The remittance basis and foreign currency bank accounts

One of the main features of the remittance basis regime introduced in Finance Act 2008 is that those who choose to be taxed on the remittance basis will no longer qualify for the Annual Exempt Amount (AEA) for Capital Gains Tax. A number of concerns have been expressed that this is causing significant administrative difficulties in completing Self Assessment returns because of the need to establish the gains and losses which arise on movements from overseas bank accounts held in currencies other than sterling. This is because such accounts are chargeable assets for the purposes of Capital Gains Tax and any transfers between them create a potentially taxable disposal.

To address these concerns, HM Revenue & Customs (HMRC) have been exploring ways in which to reduce or minimise such difficulties within the scope of their administrative discretion.

Acquisition costs of non-sterling bank accounts

Difficulties can arise in calculating the base cost for disposals and part disposals of non-sterling bank accounts in situations where it cannot be ascertained which exchange rate was in force at the time the debt was originally acquired or increased.

To reduce these difficulties, HMRC will permit a simplified approach whereby the acquisition cost, as at 6 April 2008, of a debt represented by a non-sterling account can be calculated by means of an average exchange rate over a period of time up to 6 April 2008. Under this method, individuals can establish the base or acquisition cost of their non-sterling bank accounts by reference to the average foreign currency exchange rates which were in force over the six years up to April 2008. These rates can be found on the HMRC website at Exchange rates.

For the sake of simplicity, HMRC have calculated the average exchange rate for the six years to April 2008 for US dollars and euros, namely US1 = £0.560275917 and €1 = £0.[illegible]80[illegible]81[illegible]6 respectively.

Where such an account has been established for less than six years at 6 April 2008, HMRC will permit individuals to calculate the base or acquisition cost by reference to the average exchange rates in force over the number of years, to the nearest year, that the account has been established.

This simplified averaging approach is entirely optional: individuals can still calculate base or acquisition costs by using the actual exchange rates which were in force at the date on which the currency was deposited into the bank account in question. However, any approach will always need to be followed on a consistent basis.

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Calculation of gains and losses: share matching and part disposal rules

The Residence, Domicile and Remittances Manual (RDRM) was published on the HMRC website in August 2010 and includes some guidance on foreign currency bank accounts. The simplified examples in the RDRM used the part disposal rules in section 42 TGCA 1992 to calculate gains and losses arising from withdrawals from such accounts. Although both lead to the same result mathematically, concerns have been expressed that this is contrary to HMRC guidance at paragraph CG78332 of the Capital Gains Manual which suggests that these gains and losses should be calculated on the basis of the share matching rules in Chapter 4 Part 1 TCGA 1992 (section 104 onwards).

The basis of the view expressed in the RDRM is that a debt represented by a credit in an individual's bank account is a single asset, rather than a series of fungible assets. Therefore any withdrawal of part of the funds in a bank account will be a part disposal of a single asset to which the share matching rules cannot apply. However, the guidance at CG78332 is not wholly explicit on this point and has given rise to possible misinterpretation. HMRC are currently in the process of revising this guidance to remove any ambiguity on this point.

In the meantime, HMRC will not insist that any tax computations of gains and losses arising from movements between foreign currency bank accounts which were carried out for years up to and including 2007-08 using the share matching rules need to be revisited. However, the part disposal rules should be followed from 2008-09 onwards, unless that is not a practical proposition, for instance, because IT systems were in place to calculate gains and losses using the share matching rules. In such cases the change to using part-disposal rules should be made from 2009-10.

In any case, where it is necessary to use share matching rules for 2008-09, the rules must be the revised ones introduced in Finance Act 2008. Continuing to use the old LIFO (last in, first out) and other rules that ceased to apply for disposals after 5 April 2008 will not be acceptable.

Section 13 TGCA 1992

As a consequence of the application of the loan relationship rules, a gain which accrues to a non-UK resident company on disposal of a debt represented by a balance in a non-sterling bank account will not be a chargeable gain. If the company has no chargeable gain, section 13 is not engaged, and therefore UK resident participators cannot be liable to tax in respect of such disposals. This difference in treatment between non-sterling bank accounts held directly and those held indirectly via a non-UK resident company is long standing and there are no plans for its amendment

Extension of Statement of Practice (SP) 10/84

SP 10/84 allows individuals who are domiciled in the UK to treat all the bank accounts which they hold in a particular currency as a single account for the purposes

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of Capital Gains Tax. It has been suggested that this non-statutory practice should be extended to include overseas bank accounts held by individuals who are not domiciled in the UK. Initial analysis has shown that such a change would be outside HMRC's administrative discretion, and would therefore require primary legislation. HMRC is continuing to explore this proposal for future years.

Simplifying the compliance burden

In some circumstances, there can be many separate transactions between sterling and non-sterling bank accounts in a single tax year and in each case a separate calculation will be required to establish the capital gain or loss which arises. The concern has been expressed that this would represent a significant administrative burden when completing a Self Assessment return.

To address this concern, HMRC will permit a simplified approach to calculating gains and losses arising from movements between non-sterling bank accounts. This is based on the aggregation of debits from and credits to a bank account over an appropriate period of time, thereby reducing the number of separate calculations which need to be carried out. The period of aggregation will normally be a calendar month, although part of a month will be used at the beginning or end of a tax year or where the account is opened or closed part way through a tax year.

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