

## Reforms to the taxation of non-UK domiciles – issue of consultation document by HM Revenue & Customs

Somewhat unexpectedly, and after much speculation that the new proposals might be diluted or their introduction postponed beyond 6 April 2017 in the post-Brexit climate, HMRC issued a consultation document on 19 August providing further detail on the various changes that were originally announced in the 2015 Summer Budget. It had generally been anticipated that no further detail would be announced until the issue of the Chancellor's Autumn Statement, probably in early December.

The consultation document makes it clear that whilst HMRC have considered the representations made by various professional firms and professional bodies, it is very much the case that the proposed changes take effect from 6 April 2017 as originally planned. The consultation period will end on 20 October 2016.

Some further draft legislation was issued alongside the consultation document but there are a number of proposals for which legislation is still to be published. The consultation document covers both the new inheritance tax rules for UK residential property and the new deemed domicile rules.

The key points are outlined below.

### Inheritance tax on UK residential property

These rules seek to bring within the charge to inheritance tax (IHT) the value of UK residential property which is held in an offshore corporate vehicle. The consultation document has confirmed the following aspects of the new rules:

-  The definition of residential property will probably be in line with that adopted for the non-resident capital gains tax rules although for IHT purposes, there will be no exemption for a main residence.
-  Where there have been changes in use during ownership, the property will be subject to IHT if it has been used as a dwelling at any time in the two years prior to the chargeable event, with an apportionment if only part of the property is residential.
-  The value subject to IHT will be the value of the offshore company shares, after the deduction of any relevant debt. Relevant debt is debt relating to the property, such as a mortgage. The debt will be pro-rated if it relates only partially to the property. It is HMRC's intention to disregard debt between connected parties which may mean that debt between a trust and underlying company or any loan provided to a standalone company by the individual beneficial owner may not be effective in reducing the value of the company shares for IHT purposes. So in practice, only third party debt may be taken into account which could significantly increase the anticipated liabilities for many structures. Consideration should be given to whether any re-financing would be beneficial.
-  A specific anti-avoidance rule is being introduced to target any arrangements put in place to avoid the IHT charge.
-  Due to difficulties in HMRC establishing when a liability has arisen, a new safeguard will be introduced whereby a sale of the property cannot complete unless any IHT due in respect of the property has been paid.
-  The suggested "tax breaks" for de-enveloping UK residential property which were mentioned last year are not likely to be provided.

### Deemed domicile – 15 year rule

This rule will treat individuals with a non-UK domicile of origin who have been resident in 15 out of the last 20 tax years as being UK domiciled for all tax purposes.

-  Residence status is to be determined by the rules in force for each relevant tax year i.e. the Statutory Residence Test rules can only be applied from 2012/13.
-  Childhood years of UK residence will be counted.
-  Split years of UK residence will not be disregarded and will therefore count towards the 15 year total as previously indicated.
-  A transitional rule is to be introduced in relation to the capital gains tax (CGT) temporary residence rule for those individuals who were non UK resident at the time of the 2015 Summer Budget announcements and sold assets with a view to protecting the gain under the remittance basis on their return to the UK. The new deemed domicile rules will not have retrospective effect in such cases although in practice this is likely to affect only a relatively small number of people.
-  A rebasing of foreign assets for CGT purposes will be available to longer term UK resident "non doms" i.e. those who have claimed the remittance basis in any tax year prior to April 2017. The gain relating to the pre April 2017 period can be brought into the UK without triggering a remittance charge (if the asset was acquired from clean capital) but any income or gains used to acquire the asset would be taxed on remittance in the usual way. The rebasing rule only applies to those who will be deemed domiciled under the 15 year rule on 6 April 2017.
-  A new rule will be introduced to help those "non doms" with mixed funds (e.g. bank accounts containing both income, gains and clean capital).

There will be a one year "window" from 6 April 2017 during which mixed funds can be segregated and the capital, income and gains comprised in an account can be moved to a separate account so that thereafter the individual can decide which funds to bring into the UK (i.e. clean capital or taxable income and gains) without the mixed fund rules applying.

There is no time limit on when the remittance from these newly segregated accounts must be made. This rule only applies to accounts, not mixed fund assets. Mixed fund assets will have to be sold in order for the proceeds to be segregated during this transitional window. This opportunity is only available to those with a non-UK domicile of origin (i.e. it excludes those born in the UK with a UK domicile of origin who have since become non-UK domiciled) but individuals do not need to be within the 15 year rule on 6 April 2017 in order to take advantage of the this provision.
-  The proposed flat rate tax charge on distributions from offshore trusts to beneficiaries caught by the 15 year rule has been dropped. Capital distributions will therefore continue to be taxed by reference to either trust income or gains.
-  The provisions which tax trust gains on the settlor of an offshore trust (S.86 TCGA 1992) will not apply to deemed domiciled settlors of trusts set up prior to 6 April 2017 (providing

no additions have been made after that date) unless the settlor, his spouse or his minor children/stepchildren actually receive benefit from the trust. Once benefit has been received by a relevant person, the settlor will thereafter be taxable on all trust gains whilst he remains UK resident. Distributions or benefit provided to adult children or the settlor's grandchildren (minor or adult) will not trigger these provisions so careful distribution planning will be required.

The Settlement Provisions which attribute trust income to the settlor of an offshore trust (s.624 ITTOIA 2005) will be amended so that foreign income arising to a trust set up before the settlor becomes deemed domiciled under the 15 year rule is not taxed on the settlor, providing the income is retained within the trust. However if that income is distributed to the settlor, his spouse, minor children or any other "relevant person" (as defined under the Finance Act 2008 remittance rules), it will be taxed on the settlor. Therefore, foreign income of pre-deemed domicile trusts will remain protected until such time as the income is distributed.

Similarly, the Transfer of Assets Abroad rules for transferor (s.720 ITA 2007) will be amended so that foreign income arising to a structure set up before the individual was deemed domiciled (where no additions have been made to the structure) will not be taxable on the settlor until such time as the settlor, spouse, minor children or other relevant person receives any form of capital payment or benefit or an income distribution.

The Finance Act 2008 transitional rules under which pre-2008 trust gains and pre-2008 capital payments are not taxable, together with the rules relating to the effect of a rebasing election will remain in place in for those beneficiaries treated as deemed domiciled under the 15 year rule.

The £2,000 de-minimis limit for unremitted foreign income and gains under the remittance basis will remain in place for "non doms" who are deemed domiciled under the 15 year rule as an administrative protection.

Foreign loss elections will only remain in place until the individual becomes deemed domiciled under the 15 year rule. Thereafter, foreign losses may be used without restriction.

The "run off" period for individuals to lose their deemed domicile status once ceasing to be UK resident has been reduced from six years to four years for inheritance tax purposes. This resets the 15 year period so if the individual then returns to the UK, he can access the remittance basis again until the 15/20 rule is satisfied. The previously announced six year period remains for income tax and capital gains tax but as a non-UK resident individual would not be taxable on foreign income and gains this has little practical effect.

## Deemed domicile - "returning UK dom" rule

This rule will treat individuals who were born in the UK with a UK domicile of origin, but who have acquired a non-UK domicile of choice, as being deemed domiciled in the UK for all tax purposes if they return to the UK and become resident there. A few clarifications were made in the consultation document in this respect as follows:

The one year grace period applicable for IHT purposes will not be extended to include income tax or CGT.

It is stated that no changes are to be made to the proposals set out in the original consultation document published in September 2015.

A trust set up whilst the settlor had a non-UK domicile of choice will only lose its excluded property status whilst the settlor is resident in the UK i.e. whilst he is within the definition of a "formerly domiciled resident". There is no specific mention in the consultation document of the position of such a trust after the death of the settlor but it is assumed that as the UK residence arm of the "formerly domiciled resident" definition would not be satisfied after death, the trust would regain its excluded property status following the death of the settlor. There could therefore still be long term merit in individuals with a non-UK domicile of choice settling trusts, even if they intend to return to the UK, although the overall benefit will depend on the length of UK residence and/or life expectancy of the settlor.

## Business Investment Relief

The consultation document also confirmed that the Government will consult on whether Business Investment Relief should be amended and extended in order to attract investment by "non-doms" into the UK.

## Summary

The consultation document provides some long awaited clarity regarding the future tax landscape for "non-doms", albeit that some further legislation is still to be issued.

Both individual "non-doms" and fiduciaries managing "non-dom" related structures should now consider the position in detail so that any action that is required ahead of 6 April 2017 can be dealt with in good time.

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