Non dom changes

Private Client update

August 2016

All non doms need to act now – the new rules will impact them

On 19 August 2016 the Government published more details about the proposed new rules which fundamentally change the way in which UK resident non-UK domiciled individuals (non-doms) will in future be taxed in the UK. The proposals will be legislated in Finance Bill 2017 and will take effect from 6 April 2017. There is however a consultation period and the deadline for responses is 20 October 2016. Some details may therefore change.

All non-doms could be impacted by these latest Government announcements. Many non-doms are about to pay tax on worldwide income and gains for the first time and those with UK residential property will be newly exposed to Inheritance Tax (IHT) both during lifetime and on death. In addition the new rules introduce a one year window during which non-doms will be able to rearrange and tidy their mixed funds.

This means all non-doms need to ensure they understand how the changes will impact them. To be prepared for the future rules, many non-doms may wish to implement changes in their financial affairs before 6 April 2017.

Below is KPMG Private Client team's high level summary of the key issues arising from the 19 August 2016 information. These are set out in the following six topical areas:

1. IHT and residential property
2. Tidying of mixed offshore funds – a one year window
3. Rebasing
4. Trusts
5. Individuals returning to the UK
6. Business investment relief

1) IHT and residential property

In the past non-doms (and trusts established by such individuals) have been able to shield the value of UK residential property from IHT by holding property through a non-UK company. This has been effective for IHT charges arising on death and during the lifetime of an individual as well as those arising during the life of a trust ('ten year anniversary' and 'exit' charges).

- For all IHT events on or after 6 April 2017 this will no longer be the case. The value of property deriving from an interest in a UK dwelling will be within the charge to IHT. This will apply most commonly to shares in non-UK closely held companies that hold such interests.
- It is intended that the definition of a dwelling will be modelled closely with the non-UK resident CGT definition, and will therefore apply to dwellings under construction off-plan as well as existing properties. There will be no exemptions for properties occupied as a main residence, or for properties used in a rental business.
- Debts that relate exclusively to the dwelling will be deductible against the value charged to IHT. It is not entirely clear whether this means that it is the use of borrowed funds rather than the security for such debts that will be relevant in determining whether a deduction will be available.
- There will be anti-avoidance provisions including:
    - The disallowance of debts incurred with connected persons
    - Any change in use of a property within two years of an IHT chargeable event, and
    - An overriding rule to prevent the avoidance of a charge through any 'arrangements'
- The consultation confirms that there are no proposals to allow for reliefs from other tax charges, such as CGT and SDLT, where existing property structures are unwound (so-called, "de-enveloping relief")

2) Tidying of mixed offshore funds – a one year window

The remittance basis rules governing mixed offshore funds (i.e. most commonly non-UK bank accounts consisting of a mixture of so called 'clean' capital, income and capital gains) dictate that taxable income and capital gains of a tax year are treated as remitted before non-taxable 'clean' capital. The current rules also prevent the separation of these elements into different offshore accounts. Non-doms have therefore often found their offshore 'clean' capital 'trapped' outside the UK by the application of these rules.

- A surprise and welcome proposal in the 19 August 2016 consultation document is to allow a one year window from 6 April 2017 for the separation of the income, capital gains, and clean capital elements of existing non-UK funds into separate accounts or funds. This will enable more ready access to reorganise and tidy capital for future remittances to the UK.

- The one year window will be available to all non-UK domiciled individuals not born in the UK with a UK domicile of origin and who have claimed the remittance basis at some stage prior to 6 April 2017. This is therefore an opportunity for all non-UK domiciled individuals, not just those immediately affected by the deemed domicile rules from 6 April 2017, to re-organise their offshore accounts to separate funds into their different components.

- The window is subject to the ability of an individual to identify the different elements of an offshore account at 6 April 2017.

- The special treatment will only apply to mixed funds which consist of amounts deposited in bank and similar accounts.

This is an unexpected feature of the 19 August 2016 consultation proposals as it will provide the opportunity for all non-doms (other than those born in the UK with a UK domicile of origin) to re-organise their offshore bank accounts to separate funds into their separate components. It is essential that such individuals have established the different elements of their offshore accounts at 6 April 2017 to benefit from this opportunity.

3) Rebasing

As announced in the 2016 Budget, HMRC have confirmed that individuals becoming deemed domiciled in April 2017 under the 15/20 rule will be able to benefit from rebasing of their foreign assets to their market value on 5 April 2017. This means that on a future sale of such assets, only gains accruing from 6 April 2017 onwards may be then taxable (on the arising basis). The 19 August 2016 announcements also confirm that there will be no need to hold sale proceeds offshore to benefit from this protection. This change is to be welcomed by non-dom taxpayers holding trading and investment assets outside the UK, though some points have also been clarified which will limit the potential benefits. Key points to note include:

- Rebasing will not apply on a mandatory basis: taxpayers will be able to choose whether they wish for it to apply.
- HMRC have confirmed it will be on an asset-by-asset basis.
- Rebasing will only apply to unrealised gains in directly-held assets. Funds originally invested in those assets will not benefit from protection and a tax charge may still therefore arise if these original funds are remitted. This prevents an effective 'amnesty' for all reinvested foreign income and gains.
- The protection will be limited to those assets which were foreign situs at the date of the Summer Budget 2015 (8 July 2015).
- Rebasing will only apply for individuals who have paid the remittance basis charge in any year before 5 April 2017 and who become deemed domiciled under the 15/20 rule on 6 April 2017. It will not be available for individuals who revive a UK domicile of origin, or for those become deemed-domiciled in years after April 2017.

When considering the possibility of rebasing in conjunction with the chance to reorganise and tidy so-called mixed funds during the 2017/18 tax year (see above), non-dom taxpayers will need to review their offshore holdings carefully now, so as to ensure that they can benefit from the protections available.

4). Trusts

HMRC propose that non-UK resident trusts established by non-dom settlors will be subject to special tax rules once the settlor becomes deemed-domiciled, such that:

- Foreign assets held by non-UK trusts remain outside the scope of UK IHT, as is currently the case. This is subject to the notable exception for UK residential property (see above);
- Foreign income, and gains arising, within a trust will not be subject to UK tax on the settlor unless and until a benefit is received from the trust either by a deemed-domiciled settlor or their family (i.e. spouses and minor children). Where such a benefit is received the special tax rules no longer apply and the settlor will be taxed by reference to the level of income and on gains arising within the trust (rather than simply by reference to the value of benefits received, as originally planned).

  This "settlor tax protection" will only apply to those who become deemed domiciled under the 15/20 rule, and will not be available to those who have revived a UK domicile of origin. However this is a welcome concession to HMRC's original proposals to tax the full value of benefits on receipt.
- New trusts set up after a settlor has become deemed domiciled will not benefit from any protection. In addition if a non-dom settlor adds further funds to existing trusts, or if they receive benefits from such trusts, after they have become deemed-domiciled, certain elements of the "settlor tax protection" will be permanently lost going forward. Specifically, under current proposals trust gains will then become taxable on settlors as they arise, rather than when these are distributed or matched to benefits received.
- For beneficiaries it is not intended that the current rules will change significantly. These primarily trigger tax charges for beneficiaries on the receipt of benefits or distributions. The key change for deemed-domiciled beneficiaries will therefore be that, going forward, tax will be charged on an arising basis on any trust income and gains distributed or attributed to them. One helpful clarification is that transitional reliefs introduced in 2008, relating to trust capital gains, will continue to apply even when a beneficiary becomes deemed domiciled under the 15/20 rule (but not where the individual has revived a UK domicile of origin).

5) Individuals returning to the UK

- HMRC have confirmed that non-doms who leave the UK prior to April 2017 will be within the new rules when they are introduced. Therefore irrespective of when they left the UK, non-doms will need to remain non-UK resident for a period of at least 6 tax years in order to break the 15 out of 20 tax year, deemed domiciled rule for income tax and CGT after April 2017.
- The position for IHT is different. Non-doms who leave the UK will break any deemed UK domicile status for IHT purposes after four tax years of non-UK residence if they do not return to the UK. This aligns the position with those non-doms who leave the UK prior to 6 April 2017 who may seek to break the existing 17 out of 20 tax year rule which would have historically deemed them to be domiciled in the UK for UK IHT purposes.
- However, non-doms who return to the UK prior to a non-UK resident period of at least 6 tax years, may be deemed to be UK domiciled from the date of their return for IHT purposes, to the extent they meet the new 15 out of 20 tax year rule.
- Non-doms with a domicile of origin in the UK will always be deemed to be domiciled in the UK whenever they are resident in the UK, with the only exception to this being that it is proposed those who only return to the UK temporarily and who with reference to any tax year, were not UK resident in either of the prior two tax years, should remain outside the scope of UK IHT.
- Finally, HMRC have confirmed that any transfer of non-UK property made prior to an individual being regarded as deemed domiciled for IHT purposes (a potentially exempt transfer), will not be brought within the scope of UK IHT if they later die having subsequently become deemed domiciled in the UK.

6) Business Investment Relief

- The Government have announced their intention to extend the availability of Business Investment Relief (BIR). BIR allows non-doms who claim the remittance basis to use their foreign income and gains to invest in the UK without triggering a taxable remittance, but is currently limited to certain qualifying investments. The most common of which are unlisted UK trading companies, but as an example this relief does not currently extend to UK partnerships.
- BIR has been viewed as a success by the Government, with investments made in the UK under the scheme exceeding £1.5bn. As such they are looking to attract more investment to the UK with the relief and whilst not specifically mentioned in the consultation, this policy is aligned with the Government's post-Brexit strategy of demonstrating that the UK remains open for business.
- Unfortunately at this stage there is little detail on any specific proposals to expand this relief. The Government is using the consultation to seek views on how the relief could be both expanded and simplified in order to encourage greater usage.

If you would like further information please see: Big changes to non-dom rules ahead.

To discuss how these changes might affect you please get in touch with your usual KPMG Private Client contact or one of the KPMG Private Client specialists listed below.

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