NON-DOM CHANGES – AN UPDATE

FORMERLY DOMICILED RESIDENTS

This briefing focuses on the recent tax changes affecting individuals born in the UK with a UK domicile of origin who return to the UK having acquired a domicile of choice overseas (referred to as 'formerly domiciled residents'). These measures took effect from 6 April 2017.

Losing a UK Domicile of Origin

Domicile is generally construed as the place that an individual regards as their permanent home and with which they have the closest ties.

There are three types of domicile: domicile of origin, domicile of dependence and domicile of choice.

An individual has a "domicile of origin" which is fixed at birth and usually follows the domicile status of the individual's father if he was alive at the time of the birth and married to the individual's mother.

A domicile of origin can only be displaced by a domicile of dependence (this follows the father's domicile whilst the child is a minor) or a new domicile of choice. Once an individual becomes an adult, their domicile of origin/dependency may be displaced by consciously adopting a 'domicile of choice'.

In order to adopt a foreign domicile of choice, an individual must become resident in another jurisdiction and demonstrate that they have severed sufficient ties with the previous country of domicile and have the intention of living in their new country permanently or indefinitely, and making this new country their permanent home.

Note that an individual must positively acquire a domicile of choice in another jurisdiction. It is not sufficient to simply move overseas with no intention of ever returning to the UK. There must be a positive intention of remaining in the new jurisdiction permanently or indefinitely.

A peripatetic individual who does not settle permanently in a new jurisdiction is unlikely to acquire a domicile of choice overseas.

To demonstrate an acquisition of a domicile of choice in another jurisdiction, an individual will need to be able to demonstrate that they have the intention to reside there permanently or indefinitely without any real prospect of returning to the UK on any clearly foreseen and reasonably anticipated contingency.

Even in cases where an individual has the intention of living in their new country permanently, and they take all necessary steps to be able to demonstrate the acquisition of a domicile of choice overseas, there may be circumstances that cause them to return to the UK that were not envisaged at the time they left the UK.

It is not uncommon for individuals with family in the UK to return to the UK even though they may have had no intention to return to the UK when they left the UK and for many years afterwards. For example,

they may wish to return to the UK to be closer to family if their health deteriorates and they require regular care, or if a family member themselves requires care, or to be closer to grandchildren.

In many of these cases, under previous rules, the individual's domicile of choice overseas would have been abandoned at the time they moved back to the UK, and their UK domicile of origin revived, although this would depend on the precise circumstances of the case. In other cases, the individual may claim to have retained their domicile of choice overseas even after they returned to the UK. This would allow them to access the tax benefits afforded to non-UK domiciliaries, such as the remittance basis of taxation for overseas income and gains, and exemption from inheritance tax on overseas assets.

The new measures put all FDRs on the same statutory footing. The rules ensure that such individuals are not capable of claiming non-domicile status when they become resident in the UK again, regardless of their ties overseas and how long they intend to remain in the UK.

New Rules from 6 April 2017

From 6 April 2017, individuals born in the UK with a UK domicile of origin who move overseas and acquire a domicile of choice elsewhere, and then return to the UK at a later date, will be regarded as deemed domiciled in the UK from the date they become UK resident again (with a small grace period for IHT purposes only).

Those affected will be taxed as follows:

- Worldwide income and gains will be subject to UK tax with no access to the remittance basis.

- For IHT purposes, an FDR will be liable to IHT on their worldwide assets, in the same way as UK domiciled individuals. A short grace period can apply, lasting up to the end of the first tax year in which the FDR re-establishes UK residence, where the individual was not UK resident in both of the preceding two tax years. The grace period is intended to mitigate the exposure to IHT for individuals who may return to the UK for only a brief period.

- Income and gains arising in an offshore trust settled by the FDR and from which he or his spouse can benefit will be taxable on the settlor on an arising basis whilst he is UK resident. He cannot benefit from the trust protections available to non-domiciled settlors who become deemed domiciled as a result of having lived in the UK for at least 15 years.

- The assets within an offshore trust settled by an FDR whilst he was non-UK domiciled will be subject to IHT ten yearly and exit charges for any year in which he is UK resident, in the same way as a trust settled by a UK domiciled individual. The ten yearly and exit charge can be apportioned for the periods of time that the individual was not UK resident during the relevant period.

- The IHT gift with reservation of benefit rules may apply to assets within an offshore trust settled by the FDR if he can benefit from the trust. The trust assets would therefore form part of his

chargeable estate on death.

- The transitional tax reliefs that are available to non-domiciled individuals who become deemed domiciled from 6 April 2017 cannot apply to an FDR, i.e. capital gains tax rebasing of non-UK assets and 'cleansing' of mixed funds.

Leaving the UK

If an FDR subsequently leaves the UK and becomes non-UK resident, he will no longer be subject to UK tax on worldwide income and gains (including income and gains arising on assets he settled into trust).

For IHT purposes, an FDR will lose his deemed domicile in the year after he loses his UK residence, provided he has not spent sufficient time in the UK to become deemed domiciled under the 15 out of 20 year rule. This means that, from the first full year of non-residence, his IHT exposure would be limited to UK assets (including interests in overseas entities that hold UK residential property). If an FDR had become deemed domiciled as a result of having been UK resident for at least 15 years, he would only lose his deemed domicile status for IHT purposes after three complete UK tax years of non-residence.

If the FDR intends to be UK resident for only a short period of time, but after the expiry of the IHT grace period, the IHT risk could be covered by appropriate insurance during that period of time.

When an FDR becomes non-UK resident again, any non-UK trust he settled whilst non-UK domiciled would revert to excluded property status. Therefore, the inheritance tax status of a trust settled by an FDR will follow the residence status of the settlor, and could change from one year to the next if the individual moves in and out of the UK.

Summary

Individuals born in the UK with a UK domicile of origin who re-establish UK residence after 6 April 2017 will be subject to UK tax on worldwide income and gains, including income and gains arising in offshore trusts settled whilst non-UK domiciled. Global assets (including assets the FDR settled into trust whilst non-UK domiciled) will fall within the scope of inheritance tax from the individual's second year of UK residence.

Trustees will need to keep a track of the residence status of settlors born in the UK with a UK domicile of origin. Should the settlor re-establish UK residence, trustees should seek professional advice to ensure they are prepared for the additional compliance and filing obligations they may have whilst the settlor remains UK resident.