
# Non-Dom Reforms – further details

The government has published its response to the August 2016 consultation document on the reforms to the taxation of non-domiciled individuals to take effect from 6 April 2017. The response provides further details of some of the measures first announced in 2015, and some amendments to the proposals put forward in August 2016 in light of the consultation. Draft legislation has also been published, with the exception of the income tax arrangements for offshore trusts, which will be published later.

To recap, the main areas of these reforms seek to:

- Align the tax treatment of non-domiciled individuals who have been resident in the UK for 15 out of the past 20 tax years with that of UK domiciled individuals. Such individuals will become 'deemed domiciled' in the UK for all tax purposes, so that their worldwide income and gains are taxed on an arising basis, and their worldwide assets subject to inheritance tax (IHT).
- Provide certain protections for offshore trusts settled by non-domiciled individuals before they become deemed domiciled under the new rules.
- Ensure that individuals born in the UK with a UK domicile of origin who leave the UK and acquire a foreign domicile of choice are taxed as UK domiciled individuals when they return to live in the UK.
- Bring within the scope of IHT UK residential property held in overseas structures.
- Encourage inward investment into UK businesses by widening the scope of Business Investment Relief.

To help individuals to adjust to the new regime, two transitional reliefs will be introduced: rebasing of foreign assets to their April 2017 value, and cleansing of mixed funds.

**Long-term residents of the UK**

Individuals who have been resident in the UK for 15 out of the past 20 tax years will be regarded as 'deemed domiciled' for all UK tax purposes from their 16th year of residence, even though they may remain non-UK domiciled under general law.

Part years of residence will count towards the 15 years as will any years of UK residence as a minor child.

From the date on which an individual becomes deemed domiciled under the new rules, they will no longer be able to access the remittance basis of taxation and will instead pay tax on their worldwide income and gains as they arise, with the exception of income and gains arising in an offshore trust settled by the non-domiciled individual before they become deemed domiciled (a 'protected trust').


## Transitional Reliefs

*Rebasing*

Individuals who become deemed domiciled at 6 April 2017 will be able to rebase directly held foreign assets to their market value on 5 April 2017 so that only the gain from April 2017 will be chargeable to capital gains tax on a future disposal. Rebasing will apply on an asset by asset basis but will be limited to assets which were foreign situs at the date of Summer Budget 2015 (8 July 2015), and restricted to individuals who have paid the Remittance Basis Charge in any year before April 2017.

Whilst the pre-April 2017 portion of the gain will not be taxable, individuals should be aware that a tax charge may arise if the asset was purchased with foreign income and gains, and the proceeds of sale are remitted to the UK.

Importantly, those who become deemed domiciled in any year after April 2017 will not be eligible for automatic rebasing of their overseas assets. Tax planning is therefore essential for anyone who will fall within the new deemed domicile rules from April 2018 onwards.

Rebasing does not extend to assets held in a trust settled by the deemed domiciled individual.

*Cleansing of mixed funds*

Non-domiciled individuals who become deemed domiciled at 6 April 2017 will have two years (this has been extended from the original proposal of one year) from that date to 'cleanse' any mixed funds accounts in order to separate out their clean capital, income and gains, but only where the component parts of the mixed fund can clearly be identified.

## Losing deemed domicile

An individual can lose his deemed UK domicile by remaining non-UK resident for at least six tax years. If he returns to the UK after six years of non-UK residence, the domicile clock will reset and he will only become deemed domiciled in the UK again once he has been resident for 15 years.

For inheritance tax purposes, deemed domicile status will fall away once an individual has been non-UK resident for at least three tax years. The individual will lose deemed domicile status at the start of their fourth tax year of non-residence. There is no change here to the existing rules for IHT purposes.

## Offshore Trusts

The new rules introduce the concept of a 'protected trust'. A 'protected trust' is one settled by a non-domiciled individual before he becomes deemed domiciled.

Foreign income and all gains arising in a 'protected trust' are not taxed provided they are retained in the trust (i.e. there is no attribution of the trust income and gains to the settlor, even where the trust is settlor interested and where the settlor is deemed domiciled under the 15 out of 20 year test). A tax charge will

not arise unless and until a distribution is made or a benefit is received from the trust by the settlor or a close family member (defined as a spouse, cohabitee or minor child but not a minor grandchild).

This protection is subject to two conditions:

1) The trust is not 'tainted', i.e. no additions have been made to the trust (by the settlor or another trust of which he is a settlor or beneficiary) after the settlor has become deemed domiciled.
2) The settlor has not acquired a UK domicile of choice under general law.

These measures provide a significant opportunity for individuals who are about to become deemed domiciled to shelter from tax income or gains that are not required to fund the individual's lifestyle whilst resident in the UK.

Assets held in a 'protected trust' continue to have the same IHT treatment as at present, i.e. those assets are excluded property for IHT purposes, and can be passed down to future generations free of IHT.

*Losing protection*

The trust will become 'tainted' and, as a consequence, the tax protections will be lost if any property is added to the trust by the settlor after he has become deemed domiciled (or by the trustees of another trust of which he is the settlor or beneficiary), or where the settlor acquires a UK domicile under general law. An addition by someone other than the settlor will not taint the settlement.

In the event that a trust loses its protection, all gains and foreign income arising within a settlor-interested trust will be taxed on the settlor on an arising basis whilst he is UK resident.

**Tax Treatment of Trust Income and Gains**

Under the new rules, the overarching principle is that liability to income tax and capital gains tax will only arise to the extent that benefits are received from the trust.

*Capital Gains*

Gains will be taxed only to the extent that they can be matched to capital payments received from the trust (this is the current position under s87 TCGA 1992).

Payments to the settlor or a close family member on or after 6 April 2017 that can be matched to gains arising in the trust are, in the first instance, taxed on the UK resident beneficiary if they are either UK domiciled or deemed domiciled.

If the payment is to a beneficiary who is taxed on the remittance basis, and they do not remit the payment to the UK in that tax year, the gain is instead attributed to the UK resident settlor and taxed according to his tax status. If the settlor is UK domiciled, the gains (to which the capital payment is matched) will be taxed on an arising basis. If he is not UK domiciled or deemed domiciled, the remittance basis will apply. The settlor has a right of reimbursement from the trustees or the beneficiary.


If the beneficiary later remits the capital payment to the UK, there is no charge to tax since the payment has already been attributed to the settlor.

Capital distributions to non-resident beneficiaries will no longer be matched to trust gains, i.e. they will not reduce the pool of gains within the trust. This will apply to payments either made on or after 6 April 2017 or matched on or after that date, and regardless of the domicile status of the settlor.

Recycling provisions will be introduced to prevent the avoidance of tax by making payments to a non-resident beneficiary who is not a close family member, or to a beneficiary who is a remittance basis user, which are then given or lent back to a UK resident beneficiary. Such arrangements will be taxed on the UK resident beneficiary who receives the payment within three years of the distribution.

Trustees should consider whether to make distributions to non-residents before 6 April 2017 to 'wash out' some or all of the gains pool before this new measure is introduced.

*Income*

As at present, UK source income arising to the trust or an underlying company will continue to be taxed on the settlor on an arising basis (whether the settlor is deemed domiciled or not), where he has an interest in the settlement. If the settlor is dead, non-resident or excluded, such income is taxed on the beneficiary according to their status when a capital payment is received. There is no change from the current position.

Foreign income arising in the trust will not be taxed on the settlor on an arising basis when he becomes deemed domiciled under the 15 out of 20 year test. Instead, it will be taxed on the settlor by reference to benefits received by the settlor himself or a close family member; and provided the income is not already taxed on the beneficiary.

Where the income is taxable on the settlor, he will be taxed on the remittance basis if a remittance basis user or on benefits received worldwide if he is deemed domiciled.

**Individuals born in the UK with a UK Domicile of Origin**

Individuals born in the UK with a UK domicile of origin who leave the UK and acquire a domicile of choice in another jurisdiction will be deemed to be UK domiciled for any year in which they are resident in the UK.

For income and capital gains tax purposes, such individuals (known as 'formerly domiciled residents') will be taxed on an arising basis from the date they resume UK residence.

For inheritance tax purposes, a small grace period is allowed for those who return to the UK only briefly. The individual will be treated as deemed domiciled for IHT purposes where he was UK resident for at least one of the previous two tax years. In most cases, this is likely to be from 6 April after the year in which he resumes UK residence.


Importantly, a formerly domiciled resident cannot have a 'protected trust'. Income and gains arising in a trust that was settled by the individual whilst he was non-UK domiciled will be taxed on the settlor on an arising basis, if he can benefit from the trust.

For UK IHT purposes, the trust will be treated as a relevant property trust, and subject to UK inheritance tax 10-yearly and exit charges whilst the individual is resident in the UK. The 10-year anniversaries run from the date of settlement, not the date the individual becomes deemed domiciled, so, for example, where a trust was settled in 2007, a 10-year charge would arise in 2017.

If the individual becomes non-UK resident now, and remains non-resident during 2017, the 2017 ten year anniversary would not give rise to a ten year charge.

In these cases, the trust's inheritance tax status (and UK tax liabilities) will follow the residence status of the settlor; the trust will move in out of the relevant property regime as the settlor moves in and out of UK residence.

In order to meet their UK tax obligations, trustees will need to keep track of the ten year anniversary dates and the residence status of the settlor.

**IHT on Residential Property**

From 6 April 2017, all UK residential property will fall within the scope of UK inheritance tax.

Historically, non-domiciled individuals have often held UK residential property via an offshore company to avoid a charge to IHT, as the overseas shares are considered non-UK assets and therefore excluded property in the hands of the non-domiciled individual. Even following the introduction of the ATED (Annual Tax on Enveloped Dwellings) charge that now applies to properties worth over £500,000 held by an overseas company or other structure, many non-domiciliaries chose to retain their structures, accepting the ATED charge on the basis that the property would not be subject to UK IHT on their death.

From 6 April 2017, the IHT advantage will be removed. From this date, shares in overseas companies holding UK residential property will no longer be considered as excluded property for IHT purposes, to the extent they derive their value from UK residential property. Instead, they will be regarded as UK situs assets, and will be chargeable to UK IHT on the death of the owner, regardless of their domicile status. This treatment will also extend to overseas partnerships owning UK residential property.

Where the shares are in turn held through an offshore trust, the trustees will be subject to IHT 10-yearly and exit charges. If the settlor can benefit from the trust, there is also a potential Gift with Reservation of Benefit, resulting in the shares being considered as part of his estate for IHT purposes at the date of death.

A specific anti-avoidance rule will be introduced to prevent arrangements where the main purpose is to avoid or mitigate the IHT charge.

The definition of residential property is to follow the existing definition of a dwelling under the Non-


Resident Capital Gains Tax rules, and includes:

- any building which is used or suitable to be used as a dwelling,
- any building which is in the process of being constructed or adapted for use as a dwelling

The definition will be amended for IHT purposes to include an individual's main home. Care homes, nursing homes and purpose built student accommodation are excluded.

Loans taken out to acquire or maintain the property will be deductible, but will be within the charge to IHT in the hands of the lender. Further advice should be sought as this is a complex area.

Given that the IHT advantages are being withdrawn, many individuals have considered de-enveloping (taking the property out of the structure and placing it into personal ownership). However, the potential tax costs associated with de-enveloping (see our briefing entitled 'De-enveloping') can be a barrier to restructuring.

Earlier this year, there were suggestions that the government was considering a de-enveloping relief to encourage personal ownership of properties held in overseas company structures. However, the government has again confirmed that there will be no form of de-enveloping relief. Professional advice should be taken as soon as possible to determine the most appropriate way forward in the specific circumstances.

**Business Investment Relief**

This relief was introduced in April 2012 to encourage inward investment in UK businesses. It allows a non-domiciled individual taxed on the remittance basis to remit funds to the UK without incurring a tax charge provided the investment is in a qualifying business and certain conditions are fulfilled.

However, take up of the relief has not been as high as the government had envisaged, and it is thought that this is primarily due to the complexity of the relief and the nature of the restrictions. The government consulted on ways to improve the relief to make it more attractive, and has proposed certain changes that will be included in the Finance Bill 2017 to take effect from 6 April 2017.

The government has undertaken to consider further changes in the future.

**Summary**

Individuals who will become deemed domiciled from April 2017 should seek urgent advice on how the proposed changes will affect them so that appropriate tax planning can be implemented on a timely basis.

It may be advantageous to set up an offshore trust before the rules come into effect, and this will be of particular relevance for individuals with assets or cash that are not required to fund day to day living expenses and can be set aside for future generations. If structured correctly, any income or gains arising on such assets can be generated tax free and the assets can pass down to beneficiaries free of UK inheritance tax.


Non-domiciled individuals with existing offshore trusts should review their structures urgently to determine the extent of any tax planning that can be carried out before April 2017.



Verfides, 5th Floor, 86 Jermyn Street, St James', London, SW1Y 6AW T +44 (0) 20 7930 7111 F +44 (0) 20 7930 7444 E london@verfides.com W verfides.com
Registered in England and Wales, No. 962596, VAT No. GB 200 7711 55

Verfides is a member of the verFides group of companies