Diminished returns

For many non-doms, the Remittance Basis Charge will not represent a significant new cost at all. *Simon McKie* asks if that can possibly be what the government intended

Our political leaders have performed the remarkable feat of making the taxation of non-domicillaries a matter of popular interest. All the world knows (or at least, that part of it which reads the British press) that as from next year non-domicillaries will have to pay a charge, to be known as the Remittance Basis Charge (the 'Charge'), of £30,000 if they wish to take advantage of the remittance basis in any particular fiscal year. On 18 January 2008 the government published a draft legislative schedule designed to implement the Charge[1].

In the New Schedule the Charge was not stated to be a tax but merely to be treated as a tax for certain limited purposes[2]. The result of that was that it was at best unclear whether or not the Remittance Basis Charge was a tax on income for the purposes of double tax relief. The problem presented itself particularly forcibly in relation to US citizens resident in the UK who would have been faced with paying US tax on their worldwide income in addition to the Charge, with no credit for the Charge against their US liability.

The protests that followed led the chancellor into yet another humiliating volte-face and, on Budget day, Budget Note 107 announced that the mechanism for imposing the Charge is to be totally re-jigged to ensure that it is a tax charge on unremitted income and gains rather than a standalone charge.

That has, one imagines, dealt with the problem of whether it is creditable against foreign taxes, but it raises the interesting question of whether foreign taxes will now be creditable against the charge.

The Budget Note states the new mechanism for imposing a charge as follows[3]:

'9. The tax charge to be introduced from April 2008 will take a different form from the one set out in the draft legislation published on 18 January. It will be a tax charge on unremitted income and gains (or a combination of the two) rather than a stand alone charge. Individuals paying the charge will choose what foreign unremitted income or gains the £30,000 is paid on. As a result the tax paid will either be income tax or capital gains tax. The unremitted income or gains upon which the £30,000 tax has been paid will not be taxed again when and if it is eventually remitted to the UK. There will be ordering rules that determine that untaxed unremitted foreign income or gains will be treated as remitted before income or gains upon which the £30,000 has been paid.

10. The £30,000 charge will be income tax or capital gains tax and should be treated as such for the purposes of Double Taxation Agreements. The tax will also be available to cover Gift Aid donations.'

At first sight, providing that there will be no further charge when the foreign income and gains with which the Charge is matched are remitted to the UK appears generous. A little thought, however, makes one realise that it has a purely technical purpose. If all the income and gains of a year are remitted to the UK, an election for the remittance basis will not be beneficial in relation to that year. So this is a provision that will never have practical effect. It has clearly been included to prevent a foreign taxing authority, which seeks to avoid giving credit for the Charge, from arguing that because the Charge is additional to a charge on the remittance basis, it is not truly an income tax charge at all.

So, as appears, if the charge is an income tax or capital gains tax charge, both under UK taxation law and for the purposes of the UK's double taxation agreements, it must surely be creditable for the purposes of relief under double tax agreements and for unilateral double tax relief under *ICTA* 1988, s.790. The net result may be that for many non-domicillaries the charge will not represent a significant new cost at all. The following example illustrates the position with reference to fictitious jurisdictions in order to demonstrate the application of the provisions of treaties corresponding to the OECD model treaty and the combined burdens of UK and foreign tax on non-domicillaries with interests in multiple jurisdictions.

The Narnia DTT

Mr Tumnus has been resident and ordinarily resident in the UK under UK taxation law for the last 10 fiscal years, but he is domiciled in Narnia. He is also resident in Narnia under Narnian taxation law. Under the UK/Narnia double tax treaty (the 'Narnia DTT') he is resident in the UK. He funds all of his UK expenses from his UK rental income and from foreign capital, none of which arises from disposals of assets on which a capital gain has arisen. His income for both 2007/2008 and 2008/2009 is as set out in the table (p 23).

Narnia, Archenland and Calormen charge tax on the worldwide income and gains of their residents and on the local source income and gains of non-residents. Narnia and Archenland have double tax treaties with the UK conforming to the OECD model treaty, adopting the credit method (under Article 23b) for the elimination of double taxation.

Narnia has a single rate of income tax of 10% except that it does not charge tax on interest arising to non-residents. Archenland has a single rate of income tax of 18%, but also does not charge on interest arising to non-residents. Calormen has a single rate of income tax of 45%.

Type of Property	Situs	Type of Income	Annual Income	Foreign Tax Jurisdiction	Creditable Foreign Tax Rate	Comments
Land	UK	Rent	6,000	UK	N/A	This is exempt from Narnian tax under Article 21 of UK/Narnia DTT
Land	Narnia	Rent	10,000	Narnia	10%	Under Article 6 of UK/Narnia DTT this may be taxed by Narnia and the UK, but the UK must allow credit for Narnia tax
Land	Calormen	Rent	100,000	Narnia	N/A	Article 21 of the UK/Narnia DTT prevents Narnia imposing taxation on this income
				Calormen	45%	Calormen imposes tax at 45%, which is creditable under *ICTA* 1988 s.790(4) because it arises in Calormen
Shares	Narnia	Dividends	100,000	Narnia	10%	Narnia imposes tax of 10% for which, under Article 23b of the UK/Narnia DTT, the UK must allow credit
Shares	Archenland	Dividends	400,000	Archenland	15%	Archenland may impose a tax of up to 15% under Article 10 of the UK/ Archenland double tax treaty. Under Article 23b, the UK must allow credit for this tax
				Narnia	N/A	Article 21 of the UK/Narnia DTT prevents Narnia imposing taxation on this income
Bank deposits	Narnia	Interest	100,000	Narnia	N/A	Narnia does not charge tax on interest paid to non-residents
Bank deposits	Archenland	Interest	300,000	Archenland	0%	Archenland does not charge tax on interest paid to non-residents
				Narnia	N/A	Article 21 of the UK/Narnia DTT prevents Narnia imposing taxation on this income

2007/2008

Mr Tumnus' liability to UK tax in 2007/2008 was:-

	£
UK rental income	6,000
Personal allowance	<5,225>
	775
Tax thereon at 10%	78

2008/2009

In 2008/2009 Mr Tumnus elects to treat £90,000 of his Calormen rental income as the income in respect of which the Charge has been made. His UK income tax calculation becomes:

	£
Rental income	6,000
Income from Calormen property	90,000
Total income	96,000
Basic rate tax at 20% on 36,000	7,200
Higher rate tax at 40% on 60,000	24,000
	31,200
Double tax relief restricted to UK tax on Calormen income	
(36,000 – 6,000) @ 20%	<6,000>
(96,000 – 36,000) @ 40%	<24,000>
UK tax liability	£1,200

In 2008/2009 Mr Tumnus' taxation liabilities on his total income may therefore be summarised as follows:

Item	Income	UK taxation liability	Foreign taxation liability	Total liability
	£	£	£	£
UK rent	6,000	1,200	0	1,200
Narnian rent	10,000	0	1,000	1,000
Calormen rent	100,000	0	45,000	45,000
Narnia dividends	100,000	0	10,000	10,000
Archenland dividends	400,000	0	60,000	60,000
Narnian bank interest	100,000	0	0	0
Archenland bank interest	300,000	0	0	0
	£1,016,000	£1,200	£116,000	£117,200

The only effect on Mr Tumnus of the new rules on the remittance basis is that he has lost the benefit of the personal allowance, increasing his UK taxation liability on UK rent by £1,045 (£5,225 @ 20%). The Remittance Basis Charge is entirely covered by credit for the Calormen tax on his Calormen rents. He has paid a substantial amount of tax because of his foreign tax liabilities, although the average rate of 11.5% is perhaps not too bad on an income of over a million pounds.

If one were drafting a new charge to tax the foreign income of non-domicillaries one might think that the first thought in one's mind would be how that charge would interact with the double taxation provisions of this and other countries. Anybody with any familiarity with the taxation of non-domicillaries would surely immediately consider that point. Yet in drafting the New Schedule, the draftsman adopted, with apparent deliberation, a structure where the amount charged was not an amount of tax, which had the result that it would probably not be creditable either under our double tax treaties or under the provisions of foreign countries for the unilateral relief of double taxation. Could he really have done that through incompetence?

Perhaps another explanation is that the draftsman had indeed seen that the Charge would not be creditable for double tax relief purposes and had preferred to allow non-domicillaries to suffer a double charge rather than allow the Charge to be reduced by creditable foreign tax. If that was the government's calculation, it has misfired and the government has suffered the political damage that comes from retreating in the face of public protest. Having conceded the point, the government will find it very difficult to prevent foreign tax from being credited against the charge because it will be bound by its treaty obligations.

That is not to say it won't make the attempt. Only when the legislation implementing the revised proposals is published, either in the Finance Bill or before, shall we know the approach the government will take.

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1. References to the 'New Schedule' are to the draft Schedule published on 18 January 2008. Other statutory references prefixed by 'New' are to the statutes cited as they would be amended by the New Schedule if it were enacted.
2. New *ITA* 2007, s. 809F
3. In paragraphs 9 and 10 ibid