The much talked about tax changes to non-domiciled individuals have had a rather turbulent path through the legislative process.

Draft legislation was produced at the end of 2016 with a view to its introduction into law during 2017, but with an effective date of 6 April 2017. However, the snap general election in 2017 led to much of the draft legislation being shelved.

Towards the end of 2017, the draft was resurrected, and has now finally been passed as law (almost a year later than planned). The effective date however, remained 6 April 2017.

This article addresses two of the more interesting planning opportunities contained in the legislation, as well as one point of caution that people should be aware of.

THE CONCEPT OF DOMICILE

Domicile is a concept of UK common law. A person's domicile is generally the territory which that person considers to be their permanent home.

In this respect, a clear distinction can be drawn between domicile, which has a sense of permanency to it, and residence, which is a function of where a person is considered to be living during a tax year.

THE IMPACT OF DOMICILE ON THE TAXATION OF EXPATS IN THE UK

A person's domicile is an important factor in determining the scope of UK tax law as it applies to that person.

1. Income and Capital Gains Tax

For most UK residents, the tax implications of domicile are of little relevance. However, for expats living in the UK, the "non-dom" status offers significant tax planning opportunities and potentially great complexity to their tax affairs.

Any individual who is resident but not domiciled in the UK can elect to be taxed using the "remittance basis" of taxation. In general terms, this allows those people to shelter their offshore income and gains from UK taxation provided that they do not bring those income and gains to the UK, or 'enjoy' them in the UK.

2. Inheritance Tax

Inheritance tax is applied to the worldwide assets of individuals domiciled in the UK. However, for those individuals not domiciled or "deemed domiciled" in the UK, it is applicable only to UK situs assets.

Historically, individuals have been considered deemed domiciled in the UK if they have been UK resident in 17 of the previous 20 years.

KEY POINTS OF THE NEW LEGISLATION

1. Deemed Domicile

As of 6 April 2017, we now have two different definitions of deemed domicile for UK tax purposes.

The first of these is a modification of the existing rules, and will be of interest to expats in the UK if they plan to be UK resident in the medium to long-term. The new test shortens the required period of UK residence under the old deemed domicile test for inheritance tax from seventeen out of twenty years to fifteen out of twenty years.

The second definition relates to individuals originating from the UK, but who have emigrated and subsequently returned. This states that a person will be deemed domiciled in the UK if the person was born in the UK, has a "domicile of origin" in the UK, and is resident in the UK.

The biggest change here is that the scope of the deemed domicile rules has been expanded such that it no longer only applied to inheritance tax, but now also impacts both income tax and capital gains tax.

This broadening of the scope of deemed domicile will have an impact on individuals who continue to elect into the remittance basis of taxation, individuals who wish to mitigate the risk of future inheritance tax issues, and those who have interests in certain types of trust structure.

2. Planning for Remittance Basis Taxpayers

Under the new rules, anyone who has been in the UK for more than fifteen of the previous twenty years loses the ability to claim the remittance basis

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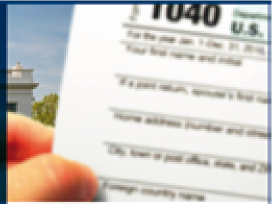

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effective from April 2017, and will now therefore become subject to UK taxation on an arising basis.

This may not be much of a concern to those with more significant assets, as the cost of the "Remittance Basis Charge" would likely have led to them reporting on an arising basis anyway. However, for those with significant offshore assets or investments, the impact of this will be not only in a higher overall UK tax liability, but also a great deal of additional complexity.

That said, it is not all bad news - there are some interesting planning opportunities included in the new provisions which are worth exploring.

a. Mixed Funds

Those who have been used to the nuances of the remittance basis of taxation may well be familiar with the term "mixed fund". For those who are not, a mixed fund is an offshore asset (generally a bank account or an investment account) which contains funds which would be treated in different ways if remitted to the UK.

A simple example of a mixed fund might be a deposit account containing capital generated prior to a move to the UK, as well as interest income earned on the account. If that were to be remitted to the UK, the capital would generally not be taxable, but the interest earned after UK residence began would be taxable.

Complex ordering rules exist to determine what is deemed to have been remitted to the UK from a mixed fund first, and these have made it difficult for expats in the UK to separate the capital from the taxable items in a mixed fund retrospectively. As a result, many expats in the UK find themselves with offshore accounts that they cannot use in the UK without what is often complex accounting as well as burdensome UK tax liabilities. In some cases, the UK tax liability may be due in addition to any tax paid in the home jurisdiction.

Included in the new legislation is a window of opportunity for expats to "clean up" mixed funds. This window of opportunity was included in the draft legislation and was to expire on 5 April 2019. The delay in finalising the legislation has not led to a postponement of that deadline.

In order to access the new cleansing rules, an individual must be resident but not domiciled in the UK and must have claimed the remittance basis in some year between 6 April 2008 and 5 April 2017.

Cleansing offshore accounts will involve going through the often burdensome exercise of analysing the nature of funds in the account. This opportunity is only applicable to cash. If a person wants to cleanse other assets, they will have to liquidate them first.

The cleansing relief operates by allowing a person to make a transfer from one account to another and to nominate the nature of the funds transferred. For example, if an individual has determined that their offshore account consists of £100,000 of capital and £15,000 of income, they could transfer the sum of £100,000 to a new account and make a nomination to the effect that the transfer consists solely of capital. The individual would then have two offshore accounts: one containing £100,000 of capital that could be brought into the UK with no adverse tax consequences; and one containing £15,000 of income that would be taxable if brought to the UK.

This relief has the potential to be a significant benefit to expats in the UK, but it is not without its difficulties:

- Foreign currency. In practice, it is likely that many offshore mixed funds will be denominated in a currency other than GBP. HMRC's approach to the issue of how currency conversions should be applied is problematic, and clear guidance on the subject is still not in place
- Excess income/gains. It is possible that the value of the accumulated income and gain in a mixed to actually be lower than the total value of the account (for example, in certain cases where there have been foreign currency issues). The nomination rules are unclear on how this should be dealt with

- Over-nomination. This point is extremely important. The nomination rules provide that if a nominated amount exceeds the actual amount available, then the nomination is void and the cleansing will not have been effective. This means that great care must be taken with any nomination.

Clearly, this is a very interesting planning opportunity, but care should be taken before making any cleansing nominations. If this mechanics of the relief are not correctly operated and a subsequent remittance to the UK arises, the results could be rather expensive!

b. Capital Gains

Another interesting opportunity created by these new rules relates to the capital gains tax treatment of certain offshore assets held by individuals who became deemed domiciled on 6 April 2017, and had paid the Remittance Basis Charge in at least one prior tax year.

Offshore assets held by such individuals are rebased so that their cost for capital gains tax purposes is the market value of the asset on 6 April 2017. Any subsequent capital gain realised on a sale of the asset being calculated by reference only to the appreciation of the asset between 6 April 2017 and the date of sale.

It is possible for an individual to elect out of the rebasing provisions and calculate their gain or loss by reference to the actual acquisition cost of the asset. This will be advisable in cases where the actual acquisition cost is higher than the 6 April 2017 market value.

It is worth pointing out that this relief will not apply to any assets held in a company or trust structure.

DISCLOSURE AND THE REQUIREMENT TO CORRECT

The world is becoming a smaller place, and Governments are finding new ways to gather information and ensure compliance with their tax laws.

The adoption of the "Common Reporting Standard" means that over 100 countries will be able to exchange financial information in 2018. HMRC will therefore be able to obtain information from banks, financial institutions, and certain other sources not only in the UK but internationally, as well as being able to gather information directly from foreign Governments.

In anticipation of this, the UK has introduced new rules requiring any person who has not correctly reported a liability to income tax, capital gains tax or inheritance tax deriving from an overseas asset or overseas interest to do so by 30 September 2018. Any such disclosure will be dealt with under the usual penalty regime.

In the event that HMRC subsequently identifies such a liability which has not been disclosed, they will impose a new and much more draconian penalty regime. The starting point for this penalty regime is to impose a penalty of 200% of the tax underpaid as a result of the error. It is possible to mitigate the penalty based on the criteria of co-operation, quality disclosure, and seriousness, but the penalty cannot be reduced below 100% of the outstanding tax.

In cases deemed to be particularly serious, an additional penalty of 10% of the value of the offshore asset or interest can be imposed.

This regime applies to the tax year ending 5 April 2017 and all earlier years, and also allows HMRC up to 5 April 2021 to assess any relevant taxes.

Given that expats in the UK are among those more likely to have overseas assets or overseas income, if they have any doubt as to the accuracy of the reporting of those, they should give serious consideration to reviewing their tax filings and making any disclosure necessary to avoid being caught by this regime.

SUMMARY

There are many points in the legislation which are not covered in this article, some of which are complex and as yet still a little unclear. However, this does represent the most significant overhaul of the taxation of non-domiciled individuals since 2008. There is good news and bad news, but one thing is certain...that tax issues facing expats in the UK do not look to be getting any simpler.

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