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## UK Budget 2008

The UK Budget 2008 was announced on 12 March and introduced widespread changes to the tax legislation in the UK. In particular, there are major changes to the way that non-UK-domiciled individuals residing in the UK will be taxed from 6 April 2008. The announcements in the budget are significantly different to the initial proposals made by the Government in November 2007.

This article is based on the Finance Bill 2008 as published on 27 March 2008 which may be subject to further changes before final enactment.

### Residence Test

Up until 5 April 2008, days of arrival and departure are not counted when assessing whether a taxpayer is resident in the UK for the purposes of both the main 183-day “presence” test and the 90-day “habitual visitors” test. The rules will now be tightened so that a day will now be counted where an individual is present in the UK at midnight. An exception will be made for people only in the UK for transit purposes, in which case their presence at midnight will not count.

### Non-UK Domiciliaries

Major changes have been made to the way that UK resident but non-domiciled individuals are taxed in the UK. Currently, individuals who are not domiciled in the UK are taxable on non-UK source income and gains only to the extent that they are remitted into the UK - the “remittance basis”. Non-UK source income includes employment income where the duties carried out wholly overseas for a foreign employer. For those who are also not ordinarily resident, which will include most expatriates who do not remain in the UK for more than four years, duties carried out overseas for a UK employer are also currently taxable on the remittance basis.

### £30,000 Charge

From 6 April 2008, the following changes will apply:-

- Long-term residents over the age of 18 who have been resident in the UK for 7 out of the last 9 tax years will have to pay a £30,000 charge in any year in which they wish to use the remittance basis. By paying the £30,000, they will not be taxed upon non-UK source income providing it remains outside the UK. This charge will

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not apply to most expatriates as many will not remain in the UK for long enough to be caught. In this case, the remittance basis will continue to be available free of charge subject to the loss of tax allowances (see below).

- If paid, the £30,000 will be available to “frank” unremitted income or gains in a particular year as nominated by the taxpayer, so that a double tax charge does not arise if the income or gains are subsequently remitted to the UK. For instance, a taxpayer could nominate for £75,000 of foreign bank interest, chargeable at 40% (e.g. £30,000 in tax if brought into the UK), to be franked by the £30,000 charge. However, due to new matching rules it will not be possible to bring in purely “nominated” income or gains if there are further offshore income or gains which have accrued overseas. A proportion of the remittance may therefore become chargeable even if capped at the original “franked” amount. This is because the “franked” amount is deemed to be the last part to be remitted of any offshore income or gains.
- The Government intends that the charge is eligible for relief under double tax treaties although this will need to be confirmed by the individual countries concerned.
- Users of the remittance basis will lose entitlement to their UK personal income tax allowance and annual CGT exemption. This includes short-term visitors who do not pay for, but nevertheless use, the remittance basis. The UK personal allowance and annual CGT exemption for 2008/09 are £5,435 and £9,600 respectively. The maximum tax payable as a result of the loss of these allowances is £2,174 and £1,728 respectively.
- An exception is where an individual’s offshore income and gains total less than £2,000 in any tax year. In this case, the remittance basis automatically applies and the user is still entitled to their tax allowances.



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It can be seen from the above that there will be no major changes for expatriates unless they have been in the UK for 7 out of the last 9 years. The main change for short-term visitors with overseas income and gains in excess of £2,000 in any year will be the loss of the income tax personal allowance with a tax cost of £2,174. As expatriate employees are often tax equalised, this may be a cost which an employer will need to bear for each UK employee and, as the extra cost will need to be grossed up, the tax cost per employee would be £3,625. Although the annual CGT exemption will also be lost, this will only be relevant in a year where a UK asset is sold at a gain or foreign gains are remitted.

For long term residents, a choice will need to be made each year as to whether the £30,000 charge is preferable to the UK tax which would otherwise be due on foreign income and gains. In general, offshore income and gains would need to amount to £75,000 for the remittance basis to be worthwhile. HMRC have confirmed that, as long as the £30,000 charge is paid to it directly from a foreign source, it will not in itself constitute a further taxable remittance.

#### **Other changes for non-domiciliaries**

Further changes will apply which are briefly outlined below.

- Certain loopholes allowing the alienation of offshore income to produce a non-taxable remittance have been closed. This includes gifting income to a connected party and then bringing it into the UK as capital, which will no longer be possible.
- A new statutory basis for the taxation of mixed funds remitted to the UK will apply, with a strict order of set-off for income, gains and capital.
- Income and gains brought into the UK to meet interest and sometimes capital repayments of offshore mortgages could previously escape UK tax. Both capital and interest repayments will now be taxable if made out of offshore income or gains. The exception is for interest repayments on existing overseas residential mortgages, which will not be taxable providing they are not met from offshore employment income or capital gains (i.e. they will need to be met from investment or trading income).

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- Structures involving offshore trusts and companies can now face new tax charges where gains are made from which a UK-resident participator or beneficiary can benefit, whether UK-domiciled or not. The rules are complex and separate advice should be sought in this area.

### **Capital Gains Tax (CGT)**

A new single rate of CGT of 18% is to be introduced from 6 April 2008 to replace rates which vary from between 10% and 40%. Taper relief and indexation relief will be abolished. The enhanced level of taper relief which was available for business assets will be replaced to some extent by a new “entrepreneurial relief”. This relief will allow certain businesses to be sold at a CGT rate of 10% where the individual is actively involved in the business and owns a sufficient stake. The 10% rate will be limited to £1,000,000 of gains in a taxpayer’s lifetime.

### **Income Tax Rates**

The basic rate of tax will be reduced from 22% to 20%. The 10% starting rate will be abolished except for individuals with low levels of savings income. The 20% rate of tax will apply to income up to £36,000, after which the 40% rate will apply. Dividend income will continue to be taxed at 10% within the basic rate band and 32.5% at the higher rate, except for foreign dividends taxed on the remittance basis. Foreign dividends taxed on the arising basis will now benefit from the 10% and 32.5% rates where an individual owns less than 10% of the company. It is intended that the 10% maximum holding requirement will be withdrawn from 5 April 2009.

### **Business Taxation**

A number of changes will affect the taxation of businesses, some of which were announced in previous budgets:-

- The main rate of corporation tax for large companies will be decreased from 30% to 28% from 1 April 2008. The small companies’ rate will increase from 20% to 21% on 1 April 2008 and to 22% on 1 April 2009.



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- Changes to capital allowances. Writing down allowances will decrease from 25% to 20% for general plant and machinery and increase from 6% to 10% for long life assets. Industrial buildings allowances will decrease from 4% to 3%. Capital allowances on the “integral features” of a building will decrease from 25% to 10%. Small and medium-sized businesses will qualify for an annual investment allowance of £50,000 which will replace first year allowances. There are also proposals from 1 April 2009 to base the capital allowances treatment of cars on levels of carbon dioxide omissions.
- The research & development tax relief scheme reliefs will be extended from 150% to 175% for small and medium-sized companies and from 125% to 130% for large companies.

### **Administration**

A new penalty regime applying to underpayments of tax arising from incorrect tax returns has been introduced. The new regime will apply to “careless” mistakes and more serious penalties will apply to deliberate errors or omissions, especially where they are concealed. Penalties will also be higher where the disclosure of an error is prompted by HMRC rather than the taxpayer. Penalties will still be levied as a percentage of tax underpaid and will range from 0% to 100% depending on the criteria outlined above.