
# April 2017 changes for UK resident non-domiciled individuals

We have been aware for some time that the rules in relation to non-UK domiciled individuals are due to change in April 2017 and are advising many clients in relation to the steps they should take in advance of these changes. The Government published further responses, draft legislation and explanatory notes on 5 December 2016. While the Government has made it clear that there is further draft legislation to come, the overall scheme of the reforms now seems clear and the Government intends to bring these changes into force in April 2017.

Much of the detail around the taxation of non-UK domiciled individuals, in particular the remittance basis and the taxation of distributions from an excluded property trust, is already complicated, and the new provisions do little to simplify this. The summary below is a brief outline of some of the existing concepts of taxation and the changes that will come into force in April 2017. Please let us know if you would like a more detailed explanation of any of the below.

## 1 BACKGROUND – THE CURRENT REGIME

### 1.1 Remittance basis and deemed domicile

- Individuals who are resident in the UK but non-UK domiciled are able to benefit from the remittance basis of taxation (an annual charge is payable to benefit from the remittance basis if the individual has been UK resident for 7 out of the last 9 tax years). The remittance basis of taxation means that the individual can shelter their non-UK income and capital gains – UK income and capital gains tax is paid only in relation to income or capital gains arsing in the UK or brought into (remitted to) the UK. A UK resident non-domiciliary may continue to benefit from the remittance basis of taxation (for an annual charge) for many years, provided it continues to be the case that the UK is not the individual's permanent or indefinite home.

- Once an individual has been resident in the UK for 17 out of 20 tax years, they will be treated as deemed domiciled in the UK for UK inheritance tax purposes only. Inheritance tax is the UK equivalent of estate and gift tax – it applies on death and on lifetime gifts. Non-UK domiciled individuals are only liable to UK inheritance tax on assets situated in the UK. Once deemed domiciled, individuals are treated the same as UK domiciled individuals for inheritance tax purposes. This means that inheritance tax is payable on their worldwide assets on death or on lifetime gifts made anywhere in the world.

### 1.2 Excluded property trusts

- Typically, before becoming deemed domiciled, UK resident non-domiciled individuals are advised to create an "excluded property trust". This is a trust created by an individual when they are neither domiciled nor deemed domiciled in the UK, and must contain non-UK assets only. An excluded property trust, which is usually for the benefit of the individual (the "settlor" of the trust) and their wider family, remains outside the scope of UK inheritance tax indefinitely, even after the settlor (or their children) become deemed domiciled in the UK.

- Under the current rules, the settlor is liable to income tax on the income arising in the excluded property trust unless the settlor is excluded from benefitting under the trust - but this is protected if the settlor clams the remittance basis and the trust income remains outside the UK. Income that has a UK source will be subject to UK income tax.

- The settlor is not liable to UK tax on capital gains as they arise in the excluded property trust (under section 86 Taxation of Chargeable Gains Act 1992 ("Section 86")) unless they are resident in the UK and decide to remain in the UK permanently and indefinitely (i.e. if they become domiciled in the UK for general purposes, not just deemed domiciled in the UK for inheritance tax).

- The settlor and any UK resident beneficiary is liable to pay UK tax on any capital benefit from the excluded property trust to the extent that this capital benefit can be matched with income or gains of the trust (under section 87 Taxation of Chargeable Gains Act 1992 ("Section 87")). However, any UK resident beneficiary, including the settlor, who pays tax on the remittance basis can shelter a benefit from UK tax provided the benefit is not enjoyed in the UK.

- Generally, if there is income within the trust, this is matched to a capital benefit received by a UK resident beneficiary under Section 87 in priority to capital gains. The value of the benefit is first matched against available income and the recipient UK resident beneficiary pays UK income tax in relation to this element of the benefit. If there is no income available for matching and/or once the trust's income "pool" is fully matched, the remaining value of the capital benefit is next matched against any capital gains in the trust (and gains in any underlying closely held companies) and the UK resident beneficiary pays capital gains tax on this element of the benefit. There are some complexities to the above, in particular if the trust has outstanding borrowing or if the trust is in receipt of offshore income gains. In addition, there are some defences against these liabilities to income tax and capital gains tax, but these are limited in scope and do not apply to all trusts.

## 2 APRIL 2017 CHANGES

### 2.1 Remittance basis and deemed domicile

- Under the new regime, individuals who are resident in the UK but non-UK domiciled will only be able to benefit from the remittance basis of taxation if they have been UK resident for less than 15 out of the 20 tax years preceding the year in question. This means that in the 16th tax year in the UK, the individual will become deemed domiciled in the UK for all taxes: income tax, capital gains tax and inheritance tax

- Once deemed domiciled, a UK resident individual will be liable to income tax and capital gains tax on the arising basis. This means they will pay UK income and capital gains tax on their worldwide income and gains (although double tax treaties will continue to prevent double taxation in many cases), whether they bring the income and gains into the UK or not. The individual will also be liable to UK inheritance tax on their worldwide estate.

- Individuals born in the UK with a UK domicile of origin are to be subject to a different set of rules. These individuals will become deemed domiciled in the UK (for all tax purposes) in their first year of returning to the UK and acquiring UK residency. Trusts set up by such individuals will also be treated differently (see below).

### 2.2 Excluded property trusts

- The new legislation continues to offer protection to excluded property trusts.

- An excluded property trust created by a non-UK domiciled individual before they become deemed domiciled, containing non-UK assets only and with no additions of assets after the settlor becomes deemed domiciled, will continue to be protected from UK inheritance tax indefinitely.

- After the settlor becomes deemed domiciled for all taxes, Section 86 will not apply to tax the settlor on the trust's gains on an arising basis. The settlor will be protected from this charge provided the trust was created before they became deemed domiciled and no further assets are added after the settlor becomes deemed domiciled.

- Section 87 will apply to tax UK resident beneficiaries (including the settlor) on receipt of a capital benefit to the extent that this capital benefit is able to be matched to income or gains within the trust. Once the settlor becomes deemed domiciled in the UK, the remittance basis of taxation will no longer be available to shelter this charge to UK tax on a distribution, even where the distribution is made outside the UK. In addition, the new legislation introduces the concept of a "closely-related beneficiary". This operates so that the settlor pays tax under Section 87 if the settlor's spouse or minor (under 18) child receives a distribution from the trust anywhere in the world. Non-UK resident beneficiaries who are not closely-related beneficiaries (e.g. the settlor's children who are over 18 or grandchildren) can receive distributions with no liability to UK tax. There are provisions to prevent distributions to non-UK resident beneficiaries who are not closely-related beneficiaries from receiving distributions and then transferring the funds to a UK resident beneficiary.

- Trusts created by settlors who were born in the UK with a UK domicile of origin will not benefit from the protections outlined above for any period during which the settlor is resident in the UK.

- We are still awaiting draft legislation in relation to income tax protection for settlors of excluded property trusts after the settlor becomes deemed domiciled. The Government / HMRC response to consultation documents explain that non-UK source income in a foreign trust created before the settlor became deemed domiciled in the UK will be sheltered from UK income tax, unless and until a UK resident beneficiary (including the settlor) receives a distribution from the trust. We hope to receive this draft legislation before 6 April 2017.

### 2.3 Upbasing of directly held assets

- Non-UK assets held directly by some individuals on or before 5 April 2017 and which are disposed of on or after 6 April 2017 will have a base cost which is the market value of the asset on 5 April 2017. It appears that this "upbasing" will only apply to individuals who, under the new rules, are already or will become deemed domiciled in the tax year commencing on 6 April 2017.

### 2.4 Cleansing mixed funds

- There is a useful opportunity for non-domiciled individuals who claim the remittance basis to 'cleanse' mixed fund accounts. So, for example, an account containing a mixture of income, clean capital and gains can be separated out into its component parts, so that in future the most tax efficient parts can be remitted first. To take advantage of this opportunity, individuals will need to have good records to determine the component parts of the mixed fund.

## 3 NEXT STEPS

What steps should you consider taking before April 2017 if the above changes affect you?

- Consider creating an excluded property trust if you are not yet deemed domiciled for UK inheritance tax purposes, but will be from April 2017.

- Consider accelerating offshore distributions from existing trusts to UK resident beneficiaries who are currently able to claim the remittance basis but who will become deemed domiciled for income and capital gains tax from April 2017.

- Consider making distributions from existing trusts to beneficiaries who are "closely-related" to the settlor, and review any arrangements where closely-related beneficiaries receive benefits such as rent-free occupation of trust property or interest free loans.

- Consider distributions to non-UK resident beneficiaries of existing trusts to "wash out" historic capital gains.

- If you are about to lose the ability to claim the remittance basis and have significant capital or income events arising outside the UK in the coming years, consider carefully the timing of these events and your and your family's plans.

- Collate records for any mixed fund accounts.

The changes due in April are far-reaching and will affect many of you. There is still time to take meaningful steps to be ready for the changes when they come into force in April, and every individual's situation will be different.

Please contact us to discuss your and your family's situation in more detail.

## Get in touch


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