



Welcome to the autumn edition of Focus

We are now settled into our new home and although there hasn't been much need to try out the air conditioning over the last few months everything went very well with the move. Many of our clients and friends have visited our new office and the feedback has certainly been positive.

Frank Hirth's New York office is now up and running and we welcome Kevin Johnson and his team as a major addition to Frank Hirth. This offers a great opportunity for Frank Hirth's expansion, along with the potential for our London team to experience work in New York, and vice versa.

In honour of our newly established New York presence we have an article covering New York State's continued scrutiny of residency issues and use of the "permanent place of abode" exception. Such topics will form a main part of future editions of Focus.

Our annual trainee programme has seen 15 new faces join the firm. They have all completed our initial internal training sessions and are now working directly on our client's tax affairs. We also welcome a number of experienced professional staff to our various tax and audit teams along with additions to our IT and administrative groups as the firm continues to grow.

We also bid a fond farewell to Jean Bantock who has decided to retire to a life of travel after running our reception for the last 8 years, and Joyce McFee, who has retired and will be spending more time with her family after 10 years of service. We thank both Jean and Joyce for their valued contribution to the firm and wish them well for their future.

Congratulations go to Kiriaki Touli for passing her CTA exams, David Foster for achieving his ATT qualification, Matthew Norris and John Bull for passing their EA and ATT exams and Nargis Khan who has passed her ACCA exam. These are major milestones in their careers so very well done to them all. Our study programme remains an integral part of the firm's development with members

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of our staff studying towards qualifications in a wide range of areas, including US and UK tax, audit, company secretarial and human resources. We will update you of their successes in future editions of Focus.

The previous months have seen a lot of attention focused on the recent UK tax changes implemented following the enactment of the Finance Act 2008, and much of this edition of Focus has been dedicated to this area. We have provided an analysis of the changes to the remittance basis of taxation available to non-domiciled individuals, including the implications of the £30,000 charge. We have also looked at the changes to the UK tax treatment of trust interests, from both a settlor's and a beneficiary's perspective.

These changes will certainly impact many of our clients as we look to try and clarify the uncertainty created following the original Pre-Budget Report and subsequent Budget. We intend to help highlight the major issues that have arisen, and the possible opportunities available for planning.

As always we urge any of our clients and friends who feel they are likely to be impacted by these changes to contact us to discuss their own circumstances in order to ascertain how significant the rule changes will be to them personally.

On the US tax side there has been a huge effort to meet the 15 September and 15 October filing deadlines which cover a multitude of compliance requirements facing individuals, corporations and trusts alike. For all US individual filers living outside the US, 15 December is the final deadline for filing 2007 Federal income tax returns. This is fast approaching so we would recommend to everybody who has not sent us their 2007 information to do so as soon as possible. Interest will currently be accruing from 15 April 2008 on any unpaid 2007 US tax liability so you should look to file all outstanding returns as soon as possible.

As ever, if you have any questions or queries, please get in touch with your usual Frank Hirth contact.

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New York Tax Residency Update

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FINANCE ACT 2008

As the saying goes, good things come to those who wait. Given the length of time that has passed since the Pre-Budget Report last October, can we now say that the Finance Act 2008, which came on to the statute books on 21 July 2008, represents good news for resident non-domiciled individuals?

The Basic Idea

The fundamental idea behind the new legislation is to prevent resident non-domiciled individuals using the remittance basis as a method of completely excluding non-UK income and gains from the scope to UK tax – a “get out of jail free” card. For those individuals coming to the UK who could live off UK source income – salary, interest, dividends, etc. – the remittance basis segregated their non-UK affairs quite neatly beyond the jealous gaze of the UK tax authorities. To continue in this fashion will, put simply, come at a cost.

For those resident in the UK for less than seven of the previous nine UK tax years, the cost of the remittance basis will be the loss of the income tax personal allowance of £6,035 and capital gains tax annual exemption of £9,600.

For the longer term residents, the cost is increased by the imposition of an additional charge of £30,000 per annum; the operation of which has been altered substantially since it was first announced.

£30,000 Charge and Nomination

The legislation now works to dis-apply the remittance basis of taxation to those non-UK income and gains nominated by the taxpayer so as to create a tax charge of no more than £30,000. The nomination will be made on the annual self-assessment return and the additional tax of £30,000 will be due on 31 January following the year of assessment, though it may be settled early.

The decision whether to pay the £30,000 charge will be a simple economic choice – the question will be whether the global tax bill will be less if the benefit of the remittance basis of taxation in the UK is retained. For US persons, there is still the lingering question as to whether the payment of the £30,000 will qualify as a foreign tax credit on their US return. No decision has been reached by the IRS on this issue, though we remain hopeful for a positive outcome by the end of the year.

There are complicated rules in connection with the ability to remit nominated income and gains to the UK. If nominated, income and gains are remitted to the UK and if there is still other unremitted income and gains, then the remittance is not regarded as having come from the nominated income and gains, rather

from the other unremitted income and gains. In this regard, the rules will place an artificial ordering of remittances to income and gain types, using a method which yields the greatest tax take for HM Revenue & Customs. Moreover, once this provision has been tripped by a remittance to the UK, then all future remittances will be caught.

In this regard, very great care will need to be made with the nomination, and it is our strong advice that great care is taken before remitting any nominated income and gains to the UK as the anti-avoidance provisions could cause great issues both in the tax year of remittance and going forward.

Worldwide Basis of Taxation

Where it is clear that retaining the remittance basis of taxation is a price not worth paying, the US/UK double tax treaty will hold the key to the tax position in both the UK and US. Where tax is being paid in the UK on worldwide income and gains, then care will need to be taken in ensuring that credit for tax payable in the UK is available for full credit in the US. In these circumstances, it is possible that payments of UK tax will need to be made before 31 December 2008 that relate to tax liabilities for the UK tax year ending 5 April 2009.

The changes in the law will also bring the differences in treatment between the US and UK into sharp contrast. Where an individual disposes of an asset, they will need to work out whether there is a gain or loss according to both US and now UK rules. The US will tax gains made on assets based on the US dollar uplift, though after conversion to sterling, exchange rate fluctuations mean that the gain charged in the UK is different.

On a practical level, this will mean a greater administrative burden to comply with UK tax requirements. The legislation does allow for the opting in and out of the remittance basis of taxation, though this will come with its own issues, especially if non-UK funds are required for use in the UK.

What is a Remittance?

When trying to make the important annual decision as to whether to be subject to tax on the arising basis or to pay the £30,000 charge, it is necessary to consider the amount which you are likely to want to remit to the UK in the tax year in question.

One of the significant areas of change to come from the Finance Act 2008, and one which may catch many people by surprise, is the definition of what is a remittance for these purposes. The new definition is now considerably wider and covers a number of situations not previously considered a remittance.

It may not be immediately apparent that shipping art work, bought in New York with non-UK income and gains, to the UK could now trigger a UK tax charge. The new definition of a remittance covers not only cash brought into or used in the UK but also assets brought into or received in the UK, and services received in the UK where these are funded from overseas income or capital gains. The rules do have a number of oddities, which in time will be ironed out.

For example, if you are bringing in suitcases of new clothes or jewellery resulting from a shopping spree in New York funded with non-UK income and gains, this will not be regarded as a remittance to the UK as long as the purchases are for “personal use”. There is a separate exemption covering items up to £1,000, so it is presumed that the accessories cost limit must, according to the Revenue, be no more than £1,000.

On a basic level, the new definition also sees “gifts” between spouses/civil partners or parents/grandparents and minor children/grandchildren made outside the UK, where the money is subsequently remitted to the UK, being treated as a remittance by the original donor – this is a departure from the



Carter v Sharon alienation abroad approach. Moreover, the rule applies to co-habitees, which for these limited circumstances are effectively treated as married – a first in UK tax law!

The new rules can also apply where a trust or offshore company is funded with offshore income and gains and these monies are subsequently brought into or used to invest in the UK.

In drafting the legislation, the Revenue have given themselves wide powers to deem many transactions and arrangements they consider offensive as tax avoidance. In essence, if monies are needed in the UK by either you or an immediate member of your family that would otherwise suffer UK tax on a remittance, then any contrived arrangement to get the money into the UK will invariably be taxed as if the money had been directly remitted.

Finally, it was possible to purchase your UK property by taking out an offshore mortgage and funding the interest with non-UK income and gains without triggering a remittance to the UK and a tax charge. This loophole has been closed though existing mortgage holders will not be affected until there is a variation in the loan arrangement or 6 April 2028, whichever is the earlier. If you have structured your UK property purchase in this fashion, then great care should be exercised in ensuring that you do not offend the tightly worded grandfathering rules.

Therefore, it is important to seek advice from your usual Frank Hirth contact before the event to minimise any resulting UK tax liabilities.

Mixed Funds

The Finance Act 2008 also finally introduces formal rules regarding the treatment of remittances to the UK from a mixed bank account. A mixed account for this purpose is one which has more than one source of income or income and capital gains within it and this will therefore cover quite a few accounts.

Under these new rules, a "roman candle" is in fact created for each tax year that the account is in existence with the sources of funds going into the account for any tax year being considered to leave the account in the following order:

1. Employment income which is not in any category outlined below i.e. UK earnings;
2. Relevant foreign earnings;
3. Foreign specific employment income such as share options;
4. Relevant foreign income against which a foreign tax credit will not be claimed;
5. Foreign chargeable gains against which a foreign tax credit will not be claimed;
6. Employment income subject to a foreign tax;
7. Relevant foreign income subject to a foreign tax;
8. Relevant foreign gains subject to a foreign tax; and
9. Any other income or capital



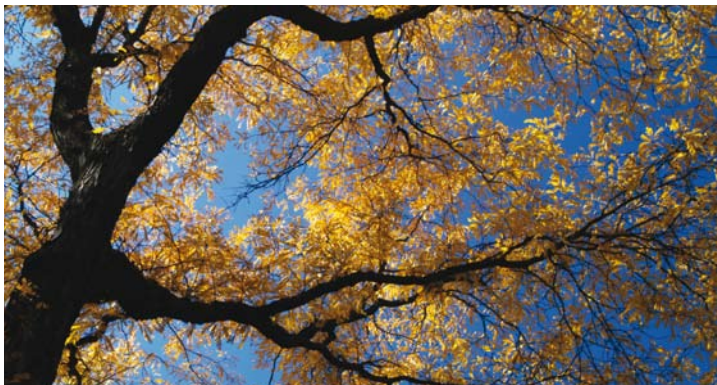
This new ordering system essentially means that UK employment income is deemed to be remitted first followed by foreign employment income, other foreign income and then foreign gains. Amounts which are not subject to overseas tax and for which a foreign tax credit will not be claimed are remitted before those on which overseas tax has been paid. Finally, any other UK income and capital are remitted. As you would expect, this is the order resulting in the greatest UK tax liability!

Only once all forms of income and capital arising in the tax year (although only up to the date of actual remittance rather than the whole of the tax year in question) have been remitted do we turn to other years with later years being considered first. The benefit to these new rules is that it is only necessary to remit the current year income and capital gains before being able to remit an element of non-taxable capital. The new rules also now separate the gain element on the disposal of an offshore asset from the original base cost or "capital" when constructing the "roman candle" for the year of disposal.

Structuring Your Non-UK Accounts

The result of the legislation is that if you intend to remit funds to the UK and claim the remittance basis then it is vital to know what is being remitted. The mixed account rules are designed with the Revenue's own best interests in mind. However, it is possible to segregate accounts to assist with remittance planning. Traditional planning was that one would operate three non-UK accounts – one for capital, which could be remitted to the UK tax-free, the second for income, which if remitted would trigger an income tax charge and a third for capital gains, which again would trigger a tax charge, albeit at the now lower 18% rate.

Where this segregated approach has not been operated before, it is not too late to start. Once up and running and correctly operated, it can reduce the issues on making remittances to the UK. In this regard, we can offer advice in setting up, as well as managing remittances from your non-UK accounts in a UK tax efficient manner.



NEW YORK TAX RESIDENCY UPDATE

Interaction with Non-UK Trusts

Many Americans will use "grantor trusts" in their US estate tax planning. Following the changes in Finance Act 2008, trusts created by resident non-domiciled individuals will now come into play when figuring the UK tax liability on remittance or on the arising basis. If the grantor, or their spouse, can still benefit from the trust, then the income of the trust will fall into the grantor's worldwide income. If they do not claim the remittance basis of taxation, then this income will be subject to UK tax as if it were their personal income. The UK has still retained the exemption for capital gains, so gains realised by a US grantor trust are not immediately assessed to UK tax on the grantor if they are resident in the UK.

However, capital gains and income not immediately assessed on the grantor can still fall into the UK tax net on distribution to a UK resident beneficiary, including the grantor. This contrasts with the US where this issue does not arise as the grantor is taxed on all income and gains as they arise, so any payments out of the trust do not attract income or capital gains tax in the hands of the recipient.

If income from a non-UK trust is paid to a UK resident beneficiary, then this will still be subject to UK tax unless the remittance basis is claimed and the funds not brought to the UK. Where payments from a trust are matched to capital gains, the situation has altered. Previously, where payments to non-UK domiciled beneficiaries were matched to capital gains made by the trust, then these would be exempt from UK tax.

This exemption still applies to capital payments to non-UK domiciled beneficiaries matched to gains realised or accrued by the trustees before 6 April 2008. Therefore, the legislation now provides for a "rebasement election" which needs to be filed on 31 January following the year in which the first capital distribution is made after 5 April 2008. In this regard, it is important to consider whether a rebasing election would be of benefit and whether distributions should be made sooner rather than later.

It is clear that the administrative burden will increase on trusts where one or more of the beneficiaries are resident in the UK and advice should be sought at an early stage.

And Finally...

When the measures relating to non-UK domiciled individuals in the Pre-Budget Report were announced, the overwhelming note was one of concern and dismay. The course of legislation through Parliament has not been smooth and, in uncertain times, the additional uncertainty as to the direction of the law was not helpful. However, the legislation has highlighted the continued need for careful and proactive planning so not to fall foul of the more draconian elements of the legislation.



With the opening of a new office in New York it is particularly topical to remind and update readers on the New York State tax rules. In particular, the state authorities' aggressive attitude to continue to ensure 'temporary' absentees have great difficulty in breaking residence.

The New York State tax law defines a resident as an individual who is domiciled in the state, unless he maintains a permanent place of abode elsewhere, and spends in the aggregate not more than thirty days of the taxable year in New York.

The New York authorities in tax appeals where an individual moves to a foreign country on a renewable visa and spends time back in New York on business have ruled that taxpayers have failed to effect a change of domicile and the determination is generally upheld on appeal.

Care needs to be taken around the concept of a permanent place of abode. A permanent abode is property suitable for year-round occupancy; it does not need to be owned by the taxpayer.

A property may not be a permanent dwelling if maintained for temporary and particular purposes. Where the taxpayer leaves New York for employment in London but returns for board meetings in New York, the property will remain a permanent place of abode.

The state tax code gives no guidance on whether a property owned but rented out on a commercial basis represents a permanent home for purposes of these residency tests.

Where you are considered domiciled and a permanent residence is maintained in New York State; you must meet an alternative test to be considered non-resident. The criteria to be fulfilled in meeting this alternative test are:

- An individual must spend at least 450 days out of 548 consecutive days in a foreign country (days for which you enter the state for the sole purpose of boarding an aeroplane to another location are excluded from this calculation).
- An individual must spend 90 days or less in New York State during the same 548 day period. Also, a spouse and children must spend less than 90 days in New York State in any permanent residence during the same period.
- During the non-resident period in the tax year in which the 548 day period begins, there are no further limitations determined by a formula that restrict return trips to New York based on the number of days in this period/548 x 90 (e.g. if you leave New York on 30 June 2008 this would be $184/548 \times 90 = 30$ days).

In future years it may be possible to maintain non-resident status in New York by renting out your New York home. The New York tax code gives no specific guidance on whether a home which you own but lease out to someone else is considered a permanent abode for the purposes of residency tests, but the evidence available would suggest that 'beneficial use' is more important than ownership in this instance.