Uncertain future

Inheritance tax and trusts



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Harriet Brown considers the new rules for non-UK domiciliaries, and provides guidance on what advisers need to know

Key Points

What is the issue?

The gradually emerging details of the changes to the treatment of UK resident but non-UK domiciled individuals that were announced in Summer Budget 2015, and which will come into effect from 6 April 2017 and how they will effect clients upon their coming into force, and in the future.

What does it mean to me?

These are major changes that will, for certain clients, result in a very different tax treatment. The changes to the law can mean changes to income tax treatment, capital gains tax treatment and inheritance tax.

What can I take away?

The changes are significant, but remain unfinalised. It is important now to identify clients that may be affected by the rules and consider their position, so that it merely requires review when the final legislation is available.

What is domicile?

Domicile is a concept of ‘belonging’ used in tax law, but also elsewhere in the English legal system. Domicile is determined in one of three ways: domicile of origin, domicile of choice and, exceptionally, domicile of dependence. As a minor you will have a domicile of origin determined by your father’s domicile at the time you were born. Anyone 16 years old or over may obtain a different domicile, a domicile of choice by residing in a country other than that of his domicile of origin with the intention of continuing to reside there indefinitely. A domicile of dependence can arise for children in certain circumstances where parents are separated and for certain individuals where mental incapacity continues from their childhood into their adult years.

The position in relation to those who are resident in some part of the UK but not domiciled in any part of the UK (‘non-UK domiciles’) have faced a number of changes over recent years. The position for non-UK domiciles has, generally speaking, been the following:

- for inheritance tax purposes non-UK domicile’s non-UK situate property is not within their estate for inheritance tax purposes;
- for inheritance tax purposes, if a non-UK domicile settles non-UK situate property on trust at a time when he is non-UK domiciled that property will be excluded property and not subject to the relevant property regime; and
- for income tax and capital gains tax purposes a non-UK domicile can make a claim to be chargeable, upon the remittance basis, i.e. they will only be charged on income or gains that are remitted to the UK.

Thus there are potential significant benefits of being non-UK domiciled while being resident here. However, successive changes to the legislation have curtailed the benefit by use of ‘charges’ to access the remittance basis and a concept of ‘deemed domicile’ so that the current position is the following.

For inheritance tax purposes there is a ‘deemed domicile’ rule in the Inheritance Tax Act 1984 (IHTA) s 267, which provides that in two circumstances a person who is a non-UK domicile will be treated for inheritance tax purposes as being UK domiciled. The circumstances are:

- he was domiciled in the UK within the three years immediately preceding the relevant time; and
- he was resident in the UK in not less than seventeen of the twenty years of assessment ending with the year of assessment in which the relevant time falls.

An individual can elect to be treated as a UK domicile – which means a full spouse exemption is available on property passing from to a non-UK domicile, but this rule is beyond the scope of this article.

In relation to income tax and capital gains tax after a certain number of years has passed, the remittance basis may only be accessed upon nomination of income and gains to give rise to a certain amount of tax (i.e. it is not worth claiming the remittance basis unless a minimum of that amount would be payable on the arising basis) (see Income Tax Act 2007 (ITA) section 809H):

- for those non-UK domiciles that have been UK resident in at least 17 of the 20 tax years immediately preceding the tax year in question, the amount is £90,000 (see ITA ss 809C(1ZA);
- for non-UK domiciles that have been UK resident in at least 12 of the 14 tax years immediately preceding that year the amount is £60,000 (see ITA s 809C(1A)); and
- for non-UK domiciles that have been resident in at least 7 of the 9 previous tax years, the amount is £30,000 (see ITA s 809C(1B)).

Thus it can be seen that the position is not as favourable – or as straightforward – as it has been previously. The proposed changes will further whittle away the benefits of being non-UK domiciled.

Where can the changes be found?

The proposals and proposed amendments are not found in a single place but are spread out over a number of different documents:

- ‘Technical Briefing on Non-Dom changes’ (July 2015) (the ‘July 2015 Non-Dom paper’);
- Consultation paper ‘Reforms to the taxation of non-domiciles’ (September 2015) (the ‘September 2015 condoc’);
- Policy paper ‘IHT: reforms to the taxation of non-domiciles’ & draft IHT clauses (December 2015);
- Policy paper ‘Domicile: Income Tax and CGT’ & draft IT/CGT clauses (2 Feb, updated 5 Feb 2016) (the ‘Feb 2016 policy paper’);
- Budget 2016; and
- ‘Reforms to the taxation of non-domiciles: further consultation’ (August 2016) (the ‘August 2016 consultation paper’).

Thus following the development of the changes has not always been straightforward. The changes will come into effect from 6 April 2017, however, and so it is important to be advising non-UK domiciled clients, or those who might become non-UK domiciles, on the new law.

Inheritance tax: individuals

After the changes there will be four categories of non-UK domiciles for inheritance tax purposes, and these are the following:

- the current rule for those who have been UK domiciled in the preceding three years will remain (still in IHTA s 267(1)(a));
- there will be a new rule for those who have formerly been domiciled in the UK (in IHTA s 267(1)(aa));
- the current deemed domicile for those who have been UK resident in 17 of the last 20 years will be amended so as to apply to those that have been so resident in 15 of the last 20 years (still in IHTA s 267(1)(b)); and
- the spouse election in IHTA s 267ZA – beyond the scope of this article – will still apply.

Thus there are two changes to concentrate on: the wholly new ‘formerly domiciled’ rule and the amendment to create a ‘15/20 years’ rule. In relation to the latter this will apply to deem a UK domicile where:

- an individual was resident for at least 15 of the 20 tax years immediately preceding the tax year in which the relevant time falls, and
- for the tax year in question or, if not, for at least one of the four tax years immediately preceding that tax year.

The rule is slightly more complicated consisting now of two conditions that must be met, the second being met by two separate sets of circumstances. Additionally, the ‘start date’ of the deemed domicile will also be different – it will be 6 April in the tax year *after* the 15/20 years test is satisfied.

Turning to the formerly domiciled rule this will apply to a UK resident who is a ‘formerly domiciled resident’, a term encapsulating the following conditions in relation to a person:

- the person was born in the UK;
- their domicile of origin was in the UK;
- they were resident in the UK for that tax year; and
- they were resident in the UK for at least one of the two tax years immediately preceding that tax year.

Domicile start date for formerly domiciled residents will be 6 April in the second year of residence and domicile end date will be 6 April in the first year of non-residence.

Inheritance tax: trusts

There will also be changes to ‘excluded property trusts’ (i.e. those of non-UK situate property that are settled by non-UK domiciles). While for many the rules will remain the same a new IHTA s 48(3E) will provide that property in such trusts is not excluded property at any time in a tax year if the settlor was a formerly domiciled resident for that tax year. This is a much more administratively complex rule and in practice is likely to be the cause of accidental and potentially avoidable tax charges under the relevant property regime.

Remittance basis for income tax and capital gains

The changes propose a new ITA s 835B which will, at present, apply for the purposes of certain legislative provisions, namely: Income and Corporation Taxes Act 1988 s 266A, Income Tax (Earnings and Pensions) Act 2003 ss 355, 373, 374 and 376, ITA ss 476, 718, 809B, 809E and 834, TCGA ss 69, 86 and 275, and certain provisions of Finance Act 2008 (but only in the case of one of the new conditions).

ITA s 835B will give two circumstances (Condition A and Condition B) under which an individual will be deemed domiciled in the UK. Only one condition must be met for there to be such a deemed domicile.

Condition A is that the individual was born in the UK, (b) their domicile of origin was in the UK, and they are resident in the UK for the tax year in question. This is equivalent to the IHT formerly domiciled resident rule but there is no equivalent grace period of one year. This means that the domicile start date is 6 April in the first year of residence (i.e. a formerly domiciled resident will be deemed domiciled for IT/CGT but not for IHT). The domicile end date is 6 April in a year of non-residence, the same as the IHT rule.

Condition B is that he individual has been UK resident for at least 15 of the 20 tax years in the immediately preceding tax year. This is the equivalent of the IHT 15-year rule, and the domicile start and end dates are aligned.

Conclusions

Obviously, the ramifications and complications of this legislation cannot be set out fully here, but are extensive. Detailed consideration of the documents mentioned earlier is recommended.

It should also be noted that the consultation runs until 20 October 2016. A response paper and further draft legislation should follow in or around January 2017. Clients should, however, consider the issues now, and then review the position in early 2017.