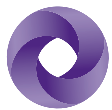

Grant Thornton

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Tax Alert

Briefing paper:

Reforms to the taxation of non-UK domiciliaries

Following the announcement of fundamental changes to the future taxation of non-UK domiciliaries (non doms) in the Summer 2015 Budget and subsequent consultation and discussions with stakeholders, the government released on Friday 19 August a further consultation document and accompanying draft legislation setting out how they propose to implement these changes.

Overview

The government announced in the Summer Budget 2015 that it would change the tax treatment of long term UK resident non doms. UK resident non doms who are either long term residents, or who have a "strong connection" with the UK by virtue of being born in the UK and having a domicile of origin here will become "deemed domiciled" for all tax purposes. These changes will come into effect from 6 April 2017 and will be legislated as part of the 2017 Finance Act.

The newly released consultation develops these proposals further and introduces draft legislation on various areas. These include detailed rules as regards the operation of the deemed domicile rules, as well as the inheritance tax treatment of UK residential property. In addition, the draft legislation sets out new rules for the income tax and capital gains tax treatment of deemed doms as well as setting out certain protections for non-resident trusts.

The government acknowledges that the draft legislation is not complete and excludes some issues which will be included in the Finance Bill 2017.

The new consultation also invites views on the ways in which Business Investment Relief could be changed to encourage greater investment from non-doms into UK businesses. This is part of the government's wider efforts to encourage inward investment in the UK and to encourage entrepreneurial activity in the UK.

Inheritance tax on UK residential property

Looking firstly at the area we know many were waiting on. It had already been announced that the government intends to prevent UK residential property held indirectly (e.g. through a company) from escaping inheritance tax. The newly released documents confirm that the value of any asset which represents an interest in a UK dwelling will not qualify as "excluded property" from 6 April 2017 and so will fall within the charge to IHT.

There are specific provisions dealing with mixed use property (where the value will need to be apportioned to tax the dwelling element) and where property use changes over time.

The Government recognises the potential difficulty in identifying inheritance tax events in opaque offshore structures and so intends to introduce wider reporting requirements and powers to prevent a sale of indirectly held UK residential property until any inheritance tax has been paid, whilst also extending liability for such tax to the direct legal owner, which will include directors of any companies holding the property.

Keen to prevent avoidance of the new inheritance tax charge, the draft legislation includes a targeted anti-avoidance rule which disregards any arrangements undertaken wholly or mainly to avoid the charge.

These changes will leave many taxpayers who indirectly hold UK residential property in a challenging situation. Their structures may no longer be effective as of 6 April 2017, but it could be difficult to unwind them without triggering tax charges. The Government has confirmed that no "de-enveloping" reliefs will be made available to assist taxpayers wishing to unwind structures, therefore it is important that advice is taken on the most appropriate actions prior to the changes becoming law.

There are also a number of further proposed changes which may make some existing arrangements less effective. For example, whilst the value of debts can be taken into account in offshore structures the government proposes to limit such debts to those that have been incurred exclusively in relation to the property, such as mortgages taken out in order to acquire the property concerned. In addition, debts incurred between related parties are to be disregarded.

Deemed UK domicile for long-term residents

The core rules in relation to the deemed UK domicile treatment for long term UK residents have not changed substantially since the original consultation document. As before, non-doms who have been UK resident in 15 of the previous 20 tax years will be treated as UK domiciled for all tax purposes.

The government has confirmed that when a non dom considers whether they are deemed dom, they should apply the tax residence rules in force during each of the tax years concerned.

Similarly, the government believes that it would be difficult to defend further changes that disregarded years of residence in the UK during childhood. Additionally, it considers that unacceptable difficulty would arise were individuals able to claim split year tax treatment in calculating when they become deemed dom.

Despite a number of respondents criticising the harshness of the regime for individuals born in the UK with a domicile of origin here who leave and subsequently become UK resident again (UK returners) the Government has confirmed its intention to legislate these changes as previously announced. In broad terms the changes will be similar to those for long term deemed doms except that for UK returners:

- there will be no long term IHT advantage in relation to offshore trusts established before UK residence resumes;
- the trust's income and gains will be assessable on the settlor as they arise where he or she is treated as having retained an interest under the terms of the trust;
- IHT deemed dom status will cease immediately on the individual becoming non-UK resident, unless the individual also meets the 15 out of 20 years test.

Transitional reliefs

The consultation document also confirms some of the transitional provisions announced earlier, as well as including some important new reliefs.

Capital gains tax – April 2017 rebasing

The consultation document confirms that a rebasing to 6 April 2017 value will apply to foreign assets held by an individual who becomes a long term deemed dom on 6 April 2017.

The relief is limited to taxpayers who have paid the remittance basis charge in any year before 6 April 2017, and to those assets that were foreign sited as at 8 July 2015. No rebasing will be available to individuals who become long term deemed doms after 6 April 2017.

This relief permits affected individuals holding foreign assets standing at a large gain to dispose of those assets after 5 April 2017 and remit the proceeds to the UK free of tax, therefore any opportunities here should be explored. However, the relief does have limits. If the foreign asset was itself purchased from unremitted foreign income or gains, any remittance to the UK will itself trigger tax on historic unremitted income or gains.

Opportunity to clean up mixed funds

Mixed funds (being single funds which consist of any mixture of capital, income and gains) are an issue for non doms because the taxing rules are complex and generally deem non doms to have remitted income which would be taxable on them at the highest rates.

Recognising that this may prevent inward investment to the UK, the Government has announced that there will be a one year window from 6 April 2017 where those becoming deemed dom will be able to rearrange their mixed funds to separate them into the constituent parts. This is likely to free up significant sums for many individuals that could then be remitted to the UK free of tax.

Work on record keeping and reconstructing the composition of mixed accounts is going to be crucial, as the Government states that this opportunity will not be available to those who are not able to determine the various components of their mixed fund.

Offshore trust protection

As expected, the Government has abandoned the original proposal in relation to settlor-interested trusts established by non doms before they become deemed domiciled ("protected settlements"). Originally the intention was to tax deemed dom settlors on the basis of the value of benefits received, regardless of the actual income or gains in the structure. This was widely seen as being punitive.

Instead, the proposal is to make various amendments to the capital gains tax and income tax rules on offshore trusts. The overall aim is to tax capital gains or foreign income on the settlor if they, or certain persons connected with them, receive a benefit from the trust. More detailed draft legislation on certain of these aspects is not expected until later this year therefore greater clarity on how the various provisions will interact should be possible then.

The Government confirmed that the 2008 transitional rules relating to capital gains of offshore trusts will be preserved for protected settlements going forward, so pre-2008 capital gains and capital payments can continue to be sheltered from capital gains tax.

One area where taxpayers will need to be very careful is in making additions to trusts - any addition made after the settlor becomes deemed domiciled will taint the entire trust, which will cease to be a protected settlement. Meeting trust expenses will require care going forward, albeit the draft legislation has included some softening of the rules in this respect. In addition, certain types of arm's length transactions are to be disregarded.

Overall, greater clarity is required on the offshore trust provisions to enable clients to understand precisely how these rules will operate. However, much preparatory work can be done now that the shape of the law is known and it is clear that knowledge of past income and gains within such structures will still be required going forwards.

Other matters

The consultation also confirmed that foreign capital losses will be available for offset once an individual becomes deemed domiciled, and any foreign loss elections will cease to have effect from that date. The Government has also decided to shorten the period of non-residence required to shed IHT deemed domicile under the new proposals from 6 consecutive years to more than 4 consecutive years.

Encouraging non-doms to invest

Business Investment Relief (BIR) was introduced in April 2012 to encourage individuals who are taxed on the remittance basis to invest their foreign income and gains in businesses in the UK. The consultation discusses ways in which BIR could be changed and expanded to make it easier for remittance basis taxpayers to bring their money from overseas to invest in UK businesses. The government is particularly keen to invite innovative ideas around how BIR can be used to encourage further investment in the UK.

Further information

These wide ranging changes to the UK's tax regime for non-doms mean that those affected will need to review their personal and family's financial positions as well as any offshore structures which will be affected. Please feel free to get in contact if you would like further information.

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