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Tax Changes for Long-Term Non-UK Domiciles

Summary update of the tax changes for non-domiciled individuals from 6 April 2017 - updated following publication of additional draft clauses to Finance Act 2017 legislation on 26 January 2017.

INHERITANCE TAX ("IHT")

• After 5 April 2017 IHT will be charged on all UK residential property whether or not held within an overseas structure such as a close company, trust or overseas partnership. Where held indirectly, the chargeable value of the estate will be the value of the holding structure to the extent that the value relates to the underlying UK property.

• These new rules may apply in the following circumstances where a UK residential property is owned within the structure:
The death of an individual shareholder in an offshore company;

- The death of a donor within 7 years of making a gift of shares in a close company;
- A lifetime transfer made by a non-domiciled individual of shares in a close company into trust;
- Gifts of shares in overseas companies where the Gifts With Reservation provisions apply;
- 10-year charging provisions for Trusts holding the property through an offshore company, directly held property already being chargeable;
- The death of a life tenant with a pre-March 2006 interest in possession.

• The IHT charge will only apply to the value attributable to the UK residential property, and only if the property has been a dwelling at any time in the two years preceding the transfer. Mixed use property will only be liable to IHT to the extent the property has residential use.

• In addition to the value of the property, the provisional legislation is drafted to include the value attributed to the collateral and guarantees on loans within the charge to IHT. Rather than disallowing connected party loans, the deduction will be allowed, however the loan will also be treated as UK situs and brought within the charge to IHT in the hands of the lender.

• A targeted anti-avoidance rule will be introduced to counter attempts to avoid the charge. There will be an exemption for companies and partnerships where the property value is less than 1% of the total assets.

• It has been confirmed that there will be no incentives to encourage de-enveloping.

• Individuals leaving the UK after becoming deemed domiciled under the 15/20 year rule will revert to non-domicile status for IHT purposes after remaining abroad for more than 3 complete tax years. Similarly, the Spousal election to be treated as deemed domiciled in the UK will fall away after a 3 year period of non-residence.

• A grace period is being introduced for returning individuals with a UK domicile of origin. Such individuals will not be treated as domiciled for IHT purposes unless they have been resident in the UK for at least one of the two tax years prior to the year in question. There is no such grace period in respect of income tax or CGT.

DEEMED DOMICILE FOR LONG-TERM RESIDENTS

• From 6 April 2017 onwards individuals currently non-domiciled will acquire a deemed UK domicile if they:

- Were born in the UK with a UK domicile of origin and who are resident in the UK;
- Have been resident in the UK for more than 15 out of the past 20 tax years.

• Residence will be assessed on the rules applying at the time of that particular tax year (meaning it is not possible to use the Statutory Residence Test to re-assess tax years prior to its introduction).

• There will be no extension to the time limit for minor children.

• To lose a UK deemed domicile for Income Tax and CGT purposes an individual will need to leave the UK and be non-UK resident for at least 6 tax years to "reset the clock" to zero. Split years will continue to count as years of UK residence for these purposes.

• Transitional provisions will apply to disposals made by non-residents before 8 July 2015 who return to the UK without resetting.

• The £2,000 de-minimis exemption is to remain for any individual who is not domiciled in the UK, even when they become deemed domiciled under the 15/20 rule.

• The foreign CGT loss election will cease to have effect once an individual becomes deemed domiciled under the new rules. Individuals who have not previously submitted an overseas loss election will be able to claim capital losses arising on overseas assets after 6 April 2017.

REBASING OF ASSETS

• Directly held foreign assets may be rebased to their market value as at 5 April 2017 for CGT purposes for individuals who will become deemed domiciled in the UK on 6 April 2017;

• Rebasing will apply on an asset-by-asset basis and therefore where assets are standing at a loss there will be no requirement to rebase these assets;

• There is no requirement to bring the gain or asset to the UK to benefit from rebasing;

• The revised January 2016 legislation states that rebasing will be available for interests in non-reporting offshore funds (which are subject to income tax under the offshore income gains regime). This is a welcome change given non-reporting funds were specifically excluded from rebasing when the initial draft legislation was published;

• Rebasing will not apply to any assets which were situated in the UK between 16 March 2016 to 5 April 2017 unless one of the remittance exemptions apply for assets brought to the UK - such as art work made available for public access;

• Rebasing may only be claimed by individuals who had paid the remittance basis charge in any year before April 2017;

• For the rebased cost to continue to apply, the individual must retain their deemed UK domicile status until disposal of the asset;

• No rebasing is available for individuals who become deemed domiciled after 6 April 2017, or for those individuals who become deemed domiciled because they were born in the UK with a UK domicile of origin.

MIXED FUNDS

• This measure will allow a non-domicile who has a mixed account to analyse the account to establish its component parts, and then to segregate the income and gains from the original capital so that the "cleansed "capital may be accessed in priority;

• Funds must be reallocated within the tax year 2017/18 or 2018/19 as a one-off transfer of cash;

• The relief is not restricted to non-domiciles who will become deemed domiciled on 6 April 2017, but excludes individuals born in the UK with a UK domicile of origin;

• Individuals must have claimed the remittance basis before 5 April 2017, but there is no need to have paid the Remittance Basis Charge;

• It is understood that the mixed fund provisions will be flexible enough that it will not be necessary to establish all the relevant component parts within a mixed fund but just the underlying clean capital (given identifying all components from available records would often be impossible). However this is subject to future guidance from HMRC on how they see the legislation working in practice. Having sufficiently details records to support nominations of clean capital could still be an issue for many individuals.

NON-RESIDENT TRUSTS

• Non-domiciles who create trusts before they become deemed domiciled under the 15/20 test will not be taxed on trust income or gains retained within the trust structure, provided no benefits are taken from the trust;

• These excluded property trusts will retain the same IHT treatment as at present, subject to the new rules for residential property situated in the UK;

• The government has abandoned its original proposal to charge tax by reference to benefits received as this could have quite punitive results.

- Where the settlor, spouse, minor children/step-children receive any benefits, the protection is lost, and the settlor is taxable on all gains arising within the trust. Similarly, the protection is lost if the settlor adds any further funds to the trust;

- There are changes to the matching rules being introduced and anti-avoidance to circumvent the onward gifting of payment from a trust;

- Section 720 of the Transfer of assets abroad legislation will be amended to prevent deemed domiciled settlors who set up a non-resident trust before becoming deemed domiciled from being taxed on the income of the trust or underlying company, except to the extent that benefits are made available to him, his spouse or minor children which can be matched to the income arising.

OFFSHORE COMPANIES

- Where assets have been transferred to an offshore company on a non-commercial basis it is likely the Transfer of Assets Abroad legislation will apply to tax the income on the transferor.

BUSINESS INVESTMENT RELIEF

- The government intends to expand the role of Business Investment relief ("BIR") to make it easier for taxpayers to invest unremitted income and gains in UK businesses;

- It has been announced that there will be a relaxation of the extraction of value anti-avoidance provisions. This will make BIR a significantly more attractive proposal to invest into controlled companies;

- The time limit for investing in a company before it starts to trade will be increased from two to five years;

- The relief will be extended to enable individuals to acquire existing company shares as well as newly subscribed shares.

NEXT STEPS

Given the magnitude of the changes there is a lot to consider for individuals impacted by the changes.

The ability for some non-domiciled individuals to rebase assets on 6 April 2017 will create planning opportuni-ties, especially given the extension of the rebasing of non-reporting funds.

The mixed fund cleansing rules also provide opportunities for non-domiciled individuals to create new clean capital accounts from 6 April 2017 however there may be significant work involved to quantify and trace the relevant capital amounts.

Lastly individuals will also want to review any trust arrangements and UK property ownership structures in light of the forthcoming changes.

NON-DOM CHANGES

The entire non-dom changes that we were expecting to be included in the 2017 Finance Bill have been withdrawn including the deemed domicile provisions and the IHT changes relating to UK residential property held in off shore structures.

The purpose of removing these items for the Finance Bill is to avoid rushing through complex legislation in to a Finance Act which would have to receive Royal Assent before Parliament is dissolved before the June general election.

The apparent intention of the government (assuming they are re-elected) is therefore to include the provisions in the second 2017 Finance Bill which will follow the election. If that were to happen the changes could take effect retrospectively i.e. from 6 April 2017 or be deferred until next April.

Although there is nothing to do at this stage except be aware of the position. However, if you should have any queries please do not hesitate to get in contact with one of our tax team.

Please note that this publication is intended as a general overview of the proposed changes. It is important that professional advice is sought on specific issues relevant to your personal circumstances and the legislation in force before any action is taken.

For further details please contact your Tax Manager or Robert Kern at RobertK@sopherco.com.