Planning for change - non-UK domiciled individuals post 5 April 2017

The draft legislation released in December 2016 on the taxation of non-UK domiciled individuals clarifies some previously announced changes and also provides some planning opportunities. The objectives are to tax long term UK residents and those who own property in the UK on the same basis as those who were born here and have lived here all their lives. The result of this is that there will be less choice and potentially more UK tax exposure for non-UK domiciled individuals. This document should be read alongside our document "Domicile for UK tax purposes".

Statutory Residence Test

It is possible to be resident in more than one jurisdiction, but an individual can only have one domicile. Citizenship is a separate concept. The basis of exposure to UK taxation is primarily driven by an individual's residence status and so the level of tax paid in the UK will depend on the individual's circumstances, the length of time spent in the UK and ties to the UK.

Action point

Undertake a review of residence status using the Statutory Residence Test for each UK tax year. This is crucial to establish when an individual will become deemed domiciled in the UK.

Remittance basis users - reviewing offshore bank accounts

There are complex rules surrounding the structuring of overseas accounts for individuals claiming the remittance basis. For a simple cash remittance to the UK, the tax rate depends on the contents of the bank account from which the cash is remitted, i.e. income, capital gains, clean capital for each relevant tax year.

If there is a mixture of different sources, the "mixed funds" rules apply, which are punitive in nature and treat the income taxable at the highest rate as being remitted first. Remittance basis users must therefore manage their overseas accounts carefully, ideally reviewing them before initially becoming UK resident. A remittance is still caught by the rules even if made in a later tax year whether or not the individual is deemed UK domiciled at that point.

Action point

As part of the consultation, the Treasury has announced that there will be a two year window of opportunity from 6 April 2017 for individuals to rearrange overseas mixed funds into separate accounts reflecting the source of the monies within. Once separated, there will be no time limit for subsequent remittance of the monies. These rules will only apply to monies held within bank accounts. We recommend that all individuals with mixed funds take steps to re-structure their accounts and ensure that their banking arrangements respect the requirement to keep capital and interest separated going forward.

Business Investment Relief is available to a non-domiciled but UK residents who are claiming the remittance basis. The relief enables an individual to remit foreign income/gains to the UK for the purposes of a qualifying investment without this income being treated as a taxable remittance. More detail is available in our separate flyer on Business Investment Relief.

Action point

Entrepreneurs who are resident in the UK should review how they fund their UK business interests to ensure that they take advantage of these rules where possible.

Rebasing of overseas assets held by long term UK residents

Post 5 April 2017, long term UK residents will become deemed domiciled and therefore subject to income tax and CGT on worldwide assets. As a result, the sale of shares held overseas from this date could create a high tax charge based on a low original acquisition cost, even if the shares were originally acquired when non-domiciled.

Action point

The Treasury has confirmed that it will be possible for individuals who become deemed domiciled on 5 April 2017 (but not on any subsequent date) to rebase their directly held overseas assets to their market value at 5 April 2017, provided that the individual has previously paid the remittance basis charge and that the assets were acquired prior to 8 July 2015. As a result, CGT would only be payable on the increase in value of assets between 5 April 2017 and sale. It is possible to apply rebasing on an asset by asset basis and the opportunity applies to gains subject to both CGT and offshore income gains. Assets acquired after 8 July 2015 are not subject to rebasing and capital gains will be calculated based on their original cost.

Foreign capital loss elections

From 6 April 2008 a foreign capital loss election was introduced to enable non-UK domiciled individuals to claim foreign capital losses. Given the implications of such an election, not all affected individuals made this election and if one is in place, it will expire when that individual becomes deemed domiciled.

Action point

From the date that an individual becomes deemed domiciled they will be able to offset overseas capital losses against UK gains, and vice versa, without restriction. Review the timing of disposals to ensure that maximum tax efficiency is planned.

Residential property and excluded property changes

As a general rule, UK assets are subject to UK inheritance tax ("IHT") wherever their owner is resident or domiciled. A UK resident but non-domiciled individual therefore pays IHT only on their UK assets while non-UK assets for these purposes are regarded as "excluded" property for UK IHT purposes.

Action point

Certain non-UK structures which hold UK assets indirectly may therefore not be subject to IHT. From 6 April 2017 the exclusion will be removed for residential property held indirectly but other assets held in this manner should continue to be excluded property. When calculating the value of assets for IHT purposes, it will be possible to deduct liabilities such as mortgages that are secured directly on the chargeable assets on acquisition; and we recommend that tax advice is sought in relation to any other loans used to fund these structures.

If non-UK trusts are excluded property at the time of creation, they retain that character as long as no changes are made to the trust. As a result, an individual not yet deemed domiciled but who may become deemed domiciled in future should consider establishing a trust before 6 April 2017

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As a result of the UK General Election called for 8 June 2017, the changes outlined above are yet to be enacted and are therefore not officially in operation. Whilst the changes may ultimately apply from 6 April 2017, this will not be confirmed until after the General Election and we therefore recommend that no planning is implemented until after the outcome of the vote.