WHEN ARE INCOME AND GAINS REMITTED? A CRITIQUE OF HMRC'S VIEWS

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Basic rules and principles

Everybody is familiar with the general idea that under the remittance basis, foreign income and capital gains are taxable if remitted to the UK, so it is important to identify what represents a remittance of the foreign income or gains.

A remittance arises under section 809L Income Tax Act 2007 where:

a) Money or property is brought to, or received, or used in the UK by or for the benefit of a relevant person, or;

b) A service is provided in the UK by or for the benefit of a relevant person.

A relevant person includes the individual, their spouse or cohabitee together with any minor children or grandchildren. It includes (inevitably) a close company where the individual is a participator and a trust where the individual is a beneficiary – although it would be wise to identify whether there is power to add beneficiaries as that would widen the class of trusts which could be regarded as relevant persons: Section 809M

The property or service must be (or derive) wholly or partly, directly or indirectly, from the foreign income or gains; or the foreign income or gains must be used in the UK in respect of a relevant debt.

The same applies to the property of a Gift Recipient who is somebody other than a relevant person to whom the individual has made a gift.

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We must also consider "connected operations" which are operations undertaken with a view to facilitating a disposition by a relevant person to provide the use or enjoyment of the property in the UK: see section 809O.

These provisions are very wide and despite the length of time they have been in force, their meaning is still unclear. Certainly, there is a good deal of difference between what HMRC think they mean in some cases – and the views of everybody else.

Pre Residence income and gains

Income received or capital gains realised before the individual becomes UK resident are not taxable and can be remitted tax free.

This is not (necessarily) the case where the individual has been Temporarily Non Resident under the Statutory Residence Test, in which case special rules apply.

But if you were UK resident when the foreign income or gains arose (and claimed the remittance basis in that year) any remittance of that foreign income or gains in a later year for which you are UK resident will be taxable – even if you are not claiming the remittance basis for that year.

Relevant Loans

Where foreign income and gains are used to repay a loan outside the UK where the money borrowed has been used or received or enjoyed in the UK, that will represent a remittance: see section 809L(3). That is only to be expected.

This applies not only to the repayments of principal but also to payments of interest (unlike the position prior to 2008). Problems can arise with secured loans – see later.

Credit cards

Credit cards give rise to contractual obligations between the individual, the credit card company and the supplier of goods and services. (Debit cards are not quite the same; there is no credit component).

HMRC take a simple view that if you buy something in the UK with your foreign credit card and the credit card bill is paid off out of foreign income or gains at the end of the month, you have made a remittance.

It is not that simple when you analyse the contractual relationship because for example when you buy something in the UK with your foreign credit card, a

contract is not necessarily created in the UK between you and the UK supplier. The contract is likely to be between the UK supplier and the foreign credit card company. Your contract is likely to be with the foreign credit card company. So when you pay off the foreign credit card bill out of foreign income that may be the discharge of a foreign debt – and not represent a remittance. However, it could be that the asset (or service) obtained is used or enjoyed in the UK.

It is obviously preferable to avoid an argument and it would be safer to arrange to have the credit card bill paid from funds which are not foreign income or gains.

Bank procedures

HMRC accept that just because money transfers (involving foreign income and gains) in the banking system pass through the UK for clearing, this does not mean that it is remitted to the UK.

Where a cheque is received in the UK – even drawn on a foreign account containing foreign income or gains – this is not a remittance. Similarly, apayment from a donor from an offshore account to the donee's UK bank account (providing he is not a relevant person) does not, on a proper analysis, give rise to a remittance – but HMRC do not agree.

Timpson's Executors v Yerbury 20 TC 155 would seem to give support for the views of HMRC as it decided that the receipt of a cheque in the UK remained the property of the donor – but this decision is not thought to survive the 2008 changes because the foreign income is not brought to or used in the UK by or for the benefit of a relevant person. Not even HMRC think it does (see RDRM36110) which makes their stance on the matter even more inexplicable.

Alienation

A gift of foreign income and gains outside the UK to a relevant person will be treated as remitted if it is subsequently remitted by them to the UK (but not if the donee has, by that time, ceased to be a relevant person).

However, this does not apply to gifts of foreign income or gains outside the UK to persons who are not relevant persons – such as an adult child. The funds can be remitted to the UK by the adult child without any remittance implications.

It may be best not to risk a transfer of the foreign income direct to their UK account. A transfer to their foreign account would avoid any argument with HMRC.

It must be a genuine, absolute and outright gift – with no implication (or any other kind of understanding) that the funds will be returned to or enjoyed by the donor.

Mixed Funds

There are familiar problems associated with mixed funds. A mixed fund is one which contains a mixture of capital and income or gains; or a fund which contains income or gains of more than one year.

Any remittance from a mixed fund will first be treated as income (up to the amount of the income in the fund), then capital gains - and only when all the income any gains have been treated as remitted will the remittance be regarded as tax free capital: see section 809Q.

Mixed funds can arise inadvertently and give rise to real practical difficulties.

A transfer of the income to another account does not remove the income from the mixed fund leaving the clean capital behind. It just creates two mixed funds with the same proportion of income and capital: section 809R. This can be helpful - but watch out for the anti avoidance rule in section 809S.

The Finance Bill 2017 contained a solution to this problem by proposing a cleansing opportunity – but it was removed from the Bill before enactment. It is likely to be back.

The proposal was to enable the taxpayer to transfer the foreign income and gains to a separate account which *would* have the effect of separating income and capital.

But it was only intended to apply to people who had paid the non dom charge (at least once) prior to 2017/18 – but specifically not to a returning non dom (a formerly domiciled resident).

Loans

Section 809L(3) provides that there is a remittance if the foreign income or gains are used outside the UK (directly or indirectly) in respect of a relevant debt.

A relevant debt is one which relates (wholly or partly, directly or indirectly) to property brought, received, or used in the UK – or a service provided in the UK.

As outlined above, the idea is clear enough. You cannot borrow money outside the UK, bring the borrowings to the UK, repay the foreign debt out of foreign income or gains and expect to avoid a remittance.

The position becomes complicated when the loan is secured on assets representing the individual's foreign income or gains.

The traditional view has always been that the foreign borrowings which were brought to the UK did not represent a taxable remittance because what was remitted was not directly or indirectly the foreign income or gains. A remittance arises only if the foreign debt is paid off by foreign income or gains.

However, in August 2014 HMRC took a new view regarding collateral in respect of a relevant debt. They announced that if the loan was secured by assets representing the individual's foreign income or gains, then a remittance was made if the loan monies were enjoyed in the UK. The argument is that the foreign income or gains used as collateral are being used directly or indirectly in the UK - or that the borrowings are derived from the foreign income or gains.

When the debt is repaid out of the foreign income or gains that would naturally also be a remittance – but HMRC say they would not charge it twice. (Why on earth not – if that is what the legislation really means; it must have been the intention of Parliament for there to be a double charge. Or maybe it wasn't and the argument is wrong.)

The potential problem can be overcome by ensuring that there is no such security. The lender may be content merely to be aware of the wealth of the borrower so that a formal security is unnecessary, and HMRC accept that no problems would arise in those circumstances.

HMRC described their change of view as the abandonment of a concession and that this was always their view of the law. It is difficult to find any support for this view.

HMRC are perfectly entitled to change their view – or to adopt new arguments. But many would argue that it is improper for them to impose their new view retrospectively by saying that it was really their view all the time.

Nudge Letter

In August 2013 HMRC issued a "nudge" letter explaining what is meant by a remittance – but what it really does is to deprive taxpayers of the opportunity of escaping from the consequences of failing to report a remittance because it is simply too complicated and they did not understand. The letter tells them in clear terms what HMRC think is a remittance and sets out a list of examples of remittances.

It is a helpful list – except that unfortunately, some of the views in the letter are highly questionable and are likely to have the effect of causing tax to be paid which is not properly payable because taxpayers will follow the HMRC guidance, assuming it to be right. This puts an even higher premium on professional advice.

The various circumstances which HMRC consider represent a remittance are set out in RDRM33050 as follows:

'Money transfers to the UK

1. You transfer some of your foreign income from your offshore bank account to your UK bank
2. You withdraw some cash from your foreign bank account (that contains your foreign income) whilst overseas and bring the cash with you when you return to the UK.
3. You give some of your foreign income to your spouse or civil partner who brings the money to the UK.
4. You transfer some of your foreign income to the UK account of a registered Charity.
5. You rent out your holiday home abroad and the customer pays the rent directly into your UK bank account.
6. You loan some of your foreign income to a company you control overseas or settle some foreign income in an offshore trust. The company or trustees bring the money to the UK.
7. You inherited money a few years ago that you deposited into a foreign interest bearing bank account and you transfer some of the money from this account to the UK. Although the inheritance is not taxable when remitted, the account will also contain taxable interest that will be treated as remitted before any of the non taxable inheritance.

Assets brought to the UK

8. You buy an asset abroad with your foreign income and bring the asset to the UK.

9. You buy a villa overseas using your foreign income which you then sell for a profit. You then transfer the sale proceeds to the UK. This is a remittance of the foreign income used to originally buy the overseas property as well as the foreign chargeable gain.

10. You buy a house in the UK (or any other UK based asset) by making a payment of your foreign income to the seller's overseas account.

11. You buy shares or bonds in a UK registered plc from a foreign broker with your foreign income.

Services provided in the UK

12. You transfer some of your foreign income from your overseas account to the overseas account of a trader who has provided you with a service in the UK.

13. You buy a return air fare from New York to London overseas using your foreign income.

14. You book a holiday with a foreign travel agent to sail from Southampton to New York which you pay for with your foreign income.

15. You transfer some of your foreign income to the overseas account of a friend in exchange for using his cottage in the UK for a week.

Use of credit cards

16. You use a credit card issued by a foreign bank in the UK for day to day expenditure and pay the credit card bill offshore using your foreign income.

17. You use a credit card issued by a UK bank while on holiday abroad and pay the credit card bill using your foreign income

Offshore loans

18. You take out a mortgage with an offshore bank to buy a house in the UK and make repayments to the bank from your foreign income.

19. You take out a loan from an offshore bank secured against your foreign income held by the bank and use the money to fund your life in the UK.

The loan requires you to repay the capital and interest after 15 years. As the loan does not have regular monthly repayments this is a remittance of the foreign income used as security when the loan is taken out.

Gifts to others

20. You give some of your foreign income to a business colleague (or any other person) overseas who brings it to the UK and makes it available for your use.

21. You make a gift of some of your foreign income to your adult son or daughter who lives abroad. Three years later your child gives some of these funds to their 16 year old child (your grandchild), who spends the money during a visit to the UK.

Miscellaneous

22. You have foreign income from a source that ceased before 6 April 2008. Although the source of the income has been disposed of, the income from it will be taxable if remitted to the UK on or after 6 April 2008.

23. You close your bank account that holds funds transferred from another account that closed before 6 April 2008 and which contained an inheritance plus interest that accrued to it over many years. You transfer the whole fund to the UK. The amount that relates to the interest credited to all the accounts is a remittance.

24. You allow a friend to stay in your holiday home overseas, that was purchased with your foreign income and in exchange the friend allows you to stay in his holiday home in the UK.

25. You transfer some of the foreign income you nominated on your tax return for the purpose of the remittance basis charge to the UK. Although you have already paid UK tax on this income, you will be deemed to have remitted other unremitted foreign income or gains you have before the nominated income. You may need to seek advice to determine which of your unremitted income or gains will be taxable instead of the income you nominated.

26. You surrender or dispose of your rights on a life insurance, life annuity or capital redemption policy overseas and keep the proceeds in an offshore account. Any gains on the disposal are not taxed on the remittance basis and should be reported on your return even though not remitted to the UK.’

Some of these are obviously right and uncontroversial – and some of them highlight points which frequently arise.

For example, you buy an asset abroad out of your foreign income and bring it to the UK. (Example 8) That could be almost anything – although not clothing, footwear, jewellery and watches for personal use as they are excluded by section 809X. However, that is a very narrow exemption; nothing else is excluded. What about:

Toothpaste

Perfumes and Deodorant

Books and magazines

Duty free tobacco or alcohol

Music or films downloaded while abroad.

… and so on. None of these may amount to very much – but there is no minimum amount to protect you from tax and penalties. (I wonder what the position is with a stock or holding of Bitcoins which you access via your phone).

A gift to your son who makes a gift three years later to your grandchild. (Example 21) Why three years – why not 10 years. What if the son did not make a gift but uses some of the money to buy the grandchild a phone, an iPad, some clothes and a suitcase. The grandchild travels to the UK with these things and they represent a remittance of your income. All except the clothes, as they are excluded by section 809X – but everything else counts, unless you can claim they are not derived property A nice little present for Grandpa!

The sale of a foreign property and the remittance of the proceeds. (Example 9) What if you sell the property at a loss – there is no gain to worry about so no CGT on the remittance. Quite right – but – what about the money you used to buy the property in the first place. If that was foreign income, this will be a remittance of that income.

Transferring money from your foreign income account to the UK account of a charity. (Example 4) In my view, for the reasons set out above this is wrong – but HMRC seem not to agree. (Exactly the same analysis would apply to a transfer to the UK account of any other non relevant person).

Buying a return fare from New York to London using your foreign income. (Example 13) Again, this is arguable – and the view of HMRC is certainly tenable. I wonder what the position would be if the flight was from New York to Frankfurt which necessarily passes over UK airspace. Part of the service would seem to be used in the UK.

Your foreign broker buys UK equities paid for out of your foreign income. (Example 11) This is arguable. Has the foreign income been received used or enjoyed in the UK? It is unlikely to have been received in the UK (it was probably received outside the UK on acquisition) and it is not used - but it may be enjoyed because you are in possession of a UK asset (and entitled to quiet enjoyment of it?). But if that is right, there would also be a remittance if you lent money outside the UK to a UK resident because the loan would then be UK asset by reference to the residence of the debtor.

These are just examples (there are many more) and the facts (and therefore the analysis) can get seriously complicated.

Finally, two things are vital; record keeping and planning. It is essential it keep good records to show what you have (and what you have not) remitted and to demonstrate its provenance. You may be asked to prove that what you have remitted is not income or gains. If you cannot prove it, you will be in difficulty in defending an assessment or determination.

You must plan ahead. You cannot undo the facts when you have remitted income or gains by mistake. If a third party has done something contrary to your express instructions there is some hope, but generally you will be stuck with what you have done.