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United Kingdom – Details on Changes to Taxation of Non-U.K. Domiciliaries

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A number of changes have been announced by the U.K. government in respect of the taxation of non-U.K. domiciled individuals ("non-doms"). A broad outline of these changes was included in our GMS *Flash Alert* on the 2015 U.K. Summer Budget (please see GMS *Flash Alert* 2015-083 (9 July 2015)). Today's supplementary *Flash Alert* provides more technical detail to help further inform global mobility professionals about the changes to the U.K. domicile rules. It is based on a technical note on the changes published by HM Revenue & Customs (HMRC), the U.K. tax authority.[1]

Why This Matters

The changes announced in the Summer Budget bring an end to a non-dom being able to benefit from a tax-advantaged filing position on an indefinite basis.

The new rules also help ensure that individuals who have a U.K. domicile at the date of their birth (i.e., a U.K. domicile of origin) but who later establish a new domicile outside the U.K. cannot claim to be a non-dom should they subsequently become U.K. resident.

A more detailed consultation document is expected to be published in September 2015, seeking views on how best to deliver these reforms, with all changes likely to be legislated in the 2016 Finance Bill – the new rules would apply from 6 April 2017.

The non-dom rules can provide a significant advantage to individuals filing U.K. returns on the remittance basis and it is important that they understand the new limitations on the availability of the remittance basis. Employees with a U.K. domicile of origin but who subsequently acquired a domicile of choice outside the U.K. may be sent to the U.K. on a tax-equalized international assignment. This will mean that such assignees will no-longer be able to benefit from Overseas Workday Relief from 6 April 2017.

Although not common, it is not unknown for some assignments to the U.K. to become almost permanent postings. Any non-dom employees who will be affected by the new deemed domicile rule (which will apply for all tax purposes, not simply Inheritance Tax (IHT) as at present) may wish to leave the U.K. before they become deemed U.K. domiciled. It is, therefore, essential that their employers also understand the impact of these new rules, and the potential for increased cost for the company.

Background

Currently, individuals resident and domiciled in the U.K. are taxed on their worldwide income and gains. They are also subject to IHT upon death on worldwide assets. Non-doms, however, may claim the "remittance basis" of taxation when filing U.K. tax returns

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and this ensures that non-U.K. source income and gains are not subjected to U.K. tax where there is no remittance to the United Kingdom. Non-doms also currently pay IHT only in respect of their U.K. assets (unless they are deemed domiciled for IHT purposes in the U.K. – see below).

Filing a tax return and claiming the remittance basis can lead to the loss of the U.K. personal allowance (tax exempt amount) and the capital gains tax annual exempt amount. However, as the personal allowance is reduced for individuals earning over GBP 100,000 (and is completely withdrawn for individuals earning GBP 122,000 or more in 2016/17) the potential tax cost of making a remittance basis claim is often negated. There is also a rising series of charges payable by longer-term U.K. residents if they wish to file using the remittance basis of taxation.

Abolition of "Permanent" Non-Dom Status – Deemed Domicile

Current Position

The current rules allow individuals to claim to be non-domiciled in the U.K. indefinitely for income tax and capital gains tax purposes provided that they do not take steps to establish a domicile of choice in the U.K. and continue to maintain links with, and intend eventually to return to, their home country. For IHT (only) there has long been a deemed domicile test which will treat an individual as domiciled for IHT once he has been U.K. resident in 17 out of the previous 20 years.

New 15-Year Rule

The government has stated that "long term U.K. resident non-doms should pay U.K. tax on their personal worldwide income and gains, regardless of whether amounts are received in the U.K. or overseas".[2] Accordingly, from 6 April 2017, any non-dom who has been resident in the U.K. for more than **15 of the past 20** tax years will be **deemed** U.K. domiciled for **all** tax purposes.

This 15-year rule will mean that those individuals will be taxable not only on their worldwide income and gains arising in the tax year, but also liable to IHT on their worldwide assets from their 16th year of residence in the United Kingdom. This will also require the current "deemed domicile" rule for IHT purposes of 17 years of U.K. residence out of 20 years to be amended to 15 years of U.K. residence out of 20.

The new rules are effective from 6 April 2017, even if the individual arrived in the U.K. prior to that date. The technical note specifically states that there will be no special grandfathering rules.

The new deemed domicile will not apply to individuals who leave the U.K. (become non-resident) before 6 April 2017. The current rules will apply to them even if they would meet the 15-out-of-20-year test at 6 April 2017. However, if they subsequently return to the U.K. the 15-out-of-20-year-residence test will be applied to them.

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KPMG Note

Longer-term U.K.-resident non-doms who are at least 18 years old and have at least GBP 2,000 of unremitted foreign income or gains need to pay an annual remittance basis charge in order to benefit from the remittance basis. The current charges are as follows:

- GBP 30,000 for individuals who have been resident for more than 7 out of the last 9 years;
- GBP 50,000 for individuals who have been resident for more than 12 out of the last 14 years; and
- GBP 90,000 for individuals who have been resident for more than 17 out of the last 20 years.

The GBP 90,000 charge will become redundant with the introduction of the 15-year rule in April 2017.

The election to be taxed on the remittance basis is made on an annual basis. The government was consulting on requiring individuals to make the election for a longer period, but has decided that the election will continue on an annual basis.

New 5-Year Rule

Once the new rules take effect, a deemed U.K. domicile will only be lost and a new non-U.K domicile acquired if the individual remains outside the U.K. for at least 5 years. This will be known as the "5-year rule." If the non-dom then returns to the U.K. (having been outside the U.K. for more than the requisite 5 years**) but he intends ultimately to leave the U.K. again and so remain a non-dom under general principles,** he will be able to remain in the U.K. for another 15 years before re-acquiring a deemed U.K. domicile. This rule does not apply to those returning to the U.K. who have a U.K. domicile of origin – see below for more details. It is worth noting the present position for IHT purposes (only) whereby an individual who has become deemed domiciled under the 17-out-of-20 rule can only lose deemed domicile status by being non-U.K. resident for 4 tax years (the "4-year rule").

Individuals with a U.K. domicile under general law leaving the U.K. after 5 April 2017, will also be subject to the 5-year rule, if they have been in the U.K. for over 15 years. This will be the case even if they intend their departure from the U.K. to be permanent.

In practice, a U.K.-domiciled or deemed-domiciled individual is not subject to U.K. tax on non-U.K. income and capital gains if he is not U.K. resident in a tax year (although there are temporary non-residence rules that can apply to certain forms of income and capital gains arising in a period of non-U.K. residence), and therefore this 5-year "hangover" domicile period may not have practical implications for income and capital gains tax. However, an individual would remain liable for IHT on any gifts of assets, or on his/her estate at death, on a worldwide basis during this 5-year period.

The "Returning U.K. Dom"

Under the new rules, it will no longer be possible for somebody who is born in the U.K. to parents who are U.K. domiciled to claim non-domicile status if she leaves but then returns and takes up residency in the United Kingdom. The government has stated, in particular, that "that those who have a strong connection with the U.K. having a U.K. domicile of origin at birth should not be able to access the remittance basis regime if they return and become U.K. resident here, even if they have lost that U.K. domicile as a matter of general law."[3]

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Where an individual who has a U.K. domicile of origin but who subsequently acquires a non-U.K. domicile of choice, returns and becomes U.K. resident, the individual will re-acquire her U.K. domicile of origin on return, irrespective of any actual intentions. The individual will, therefore, be taxed on worldwide income and gains while U.K. resident and will not have access to the remittance basis of taxation. The individual will also not benefit from any favorable tax treatment for trusts set up when non-U.K. domiciled that might otherwise apply. These rules apply not only for IHT purposes, but also for income and capital gains tax.

On departure from the U.K., an individual with a U.K. domicile of origin who had acquired a domicile of choice elsewhere but who became deemed U.K. domiciled again on becoming U.K. resident under these new rules will be considered as a non-dom for U.K. tax purposes again from the tax year following the year of departure provided that:

1. the individual has not spent more than 15 tax years in the U.K.; and

2. the individual as not acquired an actual domicile in the U.K. under general law during his return.

If the departing U.K. dom has not spent more than 15 tax years in the U.K. and has acquired a U.K. domicile under general law on return to the U.K., the individual will be subject to the 5-year rule described above before losing U.K. domicile.

If the departing U.K. dom has been resident for more than 15 tax years in the U.K. but has not acquired a U.K. domicile under general law, the technical note says that the individual will remain U.K. domiciled for IHT purposes up until 3 years after he has acquired or reacquired a foreign domicile of choice as a matter of law. This is known as the "3-year rule" and is described below.

If the individual has not spent more than 15 years in the U.K. and not acquired a U.K. domicile, the individual is subject to both the 5- and the 3-year rules and can lose his U.K. tax domicile only on the later of these events.

KPMG Note

These provisions are confusing because in this situation the individual would already be a foreign domicile under general law, although not necessarily under tax law. KPMG LLP (U.K.), therefore, awaits further clarification from HMRC on how these rules will operate.

This measure will take effect from 6 April 2017, and will apply not only to new arrivals from that date, but also to individuals who returned before that date who are still U.K. resident.

3-Year Rule

As explained above, individuals who are domiciled in the U.K. are subject to inheritance tax on their worldwide assets. Currently when such individuals emigrate and acquire a domicile of choice in another country they remain "deemed" domiciled for inheritance tax purposes in the U.K. until 3 years after they have lost their U.K. domicile and acquired a domicile of choice in another country.

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KPMG Note

An individual has to have a domicile under general law. An individual cannot be without a domicile, so the loss of U.K. domicile and the acquisition of a new domicile happens simultaneously. This can happen many years after the individual has become non-U.K. resident, for example because the individual has not settled in one country, but has moved from country to country.

An individual is domiciled in a territory subject to a single legal system, under U.K. law. As such, an individual would, therefore, be regarded as domiciled in a particular state of the United States of America and not the United States of America. Consequently, U.K.-domiciled individuals who left the U.K. permanently but moved from U.S. state to U.S. state would remain U.K. domiciled until after they had settled permanently and acquired a domicile of choice in a particular state. In addition, they would remain deemed U.K. domiciled for IHT purposes until 3 years after they had settled there. This can be later than simply 5 years after they have left the U.K. under the 5-year rule.

Overseas Workday Relief[4]

General earnings from employment earned by an individual who is resident in the U.K. are taxable in the U.K. when those earnings are received.

U.K.-resident but non-U.K.-domiciled employees who claim the remittance basis of taxation can benefit from Overseas Workday Relief (OWR). When they qualify for this relief their earnings that are not remitted to the U.K., are not U.K. taxable. If such earnings are remitted to the U.K. in that or any subsequent tax year, then they will be taxable in the United Kingdom.

Employees who are U.K.-resident but non-U.K.-domiciled can benefit from OWR if:

- they have been non-U.K. resident for the 3 consecutive tax years prior to the one in question, or if U.K. resident in the prior year, the year in question is 1 of the 2 subsequent tax years; or
- they have been non-U.K. resident for 3 consecutive tax years in the 5 tax years preceding the one in question.

KPMG Note

Employees who had a domicile of origin in the U.K. but who acquired a domicile of choice overseas will no longer be able to claim OWR. Some individuals who have been resident for more than 15 out of the last 20 years will also no longer be able to claim OWR if they leave and then return to the U.K. after a 3-year period of non-U.K. residence. This is because they will be deemed to be U.K. domiciled for U.K. tax purposes.

These changes will not affect the vast majority of U.K. assignees from overseas as they do not have a domicile of origin in the U.K. and have not been resident in the U.K. for even, say, 10 years. Accordingly, they will not be caught by the deemed domicile rules during the first 3 years of an assignment.

It is unfortunate that the proposed changes and consultation on the tax effects of domicile do not appear to include the remittance basis rules, particularly as regards Overseas Workday Relief. The

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KPMG Note (cont'd)

rules on calculating the amount of the relief and "nominating" bank accounts are very complicated and KPMG LLP (U.K.) would like to see this reviewed and reformed. We intend to request a review of these rules as part of the present consultation.

Offshore Trusts

There will be consequential changes to the treatment of income and capital gains arising in relation to offshore trusts established by persons when they are not U.K. domiciled under general law but where they become deemed U.K. domiciled under these new rules. This will require amending some complex areas of tax law and the government has indicated that it will consult on these changes.

Residential Property Held by Non-Doms through an Offshore Structure

The government believes that it is common for non-doms who own U.K. residential property to avoid the payment of IHT by placing the ownership of that property in an offshore structure or investment vehicle. Anti-avoidance measures will be introduced from April 2017, so that IHT will be payable on the value of all U.K. residential property owned by non-doms even if the property may not be owned directly.

Next Steps

HMRC intends to consult on how best to implement these new measures and on some of the details contained in the proposals. Matters that HMRC has indicated will be included in the consultation process are:

- Whether split years of U.K. residence – that is to say years of arrival in or departure from the U.K. where the individual is only taxed as a U.K. resident for part of the year – will count towards the new 15-year rule.
- The interaction between the new 5-year rule and the existing 3- and 4-year rules which presently govern how those leaving the U.K. can still remain within the ambit of IHT on their worldwide assets despite having acquired a foreign domicile under general law.
- How the new rules may apply to the taxation of employment-related securities given that it is clear that once an individual acquires a deemed U.K. domicile under the 15-out-of-20 rule, he will not benefit from OWR.
- The detailed application of the new rules to offshore trusts set up by non-doms before a deemed domicile is acquired.

KPMG Note

With the debate on the taxation of non-doms featuring so prominently during the recent U.K. general election campaign, it is no surprise that changes were introduced in the Summer Budget. In particular, the indefinite nature of the favorable tax treatment applicable to non-doms, when compared to the treatment of U.K. nationals, has been facing criticism. At the same time the government also took on board the advantage to the U.K. economy of non-doms continuing to live and work here and stopped short of abolishing non-dom status entirely.

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KPMG Note (cont'd)

The changes announced are wide-ranging and the measures covered in this *Flash Alert* are expected to raise approximately GBP 1.5 billion over the life of this Parliament. In considering the magnitude of the tax revenue which these measures are expected to generate, it is nevertheless worth noting that many of the new measures do not take effect for almost 2 years.

Employers will need to consider these changes carefully when assessing the tax implications for new assignees to the United Kingdom. They will also need to consider whether any non-U.K.-domiciled employees who are currently claiming remittance basis may now wish to leave the U.K. and become nonresident.

Wider consultation is expected to start after Parliament's summer recess and we plan to issue further updates once the consultation document and draft legislation have been published.

If you have any preliminary thoughts, please feel free to provide them to your usual KPMG People Services or GMS contact.

Footnotes:

1 HMRC's "Guidance: Technical briefing on foreign domiciled persons changes announced at Summer Budget 2015."

2 Quote from: "Guidance: Technical briefing on foreign domiciled persons changes announced at Summer Budget 2015."

3 Ibid.

4 For more on Overseas Workday Relief, see "Budget 2015: Review of Rules Around Overseas Workday Relief," a publication of KPMG LLP (U.K.).

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The information contained in this newsletter was submitted by the KPMG International member firm in the United Kingdom. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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