Cleansing of Funds

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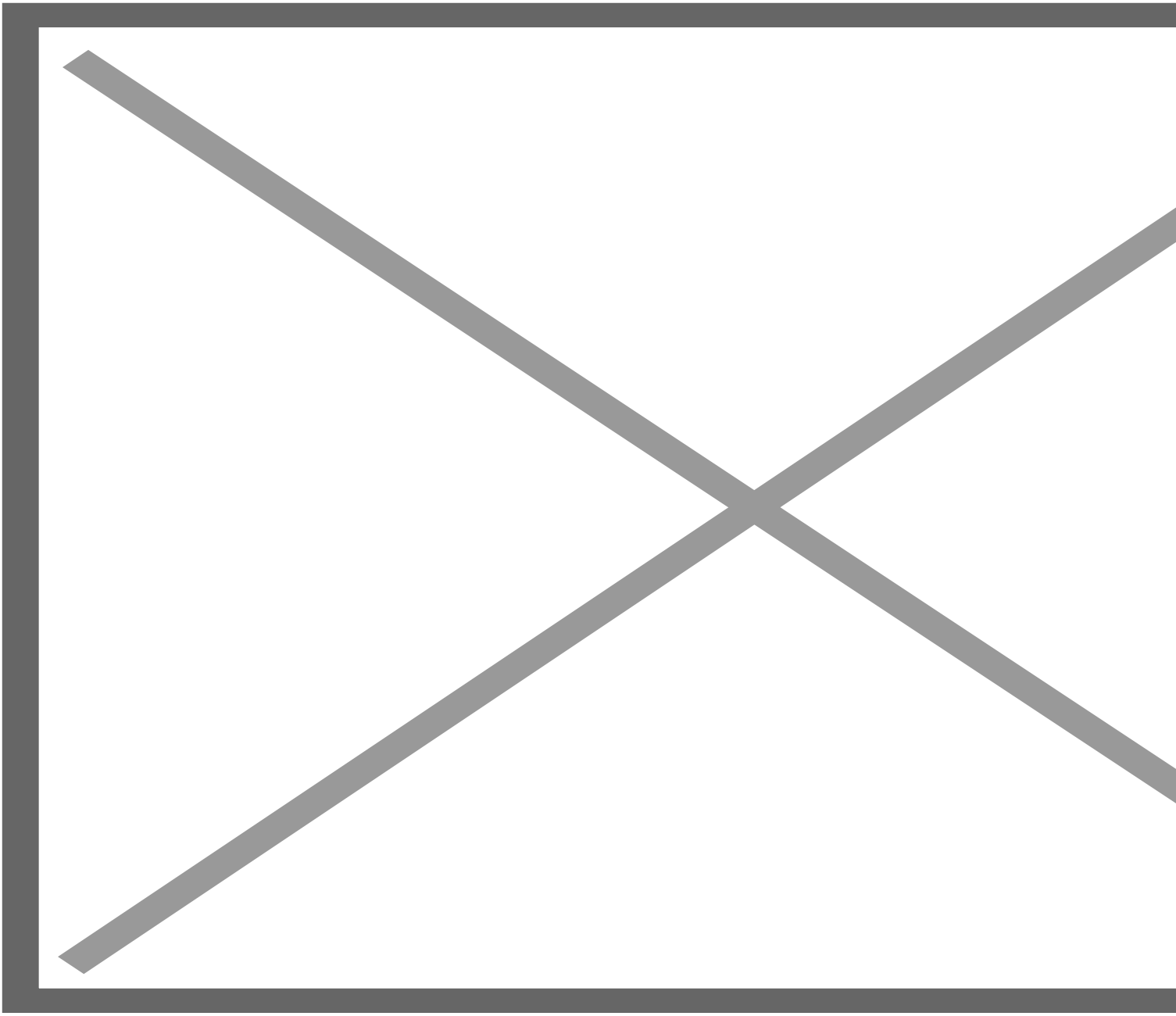

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In this article, *David Bateman* looks at the practical aspects of the new cleansing rules.

The provisions dealing with cleansing mixed funds contained in an offshore bank account are set out in Finance (No.2) Act 2017 Schedule 8 Part 4.

Limited scope

Cleansing of a mixed fund account can only be performed for those who are not formerly domiciled resident (FDR) individuals. The consequence is that those individuals who fall into the section 835BA Income Tax Act 2007 new rules will not be able to take advantage of this facility. Also excluded are those who are non-UK domiciled at the time the nominated transfer of cash takes place and have claimed the remittance basis of assessment in one of the tax years since 6th April 2008 or have fulfilled the conditions in section 809B, section 809D (the amount of unremitted foreign income is less than £2,000) or section 809E Income Tax Act 2007.

Why introduce a relief

Arguably, the motivation for creating this one-off opportunity to cleanse offshore bank accounts was made with the thought that this will incentivise non-UK domiciles to invest in the UK (without suffering the disincentive of a tax charge). The alternative for a remittance basis user to bring funds to the UK is to use the "Business Investment Relief" provisions found at section 809XX Income Tax Act 2007 et seq. which may be too complicated to adhere to given the conditions of the relief.

Time is of the essence

What is significant here is that there was only a two year window, from 6th April 2017, in which to arrange the cleansing. Quite simply, the consequence is that any transfer of funds after 5th April 2019 will not be effective for these purposes. In the limited time that is left it is necessary to calculate the income and capital gains proceeds credited to the mix fund offshore bank account, nominate the amounts of any clean capital that are to be transferred and then to effect the transfer.

The objective

What is the significance of this? Without cleansing the client will not be able to remit funds from that offshore account without incurring remittance income or capital gains tax charges in the same ratio as the underlying amount of the transfer: section 809Q & section 809R Income Tax Act 2007 provide the basis of the calculation of this remittance tax charge. The cleansing nomination process thus gives an opportunity to cleanse that offshore account so as to obtain any clean capital up until now that was not able to be remitted from the mixed fund account to the UK without a tax charge.

There is only one chance of getting this nomination correct though you may nominate another transfer to another offshore account if there is later found further clean capital in the same mixed fund account.

In simple terms then, the objective is to transfer from the mixed fund account the identified clean capital to another offshore account thus leaving the income and capital gains proceeds in the original bank account.

The mechanics

The mechanism is to approach the identification of the clean capital in one of two different directions dependent upon the complexity of the matter. Either:

1. Identify income and capital gains in the account ensuring that the remaining balance of cash is clean capital; or

2. Look to identify the clean capital in the account on the basis you will agree that the remaining is mixed funds.

Whichever way is chosen to look to identify the funds in the account, it will be necessary to have documentary evidence of the process to back up the amount you choose to transfer to the new offshore bank account as clean capital.

The supporting evidence is critical. There will need to be a formal nomination of the amount transferred as being clean capital and the evidence that you have accumulated will form part of the nomination. The records that you will have been created will need to be held and may need to be submitted to HMRC if an enquiry into the affairs of the taxpayer takes place.

Analysis of clean capital

The process mentioned in points 1 and 2 in the section above is likely to be a lengthy process as you will need documentary evidence for the basis of any calculation to identify the credited funds and relate these to any further movements of funds to other offshore accounts and the purchase of any assets from the mixed fund account.

It is important to remember that the cleansing provisions only relate to cash in offshore bank accounts and not to other assets.

It is, however, possible to purchase an asset (e.g. land, art etc.) with mixed funds. If this asset is kept outside the UK then a remittance charge under section 809R ITA 2007 is avoided. If it is brought to the UK then there is a remittance tax charge calculated upon the amount of the income and capital gains bundled up in the purchase value of the asset. The only way of bringing such assets into this new facility is to arrange for the asset to be disposed at arm's length and to place the funds in the mixed fund account that you wish to cleanse.

Clean capital

Clean capital is generally identified as the pre UK-residence balances on offshore bank accounts or the pre UK-residence employment / self-employment income and pre UK-residence disposal proceeds of capital gains which have been subject to UK tax or are not taxable in the UK. It will also include offshore gifts or inheritances of cash that has been credited to an offshore bank account which may then be credited to an offshore bank account after the date of UK tax residence.

It is also possible to receive latent employment cash bonuses relating to foreign duties earned whilst overseas which may then be created to your offshore account and be identified as clean capital.

A common feature of all these items is the fact that the amounts credited to the offshore account do not have any associated UK tax liability or has been taxed in the UK and are later remitted to the UK whilst the non-UK domiciled individual was claiming the remittance basis of assessment.

Once the clean capital bank account has been identified, it is then possible to remit these funds to the UK without a tax charge. HMRC are able to challenge any cleansing nomination under a self-assessment section 9A Taxes Management Act 1970 enquiry. This will enable them to ask for the records and nomination information of any bank transfer to create the clean capital account from which the remittance of cash came from.

If the funds which are transferred are later found to contain income or proceeds from sales of assets that stood at a capital gain then this will mean that the newly created fund in the offshore account will be a mixed fund and

any UK remittance from that account will be subject to either an income or capital gains tax remittance basis charge. It is for this reason that only the transfer of funds from the original mixed fund account that are identified as clean capital should be made.

In view of the complications that may arise in the analysis of funds process and the requirement to maintain the records required for the nomination process it is important to seek professional advice.