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NON DOMS MAKING COMMERCIAL INVESTMENT IN THE UK

The Budget on 23 March 2011 announced the Government's intention to introduce a relief for non doms using offshore funds to invest in the UK.

It was proposed that this would take effect from 6 April 2012 and that there would be a period of consultation in respect of the relief.

A consultation document has now been issued and we set out below an outline of the relief and its interaction with Entrepreneur's Relief for UK Capital Gains Tax.

Overview of the relief

Investment type

Non doms will be able to use unremitted foreign income and / or capital gains to invest in "qualifying businesses" in the UK without an immediate UK tax charge arising.

Any investment would only qualify if it is in respect of shares in, or loans to, a company. This therefore restricts the benefit of the relief as investing in funds or partnerships is not currently covered. It would seem that undertaking a "qualifying business" in a personal capacity will also be excluded.

To be a "qualifying business" the company will generally have to be a "trading company" within the usual terms of trading for UK tax purposes.

There has been a slight relaxation to the trading definition for the purposes of this relief in that investment in a business that undertakes development or letting of commercial property should also qualify. Investment in some types of residential property should also qualify.

It is proposed that this would include investment in residential nursing homes and hospitals.

To qualify for the relief trading, development or letting of commercial property must constitute a "substantial proportion" of the overall activities.

At present, "substantial proportion" has not been defined. It may be that this follows the rules for Entrepreneur's Relief, whereby 20% non trading activity is acceptable for the relief to apply. We will of course need to wait for confirmation of this.

Ownership of residential property by the business for personal use of the investor is to be specifically excluded.

At present, it is proposed that the relief will only apply to investment in unquoted trading companies, but HMRC are looking at the possibility of including investment in companies that are listed on a recognised stock exchange.

Limits on level of investment

HMRC have confirmed that there is to be no upper or lower limit on the level of investment. This is to seek to maximise the number of people using the relief.

Anti Avoidance Provisions

Whilst provisions are to be put into place to avoid abuse of the relief, HMRC are mindful that these should be as simple as possible so as not to discourage investment.

The individual investor can be connected to the company, such as by being an employee, and can be remunerated by the company provided it is on commercial terms.

Any non commercial payments made to the investor will be deemed to be a return of the original investment funds.

There will be provisions to prevent non doms buying a pre-existing business from themselves by selling it to a new company funded by income remitted from overseas.

Any sort of arrangement whereby the invested funds are used to enable other external borrowing to benefit the investor are also to be disallowed.

Position of original funds on sale of investment

Once the investment is disposed of, the investor will have a period of two weeks to send the original invested funds back outside of the UK, otherwise they will be taxed as if the original investment funds have been remitted to the UK at that point.

There are, however, due to be provisions that will allow for the funds to be re-invested into another qualifying business without the need to send the funds outside the

UK. Again, this will need to be completed within two weeks of receipt of funds on a sale of the investment.

Tax position of gain

At present there has been no guidance provided on the interaction of this new relief and existing reliefs such as Entrepreneurs' Relief.

We can only assume that any gain arising on sale will qualify for Entrepreneur's Relief provided the investment would qualify under normal circumstances.

If the gain would not qualify for further relief this should be taxed at normal rates for the purposes of UK Capital Gains Tax.

The point should be clarified during the consultation period.

Other provisions of relief

It is proposed that a claim for this relief to apply will need to be included in the investors UK tax return, although the actual investment will not need prior approval from HMRC.

The amount of information required to be disclosed will be limited to ensure that making a claim will be as simple as possible.

Only investors claiming the remittance basis can benefit from the relief. The position in respect of an individual who claims the remittance basis in year one, but is taxed on the arising basis in year two when they make an investment, is not clear. Further detail on this will be sought during the consultation.

The new relief will also recognise that non doms generally have offshore trusts to hold investments. It is proposed that there will be no restriction on an offshore trust making a qualifying investment and benefitting from the relief.

Conclusion

Overall this relief should offer benefits, in the correct circumstances, for the non dom looking to invest in the UK without triggering a UK tax liability.

There is of course the requirement to make provision to avoid potential abuse of the relief, but hopefully this will not become to onerous.

In response to the consultation, STEP's UK Technical Committee have formed a working party and will reply to the consultation on behalf of the Society.

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