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GMS Flash Alert

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United Kingdom – Details on Planned Changes to Taxation of Non-U.K. Domiciles

At Autumn Statement 2016 (see GMS *Flash Alert* 2016-139, 23 November 2016), the U.K. government confirmed that it will be going ahead with its latest proposals to change the taxation of long-term-resident non-U.K.-domiciled individuals ("non-doms") living in the United Kingdom. These changes will affect non-U.K. nationals and also individuals who were born in the U.K. with a domicile of origin in the U.K. but who subsequently established a domicile of choice outside the United Kingdom ("returners").

The proposed new rules have been subject to consultation and are set to come into force from 6 April 2017, with the draft legislation being included in the draft Finance Bill 2017 published on 5 December 2016.[1] While the changes are clearly aimed at individuals, it is important that employers are aware of the way in which their assignees and senior executives may be impacted.

WHY THIS MATTERS

These changes will mean that non-doms will no longer be able to file their U.K. tax returns on the "remittance basis" beyond a prescribed time-limit.

Furthermore, employees with a U.K. domicile of origin but who subsequently acquired a domicile of choice outside the U.K. and who return to the U.K. on a tax-equalized international assignment will no longer be able to benefit from Overseas Workday Relief from 6 April 2017.

Although not common, it is not unknown for some assignments to the U.K. to become almost permanent postings and for such assignees to settle in the U.K. on a long-term basis. Any long-term resident non-dom employees who could be affected by the amended "deemed domicile" rules (which will now apply for income and capital gains tax purposes, not simply Inheritance Tax (IHT) as at present) may have questions about whether and when they may be impacted, and so it is important that their employers are also familiar with how they operate and any potential for increased costs.

Current Rules

All U.K. resident non-U.K. domiciled individuals can claim the remittance basis of taxation meaning they are subject to U.K. tax on:

- U.K. source income and gains in the tax year in which they arise; and
- Any foreign income or gains in the tax year in which they are brought into (remitted to) the United Kingdom.

Claiming to be taxed on the remittance basis does not require the payment of a charge for the first seven tax years of tax residency, but comes at a cost thereafter if the individual has at least £2,000 of unremitted foreign income or gains. A Remittance Basis Charge (RBC) is levied as follows:

- RBC of £30,000 for the relevant tax year when the individual has been U.K. resident for at least seven out of the preceding nine U.K. tax years;
- RBC of £60,000 for the relevant tax year when the individual has been U.K. resident for at least 12 out of the preceding 14 U.K. tax years; or
- RBC of £90,000 for the relevant tax year when the individual has been U.K. resident for at least 17 out of the preceding 20 U.K. tax years.

For inheritance tax (IHT) purposes, in general non-U.K.-domiciled individuals are presently only within the scope of U.K. IHT on their U.K.-situated assets. However, such individuals become deemed domiciled in the U.K. for IHT purposes when they have been U.K. tax resident for at least 17 out of the previous 20 tax years (the "17 out of 20" rule). From this point they are within the scope of U.K. IHT on their worldwide assets in the event of their death and this can continue to be the case for an additional four tax years after they have ceased to be tax resident in the United Kingdom.

Upcoming Changes

The new rules, applying from 6 April 2017, will be as follows:

- All long-term U.K. tax-resident, non-U.K.-domiciled individuals will become deemed domiciled in the U.K. and will become subject to U.K. taxation on their worldwide income and capital gains on an "arising" basis once they have been resident in the U.K. for at least 15 out of the previous 20 tax years.
- The U.K. IHT position of such long-term U.K. tax resident, non-domiciled individuals will be aligned with their income tax and capital gains tax treatment as set out above. So the current "17 out of 20" rule will cease to apply and they will become deemed domiciled for U.K. IHT purposes if they have been resident in the U.K. for 15 out of the previous 20 tax years. The four-year "tail" will remain where deemed domiciled individuals cease to be U.K. tax resident (and their deemed domicile will re-establish if they become U.K. tax resident within six tax years).
- Individuals who were born in the U.K. with a U.K. domicile of origin but have since acquired a domicile of choice in another jurisdiction will now automatically be deemed domiciled in the U.K. if and when they re-establish U.K. tax residency, with a short grace period for IHT.
- Special new rules will be introduced in respect of non-U.K.-resident trusts established by non-U.K.-domiciled individuals who go on to become deemed domiciled in the United Kingdom. The rules will broadly allow for non-U.K. income and capital gains to be rolled up within such trusts without a U.K. tax charge so long as there are no

additions to the trust and the settlor and close family members do not receive any income, capital, or other benefits from the trust.

- U.K. residential property owned by non-U.K.-domiciled individuals (or trusts set up by such individuals) through offshore companies or partnerships will fall within the scope of U.K. IHT, as will loans (or assets given as security for a loan) made to finance the acquisition, maintenance, or repair of such property. This will be the case regardless of whether the individual has become deemed domiciled in the U.K. and irrespective of his/her U.K. tax residence status at the date of death.

Key Considerations for Individuals

There are some important points to highlight regarding the upcoming changes affecting non-U.K.-domiciled individuals which should be borne in mind by those who may be impacted. Three of these are listed below. Note that, for the first, action will be required well before the formal deadline of 6 April 2019.

Separation of Offshore Mixed Funds

The government is proposing a two-year window – from 6 April 2017 to 5 April 2019 – during which period all non-U.K.-domiciled individuals who have been taxed on the remittance basis at some stage prior to 6 April 2017 (but not returners) will be able to reorganize their offshore "mixed" funds. In particular, this means such individuals will have a limited opportunity to separate these funds into their different underlying categories of U.K. and foreign income, U.K. and foreign capital gains, and "clean capital" so that they can become accessible as such.

KPMG NOTE

Over time, non-doms may have accumulated a variety of accounts with sources of U.K. and foreign income, U.K. and foreign capital gains, as well as capital for which it may be very difficult to identify the tax cost of remitting funds to the United Kingdom. The accounts are called "mixed" funds and there is a strict set of rules designed to identify exactly what is being remitted. The mixed fund rules can mean that non-U.K. source income and gains in one tax year are deemed to be remitted before "clean" capital, and before U.K. source income and gains for a previous tax year. This currently leads to the problem of "trapped funds."

The ability to "untrap" these funds is therefore very welcome and it appears that the government is seeking to make this as straightforward and as flexible as possible. As noted, this exercise will need to be completed before the deadline of 5 April 2019. The special treatment will only apply to mixed funds which consist of amounts deposited in bank and similar accounts.

Rebasing the Value of Offshore Assets

Individuals who become deemed domiciled in the U.K. under the 15 out of 20 year rule in April 2017 (again, with the exception of returners), will be provided with an opportunity to re-base their offshore assets to their market value on 5 April 2017. This will mean that only gains accruing from 6 April 2017 onwards will be within the scope of U.K. capital gains tax upon the eventual sale of these offshore assets. The re-basing will only apply to assets held on 5 April 2017 that have been non-U.K. situated at any time from 16 March 2016 to 5 April 2017.

However, a key point here is that this opportunity will only be available to individuals who will become deemed domiciled in the U.K. on 6 April 2017, and who have paid the RBC for a tax year prior to 2017/18.

A "Protected" Trust Regime for Non-U.K. Trusts

As a result of the consultation process, the government has revisited its original proposals for the creation of a "protected" trust regime for non-U.K. trusts settled by individuals before they become deemed domiciled in the United Kingdom. The result is an alternative approach where liability to income tax or capital gains tax is dependent upon the extent to which benefits or capital payments are received from the non-U.K. trust. Accordingly, new provisions have been announced which, in certain circumstances, will treat the settlor as the recipient of any benefits and capital payments received from the trust by a "close family member."

Protected status will be available for non-U.K. trusts settled by individuals before they become deemed domiciled in the U.K., and will continue provided the settlor makes no direct or indirect additions to the trust after he or she has become deemed domiciled in the United Kingdom. The government has confirmed that protected trust status will not apply to settlors who become deemed domiciled under the "returners' rule."

The introduction of the new regime means that individuals who are currently non-U.K. domiciled may want to consider establishing a foreign trust *before* they become deemed U.K.-domiciled.

Key Considerations for Employers

With these new rules coming into force from 6 April 2017, employers should consider carefully the impact of the changes on their non-domiciled U.K.-based employee and assignee populations. We at KPMG LLP (U.K.) have outlined below a number of actions that an employer may consider taking at this time.

Employers may wish to inform U.K.-based employees and assignees about the proposed changes, their timing, and the potential need to seek further advice. It may be that impacted employees are aware of the changes, but it is almost certain that some will not be. In particular, it is important to note the following:

- The two-year opportunity to separate mixed funds is available to all U.K. non-doms (except returners) and not just those who will become deemed domiciled in the U.K. from 6 April 2017. Even those employees or assignees who have lived in the U.K. for only a short time may be interested in taking this opportunity, especially if they need access to offshore funds in the near future for U.K. expenditure (for example, to purchase a U.K. home).

- Employees who were born and originally domiciled in the U.K. but who settled abroad and subsequently acquired a non-U.K. domicile of choice, may be particularly concerned about their U.K. tax position if they were to return to the U.K. to work, as they would immediately become U.K.-deemed domiciled. It will be important that such individuals understand the position and have the opportunity to ask questions or seek personal advice as they may see fit to address their own particular circumstances (e.g., as regards their IHT position).

- For those non-U.K.-domiciled individuals becoming deemed domiciled on 6 April 2017, and who have previously paid the RBC, the ability to re-base foreign assets for capital gains tax purposes may have a significant impact on their U.K. tax position and this aspect should not be overlooked. That said, this opportunity will not apply to returners.

KPMG NOTE

In addition to any general communications to assignees, employers may wish to review their assignee population to identify those non-U.K.-domiciled individuals who will be impacted by the new rules and to consider the potential impact on their assignees under their international assignment/global mobility policy. Adjustments may be required to policy to

help ensure that the original spirit of the policy is upheld in spite of these changes in U.K. legislation, and cost projections may need to be revisited depending on the terms of the policy.

FOOTNOTE:

1 To see the draft provisions for Finance Bill 2017.

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Contact us

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