Budget 2016: Non-dom reform update

The recent Budget included some good news for non-domiciliaries. Specifically it has been confirmed that:

- The overseas assets of individuals who become deemed domiciled under the new rules in April 2017 will be rebased for capital gains tax (CGT) purposes so that pre-6 April 2017 gains will not be taxable. However, is it unclear whether rebasing will be extended to those who become deemed domiciled in subsequent years.

- Those who expect to become deemed domiciled under the new 15/20 year rule will benefit from transitional provisions in relation to offshore funds to provide certainty on taxable remittances to the UK.

These are welcome concessions; however, much is still to be confirmed in relation to the government's non-dom proposals. In addition, the new rules are to be deferred until Finance Bill 2017 so there will only be a narrow window to take action before the new regime is introduced on 6 April 2017. Therefore now is a good time to reflect on what we know so far and to consider what steps can be taken in the meantime. This is especially the case for those who will fall within the 'returning non-doms' rule (see below) who may be particularly adversely affected by the new regime.

What has been confirmed?

From 6 April 2017 non-domiciliaries will be treated as UK domiciled for income tax, CGT and inheritance tax (IHT) purposes if either:

- They have been UK resident for at least 15 out of the previous 20 tax years (such individuals will be treated as domiciled from their 16th year of UK residence); or

- They were born in the UK with a UK domicile of origin but (having left the UK subsequently and having acquired a foreign domicile of choice) then resume UK residence. Such individuals ('returning non-doms') will be deemed domiciled during such periods as they are UK resident. However, for IHT purposes this rule will only apply where the individual also has been UK resident for at least one of the previous two tax years.

Individuals who are deemed domiciled under the new rules will be subject to UK tax on their worldwide income and gains and they will no longer have the benefit of the remittance basis of taxation. In addition, their worldwide estates will be within the scope of IHT. Importantly, when applying the deemed domicile rules, split tax years will count as whole years of residence. This means that an individual could fall within the new rule after just over 14 years' presence in the UK. A period of non-residence of at least 6 consecutive tax years will be required to 'break' deemed domicile status.

> "Overseas assets of individuals who become deemed domiciled in April 2017 will be rebased for CGT purposes"

If you require further information on anything covered in this briefing please contact a member of our Private Client Team on 020 3375 7000 or your usual contact at the firm. Further information can also be found on the Private Wealth page on our website.

On a more positive note, the government has indicated that existing offshore trust structures established by non-domiciliaries who subsequently become deemed domiciled under the new regime will retain their IHT excluded property status (so that non-UK trust assets continue to fall outside the scope of IHT). Also, such trusts will not be taxed on retained trust income or gains simply as a result of the change in the settlor's domicile status, so that income tax and CGT deferral advantages may still be available. Although the details of the proposals have yet to be clarified, it appears that these tax advantages also may be available for new trusts established by non-domiciliaries before they become deemed domiciled under the new regime. However, this favourable treatment for existing and new trusts is not available to all: returning non-doms will be in a significantly worse position under the new regime.

"Returning non-doms will be in a significantly worse position under the new regime"

The position of returning non-doms

Assume that a returning non-dom established a trust for himself and his family while he was non-domiciled with consequent UK tax advantages. Under current law, if the individual subsequently became UK resident, income tax and CGT advantages would still be available in relation to the trust until the individual acquired a UK domicile under general law. In addition, the trust would still benefit from excluded property status, even if the individual became deemed domiciled under the current 17/20 year deemed domicile rule which applies for IHT only.

However, under the new regime, as soon as the returning non-dom resumes UK residence he will be taxed on trust income and gains from the year of his return. In addition, if he has been UK resident in one of the two previous tax years, the trust will forfeit its IHT excluded property status and so become subject to ten year and exit charges. Moreover, it is unlikely in these circumstances that sufficient records will have been kept to ascertain any tax due.

For internationally mobile individuals whose UK residence status changes every few years, the returning non-dom rule could result in the trust moving within and then outside of the scope of IHT with resulting administrative complications. In addition, if a returning non-dom settlor has not been excluded from benefiting from his trust, the reservation of benefit rules will apply to bring the entire trust property within his estate for IHT purposes.

The government's rationale for this approach is that those born in the UK with a UK domicile of origin have a closer connection to the UK and so should not be able to benefit from the non-dom regime whilst UK resident. However, this may lead to harsh results in some cases: for example where an individual left the UK when a child, only returning due to a temporary UK work secondment. In addition, the fact that those born outside the UK with a UK domicile of origin will not qualify as returning non-doms could result in a significant difference in tax treatment between two individuals equally connected to the UK, but one of whom happened to be born outside the UK during a temporary stay abroad. Finally, there is a significant risk that a returning non-dom comes back to the UK (and so becomes automatically deemed domiciled) without appreciating the adverse tax consequences until it is too late.

What is still to be confirmed?

Along with the detail of the non-dom proposals, we are still waiting for the consultation on the proposals to bring UK residential property held indirectly by non-doms within the scope of IHT. Following the introduction of these rules, which are expected to be included in Finance Bill 2017, some holding structures may no longer be practically viable. The government indicated that it might allow CGT and stamp duty land tax (SDLT) relief for a limited period for those wishing to unwind existing structures; however, no details have yet been announced.

What action can be taken now?

In most cases, it will not be advisable to take any planning action in relation to existing structures until the new regime becomes more certain. However, time is likely to be tight once we have full details of the changes. Therefore, if you are likely to be affected by the new rules consider taking the following steps now, so that you are in a position to act quickly when we have full details of the new regime.

- Consider your residence status in light of the new regime. Returning non-doms who wish to avoid the new rules will need to ensure that they are not UK resident from 6 April 2017. For those on the cusp of 15/20 years' residence, consider whether a 6 year 'break' to reset the deemed domicile clock might be viable. Failing this, consider to what extent foreign income and gains can be accelerated prior to becoming deemed domiciled (e.g. in the form of dividends or trust distributions) so that these can still enjoy the benefit of the remittance basis.
- Re-visit your domicile status. In particular, a careful review of domicile of origin status will be important for individuals who may qualify as returning non-doms but, at present, have little connection with the UK.
- If you expect to become deemed domiciled shortly after the introduction of the new regime, review the tax position of any existing trusts (as well as their tax reporting obligations from April 2017) so that appropriate action can be taken when the details of the new rules are released.
- If you expect to become deemed domiciled on 6 April 2017 or shortly after (and will not be a returning non-dom) you may wish to consider setting up a trust now in anticipation of this change in status.
- Consider unwinding trust structures holding UK residential property where this can currently be done without a charge to SDLT or CGT (generally where the settlor and beneficiaries are non-resident).

"Time is likely to be tight once we have full details of the changes"

This publication is a general summary of the law. It should not replace legal advice tailored to your specific circumstances.

© Farrer & Co LLP, April 2016