TAX GUIDE 05/18 CLEANSING OF MIXED FUNDS – PROFESSIONAL BODIES Q&AS

James Kessler QC[1]

Contents

1 SECTION A – FOREIGN CURRENCY ISSUES

Question 1

Foreign domiciliaries will often have foreign currency bank accounts. As such, mixed fund analysis of foreign currency accounts will often need to be carried out. The HMRC Manuals deal will some very simplified examples and suggest that the analysis should take place in the foreign currency with the conversion to sterling only occurring when the remittance takes place.

There is no legislation covering the issue and no specific case law.

Case law is definitive about the need for chargeable gains to be computed in sterling. In addition, from a practical perspective it is difficult to see how anything other than a sterling analysis can (without extreme complexity) work where there are multiple transfers (in some cases hundreds if not thousands) between accounts in multiple currencies. To add to the difficulties in such situations you can have numerous instances of investments acquired using funds from one currency, where the investment is denominated in a separate currency and the sale proceeds go into a third account in another currency.

Since the area is not covered by any legislation there should be a pragmatic position taken. Provided the individual is consistent year on year when the analysis is prepared for a foreign currency account he or she should be able to carry out the mixed fund analysis in either the foreign currency or in sterling. Does HMRC agree?

---

[1] Old Square Tax Chambers, 15, Old Square, Lincoln's Inn, London, WC2 A 3UE.

Suggested answer

Provided a consistent year on year approach is taken for each specific foreign currency account a mixed fund analysis can be carried out in either the foreign currency or in sterling.

JK's comment. That would be sensible, but ...

Example

Clara is a UK resident foreign domiciliary. She meets the criteria such that she can cleanse her mixed fund accounts. She has:

- a Swiss franc account with QRS Offshore Bank; and
- five different foreign currency accounts with LMS Offshore Bank (Swiss francs, US dollars, Euros, Australian dollars and Canadian dollars) as well as a sterling account and an active trading portfolio (buying and selling investments in various different currencies often with the currency used for the purchase not being the same as the currency the investment is denominated in and with the sale proceeds being in a different currency and going to a different account). Various transfers are made between the different currency accounts.

The account with QRS Offshore bank is analysed in Swiss francs.

The complexity of the issues with respect to the accounts with LMS Offshore Bank means that all those foreign currency accounts are analysed in sterling.

In both cases a consistent year on year approach is taken with respect to the mixed fund analysis, so both the analysis for the QRS Offshore bank and the accounts with LMS Offshore Bank are acceptable.

Question 2

HMRC's view, as expressed in the manuals, is that if a taxpayer receives $1,000 of foreign income when it is worth £500 but brings it to the UK when it is worth £700 (due to forex movements) then he is considered to have made a taxable remittance of £700. (Equally if the funds are worth £300 when brought to the UK there is a taxable remittance of £300.)

The HMRC view led to double taxation issues for foreign currency within bank accounts and the law was changed. There is still, however, an issue for other assets if the view expressed in HMRC's Manual is followed. It should be noted that we think that the HMRC view is not the better technical interpretation

JK comments: Yes: see TFD 64.6 (Remittance Basis Currency Conversion Date)

so, it is our view that, provided disclosure is made there are good grounds for not filing on that basis. This issue was discussed with HMRC in 2012 and 2013. The conclusion of these discussions was an agreement to differ in our technical opinions. The issue is, however, thrown into sharp focus by rebasing since the HMRC view does not result in the results one would expect given the Chancellor's announcement

Consider the following example:

Example

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) has $1 million of 2014/15 income which was worth £500,000 when received. It is then invested in an asset. At 5 April 2017 it is was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017. The taxpayer remits the $1.2 million (placed in a segregated account) to the UK

immediately.

HMRC's interpretation is that the $1.2 million represents:

- the $1 million of original income, worth £750,000 at the date of remittance; and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

Under this HMRC approach, since the entire mixed fund has been brought into the UK (so the remittance is not limited to the sterling value of the amount brought into the UK) the taxable remittance is £750,000 notwithstanding that the taxpayer has only remitted £900,000 of cash and expected to benefit from £400,000 rebasing relief.

In contrast, taking the alternative approach (as agreed by the professional bodies) with the same figures the $1.2 million represents:

- the $1 million of original income (£500,000); and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

That is £900,000 is brought in per the mixed fund analysis, which agrees to the value of the sterling amount transferred. Only £500,000 is taxable meaning the taxpayer benefits in full from the £400,000 rebasing relief.

Given this issue what should be done in these circumstances?

Suggested Answer

Provided a consistent year on year approach is taken for each individual mixed fund bank account analysis the conversion of Remittance Basis foreign income to sterling can take place either on the date the income arises or when the income is remitted.

JK comments: yes, on the basis that one can properly follow HMRC guidance if one wants, even if it is wrong.

Question 3

Whilst HMRC in its manuals states that income in a foreign currency should be translated to sterling using the foreign exchange spot rate on remittance this is not the case for gains as there is clear case law to the contrary (*Bentley v Pike [1981] STC 360, Capcount Trading v Evans [1993] STC 11*). As such, HMRC and practitioners agree on the position for gains.

How will rebasing work where just foreign chargeable gains were used wholly (or in part) to fund the acquisition?

Suggested Answer

This is best explained by way of an example.

Example

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) had $1 million within a bank account (this traced to the sale of an investment in 2009/10 and represented clean capital of £400,000 and Remittance Basis foreign chargeable gains of £200,000). The $1 million was re-invested in an asset. At 5 April 2017 the new foreign asset was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017. The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

The $1.2 million represents:

- the $1 million of original funds (£400,000 clean capital and £200,000 Remittance Basis foreign chargeable gains); and
- the £300,000 capital gain (that is £900,000 less £600,000).

That is £900,000 is brought to the UK per the mixed fund analysis, which agrees to the value of the sterling amount transferred.

2 SECTION B– THE OVER NOMINATION TRAP

Question 4

The way the legislation is worded (ITA 2007, Sch 8, Part 4, para 44 (5) for transfers of post 5 April 2008 funds and para 45(5) for transfers of pre-6 April 2008 funds) any over nomination (even as little as £1) can mean that a cleansing transfer fails, and the offshore transfer rules apply. As such, even an error that, for the purposes of tax return remittance computations would not be an issue, is disastrous for cleansing.

Getting a lengthy and complex mixed fund analysis completely correct is unlikely since there will be:

- hundreds/thousands of entries;
- remittances;
- offshore transfers between accounts;
- multiple share/security acquisitions and disposals; and
- various foreign currency transactions (multiple transfers between different foreign currency accounts and the potential for investments to be acquired in one currency, denominated in another and the proceeds paid into an account in a third currency).

The comments in the HMRC guidance, about what can be done where there has been an over nomination such that a cleansing transaction fails, are not helpful in this context.

In theory, where there is a failed transfer such that the original mixed fund and the new account are both mixed, both accounts can be cleansed if there is time prior to 6 April 2019. The problem is that the mixed fund analysis will have been prepared using best efforts and a realisation that there has been an over nomination is unlikely to happen in time for this second successful cleansing exercise.

What can be practically done to try to avoid this over nomination problem?

Suggested Answer

Practically, with the legislation being as unhelpful as it is, where there is a complex mixed fund analysis (meaning significant risk of an error, however small, having crept in) the only practical way forward is a conscious under nomination. For example, where clean capital is to be cleansed and the mixed fund analysis says that there is £3.45 million clean capital, deliberately reducing the amount transferred so the nomination is not too high.

[WOULD HMRC USE ITS CARE AND MANAGEMENT POWERS TO ALLOW A CLEANSING TRANSFER WHERE THE OVER NOMINATION IS LOWER THAN A CERTAIN AMOUNT – SAY £5,000?]

JK's comment: What if one specifies an amount of income/capital which exceeds the amount in the mixed fund? It is considered that the specification should be valid up to the actual amount of income/capital. Though HMRC do not agree. 2018 Cleansing Guidance provides:

If nominated transfers exceed the amount of that kind of income held in the mixed fund account immediately before the transfer then the normal mixed fund rules will apply. Such a nomination would be invalid

If that is right, another nomination could be made.

Question 5

A qualifying individual has a mixed fund account (account C) containing Remittance Basis income with no foreign tax credit, Remittance Basis gains with no foreign tax credit and clean capital. On 14 April 2018 she gives instructions to her bank to make the following cleansing transactions (the instructions for both transfers being given at the same time):

- £1 million of Remittance Basis income with no foreign tax credit to offshore account D;

and

- £2 million of Remittance Basis gains with no foreign tax credit to offshore account E.

Whilst one transfer will be shown as going through first on the bank statement for account C this is purely due to the vagaries of the banking system.

What is the position if it subsequently turns out that the nominated amount of Remittance Basis income with no foreign tax credit was less than the actual amount of income in account C and the nominated amount of Remittance Basis gains with no foreign tax credit was more than the amount of gains in account C?

Suggested answer:

If the transfers are made on the same day with the transfer instruction being provided to the bank (or financial institution) at the same time, the transfer of the understated amount (here Remittance Basis income with no foreign tax credit) will be treated as made first (and will be a valid cleansing transaction).

JK comments: if it was not made first, why should it be treated as made first?

The transfer of the overstated amount (here Remittance Basis gains with no foreign tax credit) will be treated as an offshore transfer (and not a valid cleansing transaction).

Not necessarily

If the mistake is picked up, account C (the original account) and account E could be reanalysed and further cleansing transactions to further accounts could be made within the time limit.

Or a new nomination if the first was invalid?

Question 6: Under-nomination

As stated above any over nomination (even just a £1 excess) is sufficient to mean that a cleansing transfer will fail. As such, where the rules are understood, nominations will be cautious. This will particularly be the case in lengthy and complex mixed fund analysis situations where, even when all reasonable care has been taken, the risk of errors is high due to the onerous and voluminous nature of the analysis work. This will mean that the original mixed fund account will remain mixed even when all the cleansing transfers have taken place.

Please confirm that cleansing transaction(s) and nomination(s) are valid where there have been under nominations and the original mixed fund account remains mixed when all the transfers have taken place?

Suggested answer

In such circumstances the cleansing transaction(s) and nomination(s) will be valid.

There is nothing in the legislation that states that for the cleansing transactions to be valid the original mixed fund account must be fully cleansed such that after the cleansing transactions it is no longer a mixed account.

JK's comment: Yes: see TFD 14.12.10.

Example

An individual has a mixed fund offshore account (account C). The individual knows that the account was opened initially with £10 million of clean capital but is not sure about other receipts. The mixed fund analysis is, therefore, carried out on the basis that all the other receipts are Remittance Basis income with no foreign tax credit. Having carried out the analysis on this basis there is £7.8 million of clean capital as at 29 July 2018. To be cautious £7.5 million is transferred out to newly established offshore account D and the appropriate nomination made for the clean capital (ITA 2007, s 809Q(4)(i)). The remaining contents of account C are unknown. This is not an issue.

Example

An individual has a mixed fund account (account C) and analysis breaks it down as:

- £1.2 million Remittance Basis relevant foreign income not subject to a foreign tax;
- £2.7 million Remittance Basis foreign gains not subject to a foreign tax; and
- £3.3 million clean capital (inheritances and gifts).

All funds arising after 5 April 2008.

The analysis goes back 8 years with thousands of transfers out or between accounts. The individual, therefore, wants to be cautious with cleansing transfers to avoid any risk of over nominations. Three new accounts are opened (accounts B, C and D) and the following cleansing transfers and nominations are made in 2018/19:

- £1 million to account D - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £1 million transferred to account D representing income within ITA 2007, s 809Q(4)(d) (that is relevant foreign income other than income within paragraph (g)).
- £2.5 million to account E - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £2.5 million transferred to account E representing gains within ITA 2007, s 809Q(4)(e) (that is foreign gains other than gains within paragraph (h)).
- £3 million to account F - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £3 million transferred to account F representing income within ITA 2007, s 809Q(4)(i).

The three nominations are valid. Account C remains mixed containing (in accordance with the analysis):

- £200K of relevant foreign income not subject to a foreign tax;
- £200K foreign gains not subject to a foreign tax; and

- £300K clean capital (inheritances and gifts).

3 SECTION C – ACCOUNTS WITH PRE-6 APRIL 2008 FUNDS [Not addressed in lecture for lack of time]

Para 89 Schedule 7 of FA 2008 states: "Sections 809Q to 809S of ITA 2007 (transfers from mixed funds) do not apply for the purposes of determining whether income or chargeable gains for the tax year 2007-08 or any earlier tax year are remitted to the United Kingdom (or the amount of any such income or chargeable gains so remitted)." There are some common law matching rules in place for mixed funds pre-6 April 2008 (such as for remittances from a mixed fund account). These are drawn from case law. There is, however, no case law that deals with offshore transfers.

For the purposes of the cleansing legislation, Finance (No 2) Act 2017, sch 8 para 46 provides two prescriptive mixed fund analysis rules as follows:

1) There has been a transfer of money before 6 April 2008 from the mixed fund to another overseas account (para 46(2)).

2) A transfer of money is made before 6 April 2008 from another overseas account to the mixed fund and there is insufficient evidence to determine the composition of the transfer (para 46(6)).

Question 7

Advisers had no way of knowing about the Finance (No 2) Act 2017, sch 8, para 46 rules prior to March 2017 (when the rules were published in the Finance Bill, although the Snap General Election caused them to be dropped and re-introduced such that they were enacted in November 2017 in Finance (No 2) Act 2017).

Where there are accounts dating back to pre-6 April 2008 and mixed fund analysis was performed prior to March 2017 it is very likely that a different methodology would have been used for the analysis and may have been agreed with HMRC (for example as part of a LDF settlement).

The mixed fund analysis performed, which is likely to be extremely complex and onerous (not to mention expensive in terms of professional time) if not impossible to re-do (as the records may no longer be available), will not be in line with the cleansing legislation. This issue is fundamental since (as discussed in section B above) an over-nomination invalidates the cleansing transactions.

What are taxpayers and advisers supposed to do in these circumstances?

Suggested answer

The statutory rules introduced in Finance (No 2) Act 2017, sch 8 para 46 were enacted to assist taxpayers and advisers where no mixed fund analysis had been performed prior to 20 March 2017 (when the rules were published).

Where no mixed fund analysis was performed prior to 20 March 2017, the statutory rules need to be followed.

There was, however, no intention to inconvenience taxpayers where a mixed fund analysis was carried out prior to 20 March 2017. Such individuals do not have to re-do their mixed fund analysis. Where the mixed fund analysis has been agreed by HMRC the taxpayer can have confidence that the methodology used for pre-6 April 2008 offshore transfers will not be challenged. In all other cases there will not be an issue provided what has been done is reasonable and followed consistently.

Question 8

Does the reference in the legislation to "the mixed fund" in para 46(2) purely refer to the account being cleansed such that the legislative rules above do not apply for pre-6 April 2008 offshore transfers between two mixed funds i.e. does the reference to "another overseas account" in para 46(2) include a mixed fund account or not?

Suggested Answer

There is nothing in the legislation that suggests that the reference to "another overseas account" must be a reference to an account which is not a mixed fund. Indeed, the second rule specifically suggests that the transfer from the other overseas account to the mixed fund is a transfer between different mixed fund accounts since para 46(7-9) suggests there could be income and gains in the other account.

Question 9

As mentioned above, for the purposes of the cleansing legislation, Finance (No 2) Act 2017 para 46 provides prescriptive mixed fund analysis rules in the following situations:

- there has been a transfer from the mixed fund to an overseas account before 6 April 2008 (para 46(2)); and
- there has been a transfer from an overseas account to a mixed fund before 6 April 2008, but only where you did not know the composition of the funds transferred (para 46(6)).

The rules only deal with situations prior to 6 April 2008. It is not clear what should happen where there are offshore transfers of pre-6 April 2008 funds after 5 April 2008.

Suggested Answer

The statutory mixed fund rules only apply to post 5 April 2008 funds. As such, one would look to apply the common law rules in this situation. However, as mentioned there are none. For consistency, where a mixed fund analysis has been carried out prior to 20 March 2017, whatever non-statutory pre-6 April 2008 methodology has been used for pre-6 April 2008 offshore transfers should continue to be followed for post 5 April 2008 offshore transfers of pre-6 April 2008 funds.

W here a mixed fund analysis has not been carried out prior to 20 March 2017 such that the statutory rules are followed for pre-6 April 2008 offshore transfers either of the following approaches should be followed consistently where there are post 5 April 2008 offshore transfers relating to pre-6 April 2008 funds:

- the statutory rules should continue to be followed for consistency; or
- since there is a lacuna in the legislation it would be reasonable to carry out the analysis on the basis that each transfer takes across a proportionate amount of the various different categories of pre-6 April 2008 funds within the mixed fund account.

Question 10

W here a mixed fund analysis for cleansing purposes involving pre-6 April 2008 funds is carried out what how should the analysis be performed:

a) where an analysis was carried out prior to 20 March 2017; and

b) where no analysis has been performed prior to 20 March 2017?

Suggested Answer

a) Where an analysis was carried out prior to 20 March 2017:

- for pre-6 April 2008 funds the common law rules for remittances and onshore transfers;
- for pre-6 April 2008 offshore transfers there are no common law rules provided the methodology used to deal with offshore transfers is reasonable and followed consistency it will not be challenged (see questions 7 and 9) and
- for post 5 April 2008 funds the statutory rules within ITA 2007, ss 809Q and 809R.

b) Where no analysis has been performed prior to 20 March 2017:

- for pre-6 April 2008 remittances and onshore transfers the common law rules and the Finance (No 2) Act 2017, sch 8, para 46 rules for offshore transfers;
- for transfers (remittances or offshore transfers) of pre-6 April 2008 funds after 5 April 2008 the common law rules should be followed for remittances. For offshore transfers either of the approaches outlined in the answer to question 9 should be followed consistently; and
- for post 5 April 2008 funds the statutory rules within ITA 2007, ss 809Q and 809R.

See FAQ 16 for a question on cleansing and the Finance Act 2008, Sch 7, para 86 transitional provisions with respect to relevant foreign income.

4 SECTION D- MEANING OF ACCOUNT

Question 11

The legislation specifies that for cleansing to take place there must be a transfer from one offshore account (referred to as account A) to another offshore account (referred to as account B).Many offshore banks establish a portfolio for a client with a number of different sub-accounts within one portfolio. For mixed fund purposes sub-accounts count as different bank accounts. It is, therefore, possible for one sub-account to be the mixed fund transferor account for cleansing purposes (sub-account C) with another sub-account being the transferee account (sub-account D). Can this be confirmed?

Suggested Answer

Yes, cleansing can take place between sub-accounts either within the same portfolio reference or within different portfolio references.

JK's comment: the issue is not whether there is a sub account, but what if the "fund". See TFD 14.2 (Definition of Mixed Fund) But in principle sub-accounts look like separate funds.

Question 12

Where an individual has an investment portfolio it is common that it is linked to various accounts (capital and income accounts in various relevant currencies).

Assuming the mixed fund definition at ITA 2007, s 809R(4) is met, there are two ways of going about the mixed fund analysis:

First approach

- each account (or sub-account) is treated as a separate mixed fund; and
- each individual asset held within the investment portfolio is treated as a separate mixed fund.

Second approach

An investment portfolio and the associated accounts (or sub-accounts) are treated as a single mixed fund.

Strictly the legal nature of the relationship with the bank /fund manager determines the approach to use.

a) In practise is it accepted that, provided the approach is followed consistently with respect to the investment portfolio and all linked accounts, either of the two approaches set down above will be valid for mixed fund analysis and cleansing purposes?

b) Assuming the above is accepted, how does cleansing differ between the two approaches?

Suggested Answer

a) Provided the approach is followed consistently with respect to the investment portfolio and all linked accounts either analysis will be valid for mixed fund and cleansing purposes.

JK comments: Hmmm. If the position is unclear, perhaps that will happen in practice, but will HMRC commit?

b) Where the first approach is taken, there are multiple mixed funds as:

- each account (or sub-account) is treated as a separate mixed fund; and
- each individual asset held within the investment portfolio is treated as a separate mixed fund.

The accounts (or sub-accounts) can be cleansed separately. To cleanse individual investments the investments would have to be sold. Cleansing all the investments would necessitate the disposal of all the investments.

The position is different where the second approach is taken since the investment portfolio and the associated accounts (or sub-accounts) are treated as a single mixed fund. The cleansing legislation is clear that cleansing transfers have to be transfers of cash. However, it does not say anything about the offshore mixed fund account having to be entirely in cash. As such, if the mixed fund analysis established that there is £2.67 million of clean capital, disposals could occur so as to realise £2.6 million for a prudent cash transfer to a new unconnected account. Everything else could remain invested.

Example

Chuck is a UK resident foreign domiciliary who meets the cleansing conditions.

He has a substantial investment portfolio (all offshore assets) with linked offshore accounts. There is no segregation of income and income and gains are constantly reinvested.

His mixed fund analysis is carried out on the basis that

- each account (or sub-account) is treated as a separate mixed fund; and
- each individual asset held within the investment portfolio is treated as a separate mixed fund.

He wants to cleanse his Microsoft, Apple and Facebook shares as they contain significant levels of clean capital (£5.4 million). As such he sells the shares, pays the proceeds into new account C and then carries out the cleansing transaction.

It would be different if the mixed fund analysis had been carried out on the basis that the investment portfolio and the associated accounts (or sub-accounts) were treated as a single mixed fund. In this case there might be £5.65 million of clean capital in total. Being prudent Chuck may decide to transfer out £5.5 million and would consider what the best way (from an investment perspective) of realising the necessary cash would be. The £5.5 million realised would be paid into an empty linked account and then transferred to a new offshore account with no connection to the portfolio or the linked accounts.

5 SECTION E – MIXED FUND ANALYSIS AND CLEANSING

Question 13

The derivation rules mean that the total of the various kinds of income and capital can be more than the value of the mixed fund. This can occur for various reasons such as:

- how the derivation rules work, for example where £1 million of Remittance Basis relevant foreign income, £1 million of Remittance Basis relevant foreign earnings and £0.5 million of clean capital are used to acquire) an offshore property (total cost £2.5 million) and that property is then sold at a loss for £2 million;
- the interaction with anti-avoidance rules like s13 TCGA.

How do the mixed fund rules and cleansing work in such a situation?

Suggested Answer

The various issues surrounding mixed funds and losses are considered in detail in the FAQs in section G, which consider various possible situations.

In the example in the question the funds used to acquire the property break down into Remittance Basis income and clean capital, as follows:

	Amount	%
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£1.0 million	40%
Relevant foreign earnings - – ITA 2007, s 809Q(4)(b)	£1.0 million	40%
Clean capital – ITA 2007, s 809Q(4)(i)	£0.5 million	20%
	£2.5 million	

The property is sold for £2 million, so we have a loss of £0.5 million and nothing in the legislation to assist in terms of how this loss should be treated. Applying just and reasonable methodology one would proportionally reduce each category of income and capital as follows:

	Acquisition Cost	Reductions	Proceeds
Relevant foreign income	£1.0 million	£0.2 million	£0.8 million*
Relevant foreign earnings	£1.0 million	£0.2 million	£0.8 million*
Clean capital	**£0.5 million**	**£0.1 million**	**£0.4 million**
	£2.5 million	£0.5 million	£2 million

*W hilst the above is a necessary first step as it deals with the loss, the allocation above cannot be the final position. This is because it is not in accordance with the derivation rules for income and chargeable gains in ITA 2007, Part 14, Chapter A1, which make it clear that such amounts cannot be reduced. This means that for mixed fund analysis purposes there is:

	Amount
Relevant foreign income	£1.0 million
Relevant foreign earnings	£1.0 million
Clean capital	**£0.4 million**
	£2.4 million

That is, the aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.4 million higher than the actual £2 million proceeds figure.

The £0.4 million of clean capital can be cleansed.

More complex example

Initially a painting is acquired for £4.8 million:

	Amount	%
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£1.2 million	25%
Foreign gains – ITA 2007, s 809Q(4)(e)	£1.2 million	25%
Clean capital – ITA 2007, s 809Q(4)(i)	£2.4 million	50%
	£4.8 million	

The painting is sold for £3.6 million realising a loss of £1.2 million. Step 1 – proportionally allocate out the £1.2 million loss.

	Acquisition Cost	Reductions	Proceeds
Relevant foreign income	£1.2 million	£0.3 million	£0.9 million
Foreign gains	£1.2 million	£0.3 million	£0.9 million
Clean capital	**£2.4 million**	**£0.6 million**	**£1.8 million**
	£4.8 million	£1.2 million	£3.6 million

Step 2 – adjust the step 1 result as the derivation rules mean that the income and gains figures cannot be reduced.

	Amount
Relevant foreign income	£1.2 million
Relevant foreign earnings	£1.2 million
Clean capital	**£1.8 million**
	£4.2 million

That is, the aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.6 million higher than the actual proceeds figure.

The proceeds are paid into a new offshore account (C) and then reinvested in shares. The shares are sold on 19 May 2018 for £4.4 million and the proceeds paid into account C (which contains no other funds). A Remittance Basis gain of £0.8 million is realised on the sale (£4.4 million less £3.6 million). As such, for mixed fund analysis purposes there is:

	Funds Re-invested	Remittance Basis Gain	Amount
Relevant foreign income	£1.2 million		£1.2 million
Foreign gains	£1.2 million	£0.8 million	£2.0 million
Clean capital	**£1.8 million**		**£1.8 million**
	£4.2 million	£0.8 million	£5 million

That is, again as a result of the derivation rules, the mixed fund analysis aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.6 million higher than the actual proceeds figure paid into account C.

The £1.8 million of clean capital can be cleansed.

The £2 million of foreign gains could also be cleansed (since the current CGT rates are much lower than the Income Tax rates this might be felt to be worthwhile).

Question 14

How do you carry out a mixed fund analysis where an individual has shares/securities of the same class in more than one portfolio?

Suggested Answer

Unless the portfolios mirror each other such that the amount taken from each account to acquire the investments is the same as the CGT base cost amount (TCGA 1992, s 104), there are significant mixed fund issues where shares/securities of the same class are held in more than one portfolio. This is because the TCGA 1992, s 104 legislation provides that all shares/securities of the same class that were acquired by an individual in the same capacity are pooled for base cost purposes (provided the 30 day or same day rules do not apply). As such, the base costs used for the CGT computations will be different (possibly significantly so) to the amount used to acquire the shares/securities.

We would strongly suggest that to avoid complexity, shares/securities of the same class are not held in more than one portfolio.

However, it is likely that not realising the issues, a number of taxpayers will have shares/securities of the same class in more than one investment portfolio. If the client wants to cleanse it will be necessary to carry out a mixed fund analysis taking this issue into account. This additional problem will make a mixed fund analysis in a real example extremely complex and even more time consuming. Depending on the numbers the divergence between the base cost and the amount used from the mixed fund account to make the purchases could result in significant additions to or depletions from the ITA 2007, s 809Q(4)(i) "other" category. In basic terms clean capital could either be created or depleted.

The following is a simplified example to illustrate the point (the acquisition and sales proceeds figures have been specifically chosen such that large gains and losses result in order to show what a significant difference this issue can make to the mixed fund analysis).

Example

Kurt is a UK resident foreign domiciliary.

On 15 June 2011 he paid a £5 million inheritance (received in 2011/12) into account C with XYZ Offshore Bank. He used this £5 million to acquire £1 million shares in Raven Inc (£5 per share). These shares were kept within an investment portfolio with XYZ Offshore Bank with a linked sterling account.

Kurt already held shares in Raven Inc in a mixed fund portfolio with LMN Offshore Fund Manager. The 2 million shares had been acquired in 2008/2009 for £3.50 per share using £7 million of funds representing Kurt's 2008/09 Remittance Basis relevant foreign earnings.

Raven Inc operates in a volatile sector, but Kurt feels he has specialist knowledge of the sector and that he can make a profit from investing in the shares despite the volatility.

On 19 October 2014 Kurt sold 1 million of the Raven Inc shares in his LMN Offshore Fund Manager portfolio for £8 per share.

His base cost per share must take both portfolio holdings into account so is £4 ((£5 million + £7 million) / 3 million).

Kurt is a Remittance Basis User in 2014/15. Proceeds of £8 million are received. This breaks down as:

£3.5 million traceable to Kurt's 2008/09 Remittance Basis relevant foreign earnings (that is 50% of the original £7 million used to acquire the holding of which half has been sold);

£4 million 2014/15 Remittance Basis chargeable gain (proceeds of £8 million less base cost of £4 million); and

£0.5 million – 2014/15 "other" ITA 2007, s 809Q(4)(i) - arisen as the operation of TCGA 1992, s 104 results in a £4 million Remittance Basis Chargeable Gain rather than the £4.5 million gain that would have arisen if pooling was not necessary and the actual amount used from LMN Offshore Fund had been the base cost. As the amount falls into s 809Q(4)(i) it is effectively an addition to clean capital.

Just over a year later, on 24 November 2015 Kurt acquired a further 1 million shares in Raven Inc in his LMN Offshore Fund Manager portfolio paying £2 per share (this was a low price for the shares and Kurt was confident that they would recover).

Kurt reinvested £2 million of the £8 million he received. This is an offshore transfer:

investment 25%; and (ii) kept in cash 75%.

24 November 2015 acquisition	**New Investment - 1 million holding Raven Inc shares 25%offshore transfer**	**Bank account 75%**
2008/09 Remittance Basis relevant foreign earnings	£875,000	£2,625,000
2014/15 Remittance Basis chargeable gain	£1 million	£3 million
2014/15 "other" ITA 2007, s 809Q(4)(i)	£125,000	£375,000

The original unsold 1 million Raven Inc shares in his LMN Offshore Fund Manager portfolio represented £3.5 million of 2008/09 Remittance Basis relevant foreign earnings.

On 5 October 2017 Kurt sold his entire 1 million Raven Inc shares holding in his XYZ Offshore Bank portfolio for £4.50 per share.

Again, Kurt's base cost per share must take both portfolio holdings into account, so is £3.50 ((£5 million + £3.5 million + £2 million) / 3 million). The base cost of the 1 million shares sold is, therefore, £3.5 million.

Kurt is a Remittance Basis User in 2017/18. Proceeds of £4.5 million are received, the base cost for the £1 million shares is £3.5 million (as calculated above). From a CGT perspective, because of the operation of TCGA 1992, s 104, a £1 million gain has been realised (Remittance Basis no foreign tax credit).

If pooling were not necessary and the actual amount used from XYZ Investment Bank had been used as the base cost there would have been a £0.5 million loss. There is, therefore, a mixed

fund analysis issue, since the funds within the bank account are £1.5 million less than the funds used to acquire the shares and the chargeable gain.

The situation here is different to that in question 13 but again we have a situation where there is £1.5 million less in the mixed fund and nothing in the legislation to assist in terms of how this diminution should be treated. Applying the same just and reasonable methodology as in question 13:

Step 1 – proportionately allocate out the £1.5 million across the original clean capital used to acquire the shares and the Remittance Basis gain on the sale of the shares:

	Amounts Per Category	%	Reduction	Proceeds
Clean Capital	£5 million	83.33%	£1.25 million	£3.75 million
Remittance Basis Gain	£1 million	16.67%	£0.25 million	£0.75 million
	£6 million		£1.5 million	£4.5 million

Step 2 – adjust the step 1 result as the derivation rules mean that the gains figure cannot be reduced.

	Amounts Per Category
Clean Capital	£3.75 million
ITA 2007, s 809Q(4)(I)	
Remittance Basis Gain	£1.00 million
ITA 2007, s 809Q(4)(e)	
	£4.75 million

That is, again as a result of the derivation rules, the mixed fund analysis aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is higher (in this case £0.25 million higher) than the actual proceeds figure.

On 19 February 2018 Kurt uses £4.25 million of the £4.5 million within his XYZ Offshore Bank account to acquire 600,000 shares in Raven Inc. This is an offshore transfer:

investment 94.4%; and (ii) kept in cash 5.6%.

On 31 May 2018 Kurt sells the 2 million shares in Raven Inc within his LMN Offshore Fund Manager portfolio for £11 per share.

His base cost per share must take both portfolio holdings into account, so is £3.75 ((£4.25 million + £3.5 million + £2 million) / 2.6 million). The base cost of the 2 million shares sold is, therefore, £7.5 million.

Kurt is a Remittance Basis User in 2018/19. Proceeds of £22 million are received and paid into the same LMN Offshore Fund Manager account as the funds not reinvested from the first sale. The £22 million proceeds breaks down as:

- £ 4,375,000 (£875,000 + £3.5 million) traceable to Kurt's 2008/09 Remittance Basis relevant foreign earnings;
- £1,000,000 2014/15 Remittance Basis chargeable gain;
- £125,000 2014/15 "other" ITA 2007, s 809Q(4)(i);

- £14.5 million (£22 million less £7.5 million) 2018/19 Remittance Basis chargeable gain;
- £2 million 2018/19 "other" ITA 2007, s 809Q(4)(i) - arisen as the operation of TCGA 1992, s 104 results in a £14.5 million Remittance Basis Chargeable Gain rather than the £16.5 million gain that would have arisen if pooling was not necessary and the actual amount used from the LMN Offshore Fund Portfolio account had been the base cost. As the amount falls into s 809Q(4)(i) it is effectively an addition to clean capital.

Note that the LMN Offshore Fund Portfolio account could be cleansed prior to 6 April 2019 and the total £2.5 million ITA 2007, s 809Q(4)(i) "other" (the £375,000 kept in the account and the £125,000 and £2 million above) transferred to a new "clean capital account".

Question 1: Cleansing within categories

The legislation at ITA 2007, s 809Q(4) sets out the following types of income, gains and (in the last category) capital. These are:

a) employment income (other than income within paragraph (*b*), (*c*) or (*f*)),

b) relevant foreign earnings (other than income within paragraph (*f*)),

c) foreign specific employment income (other than income within paragraph (*f*)),

d) relevant foreign income (other than income within paragraph (*g*))

e) foreign chargeable gains (other than chargeable gains within paragraph (*h*)),

f) employment income subject to a foreign tax,

g) relevant foreign income subject to a foreign tax,

h) foreign chargeable gains subject to a foreign tax, and

i) income or capital not within another paragraph of this subsection

A number of these categories can include different types of income or gains some of which are more favourable to remit than others, for example:

- employment income subject to different levels of foreign tax (say a Swiss employment and a German employment);
- relevant foreign income relating to different jurisdictions, so subject to different levels of foreign tax;
- Remittance Basis foreign chargeable gains that have been offset by foreign losses (TCGA 1992, 16ZC(2))
- foreign chargeable gains subject to different levels of foreign tax (either because they relate to property in different jurisdictions or because the jurisdiction has special rules such that no all disposals are taxed at the same level);
- foreign chargeable gains that can benefit from Entrepreneurs' Relief;
- foreign chargeable gains on a second residential property and/or carried interest (taxed in the UK at 18%/28%) and all other chargeable gains (taxed in the UK at 10%/20%);
- gains attributed to beneficiaries from offshore trusts with different levels of supplementary charge; and
- gains attributable to a foreign domiciled beneficiary from an offshore trust where the Finance Act 2008 transitional provisions are in point (matching to pre-6 April 2008 gains

or pre-6 April 2008 capital payments).

Assuming there is a mixed fund, in addition to cleansing with respect to the different categories of income, gains and capital within s 809Q(4) is it possible to cleanse within the actual (a) to (i) categories?

Suggested Answer

Cleansing specific categories of s 809Q(4) income or gains according to tax year is allowed. As such if the different types of funds within any individual category relate to different tax years they could be cleansed because of this.

The cleansing legislation does not specifically deal with circumstances where the different types of funds within any individual category relate to the same tax year. However, the mixed fund rules do acknowledge that there can be different type of income or gains within the same category (ITA 2007, s 809Q(1) Step 2:

Step 2 Find the earliest paragraph for which the amount determined under step 1 is not nil.

If that amount does not exceed the amount of the transfer, treat the transfer as containing the amount of income or capital within that paragraph (and for that tax year):

Otherwise, treat the transfer as containing the relevant proportion of each kind of income or capital within that paragraph (and for that tax year).

"The relevant proportion is the amount of the transfer divided by the amount determined under step 1 for that paragraph.

Given that the mixed fund rules do deal with different kinds of income or capital within a category[2] cleansing within specific ITA 2007, s 809Q(4)(a) to (i) categories is allowed.

JK comment: Yes

Example

Yvette is a UK resident foreign domiciliary. She has an offshore account (account C) that she uses for the proceeds from foreign gains. The original funding came from clean capital and she has then reinvested proceeds into other assets (property and shares).

Yvette also paid into the account a carried interest gain and the gain on the sale of her 100% owned French company (again initial clean capital funding and sufficient profits were made after that to not need any further injections of cash from her).

Yvette qualifies for cleansing and she decides that she would like to cleanse her mixed fund account as fully as possible (though she does not want to sell any property as she does not feel it is the right time). Immediately prior to the cleansing the fund contains:

- £11.33 million clean capital - ITA 2007, s 809Q(4)(i);
- £4.2 million Remittance Basis foreign chargeable gains with no foreign tax credit on the sale of various residential properties that she had let out - ITA 2007, s 809Q(4)(e);
- £0.5 million exempt gain with respect to one of the properties she let out that qualifies for some principal private residence relief and also letting relief as it was her only residence immediately prior to her coming to the UK - ITA 2007, s 809Q(4)(i);

---

[2] The legislation uses paragraph as it is specifically referencing ITA 2007, s 809Q(4)(a) to (i).

- £1.67 million Remittance Basis foreign carried interest gain with no foreign tax credit ITA 2007, s 809Q(4)(e);
- £1.85 million Remittance Basis foreign gains on share disposals with no foreign tax credit - ITA 2007, s 809Q(4)(e); and
- £3.75 million Remittance Basis foreign gain on the sale of her trading company where the gain qualifies for Entrepreneurs' Relief (ER) - ITA 2007, s 809Q(4)(e).

Yvette is an additional rate taxpayer. She arranges for three new offshore accounts to be set up:

- Account D – for the ITA 2007, s 809Q(4)(i) clean capital (that is the £11.33 million within the account which traces back to the original funding and the £0.5 million exempt gain resulting from principal private residence and letting relief).
- Account E – for the ER gain
- Account F – for the share disposal gains that, since she is an additional rate taxpayer, will be taxed at 20%.

She makes prudent cleansing transfers to each account leaving a buffer in account C to protect against the over-nomination risk.

The gains that will be taxed at 28%:

- the £1.67 million carried interest gain; and
- the £4.2 million Remittance Basis foreign chargeable gains with no foreign tax credit on the sale of various residential properties that she had let out

are left within account C together with the buffer amounts discussed above.

Example

Franco is a UK resident foreign domiciliary. He has an offshore account (account C) that contains a mixture of clean capital, Remittance Basis relevant foreign income with no tax credit and Remittance Basis relevant foreign income with a 15% tax credit.

Franco qualifies for cleansing and he decides that he would like to cleanse his mixed fund account as fully as possible. Immediately prior to the cleansing the fund contains:

- £1.67 of million clean capital - ITA 2007, s 809Q(4)(i);
- £320,000 of Remittance Basis relevant foreign income with no tax credit - ITA 2007, s 809Q(4)(d); and
- £165,000 of Remittance Basis relevant foreign income with a 15% tax credit - ITA 2007, s 809Q(4)(g).

Franco arranges for two new offshore accounts to be set up:

- Account D for the clean capital; and
- Account E for the Remittance Basis relevant foreign income with a 15% tax credit.

He makes prudent transfers to each account leaving a buffer in account C to protect against the over-nomination risk. Account C is left with the Remittance Basis relevant foreign income with no foreign tax credit and the buffer funds.

Note that in all the cases above there are different categories of gains and clean capital over various years, that is: there is a mixed fund as defined in the ITA 2007, s 809Q legislation. It is

highly unlikely that there will ever be an account with just one ITA 2007, s 809Q(4) category of funds all relating to the same tax year. If this were the case there would not be a mixed fund so cleansing of different types of funds within the same category could not take place. To cleanse such an account, a practical solution would be to transfer the funds in the account into another account where the composition was such that there was already or would be a mixed fund and cleansing could then happen.

Question 16: Interaction with transitional reliefs

Finance Act 2008, Sch 7 made fundamental changes to the regime for taxing foreign domiciliaries. The following transitional provisions with respect to relevant foreign income were introduced by para 86:

- *Section 809L of ITA 2007 (meaning of "remitted to the United Kingdom") has effect subject to this paragraph.*
- *If, before 6 April 2008, property (including money) consisting of or deriving from an individual's relevant foreign income was brought to or received or used in the United Kingdom by or for the benefit of a relevant person, treat the relevant foreign income as not remitted to the United Kingdom on or after that date (if it otherwise would be regarded as so remitted).*
- *If, before 12 March 2008, property (other than money) consisting of or deriving from an individual's relevant foreign income was acquired by a relevant person, treat the relevant foreign income as not remitted to the United Kingdom on or after 6 April 2008 (if it otherwise would be regarded as so remitted).*
- *Subject to sub-paragraphs (2) and (3), in relation to an individual's income and chargeable gains for the tax year 2007-08 or any earlier tax year, section 809L has effect as if the references to a relevant person were to the individual.*

[(4A) For the purposes of sub-paragraph (4), section 648(2) to (5) of ITTOIA 2005 (and corresponding earlier enactments) do not apply (so that relevant foreign income which arose under a settlement in the tax year 2007-08 or any earlier tax year is to be treated as income for the tax year in which it arose).][3]

- *"Money" has the same meaning as in section 809Y of ITA 2007.*

Amendments

Sub-s (4A) inserted by FA 2009 s 51, Sch 27 para 14 with effect for the tax year 2008-09 and subsequent tax years.

What is the position when carrying out a mixed fund analysis if either Finance Act 2008, sch 7, para 86 (2) or para 86(3) applies to funds?

What would such funds be characterised as for nomination purposes?

Suggested Answer

The transitional provisions effectively re-characterise the relevant foreign income such that it becomes clean capital.

For nomination purposes the funds are characterised as pre-6 April 2008 income or capital not subject to tax on remittance.

Example

Ivan is a UK resident foreign domiciliary. He came to the UK in 2000. He had a significant offshore share portfolio when he came and all income and proceeds from sales were invested in shares. As such, prior to 12 March 2008 almost all the relevant income within the portfolio had been invested (and is so within para 86(3)).

Ivan continues in the same vein after 12 March 2008. In 2018 he requires additional funds as he needs to acquire a larger property. He qualifies for cleansing and decides to carry out a cleansing exercise on 5 November 2018.

Ivan decides that he wants to remit to the UK all the funds he can where there will be no additional tax charge (though leaving a buffer to safeguard against any inadvertent mistakes in the lengthy and complex mixed fund analysis) and that he will leave everything else in the mixed fund account and invest as before. He, therefore, liquidates his portfolio and all his funds are within the one mixed fund offshore account (account C). The account consists of:

- £8.3 million pre-arrival clean capital (pre-6 April 2008 funds as he arrived in the UK in – pre-6 April 2008 income or capital not subject to tax on remittance
- £3.7 million of relevant foreign income that had been invested in shares prior to 12 March 2008 - pre-6 April 2008 income or capital not subject to tax on remittance;
- £2.1 million of post 5 April 2008 Remittance Basis relevant foreign income (no foreign tax credit) - ITA 2007, s 809Q(4)(d);
- £2.4 million of Remittance Basis chargeable gains (no foreign tax credit) - pre-6 April 2008 foreign chargeable gains no foreign tax credit
- £3.6 million of post 5 April 2008 Remittance Basis chargeable gains (no foreign tax credit) - ITA 2007, s 809Q(4)(e).

If Ivan were to transfer all the funds that per the analysis fall into clean capital he would transfer £12 million (the £8.3 million pre-arrival clean capital plus the £3.7 million of relevant foreign income that had been invested in shares prior to 12 March 2008). He decides to transfer £11.75 million to new offshore account D (leaving a £250,000 buffer).

For nomination purposes the entire transfer relates to pre-6 April 2008 income or capital not subject to tax on remittance. There is no need to refer to the different nature of the funds though this can be done if desired.

Question 17: Arising basis

How should Arising Basis foreign income and gains be included in a mixed fund analysis and how does this feed into cleansing?

Suggested Answer

There is no specific category within ITA 2007, s 809Q(4) for either foreign income or foreign gains taxed on the Arising Basis.

Going through the categories that are within ITA 2007, s 809Q(4) strictly foreign income or foreign gains taxed on the Arising Basis should be characterised in the same way as Remittance Basis foreign income or gains for the purposes of a mixed fund analysis, as the categories are not limited to Remittance Basis income and gains. However, since these funds can be remitted to the UK without additional tax, where mixed fund analysis work has been carried out it is highly likely that Arising Basis foreign income and/or gains would have been classified along with clean

capital under the ITA 2007, s 809Q(4)(i) category. This pragmatic method of classification made no difference to the analysis and it is, therefore, accepted that provided the methodology is followed consistently in the mixed fund analysis nominations can be made grouping together both clean capital and Arising Basis foreign income and gains under the 809Q(4)(i) category.

Example – mixed fund analysis carried out on the strict basis

For cleansing purposes it is possible to cleanse s 809Q(4) kinds of income and capital per tax year. As such, where a mixed fund contains Remittance Basis and Arising Basis income and gains the income and gains in the Arising Basis year can be cleansed as per the following example.

Account C contains the following:

- £1 million of 2012/13 Remittance Basis relevant foreign earnings (not subject to a foreign tax);
- £400,000 of 2012/13 Remittance Basis foreign chargeable gains (not subject to a foreign tax);
- £225,000 of 2012/13 Remittance Basis relevant foreign income (not subject to a foreign tax)
- £100,000 of 2013/14 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2013/14 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £150,000 of foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £60,000 of relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £100,000 of foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £2.5 million of 2016/17 Remittance Basis foreign chargeable gains (not subject to a foreign tax);
- £750,000 of 2016/17 Remittance Basis relevant foreign income (not subject to a foreign tax).

The decision is made to cleanse the Arising Basis income and gains. That is to cleanse:

- £100,000 of 2013/14 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2013/14 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;
- £150,000 of 2014/15 foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £60,000 of 2014/15 relevant foreign income (not subject to a foreign tax) taxed on the

Arising Basis;

- £100,000 of 2015/16 Remittance Basis foreign chargeable gains (not subject to a foreign tax) taxed on the Arising Basis;
- £50,000 of 2015/16 relevant foreign income (not subject to a foreign tax) taxed on the Arising Basis;

A new offshore bank account (account D) is opened and £510,000 transferred across from account C to account D. The following nominations are made:

- £100,000 of 2013/14 of ITA 2007, s 809Q(4)(e) funds;
- £50,000 of 2013/14 of ITA 2007, s 809Q(4)(d) funds;
- £150,000 of 2014/15 of ITA 2007, s 809Q(4)(e) funds;
- £60,000 of 2014/15 of ITA 2007, s 809Q(4)(d) funds;
- £100,000 of 2015/16 of ITA 2007, s 809Q(4)(e) funds; and
- £50,000 of 2015/16 of ITA 2007, s 809Q(4)(d) funds.

Example – mixed fund analysis carried out on the pragmatic basis

Mixed offshore account C has been in existence for many years and there have been many entries. It was decided to cleanse the account.

Just prior to the cleansing, the account contained the following:

- £3.6 million of Remittance Basis relevant foreign earnings (not subject to a foreign tax);
- £0.4 million of Remittance Basis foreign chargeable gains (not subject to a foreign tax);
- £2.4 million of Remittance Basis relevant foreign income;
- £5.75 million inheritance;
- £1.3 million Arising Basis relevant foreign income; and
- £0.5 million of Arising Basis gains.

It was decided to remove most of the funds that could be brought into the UK tax free from the mixed fund account into a new account (a buffer was left in the mixed fund account in case there were any issues with the analysis since it was so long). A £7 million (being £5.75m + £1.3m + £0.5m less a buffer from each) transfer occurred with the nomination referring to ITA 2007, s 809Q(4)(i) funds.

Question 18: Non-chargeable gains

How should the following be recorded for mixed fund and cleansing purposes?

- the part of the gain that is not taxable as a result of Finance (No 2) Act 2017, Sch 8, Part 3 rebasing relief; and
- foreign non-chargeable gains such as:
  - the non-taxable gain on the sale of a residential property as a result of principal private residence relief (and possibly also letting relief; and
  - foreign currency gains realised on withdrawals from accounts post 5 April 2012 (the legislation changed such that these gains were no longer taxable.

Suggested Answer

Such amounts do not fall into any of ITA 2007, s 809Q(4)(a) to (h) categories. As such, they fall within ITA 2007, s 809Q(4)(i), income or capital not within any other paragraph of ITA 2007, s 809Q(4).

Example

Bernadette is a UK resident foreign domiciliary. She became deemed domiciled in 2017/18. On 15 April 2018 she sold a set of five valuable vases and an antique table. Bernadette met all the conditions to qualify for rebasing. The proceeds were paid into a newly opened offshore account. She had acquired the vases and table in 2010 using £600,000 of Remittance Basis relevant foreign income. The part of the gain that was not taxable as a result of Finance (No 2) Act, Sch 8, Part 3 rebasing relief was £1.1 million. The Arising Basis gain post 6 April 2017 was £50,000.

Bernadette transferred the £1.1 million (exempt as a result of rebasing) and the £50,000 (Arising Basis gain) to a new account to be used for UK expenditure (since the funds could be brought to the UK free from tax. For cleansing purposes, the £1.1 million exempt as a result of rebasing relief is within ITA 2007, s 809Q(4)(i). The treatment of the £50,000 Arising Basis gain is discussed in question 17 above.

Question 19: Collateral

How should Remittance Basis foreign income and/or gains (FIG) be recorded for mixed funds and cleansing purposes where it is deemed to have been remitted to the UK as a result of, for example, being used as collateral for a UK loan?

Suggested Answer

A taxable remittance can only occur once. As such, since the funds have already been taxed in the UK, the funds used as collateral should be treated as coming within ITA 2007, s 809Q(4)(i) for the purposes of mixed fund analysis work and resulting cleansing transfers.

Example

In June 2016 £1 million of 2012/13 relevant foreign income (no foreign tax credit) was used as collateral for a £900,000 loan. The £900,000 loan was brought into the UK in August 2016. Under the current HMRC interpretation with respect to FIG used as collateral for a relevant debt £900,000 of the £1 million collateral is deemed to be remitted.

The loan is re-paid from UK funds in 2018.

In January 2019 the £1 million that was used as collateral is transferred to a mixed fund account. For cleansing purposes:

- £900,000 of this £1 million is seen as clean capital (so within ITA 2007, s 809Q(4)(i)); and
- since the remaining £100,000 has not suffered UK tax it is still Remittance Basis relevant foreign income and within ITA 2007, s 809Q(4)(d).

The £900, 000 and any other clean capital in the mixed fund account can be cleansed.

6 SECTION F – RELEVANT PERSONS AND CLEANSING

Question 20

Can cleansing transfers be carried out by an individual (P) where the funds belong to someone else (another relevant person in connection with the individual) but trace to the individual's income, gains and/or capital, such that there would be a taxable consequence if the Remittance

Basis income or gains came to the UK?

Suggested Answer

Post 5 April 2008 income and capital

The cleansing rules for post 5 April 2008 income and capital do not require the nominated funds to be held by the individual (P). The funds can be in the account of a relevant person. For cleansing to be effective all that is necessary is that the cleansing transfers must relate to income, gains and/or capital traceable to P. It is P that must make the nomination rather than the person the mixed fund account is in the name of.

Pre-6 April 2008 income and capital

The position is different for pre-6 April 2008 income and capital as the relevant person rules did not apply pre-6 April 2008. As such, for pre-6 April 2008 funds cleansing can only be carried out where the funds are in a mixed fund account in the name of P.

Example

Gérard and Clara are both UK resident foreign domiciliaries (having come to the UK in 2008/09). Gérard gifted his wife Clara a valuable painting for her birthday in February 2010. The painting was a mixed fund comprised of £6 million 2009/10 clean capital and £5 million 2009/10 Remittance Basis relevant foreign income not subject to a foreign tax.

The gift took place in France and the painting has stayed in their flat in Paris. Clara sells the painting in January 2019 realising a gain of £3.5 million (sheltered by the Remittance Basis).

Clara had the proceeds from the painting paid into a new offshore account (account C). Two further new offshore accounts (account D and account E) are opened).

Gerard was a Remittance Basis user from 2008/09 to 2016/17, thereby meeting the cleansing conditions. The decision is made to cleanse account C of the funds traceable to the acquisition cost of the painting.

The following cleansing transfers are made:

- £5 million transferred from account C to account D; and
- £6 million transferred from account C to account E.

Gérard makes the following nominations:

- the £5 million 2009/10 Remittance Basis relevant foreign income coming within ITA 2007, s 809Q(4)(d); and
- the £6 million 2009/10 clean capital coming within ITA 2007, s 809Q(4)(i).

The Remittance Basis foreign chargeable gain is left within account C. That was Clara's gain so could not have been part of a cleansing nomination made by Gérard.

After the transfers Clara can bring funds from account E to the UK without Gérard being subject to tax.

Any remittances from account C would result in a taxable remittance on Clara but only at the (currently) lower Capital Gains Tax rates.

Example

On 29 August 2014 Gérard settled The Gérard Family Interest in Possession Offshore Trust (of

which he is the life tenant and main capital beneficiary) using:

- £16 million of his Remittance Basis relevant foreign earnings (with no foreign tax credit) relating to 2012/13, 2013/14 and 2014/15; and
- £8 million of clean capital (a family inheritance from 2013/14).

The settled funds were not initially segregated as it was not envisaged that Gérard would require capital distributions for remittance to the UK.

The income arising within the trust is kept strictly segregated from the funds Gérard settled. The trust income (less income expenses) is paid out to Gérard each quarter for his offshore expenses.

Trust gains and losses are realised regularly and proceeds from the disposal of investments are reinvested.

As at 31 January 2018 the trust, therefore, had an income account (account C) for trust income and a second account (account D) for the mixed funds settled by Gérard and gains/losses realised as a result of the sale of investments.

It was decided that Gérard might require significant UK funds from the trust and that use should be made of the cleansing provisions to segregate the original clean capital (with no foreign tax credit) from the Remittance Basis relevant foreign earnings. The investment portfolio was liquidated so a thorough cleansing could occur. A remittance analysis from 29 August 2014 (when the trust was constituted) was carried out and it was established that on 13 April 2018 account D was comprised of:

- £15.9 million tracing back to the original Remittance Basis relevant foreign earnings (with no foreign tax credit) settled;
- £7.95 million tracing back to the original clean capital settled; and
- £1.5 million of gains realised on disposals within the trust. Trust gains are not attributed to the settlor so, for cleansing purposes are not seen as the settlor's gains. This means that they cannot be cleansed.

New offshore account E with a different bank and investment manager is established. To be cautious (to avoid the over nomination trap discussed in section B) a cleansing transfer of £7.9 million to account E takes place. Gérard nominates £7.9 million of 2013/14 clean capital coming within s 809Q(4)(i).

After the transfer the trustee can make a capital distribution to Gérard from account E. Should Gérard remit he will only be subject to tax on the TCGA 1992, s 87 gains attributed. The settled funds tracing back to Remittance Basis relevant foreign earnings will, however, have been left behind in account D.

Example

On 29 August 2010 Gérard funded The Gérard Family Discretionary Offshore Trust using £11 million of clean capital (a family inheritance from 2009/10). This broke down as a £2 million settlement and a £9 million loan. During his lifetime Gérard was to be the main beneficiary of the trust.

There was no segregation of income and gains as it was not envisaged that Gérard would need to extract funds (even by way of loan repayment) for remittance to the UK.

Gérard's UK needs changed, and it became clear that loan repayments for remittance to the UK would be helpful. The trustees considered the position. Whilst the provisions for settlors of

non-UK resident trusts changed from 2017/18 the transitional settlement's provisions are insufficiently wide (see footnote 2) to allow repayment of the loan to Gérard from the mixed fund and remittance of the repayment without a tax liability.

As such, a mixed fund analysis was carried out to enable cleansing to take place. At 19 April 2018 the account was found to contain:

- £10.95 million tracing back to the original settled funds (Gérard's clean capital).
- £4.75[4] million of pre-6 April 2017 Remittance Basis foreign income that arose within the trust (deemed to be Gérard's income under ITA 2007, s 720).
- £135,000 of 2017/18 income. As a result of the Finance (No 2) Act 2017 changes this income is Protected Foreign Source Income not income arising to Gérard, so it cannot be cleansed.
- £3.5 million of gains realised on disposals within the trust. Trust gains are not attributed to the settlor so, for cleansing purposes are not seen as the settlor's gains. This means that they also cannot be cleansed.

New offshore account C with a different bank and investment manager is established. To be cautious (that is to avoid the over nomination trap discussed in section B) a cleansing transfer of £10.9 million to account C takes place.

Gérard makes the following nomination the £10.9 million 2009/10 clean capital coming within s 809Q(4)(i).

After the transfer the trustee can make loan repayments to Gérard from account C and he can remit these funds to the UK without any tax consequences.

Example

Heidi is a UK resident foreign domiciliary who came to the UK in May 1995. She has always been a Remittance Basis user, so is eligible for cleansing.

In July 2000 Heidi used £3.5 million of her Remittance Basis relevant foreign income (no foreign tax credit) to buy a property in New York.

She also invested £3 million of Remittance Basis relevant foreign income (no foreign tax credit) in a portfolio of shares in 2000.

In April 2010 she established The Heidi Offshore Discretionary Trust of which she was the main beneficiary transferring £1 million of Remittance Basis relevant foreign earnings. She also loaned £3 million of clean capital to the trust. The loan was originally repayable on demand and interest free but a new loan was put in place in July 2017 that was still repayable upon demand but with interest set at the official rate of interest (since Heidi was deemed domiciled from 2017/18 the change was necessary to avoid tainting the trust).

In June 2010 Heidi transferred:

- The New York property to The Heidi Offshore Discretionary Trust. Her gain on the deemed disposal was £1.25 million.
- The share portfolio and associated broker account to the trust. At the time of the transfer £4 million represented clean capital (as a result of the Finance Act 2008, Sch 7, para

[4] Note that the £4.75 million of pre- 6 April 2017 Remittance Basis foreign income that arose within the trust is not caught by the settlements' regime unless and until it is remitted (ITTOIA 2005, s 648). If a remittance occurred there would be a tax liability if Gérard (or any relevant person other than the trustee) benefits as the transitional rule for pre-6 April 2017 income under the settlements' regime is narrower than that under the transfer of assets abroad legislation).

86(3) transitional provision), £75,000 post 5 April 2008 Remittance Basis relevant foreign income, £1.3 million Remittance Basis capital gains with no foreign tax credit (£1 million pre-6 April 2008 and £300,000 post 5 April 2008) and there was a gain on the deemed disposal of the share portfolio on the transfer into trust of £875,000.

In May 2017 Heidi asked the trustees to repay £750,000 of the loan. She wanted to be able to bring the funds into the UK.

Even though the loan had come from Heidi's clean capital the trustees realised that care had to be taken as to what funds to use for the loan repayment as, if the funds used to make the partial loan repayment traced to any of the Remittance Basis income and/or gains that Heidi had settled, there would be a taxable remittance when the funds were brought into the UK.

The share portfolio and associated broker account was worth £6.4 million and a significant amount was clean as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision. However, pre-6 April 2008 funds cannot be cleansed and, as mentioned the £4 million of funds that represented clean capital (as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision) were mixed in with £1 million of Heidi's pre-6 April 2008 Remittance Basis chargeable gains. As such, it was not possible to access the clean funds by way of cleansing within the trust.

The trustees, therefore, considered the New York property, which was not required any longer and had risen in value considerably. The property was sold in July 2017 for the US dollar equivalent of £7.25 million (realising a gain of £2.5 million within the trust). The proceeds from the sale were paid into new offshore account (account D). The funds within account D broke down as follows:

- £3.5 million of clean capital (as a result of the Finance Act 2008, Sch 7, para 86(3) transitional provision). This could not form part of a cleansing transfer as the funds were pre-6 April 2008.
- The £1.25 million deemed gain on the transfer in of the New York property to the trust in 2009/10. This is Heidi's gain (within ITA 2007, s 809Q(4)(e)) and can be cleansed by her as it accrued after 5 April 2008.
- The £2.5 million trust gain on the disposal of the New York property. Note that (from 6 April 2017) trust gains are not attributed to a foreign domiciled settlor unless either the individual is deemed domiciled as a result of being born in the UK with a UK domicile of origin or deemed domicile and the trust protections have been forfeited. Heidi was born in Zurich with a Zurich domicile of origin and had not forfeited protection so, for cleansing purposes this £2.5 million is not seen as her gain.)

Cleansing of account D occurred in August 2017 with the £1.25 million Remittance Basis chargeable gain being transferred to a new offshore account (account E) and the appropriate nomination being made by Heidi.

The £750,000 loan repayment was made from the £6 million in the account D and could be brought into the UK by Heidi without any UK tax being due.

Question 21

Where a UK resident foreign domiciliary has made a loan to a relevant person (the loan funds having been kept offshore up to now in a capital account) and the funds loaned represent a mix of clean capital, Remittance Basis income and Remittance Basis chargeable gains, is cleansing the cash sufficient or does the loan have to be repaid?

Suggested Answer

The loan is an asset in the hands of the UK resident foreign domiciliary. As such, if the loan were not to a relevant person it would have to be repaid in order for the funds to be cleansed.

The fact that the loan is to a relevant person changes the analysis as the mixed funds are in two places:

1) within the cash held offshore by the relevant person; and

2) the loan asset in the hands of the UK resident foreign domiciliary.

The loan funds (clean capital, Remittance Basis income and Remittance Basis chargeable gains), can be cleansed in the hands of the borrower by appropriate offshore transfers provided the UK resident foreign domiciliary qualifies for cleansing and makes the nominations. As such, if the relevant person wants to bring the clean capital portion of the loan funds into the UK then cleansing will make this possible.

However, as stated the mixed funds are in two places and the loan itself has not been cleansed. If the UK resident foreign domiciliary wants to cleanse his loan it will need to be repaid offshore and the cash then cleansed.

7 SECTION G - MIXED FUND ANALYSIS AND FOREIGN CAPITAL LOSSES

As set down in question 13, the mixed fund legislation does not deal with how losses should be treated. We have, therefore, suggested that for mixed fund analysis purposes a two-step approach should be adopted:

1) proportionally allocate out the loss amongst the different categories of funds used to acquire the property sold at a loss;

2) adjust the step 1 result where either income or gains were used to acquire the property since the derivation rules mean that for mixed fund analysis purposes these categories cannot be reduced.

In terms of utilising the losses one follows the normal loss set-off rules.

Question 22

Where an individual, who has previously made a Remittance Basis claim and made the foreign capital losses election within the deadline, is taxed on the Arising Basis[5] for a tax year how are foreign losses accounted for in the mixed fund analysis?

Suggested Answer

The steps set down in the introduction to this section are followed, as shown in the following examples.

Example

Phoenix Guernsey Ltd shares are acquired using £75,000 of 2015/16 Remittance Basis relevant foreign income (not subject to a foreign tax). A foreign loss election has been made. The shares are sold in 2017/18 for £50,000, with the proceeds being paid into account C a pre-existing mixed fund account.

Allocating out losses using the two step processset down will be timeconsuming where the property has been acquired using more than one category of income and capital. A quicker pragmatic approach would be to say that losses and gains cancel each other out in themixed fund analysis. (Where Arising Basis income and gains are characterised as being within ITA s 809Q(4)(i) – see question 17 – the quicker approach would be a reduction of clean capital.)
Provided it is followed consistently either the method set down in the suggested answer of the method set down in this footnote would be acceptable.

The taxpayer is taxed on the Arising Basis for 2017/18.

Since only Remittance Basis relevant foreign income was used for the acquisition of the shares the entire loss is set against this income in step 1.

Step 2 - adjust the step 1 result since income was used to acquire the property and the derivation rules mean that for mixed fund analysis purposes income cannot be reduced.

This means that whilst only £50,000 is added to account C £75,000 of Remittance Basis relevant foreign income is added for the purposes of the mixed fund analysis.

The £25,000 Arising Basis loss is available to set against any gains in the year.

Example

A taxpayer (who has made a foreign loss election) has two mixed fund accounts:

- Account C; and
- Account D.

The taxpayer is taxed on the Arising Basis for 2017/18 and two chargeable disposals were made in the tax year:

- Pineapple Tropical Ltd shares (acquired using £100,000 of 2015/16 Remittance Basis relevant foreign income (not subject to a foreign tax) and £75,000 of 2014/15 clean capital) were sold for £250,000, thereby realising a gain of £75,000. The proceeds are paid into account C.
- Grapefruit Florida Inc shares (acquired using £50,000 of 2014/15 Remittance Basis relevant foreign income (not subject to a foreign tax) and £100,000 of clean capital) were sold for £50,000, thereby realising a loss of £100,000. The proceeds are paid into account D.

These were the only two disposals that the taxpayer made in the year.

Pineapple Tropical Ltd

For the mixed fund analysis purposes, the £250,000 of proceeds paid into Account C breaks down as follows:

	Amount
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£100,000
Clean capital – ITA 2007, s 809Q(4)(i)	£75,000
Foreign gains – ITA 2007, s 809Q(4)(e) taxed on the Arising Basis	£75,000
	£250,000

Grapefruit Florida Inc

As a loss has been realised on the share disposal the two step process is followed.

Step 1 - proportionally allocate out the £100,000 loss

	Amount	%
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£50,000	33.33%
Clean capital – ITA 2007, s 809Q(4)(i)	£100,000	66.67%
	£150,000	

	Acquisition	Reductions	Proceeds
CostRelevant foreign income	£50,000	£33,333	£16,667
Clean capital	**£100,000**	**£66,667**	**£33,333**
	£150,000	£100,000	£50,000

Step 2 - adjust the step 1 result since income was used in part to acquire the shares and the derivation rules mean that for mixed fund analysis purposes income cannot be reduced.

For mixed fund analysis purposes only the following is added into Account D as a result of the receipt of the proceeds from the sale of the Grapefruit Florida Inc shares:

	Amount
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£50,000
Clean capital – ITA 2007, s 809Q(4)(i)	**£33,333**
	£83,333

Normal loss relief rules apply, so there will be no tax to pay on the £75,000 gain on the sale of the Pineapple Tropical Ltd shares.

A new account (account E) could be opened with cleansing transactions as follows:

- from account C the £75,000 clean capital;
- from account C the £75,000 Arising Basis gain (offset by the current year annual exemption and the loss on the Grapefruit Florida Inc shares);
- from account D the £33,333 remaining clean capital.

Question 23

Where an individual, who has previously made a Remittance Basis claim and made the foreign capital losses election within the deadline, is taxed on the Remittance Basis[6] for a tax year how are foreign losses accounted for in the mixed fund analysis?

Suggested Answer

The steps set down in the introduction to this section are followed, as shown in the following example.

Example

Ginger Guernsey Ltd shares are acquired using £250,000 of 2015/16 Remittance Basis foreign chargeable gains (not subject to a foreign tax) and £150,000 of 2014/15 clean capital. A foreign loss election has been made. The shares are sold in 2017/18 for £275,000. As such, a loss of £125,000 has been realised.

The taxpayer is taxed on the Remittance Basis for 2017/18.

The taxpayer has only one offshore account (account C), so all gains in the year are paid into the account (£300,000 of gains are realised with this being the only loss). There are no remittances

Again, allocating out losses using the two step process set down will be time consuming where the property has been acquired usingmore than one category of income and capital. A quicker pragmatic approach would be to say that in such a situation, foreign capital losses have to be allocated in accordance with the specific legislative rules:
• they cannot be automatically set against foreign gains of the same year in the mixed fund account;
• where the legislation provides that the losses can reduce the gains within the mixed fund then the foreign chargeable losses can go in as negative entries in the s 809Q(4)(e) fund category. If the gains are greater than the total losses and there are remittances it is important to remember that the losses must go against remitted gains first and the analysis must be prepared accordingly; and
• the losses will be disregarded in a mixed fund analysis where they cannot be used against gains in the account. In such a situation the bank account balance will be lower than the total of the different kinds of income and capital.
Provided it is followed consistently either the method set down in the suggested answer of the method set down in this footnote would be acceptable.

in the year.

Step 1 - proportionally allocate out the £125,000 loss

	Amount	%
Foreign chargeable gains – ITA 2007, s 809Q(4)(e)	£250,000	62.5%
Clean capital – ITA 2007, s 809Q(4)(i)	£150,000	37.5%
	£400,000	

	Acquisition Cost	Reductions	Proceeds
Foreign gains	£250,000	£78,125	£171,875
Clean capital	**£150,000**	**£46,875**	**£103,125**
	£400,000	£125,000	£275,000

Step 2 - adjust the step 1 result since gains were used in part to acquire the shares and the derivation rules mean that for mixed fund analysis purposes gains cannot be reduced.

For mixed fund analysis purposes only, the following is added into Account C as a result of the receipt:

	Amount
Relevant foreign income – ITA 2007, s 809Q(4)(d)	£250,000
Clean capital – ITA 2007, s 809Q(4)(i)	**£103,125**
	£353,125

The TCGA 1992, s 16ZC loss relief rules apply, so the £125,000 loss can be set off against the £300,000 unremitted gains. Since the £125,000 is less than £300,000, and none of the gains are remitted, the losses are deducted against gains in reverse chronological order as per TCGA 1992, s 16ZC(2) step 1.

Cleansing transactions could:

- Remove the £103,125 clean capital and any other clean capital in the account.
- Remove the Remittance Basis Chargeable gains offset by the £125,000 loss (see question 15).

Question 24

Where a Remittance Basis user has not made a foreign capital loss election and cannot, therefore, claim foreign losses, what is the analysis where there is a foreign disposal and a loss is realised?

For example, shares in XYZ Jersey Ltd are:

- acquired using £375,000 of Remittance Basis relevant foreign earnings and £550,000 of clean capital; and
- sold in 2017/18 for £750,000 realising a capital loss of £175,000.

Suggested Answer

The steps set down in the introduction to this section are followed. Step 1 - proportionally allocate out the £175,000 loss

	Amount	%
Relevant foreign earnings – ITA 2007, s 809Q(4)(b)	£375,000	40.54%
Clean capital – ITA 2007, s 809Q(4)(i)	£550,000	59.46%
	£925,000	

	Acquisition Cost	Reductions	Proceeds
Relevant foreign earnings	£375,000	£70,945	£304,055
Clean capital	**£550,000**	**£104,055**	**£445,945**
	£925,000	£175,000	£750,000

Step 2 - adjust the step 1 result since income was used in part to acquire the shares and the derivation rules mean that for mixed fund analysis purposes income cannot be reduced.

For mixed fund analysis purposes only the following is added into Account C as a result of the receipt:

	Amount
Relevant foreign earnings – ITA 2007, s 809Q(4)(b)	£375,000
Clean capital – ITA 2007, s 809Q(4)(i)	**£445,945**
	£820,945

Question 25

W ould the analysis be the same, as in question 24, if the individual (a foreign domiciliary who previously made a Remittance Basis Claim and has not made a foreign capital loss election) were taxed on the Arising Basis for the tax year (assuming they are not deemed domiciled and, therefore, entitled to claim foreign chargeable losses)?

Suggested Answer

Yes, again the same process must be followed. If the property is acquired purely out of clean capital the clean capital is reduced by the loss. If the loss is acquired using income, gains and clean capital the derivation principle comes in and the income and gains cannot be reduced, so the two stage process illustrated in question 24 must be utilised.

8 SECTION H - CLEANSING & THE OFFSHORE ANTI-AVOIDANCE LEGISLATION

Question 26

Individuals may wish to cleanse amounts of cash which they have received as a capital distribution from an offshore trust of which they are a beneficiary.

Where such distributions are made in circumstances where the anti-avoidance rules in ITA 2007, s 731 and TCGA 1992, s 87 apply, it is technically not possible to determine the precise amount of income or gains arising to the beneficiary as a result of the distribution until after the end of the tax year of receipt, since the relevant matching rules for both provisions require consideration of events covering the entire tax year.

In such circumstances, any cleansing transaction must necessarily be based on estimates of how the payment will ultimately be matched and taxed. There is, therefore, the inherent risk of an over-nomination.

Will the taxpayer be able to carry out a valid cleansing transaction in respect of the income/gains treated as arising under the above provisions before the end of the tax year in which the income/gains will be treated as arising?

This will of course be a particular problem in 2018/19 since the cleansing deadline is 5 April 2019.

Suggested Answer

Whilst the determination of what the sum distributed represents can only take place after the end of the relevant tax year, the determination applies back to the date of the distribution (in other words, the analysis after the end of the tax year only confirms what the sum is and always has been).

A valid cleansing transfer as envisaged above could, therefore, be made during the tax year of the distribution. However, as mentioned in the question there is the risk of an overnomination.

It is suggested that the calculations are carried out using the best information at the time, that is:

- the current pools (either for ITA 2007, s 731 relevant income or TCGA 1992, s 87 gains purposes);
- best estimates of future gains and relevant income;
- capital payments made to date; and
- any future capital payments the trustee(s) expect to make in the year.

Once this has been done rather than make the transfer in accordance with the figures calculated, a buffer should be kept behind in the mixed fund account (that is, caution is required) with a view to mitigating the risk of an over nomination.

If at all possible where the distribution occurs in 2018/19 waiting until March 2019 and having the work done to calculate the pools on an ongoing basis would give the best chance of avoiding an over-nomination issue.

Where distributions happen in 2018/19 the trustees could try to refrain from making any capital disposals or further distributions until after 5 April 2019. Income is more difficult since the only way of avoiding further income may be to make distributions after having adjusted the trust investment strategy (which would involve disposals and may not be commercial) to avoid it arising until after 5 April 2019.

Example

Jean-Luc is a UK resident foreign domiciliary. He has no clean capital and is an additional rate tax payer.

An offshore trust was set up by Jean-Luc's grandfather (a foreign domiciliary who was never UK resident and has died). Jean-Luc's uncle is the life tenant (initially the life tenant was his father who has died). As such, there is no relevant income within the structure. Jean-Luc can benefit from capital payments.

A capital payment of £3 million (paid into account C) was made to Jean-Luc on 17 November 2018. He needed £2 million to complete on a house purchase in the UK and £1 million for urgent renovations to his French chateau (the urgency meant that it was not possible to wait until later in the tax year).

Jean-Luc wants to mitigate his tax liability on the £2 million remittance by cleansing the £3 million. He meets the criteria such that he can cleanse.

In the year the trustee had already made a capital distribution of £500,000 to Jean-Luc's uncle and knew that later in the tax year they would make a capital distribution of £200,000 to

Jean-Luc's sister. There were no unmatched capital payments brought forward.

To enable them to have the best picture of the s 87 gains pool at the year end the trustee made the necessary disposals of assets not just to finance Jean-Luc's distribution but also so that there will be sufficient cash for the distribution to his sister. The trustee decides to wait until after 5 April 2019 to make any further asset disposals or further distributions unless something exceptional happens.

The trustee has its tax advisers carry out the TCGA 1992, s 87 pool calculations and it is established that £0.7 of the £3 million will not be matched to gains and the remainder will be matched as follows:

- £0.5 million to 2017/18 gains;
- £0.7 million to 2016/17 gains;
- £0.5 million to 2015/16 gains; and
- £0.6 million to 2006/07 gains.

To create a mixed fund (a prerequisite for cleansing as discussed above), Jean-Luc has the £3 million paid into an offshore account with Remittance Basis relevant foreign income (account C). Jean-Luc then opens five new offshore accounts and makes the following transfers:

- Account D – for the unmatched capital payment. Note that since it has not yet been matched this must come within ITA 2007, s 809Q(4)(i) for nomination purposes even though it may be matched to gains in future tax years.
- Account E – for the 2017/18 gains.
- Account F – for the 2016/17 gains.
- Account G – for the 2015/16 gains.
- Account H - for the 2006/07 gains

Jean-Luc makes prudent transfers to each account leaving a buffer in account C to protect against the over-nomination risk. Account C is left with the Remittance Basis relevant foreign income with no foreign tax credit and the buffer funds.

So he has the £2 million for the UK house purchase Jean-Luc remits:

- the whole of accounts H (no tax charge due to the Finance Act 2008 supplementary provisions for gains realised prior to 6 April 2008);
- the whole of account D (no tax charge since not currently matched. The capital payment will be carried forward and may be matched in the future depending on subsequent trust gains, other capital payments made and whether Jean-Luc remains UK resident);
- the whole of account E (no supplementary charge as 2017/18 is the tax year preceding the year the capital payment is made); and
- what is required from account F to make up the shortfall (supplementary charge but at the lowest level).

Since he may need to make further remittances to the UK and the CGT tax rates are currently lower (even taking the supplementary charge he would pay) than the 45% tax rate on remitting the relevant foreign income he uses the contents of account C for the chateau repairs and makes up the shortfall from account G (since the supplementary charge would be higher on account G

remittances than account F).

9 SECTION I – OVERSEAS WORKDAY RELIEF

Question 27

Anne-Marie, a UK resident foreign domiciliary had a foreign employment but performed duties in the UK that were more than incidental. She benefitted from overseas workday relief in her first three years of UK residence (2013/14, 2014/15 and 2015/16).

In 2013/14 Anne-Marie's overseas workdays were low and she was taxed on the Arising Basis on 75% of her foreign employment income. In 2014/15 her overseas days were much higher and she was only taxed on the Arising Basis on 45% of her foreign income. Finally, in 2015/16 she was taxed on the Arising Basis on 55% of her foreign income.

From 2016/17 Anne-Marie was taxed on the Arising Basis on her entire salary as she continued to perform more than just incidental UK duties. In 2017/18 the nature of her employment changed and she did not perform any UK duties in that year or in 2018/19 (she was also not within the ITEPA 2003, s 24A provisions). As such, all of her income in 2017/18 and 2018/19 was taxed on the Remittance Basis.

Anne-Marie received a bonus in 2017/18 related to her 2014/15 duties so this was taxed in the same way as her basic 2014/15 employment income was (55% Remittance Basis and 45% Arising Basis).

The foreign employment income was all paid into one offshore account. There were no transfers out and no other income was added to the account. However, the account was previously used as a clean capital account and at the time the first month's employment income was paid in there was £1,235 of clean capital in the account. As such, the special mixed fund rules for certain employment cases (ITA 2007, s 809RA to s 809RD) are not in point.

Towards the end of 2018 Anne-Marie decided that she wanted to remit funds to the UK. How would she use cleansing to enable her to do this as tax efficiently as possible?

Suggested Answ er

Anne-Marie should open a new account (account C). She can then transfer to account C:

- the £1,235 of clean capital
- the 2013/14, 2014/15 and 2015/16 UK portion of Arising Basis employment income;
- the UK portion of the 2014/15 Arising Basis employment income that was paid in 2017/18 (this bonus being taxed in the way 2014/15 income was taxed since it relates to 2014/15 duties); and
- her entire salary for 2016/17 duties since this was all taxed on the Arising Basis

The original mixed fund account will after these transfers be left with Remittance Basis relevant foreign earnings. There is no need to cleanse further unless there are tax credit issues (for example a change in tax rates) such that one or more year has a better tax credit than other years.

Note that if Anne-Marie had initially opened a new account for the employment income and made the necessary nomination the special mixed fund rules for certain employment cases (ITA 2007, s 809RA to s 809RD) would apply. The cleansing legislation applies to all mixed funds, so nominated mixed funds accounts can be cleansed in just the same way as any other mixed fund (the only difference being that if the mixed fund has not breached the special rules it does not

have the potential to have as many different categories of income and gains as general mixed fund account).

In the case of Anne-Marie, apart from the fact that the £1,235 of clean capital would not be in the special nominated account the cleansing would be the same as set out above.

10 SECTION J - FIG AND COLLATERAL

Question 28

W here does Remittance Basis foreign income or gains (FIG) used as collateral "sit" when it comes to cleansing (i.e. does it "sit" in the bank account that is collateralised or does it "sit" in the loan/asset acquired with the loan funds)?

Suggested Answer

FIG held in a bank account used as collateral, remains in the bank account for the purpose of cleansing.

Where the loan funds were brought into the UK, but the loan dates back to before the August 2014 change in HMRC stance on FIG used as collateral such that grandfathering is in place and the FIG is not treated as having been remitted, the individual might want to make use of cleansing to adjust the collateral as the loan terms might be about to change such that the grandfathering will be lost - see example (a).

Where the loan funds have to date been kept outside of the UK the individual might want to make use of cleansing so that the funds can be brought to the UK without a negative tax consequence - see example (b).

Example (a)

There is a £1 million loan and the bank requires £1.5 million collateral. Currently the collateral mixed fund account contains £1 million of clean capital and £500,000 of FIG. The individual recently received a £750,000 inheritance.

The loan was for a fixed term ending in May 2019 and a new loan must be re-negotiated. As such, grandfathering will be lost.

On the basis that the loan is still required and there is insufficient alternative clean capital for the new loan it will be necessary to cleanse the collateral mixed fund account of the £500,000 FIG prior to 6 April 2019. The necessary additional clean capital can be transferred into the clean collateral account as required.

Example (b)

If the collateral mixed fund account contains £500,000 of FIG and £600,000 of clean capital, a loan of £550,000 is likely to be considered to represent £500,000 of FIG and £50,000 of clean capital – the loan cannot be brought to the UK without triggering a taxable remittance. If the account is cleansed and the capital account used as the collateral, then the loan automatically becomes capital and so can be brought to the UK without triggering a taxable remittance.

Question 29

Loan funds are treated as capital within a mixed fund (account C) and can, therefore, be cleansed out as capital (into account D). If the loan is subsequently repaid using a mixture of capital and FIG, however, does this then (almost retroactively) taint the cleansed capital?

Suggested Account

In circumstances where the debt is cleared using a mixture of capital and FIG then this will taint the cleansed account. The account will then become (upon repayment of the loan) a mixed fund representing the capital and FIG. If there is time prior to 6 April 2019 account D can be cleansed.

11 SECTION K - INTERACTION BETWEEN MIXED FUND CLEANSING AND REBASING

Question 30

How does Finance (No 2) Act 2017, Part 3 (Capital Gains Tax rebasing) interact with, Part 4 (cleansing)?

Suggested Answer

It is possible to benefit from both rebasing and cleansing. However, to do so an individual has to meet the conditions in both sets of legislation. Assuming they do the asset would need to be sold so as to leave enough time for the cleansing transaction prior to 6 April 2019 (the cleansing deadline).

It is only necessary to cleanse where rebasing has been carried out if the acquisition costs were tainted (in whole or in part) with Remittance Basis income or chargeable gains. Where they are not the proceeds can be brought into the UK without any resulting tax liability since:

- the acquisition costs are clean capital;
- rebasing wipes out the gain up to 5 April 2017; and
- any post 5 April 2017 gain is taxed on the Arising Basis (since the individual must be deemed domiciled to qualify for rebasing).

Cleansing will be necessary where in whole or in part the acquisition cost traces to Remittance Basis income or chargeable gains and the individual wants to bring the clean capital to the UK. This can be done either by:

- transferring out the Remittance Basis income and/or chargeable gains; or
- Transferring out: (i) the clean capital (if any); (ii) the gain that disappears as a result of rebasing; and (iii) the Arising Basis gain (if any).

Example

An individual is deemed domiciled in 2017/18 and qualifies for rebasing. A valuable painting (qualifying for rebasing) is sold on 19 April 2018. The painting was:

- acquired for £11 million using £7 million of clean capital and £4 million of Remittance Basis relevant foreign income without a foreign tax credit;
- worth £15.2 million on 5 April 2017; and
- sold for £15.4 million.

The £15.4 million is paid into a new offshore bank account (account C). The rebasing means that only £200,000 is subject to tax on the Arising Basis in 2018/19.

Funds representing the £7 million of clean capital, the £4.2 million gain benefitting from rebasing and the £200,000 chargeable gain taxed on the Arising Basis can all be brought into the UK free from additional tax if the £4 million of Remittance Basis relevant foreign income is cleansed from account C. To do this the following would happen:

- New offshore account D is opened and a £4 million cleansing transfer from account C to account D takes place. An appropriate nomination with respect to the ITA 2007, s 809Q(4)(d) Remittance Basis relevant foreign income is made.
- The £11.4 million remaining within account C is brought into the UK (no tax is payable as

a result of this remittance).

Note that if it was decided to do the cleansing the other way around, with the £4 million of Remittance Basis relevant foreign income without a foreign tax credit remaining in account C the nomination for the £4.2 million gain benefitting from rebasing would not refer to ITA 2007, s 809Q(4)(e) as the rebasing means that the £4.2 million is not a foreign chargeable gain. Rather it would be within ITA 2007, s 809Q(4)(i) (income or capital not within another paragraph of s 809Q(4)). This is important when documenting the cleansing nomination (incorrect documentation could lead to the nomination being invalid).

Question 31

Kiki is deemed domiciled in 2017/18 and qualifies for rebasing. She has a mixed fund investment portfolio that contains a significant amount of clean capital which she wants to cleanse. Kiki does not, however, want to be out of the market for long or acquire different investments. As such:

- a new investment portfolio is opened for the clean capital;
- all the investments are sold on 19 June 2018;
- a cautious cleansing transfer (and nomination) to the new clean capital investment portfolio takes place;
- on 20 June 2018 acquisitions are made such that, once all the acquisitions are made, across the two portfolios Kiki is left with exactly the same investments and in the same quantities as she held on 19 June 2018.

What is the tax analysis?

Suggested answer

From a CGT perspective because there has been a re-acquisition within the period of 30 days after the disposal the base cost for the disposal is the acquisition cost of the new shares (that is the “bed and breakfasting” rule applies).

The base cost for the shares Kiki has in her portfolios as at 20 June 2018 is the rebased 5 April 2017 amount.

As explained in Question 14 above holding the same shares/securities of the same class in more than one portfolio should be avoided to prevent significant mixed fund analysis difficulties going forward

12 SECTION L – INTERACTION WITH (ITA 2007, S 809I TO S 809J)

Question 32

Is there any benefit to cleansing where the provisions at ITA 2007, s 809I have been triggered?

Suggested Answer

Only if an individual has one or more mixed funds containing clean capital. The clean capital can be cleansed and brought to the UK without ITA 2007, s 809J changing its classification.

There is no benefit to cleansing for Remittance Basis income and chargeable gains as the ITA 2007, s 809J rules take the total remittances of nominated income and chargeable gains and Remittance Basis income and chargeable gains and, following the steps set down in ITA 2007, s 809J(1), match this figure in the order set down in s 809J(2) regardless of what has actually been remitted.

Question 33

Where either:

- pre-6 April 2012 nominated income or gains; or
- post 5 April 2012 nominated income or gains in excess of £10 for a tax year

are paid into an account with other income or capital is it possible to cleanse the account so as to remove the other income or capital?

Suggested Answer

Cleansing is possible but great caution should be exercised as one would not want to trigger the ITA 2007, s 809I and s 809J rules. There should be no attempt to remove income or gains of the same type and of the same year as what was nominated.

Provided a sufficient buffer is left to guard against the dangers of an over nomination, the following can be cleansed:

- clean capital within the mixed fund account;
- income or gains other than that which has been nominated and paid into the mixed fund account; and
- income or gains of the same type but a different year to that which has been nominated and paid into the mixed fund account.

Where there is even the slightest doubt as to the accuracy of the mixed fund analysis cleansing should not be attempted as the risk of an over-nomination and triggering the ITA 2007, s 809I and s 809J rules on remittance would be too great.

13 SECTION M – NON-RESIDENTS & CLEANSING

Question 34

The employment earnings rules mean that income paid out in a tax year is subject to tax on the basis of the individual's circumstances in the tax year that the duties arose. Where as a result of this issue a mixed fund is created can a non-UK resident individual cleanse the account?

Suggested Answer

There is nothing in the legislation that prohibits a non-resident from cleansing. They must, however meet all the conditions so they must have been UK resident in at least one year between 2008/09 and 2016/17 (inclusive) and been a Remittance Basis user.

Example

Anastasia meets the cleansing qualifying conditions. In 2017/18 she receives a £1 million bonus relating to duties performed in 2016/17 (when she was UK resident and qualified for overseas workday relief). This means that if she remits the foreign duties part of the bonus (even though she is non-UK resident) it will be taxable. She is entitled to 50% overseas workday relief as a result of the split between UK and foreign workdays. As such, £500,000 relates to UK duties and

£500,000 to foreign duties.

Anastasia paid the bonus into the same offshore account (account C) that contained an inheritance of £5 million.

Anastasia wants to cleanse the account because she wants to bring funds to the UK for various reasons (she wants to acquire a London flat for when she is in the UK on business and she also wants to acquire some quoted UK investments).

In this situation the easiest thing for Anastasia would be to open a new offshore account (account D) and transfer the portion of the bonus relating to foreign duties (£500,000) to the account. She will then be left with £5.5 million in account C that she can bring into the UK and can use the £500,000 in account D for offshore expenditure,

14 SECTION N - TRANSFER OF MONEY

Question 35

What is meant in the legislation by "a transfer of money"?

Suggested Answer

The legislation states that for a cleansing transfer to be valid it must be a transfer of money. That is money only NOT money or money's worth.

Funds within a saving account qualify as money. Similarly, funds within a money market deposit account qualify as money. However, holdings within money market investment funds or any other liquid investments do not qualify as money.

Generally, for cleansing to occur property (other than money) will have to be liquidated so the cleansing transfer can occur.

See question 12 for a consideration of the issues where there is an investment portfolio linked to various accounts.

JK comments:"money" has its general law meaning

15 SECTION O– JOINT ACCOUNTS

It should be noted that due to the complexities it is recommended that Remittance Basis users do not use joint accounts.

Question 36

Can you cleanse funds within a joint account and if so how?

Suggested Answer

Funds within a joint account can be cleansed (as stated in the HMRC Guidance). However, before cleansing can be carried out the mixed fund analysis must be carried out.

Mixed fund analysis where there are joint accounts is extremely complex because of the problem in determining the nature of the funds in the account. It is even more complex where there are accounts in the names of more than two people.

A separate mixed fund analysis has to be carried out for each individual whose name the account is in. However, the analysis cannot be carried out just on the basis of the source of the funds and who the expenses relate to. Even the intentions of the parties when the funds are paid into and

taken out of the account is not necessary sufficient[7]. It will be necessary to look at the legal documentation with respect to the account such as the terms and conditions, the documents that have been signed and in particular the bank mandate.

16 SECTION P - CLEANSING TRANSFERS

Question 37

Cleansing is carried out with the express intention of either freeing up clean funds (possibly leaving other funds behind in the mixed fund account) or funds that can be remitted at a lower tax cost (Remittance Basis foreign income and/or gains with foreign tax credits, entrepreneurs' relief gains, normal gains taxed at 10%/20% or even gains taxed at 18%/28% where the taxpayer has a high marginal Income Tax rate that would apply to remittances of income). As such, whilst a remittance to the UK may not occur in the tax year cleansing takes place there is the intention to remit at some point.

Can it be confirmed that this is not an issue given that the legislative wording refers to the cleansing transfer as an offshore transfer and links that to the ITA 2007, s 809R(4) "offshore transfer" definition?

Our concern is that s 809R(4) links in to s 809R(5) and (6) and 809R(6) deems any transfer to be an offshore transfer if remittance does not occur before the end of the tax year in which the transfer occurs and is not then expected to occur thereafter. Put another way the transfer is only an offshore transfer if the funds are not brought into the UK in the year and there is no intention that they will be bought to the UK. With cleansing even if the funds are not brought to the UK in the year the transfer occurs there is an intention that they will be.

Suggested Answer

HMRC took legal advice on this point prior to the legislation being passed. The advice was that the legislation worked as intended and cleansing transfers would be valid where the funds are brought to the UK in the tax year or the intention is that they will be brought to the UK in future tax years.

Example

Fatima is a UK resident foreign domiciliary. She has a mixed fund account (account C).

Fatima requires funds in the UK and knows that the account C contains significant clean capital. She decides to cleanse but only removing the clean capital. Just prior to cleansing the analysis shows £5.67 million clean capital in account C. She opens a new offshore account (account D). To be prudent (mitigating the risk of an over nomination) on 19 January 2019 she transfers £5.5 million to account D and makes the appropriate nomination. She immediately remits the funds to the UK.

Assuming there is no over nomination, Fatima has made a valid cleansing transfer and the £5.5 remitted to the UK is free from UK tax.

Question 38: Transfer back to old account

Opening offshore accounts is very difficult and from a practical perspective where a mixed fund account has been fully cleansed such that there are no funds within the account it will often be helpful to re-use the account for cleansing transactions with other accounts. It is also helpful to cleanse the same categories of funds from different mixed fund transferor accounts

[7] The Privy Council recently decided in Whitlock and another (Appellants) v Moree (Respondent)(Bahamas) [2017] UKPC 44 that, even if there may not have been an intention to make a gift, the terms of the bank mandate (which clearly showed that the account was, both legally and beneficially, owned jointly) took precedence.

to the same transferee account)

Suggested Answer

Provided cleansing transfers take place in the two- year window the only prohibition put in place by the legislation is on making more than one nomination going the same way between the same two accounts.

Example

An individual has a mixed fund account (account C) and analysis breaks it down as:

- £1.5 million Remittance Basis relevant foreign income not subject to a foreign tax; and
- £3.5 million clean capital (inheritances and gifts).

The individual already has the following other offshore accounts:

- an account (account D) just containing Remittance Basis relevant foreign income not subject to a foreign tax; and
- a clean capital account (account E).

The individual makes the following cleansing transfers and nominations:

- the £1.5 million Remittance Basis relevant foreign income not subject to a foreign tax is transferred from account C to account D; and
- the £3.5 million clean capital (inheritances and gifts) is transferred from account C to account D.

Account C has a nil balance. The individual also wants to cleanse offshore account F which contains:

- £1 million Remittance Basis foreign chargeable gains not subject to a foreign tax; and
- £1.5 million clean capital (inheritances and gifts).

The individual intends to make the following cleansing transfers and nominations:

- a transfer of the £1 million Remittance Basis relevant chargeable gains not subject to a foreign tax is transferred from account F to account C; and
- a transfer of the £1.5 million clean capital (inheritances and gifts) from account F to account D.

Example

An individual has a mixed fund account (account C) containing Remittance Basis relevant foreign income not subject to a foreign tax, Remittance Basis foreign chargeable gains not subject to a foreign tax and clean capital. Cleansing transfers occur on 18 June 2018 such that the three different categories of funds go to new offshore accounts D (clean capital), E (Remittance Basis relevant foreign income not subject to a foreign tax) and F (Remittance Basis foreign chargeable gains not subject to a foreign tax) with account C having a nil balance.

On 29 September 2018, a valuable painting is sold for £25 million. The acquisition cost of £19 million is pre-UK arrival capital. The £6 million gain represents Remittance Basis foreign chargeable gains not subject to a foreign tax. The £25 million is paid into account C. The £6 million gain can be cleansed by way of a cleansing transfer and nomination provided the transfer is not to any of accounts D to F.

Question 39: additional payment in

Provided the transfer occurs before 6 April 2019 can further cleansing take place if a mixed fund account that does not have a nil balance receives additional funds after cleansing transfers have occurred?

Suggested Answer

Yes. As mentioned above, the legislation does not place any restrictions on the number of cleansing transactions that can take place from a mixed fund account or when in the twoyear cleansing period the transactions have to take place. The only prohibition is on making more than one nomination going the same way between the same two accounts.

JK comment: an easy question

Example

An individual has a mixed fund account (account C) containing Remittance Basis relevant foreign income not subject to a foreign tax, Remittance Basis foreign chargeable gains not subject to a foreign tax and clean capital. Cleansing transactions are made as follows:

- 17 January 2018 to transfer the clean capital to new offshore account D; and
- 25 April 2018 to transfer the foreign chargeable gains to new offshore account E.

The Remittance Basis relevant foreign income not subject to a foreign tax remains within account C.

On 4 March 2019 the individual's non-UK resident mother mistakenly transfers a £1 million birthday gift to account C rather than account D. Realising her mother's error the individual quickly opens a new clean capital offshore account (account F) and makes a £1 million cleansing transfer on 7 March 2019 to account F (no other transactions having happened with respect to account C between 4 March 2019 and 7 March 2019, so there is no over nomination concern). The transfer cannot be to account D as that would be the second transfer from accounts C to account D and would not, therefore, be valid for cleansing purposes.

The three cleansing transfers to accounts D, E and F are all valid.

17 SECTION Q – CLEANSING SPECIFICS

Question 40: Actual domiciliary

Can an individual who was foreign domiciled and a Remittance Basis user in one or more of the tax year(s) between 2008/09 and 2016/17 and has acquired a UK domicile of choice qualify for cleansing?

Suggested Answer

Yes, in contrast to rebasing, the acquisition of an actual UK domicile will not prevent an individual from cleansing a mixed fund account provided he or she was a Remittance Basis user at least once between 2008/09 and 2016/17 and the other cleansing conditions are met.

Question 41: Clearance

Due to the risk of over nominating (see section B) and the nomination then being invalid (with the transfer being treated as an offshore transfer), will HMRC enter into correspondence with taxpayers, so they can obtain certainty that HMRC agrees the figures prior to the cleansing transaction(s) taking place?

Suggested Answer

HMRC will review a taxpayer's figures where the taxpayer has a Customer Compliance Manager (previously a Customer Relationship Manager). The approach should be made to the Customer Compliance Manager who will obtain guidance from HMRC technical. The approach will need to be made so as to give HMRC sufficient time to look through the analysis work. Common sense needs to be used as the time HMRC will take will depend on the length and complexity of the analysis.

JK's comment: will HMRC want to devote resources to that?

HMRC cannot review figures where a taxpayer does not have a CRM. However, where there is uncertainty as to the law the non-statutory clearance process is available (see *https://www.gov.uk/guidance/non-statutory-clearance-service-guidance*).

18 SECTION R – NOMINATIONS AND RECORD KEEPING

It is clear from the legislation that the nomination is crucial in order for the cleansing transfer to be valid. The legislation does not, however, say anything about what is required for the nomination. In the HMRC guidance it states that there is no need for a formal nomination process. Given the importance of the nomination additional guidance is required, so we consider nomination issues and record keeping requirements below.

We include a potential cleansing nomination template in the Appendix 3.

Question 42 Nomination

a) For post 5 April 2008 funds one nominates the appropriate category of income or capital within the ITA 2007, s 809Q(4) categories. Since these categories of income and capital set only apply for post 5 April 2008 funds how should nominations be made for pre-6 April 2008 funds?

B) Regardless of whether the funds are post 5 April 2008 or pre-6 April 2008, how should a nomination be made where a sub-category of funds (see question 15) is being cleansed?

Suggested Answer

a) The same categories of income and capital as set down in ITA 2007, s 809Q(4) should be used only that legislation should not be referred to (as it does not apply to ore-6 April 2008 funds). The fact that the funds are pre-6 April 2008 should be stated. Appendix 3 provides examples.

b) Where there is a situation, such as is envisaged in question 15, and the transfer is to cleanse a specific sub-category of income or gains the nomination should clearly describe the sub-category in question. Again appendix 3 provides examples.

Question 43: Time of nomination

When does the nominationneed to be made?

Suggested Answer

Making the nomination and documenting the making of the nomination are two different things.

It is the making of the nomination that is crucial. The actual documentation of the nomination can occur after the nomination.

In the HMRC Guidance (see Appendix 2) it states that the nomination should be made prior to

6 April 2019. To be prudent the nomination should also be recorded in writing prior to that date. From a practical perspective, it would make sense for the documentation of the making of the nomination to take place at the same time as the nomination or soon after to ensure that it is not forgotten about.

Whilst in, theory, there is nothing to prevent a random transfer being made and a nomination at a later stage (when a mixed fund analysis has been carried out) the risk of such a transfer not agreeing to any mixed fund analysis such that the amount transferred is either an over-nomination for all purposes (such that it falls to be treated as an offshore transfer) of a significant under nomination is high. Waiting until after the mixed fund analysis has been performed is always going to be the better route.

The one exception to the above will be where an individual has left things too late to carry out the necessary detailed mixed fund analysis by the deadline. In such cases a best (very prudent) guesses for cleansing may be made with appropriate transfers and nominations (the aim will be to under nominate so the cleansing transfers will be valid). Prior to any remittances the mixed fund analysis would then need to be carried out to see check whether the transfers are valid for cleansing purposes (that is whether they are under of over nominations).

JK comment: A nomination can IMO be made at any time: TFD 14.12.6 (Condition (d): Nomination).

Question 44: Form of nomination

What should be put in the nomination document?

Suggested Answer

The nomination document can either be a separate document (an e-mail would suffice) or the information can be put on the face of the electronic transfer document that the bank provides (this might be a downloaded document if internet banking is used).

The following details should be recorded on the nomination document (see Appendix 3):

- the transferor account;
- the transferee account;
- the amount that is being cleansed; and
- the kind of income or capital being cleansed. See question 42 and Appendix 3 for how to provide these details.

There is no specific requirement to record the tax year with respect to which the foreign income or gains arise/accrue. However, it is possible to separately nominate foreign income or gains for specific tax years and where this is done the tax year should be recorded.

JK comment: this is good practice: TFD 14.12.6 (Condition (d): Nomination).

Question 45

What records/evidence must be kept with respect to nominations?

Suggested Answer

The mixed fund analysis on which the nomination(s) are based, the electronic transfer document(s) and (if it is not made on the face of electronic transfer document) the document containing the nomination details.

JK comment: This is good practice

Question 46

How long must the records/evidence with respect to the nomination be kept?

Suggested Answer

The cleansing transaction itself cannot result in tax liabilities so in itself is not of interest to HMRC. It is the remittance to the UK of cleansed funds that HMRC might enquire into. As such, records/evidence in connection with the nomination should be kept until all cleansed funds have been remitted and the enquiry window has elapsed for the last remittance. To be cautious it would be sensible to retain records/evidence until the period of time for a discovery assessment has elapsed.

JK comment: Yes

Question 47: Minors

W hilst a minor does not pay the Remittance Basis Charge, a minor can be a Remittance Basis user, such that cleansing can be in point where the minor has a mixed fund. It is appreciated that cleansing can only occur where the account beneficially belongs to the minor and the minor will be absolutely entitled to the funds on reaching 18. Where this is the case who should make the nomination? A tax return submitted for a minor is approved by a parent (or guardian where appropriate)? Would this also be the case for a cleansing nomination? Presumably the name of the nominee on the account (which could be a grandparent) is disregarded?

Suggested Answer

The position for the approval of a cleansing nomination with respect to an account held absolutely for a minor, which the minor will be absolutely entitled to on reaching the age of 18, is the same as for the signing of a tax return for the minor. The name of the nominee on the account that is being cleansed (or the transferee account) is irrelevant.

Similarly, an individual who has lost mental capacity does not sign their tax return and would not sign a nomination. Where a mixed fund account beneficially belongs to the incapacitated individual the Court appointed deputy or the person who has the necessary power of attorney will be able to make the decision about the cleansing transfer and will make the nomination

Note that the nomination template wording in Appendix 3 should be slightly adapted where the taxpayer is a minor or does not have the mental capacity necessary to approve the nomination. For example:

For a minor

I am the parent/guardian [DELETE AS APPROPRIATE] of [INSERT CHILD'S NAME] who is a minor. He/she [DELETE AS APPROPRIATE] was a Remittance Basis user at least once between 2008/09 and 2016/17 inclusive.

In cases of mental incapacity

I act as [INSERT CAPACITY IN WHICH PERSON IS ENTITLED TO ACT FOR THE INDIVIDUAL WITH RESPECT TO THEIR FINANCIAL AFFAIRS] for [INSERT NAME] who was a Remittance Basis user at least once between 2008/09 and 2016/17 inclusive.

Question 48

If a mistake has been made with a cleansing transfer to a new offshore account (account D) and

this is appreciated prior to 6 April 2019 can the funds be transferred back from account D to the original mixed fund account (account C) and the account cleansed correctly?

Suggested Answer

Yes. Further mixed fund analysis may need to be carried out depending on whether there have other transfers from account C.

It is also possible to analyse account C and account D and cleanse those accounts without transferring the funds from account D back. This is likely to be the easier approach where account D was an existing account that was made into a mixed account by the failed cleansing transaction.

Example

Renée makes a cleansing transfer to a new account (account S) on 17 July 2018 of £9.75 million of what he thinks is clean capital. When he sends the paperwork to his tax adviser his tax adviser realised that Renée made a transposition error as the transfer should have been of £9.57 million clean capital. The transfer is not, therefore, valid. Renéé transfers the funds back to the original account. This was the only cleansing transfer, so he can open a new offshore account and make the £9.57 million transfer.

Question 49

Can cleansing transfers be made from account C to account D and, at a later date (but prior to 6 April 2019), from account D to account C?

Suggested Answer

It seems unlikely that this would happen. The answer is, however, yes. This is because the transfer is going the other way to the first transfer. The legislation allows for one transfer each way between accounts.

Example

Sabrina is a UK resident foreign domiciliary who meets the cleansing criteria. She has no clean capital other than that within her mixed fund account (account C).

Sabrina wants to cleanse account C so she has funds she can bring to the UK without a tax charge. She decides to remove all the Remittance Basis income and gains from account C transferring the funds to new offshore account D and leaving the clean capital within account C. Her mixed fund analysis is straightforward, so she is happy to use the precise figures for the cleansing hence removing the other funds rather than transferring out a cautious estimate of the clean capital.

Once the first cleansing is carried out she brings the clean funds in account C to the UK.

She realises that she will need further funds in the UK. Within account D she has a significant level of Remittance Basis foreign capital gains (none of which are chargeable at the higher 18%/28% rates or have foreign tax credits). She decides that a 20% tax rate is acceptable and that she will cleanse account D to remove these gains. Rather than open another bank account she uses account C. This is a valid cleansing transfer as it is the first time that a nomination from account D to account C will have been made.

Question 50

How should the nomination be made where the mixed fund bank account is in a foreign currency?

Suggested Answer

As with any other nomination the nomination does not need to be signed and could be in an e-mail.

Where the mixed fund analysis has been carried out in a foreign currency and the cleansing transfer is also in the foreign currency the nomination can be in that foreign currency.

Where the mixed fund analysis has been carried out in sterling the nomination should also be made in sterling.

1. Mixed fund analysis carried out in the foreign currency Example nominations From and to accounts in the same foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

L US$ Account

- *$5 million transferred from L USD Mixed Account to J Capital USD Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *$5 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in a different foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

P AUS$ Account

- *AUS$ 6 million transferred from P USD Mixed Account to Q Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *AUS$ 6 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in sterling

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

J Euro Account

- *Euro 4 million transferred from J Euro Mixed Account to K Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *Euro 4 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

2. Mixed fund analysis carried out in sterling

Where the mixed fund analysis has been prepared in sterling the cleansing transfer must not be

higher than the sterling mixed fund analysis figure for the ITA 2007, s 809Q(4) category of funds being transferred. That is the foreign currency transfer must equate to the appropriate sterling amount using an appropriate foreign exchange spot rate on the date of the cleansing transaction. For example, where the analysis shows a US$ account has £11 million clean capital the US$ figure transferred cannot be higher than the US$ equivalent of £11 million on the date of the transfer.

Example nominations

From and to accounts in the same foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

L US$ Account

- *The US$ equivalent, at the date of the cleansing transfer, of £4 million (that is $5.6 million) was transferred from L USD Mixed Account to J Capital USD Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) *£4 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in a different foreign currency

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

P AUS$ Account

- *The AUS$ equivalent, at the date of the cleansing transfer, of £6 million (that is AUD$*

10.62 million) was transferred from P USD Mixed Account to Q Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2)(d*) £6 million* was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

Funds from an account in one foreign currency to an account in sterling

"I claimed the Remittance Basis at least once between 2008/09 and 2016/17 inclusive. On [INSERT DATE BETWEEN 6 APRIL 2017 AND 5 APRIL 2019] I gave instructions to [INSERT BANK NAME] Bank to carry out an electronic transfer pursuant to the legislation in Finance (No 2) Act 2017, Sch 8, Part 4 (cleansing of mixed funds). This document formally records the Finance (No 2) Act 2017, Sch 8, para 44 (2)(d) nomination made.

J Euro Account

- *The Euro equivalent, at the date of the cleansing transfer, of £4 million (that is Euro 6.72 million) was transferred from J Euro Mixed Account to K Capital Euro Account. In accordance with Finance (No 2) Act 2017, Sch 8, para 44 (2*)(d) £4 million was nominated as being funds within ITA 2007, s 809Q(4)(i).*"*

19 SECTION S – TAX RETURN DISCLOSURE

Question 51

What disclosure is required on self-assessment tax returns?

Suggested Answer

It is not necessary to make any disclosure on self-assessment tax returns. It is, however, appreciated that disclosure may be felt to be desirable.

Disclosure in the year that cleansing takes place – there is no merit in making disclosure in the year that cleansing takes place unless remittance also occurs in this year. This is because it is only once remittance has occurred that there could be any UK tax issue.

In the year that a remittance of cleansed funds occurs the following disclosure might be made on the tax return.

"On 24 March 2020 I remitted [INSERT AMOUNT] that following a cleansing transaction, which occurred on[INSERT DATE], is deemed to trace to clean capital."

Additional detail should be given if any assumptions were made with respect to the mixed fund analysis that underpins the cleansing.

[WHAT WOULD HMRC CONSIDER TO BE SUFFICIENT DISCLOSURE TO PROTECT AGAINST A DISCOVERY ASSESSMENT? IS IT POSSIBLE TO PROVIDE SUFFICIENT DISCLOSURE SHORT OF ACTUALLY ADDING THE MIXED FUND ANALYSIS AS AN ATTACHMENT? WOULD EVEN THAT BE ENOUGH WITHOUT THE SUPPORTING BANK STATEMENTS? IN MANY CASES THE ON-LINE SYSTEM WILL NOT BE CAPABLE OF TAKING SUCH LARGE FILES]

JK comment: The issue in s.29 TMA is whether :

> the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above [the insufficiency].

20 SECTION T – INTERACTION WITH REQUIREMENT TO CORRECT

Question 52

How could cleansing work interact with the requirement to correct (introduced by Finance (No 2) Act 2017, Sch 18)?

Suggested Answer

The requirement to correct (RTC) legislation establishes a new legal obligation on taxpayers to disclose to HMRC undeclared UK tax liabilities, as at 5 April 2017, with respect to offshore matters or transfers. The RTC period runs from 16 November 2017 (Royal Assent) to 30 September 2018 after which far tougher penalties come into force (the failure to correct penalty (FTC) being 200%, of the offshore unpaid tax, which can be reduced but not below 100%).

As will have become clear from the questions above a cleansing transaction occurs after a mixed fund analysis has determined the composition of the fund. It is possible that the analysis will uncover inadvertent unreported taxable remittances that fall within the RTC legislation. If this happens a disclosure of the unreported liability will need to be made as soon as possible to meet the 30 September 2018 deadline.

3rd May, 2018 **James Kessler QC**