

All change for non-domiciliaries?

Those resident in the United Kingdom but not domiciled here received a shock in the Pre-Budget Report this autumn in which proposals were announced which effectively mean the withdrawal next year of the remittance basis of taxation for those who have been resident in the United Kingdom for more than seven years. All but the very wealthy can escape, and they would do so by paying what amounts to an 'entry fee' of £30,000 per annum to enable them to continue with taxation on the present basis.

The remittance basis of taxation has long been controversial. So long as the non-domiciliary brings nothing but foreign capital into the United Kingdom, keeping overseas income and gains segregated in a different account, he or she would pay tax in this country only on income and gains arising here. If those income or gains were relatively small, the tax liability could be equally small, despite a very evident opulent lifestyle. In defence of this regime, it was argued that wealthy foreigners bring enormous economic benefit to the United Kingdom and they would simply leave for better regimes elsewhere if this basis of taxation was withdrawn. The argument in their favour was not all that persuasive, since domiciled and resident wealthy people may equally bring enormous economic benefits to the country, but they had to pay their full share of tax. Nevertheless, such political questions are not ones for tax advisers to get involved in.

What is more important is to keep track of the proposals as they develop, and to review what steps need to be taken before 6 April next year when it is expected that the new rules will come into force.

One privilege which non-domiciliaries enjoy does not appear to be affected by the current proposals. This is the excluded property rule for inheritance tax. Assets whose situs is not in the United Kingdom are excluded property in the hands of a non-domiciliary for inheritance tax purposes, and therefore effectively exempt from the tax. After 17 out of 20 years of residence in the United Kingdom, the non-domiciliary will become deemed domiciled here and will thus lose the benefit of this effective exemption for foreign assets which he or she owns directly. However, this can be circumvented by transferring the assets into trust before becoming deemed domiciled. For foreign assets held in trust, the excluded property rule applies indefinitely if the settlor was not domiciled when the settlement was made, even though he or she may become deemed domiciled or indeed actually domiciled after the transfer of assets to the settlement. This favourable tax treatment does not appear to be affected by the latest proposals, which focus only on income and capital gains.

One point which has recently emerged is that the capital gains tax treatment of assets in offshore trusts is, however, to be changed under the current proposals. Under the existing rules, a non-resident excluded property trust set up by a non-domiciliary effectively offers indefinite shelter from capital gains tax for all beneficiaries of the trust who remain non-domiciled in the United Kingdom (and for this purpose there was no deemed domicile rule). Gains of

offshore trusts are taxed on UK resident beneficiaries who receive capital payments from the trustees, but this rule did not apply to any non-domiciled beneficiary.

A recent publication by certain professional bodies has indicated that this treatment is expected to change from 6 April next year. Non-domiciliaries will be taxed on capital payments from non-resident trusts if the money is brought into the UK, although whether this will apply only after seven years of residence here is not yet clear.

It will therefore be important for all non-domiciliaries who have substantial overseas assets to keep the position under close review over the coming months. It is expected that draft legislation will become available late in December, and there will therefore be the opportunity to consider whether any action should be taken early in 2008, with at least a reasonable idea of what the consequences will be, although of course the draft legislation might well be subject to many amendments before it passes into law in the summer of 2008.

Non-resident trustees should resist the idea of simply transferring all existing funds into a newly-formed non resident settlement in order to update capital gains tax base costs. There are now detailed provisions in the capital gains tax legislation to identify who the settlor of a settlement is when there is a transfer of funds in this way, and under these provisions the settlor of the first trust will be treated as the settlor of the newly-formed trust created by the trustees. In addition, gains will be realised by any such transfer and under the capital gains tax rules as they apply to non-resident trusts, these gains will be transferred to the new settlement and so little will be achieved by this process. What may be more appropriate is to terminate the existing settlement completely and return all funds to the settlor or distribute them to some other beneficiary who is non-domiciled. It will then be open to the settlor, or the beneficiary, to create a new offshore settlement which will start without any history of capital gains and with a newly updated base cost. Under the current rules, these steps will not cause any capital gains tax liability so long as the person receiving the funds distributed from the trust is non-domiciled. There are many other tax issues which need to be considered before taking any such action; for example a new trust created by a resident non-domiciliary might well be caught by the income tax anti-avoidance provisions relating to 'transfers of assets abroad', whereas the present settlement may have been created in such circumstances that there was adequate defence against those anti-avoidance provisions. The excluded property status of the new trust also needs careful review.

Above all, non-domiciliaries should not live in the hope that the proposals may be withdrawn as a result of the many representations being made. It seems clear that there are going to be some major changes and Parmentier Arthur can advise in this area.

Parmentier Arthur Group Plc

**90 Long Acre
Covent Garden
London
WC2E 9RZ**

**7 The Waits
St Ives
Cams
PE27 5BY**

**Tel: 020 7849 3018
Fax: 020 7849 3171**

**Tel: 01480 465522
Fax: 01480 461221**

Disclaimer

These notes are not intended to be exhaustive and they should not be regarded as such. Neither do these notes offer specific advice. They are merely an outline of the subject matter.

No liability will be accepted in respect of actions taken or refrained from as a result of information given herein or given by the author during the presentation. Specific professional advice should always be obtained.