ROOKS RIDER SOLICITORS

Changes to the Taxation of Non-UK Trusts

Background

In the July 2015 Budget, the Government announced various changes to the taxation of UK resident individuals who were not domiciled in the UK. As part of the original proposals, the Government suggested that the non-UK income and capital of non-UK resident trusts created by an individual who became deemed domiciled under the new rules would not be taxed on the individual following the changes (with the IHT position also remaining unchanged). However, the original proposals were not clear on how benefits or distributions from those trusts would be taxed.

The Government has now outlined that they plan to adapt the existing anti-avoidance legislation that already applies to income and capital gains arising from non-resident trusts. The adapted legislation will provide certain protections for trusts established before the Settlor becomes deemed domiciled, provided that no-one from the Settlor's immediate family receives any benefit from the trust. It should be noted that none of these protections apply to trusts created by individuals who become deemed domiciled because they were born in the UK with a UK Domicile of Origin and are resident in the UK.

The proposals are discussed in more detail below.

Inheritance Tax ('IHT')

Currently, a trust established by a non-domiciled individual before they become deemed domiciled is outside the scope of IHT, provided the trustees do not hold UK assets directly. From 6 April 2017, this benefit is largely retained but subject to two exceptions:

1. Where the Settlor is non-UK domiciled when they settled the trust, but will be treated as UK domiciled whilst resident in the UK because they were born in the UK with a UK domicile of origin. This is outlined in more detail in our Briefing Note entitled: "*A New Deemed Domicile Rule for formerly Domiciled UK Residents – Returning Ex Pats*".

2. Any trust which holds UK residential property after 5 April 2017. These changes are discussed in more detail in our Briefing Note entitled: "*IHT: UK Residential Property held through Non-Resident Trust Structures*".

Capital Gains Tax ('CGT')

Currently there are two regimes for the CGT treatment of offshore trusts. The first, which applies to UK resident and domiciled settlors who can benefit under the trust, treats the offshore trust as transparent and taxes the capital gains made by the trustees on the Settlor (known as 'the Settlor Regime'). Under the CGT rules, the Settlor retains a benefit under a trust unless, essentially, they, their spouse, children and grandchildren are excluded from benefit.

The other regime (known as 'the Beneficiary Regime') applies to trusts where the Settlor cannot benefit, or is non-UK domiciled or non-UK resident or dead. Under this regime, capital gains are calculated on each of the disposals made by the trustees and go into a notional pool which can be matched to capital benefits received by beneficiaries. The Beneficiary Regime also has a valuable relief that applies to distributions made to non-UK domiciled beneficiaries that generally allows assets held by the Trustees in April 2008 to be rebased to their value on that date. In certain circumstances, this means that only capital gains arising after that date can be matched to capital payments or benefits, and only capital payments made or benefits received after 5 April 2008 will trigger a capital gains tax charge when matched to capital gains. It seems that this will continue to apply to distributions to actual non domiciled beneficiaries, even after they have become deemed domiciliaries.

Under the new changes, it is proposed that any trust established by a settlor who becomes deemed domiciled will be under the Settlor Regime rather than the Beneficiary Regime as it is currently, unless the settlement is a 'protected settlement'. The rebasing election referred to above will not apply to any capital gains realised under the Settlor Regime, and so there could be significant capital gains tax charges on settlors when assets are disposed of which have been held for a long time. Benefits conferred on beneficiaries, rather than the Settlor, would still be taxable on them under the Beneficiary Regime to the extent they are not taxed on the Settlor.

A settlement will be a Protected Settlement as long as it was created before the Settlor becomes deemed domiciled in the UK and no additions are made until a benefit is received by the Settlor, his spouse or cohabitee or his minor children or grandchildren (including stepchildren). Under the current proposals a benefit will result in the protections being lost for good. (There is a limited ability for additions to be made to meet running expenses without losing protected status). The interaction between these two regimes will be complex, however it may be worthwhile rebasing asset values and realising capital gains prior to 6 April 2017 for some trusts. Interest-free loan arrangements will need to be reviewed.

Income Tax

Under the current regime, UK resident and non-domiciled settlors of non-resident trusts are taxed on the arising basis in relation to UK source income and can claim the remittance basis in relation to the non-UK source income if either or both of two anti-avoidance regimes apply; the Settlement Provisions and the Transfer of Assets regime. Both regimes apply if the Settlor or his spouse retain a benefit in the structure (although the Transfer of Assets regime is subject to a motive defence).

Under the changes due to come into effect in April 2017, it is proposed a deemed domiciled settlor will be taxed on the non-UK source income, unless the income is 'protected'. The income will be protected for as long as the Settlor, his spouse, cohabitee and minor children or grandchildren (including stepchildren) do not receive any benefits and no additions are made after the Settlor becomes deemed domiciled. (As with the CGT provisions, there is a limited ability for additions to be made to meet the running expenses without losing protected status).

It appears that in contrast to the CGT rules however, a settlement may be able to move between being protected and not protected in different years. The effect of this would be that the Settlor would only be taxed on the non-UK income for the year of the benefit and to the extent the benefit could be matched to retained protected foreign income in the structure.

Non-UK Resident Companies

There is little discussion on non-UK resident companies in the consultation documents either in isolation or in the context of underlying companies of non-resident trusts. Currently where the anti-avoidance Transfer of Assets Abroad rules apply to offshore companies, UK income will be taxable on the Transferor and the non-UK income will be subject to the remittance basis. The offshore company will similarly be transparent (if anti-avoidance provisions apply) as regards capital gains made by the company with UK capital gains taxable on the arising basis and non-UK capital gains subject to the remittance basis.

For a deemed domiciled transferor, they will become taxable on both the UK and non-UK capital gains going forward unless they can establish that the offshore company was established for a reason other than tax avoidance.

Further detail on the charges may be published with the Autumn Statement on 23rd November and the Finance Bill on 5th December 2016.

For further information on any of the issues raised in this Briefing Note, please contact a member of the Rooks Rider Solicitors Wealth Planning Team.

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