segregated into different accounts. Her adviser explained that, as a non-UK situs asset this should be excluded property in the hands of a non-UK domicile such as herself.

The couple are aware that they do not have a full spousal exemption for IHT purposes if Nick were to die first and his estate was to pass to Sophia. Sophia could potentially elect for UK domicile status for IHT purposes which would grant a full spousal exemption between them, but this election would also mean that her overseas bank accounts would then be subject to IHT.

A SOLUTION FOR SOPHIA AND NICK?

Sophia could settle the £2m accumulated capital into an excluded property trust before she becomes UK domiciled, which will happen at the start of her 16th year of UK tax residency due to the deemed domiciled rules (if not acquired before).

To qualify as an excluded property trust, the settlor must be non-UK domiciled when any monies are settled into the trust and the assets transferred into trust must be non-UK assets at the time of transfer (although note special treatment for authorised unit trusts/OEICs).

The trustees could purchase a single premium overseas bond for ease of administration, also enabling simple distributions to Sophia and her family using the 5% annual tax-deferred entitlement.

Under current legislation, the value of assets/investments held subject to the trust will not be included in Sophia's taxable estate for IHT purposes potentially saving £800,000 in UK IHT.

FURTHER PLANNING POINT

Sophia, Nick and the children can also be beneficiaries of the trust and, even if Sophia subsequently becomes UK domiciled, they can benefit without infringing the gift with reservation of benefit rules.

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