The Government has settled on a new regime that will give a “protected” status to offshore trusts made before and not added to after, an individual becomes deemed domiciled, with settlors being charged to income tax and capital gains tax on benefits and capital payments received.

These changes will impact individuals becoming deemed domiciled in the UK on or after 6 April 2017 who are the settlor or a beneficiary of a non-UK resident trust, or who have established non-UK resident companies.

The UK tax regime for non-UK trust income and capital gains applying to non-UK settlements and corporate structures will, from 6 April 2017, be as set out below.

Capital gains tax – protected trusts

There will be a “protected trust” regime so that capital gains of a non-UK trust will not be attributed to a UK resident settlor becoming deemed domiciled in the UK under the 15 out of 20 year rule. The protections will continue to apply provided the settlor makes no direct or indirect additions to the trust on or after the date at which they become deemed domiciled in the UK. The settlor of a protected trust will instead be taxed under the “capital payments” regime set out below. Protected trust status will not apply to a settlor resident and deemed domiciled in the UK under the “returning domicile” rule, and therefore these individuals will have trust gains attributed to them for years in which they are resident in the UK.

In considering whether trust protection is maintained, additions to trusts will be disregarded if these are made on arm’s length terms or where a settlor meets trust expenses that are in excess of its income for a tax year.

Capital gains tax – capital payments regime

Capital gains arising to protected trusts will be taxable in accordance with the existing rules that match trust capital gains to capital payments received by beneficiaries. These rules will be reformed for all non-UK trusts from 6 April 2017, irrespective of the domicile status of the settlor.

As under current rules, trust capital gains will be matched to capital payments received by beneficiaries and taxed on them accordingly. Any beneficiary domiciled or deemed domiciled in the UK will be taxed on the matched capital payment on the arising basis.

There are some refinements to the rules that will apply from 6 April 2017 –

- Capital payments made to non-UK resident beneficiaries will not be matched with trust gains and therefore cannot be used to reduce the stockpile of gains in the trust. Capital payments made to a beneficiary in a period of temporary non-residence (of less than five years) will be treated as matched to trust gains in the year of return to the UK. These rules do not apply if the capital payment is treated as made to the settlor under the next new rule set out below, or if the capital payments are made in the final tax year of a trust and there are payments to both UK resident and non-UK resident beneficiaries in that year.

- Capital payments made to “close family” of the settlor will be treated as made to a UK resident settlor where in the year of payment the family member is either non-UK resident, or the remittance basis applies and the payment is not remitted to the UK.

- New rules will treat a capital payment received by a beneficiary that is paid on to another recipient within a period of 3 years as being a capital payment made to the “onward” recipient, unless the original recipient would already be charged to tax on the payment. The tax treatment of the capital payment will then follow based on the identity of the onward recipient rather than the original recipient. This is to prevent capital payments being made initially to non-UK resident or remittance basis user beneficiaries as a way of avoiding a taxable capital payment when the intention is to benefit an individual who would be within the charge to tax.

Income tax

Non-UK income of a non-UK trust and its underlying companies will not be treated as arising to the settlor. Instead the income will only be treated as arising to the settlor if he or a close family member receives a benefit from the trust, and the close family member is not already taxed on the benefit under existing rules.
This would suggest that a UK resident beneficiary not claiming the remittance basis in respect of the benefit would be charged to tax on the benefit in priority to the settlor.

A deemed domiciled recipient of a benefit will be taxed on the arising basis.

UK income of the trust and its underlying companies will be taxed on the settlor on the arising basis.

It is expected that this treatment will only apply for so long as the trust is “protected” (i.e. no additions to the trust on or after the time that the settlor becomes deemed domiciled), this point will be confirmed when legislation is available.

These new rules do appear to present an opportunity for such trusts and underlying companies to use non-UK income to invest in and meet expenses in the UK without any tax consequence for the settlor or other beneficiaries, provided there is no benefit to these individuals from this use of the income. However, income arising from such investments would be taxable on the settlor.

UK and non-UK income of a non-UK company not owned through a trust will be taxable on a deemed domiciled individual who set up the company on the arising basis.

Close family members

For both the income and capital gain tax rules close family members will be the settlor, spouse or civil partner of the settlor (or those living with the settlor as such), and the minor children of all of the preceding categories.

Valuation of benefits

New rules are proposed to fix the valuation of non-cash benefits received from trusts. These benefits would include use of assets or provision of loans at beneficial rates of interest. These rules are proposed to provide certainty of treatment but may produce higher tax costs than some of the current methods of valuation which are based on practice and case law.

Our view

The proposed rules for trust capital gains published on 5 December 2016 in the draft clauses for Finance Bill 2017 are welcome as they provide certainty on how trust protections are preserved, but the new rules for the capital payments regime do bring additional complexities.

The lack of draft legislation on the income tax regime does leave some areas of uncertainty as to precisely how certain aspects of these rules will operate in practice. It is to be hoped that the draft legislation will be available on a timely basis.

For further information see

Big changes for non doms

UK residential property

If you would like KPMG to assist in considering any of the issues that could arise for you from the new rules on the taxation of non-domiciled individuals, please contact one of the KPMG Private Client specialists below.