

Proposed reforms to UK tax legislation post 6 April 2017

A number of significant reforms to the UK tax system were announced in summer aimed primarily at foreign domiciled persons and their offshore interests.

The aim of the proposals is to ensure a consistent tax treatment between UK domiciled individuals and foreign domiciliaries who are long-term UK tax residents. The new reforms will come into effect from 6 April 2017.

At present we have only been issued with draft legislation in respect of the new proposals. It is anticipated that there will be very little time between the issue of the full legislation and the enactment of the proposals. Therefore, if any planning is to be done it must be undertaken as soon as possible.

The information set out below is based on the current draft legislation but this is subject to change.

New proposals

At present two specific changes are being proposed:

- A new 'deemed domicile' status for income tax, capital gains tax and inheritance tax when an individual has been resident in the UK for at least 15 out of the previous 20 tax years - the 15 year rule.
- 2. Extension of the UK inheritance tax rules to catch UK residential properties held through overseas structures.

The changes proposed will have a significant impact going forward. The key aspects of the changes are outlined below.

1. The new 'deemed domicile' position

The new 'deemed domicile' status will apply for the following categories of individuals:

- Foreign domiciliaries who have been tax resident in the UK for 15 out of the last 20 years – long-term foreign residents
- Individuals, who were born in the UK with a UK domicile of origin, then left the UK and acquired a domicile of choice elsewhere but later return to the UK - 'the formerly domiciled resident'

Income tax and capital gains tax

Currently, it is possible for foreign domiciliaries to limit their exposure to UK tax by electing to be taxed on the remittance basis – this means that they are only taxed in the UK on foreign income and gains to the extent they are remitted to the UK.

The above changes will remove the option of the remittance basis of taxation for long-term residents and those returning to the UK who have a UK domicile

of origin. This means they will be assessable to UK income tax and capital gains tax on their worldwide income on an arising basis.

Inheritance tax

There is a 'deemed domicile' rule for inheritance tax at present where an individual has been resident in the UK for not less than 17 out of the last 20 years. Prior to this point, any non-UK domiciliary is taxed only on their UK source assets. After the 17 year has been breached, they will be assessable to inheritance tax on their worldwide assets.

These rules will be replaced with the new deemed domicile 15 year rule.

The above rules will replace the current legislation and apply for all taxes i.e. income tax, capital gains and inheritance tax.

Transitional provisions

There are two transitional provisions which have been brought in to help long-term resident foreign domiciliaries 'ease' into the new regime being:

- a) Mixed Fund cleansing this enables any mixed bank accounts (comprising untaxed foreign income gains and clean capital (which will never be taxed) for example) to be separated into their different components and transferred into new accounts in order that they can be remitted in the most tax efficient manner. This applies to all non-domiciliaries who have claimed the remittance basis in the past. Detailed examples of how this works will be published in spring.
- b) Capital gains tax rebasing if the individual has paid the remittance basis charge at some point they will be able to rebase all their foreign assets for capital gains tax purposes to the market value as at 5 April 2017, thus eliminating any historical gains. There have been comments in the Spring Budget that the need to pay the remittance basis charge was omitted but this has not been clarified. This also applies to assets that are subject to an income gain i.e. non-reporting funds but not offshore income gains on foreign life policies.

Impact of offshore trust structures

Income and capital gains tax

The impact the new rules will have on offshore trust structures depends on the terms of the trust, when it was set up and whether it has been tainted post 6 April 2017.

Trusts created pre 5 April 2017 and trusts created post 6 April 2017 by an individual who is not deemed domiciled in the UK under the 15 year rule have protected status – they are seen as 'golden trusts'. However, if these are tainted by any additions post 6 April 2017 (when the settlor is deemed domiciled under the 15 year rule) this will cause the entire trust to be tainted going forward and will lose this protected status.

Additions include the provision of an interest-free or uncommercial loan to the trust by the settlor, but does not include transferring funds into the trust to enable fees to be paid.

A summary of the tax treatment of various different trusts post 6 April 2017 is set out in Appendix A.

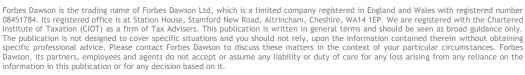
• Inheritance tax

Offshore trusts, settled at a time when the settlor was neither domiciled nor deemed domiciled in the UK for inheritance tax purposes, have a beneficial status as they are termed 'excluded property trusts'. This means they are outside the scope of UK inheritance tax to the extent they hold foreign assets.

Where trusts are/were settled on an excluded property trust prior to the settlor becoming 'deemed domiciled' under the new 15 year rule, the assets will retain their beneficial inheritance tax status after the settlor attains deemed domicile status.

However, if the trust was settled by an individual who falls within the formerly domiciled resident rules the position is much less favourable. The assets in these trusts will lose their excluded property status for any tax year in which the settlor is UK resident in one of the previous two tax years.

These latter trusts will be liable to inheritance tax charges being 10 year charges and exit charges on worldwide assets. However, they could fall in and out of the inheritance tax regime, dependent upon the settlor's residence status.





Structures should be reviewed as soon as possible to establish the potential impact these changes will have. Further additions to any trusts should be considered either pre 5 April 2017 or before the settlor becomes deemed domiciled in the UK under the new 15 year rule.

 Settlor interested trust - distributions to beneficiaries

Previously, the income of this type of trust would have been assessed to tax on the settlor but often they would have claimed the remittance basis. On this basis this income remained untaxed in the trust but could not be assessed on anyone else except the settlor. This historical untaxed relevant income at 5 April 2017 will move into a new pool and can only be matched to benefits and payments made post 6 April 2017 to any beneficiaries, including the settlor. It can be matched to payments made prior to 5 April 2017 to beneficiaries except the settlor.

These monies can now be invested in the UK by the trust or the underlying company without it causing a remittance taxable on the settlor. (Previously this was deemed to be a remittance)

From 5 April 2017, capital gains will be matched to any benefit/payment made after all the relevant income has been matched. It will no longer be possible to match stockpiled gains to payments to non-UK residents.

As there is likely to be significant amounts of untaxed historical income in the trusts, if the settlor has claimed the remittance basis, it means payments to beneficiaries are much more likely to be taxed to income than capital gains.

Where trusts are tainted, the income and gains arising to a settlor interested trust post 5 April 2017 will be taxed on the settlor on an arising basis. It is unclear how the taxation of UK residential property will interact with the gains being assessed on the settlor, as to whether the settlor will be assessed on all the historical gains pre 5 April 2015 (that would otherwise have been stockpiled).

Is it worthwhile bringing forward any gains to pre 5 April 2017 if the settlements are likely to be tainted post 5 April 2017?

 Non-settlor interested trust – distributions to beneficiaries These trusts will continue to be taxed as before. Any income arising that is not distributed will become relevant income and is matched to payments/benefits made.

Payments to non-UK resident beneficiaries cannot reduce the relevant income pool. When they are made to a non-resident or non-domiciled beneficiary (under the remittance basis) who is a close relative of the settlor, the income or gains will be assessed on the settlor.

Payments/benefits are only matched to capital when the relevant income has been fully matched at the time the payment is made.

Payments to non-UK resident beneficiaries will not reduce the stockpiled gain pool post 5 April 2017 but can do so if made before this date.

2. Extension of UK inheritance tax rules to UK residential properties held through overseas structures

Holding UK assets through a foreign registered company acts as an inheritance tax shelter as the individual or trust holding the shares is treated as holding a foreign asset; the foreign shares.

From 6 April 2017, where UK residential property is held through such an offshore structure, specific rules will bring the value back into charge to inheritance tax. UK residential property will include existing dwellings as well as land purchased 'off plan'.

A summary of the key proposals is set out below:

- The value of UK residential property held through an offshore company or a partnership, whether directly or indirectly held, will be liable to UK inheritance tax post 6 April 2017.
- There is a let out in the draft legislation where a 'qualifying interest' held in the company or partnership is less than 5% (previously 1%), although we expect these instances will be few and far between.
- Loans made to finance the acquisition or maintenance/improvement of UK residential property (directly or indirectly) by an individual, partnership, trustee or close company will also be caught by these new rules and will be

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deemed to be an interest in UK residential property.

- Other interests may be caught to the extent that its value is attributable to any rights of a creditor or to any collateral or security for a loan used to acquire UK residential property. These rules are potentially being relaxed but it is expected only to restrict the value of the collateral that is subject to the charge, to the value of the loan it is securing.
- The proceeds received for the disposal of shares in a close company, the disposal of an interest in a partnership or the repayment of a 'relevant loan' remains within the charge of inheritance tax for a two year period. The sale of a property directly will not be caught by this two-year tail.

These changes will have a HUGE impact on a number of structures and potential inheritance tax charges will apply irrespective of whether the settlor is UK resident or domiciled. Therefore, a review should be undertaken of all offshore structure which hold UK residential property before 5 April 2017 with a view to moving these out of individuals' estates entirely or into the relevant property regime whilst an entry charge does not apply.

To discuss how we can help, please contact:

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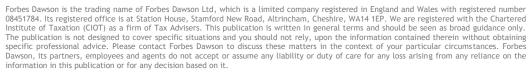
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Appendix A - tax treatment of offshore trusts post 6 April 2017

Trusts created by individuals who are not deemed domiciled when the trusts are created and the trusts are not tainted : protected

	Non settlor interested		Settlor interested	
When trust was set up	Pre 5 April 2017	Post 6 April 2017	Pre 5 April 2017	Post 6 April 2017
Income Tax				
UK source income	Taxed in the UK on the trustees on an arising basis	Taxed in the UK on the trustees on an arising basis	Taxed on the settlor on an arising basis	Taxed on the settlor on an arising basis
Foreign income	Not liable to UK tax but forms relevant income that will be matched to payments/benefits to UK resident beneficiaries	Not liable to UK tax but forms relevant income that will be matched to payments/benefits to UK resident beneficiaries	Is assessable to tax on the settlor unless the remittance basis is claimed. This income can only ever be assessed on the settlor up to 5 April 2017 (no other beneficiaries)	The income arising post 5 April 2017 is not assessable to tax until distributed or benefits made. The 'old' untaxed income prior to 5 April 2017 is added to this income and it becomes available to match to any payments/benefits made to any UK resident beneficiary wherever in the world. Payments made to any non-resident close relative of the settlor will be assessed on the settlor
Capital gains				
UK residential property	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.
Other disposals	Form stockpiled gains in the trust that can be matched to payments/benefits to any beneficiary once the relevant income has been depleted	Form stockpiled gains in the trust that can be matched to payments/benefits to any beneficiary once the relevant income has been depleted	Form stockpiled gains in the trust that can be matched to payments/benefits made to beneficiaries of the trust except the settlor who will be matched to income first	Form stockpiled gains in the trust that can be matched to payments/benefits to any UK resident beneficiary once the relevant income has been depleted

 $^{{}^{*}\}text{There}$ are other ways to calculate this gain if it produces a lower gain



Trusts created by individuals post 6 April 2017 by individuals who are deemed domiciled or trusts created pre 5 April 2017 which <u>are</u> tainted ∴ not protected

	Non settlor interested		Settlor interested	
When trust was set up	Pre 5 April 2017	Post 6 April 2017	Pre 5 April 2017	Post 6 April 2017
Income Tax				
UK source income	Taxed in the UK on the trustees on an arising basis	Taxed in the UK on the trustees on an arising basis	Taxed on the settlor on an arising basis	Taxed on the settlor on an arising basis
Foreign income	Form relevant income in the structure that will be matched to payments/benefits to UK resident beneficiaries	Form relevant income in the structure that will be matched to payments/benefits to UK resident beneficiaries	Provided they are non-domiciled when created. Is assessable to tax on the settlor unless the remittance basis is claimed. This income can only ever be assessed on the settlor up to 5 April 2017 (no other beneficiaries)	Subject to tax on an arising basis on the settlor
Capital gains				
UK residential property	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.	Liable to UK capital gains tax on gains post 5 April 2015.* The gain prior to this period is stockpiled as per 'other disposals' below.	Liable to UK capital gains tax on gains post 5 April 2015.* Also the settlor is assessable to tax on the arising basis on gains realised. It is unclear how this interacts with the non-resident CGT on UK residential property gain that is restricted to post-5 April 2015
Other disposals	Form stockpiled gains in the trust	Form stockpiled gains in the trust	Form stockpiled gains in the trust that can be matched to any payments/benefits made to beneficiaries of the trust except the settlor who will be matched to income first	Subject to tax on the settlor on an arising basis

^{*}There are other ways to calculate this gain if it produces a lower gain