Briefing Note

Tax Planning for Non-UK Domiciliaries

The tax status of non-UK domiciliaries (non-doms) resident in the UK became a political issue during the 2015 General Election. Further changes to the special tax rules for non-doms were announced by the Chancellor in the July 2015 Budget; with the changes taking effect from the 6th April 2017.

Who is a non-UK domiciliary?

Under the UK tax rules, domicile is a broad concept which is determined by the courts rather than legislation. Domicile is not necessarily where someone is born or their nationality, but a test of where someone regards as home. At birth you usually acquire your father's domicile, which is your domicile of origin. While in theory it is possible to acquire a domicile of choice in another jurisdiction by settling there permanently, in practice, it can be very difficult to lose a UK domicile of origin and acquire a domicile of choice elsewhere. Conversely, for a non-UK domiciliary coming to the UK it is difficult to acquire a domicile of choice in the UK. Any individual seeking to change their domicile for tax purposes is recommended to take specialist advice.

Remittance rules for income and capital gains

UK domiciliaries are taxed on their worldwide income and gains when they are tax resident in the UK. The position for non-UK domiciliaries is different; they can choose to be taxed on the remittance basis. Under these rules UK income and gains are subject to UK tax in the normal manner but non-UK income and gains are only subject to UK tax to the extent they are paid ("remitted") to the UK. This potentially opens up important tax planning opportunities for most non-UK domiciliaries.

Where a non-UK domiciled individual has been UK tax resident for less than seven out of the previous nine tax years, the remittance basis can be used without cost. After seven years of tax residence, there is a £30,000 "remittance basis charge" ("RBC") for every tax year in which a non-UK domiciliary chooses to be taxed on the remittance basis. Where a non-domiciliary has been UK resident for 12 out of the preceding 14 tax years, the RBC is £60,000 for each tax year in which the remittance basis is claimed. For non-UK domiciliaries who have been a UK resident for 17 out of the previous 20 tax years, the RBC will be £90,000 but only for tax years 2015/16 and 2016/17. From 6th April 2017 onwards any non-UK domiciliary resident in the UK for 15 out of the preceding 20 years will no longer be able to be taxed on the remittance basis.

Individuals who claim to use the remittance basis will lose their entitlement to their personal allowance for income tax purposes and will not be entitled to the capital gains tax annual exemption for those tax years for which the remittance basis is claimed.

Therefore, non-UK domiciled individuals who have been resident in the UK for more than the seven or twelve year trigger periods may need to consider carefully whether it is more efficient to pay UK tax on their foreign income and gains (whether remitted to the UK or not) or to claim remittance basis in respect of foreign income and gains retained outside the UK and pay the relevant RBC. For those who require to bring their foreign income and gains to the UK there will be little choice but for others it will be necessary to calculate their UK tax bill for any year under each of the bases and choose the more favourable option.

Individuals with foreign income and gains of less than £2,000 for any tax year, however, may continue to be taxed on the remittance basis for that year without paying the RBC. Remittance basis users who are below the £2,000 threshold have the additional benefit of retaining their entitlement to the personal allowance and the capital gains tax annual exemption.

Tax planning

In practice, a non-UK domiciliary taking up residence in the UK will not be subject to UK tax on their foreign income and gains for the first seven years unless the income or gains are brought into the UK. After seven years, the amount of the foreign income and gains will determine if the annual charge justifies being taxed on the remittance basis.

There are some planning techniques that a non-domiciliary may consider, depending on their circumstances and, again, it is recommended that specialist advice is sought. However one of the most straightforward forms of planning is to ensure as far as possible that investment returns and capital gains are structured to be realised periodically so that the RBC is payable in only one tax year rather than paying it every tax year. In this respect it is important that the individual’s tax advisers and investment managers not only understand the implications of the remittance basis but that they also liaise with each other to ensure maximum tax saving opportunities.

Where foreign income and gains are insufficient for the remittance basis charge to be worthwhile, assets could be located so that less than £2,000 arises outside the UK which would be taxed on the remittance basis under the de minimis rule.

Tax compliance

It is essential UK self-assessment tax returns are completed correctly. This requires detailed record keeping not only of all foreign income and gains arising but also of where those funds are held. Where foreign income and gains that would be taxed in the UK, if remitted, are used to acquire new overseas investment holdings, the new investments take on the characteristics of the income used to acquire them.

Thus, a remittance to the UK of such an investment is a remittance of the original income or gains. Non-remitted income and gains should also be kept in earmarked accounts to demonstrate to the UK tax authorities that no income or gains were remitted.

Inheritance tax rules

UK domiciliaries are subject to UK inheritance tax on their worldwide assets. The inheritance tax nil rate threshold is presently £325,000 and an individual’s estate in excess of this threshold will be subject to inheritance tax at 40%, after any reliefs and exemptions which may apply. Unlimited exemption is available where assets pass to a UK domiciled spouse during lifetime or on death.

In contrast, non-UK domiciliaries are subject to UK inheritance tax only on assets situated in the UK. Assets owned by a non-UK domiciliary and situated outside the UK are “excluded property” and outside the scope of UK inheritance tax. While the inheritance tax nil rate threshold and all reliefs and exemptions are available to set against UK situated property, importantly, spouse exemption is limited to £325,000 on a transfer from a UK domiciled spouse to a non-UK domiciled spouse (see below). This limited exemption is in addition to any nil rate threshold available.

It is possible for a non-UK domiciliary to hold UK assets, such as investments or land and buildings through offshore company structures. Any such assets would then be excluded property and outside the scope of UK inheritance tax.

An important point to note, however, is that after being UK tax resident for 17 years out of 20, a non-UK domiciliary automatically becomes “deemed” domiciled in the UK for inheritance tax purposes. At that point a non-UK domiciliary’s worldwide assets would be within the scope of UK inheritance tax were they to die, transfer assets to a trust or make gifts (potentially exempt transfers). As the deemed domicile rule only applies for inheritance tax purposes, it is still possible to be taxed on the remittance basis for income tax and capital gains tax purposes after year 17. From 6th April 2017, this rule will also change, and will be harmonised with the remittance rules. Any non-UK domiciliary who has been resident in the UK for 15 tax years out of 20 will be deemed to be UK domiciled for inheritance tax purposes.

Before being deemed domiciled, whether under the present 17 out of 20 year rule or, from 6th April 2017, under the new 15 years out of 20 rule, it is possible to transfer non-UK situated assets to offshore trust structures. By doing so, the assets held in the trust are permanently outside the scope of UK inheritance tax providing the trust does not later hold UK situated property. It is best to put these structures in place as soon as possible in case there is a risk of acquiring a UK domicile of choice.

Inheritance tax and married couples

Where a UK domiciliary has a non-UK domiciled spouse to whom they transfer assets during their lifetime or on death, spouse exemption is limited to £325,000. The limit on spouse exemption for inheritance tax is a significant tax disadvantage for “mixed” domicile marriages where one spouse is UK domiciled and the other is not. Advice should be taken on lifetime planning and appropriate testamentary provisions should be included in wills. For a mixed domicile marriage, depending on how assets are held and the order of deaths, the limited spouse exemption could result in inheritance tax on the first death rather than everything passing tax free. It is most important that advice is taken to protect against this situation.

The limited spouse exemption would resolve itself after a non-UK domiciled spouse became deemed domiciled in the UK after 17 tax years (or 15 tax years after 6th April 2017).

A non-UK domiciliary married to a UK domiciliary can elect to be treated as UK domiciled for inheritance tax purposes. The most likely scenario where this election would be exercised is following the death of the UK domiciled spouse. This would then enable unlimited spouse exemption to apply and avoid an inheritance tax charge on the first death. Caution should be exercised before making such an election as the consequence would be that the surviving spouse’s worldwide estate together with the assets they had inherited would all be within the scope of UK inheritance tax. This could result in a much larger inheritance tax liability in the future. The surviving spouse’s status as being UK domiciled for inheritance tax purposes would only lapse if they were non-UK resident for four complete tax years.

Earlier inheritance tax planning implemented by a non-UK domiciliary should not be affected by making such an election following the death of their UK domiciled spouse. It is recommended that specialist advice is taken given those complex rules.

If you are non-UK domiciled, or married to a non-UK domiciliary, and wish to discuss how Turcan Connell can assist you, please contact Donald Simpson on 0131 228 8111 or by email: donald.simpson@turcanconnell.com or Anne Marie Renz on 0131 228 8111 or by email: annemarie.renz@turcanconnell.com

This note is intended as a brief summary of the taxation and legal position of non-UK domiciliaries as at July 2015. Taxation is subject to change and depends on the individual circumstances of each client. Legislation is also subject to change. Information provided in this document and any opinions expressed are for general use and not personal to your circumstances, nor are they intended to provide specific advice. No responsibility can be accepted for any action taken in reliance of this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.
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