



# Budget 2015 – Significant tax changes for non-doms

July 2015

## Keep Calm and Carry On?

The original “Keep Calm and Carry On” posters - now seemingly everywhere - were in fact never used. They were produced by the British government during World War II, to be deployed if an invasion happened. Those waking up the day after such an invasion would know that while on one level everything had changed, on another level everyday life still continued.

For non-UK domiciliaries resident in the UK (“non-doms”), the worst – the abolition of non-dom tax status – may seem to have happened. Non-doms who expected a Conservative victory in the General Election to mean five more years of the same tax treatment have been sadly disillusioned. Waking up on 9 July, the whole non-dom tax system may seem to have changed for ever.

And yet, despite George Osborne’s announcement, everyday life not only goes on but will, in our view, continue to go on even once the reforms come into force on 6 April 2017. The worst may have happened, but – reflecting a week on from the Budget – our view is that this may not be the fatal blow which non-doms feared. Indeed, there are some positive aspects of the proposals which have been lost amid the predictable outcry.

The purpose of this briefing is to offer some reflections on the Budget announcement; to look at what opportunities will still remain; and to examine what non-doms should be doing both before and after 6 April 2017.

### The main proposals

We start with a summary of the proposals. These have been well trailed in a number of briefings, so we give only the headlines.

From 6 April 2017, the following will come into force:

- Non-doms who have been resident in the UK in 15 out of the previous 20 tax years will become “deemed domiciled” for all UK tax purposes from the start of tax-year 16.
- Such “deemed doms” will lose the remittance basis and will be taxed on their worldwide income and capital gains.
- Inheritance tax (for which a 17/20 year test already exists) will also be aligned with the 15/20 test.

- This will affect all non-doms resident in the UK on 6 April 2017 with no “grandfathering”. Those who have been resident in the UK continually since the 2002/03 tax year (or 15 of the tax years since 1997/98) will be in the regime straight away on 6 April 2017.
- Those with a UK domicile of origin<sup>1</sup> (“returning-doms”) which they have subsequently lost, will become deemed-domiciled immediately on return to the UK. This will also affect returning-doms who are already in the UK on 6 April 2017.
- Separately, UK residential property held via offshore company and partnership structures will cease to be treated as an offshore asset (“excluded property”) from 6 April 2017. The shares in that company or partnership will be treated as UK assets to the extent to which the value of those shares derives from the UK residential property.
- This will cause residential properties held through company structures to come back into the scope of UK inheritance tax. Trusts owning such companies may find themselves subject both to the periodic 6% IHT regime and the settlor liable to 40% IHT on his or her death. The exclusions for ATED (such as let properties and properties below £500,000) will not apply.
- Trusts set up by returning-doms will lose their excluded status on 6 April 2017 if the returning-dom is resident in the UK on that date, or subsequently if the returning-dom subsequently returns. This is probably the most retrospective aspect of the proposals.

### Other Budget proposals

Alongside the main Budget proposals, the following additional points are worth noting:

- The changes look likely to override the special tax treaties with India, Pakistan, Italy and France, although this is subject to consultation and, presumably, may require re-negotiation of those treaties.

<sup>1</sup> The Budget notes are unclear whether they must also have been “born in the UK” or whether simply having a UK domicile of origin is sufficient.

- Those who let-out UK residential property will have tax relief on the expenses of letting (including mortgage interest) restricted to 20%. This could particularly affect non-doms and non-residents.
- Carried-interest structures for managers of private-equity funds will be taxed at the full CGT rate of 28% and base-cost shift (which reduces the effective rate of CGT) will no longer be permitted.
- The government announced an additional £60m for HMRC to focus on criminal investigations into wealthy individuals and a further £36m to focus specifically on non-compliance by trusts and non-doms.
- There will be a consultation on whether those “de-enveloping” (that is, collapsing their offshore company structures for UK residential property) will get some form of relief against the SDLT and CGT charges which currently deter this.
- We shortly expect further clarity on the collateral issue which was announced on 4 August 2014.
- We expect – from informal conversations we have had – some amendments to improve the business investment relief (BIR) regime. BIR currently allows non-doms to remit foreign income and gains to the UK for investment in UK businesses.
- By removing excluded property status from offshore companies owning UK residential property, it appears that borrowing taken out to acquire shares in those companies will revert to being deductible<sup>4</sup> for inheritance tax purposes.

### But it's not all bad news

While the above proposals – particularly as regards UK residential property and returning-doms – go further than was anticipated, in several other respects the proposals are not as bad as they might have been:

- The rule does not abolish the remittance basis altogether (as a Labour government promised to do). Non-doms can continue to use the remittance basis for the first 15 tax years here (and for the first 7 of those without paying any charge).
- The 15/20 year test can be reset by 5 years<sup>2</sup> of non-residence – now much easier to establish under the Statutory Residence Test.
- The proposal that the remittance basis charge should be paid for 3 consecutive years has been dropped.
- Although there will generally be no “grandfathering”, those who have left before 6 April 2017 will still be subject to the old rules.
- While excluded property trusts<sup>3</sup> will no longer work for UK residential property or for returning-doms, such trusts will continue to keep their excluded status for other UK assets (e.g. UK commercial property) and non-UK investment assets, even after the settlor has gone past the 15 year limit.
- Further, such trusts will seemingly – although subject to consultation – also now keep their excluded status for income tax and CGT purposes as well. Non-dom settlors (except returning-doms) will potentially no longer have the income of such structures automatically imputed to them. Tax will only be charged when a person benefits from the trust. This looks to be a major overhaul of the overlapping tax rules regarding trusts and will make them an increasingly important planning tool in the future.

### What should non-doms be doing now?

With the promise of at least three consultations and legislation split across two Finance Bills<sup>5</sup>, it would clearly be sensible for non-doms to delay taking definite action until the details become clearer. However, in our view, there are some actions which non-doms can start taking now.

- 1 Review your domicile status. Domicile will continue to be key to the new regime and HMRC currently seems to be investigating domicile claims much more actively than previously. We expect this to continue. Consequently, make sure that you have the evidence in place to support your non-domicile. Those at risk of being treated as returning-doms, in particular, will need to be clear as to their domicile of origin.
- 2 Review your residency status. It will clearly be important to assess residence-status back to at least 2002/03 and possibly to 1997/98. For years prior to 2013/14 (when the statutory residence test was introduced) this may require more work. Future residence also needs to be considered. In some cases it may not yet be too late to become non-resident for the current tax year (2015/16).
- 3 Review your trusts. While a final decision should await the legislation being in place, trusts should be reviewed now to ensure that the trustees have the right powers; that valuations are in place; and that any CGT history (e.g. rebasing elections and forms 50FS) is up to date. There is a particularly nasty trap which may apply if past benefits from a trust have not already been matched with capital gains. Depending on the form of the new legislation, such benefits may come into charge on 6 April 2017.

<sup>2</sup> Probably tax-years, but this will be consulted on

<sup>3</sup> Trusts set up by non-doms before 17 years (now 15 years) residence

<sup>4</sup> It ceased to be so as a result of changes in 2013

<sup>5</sup> The main legislation will be in Finance Bill 2016. The Inheritance Tax aspects will be in Finance Bill 2017.

- 4 Consider setting up a trust. Again, a final decision on this should await the legislation, but it currently looks likely that trusts created before the 15 year limit may be more advantageous than they are at present and may preserve non-dom status past the 15 year limit.
- 5 Leaving the UK? The government has obviously gambled that net emigration will not be significant, although clearly some will choose to take this final step. In most cases there will be no urgency to leave. However, returning-doms may need to be out of the UK before 6 April 2017 and, as planning for a move may take some time, the plans for this may need to start being laid soon.

### What planning might be done after 6 April 2017?

It is obviously much too early to be definitive, but we speculate that the following are likely in the brave new world after 6 April 2017:

- It seems likely that trusts may need to be collapsed for returning doms and for UK residential property structures. Trusts for investment assets are likely to continue and be more beneficial than currently.
- Planning patterns of residence will be more important than now. The statutory residence test introduced in 2013 gives much more certainty over this and the ability to be non-resident while still spending 90 days (sometimes 120 days and occasionally 182 days) in the UK in a tax year.
- Re-setting the 15 year clock obviously looks possible. However, beware the point that unless there is a predictable event which will cause you to leave the UK, you may have acquired a UK domicile of choice.
- For some clients, acquiring a domicile of choice rather than a deemed domicile may be more advantageous. This will particularly be the case where individuals want to utilise English succession law, for instance.

- Conventional IHT planning-techniques used by UK domiciliaries will become more fashionable. Gifts, trusts, family partnerships, business property, and insurance-based solutions all look likely to see a renaissance. Family investment companies may prove particularly popular (especially given the further reductions to the corporation tax rate to 18%).

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