OLD SQUARE
TAX CHAMBERS

Harriet Brown
Old Square Tax Chambers
15 Old Square,
Lincoln's Inn, London WC2A 3UE
T: (020)7242 2744 F: (020)7831 8095
harrietbrown@15oldsquare.co.uk

CHANGES FOR NON-UK DOMICILES: DEEMED DOMICILE FROM 2017

HARRIET BROWN
BARRISTER AND JERSEY ADVOCATE
OLD SQUARE TAX CHAMBERS

About the presenter

Harriet is an English barrister and Jersey advocate with rights of audience before all courts in both jurisdictions.

She advises taxpayers in relation to UK tax matters, frequently with an international or offshore element. She advises on all tax matters, particularly in relation to individuals and trusts. In addition Harriet regularly negotiates settlements with HMRC on behalf of taxpayers and charities, as well as advising on, and representing taxpayers in, litigation (primarily against HMRC). She also advises on Jersey trusts and tax.

She can be contacted as follows:
Old Square Tax Chambers,
15 Old Square, Lincoln's Inn,
London WC2A 3UE
T: (020)7242 2744 F: (020)7831 8095
harrietbrown@15oldsquare.co.uk
www.taxchambers.com

INTRODUCTION

- These slides are based on Chapter 5 of James Kessler QC's Taxation of Non-Residents and Foreign Domiciliaries: "Deemed Domicile from 2017", with his permission and my grateful thanks

- The changes I am discussing today have been well-publicised, but final details are still not available. To date there have been the following documents:
  - "Technical Briefing on Non-Dom changes" (July 2015) (**"the July 2015 Non-Dom paper")**[1]
  - 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
  - "Reforms to the taxation of non-domiciles: further consultation" (August 2016) ("**the August 2016 consultation paper**")

CURRENT RULES AND SUMMARY OF NEW RULES FOR IHT

- Only deemed domicile for inheritance tax (so rules for IT/CGT will be completely new to those taxes)

- IHTA, section 267 currently provides two rules:
  - Deemed domiciled where a non-domiciled person was domiciled in the UK within the three years immediately preceding the relevant time (the 3-year rule), or

  - 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 (17-year rule)

- In summary there will, from 6 April 2017, be the following rules:

IHT deemed domicile	**Comment**	**IHTA s.**
3-year rule	Unchanged	267(1)(a)
Formerly domiciled resident	New	267(1)(aa)
15-year rule	Was 17-year rule	267(1)(b)
Spouse-election	Unchanged	267ZA

NEW RULES FOR IHT: 15-YEAR RULE

- IHT 15-year rule (IHTA, section 267 will be amended to provide):

A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if ...

(b) he was resident in the UK—

(i) for at least fifteen of the twenty tax years immediately preceding the tax year in which the relevant time falls, and

(ii) for that tax year or, if he was not resident in the UK for that tax year, for at least one of the four tax years immediately preceding that tax year

- Domicile start date: 6 April in the tax year *after* the 15/20 year test is satisfied. (That is different from the start date of the current IHT 17-year rule)

- Domicile end date: once an individual has been non-resident for more than four *consecutive* years (but if the individual has not been UK resident for 15 consecutive years, then the condition in (i) may not be satisfied)

NEW RULES FOR IHT: FORMERLY DOMICILED RULE

- Further amendments to section 267 will mean it will provide that a non-domicile will be deemed domicile where he is a formerly domiciled resident for the tax year in which the relevant time falls ...

- Formerly domiciled resident will be defined in IHTA, section 272 as meaning a person meeting the following criteria:
  - born in the UK
  - domicile of origin was in the UK
  - resident in the UK for that tax year, and
  - resident in the UK for at least one of the two tax years immediately preceding that tax year.

- The July 2015 Non-Dom paper said:

[a] returning UK domiciliary will not benefit from any favourable tax treatment in respect of trusts set up while not domiciled here (whether inheritance tax treatment or otherwise)

- Domicile end date: 6 April in the first year of non-residence

FORMERLY DOMICILED RULE: TRUST OF FORMERLY DOMICILED RESIDENT

- A new IHTA, section 48(3E) will provide:

In a case where the settlor of property comprised in a settlement is not domiciled in the UK at the time the settlement is made, the property is not excluded property by virtue of subsection (3) or (3A) above at any time in a tax year if the settlor was a formerly domiciled resident for that tax year.

- The September 2015 condoc provides:

… if an individual caught by this test acquires an overseas domicile and then sets up an offshore trust while non-UK domiciled, once that individual becomes UK resident the assets in that trust will cease to qualify as excluded property and would be liable to inheritance tax charges

…

If someone is frequently coming and going from the UK, the property in the trust will be excluded property one year and relevant property in the next year. The government accepts this position as it would allow individuals flexibility to move in and out of the UK as and when necessary. However, trustees will need to consider whether a ten year anniversary charge arises at any point during each period the settlor is UK resident.

NEW RULES: IT AND CGT

- For IT and CGT from 6 April 2017 there will be:

IT/CGT deemed domicile	**Comment**	**s.835B ITA**
Formerly domiciled resident	New	Condition A
15-year rule (differs slightly from IHT rule)	New	Condition B

- Will be brought in by a draft ITA, section 835B, which will provide:

(1) This section has effect for the purposes of the provisions of the Income Tax Acts or TCGA 1992 which apply this section.

(2) An individual not domiciled in the UK at a time in a tax year is to be regarded as domiciled in the UK at that time if—

(a) condition A is met, or

(b) condition B is met.

- Applies to provisions that apply section 835B, which are listed in the draft legislation as:

Income tax

ICTA: s.266A

ITEPA: s.355, 373, 374, 376

ITA: s.476, 718, 809B, 809E, 834

CGT

TCGA: s.69, 86, 275

FA 2008 transitional reliefs (formerly domiciled residents only):

paragraphs 100(1)(b), 101(1)(c) and 102(1)(e),

paragraph (b) of paragraph 118(3) so far as having effect for the purposes of paragraph 118(1)(d), and

paragraphs 124(1)(b), 126(7)(b), 127(1)(e) and 151(1)(b).

IT AND CGT: CONDITION A

- Condition A is that—
  - the individual was born in the UK,
  - the individual's domicile of origin was in the UK, and
  - the individual is resident in the UK for the tax year

- This is the equivalent of the IHT formerly domiciled resident rule.

- Domicile start date: there is no equivalent to para (d) of the IHT rules (a grace period of one year). So the domicile start date is 6 April in the 1st year of residence. In that year, 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, which is the same as the IHT rule

IT AND CGT: CONDITION

- Condition B is that the individual has been UK resident for at least 15 of the 20 tax years immediately preceding the tax year

- This is the equivalent of the IHT 15-year rule and the domicile start and end dates are aligned.

SPLIT YEARS: INCONSISTENCY

A tax year for which the individual is UK resident will count in full (regardless of whether the year is a split year under the SRT):

It follows that there is a mismatch in the overseas part of a split year:

(1) For IT/CGT: Foreign income and gains in the overseas part of the year are not taxed;

(2) For IHT: Foreign situate property is non-excluded property even in the overseas part of the year

CGT 2017 REBASING

- The August 2016 consultation paper provides:

The government agrees that it would be punitive to require long-term resident non-doms to pay CGT on gains that have accrued on foreign assets held while the individual was a non-dom. To address these concerns, Budget 16 announced that those individuals who will become deemed-domiciled in April 2017 because they have been resident for 15 of the past 20 years will be able to rebase directly held foreign assets to their market value on 5 April 2017

- The relief will not be available to those who become deemed domiciled after 2017. Someone who would be deemed domiciled but for being non-resident in 2016/17 might be able to arrange to be UK resident during the year, in order to qualify

- The August 2016 consultation paper continues:

… any further increase in the value of an asset between April 2017 and the date of disposal will be charged to CGT in the normal way.

Rebasing will apply on an asset by asset basis and there will be no requirement that any part of the sales proceeds relating to the part of the gain which arose before April 2017 should be left outside the UK. Where the asset was originally purchased with clean capital, the entire proceeds from the disposal can be brought to the UK without triggering a remittance … [t]he protection will be limited to those assets which were foreign situs at the date of the Summer Budget 2015

2017 Mixed Fund Segregation Relief

- The August 2016 consultation paper provides:

The government recognises that the mixed fund rules can (!) be complicated, and that these reforms will mean that those non-doms who become deemed-domiciled in April 2017 who were taxed on the remittance basis will have to pay tax in the UK on their offshore income and gains on an arising basis for the first time. It will also mean that an individual with a mixed fund will find it difficult to bring any money from the fund into the UK without paying tax at their top rate of tax when they do so. For some, this will be a punitive outcome, as the fund will be comprised of a mix of both foreign income which would be taxable at the highest rate of tax as well as money that would be taxable at a lower rate; for example, foreign gains which would be taxed at a top rate of 28% or clean capital, which would not be taxable at all even when remitted

- The relief will, broadly, be along the following lines:

The government has therefore decided to introduce a temporary window in which such individuals will be able to rearrange their mixed funds overseas to enable them to separate those funds into their constituent parts. This window will last for one tax year from April 2017 and it will provide certainty on how amounts remitted to the UK will be taxed.

During this time, non-doms with mixed funds will be able to rearrange their mixed funds and separate out the different parts. This will mean, for instance, that they will be able to move their clean capital, foreign income and foreign gains into separate accounts, and will then be able to remit from their accounts as they wish and pay the appropriate amount of tax … This will mean that an individual who separates their mixed funds may, if they wish, remit funds from each separated fund, even if that remittance takes place in a later tax year after the transitional period has ended.

The special treatment will only apply to mixed funds which consist of amounts deposited in bank and similar accounts … an individual will be able to sell any overseas asset during the transitional window and separate the sale proceeds in the same way as any other money.

Cleansing will not be available where an individual is unable to determine the component parts of their mixed fund …

- Draw up mixed funds accounts now so that the data is ready when needed!

"PROTECTED" TRUSTS

- Special rules apply to a trust made by a settlor at a time when:
  - Not UK domiciled; and
  - Not deemed domiciled under the IT/CGT 15-year rule (including all pre 2017 trusts as this rule does not begin to apply until 2017/18)

- The proposed rules are summarised in the August 2016 consultation paper:

... the legislation does not extend to the settlor of a non-resident trust who is deemed-domiciled where the trust was set up before they became deemed-domiciled and no additions of property have been made since that date. However, if the settlor, their spouse, or their minor children and/or stepchildren receive any actual benefits from the trust then the protection will not apply.

- In short, protected trust status will impact upon:
  - TCGA, section 86: will not apply where 6 conditions are met
  - ITTOIA, section 624: the legislation at section 624 does not apply to a deemed-domiciled settlor on foreign income arising to a non-resident trust that they had set up before becoming deemed-domiciled, if the income is retained within the trust where conditions broadly similar to those for the section 96 relief in TCGA, Schedule 5, paragraph 5A are met

COMMENCEMENT AND TRANSITIONAL PROVISIONS

- Para 11(1) of the draft schedule which will go into the FA 2017 provides that the amendments made by paragraph 10 have effect in relation to the tax year 2017-18 and subsequent tax years

- IHT 5 –year rule: the July 2015 Non-Dom paper provides that for those who leave the UK before 6 April 2017 but would nevertheless be deemed domiciled under the 15 year rule on 6 April 2017 the present rules will apply

- Thus clause 2 of the draft legislation provides:

(10) The amendment to section 267(1) of IHTA 1984 made by subsection (1)(c) [inserting the 15 year rule] does not have effect-

(a) in relation to a person who has not been resident in the UK after 5 April 2017;

(b) in determining-

(i) whether settled property which became comprised in the settlement on or before that date is excluded property for the purposes of IHTA 1984;

(ii) the settlor's domicile for the purposes of section 65(8) of that Act in relation to settled property which became comprised in the settlement on or before that date;

(iii) whether, for the purpose of section 65(8) of that Act, the condition in section 82(3) of that Act is satisfied in relation to such settled property

- Long term remittance basis taxpayers who will be caught by the 15-year rule may wish to arrange to be non-resident from 2017/8 if that is practical.

- Although there is no grandfathering this is not retrospective in that it does not impact on past actions taken. For example: a trust settled on 17 January 2017 when an individual is not deemed domiciled under either the current 17-year rule or the 3-year rule but would be under the proposed 15-year rule will continue to be excluded property after 5 April 2017

COMMENCEMENT AND TRANSITIONAL PROVISIONS: IHT FORMERLY DOMICILED RULE

- No transitional relief!

COMMENCEMENT AND TRANSITIONAL PROVISIONS: CGT AND IT

- The February 2016 policy paper explains the situation in relation to pre-2015 non-residents:

The part of the measure affecting capital gains tax in respect of foreign chargeable gains accruing to temporary non-residents will not affect accruals arising in respect of periods of temporary non-residence beginning on or before 7 July

- Draft provisions in this respect have been provided

- For employment income, the August 2016 consultation paper provides:

Some stakeholders sought clarification of the tax treatment which would apply where an individual who is subject to the remittance basis receives employment income relating to a period when they were not deemed-domiciled under the 15 out of 20 rule but is paid after they become deemed-domiciled... the government can confirm that such income will be taxable only to the extent that it is remitted to the UK. This is in line with the current treatment, which currently applies to deferred payments made after an individual ceases to be taxed on the remittance basis.

- In relation to deemed domicile for 2017 non-residents the draft legislation, clause 1(3) provides:

The amendments made by this section [IT/CGT deemed domicile] and Schedule 1 do not have effect in relation to a person who has not been resident in the UK after 5 April 2017.

What Next?

- The changes will be legislated in Finance Bill 2017
- Consultation is not closed until 20 October 2016
- You should consider client's position now so it is ready for review in early 2017