

Briefing Note

Non-Dom Tax Reforms:
An Update

Introduction

In the Summer Budget of 2015, the Government announced it would change the tax regime for individuals who have a foreign domicile (“non-doms”). The first consultation was published on 30 September 2015 which set out the detail of the proposals. A further consultation was published on 19th August 2016 and the Government published its response and draft provisions of the Finance Bill 2017 (“the Finance Bill”) on 5th December 2016. The Finance Bill is proposed to take effect from 6 April 2017.

As a reminder, the two main planks of the proposed reforms for non-doms are:

- the introduction of the deemed domicile rule for income tax and capital gains tax (CGT); and
- the introduction of inheritance tax (IHT) charge on all UK residential properties held indirectly by non-doms through offshore trusts and companies.

This briefing note provides a summary update of the reforms.

The Deemed Domicile Rule for Income Tax and Capital Gains Tax

With effect from 6th April 2017 non-doms will be treated as deemed UK domiciled for all purposes once they have been resident in the UK for 15 of the past 20 tax years. Once deemed domiciled, a non-dom will not be able to use the remittance basis, and will be taxed as a regular UK resident on all income and gains. They will be subject to tax on an arising basis, meaning that they will be taxed for income, capital gains and IHT on all assets around the world.

An individual will need to become non-UK resident for six consecutive tax years in order to lose the deemed domicile status for income tax and CGT purposes.

Individuals who become deemed domicile under the 15 out of 20 year rule but who subsequently leave the UK, will lose their deemed domicile status for IHT purposes at the start of their fourth year of non-residence. Care is needed, however, not to become UK tax resident within six years of leaving, otherwise the 15 out of 20 deemed domicile status revives.

Inheritance Tax Formerly Domiciled Rule

IHT already has a deemed domicile rule so the changes principally affect income tax and CGT (which previously did not have a deemed domicile rule). However, the draft legislation also introduces a new rule providing that an individual born in the UK with a UK domicile of origin who acquired a domicile of choice elsewhere will be treated as domiciled for IHT purposes if they return to the UK. Further, any trusts established by that individual while non-domiciled will lose their excluded property status while the settlor is resident in the UK.

IHT Reforms regarding Residential Property

Under the new rules, interests in UK residential property held through offshore structures by foreign domiciled individuals or trusts established by them will be subject to an IHT charge.

The rules are wide-reaching and apply to:-

- loans or shares in closely held companies;
- interests in partnerships; and
- the benefit of loans made to enable an individual, trustees or a partnership to acquire or improve UK residential property. The rules also apply to assets used as collateral for such a loan in order to catch back to back loans.

This potentially affects many non-doms globally and existing structures may require to be reorganised or dismantled.

The new provisions are to be accompanied by a wide targeted anti-avoidance rule to prevent arrangements that seek to get round the charge.

Some double-tax treaties will prevent the UK IHT charge arising but only where some tax is payable in the non-dom's home country of domicile.

Offshore Trusts – Capital Gains Tax and Income Tax

The position in relation to the future taxation of offshore trusts will become even more complex than at present.

The CGT changes are extremely conceptual and outside the scope of this article, but will include:-

- a settlor charge on arising capital gains for trusts established by deemed UK domiciliaries;
- a settlor charge on capital payments made to close family members of UK resident settlor who, broadly, are non-UK residents (this applies whether or not the settlor has a deemed UK domicile);
- a removal of the ability to “wash out” stockpiled capital gains by paying these to non-UK resident beneficiaries (save on a winding up where gains will be apportioned pro rata);
- an “onward gift” rule to prevent capital payments made tax free to non-UK residents or domiciliaries being gifted to a UK resident within three years.

Legislation has not yet been published for the income tax changes. It is expected these will be equally, if not more, complicated

Transitional Rules

The August 2016 consultation paper included the following transitional provisions intended to soften the blow for long term resident non-doms becoming deemed domicile on 6th April 2017. The two main rules are summarised below.

Rebasing Foreign Assets for Capital Gains Tax Purposes

This rule allows non-doms who will become deemed domicile at 6th April 2017 to rebase their foreign assets for CGT purposes to their market value on that date. In other words, an individual may effectively have assets revalued at current rates and potentially brought onshore to the UK without a tax charge. Only those who have paid the remittance basis charge in a tax year from 2008/09 up to and including 2016/17 will be entitled to the relief.

Despite calls to make re-basing more widely available, in particular to those who become deemed domiciled in later years, and to assets held through trust structures – the Government does not propose to extend the ability to rebase foreign assets as at 6th April 2017 beyond those individuals who are set to become deemed domiciled at that date.

Mixed Funds Rules

This transitional rule allows mixed funds to become ‘unmixed’. Capital can be brought into the UK without triggering a tax charge, whereas foreign income or gains that date from a tax year in which the remittance basis is used would broadly speaking trigger tax if they are brought into the UK. This will still be the case for non-doms who acquire a deemed domicile status.

This transitional rule has been extended from one year to two to provide non-doms more time to plan becoming deemed domicile. Those non-doms with a domicile of origin in the UK will not benefit from this rule.

Comment

Although the published fragments of draft legislation are helpful in providing some insight into what the final Finance Act 2017 will eventually look like, it is unhelpful that full draft provisions have not been published and that no provisions regarding the income tax treatment of offshore trusts have been established. It is understood that the full draft legislation will be published in March leaving little time for any changes to be made. Given the Government focus on the Brexit negotiations, it may be that the implementation date of the reforms will be pushed beyond the scheduled April 2017 implementation date.

This briefing note is a short summary of the Government’s further changes to the tax regime for people domiciled outside the United Kingdom. No responsibility can be accepted for any action taken in reliance on this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.

© Turcan Connell January 2017