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PLANNING FOR LIFE IN THE UK AS A LONG-TERM RESIDENT DEEMED DOMICILIARY

On 6 April 2017 the UK tax rules relating to the taxation of long-term UK residents changed dramatically, leading to a seismic shift in the UK tax treatment of non-UK domiciled individuals once they have been resident in the UK for at least 15 out of the previous 20 tax years.

Whilst many non-doms living in the UK have reconciled themselves with the idea of paying tax in the UK on the arising basis (i.e., on their worldwide income and capital gains) going forwards, there is much more to this new regime than may initially meet the eye. There are certain planning opportunities available but also a variety of pitfalls of which to be aware. Further, simply continuing to run existing account and investment structures in the same way as before the rules changed may no longer be effective (and may in some instances actually be counterproductive).

This briefing note is intended to provide an overview of some of the key features of the new regime which long-term UK residents need to be aware of. It is not intended to be exhaustive, but rather to highlight some important issues and planning points on which further advice may be sought.

PAYING TAX ON THE ARISING BASIS: A SEISMIC SHIFT

Whilst it is beyond the scope of this briefing note to reiterate in detail all of the tax changes which were implemented with effect from 6 April 2017, the key change relevant to longer-term UK residents is that, from that date, any individual who is UK resident for at least 15 out of the previous 20 tax years will become deemed domiciled in the UK (irrespective of their actual domicile status) for income tax, capital gains tax and inheritance tax purposes. As such, these individuals (referred to in the rest of this briefing note as “longer-term UK residents”) will be subject to all three of the main UK taxes on a worldwide basis. This is a significant change from the previous “remittance basis” regime (where, on electing the remittance basis of taxation and, where necessary, paying a remittance basis charge, a non-domiciliary’s non-UK income and gains were only taxable in the UK to the extent that they were remitted to the UK, irrespective of how long they were resident in the UK). The change leads to a number of important questions, the answers to which in many cases appear often to have been the

subject of misconceptions. This section outlines some of those misconceptions and sets out the actual position, as well as offering practical pointers as to how best to navigate the new regime.

Misconception 1: Paying tax on the arising basis will simplify future tax compliance, as UK tax is now due on everything

Going forwards, longer-term UK residents will need to understand the nature (for UK tax purposes) of any offshore assets and investments they hold

Unfortunately, it is not this simple.

Previously, non-domiciliaries paying the remittance basis could simply pay the remittance basis charge and keep as much as possible offshore – in this way it was not necessary to know how any assets held would be treated for UK tax purposes. However, longer-term UK residents now have to pay tax on all income and gains arising offshore after they become deemed domiciled and will not have the option to pay the remittance basis charge to access the remittance basis. It will therefore be necessary to understand the nature (for UK tax purposes) of all such assets and any returns they generate.

The tax treatment of certain types of return, for example dividends and interest payments, will of course be obvious. However, many individuals affected by the new rules will have investments that are more difficult to analyse for UK tax purposes, or investments that have surprising results for UK tax purposes. For example, it was not previously necessary to look at underlying entities in offshore asset holding structures, where nothing was actually received by the individual taxpayer. However, this will often no longer be the case, either where the entity is treated as tax transparent (for example a partnership investment) or where anti-avoidance rules operate to attribute income or gains to a shareholder of an offshore company (in either case, without the individual in question actually receiving anything). It will also sometimes be the case that certain assets are expensive to analyse in UK tax terms which in itself can cause unwanted or disproportionate expense.

Individuals who are now (or are about to become) deemed domiciled under the new 15 out of 20 years rule should therefore consider carrying out a "health check" on the assets they hold, to consider how easy it will be to calculate the likely UK tax bill going forwards and whether there are any investments that might cause surprising tax results. Some people following such a health check may wish to simplify their holdings. Such individuals are also likely to need to engage with the tax return process earlier than was previously the case, as analysing all assets and investments for UK tax purposes will be a more involved and time-consuming process than before – at least in this transitional period.

Misconception 2: Paying the tax will be easier when UK tax is due on everything as any funds can be used to pay the tax charge without causing further issues

Using the wrong source of funds to pay a UK tax charge could create a remittance and generate further tax

This is sadly not the case and using the wrong source of funds could actually create a remittance and generate further tax.

Longer-term UK residents are not able to access the remittance basis of taxation by paying the remittance basis charge where this is lower than the actual tax charge due, as they may previously have done before becoming deemed domiciled in the UK. As such, it is quite possible that many will end up with much higher annual tax charges than before. Although many individuals have reconciled themselves to this, it appears many have not actually thought about how the arising basis tax is actually going to be funded due to a misapprehension about the new regime going forwards.

It is commonly understood that the rules only subject *future* income and gains to the arising basis of taxation. However, many people believe that this means that pre-existing income and gains held offshore at the date the individual becomes deemed domiciled, on which tax has never been paid in the UK, can therefore be remitted to the UK with impunity. Unfortunately, this is not the case; such income and gains remain subject to the remittance basis and will therefore incur a further charge to UK tax if remitted. Moreover, many people do not realise

that bringing funds to the UK to pay the arising basis tax charge to HMRC is actually a remittance (unlike the remittance basis charge which could freely be paid out of offshore funds) or that they cannot "choose" what they remit – rather, very prescriptive rules apply known as the mixed fund regime. The details of this complex regime are beyond the scope of this briefing note but it will be seen from the following paragraphs that, with careful planning, there are ways of navigating it and improving the situation somewhat.

Misconception 3: Advice previously taken about the best way to structure onshore and offshore assets will still apply, so nothing needs to be changed now

Account and investment structures which previously worked most efficiently may no longer be as effective and may even be counterproductive

The account and investment structures which previously worked most efficiently may no longer be as effective and, in some cases, may actually be counterproductive.

First, given the difference in tax treatment of offshore assets before and after the date on which a longer-term UK resident became deemed domiciled it will be important to try to ensure that, to the extent possible, such assets are not mixed. Of course this will not always avoidable, particularly with capital gains. However, certainly for income it will often be sensible to maintain separate accounts for the pre- and post-deemed domiciled periods.

Secondly, aside from the question of making sure that arising basis tax can be paid as outlined above, there is a wider issue to consider around optimising the flow of funds into the UK over the years to come. With the right planning and account structuring it ought (in theory at least) to be possible to ensure that future growth in value of assets currently held outside the UK is held in the UK and only the same original value is held offshore (by bringing to the UK everything subject to UK tax). People who can achieve this will be in an increasingly flexible position as their onshore "pot" (and therefore the funds in relation to which issues such as inadvertent remittances, always investing outside the UK, what the money can be used for, or moving money from one account to another, are not a concern) will increase. If thought is not given to these issues the offshore pot will continue to increase and deemed domiciled individuals may find that each year they end up depleting limited onshore funds in something of a scramble to fund the arising basis tax bill. Whereas in the past there has been a tendency (and, indeed, often a sensible rationale) for non-domiciliaries to hold a multitude of accounts, it may now be the case for longer-term UK residents that rationalising and having fewer accounts would prove beneficial in order to facilitate this sort of planning.

Although there is no easy answer, longer-term UK residents may wish to consider the way in which they are operating their offshore cash and investment accounts. Thought may also be given to whether a "plan" can be put in place to access as much as possible in the UK in as simple a way as possible. This is something that needs to be considered on a case-by-case basis.

UN-MIXING AND REBASING

Where someone has paid the remittance basis charge at least once since 2008 and became deemed domiciled under the new 15 year rule **on** 6th April 2017 (only – this opportunity is not available to individuals who become deemed domiciled in any other circumstances), a mechanism known as "rebasing" automatically applies to them. This means that all of their assets that were held at 5 April 2017 will be deemed to have been sold and reacquired (without capital gains tax consequences) for the market value on that date. This can be hugely beneficial for some people, although it is important to note that its treatment applies automatically such that if any assets held as at 5 April 2017 were sitting at a loss, an election would pro-actively need to be made for the rebasing rule not to apply.

On a practical note, given the arising basis of taxation going forwards, it is helpful for individuals to whom rebasing is relevant to gather as much information as they can around the market value of any investments held at 5 April 2017. Of course this is quite straight forward for listed securities etc., but may be more complex for other assets (particularly

illiquid assets). It should also be noted that the rebasing would be in sterling, so investments denominated in non-sterling currencies would need to be converted into sterling at the 5 April 2017 exchange rate. Rebasing also only applies to assets that are held (or deemed to be held) directly.

The window for un-mixing closes on 5 April 2019 – anyone wishing to un-mix an offshore account should instruct advisers as soon as possible

There is also a planning opportunity known as "un-mixing", which is a one off opportunity (available only until **5 April 2019**) to override part of the mixed fund regime and enable individuals to "choose" what they move into different accounts. In contrast to the rebasing outlined above, un-mixing is available more widely and can be claimed by any non-UK domiciled individual (other than someone originally born with a UK domicile of origin but who subsequently acquired a different domicile) who was subject to the remittance basis in any year before the 2017/18 tax year, irrespective of whether they actually paid the remittance basis charge.

Un-mixing is only permitted in relation to cash, so any non-cash investments would have to be sold to take advantage of this opportunity. There are obviously instances where, commercially, this will not be desirable, irrespective of the advantages of the availability of un-mixing. It should also be borne in mind that some assets may only have limited liquidity windows, with redemption notice being required by a particular time before 5 April 2019 in order to achieve cash proceeds by then. Moreover, although the detail is outside the scope of this note, it is worth noting that the mechanics of the nomination process for un-mixing are complex.

Despite the potential hurdles mentioned above, it is possible that this un-mixing opportunity can be utilised in a very efficient way, particularly in conjunction with rebasing. However, in order to carry out a thorough and effective un-mixing exercise, it would be important to work out precisely what is located in each of your investment and cash accounts for UK tax purposes. This will often be a rather complex and involved exercise, particularly as most longer-term UK residents will have a multitude of investments and do tend not to be immediately aware what these comprise for UK tax purposes. The question then is what work is worth doing, if any, to assess how beneficial the un-mixing regime could be in a particular case. From a commercial perspective, it would not be proportionate to undertake a great deal of detailed forensic work to establish that, within accounts or investments of large value, there is relatively little which is remittable to the UK (as in this case the expense of the work may outweigh the benefit).

Before deciding whether to proceed with an un-mixing exercise, longer-term UK residents may therefore find it helpful to consider how much could theoretically likely be remitted into the UK without tax charges if all of their assets were converted into cash (bearing in mind that un-mixing can only be done with cash). Such a thought process would give at least some indication as to the likely benefit of such work.

TRUSTS

The amended legislation in relation to trusts is outside the scope of this briefing note. However, where a longer-term UK resident has settled any offshore trusts prior to becoming deemed domiciled in the UK, urgent advice should be taken (if it has not already) on a number of issues, but in particular in relation to how not to "taint" the trust, as tainting actions risk causing such trusts to lose forever certain valuable protections that would likely otherwise have been afforded to them.

CONCLUSION

Longer-term UK residents will now be in an entirely different regime to that which they were used to. They will have to learn to deal with not only the prospect of a greater annual tax bill, but also with the potential difficulty in knowing what will be taxed and how it will be treated, as well as issues to deal with in terms of how the tax bills will be paid.

We believe it is very important to address whether a "road map" can be put in place as to how such individuals will operate their lives going forwards. As stated, the previous conventional wisdom about the best ways to structure and operate such individuals' investments will often no longer give the best results and may, in some cases, be counterproductive and, over time, create an unhelpfully inflexible position. The complexity of those same structures are now also likely to lead to greater expense in having to correctly analyse them for UK tax compliance purposes, often without any significant benefit.

Longer-term UK residents who are able to give some thought now to their asset holding structures are likely to benefit from establishing a sensible road map that may guide them efficiently for many years to come, as well as considering whether the particular planning opportunities afforded by the un-mixing regime and the rebasing regime may be of assistance to them.

Please do not hesitate to contact us if you would like to take specific, detailed advice in relation to any of the issues outlined above. Please note in particular that the un-mixing opportunity is only available until 5 April 2019 – making the most of this opportunity is likely to entail detailed and time-consuming forensic work and therefore needs to be undertaken as soon as possible.

KEY CONTACT

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The information contained in this guide is intended to be a general introductory summary of the subject matters covered only. It does not purport to be exhaustive, or to provide legal advice, and should not be used as a substitute for such advice.

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