



# Credit where credit's due

*Mark Summers* and *Louisa Mannooch* consider the creditability of the UK GBP30,000 non-dom charge

**O**n April 6, 2008, a GBP30,000 annual charge was introduced in the UK for foreign domiciliaries who have been resident in the UK for seven out of the previous nine UK tax years (April 6 to April 5), and who wish to continue to be taxed on the remittance basis. The remittance basis allows UK resident foreign domiciliaries (those who do not regard the UK as their permanent home) to pay UK tax only on UK source income and gains and those they remit to the UK. For non-UK domiciled US citizens and long-term green card holders resident in the UK who are subject to US taxation on a worldwide basis, the remittance basis had allowed a simplification of their tax affairs. The GBP30,000 charge therefore represented a significant cost to retain this position unless it was creditable against their US income tax.

Initially the GBP30,000 annual charge was proposed as a stand alone charge and so it appeared it would not qualify for a credit against US income tax. However, after much lobbying on behalf of the US expat community in the UK, it was reworked as attributable to specific foreign income or gains and so was to be treated as income or capital gains tax in the UK. Accordingly, it is now hoped that it will be creditable. However, the US tax authorities are yet to provide confirmation. In this article we consider the changes to the UK tax treatment of UK resident foreign domiciliaries, look at the creditability of the reworked GBP30,000 charge for US income tax and consider the possible limitations of any credit given.

## The non dom tax changes

In October 2007 the Pre-Budget Report was released, which announced the UK government's intentions to make extensive changes to the UK tax treatment of UK resident foreign domiciliaries. Draft legislation was published on January 18, 2008, which proposed extremely harsh and retroactive tax changes particularly with reference to what constituted a remittance and the taxation of UK resident grantors and beneficiaries of non-UK resident trusts and closely held companies.

Extensive lobbying and representations by STEP and other professional bodies and other interested parties to HM Treasury and HM Revenue and Customs (HMRC) resulted in a significant watering down of the original proposals in the Chancellor of the Exchequer's Budget Statement on March 12, 2008. However, the tax regime for non-UK domiciliaries from April 6, 2008 is still not as favorable as it once was.

Significantly, the government stated that there will be no further changes to the tax treatment of UK resident foreign domiciliaries during the remainder of this Parliament and the next Parliament (provided, of course, that the Labour Party is re-elected).

However, the introduction of the GBP30,000 annual charge for foreign domiciliaries who have been resident in the UK for seven out of the previous nine UK tax years and who wish to continue to be taxed on the remittance basis from April 6, 2008 was confirmed. Such individuals will be able to decide on

an annual basis whether or not to pay the charge. If the remittance basis is claimed, then personal allowances for UK income tax and capital gains tax purposes will not be available to the individual in respect of that particular tax year.

The charge is payable in addition to any tax on foreign income and gains remitted to the UK, and is only payable by adults.

A UK resident non-domiciliary will be able to claim the remittance basis without paying the charge if his untaxed foreign income and gains do not exceed GBP2,000.

The Budget additionally clarified that the charge will be a tax charge on unremitted income and gains rather than a stand alone charge as originally proposed. Therefore, the charge will be regarded as payment of UK income tax or capital gains tax. The individual will be able to choose the unremitted foreign income or gains against which the charge is to be matched. However,



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due to a change in the ordering rules, it is likely that any untaxed foreign income and gains that are remitted to the UK will take priority over the foreign income and gains on which the charge has been assessed. Therefore, the individual will have to remit all his post April 6, 2008 income and gains in order to receive credits for the GBP30,000 charge paid.

If an individual pays the charge from a foreign untaxed income or gains direct to HMRC by check or electronic transfer, this payment will not be taxed as a remittance.

### Creditability of the GBP30,000 charge

The Budget Statement altered the nature of the charge to a tax meaning that the charge could potentially qualify for relief under the UK's double taxation agreements. The issue was of particular concern to UK resident non-domiciled US citizens and green card holders since they pay US income tax on a worldwide basis.

US law firm Skadden was instructed by HM Treasury to advise on certain of the US Federal income tax consequences of specific proposed revisions to the current UK remittance basis of taxation as applied to US citizens subject to that tax. Skadden prepared a memorandum containing their advice, which was, in an unprecedented move, annexed to Budget Notice BN107 that set out details of the reworked GBP30,000 charge. It is thought that HM Treasury took this step because they were unable to procure the agreement of the IRS as to the creditability of the charge in advance of the Budget Statement.

The Skadden advice was stated to be provided primarily on the basis of the United

States Internal Revenue Code of 1986, as amended, regulations issued by the US Treasury on the 2001 US/UK Treaty on Income and Capital Gains and the US Treasury's technical explanation of the Treaty.

Skadden considered Article 24 of the Treaty and Section 901 of the Code in its analysis.

Article 24 provides that 'the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income the income paid or accrued to the United Kingdom by or on behalf of such citizen or resident'. Skadden concluded that the charge should be creditable under Article 24 on the basis that the tax levied on the remittance basis should be viewed as creditable under Article 24 and that this would be unaffected by including the charge since the character of the tax is not changed.

Section 901 allows a credit for income taxes paid or accrued to a foreign country. Skadden concluded that the charge should be creditable under Section 901. In reaching this conclusion, it first considered whether the charge and the UK tax charged on the remittance basis are separate levies and concluded that they should be viewed as part of the same levy.

Second, it considered whether the remittance basis of taxation, as amended to include the charge, gives rise to an income tax or a tax in lieu of an income tax for United States purposes. It concluded that 'if tax charged on the remittance basis, as amended to include the charge, is not treated as having the predominant character of an income tax in the United States sense, it believed that it should be viewed as tax imposed in substitution for income tax collected on an arising basis and therefore as a tax paid in

lieu of an income tax.'

Third, it considered whether the remittance basis of taxation, as amended to include the charge, is a tax in lieu of an income tax and concluded that the charge arguably meets the definition of a tax paid in lieu of an income tax.

### Limitation on credits

Even if the charge were to qualify for a tax credit against US income tax it would never be fully creditable in the US due to the differing tax rates. Higher rate UK income tax is 40 percent compared to the 35 percent Federal rate in the US. The tax rates on long-term gains also differ being 15 percent in the US and 18 percent in the UK. This means that a US citizen resident but not domiciled in the UK paying the GBP30,000 charge in respect of non-UK income or gains would receive a Treaty credit for only 80 to 90 percent of the charge.

In some cases the amount that is creditable will be even less. Whereas in the US relief is restricted to the first USD250,000 of gain on the sale of a main residence, it can exempt the entire gain in the UK. In the UK mortgage interest is not usually deductible except on rental investment property. Most US mutual funds are of 'non-reporting' status for UK purposes and so attract 40 percent income tax rates on capital gains. Qualifying US dividends will attract UK income tax at 40 percent on the remittance basis. UK resident US taxpayers will therefore need to take care as to which non-UK income or gains they attribute the charge.

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