The UK Government has proposed wholesale changes to the tax treatment of non-domiciled individuals (non-doms) to take effect as of April 2017. It had been expected, that given the wave of uncertainty following the Brexit vote, that the majority of these changes would be stalled until more thought could be given as to the impact.

However, in its wisdom the UK Government is pushing ahead with the April 2017 timetable. We take a look at what this means following the latest consultation and draft legislation produced as at 5 December 2016. This update is relevant for almost all of our clients who have an international aspect to their estate, family or assets.

This is an extremely technical area and the implications are far reaching. It is worth noting that we are still in the ‘Bill’ stage of the legislative process and there will be ongoing professional commentary on the proposed changes up to February 2017. Nevertheless, the detail is incredibly important and if there are any questions then we are here to help; time will be of the essence for many of our clients if planning needs to be reviewed.

Here, we cover the key points to consider as at 5 December 2016.

The key points

• No delay, changes to be enacted as of 6 April 2017.
• UK ‘deemed domicile’ status to be extended to include personal taxation: Income Tax (IT) and Capital Gains Tax (CGT). This essentially takes away the ability of deemed domiciled individuals to claim the remittance basis of taxation indefinitely.
• Deemed domicile status to apply after 15 out of 20 tax years, as opposed to the current 17-20 tax years.
• Inheritance Tax (IHT) to be charged on UK residential property held in offshore structures (enveloped structures including closed companies and certain overseas partnerships).
• Pre-existing trusts, and indeed newly settled trusts, set up by non-domiciled and non-deemed domiciled settlors will retain the protection of Excluded Property Trust (EPT) status.
• Amnesty on the segregation of mixed funds offshore for a limited period in 2017-18 and 2018-2019 tax years to allow remittance basis tax payers to align their affairs for the new changes.
• UK non-domiciled individuals with a UK domicile of origin will immediately invoke their original UK domicile during any period in which they become UK tax resident, irrespective of how short term (this will also impact any EPTs that were established during a period of non-domiciled status).
• Rebasing and remittance provisions to allow those who are caught by the new deemed domicile rules for IT and CGT on 6 April 2017 to rebase their non-UK assets.
1. Extension of deemed domicile status

The UK has long been seen as a rather favourable proposition for wealthy foreign investors. The opportunity to invest in a stable infrastructure and to remain a tax resident here for a considerable number of years, whilst sheltering and segregating your worldwide estate from UK taxation.

The generosity of UK PLC began to wane in 2013 with the introduction of the Annual Tax on Enveloped Dwellings (ATED). This has been followed by a series of targeted legislation that has impacted traditionally foreign clients and traditional planning for non-domiciled individuals: Increases in ATED charges at a phenomenal rate, introduction of Non-Resident Capital Gains Tax (NRCGT), increases in charges for the use of the Remittance Basis of Taxation and the extension of Stamp Duty Land Tax charges. The proposed changes to the deemed domicile rules will be the most significant of all.

The two key elements are:

- Deemed domicile status to apply to an individual if they are UK tax resident for 15 out of the previous 20 tax years.
- Deemed domicile will now apply to IT and CGT and not just IHT as is currently the case – therefore deemed domicile individuals will lose the right to claim the remittance basis of taxation post April 2017 and worldwide income and gains will be subject to UK annual taxation.

Key points from the draft legislation/consultation

- This is down from 17 out of 20 and will catch non-doms who had previously relied on the longer period.
- The relatively new Statutory Residence Test (SRT) as of April 2013 will only apply to individuals in calculating their tax residency status since the SRT has been in force, April 2013. Tax years prior to 13/14 will be considered under the old common law position and allowing for HMRC guidance/concession.
- Long term UK tax residents will be deemed domiciled from the 16th tax year.
- Those tax residents who are tax resident in more than one jurisdiction and who claim a split year tax treatment will have their split year included in the 15-20 year calculation.
- The current requirement to ‘reset’ your UK deemed domicile status even after leaving the UK, four consecutive tax years of non-UK tax residency, will be retained for IHT purposes only. However, individuals will still require six years of consecutive absence in order to avoid becoming UK deemed domicile on a return to the UK.
- There will be no concession for children who will receive the same treatment; this will apply from birth.

Concessions

- If an individual has claimed the remittance basis of taxation at any point prior to 6 April 2017 (or been under the 2k de minimis) then they will be allowed to rebase their foreign assets to the April 2017 market value. This will ONLY apply to individuals who are affected by the deemed domicile rule changes as of 6 April 2017. Therefore, if they have been UK tax resident (under the SRT or the pre 2013 rules) for 15-20 tax years. This will affect those caught as of April 2017 and indeed those already within the current deemed domicile provisions. It will not be available to those not already deemed domicile at April 2017. Concessions will not be available to UK Domiciles of Origin who are returning to the UK and technically not deemed domiciled in the UK.
- No formal election is required to un-mix the funds.
- The 5 December revised draft Bill has clarified that the mixed funds that you seek to clean do not have to be mixed on that exact date (05/04/17).
- Rebased gains will effectively ‘clean’ the capital for tax-free remittance to the UK going forward, segregation of funds as always will be key.
- Post April 2017 gains will of course all be taxed on the arising basis.
- The rebasing will not apply where existing foreign assets represent the proceeds of ‘relevant foreign income/gains’ ITTOI 2005 s.830 and these will be taxed under current remittance rules as relate to the those assets only.
- The Temporary Non-Residence Rules (s.10A TCGA 1992) (periods on non-residence broadly fewer than five complete tax years in which a gain is made offshore) will not apply to an individual who would have expected to have been able to claim the remittance basis of taxation on a return to the UK – this is a motive/factual concession and could only be argued by those unaware of the impending changes, therefore the lifespan of this concession is limited.
- 2017/2018 and 2018/2019 will represent an ‘amnesty year’ within which all individuals can clean their offshore funds and correctly segregate income, offshore income gains, capital gains, and clean capital, etc. This will allow individuals whether UK deemed domiciled under the new rules or not, to avoid the existing mixed funds rules and create clean capital as long as a paper trail can prove that the new funds are indeed clean capital. This again will be limited to clients who have claimed the remittance at any time prior to 5 April 2017.
- Continued concession for overseas income and gains that is de minimis, below £2,000 in any given tax year.
2. Residential Property and Inheritance Tax (IHT)

This is perhaps the most unfair of the proposed changes. As mentioned above, recent years have seen significant changes in the taxation of offshore entities and this has predominately affected non-doms.

Indeed, many will have sought professional assistance on a number of occasions since 2012 and may have restructured as a result of ATED, ATED CGT and NRCGT. However, now will see what could be called the final nail in the coffin of traditional tax planning using offshore structures and involving UK property; certainly corporate structures.

There will be some that will have accepted the ATED regime in order to retain the preferential IHT treatment that offshore company or company/trust structures provided. The protection offered by offshore company structures will now be taken away post April 2017 and many years of sensible and legitimate tax planning for those investing in UK property from abroad will need to be revisited (yet again).

Key points from the draft legislation/consultation

- Post April 2017 offshore companies owning UK residential property, including structures whereby an offshore trust is involved in the ownership structure, will not shelter the underlying beneficiaries from IHT on the value of that property at the time of death – the structure will be see-through to the beneficial owners.
- There will be no concessions for the punitive effect on structures that have been in place for many years and which are now rendered superfluous; there will be potentially significant other tax liabilities as a result of having to de-envelope (other than IHT).
- Those who have paid the ATED charge for some four years at significant cost may find that this was a waste of money as the sole purpose for retaining the structure in tact has now been taken away. As if to add insult there is likely now also to be a CGT liability.
- There will be a 2 year ‘trail’ if interests in a property that is affected by these rules is sold (i.e. property or shares in a company), that means that disposal does not immediately solve the problem.

Points of note

- Debts: a topic that has been in HMRC’s firing line re: offshore structures for some time. Debt against a UK property will only be deductible to the extent that it relates purely to that UK structure i.e. a mortgage secured over that property.
- However, IHT will be attributed to any debt of a relevant structure that is used to acquire, maintain or repair UK residential property, as an asset subject to IHT in the hands of the lender – a harsh situation for structures with historic (legitimate) debt leveraging used for tax planning.
The consultation attributes the value of the property to the value of the property to the company. Therefore, it appears that HMRC will accept a reduction for disputes over ownership and the effect of joint ownership, for example.

There will likely be strong powers of enforcement to accompany this legislation and it is proposed that HMRC will have the power to block the sale of property; although proposals to attribute the IHT liability to the underlying offshore directors of companies have been seemingly abandoned.

Interests of less than 1% of the total value of the underlying company will seemingly be disregarded; this could be important for larger structures.

There will be targeted catch all anti-avoidance legislation where planning in this area has the sole purpose of IHT avoidance (an increasingly common theme since the 2013 FA).

There will be no relief for CGT and SDLT consequences of de-enveloping.

**Planning**

The planning points here are difficult to articulate given the clear message: UK residential property held through an offshore company (in any way) is of little or no benefit going forward and is likely to be costly to maintain and also costly to unscramble, somewhat of a catch 22.

**Underlying beneficial owners are left broadly with three options:**

- **De-envelope and remove the company from the structure so as to avoid the ATED regime (annual charges).** This would leave the trust owning the property and the trust would enter the UK tax net for IHT (known as the Relevant Property Regime (RPR)). This would bring the trust into ten-year anniversary charges and exit charges (at a maximum of 6% above the nil rate band tax free allowance currently £325,000). This option could shelter the full value of the property from a death charge to IHT at 40%. This is a trade off and requires acceptance of the RPR liabilities.

- **Collapse the structure and accept that the asset will be UK situs for IHT purposes.** This takes the asset into the name of the underlying beneficiary’s taxable estate. There may be a consideration here as to whether the underlying beneficiaries are UK deemed domicile/domicile under general law (by choice) or not. If the beneficiaries are not UK domiciled then they could gift the underlying shares in the company prior to April 2017 and before the structure is collapsed. This would have no IHT implication (not a PET that requires seven year survival for gifting purposes) and essentially skip a generation. Alternatively, there may be scope to take the asset out of the UK IHT net by selling the property and taking the funds offshore if the beneficial owners are no UK domiciled and will remain so.

- **The third option is the least desirable and that would be to simply do nothing.** This would likely give rise to ongoing ATED charges, a building CGT issue and no protection for IHT. There may be circumstances whereby restructuring could trigger a tax liability that would be more of an immediate issue for the specific family involved than simply continuing to pay ATED charges and accepting an IHT ‘hit’ on death. Review of any debt arrangements would be a must!

All of the above examples are of course much simplified and there will be many tax implications, and personal family situations, that need to also be considered (i.e. the age of the underlying beneficial owner, potential impact of attribution/matching rules s.86 and s.87 TCGA 1992 and many other factors involving anti-avoidance legislation and tax that may be triggered in the UK as a result of restructuring). It is worth pointing out that after April 2015 it is mandatory for non-UK resident property owners to report the transfer of UK property to HMRC within 30 days of the transfer.

**3. Trust planning: Excluded Property Trusts (EPTs)**

It is with great relief that I’m able to address the final major proposed change with some good news. The government have partially listened to the tax adviser community and mothballed the proposed benefits charge that would have levied ongoing charges on beneficiaries of offshore trusts.

Nom-doms will still be able to settle assets into a trust offshore before they become UK domiciled (or deemed domiciled) and that trust will benefit from EPT status; the trust will be exempt from IHT to the extent that the assets remain located outside of the UK. Instead there will be some tweaking of the taxation of offshore trusts.

**Key points from the draft legislation/consultation**

- It will be more difficult for UK deemed domiciled individuals to benefit from EPTs of which they were the settlor.

- In terms of IT the attribution rules for income in an offshore trust will not apply so as to attribute the income to the settlor. This will be the case as long as any income is retained in the trust. The Transfer of Assets Abroad Rules (TAAR) will also in effect not apply for these purposes and not attribute income to the settlor.

- Settlers will instead be taxed on the basis of the benefit that they receive and until all offshore income has been matched with that benefit. So taxation limited to benefit/distributions.

- s.86 TCGA 1992 as regards CGT will now extend to settlors who are deemed domiciled under the new rules. This will attribute offshore gains to the settlor in the UK (by proxy their spouse and/or minor children) if they receive a benefit (whether remitted or not).
If they do not receive a benefit then there will be no attribution of the gains to them. The gains that build up in the trust will be matched to those who receive a benefit in the future (and are UK tax resident) as is currently the case under s.87 TCGA 1992.

HOWEVER, if the settler (spouse/minor children) do receive a benefit then from that point onwards, and in all future tax years, the trust gains will be taxed on the settlor on an arising basis in the UK.

This continued protection of matching only to benefit, will not apply if the Settlor adds to the trust once they have become deemed domicile (in any way other than arm’s length transactions for full consideration or where trust expenses are met as the trust does not have the funds to do so).

A benefit will be deemed to have been received by the Settlor in the UK if payment is made to a close family member of the Settlor who is offshore and who then does not remit to the UK.

A long anticipated anti avoidance provision: payments of taxable benefit from a trust to a non-UK resident individual offshore that are then onward transferred to the ‘true’ intended recipient who is a UK tax resident – if the onward transfer is within 3 years of the initial transfer then this is to be treated as taxable in the hands of the ultimate beneficiary.

As regards the income tax position, the legislation as it stands seems to suggest that a beneficiary receiving in the UK and taxable in the UK will be taxable in priority to the Settlor – we will have to see what the final position is on this.

Finally, clarity is going to be given as to what the definition of ‘non-monetary benefit’ should extend to in relation to trust assets and therefore the tax treatment of the same. This could be a worse regime than is currently the norm.

Planning and concessions

The proposals here are not entirely unfair and in essence provide a manageable new playing field for settlors and trustees that mean that if settlors receive a benefit then they should pay tax on that to the extent there is income or gains within the trust.

It will be important to consider whether benefits be taken prior to April 2017 so that post April 2017 capital is not needed from the trust and thus preventing all future capital being matched to the settlor.

4. Domicile of origin (Non-doms born in the UK)

As of April 2017, those individuals who were born in the UK with a UK domicile of origin (meaning that their parents were UK domiciled at the time of their birth), but who has subsequently acquired a domicile by choice in a different jurisdiction (technically non-domiciled) will not be able to claim non-dom status if they return to the UK. This is simple in most terms in that an individual with a UK domicile or origin cannot return to the UK and claim any of the benefits associated with a non-dom i.e. the remittance basis of taxation for up to 15 years, the ability to settle EPTs, preferential treatment on taxation of worldwide assets.

However, it also has a broader and potentially difficult impact on EPTs that may have been set up during a period that the individual was non-domiciled. Although, on paper, such EPTs could be perfectly valid if correctly established, as of April 2017 they will not be treated as EPTs in the period that the individual is back (tax resident) in the UK. This will mean that EPTs can dip in and out of UK tax reporting requirements. The relevant property regime could give rise to significant tax charges if an individual is UK tax resident at the time of, say a ten year anniversary.

When the individual leaves the UK again (not tax resident) and presuming they have not regained their UK domicile by choice or through deemed domicile, then they can be treated once again as non domiciled.

Concessions

It appears that there may be a minor concession for IHT in that there will be a one year period of grace on any return to the UK before IHT will apply to offshore assets and possibly EPTs but we will have to wait and see on this point.

Planning

The point here is that close attention will have to be paid to whether an individual has a UK domicile of origin and if so the tax implications of a return; certainly in relation to the timing of a return in relation to any trusts set up by that individual whilst non-domiciled.

5. Summary

These changes are significant to say the least. They will impact traditional planning IHT for non-doms involving UK residential property in a major way. It is also likely to mean that all non-doms, past and present, will have cause to review their planning. The final period of consideration before final legislation ends in February 2017.

It will be vital that all those affected by the new rules take timely advice in preparation for April 2017 and certainly we would suggest that this review process is initiated as soon as possible in order to provide ample time for due consideration of the issue and then to effect any necessary changes; the first few months are likely to be extremely busy for advisers!
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