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Changes to UK resident non dom Income Tax Laws Leads to Need to Establish a Resident Non Dom Income Tax Trust Before April 6th 2017

The UK government announced sweeping changes to the taxation of "resident non doms."

The UK tax obligations of an individual depend in large part on the individual's "domicile" under generally applicable English common law principles. The citizenship of an individual is irrelevant under the UK tax system. The UK income tax and capital gains tax systems take into account the "residence" status of an individual.

Because of quirks in the English common law approach to determining domicile, in certain cases it is possible for several generations of a family whose patriarch was domiciled at birth outside of the United Kingdom to live in the United Kingdom without becoming UK domiciled. These "non-doms" enjoy certain UK income and capital gains tax advantages. The key benefit enjoyed by a UK resident non dom is the ability to elect to be taxed "on the remittance basis". This means a non dom can recognize unlimited income and gains outside the United Kingdom without paying UK tax unless and until the income or gains are treated as "remitted" to the United Kingdom.

For many years the UK inheritance tax or "IHT" regime has operated a "deemed domicile" rule making actual domicile irrelevant for transfers by an individual who has been a UK resident for income tax purposes in any portion of the prior 17 out of 20 UK tax years. There have been proposals for some years now to incorporate a similar deemed domicile concept into the UK income tax and capital gains tax systems. With the recently announced tax reforms, that concept will finally become law. Starting 6th April 2017, any individual who has been a resident in the UK for any portion of 15 out of 20 tax years will lose the benefit of remittance basis taxation, at least with respect to their "personal" income and gains. The technical paper published by the UK Government advises that such individuals can continue to escape UK taxation on income and gains retained in trusts to the extent funded prior to the later of 6th April 2017 or their 15th year of residence.

A further change taking effect 6th April 2017 prevents individuals who were UK domiciled at birth from ever claiming non dom status while a resident of the UK.

For the time being it remains possible for many individuals with strong ties to the United Kingdom to enjoy the remittance basis of taxation for many years. Many wealthy resident non doms historically established what are known as "excluded property" trusts prior to reaching their deemed domicile date for UK IHT purposes, although such trusts are less common with US citizens residing in the United Kingdom because such individuals are subject to the US worldwide estate tax regime. We expect a considerable move prior to 6th April 2017 on the part of UK resident non doms to establish similar trusts for UK income and capital gains tax avoidance purposes but only if they are able to fund the trust without triggering a UK inheritance tax charge.

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