BRIEFING

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All Change for Non-Doms and Offshore Trusts – Are You Ready?

It has been a tumultuous two year period for non-UK domiciled individuals ("**Non-Doms**") since the government first announced it was considering (yet again) transforming the tax rules.

The government published the draft Finance Bill (No.2) on 8 September 2017, which will have its second reading in the House of Commons on Tuesday 12 September. Whilst there are no substantive changes to the draft legislation published in July, it is important to note that a number of the provisions will take retroactive effect from 6 April 2017. All non-doms and offshore trustees should consider what action they need to take now. We provide a broad overview of the changes in this briefing.

UK Residential Property

UK residential property, however held, will be subject to UK Inheritance Tax ("**IHT**"). Furthermore loans used to finance the acquisition of UK residential property will also be brought within the scope of IHT.

This means that (i) many offshore structures for the first time will be subject to tax and filing requirements under the IHT relevant property regime, and (ii) individuals and structures which have lent funds for property purchases will have potential IHT liabilities to consider.

There is no longer an IHT benefit to using an offshore company to hold UK residential property, and where relief from the Annual Tax on Enveloped Dwellings (ATED) is not available; it will usually make sense to unwind the structure. Advice should be sought before "de-enveloping" a property to ensure that this is done in the most tax efficient manner and the correct UK tax filings are made.

Changes to Domicile

Formerly Domiciled Residents (UK domiciliaries)

From 6 April 2017, individuals who were born in the UK with a UK domicile of origin are treated as UK domiciled for income tax and capital gains tax purposes whilst they are resident in the UK. For IHT purposes, such individuals will be treated as UK domiciled after they have been UK resident for one year (as a "**formerly domiciled resident**").

Non-UK domiciled individuals can establish so called "excluded property trusts" to protect assets from IHT. Any excluded property trusts established by a formerly domiciled resident will fall within the scope of IHT (under the relevant property regime) whilst such individuals are UK resident. Formerly domiciled residents do not benefit from the rebasing relief or the cleansing mixed funds opportunity discussed below.

Deemed Domicile

From 6 April 2017, individuals with a non-UK domicile of origin will be treated as deemed domiciled in the UK for all UK tax purposes once they have been resident for 15 out of the previous 20 tax years (the "**15 year rule**"). A deemed domiciled individual will no longer be able to claim the remittance basis or establish a trust that will be outside the scope of IHT. It is important to note that the new 15 year rule does not prevent HMRC from claiming that an individual has acquired a domicile of choice in the UK before 15 years of UK residence, under the common law test. We therefore recommend that every individual who

relies on their non-domicile status for tax purposes (e.g. to claim the remittance basis) obtains a domicile report from their advisor and records their ties to their country of domicile. This advice will need to be updated regularly.

Rebasing

A long term non-dom affected by the 15 year rule can rebase his or her personally held offshore assets as of their market value on 5 April 2017. This relief can be used to dispose of assets and remit clean capital (which is not subject to UK tax) to the UK. The individual has to have claimed the remittance basis and paid the remittance basis charge in order to benefit from this relief. Deemed domiciled individuals who have not claimed the remittance basis historically need to carry out an analysis to see if it would be worth paying the remittance basis charge by 31 January 2018, in order to benefit from this relief. Individuals who become deemed domiciled in subsequent tax years will not benefit from this rebasing relief.

Cleansing Mixed Funds

It is usually not possible for a non-dom to separate out income, capital gains and clean capital when such funds are all held together in a "mixed fund" bank account. However, all non-doms who have claimed the remittance basis will have the opportunity until 5 April 2019 to separate out the different elements of a mixed fund and be able to remit the clean capital to the UK. The rules to take advantage of this opportunity are complicated and specialist advice should be taken. There are significant planning opportunities for individuals who can use both the rebasing relief and this cleansing opportunity. These are "one-off" opportunities for affected individuals to preserve and use clean capital in the UK tax efficiently and so advice should be sought well before the 5 April 2019 deadline.

Offshore Trusts

Excluded property trusts established before an individual became deemed domiciled under the 15 year rule will retain their beneficial status for IHT purposes.

Protected Trusts and Tainting

Offshore trusts can provide a tax efficient way for non-doms to "roll up" income and gains realised on assets offshore. This advantageous treatment can still be preserved once the settlor becomes deemed domiciled provided further funds are not added (directly or indirectly) by the settlor or the trustees of another trust of which the settlor is a settlor or beneficiary. Such an addition will "taint" the trust and (from 6 April 2017) cause the income and gains of the trust to be taxable on the settlor on an arising basis; as if the settlor owned the assets personally.

Special care will be required to ensure that trusts are not accidentally tainted, which will include a review of all loans to the trust from the settlor and from any other trusts of which the settlor is also a settlor or a beneficiary. The HMRC official rate of interest will need to be paid each year on a loan by the settlor to the trustees to prevent tainting. There is a grace period until 5 April 2018 for loans that would taint the trust to be updated.

Impact on beneficiaries

Benefits from offshore trusts such as loans, use/occupation of land, artwork and yachts now have specific rules regarding how they are valued. Deemed domiciled beneficiaries will now be taxable on benefits received from offshore trusts (to the extent they are matched with trust income and gains), regardless of whether they are received inside or outside the UK.

Income arising within a trust or offshore company held by a trust will not be treated as taxable on the settlor (unless the trust is tainted). However, when such income is received by a close family member of the settlor (such as a spouse or minor child) who is not immediately subject to tax (due to non-UK residence or the availability of the remittance basis), this can be charged on the UK resident settlor.

Whilst not included in the Finance Bill, the Government has announced its intention to stop offshore trustees being able to match offshore trust gains with distributions to non-UK resident beneficiaries from 6 April 2018. Historically trustees have been able to reduce trust gains by making distributions to non-UK resident beneficiaries, enabling them to make more tax efficient distributions to the UK resident beneficiaries. Trustees now need to consider whether to make a distribution (and potentially a larger distribution) to non-UK resident beneficiaries this tax year, to make use of this

opportunity before it falls away.

Further anti-avoidance rules that the government plans to introduce from next April include an anti-conduit rule, to prevent a non-UK resident individual gifting offshore trust distributions to a UK resident beneficiary, free from tax. It is also intended that benefits provided by offshore trusts to close family members, should be chargeable on UK resident settlors when matched to trust level income, and trust gains.

Requirement to Correct

Individuals need to ensure that their UK tax affairs relating to offshore assets are correct before 30 September 2018. If any inaccuracies are not corrected by this deadline, they will face increased penalties of up to 200% of the tax due. The most serious cases could also see a penalty on the value of the relevant assets, in addition to HMRC's naming and shaming powers.

This harsher regime of penalties can apply to innocent mistakes, subject to the "reasonable excuse" defence; a narrow category which does not include reliance on generic professional advice. Given the complexity of the UK tax rules and the severity of the new regime, it is imperative that individuals ask their advisors to review any areas of uncertainty.

For further information, please contact:

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