Cleansing Mixed Funds

Non-doms, remember to cleanse your mixed funds before the window of opportunity closes!

Non-domiciled UK residents should be reminded that the window of opportunity to “cleanse” mixed fund bank accounts will close on 5 April 2019. This is an opportunity not to be missed since, if successfully utilised, cleansing allows a non-dom remittance basis user to create (or increase) a fund of non-taxable “clean” capital which can be brought to the UK free of tax.

This briefing provides an overview of the mixed fund cleansing opportunity. It is, however, important that specific advice is obtained.

Do I qualify for the cleansing opportunity?

Any non-domiciled UK resident who was taxed on the remittance basis in any tax year up to and including 2016-17 will qualify for the cleansing opportunity (the only exception is those who were (i) born in the UK (ii) with a UK domicile of origin). This includes those taxed on the remittance basis without the need for a formal election (i.e. because their foreign income and gains for the year totalled less than £2,000).

Which mixed funds can be cleansed and how?

Any mixed fund bank account can be cleansed by making transfers of money into other bank accounts. However, the transfers must be “nominated” and there must have been no previous nominated transfers between the relevant accounts. Nominated transfers must be made by 5 April 2019.

“Nomination” of transfers involves making a formal record of the bank transfer including the amount of each category fund it consisted of. This involves analysing the account to identify the different categories of fund in the mixed account, which can be complicated.

Why might it be complicated?

The complexity will depend on factors including the number of credits to the account, whether foreign currency exchange is involved and the nature/source of the credits.

Nominations must be accurate (or at least conservative); excessive nominations are void, meaning the attempt to cleanse will have failed.

Where proceeds from the sale of an asset have been credited to the account, it will generally be necessary to retrieve records that allow any gain to be calculated according to UK rules.

The complexities involved are evidenced by the 67-page Q&A document published by the professional bodies (relating to law of only 3 paragraphs), on which HMRC is yet to comment.

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Professional advice is therefore essential when cleansing all but the simplest of mixed funds. In addition to analysing accounts, advising on transfers and drafting nominations, we advise clients on the risks and benefits of making full disclosure to HMRC in respect of cleansing transactions undertaken.

But is it possible to cleanse a very recent gain?

Yes! Cleansing is particularly relevant to gains since the sale proceeds in a remittance basis gains transaction are always a mixed fund. This means that normally (i.e. in the absence of cleansing) the gain (which is taxable) must be remitted in full before the original investment (which may be non-taxable "clean" capital) can be accessed.

So, in particular those non-doms with recent or imminent remittance basis gains should act to cleanse before the window of opportunity closes on 5 April 2019.

Hang on, let's start again from the beginning. What is a "mixed fund" and what are the consequences?

A "mixed fund" is an account consisting of money of various categories for remittance basis purposes. The main categories we are concerned with are those that are taxable if remitted to the UK (i.e. foreign income and gains that have been protected by a claim for the remittance basis of taxation) and those that are not (i.e. non-taxable "clean" capital, which can be remitted to the UK free of tax). Foreign income and gains are further categorised according to whether they carry a foreign tax credit.

A mixed fund is created wherever different categories of funds are mixed within the same bank account.

The consequences of a mixed fund are the special ordering rules that determine how remittances from the account are matched with the different categories of funds in the account. These rules are severe since the effect is generally that a remittance is deemed to come first from the funds that will suffer the highest tax charge upon remittance to the UK.

The law on cleansing of mixed funds acts to switch off these special ordering rules where the requirements of the law have been followed.

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