UK Summer Budget 2015
Offshore aspects for foreign domiciliaries and their Trustees

The most significant changes are set out below including changes affecting individuals who are resident, but not domiciled in the UK. Further Briefings will follow in due course as more clarity emerges on these issues. Onshore aspects of the UK Summer Budget 2015 are set out in a separate Briefing Note.

1. New "deemed domicile" rule after 15 years

- Currently, individuals who are resident and domiciled in the UK are taxed on their worldwide income and gains but, broadly speaking, non-domiciliaries are able to claim the remittance basis of taxation with the advantage that foreign income and gains are not taxed provided they are not remitted to the UK.

- From 6 April 2017, however, any non-UK domiciliary (including someone who is already here) who has been resident for more than 15 out of the past 20 tax years will be "deemed" to be domiciled in the UK for all tax purposes. This includes Inheritance Tax (IHT), the rules for which were previously 17 out of the past 20 years. The 15-year rule will not affect their domicile position generally, only the UK tax treatment. Nor will it affect the domicile of the individual's children, whose domicile under general law and deemed domicile for tax purposes will be treated separately by reference to the child's own individual circumstances.

- A technical consultation is expected to be published later in the year between HMRC and interested parties with changes legislated in Finance Bill 2016 and introduced from 6 April 2017. From then on, non-UK domiciliaries will be taxable on their worldwide income and gains and will pay IHT on their worldwide assets in the same way as a UK domiciled taxpayer. Consultation points will include whether split years of UK residence count towards the 15 years for this purpose or whether complete tax years of UK residence are required.

- It is apparent that excluded property trusts set up before becoming deemed domiciled will still be effective for UK tax purposes (subject to the announcements in relation to UK residential properties held in offshore companies – see paragraph 3 below).

- These proposed reforms mean the £90,000 Remittance Basis Charge or RBC payable by those resident for 17 out of the last 20 years will become redundant as such individuals will be taxable on an arising basis after 15 years. The £30,000 and £60,000 RBC remain unchanged though.

2. Returning UK domiciliaries – new rules from April 2017

- Subject to the consultation process and legislative timetable referred to above, new rules to be introduced by the Government are intended to restrict the ability of individuals who had a domicile of origin in the UK, but who have since acquired a foreign domicile abroad, to return to the UK even for a brief period of residency without losing their non-domicile status for tax purposes.

- Individuals born in the UK with a UK domicile of origin will not be able to benefit from the non-domicile taxation regime at any time that they are UK resident (including individuals who are currently UK resident).

- An excluded property trust set up while non-domiciled will cease to be effective after becoming UK resident. This means that IHT will be payable on the Settlor's death if he is a beneficiary.

3. IHT on enveloped residential property

- The Government have introduced anti-avoidance measures to target the ownership of UK residential property held directly or indirectly by non-UK domiciled individuals or their excluded property trusts. Currently, UK residential property held by non-resident companies can benefit from the excluded property status of the shares in the non-resident companies for IHT purposes. Excluded property, held by non-domiciled individuals or trusts created by non-domiciled individuals is currently outside the scope of IHT offering a significant advantage over UK domiciled individuals.

- From 6 April 2017, all UK residential property held indirectly by non-domiciliaries or excluded property trusts through vehicles such as companies, foundations or partnerships will be subject to IHT. The rules will apply to non-residents as well as UK residents. It is intended the IHT charge will be based on the Annual Tax on Enveloped Dwellings (ATED) Rules with the proposals going further than ATED with no minimum threshold and with no availability of the various ATED reliefs such as the charge applicable to properties held by offshore companies (and certain other entities) that are commercially let to unconnected parties. The value of any relevant entity will come within the scope of the new IHT charge for any chargeable event. This would include the death of the individual or the transfer of the shares to the trust, or where there is a gift of the shares to an individual where the transferor dies within 7 years of having made the gift. Additionally, there will be a tax charge on non-resident trustees on every 10-year anniversary or if the shares are distributed by the trustees.

- It is apparent that there will be no benefit in holding UK residential property through closely controlled non-resident companies, partnerships or similar structures which will be within the new rules, although the current proposals do not affect commercial property, which will remain unaffected. Complications already identified include circumstances in which the non-domiciliary or excluded property trust does not wholly own the relevant company or entity.

- There may be limited scope for non-residents and non-domiciles to benefit from the anticipated increase in the IHT nil rate band of £100,000 in 2017/18 rising to £175,000 in 2020/21 for individuals who pass their family home onto their children or grandchildren on death. This is set out in more detail in our separate Briefing Note on Onshore Aspects of the 2015 Budget.

4. Reduced tax relief for investors in residential property

- All buy to let landlords are currently able to offset the interest paid on mortgages taken out to acquire their buy to let properties, against their tax profits. Currently, individual landlords can deduct all of their finance costs (mortgage interest, interest on loans to buy furnishings and fees incurred when taking out or repaying mortgages or loans) from their rental income received to determine taxable profits on their rental investments. This means relief is currently given at the individual’s marginal rate of Income Tax (20%, 40% or 45%). Tax relief available on interest payments for individual landlords against income from residential properties both in the UK and abroad will be restricted to the basic rate of Income Tax (20%) for all individuals. The changes, which will affect any higher and additional rate taxpayers, will be introduced gradually between April 2017 and April 2021.

- This will have a significant impact on property investors, particularly those relying on rental profits as their main source of income. This is also likely to result in increased rents if the landlord is no longer able to achieve the same return on their investment.

- It is unclear how this will affect trusts. Some clients may want to consider carrying on their property letting business through a company.

5. Dividends

A significant change was also announced to the way in which dividends are taxed. From April 2016, the system of applying a “10% notional credit” to dividends will be abolished and replaced with a new annual Dividend Tax Allowance of £5,000 (which the commentary states will be available to all taxpayers). Above this amount, dividends will be taxed at a rate of 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

6. Tax avoidance and General Anti-Abuse Rule (“GAAR”)

- Following other announcements in earlier Budgets in this respect, the Government are seeking to introduce more measures aimed at tackling tax avoidance. As part of the consultation process, new measures are being considered for serial avoiders who persistently enter into tax avoidance schemes, which are defeated, and to strengthen GAAR.

- The proposals are that the penalties will be proportionate to the amount of tax recovered and individuals who continue to use tax avoidance schemes caught by GAAR will be “named and shamed”.

- HMRC will receive more funds to use information received under the Common Reporting Standard from 2017 to tackle tax avoidance and pursue criminal investigations of wealthy taxpayers and a specialist recourse will be established to focus on non-compliance by trusts, pension schemes and non-domiciled individuals.

These changes will require all structures / planning for non-domiciled individuals (including some non-residents) to be carefully reviewed and, in many cases, restructured.

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