DEEMED DOMICILE FROM 2017

James Kessler QC

5.1 Introduction

This article discusses the deemed domicile rules announced in Summer Budget 2015. References throughout to chapters and Appendices are to those in *Taxation of Non-Residents and Foreign Domiciliaries* published by Key Haven Publications plc.

The rules will take effect from 6 April 2017. The details are gradually emerging:

- "Technical Briefing on Non-Dom changes" (July 2015) (**"the July 2015 Non-Dom paper")**[1]
- Consultation paper "Reforms to the taxation of non-domiciles" (September 2015) **("the September 2015 condoc")**.[2]
- Policy paper "IHT: reforms to the taxation of non-domiciles" & draft IHT clauses (December 2015)[3]
- Policy paper "Domicile: Income Tax and CGT" & draft IT/CGT clauses (2 Feb, updated 5 Feb 2016) ("**the Feb 2016 policy paper**")[4]
- Budget 2016
- "Reforms to the taxation of non-domiciles: further consultation" (August 2016) ("**the August 2016 consultation paper**")[5]

5.2 Terminology

Section 267(1) IHTA currently provides:

A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if—

(a) he was domiciled in the UK within the three years immediately preceding the relevant time, or

(b) he was resident in the UK in not less than seventeen of the twenty

years of assessment ending with the year of assessment in which the relevant time falls.

Para (a) is "**the IHT 3-year rule**" and para (b) is "**the IHT 17-year rule**".

In this chapter:

"**The domicile start date**" is the date on which deemed domicile begins

"**The domicile end date**" is the date on which deemed domicile ends

5.3 Deemed domicile: Summary

In summary, there will be four categories of IHT deemed domicile and two categories of IT/CGT deemed domicile:

IHT deemed domicile	**Comment**	**IHTA s.**
3-year rule	Unchanged[1]	267(1)(a)
Formerly domiciled resident	New	267(1)(aa)
15-year rule	Was 17-year rule	267(1)(b)
Spouse-election	Unchanged[2]	267ZA

The IT/CGT deemed domicile rules will be:

IT/CGT deemed domicile	**Comment**	**s.835B ITA**
Formerly domiciled resident	New	Condition A
15-year rule (differs slightly from IHT rule)	New	Condition B

5.4 IHT 15-year rule

Section 267(1) IHTA will be amended to read:

> A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if...
>
> (b) he was resident in the UK—
>
> (i) for at least fifteen of the twenty tax years immediately preceding the tax year in which the relevant time falls, and

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1 See chapter 4.2.1 (3-year rule)[[Deemed Domicile for IHT#3-year rule | 3-year rule]].

2 See chapter 4.6 (Spouse-election domicile)[[Deemed Domicile for IHT #Spouse-election domicile | Spouse-election domicile]].

(ii) for that tax year or, if he was not resident in the UK for that tax year, for at least one of the four tax years immediately preceding that tax year.

I refer to this as “**the IHT 15-year rule**”.

The start date for acquisition of 15-year deemed domicile is 6 April in the tax year *after* the 15/20 year test is satisfied. (That is different from the start date of the current IHT 17-year rule).

Assuming a continuous period of UK residence:

UK residence from	**Deemed domicile start date:**	
	15-year rule	**17-year rule**
2002/03	6 April 2017	6 April 2018
2003/04	6 April 2018	6 April 2019
2004/05	6 April 2019	6 April 2020
2005/06	6 April 2020	6 April 2021

5.4.1 *Domicile end date*

Deemed domicile under the 15 year rule ends under (ii) once an individual has been non-resident for more than four *consecutive* years. But if the individual has not been UK resident for 15 consecutive years, then the condition in (i) will not be satisfied. So the condition in (ii) only matters at the margin.

Take the case of someone continually UK resident since 2004/05 who ceases to be UK resident in 2018/19:

Year		**deemed dom**	**Years res. in previous 20**
2004/05	resident	no	0
2005/06	resident	no	1
2006/07	resident	no	2
2007/08	resident	no	3
2008/09	resident	no	4
2009/10	resident	no	5
2010/11	resident	no	6
2011/12	resident	no	7
2012/13	resident	no	8
2013/14	resident	no	9
2014/15	resident	no	10
2015/16	resident	no	11

2016/17	resident	no	12
2017/18	resident	no	13
2018/19	resident	no	14
2019/20	non-resident	yes	15
2020/21	non-resident	yes	15
2021/22	non-resident	yes	15
2022/23	non-resident	yes	15
2023/24	non-resident	no *	15
2024/25	non-resident	no *	15
2025/26	non-resident	no	14

In the years marked *, ie 2023/24 and 2024/25, the individual is not deemed domiciled under rule (ii) (four continuous years of non-residence). But in the following year he is not deemed domiciled under rule (i) (less than 15 years UK residence).

Note that deemed domicile in the year can depend on UK residence for that year, which depends on facts during the year (and in some cases, after the year). On 6 April, and for some time after, an individual cannot know for sure whether they are resident, and so cannot know if they are deemed domiciled for IHT or not. Similar problems arise for formerly domiciled residents, whose domicile in a year depends on UK residence for that year.

5.5 Children

5.5.1 *Child of deemed domiciliary*

The July 2015 Non-Dom paper provides:

> 20. The deemed domicile of the long term resident non-dom has no effect on the domicile status of the children, whose actual and deemed domicile position is looked at independently. Thus they will take their father's domicile under general law at the date of their birth and if they are long term residents within the new rules will become deemed domiciled here. But they do not become deemed domiciled here simply because either parent is deemed domiciled here nor do they lose deemed domicile just because a parent does.

5.5.2 *Children under 18*

UK resident years count towards the 15 year total even if the individual is under the age of 18. So a child who is born in the UK and who does not have a UK domicile of origin could become deemed-domiciled before reaching adulthood. However,

that individual could still lose their deemed-UK domiciled status if they leave the UK and spend sufficient years non-resident.

5.6 Formerly domiciled resident: IHT rule

Section 267 IHTA will be amended to read:

> (1) A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if...
>
> (aa) he is a formerly domiciled resident for the tax year in which the relevant time falls ...

"Formerly domiciled resident" is a technical term, a label for a set of four rules. Section 272 IHTA will provide:

> "formerly domiciled resident", in relation to a tax year, means a person—
>
> (a) who was born in the UK,
>
> (b) whose domicile of origin was in the UK,
>
> (c) who was resident in the UK for that tax year, and
>
> (d) who was resident in the UK for at least one of the two tax years immediately preceding that tax year.

The domicile start date for formerly domiciled residents is 6 April in the 2nd year of residence.

The July 2015 Non-Dom paper provides:

> 25. Some individuals who have a UK domicile at the date of their birth (i.e. a UK domicile of origin) may emigrate. They may successfully be able to show that under general law they have acquired a domicile of choice overseas as they intend to settle in the foreign country. Under current rules... they will remain UK deemed domiciled for IHT purposes for at least 3 years after they have formed the intention to settle permanently (and do settle) in the foreign country even if they have been non-UK resident for many years before reaching that decision. Once they have lost their UK domicile and deemed domicile for IHT purposes they can set up trusts and obtain favourable treatment for excluded property trusts and their worldwide estate will fall outside IHT...

26. However some of these individuals later return to the UK for some years and still maintain they have a foreign domicile of choice. In these circumstances, the new rules will mean that they are taxed as UK domiciled for tax purposes on their return irrespective of their domicile status under general law.

27. Irrespective of their actual intentions, such an individual (the returning UK dom) will become UK domiciled for tax purposes once they become UK resident. In addition, while UK resident after their return here, the returning UK domiciliary will not benefit from any favourable tax treatment in respect of trusts set up while not domiciled here (whether inheritance tax treatment or otherwise)...

5.6.1 *Who is affected by formerly domiciled resident rule?*

The rules will catch in particular:

(1) Those who (would like to) return to the UK for medical treatment of a terminal illness

(2) Short term secondees from abroad

The rule may work somewhat arbitrarily, because of the capricious rules which determine domicile of origin. CIOT give this example:

an individual:

- born in the UK of UK domiciled but non-resident father who is in the UK for some temporary purpose
- taken out of the UK in infancy, grows up, lives and works abroad for the next, say, 30-40 years during which time he acquires a foreign domicile of choice;
- seconded by his employer to the UK on a short term basis

CIOT say:

> The individual will, under current proposals, be treated for income tax and capital gains tax purposes in the same way as a UK domiciliary. This is arguably inequitable given that it is pure happenstance that the individual was born in the UK.
>
> The harshness of the rule is highlighted further if one compares the position with the individual's sibling who was born outside the UK and who is, therefore, not affected by the returning UK domiciliary proposal. The sibling may therefore take up temporary secondment in the UK or

come to the UK to look after his/ her parents without incurring the same adverse consequences as the individual.[38]

5.6.2 *Formerly domiciled resident: domicile end date*

The domicile end date for formerly domiciled residents is 6 April in the first year of non-residence.

5.6.3 *Pre-domicile trust of formerly domiciled resident*

Section 48 IHTA currently reads (so far as relevant):

> (3) Where property comprised in a settlement is situated outside the UK—
>
> > (a) the property ... is excluded property unless the settlor was domiciled in the UK at the time the settlement was made...
>
> (3A) Where property comprised in a settlement is a holding in an authorised unit trust or a share in an open-ended investment company—
>
> > (a) the property ... is excluded property unless the settlor was domiciled in the UK at the time the settlement was made...

Draft s.48(3E) IHTA provides:

> In a case where the settlor of property comprised in a settlement is not domiciled in the UK at the time the settlement is made, the property is not excluded property by virtue of subsection (3) or (3A) above at any time in a tax year if the settlor was a formerly domiciled resident for that tax year.
>
> If the formerly domiciled resident dies, the trust property becomes excluded property again.

The September 2015 condoc provides:

> [Formerly domiciled residents] will be treated as having a UK domicile for tax purposes. This means there will be no protection for offshore trusts, either in terms of the tax on income/gains in the trusts or for IHT purposes.
>
> The excluded property trust rules for IHT will be changed so that they do not apply in these circumstances. This will be the case even for trusts

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3 CIOT, "Response to Consultation on draft clause 43 Finance Bill 2016" (Feb 2016)

> that are set up offshore while the individual was not domiciled or resident in the UK (and would therefore be excluded property for IHT purposes under the current rules). So if an individual caught by this test acquires an overseas domicile and then sets up an offshore trust while non-UK domiciled, once that individual becomes UK resident the assets in that trust will cease to qualify as excluded property and would be liable to inheritance tax charges. ...
>
> Since the residence criteria will be based on the statutory residence test where individuals are either resident or non-resident for the whole year, it will create situations in which property will switch from being excluded property to being liable to IHT under the "relevant property" regime for periods of one or more tax years. If someone is frequently coming and going from the UK, the property in the trust will be excluded property one year and relevant property in the next year. The government accepts this position as it would allow individuals flexibility to move in and out of the UK as and when necessary.[4] However, trustees will need to consider whether a ten year anniversary charge arises at any point during each period the settlor is UK resident.

The rules operate in an arbitrary way. Eg, if an formerly domiciled resident who has created a trust comes to the UK for 5 years, a 10 year charge depends on the accident of whether the 10 year anniversary falls within any of those 5 years. It may be possible to wind up the trust before coming to the UK, to avoid the charge, if one arises.

This is particularly harsh for foreign charitable trusts (not charities for UK tax purposes).[5] It may be possible for such charities to convert into a form which qualifies as a charity for UK tax. But the issue will rarely if ever arise.

5.7 IT/CGT deemed domicile

Draft s.835B ITA provides:

> (1) This section has effect for the purposes of the provisions of the Income Tax Acts or TCGA 1992 which apply this section.
>
> (2) An individual not domiciled in the UK at a time in a tax year is to be regarded as domiciled in the UK at that time if—
>
> (a) condition A is met, or
>
> (b) condition B is met.

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4 It is difficult to understand the thinking behind this sentence.

5 See Kessler & Marre, *Taxation of Charities & Nonprofit Organisations* (10th ed) chap 3 (Definitions of Charity) online version *http://www.taxationofcharities.co.uk*

I refer to "**IT/CGT dom conditions A and B**"; the individual who satisfies one of these conditions is "**IT/CGT deemed domiciled**".

5.7.1 *Scope of IT/CGT deemed domicile*

IT/CGT deemed domicile applies only for provisions which apply s.835B ITA. The list of provisions in the draft legislation is:

> ***Income tax***
>
> > ICTA: s.266A
> >
> > ITEPA: s.355, 373, 374, 376 ITA: s.476, 718, 809B, 809E, 834
>
> ***CGT***
>
> > TCGA: s.69, 86, 275
> >
> > FA 2008 transitional reliefs (formerly domiciled residents only):
> >
> > paragraphs 100(1)(b), 101(1)(c) and 102(1)(e),
> >
> > paragraph (b) of paragraph 118(3) so far as having effect for the purposes of paragraph 118(1)(d), and
> >
> > paragraphs 124(1)(b), 126(7)(b), 127(1)(e) and 151(1)(b).

Are there any important cases where the taxes acts refer to domicile but do not apply s.835B, so not within the IT/CGT deemed domicile rules? Are any omissions deliberate or accidental? And will the list change before the provisions become final?

5.7.2 *IT/CGT dom condition B (15-year rule)*

I deal with condition B before condition A, as that is the more important.

Draft s.835B(4) ITA provides:

> Condition B is that the individual has been UK resident for at least 15 of the 20 tax years immediately preceding the tax year referred to in subsection (2).

This is the equivalent of the IHT 15-year rule. At first it seems slightly different, because s.835B(4) does not have an equivalent of s.267(1)(b)(ii). But on further examination that does not matter.

The £90,000 remittance basis charge (introduced 2015/6) will end after 2016/17.[6]

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6 Because the £90k charge only applies once an individual has been UK resident for 17 years; such a person will be deemed UK domiciled and no longer qualify for the remittance basis.

Such is the instability of UK tax.

5.7.3 *IT/CGT dom condition A (formerly domiciled resident)*

Draft s.835B(3) ITA provides:

> Condition A is that—
>
> (a) the individual was born in the UK,
>
> (b) the individual's domicile of origin was in the UK, and
>
> (c) the individual is resident in the UK for the tax year referred to in subsection (2).

This is the equivalent of the IHT formerly domiciled resident rule.[7] However, there is no equivalent to para (d) of the IHT rules (a grace period of one year). So the domicile start date is 6 April in the 1st year of residence. In that year, a formerly domiciled resident will be deemed domiciled for IT/CGT but not for IHT.

Spilt year rules do not strictly alter deemed domicile, but in practice IT/CGT relief would usually be available in the offshore part of a split year, and deemed domicile is usually irrelevant during that period, so that may to some extent mitigate the absence of a grace period.

The domicile end date is 6 April in a year of non-residence, which is the same as the IHT rule.

5.8 Meaning of "residence" in deemed domicile rules

Section 267(4) IHTA provides:

> For the purposes of this section the question whether a person was resident in the UK in any year of assessment shall be determined as for the purposes of income tax.

This will be amended to read:

> (4) For the purposes of this section the question whether a person was resident in the UK ~~in any year of assessment~~ for any tax year shall be determined as for the purposes of income tax.

This brings the wording into line with the statutory residence test but there is no change in the meaning.

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7 See chapter 5.6 (Formerly domiciled resident: IHT rule)[[#Formerly domiciled resident: IHT rule | Formerly domiciled resident: IHT rule]].

Thus "residence" has its normal tax meaning. From 2013/14, the statutory residence test applies.

5.8.1 *Split years*

A tax year for which the individual is UK resident will count in full for the 15-year test even if the year is a split year under the SRT.[8]
It follows that there is a mismatch in the overseas part of a split year:

(1) For IT/CGT: Foreign income and gains in the overseas part of the year are not taxed; deemed domicile will not prevent the split year rules applying.

(2) For IHT: Foreign situate property is non-excluded property even in the overseas part of the year.

But this is not the only mismatch between the IHT and IT/CGT deemed domicile rules, so perhaps it does not matter.

5.9 Start and end date uncertainties

As at a domicile start or end date of 6 April, in any year, the individual will often not know whether they will be resident for the year or not, because facts which emerge during the year (or even after the year) are relevant to determine residence. So they will not know whether they are deemed domiciled or not. For IT/CGT this matters less, as tax returns are due long after the year end, by which time the position should be known. For IHT, on the other hand, the returns may be due before the relevant facts are known. Taxpayers will have to judge as best they can.

5.10 2017 rebasing

The August 2016 consultation paper provides:

> The government agrees that it would be punitive to require long-term resident non-doms to pay CGT on gains that have accrued on foreign assets held while the individual was a non-dom. To address these concerns, Budget 16 announced that those individuals who will become deemed-domiciled in April 2017 because they have been resident for 15 of the past 20 years will be able to rebase directly held foreign assets to their market value on 5 April 2017.

8 See chapter 10.1 (Year of arrival and departure)[[Split Years: Arrival and Departure#Default rule: individual resident throughout tax year | Default rule: individual resident throughout tax year]].

I refer to this as **"2017 rebasing"**.

"Directly held" would seem to exclude:

> (1) assets held in companies held by individuals
>
> (2) assets held in trust, subject to the s.86 charge

Is that intended?

The relief will not be available to those who become deemed domiciled after 2017. Someone who would be deemed domiciled but for being non-resident in 2016/17 might be able to arrange to be UK resident during the year, in order to qualify.

> Individuals will be able, if they wish, to rebase overseas assets to the market value of the asset at 5 April 2017 with the result that any gain[9] which accrued before April 2017 will not be charged to CGT in the UK. However, any further increase in the value of an asset between April 2017 and the date of disposal will be charged to CGT in the normal way.
>
> Rebasing will apply on an asset by asset basis and there will be no requirement that any part of the sales proceeds relating to the part of the gain which arose before April 2017 should be left outside the UK. Where the asset was originally purchased with clean capital, the entire proceeds from the disposal can be brought to the UK without triggering a remittance. However, where it was purchased wholly or partly with foreign income and gains, an element of the disposal proceeds will still relate to[10] those income and gains and so will be subject to the remittance basis in the normal way when the proceeds are brought to the UK. The protection will be limited to those assets which were foreign situs at the date of the Summer Budget 2015 [8 July 2015].

One might have expected rebasing to apply to assets held on 6 April 2017, but perhaps this is an anti-forestalling rule.

> Rebasing will provide transitional protection for those non-domiciled individuals who have been resident in the UK for a long period, and to ensure that the protection is properly targeted it will be restricted to those who had paid the remittance basis charge in any year before April 2017.

If necessary, consider electing and paying the remittance basis charge in 2016/17 to qualify for rebasing.

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9 I assume this means, any *unrealised* gain.

10 "Relate to" is an inaccurate paraphrase of the statutory wording, "derive from". But it does not matter.

> The government will legislate for this transitional protection in Finance Bill 2017 alongside the rest of the non-dom reforms. Draft legislation on this aspect of the reforms will be published later in 2016.
>
> Those individuals who become deemed-domiciled in years after April 2017, and those who become deemed-domiciled because they were born in the UK with a UK domicile of origin will not be able to rebase their foreign assets.

Re-basing was an afterthought, first suggested in the 2016 budget, and even now, HMRC have not thought very deeply about it.

Those who will become deemed domiciled in April 2017 may do well to avoid disposals before 6 April 2017 of any property which will qualify for rebasing.

5.11 2017 mixed fund segregation relief

The August 2016 consultation paper provides:

> The government recognises that the mixed fund rules can (!) be complicated, and that these reforms will mean that those non-doms who become deemed-domiciled in April 2017 who were taxed on the remittance basis will have to pay tax in the UK on their offshore income and gains on an arising basis for the first time. It will also mean that an individual with a mixed fund will find it difficult to bring any money from the fund into the UK without paying tax at their top rate of tax when they do so. For some, this will be a punitive outcome, as the fund will be comprised of a mix of both foreign income which would be taxable at the highest rate of tax as well as money that would be taxable at a lower rate; for example, foreign gains which would be taxed at a top rate of 28% or clean capital, which would not be taxable at all even when remitted.
>
> The government has therefore decided to introduce a temporary window in which such individuals will be able to rearrange their mixed funds overseas to enable them to separate those funds into their constituent parts. This window will last for one tax year from April 2017 and it will provide certainty on how amounts remitted to the UK will be taxed. During this time, non-doms with mixed funds will be able to rearrange their mixed funds and separate out the different parts. This will mean, for instance, that they will be able to move their clean capital, foreign income and foreign gains into separate accounts, and will then be able to remit from their accounts as they wish and pay the appropriate amount of tax. There will be no requirement for the non-dom to make a remittance from their newly segregated accounts in any particular order or within any particular time limit. This will mean that an

> individual who separates their mixed funds may, if they wish, remit funds from each separated fund, even if that remittance takes place in a later tax year after the transitional period has ended.
>
> The special treatment will only apply to mixed funds which consist of amounts deposited in bank and similar accounts. Where the mixed fund takes the form of an asset (for example a valuable painting), it will not qualify for the special treatment. However, an individual will be able to sell any overseas asset during the transitional window and separate the sale proceeds in the same way as any other money.
>
> Cleansing will not be available where an individual is unable to determine the component parts of their mixed fund. The mixed fund rules have always required a remittance basis user to track and monitor their offshore funds in order to benefit from the remittance basis, and while the government is willing to introduce a transitional rule to help people to separate their funds, this will not extend to those who are unable to identify the source of those funds.

It would be worth drawing up mixed fund accounts now, so the data is ready when needed on 6th April 2017.

> This treatment will be available to any non-dom who was not born in the UK with a UK domicile of origin – it will not be restricted only to individuals who have been resident for 15 of the past 20 years who will become deemed-domiciled under the new rules.
>
> An individual need not be resident in the UK in April 2017 to be able to use this protection, but it will only be of any benefit to those individuals who have been UK resident at some point in time and who have used the remittance basis of taxation.
>
> Draft legislation will be published on this protection later in 2016.

Taxpayers will often want to realise assets in order to qualify for the relief. That may take place in 2017/18 in order to qualify for 2017 rebasing.

Consider deferring remittances from mixed funds until next year, in order to take advantage of the relief.

5.12 Protected trusts: Introduction

Special rules apply to a trust made by a settlor at a time when:

(1) Not UK domiciled; and

(2) Not deemed domiciled under the IT/CGT 15-year rule (including all pre 2017 trusts as this rule does not begin to apply until 2017/18).

I use the term **"protected trust"** to describe such trusts; it is not completely accurate, but conveys the general idea.

Some settlors will be better off than before 2017, as they will not have to pay the remittance basis charge in order to qualify for the transitional reliefs.

5.12.1 *The 2015 proposal*

The September 2015 condoc provided:

> The government intends to base the new rules on the taxable value of benefits received by the deemed domiciled individual **without reference to the income and gains arising in the offshore structure**. ... Once a non-dom becomes deemed-UK domiciled, it will no longer be relevant whether a benefit is received in the UK or overseas; the value of that benefit will be treated as taxable regardless. However, UK source income will be taxable on the arising basis, as it would be under the existing rules if either the settlements legislation or the transfer of assets legislation applied.

This is not fair and indeed not rational, unless the rationale is to tax trusts so penally that they cease to be accessible to deemed domiciled UK residents.[11] The proposal is now of historical interest only, but I think the story deserves to be recorded. Should the reader be more pleased that the proposal was withdrawn? or more concerned that it reached the consultation paper? Discuss.[12]

5.13 Protected trusts: s.86

The August 2016 consultation paper summarises the proposed rule as follows:

> ... the legislation does not extend to the settlor of a non-resident trust who is deemed-domiciled where the trust was set up before they became deemed-domiciled and no additions of property have been made since that date. However, if the settlor, their spouse, or their minor children and/or stepchildren receive any actual benefits from the trust then the protection will not apply.

Draft para 5A(1) sch 5 TCGA provides:

Section 86 does not apply in relation to a year ("the particular year") if—

11 In addition, the rule is also not EU-law compliant, though the force of that objection may be reduced by the approaching Brexit.

12 Some readers may speculate whether it was put forward with a view to withdrawing it in consultation as a sop to the consultation process; but that seems far-fetched.

A set of 6 conditions then follow.

> (a) the particular year is the tax year 2017-18 or a later tax year

That is straightforward.

> (b) the settlor is not domiciled in the UK when the settlement is created,
>
> (c) where the settlement is created on or after 6 April 2017, it is created at a time when the settlor is not regarded for the purposes of section 86(1)(c) as domiciled in the UK as a result of section 835BA of ITA 2007 (see section 86(3A))

That is, when the trust is made, the settlor is not:

(1) Domiciled or

(2) Deemed domiciled under the IT/CGT deemed domicile rules

> (d) there is no time in the particular year when the settlor is—
>
> (i) domiciled in the UK, or
>
> (ii) regarded for the purposes of section 86(1)(c) as domiciled in the UK as a result of section 835BA of ITA 2007 having effect because of condition A in that section being met [formerly domiciled resident[13]]

That is, the relief ceases to apply to those who become:

(1) Actually UK domiciled or

(2) Previously domiciled residents

5.13.1 *Adding to trust*

The next condition concerns adding to the trust:

> (e) no property or income is provided directly or indirectly for the purposes of the settlement at a time—
>
> (i) in or after the first post-settlement 15/20 tax year,[14] and

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13 See chapter 5.7.3 (IT/CGT dom condition A (formerly domiciled resident)[[#IT/CGT dom condition A (formerly domiciled resident) IT/CGT dom condition A (formerly domiciled resident)]].

14 See chapter 5.13.3 (“Post-settlement 15/20 tax year”)[[#”Post-settlement 15/20 tax year” “Post-settlement 15/20 tax year”]]. 20 The date is unspecified.

(ii) before the end of the particular year

(2) For the purposes of sub-paragraph (1)(e), ignore—

(a) property provided under a transaction entered into at arm's length,

(b) property provided in pursuance of a liability incurred by any person before [(date)],[15] and

(c) where the settlement's expenses relating to taxation and administration for a tax year exceed its income for that year, property provided towards meeting that excess if the value of the property is not greater than the amount of the excess.

The wording is based on s.86 transitional rules; see chapter 56.5.1 (Trigger condition 1: provision of property)[[Gains of Non-Resident Settlor-Interested Trusts: s.86#Trigger condition 1: provision of property | Trigger condition 1: provision of property]].

5.13.2 *Family benefit*

The sixth requirement is:

(f) no family benefit is conferred at a time—

(i) in or after the first post-settlement 15/20 tax year,[16] and

(ii) before the end of the particular year.

It may be desirable to confer family benefits before the first post-settlement 15/20 year. It may be desirable to split trusts into two, one which will continue to qualify as a protected settlement.

Draft para 5A(4) sch 5 TCGA defines family benefit:

For the purposes of sub-paragraph (1)(f), a family benefit is conferred if—

(a) [i] any relevant property[17] comprised in the settlement, or [II] any relevant income[18] arising under the settlement, is applied

15 The date is unspecified.

16 See chapter 5.13.3 ("Post-settlement 15/20 tax year")[[#"Post-settlement 15/20 tax year" |"Post-settlement 15/20 tax year"]].

17 Draft para 5A(5) sch 5 TCGA provides the definition: "relevant property" is property originating from the settlor.

18 Draft para 5A(5) sch 5 TCGA provides the definition: "relevant income" is income originating from the settlor.

for the benefit of or paid to—

(i) the settlor, or

(ii) a person who is a family member when the property, or income, is applied or paid, or

(b) the settlor, or any other person at a time when that person is a family member, otherwise enjoys a benefit directly or indirectly from any relevant property comprised in the settlement or any relevant income arising under the settlement.

This should not include a payment on arm's length terms, which is not a benefit, such as a loan to the settlor on arm's length terms.[19]

This is a problem for trusts where the settlor has an interest in possession (if there is trust income in excess of trust expenses). Perhaps insert an underlying company so there is no income? Is it sufficient for the life tenant to mandate income to a non-family member?

Draft para 5A(5) sch 5 TCGA defines family member:

In sub-paragraph (4)—

"family member" means any of the following—

(a) the settlor's spouse or civil partner, and

(b) any child, or step-child, of the settlor who has not reached the age of 18

5.13.3 *"Post-settlement 15/20 tax year"*

This term is used in the rules relating to family benefits and adding property.

Draft para 5A(3) sch 5 TCGA provides:

For the purposes of sub-paragraph (1)(e) and (f), a tax year is a "post-settlement 15/20 tax year" if—

(a) it begins after the creation of the settlement, and

(b) the settlor has been UK resident for at least 15 of the 20 tax years immediately preceding that tax year.

It does not say that the post-settlement year must be a year after 2017, though that is presumably the intention. Perhaps the text will be amended on this point.

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19 This view is consistent with the settlor-interested trust rules: see 33.3.2 ("Settlor-interested" for IT purposes)[[Settlor-interested Trusts# "Settlor-interested" for IT purposes | "Settlor-interested" for IT purposes]].

5.14 Protected trusts: s.87

The August 2016 consultation paper provides:

Settlors who become deemed-domiciled will not be taxed under section

> 87. Their trusts will either not be protected, in which case they would be liable for all gains under section 86 or, if the trust is protected, it will lose its protection once a benefit is paid out to them, their spouse or minor children resulting in the settlor being taxed on all gains arising.

The draft legislation does not address this.

5.15 Protected trusts: s.624

The August 2016 consultation paper summarises the proposed rule as follows:

> ... the legislation at section 624 does not apply to a deemed-domiciled settlor on foreign income arising to a non-resident trust that they had set up before becoming deemed-domiciled, if the income is retained within the trust. UK source income arising to a non-resident trust will continue to be taxed on a deemed-domiciled settlor as it is now currently. The legislation at section 633 onwards taxing a non-domiciled settlor on capital sums they receive from a non-resident trust to the extent the capital sums can be matched to trust income available will be extended to deemed-domiciled settlors.
>
> However, if the settlor, their spouse, minor children or other relevant person receives a distribution of relevant foreign income arising in a year when
>
> [1] the settlor was non-domiciled and
>
> [2] the trust was protected
>
> that distribution will be taxed on the settlor under section 624 to the extent that it can be matched against relevant foreign income arising in that year and in any other years when the settlement is protected and the settlor is a long term resident non-dom.

5.15.1 *"Protected year"*

Draft s.628C(1) ITTOIA provides:

> For the purposes of sections 628A and 628B, a particular tax year is a "protected year" for a settlement if—

A set of 7 conditions then follow. They broadly follow the form of s.96 relief in para 5A sch 5 TCGA, though (for no obvious reason) the conditions are set out in a different order.

> (a) the trustees of the settlement are non-UK resident in the particular year,
>
> (b) the settlor has been UK resident for at least 15 of the 20 tax years immediately preceding the particular year,

This is straightforward.

> (c) there is no time in the particular year when the settlor is—
>
> > (i) domiciled in the UK, or
> >
> > (ii) regarded for the purposes of section 809B of ITA 2007 as domiciled in the UK as a result of section 835BA of ITA 2007 having effect because of condition A in that section being met [formerly domiciled resident],

This is the same wording as para 5A(1)(d).

> (d) the settlor is not domiciled in the UK when the settlement is created,

This is the same wording as para 5A(1)(b).

> (e) where the settlement is created on or after 6 April 2017, it is created at a time when the settlor is not regarded for the purposes of section 809B of ITA 2007 as domiciled in the UK as a result of section 835BA of ITA 2007,

This follows the wording of para 5A(1)(c).

> (f) no property or income is provided directly or indirectly for the purposes of the settlement at a time—
>
> > (i) in or after the first post-settlement 15/20 tax year, and
> >
> > (ii) before the end of the particular year

This is the same wording as para 5A(1)(e).

> (2) For the purposes of subsection (1)(f), ignore—
>
> > (a) property provided under a transaction entered into at arm's length,
> >
> > (b) property provided in pursuance of a liability incurred by any person before [(date)], and

(c) where the settlement's expenses relating to taxation and administration for a tax year exceed its income for that year, property provided towards meeting that excess if the value of the property is not greater than the amount of the excess.

(3) For the purposes of subsection (1)(f), a tax year is a "post-settlement 15/20" tax year if—

(a) it begins after the creation of the settlement, and

(b) the settlor has been UK resident for at least 15 of the 20 tax years immediately preceding that tax year.

This is the same wording as para 5A(2)(3).

The last condition is:

(g) the particular year begins on or after 6 April 2017.

5.15.2 *"Protected income"*

Draft s.628B(2) ITTOIA provides:

In subsection (1) "protected income" means income that—

(a) arises under the settlement—

(i) in the tax year mentioned in subsection (1) if that year is a protected year for the settlement, or

(ii) in any earlier tax year that is a protected year for the settlement,

(b) arises during the life of the settlor from property in which the settlor has an interest,

(c) is relevant foreign income, and

(d) is not excepted by sections 626 to 628.[20]

5.15.3 *"Confer a family benefit"*

Draft s.628B ITTOIA provides:

(1) For the purposes of section 628A, a family benefit is conferred in a tax year if—

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20 These exceptions are:

s.626: outright gifts to spouses. This could not apply here.

s.627: divorce settlements; and certain commercial arrangements (not relevant here). s.628: charity distributions from a UK settlement. This could not apply here.

(a) any protected income is in the year applied for the benefit of or paid to—

(i) the settlor, or

(ii) a person, other than the settlor, who is a relevant person[21] when the income is applied or paid, or

(b) the settlor, or any other person at a time when that person is a relevant person, in the year otherwise enjoys a benefit directly or indirectly from any protected income.

This is wider than the equivalent CGT rule.

5.15.4 *Two computations*

Armed with these definitions, we can proceed. Draft s.628A ITTOIA provides:

(1) Subsections (2) and (3) apply if a tax year ("the current year"), or any earlier tax year, is a protected year for a settlement.

(2) If the current year is a protected year for the settlement, calculate the amount ("RFI") of income that—

(a) arises under the settlement in the current year,

(b) arises during the life of the settlor from property in which the settlor has an interest,

(c) is relevant foreign income, and

(d) is not excepted by sections 626 to 628.

(3) Calculate the total value ("FB") of family benefits conferred in the current year (see section 628B).

With these figures in hand, one proceeds to the relief. Draft s.628A ITTOIA provides:

(4) If—

(a) the current year is a protected year for the settlement, and

(b) RFI exceeds FB, the amount of income arising under the settlement in the current year to which the rule in section 624(1) applies is treated as reduced by the excess.

---

21 Section 628B(3) ITTOIA provides a referential definition: "Section 809M of ITA 2007 (meaning of "relevant person") applies for the purposes of subsection (1) as for those of Chapter A1 of Part 14 of ITA 2007, but with references in that section to "the individual" being read as references to the settlor."

5.15.5 *The matching charge*

Draft s.628A ITTOIA provides:

(5) If—

(a) the current year is a protected year for the settlement, and

(b) FB exceeds RFI,

the amount of income arising under the settlement in the current year to which the rule in section 624(1) applies is treated as increased by the excess.

(6) If the current year is not a protected year for the settlement, the amount of income arising under the settlement in the current year to which the rule in section 624(1) applies is treated as increased by FB.

5.16 Transfer of assets abroad

The August 2017 consultation paper provides:

[1] To deliver the protections, it will be necessary to partially dis-apply the part of the TOAA legislation at section 720 ITA 2007 that would apply to deemed-domiciled settlors who set up a non-resident trust before they become deemed-domiciled, to prevent them from being taxed on the foreign income of the trust or any underlying entity if it pays out dividends to the trust.

[2] If it doesn't, the income arising to the foreign company will still be taxed under section 720.

Point [2] will complicate trust administration, and may be quite impractical for an IP trust. The author of the paper seems to have overlooked that according to HMRC, s.720 does not apply under current law to income distributed immediately.[22]

UK-source income

UK-source income arising to a non-resident trust or underlying entity that is available to the deemed-domiciled settlor/transferor will continue to be taxed as it currently is for a non-domiciled settlor under section 624 ITTOIA 2005 or section 720/ 727 ITA 2007. Where the trust is settlor interested, the settlor will be taxed on the income on an arising basis under section 624 ITTOIA 2005, with any income arising within an

22 See chapter 37.6.1 (Trust/company structure: HMRC practice).

underlying company being taxed under section 720 or section 727 ITA 2007.

Non UK-source income

Under the existing legislation, if the settlor/transferor has power to enjoy or entitlement to a capital sum then for a remittance basis user, the foreign-source income is taxable to the extent it is remitted to the UK. The individual is not taxable on the benefits they receive. Under the proposed new rules which will provide the protections for non-resident trusts, the intention is that the foreign source income is not assessable on an arising basis, but instead the transferor is liable to income tax on any worldwide benefits received. If the settlor, their spouse, minor children or other relevant person receive any actual benefits from the trust for example by way of an income or capital distribution or enjoyment of trust assets, the trust will still be protected but the distribution will be taxed on the settlor under section 720 to the extent that it can be matched against relevant foreign income arising in that year.

It will be necessary to provide a mechanism for matching any benefits against relevant foreign income. This could be achieved by using similar provisions to those in section 733 which relate to the matching of benefits under section 731 to income arising under the settlement but with matching confined in this case to relevant foreign income arising, where the settlement is protected and the settlor is a long-term resident non-dom.

The part of the TOAA legislation at section 731 that taxes any UK-resident individual, excluding the transferor/settlor who receives a benefit arising from a non-resident trust that is linked to the transfer, will remain in place.

The draft legislation outlining the amendments to the TOAA provisions will be published later in the year.

Extending the non-transferor provisions to all non-doms The government will continue to consider this point.

5.17 FOTRA securities and double tax treaties

Section 267(2) IHTA is not amended, and so deemed domiciliaries can continue to qualify for IHT exemption for:

(1) FOTRA securities and qualifying certificates of Islanders[23]

23 See chapter 67.5.1 (Disapplication of IHT deemed domicile rule)[[Excluded Property:Definition#Disapplication of IHT deemed domicile rule | Disapplication of

(2) Estate Duty/IHT double tax treaties[24]

5.18 CGT loss election

The August 2016 consultation paper provides:

> It is intended that after April 2017, a foreign loss election will last only until the individual concerned becomes UK domiciled, or becomes deemed-domiciled. If that individual later loses their UK domicile or deemed-domicile status then they will be able to make another election.

The current legislation in s.16ZA TCGA will be substantially amended.

5.19 Commencement and transitional rules

Para 11(1) of the draft schedule which will go into the FA 2017 provides:

> The amendments made by paragraph 10 have effect in relation to the tax year 2017-18 and subsequent tax years.

5.19.1 *Transitional rules for IHT 15-year rule*

The July 2015 Non-Dom paper provides:

> 16.... For those who leave the UK before 6 April 2017 but would nevertheless be deemed domiciled under the 15 year rule on 6 April 2017 the present rules will apply.

Accordingly, clause 2 of the draft legislation provides:

> (10) The amendment to section 267(1) of IHTA 1984 made by subsection (1)(c) [inserting the 15 year rule] does not have effect-
>
> (a) in relation to a person who has not been resident in the UK after 5 April 2017;

IHT deemed domicile rule]]. For these exemptions generally, see chapter 67.4 (Non-settled property: FOTRA securities)[[Excluded Property: Definition#Non-settled property: FOTRA securities | Non-settled property: FOTRA securities]]; 67.11 (Trusts: FOTRA Securities)[[Excluded Property: Definition#Trusts: FOTRA securities | Trusts: FOTRA securities]]; 67.7 (Individual domiciled in Channel Islands or Isle of Man)[[Excluded Property: Definition#Individual domiciled in Channel Islands or Isle of Man | Individual domiciled in Channel Islands or Isle of Man]].

24 See chapter 74.5 (Domicile requirements of treaty IHT exemption)[[IHT DTAs: India, Pakistan, Italy, France#Domicile requirements of treaty IHT exemption | Domicile requirements of treaty IHT exemption]].

(b) in determining-

(i) whether settled property which became comprised in the settlement on or before that date is excluded property for the purposes of IHTA 1984;

(ii) the settlor's domicile for the purposes of section 65(8) of that Act in relation to settled property which became comprised in the settlement on or before that date;

(iii) whether, for the purpose of section 65(8) of that Act, the condition in section 82(3) of that Act is satisfied in relation to such settled property

Long term remittance basis taxpayers who will be caught by the 15-year rule may wish to arrange to be non-resident from 2017/8 if that is practical.

Although there is no grandfathering this is not retrospective in that it does not impact on past actions taken. For example: a trust settled on 17 January 2017 when an individual is not deemed domiciled under either the current 17-year rule or the 3-year rule but would be under the proposed 15-year rule will continue to be excluded property after 5 April 2017 ....

CIOT lobbied for transitional relief for those who

(1) left the UK before they became deemed-domiciled for IHT under the 17/20 year rule and

(2) subsequently returned to the UK:

a non-UK domiciliary who had been in the UK for many years, then left prior to 2011/12 and returned just after 2014/15 would have stayed for four complete tax years out of the UK. On their return he/she would have reasonably expected to be able to complete another 17 years in the UK before the current IHT deemed domicile 17/20 year test would have caught them again. It is not unreasonable for 17 years to be shortened to 15 years for such a case. However, it is unreasonable for the period to be shortened to zero years, because they will be become immediately deemed domicile again on 6 April 2017.[25]

However no relief is given for this case, so on these facts the individual will become deemed domiciled on 6 April 2017.

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25 CIOT, "Response to Consultation on draft clause 43 Finance Bill 2016" (Feb 2016) *http://www.tax.org.uk/sites/default/files/file_uploads/160201%20Draft%20Finance%20Bill%202016%20Clause%2043%20Inheritance%20Tax%20-%20Domicile%20-%20CIOT%20comments.pdf*

5.19.2 *HT transitional rules for formerly domiciled resident*

There is no transitional relief.

The July 2015 Non-Dom paper provides:

> 29. This measure will affect all returning UK doms from 6 April 2017, including those who returned prior to April 2017. The five year rule will affect UK doms leaving after 5 April 2017. It will also affect trusts set up while such individuals were not UK domiciled if they are UK resident on or after 6 April 2017. In these circumstances, an individual will be taxed on all income and gains arising in such trusts under the same rules as any other UK domiciliary. The IHT treatment of such trusts will also be the same as for UK taxpayers who have never lost a UK domicile.

5.19.3 *CGT transitional rule for pre-2015 temporary non residents*

Taxguide 04/15 provided an example of a problematic interaction with the temporary non-UK residence rules.

> On 2 January 2015, prior to the announcement, an individual, who would have met the "15 out of 20" rule if it had been in force, left the UK on a three year secondment.
>
> Between January and June 2015 she made various disposals of foreign assets at very significant gains with the expectation that when she returned she would pay the £90,000 Remittance Basis Charge and not have to pay tax on the gains (as there would not be any remittances).
>
> Without a transitional provision the changes mean that she will not be able to access the remittance basis when she returns to the UK, so she will have a very significant CGT liability.

The Feb 2016 policy paper accepted the point:

> The part of the measure affecting capital gains tax in respect of foreign chargeable gains accruing to temporary non-residents will not affect accruals arising in respect of periods of temporary non-residence beginning on or before 7 July.

Accordingly, para 21 of the draft schedule provides:

> (1) This paragraph applies in a case where section 10A of TCGA 1992 as substituted by paragraph 119 of FA 2013 applies in relation to an individual.

(2) For the purposes of capital gains tax in respect of foreign chargeable gains accruing to the individual during a temporary period of non-residence beginning before 8 July 2015, the amendment made by paragraph 18(2) does not have effect in relation to the tax year which consists of or includes the period of return.

(3) Where by virtue of sub-paragraph (2) an individual makes a claim under section 809B of ITA 2007 for any of the tax years 2017-18 to 2020-21 inclusive, sections 809C, 809G and 809H of ITA 2007 do not apply to the individual for that tax year.

(4) In this paragraph, “foreign chargeable gain” has the meaning given by section 12(4) of TCGA 1992.

(5) Part 4 of Schedule 45 to FA 2013 explains what “temporary period of non-residence” and “period of return” mean.

Para 20 of the draft schedule contains the same rule for pre-2013 departures; that is needed as they have a separate code.

This only refers to gains. It does not apply to *income* accruing in the period of temporary non-residence. For employment income, the August 2016 consultation paper provides:

> Some stakeholders sought clarification of the tax treatment which would apply where an individual who is subject to the remittance basis receives employment income relating to a period when they were not deemed-domiciled under the 15 out of 20 rule but is paid after they become deemed-domiciled... the government can confirm that such income will be taxable only to the extent that it is remitted to the UK.
>
> This is in line with the current treatment, which currently applies to deferred payments made after an individual ceases to be taxed on the remittance basis.

5.19.4 *IT/CGT deemed domicile for 2017 non-residents*

Draft clause 1(3) provides:

> The amendments made by this section [IT/CGT deemed domicile] and Schedule 1 do not have effect in relation to a person who has not been resident in the UK after 5 April 2017.

Domicile does not affect the tax position of a non-resident, so it is not immediately obvious what this is for.

5.20 Planning

There is scope for tax planning in anticipation of acquisition of deemed domicile. Many of the proposals discussed at Appendix 8.1 (Pre-arrival planning) [Appendix 8: UK Arrival Or Departure: Tax Checklist #Pre-arrival planning, Pre-arrival planning] will be relevant here.

A person ("H") with a UK place of birth and domicile of origin may be married to a person ("W") who was not born in the UK, or who did not have a UK domicile of origin. If H and W become UK resident, then H will be deemed domiciled as a formerly domiciled resident; and W will not. In that case the tax issues can be resolved by a transfer from H to W (and a transfer from a settlement made by H to W). This should be considered before H and W become UK resident.