U.K. NON-DOM TAXATION – WHERE IT IS AND WHERE IT IS GOING

Author
Gary Ashford

Tags
Non-Dom
Pre-Immigration Planning
Remittance Basis
Tax Residency
U.K.

Gary Ashford is a partner at Harbottle and Lewis LLP, and a fellow and council member of the Chartered Institute of Taxation. His practice focuses on high net worth individuals, especially regarding non-domiciled taxation.

INTRODUCTION

The granddaddy of all national legislation adopting a favorable tax regime designed to entice wealthy foreign nationals to establish residence is the set of special rules in the U.K. that have applied to non-domiciled individuals ("Non-Doms"). The headline benefit is remittance taxation regarding foreign-source income and gains, meaning that tax is deferred until the proceeds of the foreign-source income and gains are remitted to the U.K. Recent legislation in the U.K. has announced that remittance basis taxation – the bulwark of the Non-Dom rules – will terminate in April 2017 for persons who have been tax resident in the U.K. for 15 out of 20 years. There will also be a major change in the taxation of Non-Doms that are beneficiaries of nonresident trusts. This article looks at the special rules that continue to be offered to Non-Doms other than long-term Non-Doms and comments on several tax plans that might be recommended for the long-term Non-Dom at the time when they face a new tax reality.

NON-DOMS MOVING TO THE U.K.

For a non-domiciled nonresident individual wishing to relocate to the U.K., pre-immigration tax planning often is viewed as necessary to avoid significant unintended tax liabilities.

Who and What is a Non-Dom?

Under U.K. tax law, a person's domicile (separate from residence), provides an opportunity to be taxed as a resident in a way that is different and more beneficial than the way other residents are taxed. A person who is resident and domiciled in the U.K. is effectively taxed on a worldwide basis with credit given for foreign tax paid. In comparison, an individual who is resident but is a Non-Dom can elect to be taxed on a remittance basis. Those electing for the remittance basis of taxation are taxed on all U.K.-source income and gains, but in terms of foreign income and gains, are taxed only to the extent of the foreign income and gains are actually remitted to the U.K.

Domicile follows the principles set down in private international law. The main areas of domicile borrowed by the U.K. tax law are the domicile of origin, domicile of choice, and domicile of dependency. Any person born outside the U.K. to parents who are themselves born outside the U.K. will almost certainly fall within the Non-Dom category. Such persons have a domicile by origin and the origin is at the place of birth. These people are the focus of this article.

U.K. Tax Residence

The remittance basis of taxation for Non-Doms comes to life only when the person becomes a U.K. tax resident. As of April 6, 2013, the U.K. introduced a Statutory Residence Test ("S.R.T."). The S.R.T. sets out the various tests for determining a person's residence. There are tests for automatic U.K. residence and non-U.K. residence. There are "sufficient ties" tests for determining residence for those cases which fall outside the automatic tests.

Automatic U.K. Residence Tests

There are three main tests for automatic U.K. residence:

- Presence in the U.K. for 183 days or more
- Having a home in the U.K. for a period of 90 days within the relevant tax year and using the property for a continuous period of 30 days during that period
- Full-time employment in the U.K.

Where an individual does not meet the automatic U.K. residence tests, residence might still exist by virtue of the number of days of presence in the U.K. and the number of ties maintained with the U.K. For those who have not been resident in the U.K. previously, there are four possible ties:

- Accommodation
- Family
- Work
- Ninety days of presence

Depending on the number of days and the number of ties, the individual might be viewed as resident. If the person has all four ties, he or she could be regarded as resident where the person has been present in the U.K. for as little as 46 days. Where the person is present in the U.K. for more than 120 days in a tax year and only two ties exist, residence in the U.K. may also exist.

Split Tax Year Rules

If an individual arrives in the U.K. in the middle of the tax year, rules exist allowing an individual to be nonresident for the period prior to arrival. This is known as the "split tax year rules." This treatment is not automatic, so it is important to consider these rules prior to arrival in the U.K. Otherwise, the individual could be liable to tax on worldwide income in the entire first year of residence, subject to the Non-Dom rules set out below.

The main factual circumstances where the split tax year rules can be applied in relation to those coming to the U.K. are

- starting to have a home (only) in the U.K.,
- starting full-time work in the U.K.,

- ceasing full-time work overseas,
- being a spouse or partner of someone ceasing full-time work overseas, and
- starting to have a home in the U.K. even if it is not the only home.

If someone comes to the U.K. and becomes resident, the benefit of the split tax year rules will not be available unless one of the above facts exists.

TAX RULES FOR NON-U.K. DOMICILARIES

Where the individual has become a U.K. tax resident, but is a Non-Dom, an election may be made to be taxed on the remittance basis. As mentioned above, the remittance basis of taxation taxes the foreign income and gains of the Non-Dom only when remitted to the U.K. The rules around what is or is not a remittance are voluminous and complex. In essence, a remittance will occur if a "relevant person" receives, uses, or brings to the U.K. foreign income and gains relating to the period after becoming a resident. Therefore, income and gains made prior to becoming a resident can be brought into the U.K., as the proceeds from those transactions will be regarded as "clean capital," which is discussed below.

There are several technical rules that apply to persons wishing to be taxed under the remittance basis. Briefly, these may be summarized as follows:

- Where an individual's foreign income and gains are less than £2,000 the remittance basis rules apply automatically.
- Where a person has been resident in the U.K. for seven out of nine tax years, as of April 6, 2008 a remittance basis charge ("R.B.C.") is required in order to retain the benefits of remittance basis tax rules. Currently, the R.B.C. amounts to £30,000 beginning in the eighth year of residence. The R.B.C. increases to £60,000 after 12 years of residence and £90,000 when the person has been resident for 17 years. In order for the R.B.C. to be a creditable tax for U.S. persons, the R.B.C. deems the Non-Dom as "nominating" some of the foreign income and/or gains to be taxed in the U.K. This nomination effectively creates an income tax charge equivalent to the R.B.C.
- The individual newly arriving in the U.K., who has not been resident previously, need not therefore have to worry about this for seven years.

There are some differences between the R.B.C. rules that claw back income tax benefits for a Non-Dom and the benefit claw-back rules for U.K. inheritance tax purposes. For purposes of the inheritance tax, there is a deeming provision under which a person who has been a U.K. resident for 17 out of 20 tax years will be deemed to be U.K. resident.

2015 BUDGET CHANGES

The U.K. government announced proposals for significant changes to the tax rules for Non-Doms. H.M.R.C. has stated that the new changes will be effective from April 6, 2017, and H.M.R.C. has not as yet published the final draft legislation or technical guidance. These are anticipated in January 2016. The changes may be summarized as follows:

- The first is a change in domicile rule for a person who was born with a U.K. domicile and acquired a domicile somewhere else after having left the U.K. for a minimum period of three years. Should that person return to the U.K., U.K. domicile will exist automatically upon return.

- The second is a deemed domicile provision for all U.K. tax purposes. Where an individual has been resident in the U.K. for 15 years as of April 6, 2017, the person will be deemed to be U.K. domiciled for all U.K. tax purposes beginning with the 15th year. This new rule, will effectively override the current 17-out-of-20-years deeming rules for inheritance tax purposes and the current rule for the increased R.B.C. at that point in time.

Long-term Non-Doms have already begun to consider revising tax affairs in response to these changes. There is no doubt that some Non-Doms are considering becoming nonresident before April 6, 2017 or, if they have not yet been resident for 15 years at that point, becoming nonresident prior to triggering a deemed domicile in the U.K.

For others who do not wish to leave the U.K., H.M.R.C. has provided some guidance to the thinking of Ministers and some planning can begin at this time. For example, H.M.R.C. has advised that it plans to align the rules for becoming nonresident in the U.K. and acquiring a new domicile elsewhere for inheritance tax purposes. Currently, there is a three-year rule for inheritance tax for U.K.-domiciled individuals but a four-year rule for deemed Non-Doms. H.M.R.C. is proposing an aligned period of five years. H.M.R.C. has said it will consult on the interaction between the new five-year rule and the old three- and four-year rules.

"The proposed rules around returning U.K. Non-Doms will restrict this opportunity to those who did not have a U.K. domicile at birth. Those with a U.K. domicile at birth may need to consider leaving the U.K. for good and resettling elsewhere."

H.M.R.C. has indicated that under the new rules, after April 6, 2017, if an individual leaves the U.K. and a new domicile is acquired somewhere else (including perhaps the individual's domicile of origin outside the U.K.), the 15-year "clock" under the deemed domicile rule could be restarted. The proposed rules around returning U.K. Non-Doms will restrict this opportunity to those who did not have a U.K. domicile at birth. Those with a U.K. domicile at birth may need to consider leaving the U.K. for good and resettling elsewhere.

We also understand that a person who would be deemed U.K. domiciled under the new 15-year rule on April 6, 2017 who leaves the U.K. before April 6, 2017, will be treated under the current rules, rather than the post-April 6, 2017 version of the rules.

Other tax planning is less extreme. The U.K. government has set out that the current Non-Dom rules will remain as they are until April 6, 2017, and they will potentially accept planning that is undertaken under the current rules prior to that date. Particularly, in relation to inheritance tax, where an individual is not yet deemed to be U.K. domiciled under the current 17-out-of-20-years rules, this would appear to support the opportunity to settle non-U.K. property by gift to the next generation or by transfer to an offshore trust. Provided the individual lives long enough, the property could fall out of inheritance tax exposure in the future under the excluded property rules.

H.M.R.C. has said it will also consider changing some of the anti-avoidance rules, such as the Transfer of Assets Abroad rules, to protect some of the structures set up before April 6, 2017.

The new proposals also raise questions over Non-Dom banking facilities. Will it be effective, for example, to have separate bank accounts for offshore income and gains generated before the new law and different bank accounts for income and gains after the changes? Our understanding is that some consideration is being given to this in the government, but clearly, if nothing further is introduced or issued on this matter, that would appear to be a sensible possible solution.

In summary, while there is definitely scope to begin conversations with affected clients, or those Non-Doms who will be affected in the future, some caution would be advised until the draft legislation and technical guidance is published.

RIGHT TO RESIDE AND WORK IN THE U.K.

The U.K. immigration system is split between (i) citizens of the European Economic Area (the "E.E.A."), which is wider than the E.U., and Switzerland; and (ii) migrants from outside these countries. Most citizens of countries within the E.E.A. and Switzerland have the right to live and work in the U.K. without restrictions. They may also bring their families with them to live in the U.K., provided they are able to support themselves without recourse to public funds.

The U.K. has a tiered points-based system, which applies to migrants from outside the E.E.A. and Switzerland and is appropriate for individuals working or setting up businesses in the U.K. This portion of the article will focus on Tier 1, which is aimed at high-net-worth and highly skilled individuals who will contribute to the U.K.'s productivity and growth, and specifically on the Tier 1 (Investor) and Tier 1 (Entrepreneur) routes. Family members can also seek leave to enter the U.K. as the dependents of a points-based-system migrant.

Tier 1 (Investor)

The Tier 1 (Investor) route requires individuals to have at least £2 million available to invest in the U.K. The funds must belong to the applicant and have been held for at least three months prior to making the application. If the funds have not been continuously held for that period, the individual can still satisfy the requirement provided it can be demonstrated that the funds have come from acceptable sources including a gift, deed of sale, inheritance, or winnings.

Investment of such funds must be made in U.K. government bonds, or share or loan capital in active and trading U.K. companies, and must be maintained throughout the duration of the visa. Funds invested in property do not count toward investment under this route. An initial visa will be granted for three years and can be extended for a further two years. Assuming the initial investment has been maintained and the individual has remained in the U.K. for a period of five years, the migrant may qualify for settlement in the U.K. (known as Indefinite Leave to Remain ("I.L.R."). In order to qualify for I.L.R., absences from the U.K. must not exceed 180 days in any 12-month period.

The route to settlement can be accelerated if applicants are willing to invest £5 million or £10 million; under these categories, assuming the investment is maintained, the individual may be eligible for I.L.R. after two or three years respectively.

The Tier 1 (Investor) is an attractive route as it allows unrestricted employment or self-employment in the U.K. and an accelerated route to settlement in the U.K.

Tier 1 (Entrepreneur)

The Tier 1 (Entrepreneur) route is for individuals who wish to set up, join, or takeover a business in the U.K. An applicant must have access to £200,000 available for investment into a new or existing business in the U.K. The funds must be held in a U.K. regulated financial institution or be transferable to the U.K. Evidence must be submitted to show that the individual intends to set up or join the business, invest the relevant funds, and not seek employment other than in the identified business. As part of an application, the individual must demonstrate the status as a "genuine entrepreneur" by providing information about the business they intend to invest in, a business plan, and personal background.

"The Tier 1 (Investor) is an attractive route as it allows unrestricted employment or self-employment in the U.K. and an accelerated route to settlement in the U.K."

If the visa is granted, the applicant must register as a director of the company, invest the sum of £200,000 in cash into the business, and ensure that the business creates two new full-time jobs for settled persons in the U.K. for at least 12 months. The funds must remain available to the Tier 1 (Entrepreneur) at all times until they are spent in the running of the business.

The sum of £200,000 may be reduced to £50,000 in circumstances where the funds are being provided by certain U.K. venture capitalists, seed funding competitions, or government departments.

After five years in the U.K. as a Tier 1 (Entrepreneur), the individual may be eligible to qualify for I.L.R. provided that absences from the U.K. do not exceed 180 days in any 12-month period.

Visitor Visas

Non-E.E.A. nationals may enter the U.K. outside of the points-based system as a visitor for up to six months in a 12-month period. However, the visitor rules are limited and individuals are not able to carry out productive work in the U.K., whether paid or unpaid. A business visitor is able to attend meetings, conferences, and seminars; negotiate and sign deals and contracts; and gather information for an overseas employer; but must not receive payment from a U.K. source and must not intend to transfer a permanent work base to the U.K. Even temporary transfers of a base are prohibited.

PRE-ARRIVAL TAX PLANNING

It is very important to plan the individual's affairs before arrival in the U.K. This is equally important for the whole family, individually, in terms of children in their own right and the residence of parents. As mentioned above, the residence of a parent is affected by family ties in the U.K. Consequently, within a family, each person's tax residence position will affect the positions of other family members.

As stated above, the Non-Dom rules allow a Non-Dom to choose the method for recognizing income and gains from sources outside the U.K. between (i) the world-wide arising basis of taxation and (ii) the remittance basis of taxation. Therefore, it is imperative for a Non-Dom to review non-U.K. banking facilities prior to arrival.

"While planning for an event that is 15 years in the future is often difficult for practical reasons, it is still important to look at whether any structuring should be undertaken to address exposure to asset protection and future inheritance tax."

It is very important to set up separate accounts for the Non-Dom. All overseas monies of the Non-Dom amount to what is "clean capital" up until the day of arrival in the U.K. This assumes that the individual had no previous periods of U.K. residence. Providing that clean capital remains segregated from any post-residence income and gains, the clean capital can be brought into or used by the Non-Dom in the U.K. during a period of residence without the imposition of tax. If any income and gains are not segregated as they arise after an individual becomes a U.K. resident, the clean capital fund will become a "mixed fund." The result of this is that any monies remitted to the U.K. from a mixed fund will effectively be treated as a remittance of income, and taxed at the relevant rate of income tax. The current highest rate of income tax is 45%. Income or gains should be segregated into new accounts as they arise, leaving the original "capital" for future use by the U.K.-resident Non-Dom.

It is worth setting up an account for income such as interest and one for capital gains. This allows the Non-Dom to control the order of remittances. The first remittances would come exclusive from clean capital until the fund is exhausted. The next tranche of remittances would be made exclusively from the capital gains fund until that fund is exhausted. This limits the U.K. tax on the remittance to the favorable capital gains rates, currently 28%.

Once a Non-Dom begins paying the R.B.C. after the seventh year of residence, it is important to nominate an amount of foreign income and/or gains to be taxed to create the R.B.C. Note that if that nominated income is remitted to the U.K., the U.K. tax rules will look beyond the nominated amounts to identify an equivalent amount of unremitted income and/or gains that will be taxed in addition to the R.B.C.

While planning for an event that is 15 years in the future is often difficult for practical reasons, it is still important to look at whether any structuring should be undertaken to address exposure to asset protection and future inheritance tax. At the time of writing this article, technical guidance has not yet been issued on how the 2015 Budget will be implemented as of April 6, 2017. This guidance is eagerly awaited in order to allow tax advisers in the U.K. to be fully able to consider any specific planning that should be undertaken. However, issues such as whether pre-2017 income and gains should be separated from post-2017 income and gains, will have to be considered, as well as the whole issue of offshore assets that would currently be regarded as "excluded property" for inheritance tax purposes for non-U.K. situs assets held by a Non-Dom who is not yet deemed domiciled under the 17-out-of-20-years rule.

OTHER FOREIGN-SOURCE INCOME

As the U.K. Non-Dom remittance rules seek to tax U.K.-source income and remitted foreign-source income, various planning opportunities exist. For example, where a Non-Dom is an extensive world traveler, there may be scope to structure affairs so that income earned overseas is not remitted to the U.K. This income would be placed into a foreign account and no U.K. tax would be due. Care must be taken to coordinate with taxing regulations outside the U.K. as, typically, income tax treaty benefits are not allowed for unremitted income of a Non-Dom who computes tax on the remittance basis of taxation. If the person is considering leaving the U.K. at some point in the future, this approach may convert deferral into forgiveness if the facts are appropriate.

It is very important to look at family office structures to make sure they are compliant with U.K. tax rules. If a family office structure is set up, the U.K. Non-Dom rules can provide good opportunities for those internationally focused families operating in different jurisdictions.

BUSINESS INVESTMENT RELIEF

Entrepreneurial Non-Doms may be interested in this relief. The relief effectively overrides the normal remittance rules of taxing foreign income and gains earned after the individual becomes resident, providing they remit the funds into what is, or is intended to be, a "qualifying investment." A qualifying investment involves taking shares in or making a loan to an eligible trading company, which is primarily engaged in carrying on a trade in the U.K., or will do so within two years of the investment being made.

It is very important that the investment funds are placed into the company within 45 days of remittance in order to avoid application of the ordinary remittance basis taxation rules. It is also important that, when the funds are taken back from the company, they flow overseas or are reinvested into another eligible trading company within 45 days.

CONCLUSION

Although the headline news is the tightening of the remittance basis of taxation rules, the U.K. remains an attractive place for a wealthy Non-Dom. The 15-year period of benefits is significantly longer than in most countries having favorable Non-Dom tax regimes, significant planning can be considered around this relief. As with most cross-border movers, pre-immigration planning is often crucial, separating actual benefits from what-if regrets.