Changes to the taxation of non-domiciled individuals: A welcome relaxation for offshore trusts

Almost 18 months after the original announcement at the 2015 Summer Budget, the government published the latest and final response concerning the changes to the taxation of non-domiciled individuals, which will take effect from 6 April 2017.

The comments in today’s consultation response broadly confirm the provisions that had been announced in the earlier consultations; however, there are some welcome relaxations to the rules relating to the taxation of offshore trusts compared to those published on 19 August 2016.

Whilst not all the draft legislation has been published today, and there are some final points of detail to be concluded, non-domiciled individuals and trustees of offshore trusts should now be able to plan with greater certainty for the changes taking effect from 6 April 2017.

Summary of main changes

- Non-domiciled individuals who have been resident for 15 of the past 20 tax years will be treated as being deemed domiciled for all personal taxes from 6 April 2017.

- It will be possible to break ‘deemed domiciled’ status for income tax and capital gains tax (“CGT”) purposes where the non-domiciled individual completes six consecutive UK tax years of non-residency. This provision is slightly shorter for inheritance tax (“IHT”) purposes where only three tax years of non-residency are required – this revised provision is aligned with the existing 17 out of 20 year rule. However, non-domiciled individuals who return to the UK after six years of absence are likely to face increased scrutiny from HM Revenue & Customs (“HMRC”) as to whether they are genuinely still non-domiciled or whether they have decided to make the UK their permanent home.

- Those individuals who were born in the UK with a UK domicile of origin, but subsequently claimed a domicile of choice outside the UK, will be treated as UK domiciled if they become UK resident. This will mean that any overseas structures established by the individual whilst living abroad will not be afforded any non-domicile protection if the individual returns to the UK in the future.

- Non-domiciled individuals who become deemed domiciled on 6 April 2017 (and who have paid the remittance basis charge at some point since 2008) will be able to rebase personally held foreign assets, so that only the capital gain arising thereafter will be subject to CGT. Rebasing will be available for non-UK situated assets held between 16 March 2016 (previously thought to be 8 July 2015) to 5 April 2017. The rebasing will not be available for those who become ‘deemed domiciled’ in subsequent tax years. Further, the rebasing provision will not be extended to offshore trusts and will not apply to gains in respect of offshore funds which are assessed to income tax (i.e. non-reporting offshore funds).

- As previously announced, the government will allow all non-domiciled individuals the opportunity to ‘untangle’ mixed funds in overseas bank accounts, but the window to complete this exercise has been extended from the original one year proposed to two years (now running from 6 April 2017 to 5 April 2019).

- The rules concerning the taxation of UK resident deemed domiciled settlors of offshore trusts will be altered and, in the main, significantly relaxed (see further details below).

- UK IHT will be extended to non-UK companies with an interest in UK residential property. A number of anti-avoidance provisions will be introduced, particularly concerning the use of debt, to counteract any artificial arrangements to reduce the net value of the chargeable estate. Significantly, where an overseas entity (company, trust etc) sells a UK residential property, the cash proceeds will continue to be within the scope of UK IHT for a further two years. However, in a slight change from the previously proposed rules, it now seems likely that the directors of the company owning the UK residential property will no longer be liable for any unpaid IHT.

- The current rules regarding Business Investment Relief (“BIR”) will be relaxed, but it was hoped the government would have gone further, to encourage greater take-up of the scheme and more investment in UK businesses (see further detail below).
**Taxation of offshore trusts**

The final consultation response offered some welcome relaxations of the taxation of offshore trusts from those originally published in the 19 August 2016 consultation.

The most welcome announcement is that offshore trusts settled by a non-domiciled individual before they become deemed domiciled will be given complete protection from income tax (in relation to non-UK source income) and CGT (UK and non-UK assets, other than UK residential property and carried interest capital gains). These protections will remain (for the income and capital gains remaining within the trust) irrespective of whether a beneficiary receives a distribution or benefit from the offshore trust. Therefore, the trust can accumulate non-UK income and realise capital gains without UK taxation, even where the settlor has become ‘deemed domiciled’. This may provide a favourable outcome for a non-domiciled individual becoming deemed domiciled as they no longer have to pay the remittance basis charge in order to benefit from income tax protection.

A distribution or benefit received from the trust will, in most cases, be taxed on the recipient. However, there can be occasions where payments to the settlor’s spouse, cohabitee or minor child (but not minor grandchild) will be assessed on the settlor, if not otherwise taxed on the recipient – this will be the case where the beneficiary concerned is non-resident or non-domiciled and elects to claim the remittance basis. Where the settlor is taxed because of a distribution to a close family member, there will be a right for the settlor to be reimbursed for the tax from the trust.

A distribution/benefit will be taxed according to the accumulated income and stockpiled capital gains within the trust. However, distributions to non-resident beneficiaries will no longer reduce the ‘pool’ of income and stockpiled capital gains.

There will also be anti-avoidance rules introduced in relation to “recycling” funds between family members. For example, if a non-domiciled or non-UK resident beneficiary receives a distribution from an offshore trust and subsequently gifts those funds to a UK resident beneficiary, under current rules, the ultimate recipient of the gift may not suffer tax on it. Now, where such arrangements are put in place, the UK resident recipient will be taxed on the amount where the onward gift is made within three years of the distribution.

A new method of valuing benefits from offshore trusts will be introduced to determine how a benefit should be taxed. For example, the benefit on the use of art will be calculated by multiplying HMRC’s official rate of interest by the acquisition price of the art. For loans from the trust, the benefit will be equal to applying HMRC’s official rate of interest less any interest actually paid (not simply rolled up).

Where a settlor has lent money to an offshore trust and this is repaid after 5 April 2017, a charge to income tax may arise on the repayment of that loan if the trust has accumulated income. Therefore, settlors with loans to offshore trusts should review these as soon as possible, and undertake any appropriate restructuring before 6 April 2017.

Finally, following the 2015 Summer Budget changes to the rules concerning carried interest capital gains, carried interest held within offshore trusts could have been taxed twice. Such carried interest capital gains will now be excluded from the new offshore trust rules to prevent double taxation.

**BIR**

BIR was introduced in April 2012 to encourage greater investment in the UK by non-domiciled individuals. Whilst the government noted over £1.5 billion has been invested under the scheme, the general view has been that the existing rules are complex and can unknowingly result in taxable remittances because of the broad ranging anti-avoidance provisions.

The BIR rules will be relaxed to allow for the following –

- A “hybrid” company, being both a trading company and stakeholder company, will be a qualifying company for BIR purposes – currently, the company has to be one or the other to qualify.
- The time limit for investing in a company before it starts to trade will increase to five years (it is currently two years).
- A qualifying investment will include the acquisition of existing shares, and not just be limited to the subscription of new shares.
- The ‘grace period’ for a potentially chargeable event will be extended to two years (it is currently 90 days and the monies must be taken outside the UK within 45 days).

Whilst the relaxations to BIR are again welcomed, it was hoped the government would go further by widening the regime to permit investment in partnerships and quoted companies, and also by offering incentives for monies to remain in the UK tax free if they had been invested for a certain timeframe. The government has indicated that it will monitor the use of BIR and re-consider some of these suggestions in the future.
Comment

After three consultation documents within 18 months, the rules now appear to be almost in final form, and it is important that the appropriate planning steps are taken in advance of 6 April 2017.

The confirmation of the offshore trust rules will allow non-domiciled individuals and trustees of offshore trusts to restructure with certainty. The offshore trust rules announced today are more in line with those expected when the announcements were first made at the 2015 Summer Budget, and the relaxed provisions present a valuable opportunity for some non-domiciled individuals to establish an offshore trust before 6 April 2017 to protect their position, even though they will become deemed domiciled thereafter.