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CHARTERED ACCOUNTANTS

REFORM OF THE NON-DOM REGIME - AUGUST 2016 CONSULTATION

Introduction

On Friday 19 August 2016, the government issued their long awaited update on the proposed changes to the tax regime for individuals who are resident but not domiciled in the UK ("non-dom"). It came in the form of another consultation document, following up the previous consultation document issued in September 2015. The government have considered the responses to the proposed changes and the new consultation document seeks further responses but also helpfully provides more clarity on where the proposals will end up. None of this is confirmed yet and the next step is that the consultation will run until 20 October 2016, following which we can expect more draft legislation.

Importantly, the consultation document confirms that the government's view is that these changes should still come into force from 6 April 2017 and there is no mention of them being delayed (as was speculated by some).

We have summarised the key points of the consultation below.

Inheritance tax treatment of UK residential property held within non-UK structures (enveloped properties)

All UK residential property will come within the scope of UK inheritance tax ("IHT") from 6 April 2017, regardless of how it is owned.

The government has confirmed that there will be no reliefs available to allow individuals to de-envelope properties from structures whilst avoiding, or at least deferring, the associated tax charges.

The consultation raises questions regarding the definition of "residential properties", the approach to valuing properties and the practical impact of changing the IHT treatment.

Given the difficulty of assessing and enforcing IHT on certain non-UK structures, it is proposed that HM Revenue & Customs might be able to block the sale of properties until any outstanding IHT is paid.

Deemed domiciled for long term residents

The government remains committed to the proposal that from 6 April 2017 non-doms who have been resident for at least 15 out of the previous 20 tax years will become deemed domiciled in the UK for all tax purposes.

There are likely to be very specific transitional reliefs for individuals who left the UK prior to this change in the rules and subsequently return, or individuals who sold assets whilst non-UK resident.

Childhood years spent in the UK, and split years of UK residence, will be taken into account for the purposes of the 15 out of 20 years test.

Rebasing of non-UK assets held at 5 April 2017

Rebasing will be voluntary and will apply on an asset by asset basis for those assets held at 5 April 2017.

It will not, as some had speculated, be "complete" rebasing. Only the unrealised gain on the asset at 5 April 2017 is rebased and will not be taxed. If unremitted income/gains were originally used to acquire an asset, these will still be taxed when proceeds of the sale of that asset are remitted to the UK.

Rebasing will only be available to individuals who become deemed domiciled from 6 April 2017 as a result of the 15 out of 20 years rule, and who have previously paid the remittance basis charge. It will not be available to individuals who become deemed domiciled in later years. It will also not be available to individuals who become deemed domiciled under the new rules because they were born in the UK and had a UK domicile of origin.

It will only apply to assets that were foreign situs at the date of the Summer Budget 2015, which was 8 July 2015.

Cleansing of mixed funds

The government has acknowledged the complexity of the tax treatment of mixed funds and the fact it often discourages non-doms from remitting money to the UK, particularly in cases where accounts

were originally set up with clean capital but have subsequently generated income/gains that would be taxable in priority if remitted.

It is proposed that there will be a one year window in which to re-arrange ("cleanse") mixed funds, from April 2017 to April 2018.

During the window individuals will be able to cleanse mixed funds by separating them into different parts e.g. segregate foreign income, foreign gains and clean capital into separate accounts and then choose which account they remit from.

There will be no requirement to actually make a remittance for these rules to apply. The rules only apply to amounts deposited with banks (and similar accounts) and not to illiquid assets.

The individual will need to be able to determine the component parts of the mixed fund. If they cannot identify the underlying income/gains/clean capital then they cannot benefit from cleansing. In practice, this could prove to be a very challenging exercise for funds invested over many years.

Cleansing will be available to all non-doms (apart from those born in the UK with a UK domicile of origin), not just those deemed domiciled under the 15 out of 20 years rule in April 2017. This is in contrast to the rebasing proposal above.

Changes to tax treatment of non-UK trusts

The previous proposal to introduce a benefits charge (i.e. assessing non-doms on the benefits they receive from the trust) has been abandoned. The new proposal is to alter existing taxing provisions.

Currently, a UK domiciled individual who settles a non-resident trust and retains an interest in that trust is treated as taxable on any gains within the trust. The new rules propose that the same treatment will apply to deemed domiciled settlors. However, if an individual sets up a trust prior to becoming deemed domiciled they will be protected from tax on gains within the trust as long as they, their spouse and their minor children do not receive a benefit from the trust. This protection is lost starting from the tax year in which a benefit is first received.

Similar amendments to taxing provisions relating to income are proposed. Essentially if the settlor (or their spouse or minor children) receives a benefit from the trust then income in the trust will be taxable on them, but only to the extent that they receive a benefit from the trust. UK source income remains taxable in the UK as before.

The protections described above only apply to trusts set up prior to becoming deemed domiciled. Any additions made to trust property after becoming deemed domiciled will permanently remove the protections for all assets in the trust.

Remittance basis - other

The annual £2,000 unremitted income/gain de minimis level for any non-dom will remain, even after they become deemed domiciled (apart from those born in the UK with a UK domicile of origin).

Foreign capital loss elections will only apply until an individual becomes deemed domiciled.

Inheritance tax

An individual who leaves the UK and is non-resident for four consecutive tax years will cease to be treated as deemed domiciled after that point. The 15 out of 20 years rule will still apply if the individual then returns to the UK, therefore six years of non-residence is required to "reset the clock" and allow the individual to return and continue to benefit from their non-dom status.

UK domicile – individuals born in the UK with a UK domicile of origin

The government have confirmed that such individuals will be deemed domiciled from 6 April 2017 while they are resident in the UK.

Business Investment Relief

The government are seeking input on how they can make this scheme more attractive to UK taxpayers.

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