# Non-domiciliaries
# Deemed domicile / rebasing / cleansing mixed funds / business investment relief

**The benefits of non-domicile status**
An individual who is resident but not domiciled in the UK does not pay tax on overseas income and gains, as long as they are kept outside the UK and are not used to provide benefits in the UK. This is called the remittance basis of taxation.

In addition, non-UK assets are outside the scope of UK inheritance tax.

**Deemed domicile – the position before 6 April 2017**
Even before the changes which were made in 2017, an individual would be deemed to be domiciled in the UK for inheritance tax purposes at the beginning of their seventeenth year of UK residence. From that point, all assets on a worldwide basis would be within the scope of UK inheritance tax unless they had been put into a trust before the individual became deemed domiciled in the UK.

An individual could, however, continue to benefit from the remittance basis of taxation for income and capital gains tax purposes without any time limit as long as they had not decided to remain in the UK indefinitely (in which case they would have acquired a UK domicile and so would no longer qualify for the remittance basis of taxation).

Once an individual had been in the UK for more than seven years, an annual remittance basis charge of £30,000, £60,000 or £90,000 was payable, depending on how long the individual had been living in the UK.

**Deemed domicile – the rules from 6 April 2017**

***Formerly domiciled residents***
From 6 April 2017, any non-UK domiciliary who was born in the UK with a UK domicile of origin no longer receives any of the benefits of non-domiciled status whilst they are resident in the UK.

This means that they are taxed on worldwide income and gains, including income and gains of overseas trusts which they have established and of which they (or certain family members) are beneficiaries.

They are also subject to inheritance tax on a worldwide basis.

In addition, trusts which they have established whilst non-domiciled are no longer protected from inheritance tax whilst they are UK resident.

The only minor relief from the rigour of these rules is that liability to inheritance tax on non-UK assets only applies for events occurring after the individual has been UK resident for one year.

None of the reliefs or the trust protections referred to in this or our other briefing notes are available to formerly domiciled residents.

The worldwide liability to inheritance tax, however, ceases once the formerly domiciled resident is no longer UK resident although, as with other deemed domiciliaries, liability to inheritance tax continues until the beginning of the fourth year after leaving the UK if the formerly domiciled resident has spent at least 15 years living in the UK.

**Long-term residents**
Non-domiciliaries who have been UK resident for at least 15 years in any 20 year period will become deemed domiciled in the UK for all tax purposes (i.e. for income and capital gains tax purposes as well as inheritance tax) at the beginning of the following tax year whether or not they are UK resident in that year.

As far as inheritance tax is concerned, this means that, if the individual wishes to avoid becoming liable to inheritance tax on a worldwide basis, they must leave the UK before the start of their fifteenth year of UK residence. If they only leave during the course of the fifteenth year of UK residence, they will become deemed domiciled and will remain subject to UK inheritance tax on a worldwide basis until the beginning of their fourth year of non-UK residence.

This does not matter for income or capital gains tax purposes as non-residents are generally not liable to UK income or capital gains tax in respect of non-UK income / gains in any event.

Individuals who become deemed domiciled in the UK as a result of long term residence are no longer able to benefit from the remittance basis of taxation. They are therefore taxed on their worldwide income and gains, whether or not remitted to the UK.

They do not, however, pay tax on gains or on non-UK source income arising in offshore trusts which have been established before becoming deemed domiciled, as long as the trust is not tainted by making an addition to the trust after becoming deemed domiciled. These trust protections are explained in more detail in our briefing note: Non-domiciliaries - trust protections.

Once a long term resident becomes deemed domiciled in the UK, they are also subject to UK inheritance tax on their worldwide assets. However, again, a trust will provide protection. Any non-UK assets (other than certain assets which derive their value from UK residential property) held in a trust established before becoming deemed domiciled remains outside the scope of UK inheritance tax.

**Deemed domicile – use of offshore losses**

The default rule is that a non-domiciliary cannot set off losses realised on non-UK assets against any gains, whether those gains arise on UK assets or whether they are gains on overseas assets which are remitted to the UK.

A non-domiciliary can, however, elect that overseas losses should be allowable. However, if this is done, losses must be set against gains in a particular order. This could be disadvantageous as it can result in losses realised on UK assets being set against overseas gains which are never remitted to the UK.

Irrespective of whether a loss election has been made, once an individual becomes deemed domiciled in the UK, overseas losses can be set against gains realised either on UK assets or non-UK assets in exactly the same way as for somebody who is actually domiciled in the UK.

**Deemed domicile and temporary non-residence – transitional rule**

An individual who has been UK resident for at least four years but then becomes non-resident is subject to UK tax on certain income and gains realised during the period of non-residence unless they remain non-resident for more than five years.

It is possible for a non-domiciliary who is caught by the temporary non-residence rules but who returns to the UK after 5 April 2017 to find that they are deemed domiciled under the new rules on their return to the UK as a result of having been UK resident for more than 15 years in a 20 year period.

The result of this is that foreign income / gains during the period of temporary non-residence would normally be taxable in the year of return without the benefit of the remittance basis of taxation.

In order to prevent an unexpected tax charge, any non-domiciliary who started a period of temporary non-residence before 8 July 2015 (when the introduction of deemed domicile was first announced) continues to be able to claim the benefit of the remittance basis in the year of return but only in respect of overseas income and gains arising during the period of non-residence and which would otherwise be taxed as a result of the temporary non-residence rules. The deemed domiciliary does not have to pay the remittance basis charge in order to benefit from this provision.

This is only likely to affect a limited number of individuals but is a welcome relief where it applies.

**Capital gains tax rebasing**

Rebasing applies automatically to all of the personally held assets of a non-domiciliary who became deemed domiciled in the UK on 6 April 2017 as a result of having been UK resident for at least 15 out of the previous 20 years, as long as the individual has paid the remittance basis charge in one or more previous tax years. As mentioned above, it is not available to formerly domiciled residents.

The effect of rebasing is that, on a future disposal of the asset, the individual is treated for capital gains tax purposes as if they had acquired the asset at its market value on 5 April 2017. Any gain relating to the period before this date is simply not taxable.

This is an incredibly generous relief, as can be seen from the following example.

Assume Angela, who became UK deemed domiciled on 6 April 2017, purchased shares in a non-UK company for £1m in 2005. On 5 April 2017, the shares are worth £5m. She sells the shares on 31 August 2017 for £5.5m.

The £500,000 gain relating to the period from 6 April 2017 to 31 August 2017 is taxable as Angela is now deemed domiciled in the UK and cannot benefit from the remittance basis of taxation. She will pay 20 per cent tax – i.e. £100,000. The gain of £4m for the period up to 5 April 2017 can be brought to the UK tax free. The original £1m investment would be taxed when it is brought to the UK if it represents Angela's overseas income and gains but, as a result of the way in which the mixed fund rules work, the £4m of gains can be brought to the UK in priority to the £1m original investment and so there is no need to remit the £1m to the UK.

Rebasing applies to offshore funds which do not have reporting status (where the gain would otherwise be taxed as income rather than as a capital gain). Rebasing is not, however, available for assets held in offshore structures. It only applies to assets owned by the deemed domiciliary personally.

Rebasing only applies to non-UK assets. It is not available for UK assets or for any asset which has been situated in the UK at any time after 16 March 2016. This is to prevent rebasing being available, for example, in respect of a painting which was held in the UK when rebasing was announced (in March 2016) but which was then moved out of the UK in the hope that rebasing would be available.

The deemed domiciliary can elect on an asset by asset basis that rebasing should not apply, for example where the asset was worth less on 5 April 2017 than it originally cost.

Individuals will need to remember to make this election in their tax return for the year in which any relevant asset is disposed of.

**Separating mixed funds**

In order to encourage non-domiciliaries to bring funds to the UK (and therefore benefit the UK economy), all non-domiciliaries (other than formerly domiciled residents) have a window of opportunity until 5 April 2019 to separate income, capital gains and capital which have been mixed in a single account.

On the face of it, this is very helpful as it will, for example, allow individuals to separate original clean capital invested from capital gains on the sale of an asset or to separate capital gains from income so that the gains can be remitted to the UK at a 20 per cent tax cost instead of being treated as remitting income at a tax cost of up to 45 per cent.

There will, however, be many individuals who will find it difficult to identify exactly how much income, gains and capital are contained in a mixed account, for example where the individual has had a portfolio of investments for many years with payments going in and out of the portfolio.

The good news, however, is that it is not necessary to identify all of the constituent parts of the mixed fund. As long as the taxpayer can show that the account contains a particular amount of capital, capital gains or income, that amount can be transferred out of the mixed account into a new account leaving the remainder of the funds (whatever they may be) in the mixed account.

There is no formal process for nominating the income, gains or capital which are paid out of the mixed fund to the new account. The taxpayer just has to keep a record of how this was calculated so that it can be produced to HMRC if requested.

There is one slightly odd provision which is that only one transfer out of the mixed account to a single new account will be effective to achieve any segregation. A second transfer to the same account will be ineffective.

So, for example, if Jim has £50,000 in his mixed account and has identified that £10,000 is clean capital and £5,000 is capital gain but does not know what the rest is, he can transfer £10,000 to a new clean capital account and £5,000 to a new capital gains account. However, if he subsequently discovers that there was a further £7,000 of clean capital, he cannot make a second transfer to the new clean capital account.

Instead, he would have to transfer the entirety of the remaining £35,000 to a new mixed account. He could then make a transfer of £7,000 out of the new mixed account into the new clean capital account which would be effective to segregate the additional £7,000 of clean capital.

Another potential trap is that HMRC takes the view that, if a transfer out of the mixed account exceeds the amount of income, gains or capital in the account, this will not provide any segregation.

For example, if a mixed fund of £100,000 is thought to contain £20,000 of clean capital which is therefore transferred into a new clean capital account, but it turns out that there was only £19,500 of clean capital in the mixed account, the new account will not contain £19,500 of clean capital and £500 of income / gains but will instead contain a proportion (20 per cent) of all of the income, gains and capital which were in the original mixed account.

The draft legislation also creates a potential difficulty in respect of income and gains which have arisen before 6 April 2008. Prior to that date, there were no statutory rules to determine whether a payment out of a mixed account constituted income, capital gains or capital and the case law dealing with this did not provide clear guidance.

It was generally thought that income could be treated as having been paid out first and that capital and capital gains would then be paid out proportionately. However, the draft legislation treats any previous payment out of a pre-2008 mixed account as containing a proportion of any income or capital gains rather than treating the income as coming out first.

For those who have actually been keeping track of what is contained in their mixed funds, this means that calculations will have to be re-done. It may also be disadvantageous as it will mean that the mixed account will contain more income and less gains than would otherwise be the case.

There has been some discussion as to whether a mixed account can be separated if it is held by someone other than the individual taxpayer. This might be the case, for example, if an individual has transferred income or gains into a trust or an offshore company.

It is clear from the legislation that income and gains arising after April 2008 can be segregated even if the mixed account is not held by the taxpayer but it seems that income and gains arising before April 2008 can only be segregated if the mixed account is held by the taxpayer. There is no obvious reason for this distinction.

HMRC has been asked to comment on some draft questions and answers on the operation of the cleansing rules. It is hoped that they will take a pragmatic view to calculations of the income, gains and capital contained in mixed accounts, for example allowing calculations to be made in local currency or in sterling, accepting calculations which represent best estimates based on the information available and also treating an investment portfolio as a single mixed fund rather than treating each separate investment as a separate mixed fund.

Where the position is complicated, it may be worth waiting to see this guidance before taking any action.

**Business investment relief**

Business investment relief allows non-domiciliaries to remit overseas income and gains to the UK to make certain investments without a tax charge arising.

The take up of business investment relief has been relatively limited, partly as a result of the very wide anti-avoidance provisions.

There are two significant changes to business investment relief which should make the relief much more attractive:

- An investment can now include the acquisition of existing shares in a company rather than subscribing for new shares.
- The claw back of relief where value is extracted from a company now only applies if the extraction of value has some link to the original investment. Under the original rules, the receipt of value from an associated company (which was very widely defined) resulted in the claw back of relief, even if this had nothing at all to do with the investment or the company which qualified for relief.

**Practical implications**

Despite increasing competition from other jurisdictions, the UK tax regime for non-domiciliaries remains attractive for foreigners looking to relocate:

- There is no prohibition on working in the UK.
- Earnings for work done outside the UK are not taxable for the first three years.
- Tax benefits are available for at least 15 years and, even after that, assets held in trust remain protected.

It is however more important than ever to take proper advice and to plan appropriately both before becoming UK resident and in advance of becoming deemed domiciled in the UK.

There are some immediate steps which should be considered:

- Individuals who will become deemed domiciled in the future should take action to optimise their UK tax position.
- All non-domiciliaries should consider whether they can take advantage of the ability to separate out mixed accounts before 5 April 2019.
- Anybody who became deemed domiciled on 6 April 2017 should identify which assets have qualified for rebasing and whether this provides any opportunities for tax free remittances to the UK.
- Business investment relief is now more attractive and can continue to shelter overseas income and gains which are invested in the UK even after an individual becomes deemed domiciled. This is a relief which should not therefore be overlooked.

**Contact details**

If you would like further information or specific advice please contact:

Jonathan Conder
Partner
Private client
DD +44 (0)20 7849 2253
jonathan.conder@macfarlanes.com

Jennifer Smithson
Partner
Private client
DD +44 (0)20 7849 2891
jennifer.smithson@macfarlanes.com

Robin Vos
Solicitor
Private client
DD +44 (0)20 7849 2393
robin.vos@macfarlanes.com

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**Macfarlanes LLP**
20 Cursitor Street London EC4A 1LT
T +44 (0)20 7831 9222 | F +44 (0)20 7831 9607 | DX 138 Chancery Lane | www.macfarlanes.com