ABOLITION OF THE NON-DOM REGIME: THE STATE OF TAX PLANNING FOR U.S. PERSONS WITH U.K. CONNECTIONS

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INTRODUCTION

For over 100 years, individuals who were domiciled outside of the U.K. have benefitted from the non-dom tax regime. Many readers will be familiar with the key features of this regime. It allowed individuals who were not domiciled in the U.K. to defer the imposition of U.K. taxation on income and gains derived from sources outside U.K. until remitted. It also meant that only U.K. situs assets of an individual domiciled outside the U.K would be subject to U.K. inheritance tax ("I.H.T.").

The non-dom tax regime was abolished earlier this year and was replaced with a new system based on residency rather than domicile. The new system came into place on April 6, 2025, with the start of the new fiscal year. This article will explain the key features of the new rules and explore the impact on tax planning for U.S. persons with U.K. connections.

KEY FEATURES OF THE NEW REGIME

- For I.H.T. purposes, from 6 April 2025, individuals who have been resident in the U.K. for at least ten of the previous twenty tax years are regarded as long-term residents ("L.T.R.'s") in the U.K. The worldwide estate of an L.T.R. will be subject to I.H.T. on death and in relation to certain lifetime gifts, subject to any available reliefs and exemptions.
- Potential I.H.T. exposure will continue for a tail period of between three and ten years once the L.T.R. ceases to be a U.K. resident. The length of the tail will depend on the number of years during which the L.T.R. was resident in the U.K. The tail will be subject to the limitations provided in the U.K.-U.S. Estate Tax Treaty ("E.T.T.").
- The remittance basis has been abolished. It has been replaced with the new Foreign Income and Gains ("F.I.G.") regime. In any particular tax year, it is only available to individuals who were not U.K.-resident in any of the previous ten tax years. If eligible for the F.I.G. regime, newly U.K.-resident individuals may claim an exemption from U.K. tax on non-U.K. source income and gains.

We will explore these rules in further detail by reference to a case study. The new rules are complex and, as ever, a detailed understanding of the new rules is crucial in understanding recent tax legislation. The examples in the two case studies that follow provide an overview of the types of issues that U.S. persons with U.K. connections may face at the time of arrival and departure.

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CASE STUDY NO. 1

Background Facts

Kate is a U.S. citizen. She was raised in New York where she attended university. On being graduated in 2000, she took a job at a global corporation based in New York. After ten years, she was offered the chance to move to London to lead a team in the London office. She accepted the transfer and moved to the U.K. Her first year of tax residency in the U.K. was in the U.K. tax year 2010/11.[1]

In 2017, Kate married Alan. Alan is a U.K. national. They have two children, Joe who is four years old and Charlotte who is three years old.

In 2025 Kate and her family decide to move to New York. Their plan is to spend Christmas in London and move to the U.S. in January 2026. Kate will remain a U.K. resident in the tax year 2025/26 and will lose U.K. residency as of April 6, 2026.

Kate owns a small apartment in New York which she has been renting out since she left New York City in 2010. She intends to retain the rental unit after her return to New York. She also has an investment portfolio custodied in New York and an individual retirement account ("I.R.A."). Kate and Alan also jointly own a house in London which they plan to sell when they leave the U.K.

Residency Status

Kate has been resident in the U.K. for more than ten tax years and is designated as an L.T.R. under the new tax regime. This means that should her life end within a specified period of time after her departure, her worldwide estate will be subject to the U.K. I.H.T. regime. This is often referred to as a tail period. The length of the tail will depend on the number of years she was resident in the U.K.

Length of Residence	Date When Tail Terminates
Under 10 years	Not L.T.R. at all
10 to 13 years	After 3 more tax years
14 years	After 4 more tax years
15 years	After 5 more tax years
16 years	After 6 more tax years
17 years	After 7 more tax years
18 years	After 8 more tax years
19 years	After 9 more tax years
20+ years	After 10 more tax years

[1] The U.K. tax year runs from April 6 of one calendar year to April 5 of the next calendar year.

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> *“It remains to be seen whether the U.K. will seek to amend the treaty, but for now there seems to be consensus among advisors that this is how the I.H.T. and the E.T.T. will operate.”*

Kate has been resident in the U.K. since the tax year 2010/11. Consequently, she will have been resident for 16 years at the point she ceases to be U.K. resident, determined as of the start of the next following U.K. tax year, April 6, 2026. This means her tail period will last for six tax years. She will cease being an L.T.R. on April 6, 2032.

The same set of rules apply to Alan. Since he has been U.K. resident for more than 20 years, he will have a tail period of 10 years. He will cease being an L.T.R. on April 6, 2036.

E.T.T. Relief

There may be some protection available to Kate under Article 5 (Taxing Rights) of the E.T.T. As a U.S. citizen, so long as Kate has never acquired U.K. nationality, the E.T.T. may reduce or eliminate the I.H.T. tail exposure. At present, the relevant paragraphs for Kate to be taxed only in the U.S. are Paragraphs 1 and 5. They provide as follows:

> (1)
>
> (a) Subject to the provisions of Articles 6 (Immovable Property (Real Property)) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) and the following paragraphs of this Article, if the decedent or transferor was domiciled in one of the Contracting States at the time of the death or transfer, property shall not be taxable in the other State.
>
> (b) Sub-paragraph (a) shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State.
>
> *   *   *
>
> (5) If by reason of the preceding paragraphs of this Article any property would be taxable only in one Contracting State and tax, though chargeable, is not paid (otherwise than as a result of a specific exemption, deduction, exclusion, credit or allowance) in that State, tax may be imposed by reference to that property in the other Contracting State notwithstanding those paragraphs.

It remains to be seen whether the U.K. will seek to amend the treaty, but for now there seems to be consensus among advisors that this is how the I.H.T. and the E.T.T. will operate.

For the purposes of the case study, let us assume that Kate acquired U.K. nationality and so is not assisted by Article 5 of the E.T.T.

Kate’s U.S. Estate Plan

In September 2026, Kate decides that she needs to think about her estate plan and visits an attorney in New York City to discuss her options. Her attorney suggests

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setting up a revocable living trust and transferring her assets into it. This will enable her estate to avoid probating her will. It also means it would be easier to manage assets on her behalf if she were to become incapacitated. The trust is a grantor trust for U.S. income tax purposes, and for that reason, will be disregarded under U.S. income tax rules. Consequently, all income and gains of the trust will be treated as belonging to its grantor, namely Kate.

Notwithstanding the favorable tax treatment in the U.S., Kate still needs to think about the U.K. tax implications of setting up a revocable living trust because she remains an L.T.R. until April 6, 2032. Tax law in the U.K. does not provide for the concept of revocable living trusts in the same way as the U.S. The general position is that, during the lifetime of the grantor, the trust will be treated as either (i) a bare trust (*i.e.* a nominee arrangement for the grantor, also found in Canadian tax law) or (ii) a fully constituted substantive trust. There are no clearly defined rules to determine whether a trust is bare or substantive. The final determination will depend on the terms of the trust and whether, on balance, the U.K. tax authority considers the trust is more akin to a U.K. bare trust or to a U.K. substantive trust.

A bare trust will be treated as a look-through for U.K. purposes, much like in the U.S. A substantive trust will instead be taxed under a separate taxing regime for trusts. If Kate sets up a revocable living trust and funds it while she remains an L.T.R., she risks triggering the following tax exposures:

- An immediate 20% I.H.T. charge on the value of the assets transferred and
- Ongoing 6% charges every 10 years under the relevant property regime,[2] until the tail drops away on April 6, 2032, essentially more theoretical than real in the facts presented.

To be clear, these charges will arise if the revocable living trust is treated as a substantive trust in the U.K. It does not matter that the trust will only hold U.S.-situs assets. Before she establishes the revocable living trust, Kate should take advice from a U.K. solicitor on how best to mitigate the risk of it being treated as a substantive trust.

Kate’s estate is well below the U.S. estate tax exempt amount, scheduled to be $15.0 million as of January 1, 2026, and adjusted for inflation each year thereafter. In Kate’s circumstances, she knows there will be no estate tax to pay in the U.S. at the culmination of her life. However, she still needs to consider the U.K. tax implications if she dies while an L.T.R. The exempt amount for U.K. tax purposes (known as the nil rate band) is only £325,000. Any amount above this will be subject to I.H.T. at a flat rate of 40%, unless other reliefs and exemptions are available. Kate plans to pass her entire estate to Alan if she dies before him, and so wants to benefit from the spouse exemption from I.H.T. As with the transfer of assets to the revocable living trust, Kate should take advice from a U.K. solicitor on how best to make sure that the provisions of her will are sufficient to capture the spouse exemption.

Lifetime Giving

Lifetime gifts are another area where it is easy to encounter a problem. While the U.K. does not impose a gift tax, it does impose I.H.T. In order for a lifetime gift to be

[2] The relevant property regime is the name for the special tax regime applying to most substantive trusts in the U.K.

excluded from I.H.T. at the conclusion of the donor's lifetime, the donor must survive the gift by seven years.[3] While Kate and Alan remain L.T.R.'s, this rule will apply.

U.K. Situs Assets

U.K. situs assets will always remain subject to U.K. I.H.T., even if the owner is not an L.T.R. Let us assume that Kate and Alan decide to keep their London home as an investment property, rather than sell it shortly after leaving the U.K. If the property is owned at the time of their respective deaths, Kate's half share will be included in her estate for I.H.T. purposes even after she loses L.T.R. status. The same treatment will apply to Alan.

If, for any reason, it is projected that neither Kate's estate nor Alan's estate pay any U.S. estate tax because, for example, the total value of assets is below the lifetime exclusion in the U.S., the 40% U.K. I.H.T. is a real cost. Even though the U.K. I.H.T. may be claimed as a credit against U.S. estate tax due on the U.K. property, no U.S. tax is due.

Paying the I.H.T. Bill

To the extent that the estates of Kate and Alan have an I.H.T. liability, they could consider taking out life insurance to cover the projected cost. The policy would usually be placed into trust so that the proceeds are kept outside their estates for tax purposes. The policy payout could be used to settle the I.H.T. bill without needing to sell or dip into assets earmarked for family or other priorities.

If the policy is denominated in terms of pounds sterling, risk of currency movement between the I.H.T. anticipated and the face amount of the policy can be eliminated by taking out a policy denominated in pounds sterling with an insurance carrier based in the U.K. However, premiums paid with regard to a life insurance policy issued by a non-U.S. insurance company that covers the life of a U.S. citizen or resident may be subject to a 1% excise tax.[4] Where the insurance company is a resident of the U.K., the excise tax may be waived if the U.K. resident insurance company has entered into a closing agreement with the I.R.S. and the U.K. company is not acting as a conduit to an insurance carrier based in another country. Advice of U.S. legal counsel should be taken to confirm that the conditions are met for the elimination of the excise tax.

The Other Tail

For completeness, it is also important for those leaving the U.K. to be aware of a rule relating to U.K. capital gains tax ("C.G.T."). This is a five-year rule and comes into play where (i) individuals leave the U.K., (ii) dispose of assets that do not trigger U.K. C.G.T. due to their nonresident status in the U.K. at the time, and (iii) return to the U.K. within five years of their departure. These are known as temporary nonresidence rules and are noted because of the U.K. C.G.T. implications they can cause.

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[3] This is in relation to outright gifts made to individuals or institutions. Gifts made into trust are subject to I.H.T. at the time of the gift, unless reliefs or exemptions are available

[4] Code § 4371(2).

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CASE STUDY NO. 2

Kate has a brother, Nick. Like Kate, he was raised in New York where he attended university. After graduation, he moved to Silicon Valley and helped build a technology company. He still holds a 1% stake in the company although he no longer works there. He built a large investment portfolio from his salary and bonuses over the years.

Nick has been offered an executive role at a start-up in the U.K. He has decided to accept the job but doesn't know how long he will stay in the U.K. He will arrive in London on April 6, 2026, and his first tax year of U.K. residency will be 2026/27.

Nick lived in the U.K. once before. He was U.K. resident in U.K. tax years 2005/06 and 2006/07. During that time, he claimed the benefit of remittance basis taxation and sheltered all his non-U.K. income and gains from U.K. income tax and C.G.T. During that period, he participated in a liquidity event involving a U.S. business and recognized a significant gain. He invested the proceeds of that sale in a portfolio which remained segregated from his other accounts, and all the income has been paid to him every year since.

The F.I.G. Regime

Nick has not been U.K.-resident in any of the ten tax years preceding tax year 2026/27. He will therefore be eligible for the F.I.G. regime. He can claim an exemption from U.K. income tax and C.G.T. on all of his non-U.K. income and gains. He will still need to pay U.K. income tax on his U.K. salary but will not suffer any U.K. tax on his U.S. income and gains.

Tax treatment is the same under the F.I.G. regime whether the U.S. income and gains are left in the U.S. or are brought into the U.K. He will be able to claim this exemption for his first four years of U.K. tax residence. Nick could consider the following:

- If Nick thinks he is going to stay in the U.K. for longer than four years, he could sell and reinvest, or otherwise reset the value of key investments, during the four-year period. For example, he could sell out of non-reporting mutual funds, which are common in the U.S. but highly tax-inefficient in the U.K. The U.K. may treat gains from such funds as income rather than capital gains, taxing them at rates of up to 45%.
- Nick should review any U.S. L.L.C. structures which he has. Although commonplace in the U.S. and typically treated as transparent for U.S. tax purposes, the U.K. tends to treat L.L.C.'s as opaque entities for tax purposes. This means that they are treated as the equivalent of U.S. privately held corporations. This mismatch can cause double taxation problems. The U.S. will tax Nick directly on the income of the L.L.C., when and as earned. In comparison, the U.K. will tax Nick only when he receives distributions from the L.L.C. Moreover, the U.K. will provide no foreign tax credit relief for taxes previously paid by Nick in the U.S. with regard to the L.L.C.'s income.

The F.I.G. regime provides a four-year window to eligible individuals during which strategic planning can be carried out. It will be important for Nick to consider tax planning options and take implementation steps prior to becoming resident in the U.K.

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The Temporary Repatriation Facility ("T.R.F.")

Nick can also make use of the T.R.F. if he brings additional funds to the U.K. The T.R.F. is a new regime which is available for a limited time and only for certain individuals. The relief may be claimed by individuals who have been U.K. residents in previous years and claimed the benefit of remittance basis of taxation during that time.

As mentioned above, prior law allowed persons domiciled abroad to defer tax on non-U.K. income and gains until proceeds were remitted to the U.K. Under the T.R.F., those individuals can now bring the proceeds of previously deferred income and gains into the U.K. tax net at a beneficial tax rate.

- Funds that are brought into the U.K. tax net in tax years 2025/26 and 2026/27 will be taxed at a flat 12% TRF rate.
- Funds that are brought into the U.K. tax net in tax year 2027/28 will be taxed at a flat 15% TRF tax rate.

The funds do not have to be physically brought into the U.K. in order to benefit from the T.R.F. Instead, by participating in the T.R.F. and paying the flat rate of tax now, Nick can bring the proceeds into the U.K. in future years without paying any additional U.K. tax. Whether it makes sense to use of the T.R.F. depends on certain variables:

- Does Nick need to supplement his U.K. salary?
- Does Nick plan to stay in the U.K. for the long term?
- Does he need capital in the U.K. to purchase real estate?

If Nick does not participate in the T.R.F. he will pay tax at full rates at the time of repatriation.

"During times of change, the value of advice of competent tax counsel is at a premium."

CONCLUSION

During the past two calendar years, tax rules in the U.K. have changed dramatically. The concept of domicile is no longer relevant to taxation, having been replaced with a residence-based test. U.S. persons with connections to the U.K. should take steps to understand the impact of the new tax rules especially with regard to I.H.T. There are also opportunities to carry out pre-arrival planning for those intending to move to the U.K. During times of change, the value of advice of competent tax counsel is at a premium.

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