Introduction

Welcome to the Consultation document special edition of our non-dom newsletter.

Here we share our initial thoughts on the recently published consultation on all things non-dom, including what this means for our clients and the potential actions they should be considering now.

If you would like to discuss any of the issues raised in this Newsletter, please get in touch – for contacts, click here.

Tainting, cleansing and rebasing – the condoc arrives

The long-awaited consultation on the changes to non-dom taxation was released on 19 August.

After such a long wait, the final published consultation document certainly gives us a lot to think about. This edition of the non-dom newsletter provides you with a summary of the key issues in the document that we think you need to be aware of. Our next edition of the newsletter will focus on what action you and your clients need to be taking in the light of the new information.

The main proposals from the original consultation will go ahead virtually unaltered – i.e., those who have been here for 15 out of 20 years will be deemed domiciled in the UK and those born in the UK with a UK domicile of origin will be deemed domiciled here whenever resident.

The big news from this document concerns the proposed changes to the rules for protected settlements – those settlements which were established before individuals became deemed domiciled in the UK and which will qualify for special treatment. The initial proposal that individuals would be taxed on benefits received from trusts regardless of the income or gains within it has been significantly altered. Instead, a different solution has been adopted where the income and gains of the trust will be taxed on the settlor, but only where there has been tainting or where benefits have been paid out.

The proposed rebasing of assets for those becoming deemed domiciled in April 2017 is confirmed along with other transitional provisions, including a new and exciting opportunity to cleanse mixed funds.
We also finally have some more detail on how the proposals to bring enveloped UK residential property into the UK tax net will operate and the disappointing news that the hoped-for transitional provisions will not materialise.

The non-dom changes have been a little bit like a jigsaw puzzle for which we only have some of the pieces. This latest publication may give us the pieces we need to now be able to understand the big picture. Crucially for some clients, this may finally be the level of detail needed to begin to make some major decisions - for example, whether to keep existing trust structures or whether to establish new trusts. Those wanting to be in the best position on 6 April 2017 need to be acting now to review structures and ensure records are up to date - the Autumn statement may be too late.

Action needed

With more detail now emerging, those who have not already begun reviewing their structures now need to do so urgently. We still do not have all the pieces of the jigsaw puzzle, but in some cases we may now have enough detail to allow individuals to make in principle decisions - e.g., should they retain certain structures or set-up new ones? Even if clients decide to wait until after the Autumn Statement to take action, they need to have at least given thought to these big issues sooner. Click here for a suggested action list.

Across the globe

As part of our look at the tax treatment of ex-pats in other jurisdictions, in this edition, we consider the position in Guernsey.

Guernsey is the second largest of the Channel Islands and is known for its striking cliff views and sandy beaches. It is a 24 square mile island with a population of about 65,000 situated just off the coast of France, and just a short flight away from London and the other main UK cities. Although the island is constitutionally separate from the UK, it benefits from close ties to the UK as a Crown Dependency.

Guernsey is an English-speaking island, although has strong French roots with its original language known as ‘Guernsey-French’ with many French surnames and street names. The island also has exceptional standards of healthcare and education.

Guernsey has a standard income tax rate of 20%, no capital gains tax, no inheritance tax, no VAT or other sales taxes. For those with substantial income, a tax cap may apply to limit the total amount of income tax payable in Guernsey in a calendar year. A £110,000 cap applies to Guernsey source income or a £220,000 cap applies to all worldwide income (excluding income from Guernsey land and property). A lower cap applies to the island of Alderney. Alternatively, a standard income tax charge of £30,000 may apply to certain individuals who are resident in Guernsey but spend significant time in another jurisdiction.

The standard rate of company income tax in Guernsey is 0% and applies to most companies, with exceptions for certain sources of income from local financial services business taxed at 10%, rental profits taxed at 20%, and a limited number of retail and utility businesses taxed at 20%.

The island offers stability in a highly regulated environment and has established itself as a top tier financial centre. It is well regarded in the finance industry with highly experienced lawyers, accountants, trustees, asset managers and fund administrators.

For further details please contact David White, +44 1481 717 445, dwhite1@uk.ey.com or Dan Collins, +44 1481 717 598, dcollins@uk.ey.com.
Legislation watch

Even now we have the consultation document, we still don’t have all the legislation to help us understand the full detail of the proposals and it can be hard to keep track of precisely what we do and don’t know. Below is an updated guide to the details of the draft legislation we have received and those that we are still expecting.

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Draft legislation?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main 15 out of 20 years proposals for income tax/capital gains tax as well as deemed domiciled for those born in the UK with a UK domicile of origin</td>
<td>Yes – see <a href="#">here</a></td>
</tr>
<tr>
<td>Inheritance tax (IHT) proposals for those deemed domiciled under the new rules</td>
<td>Yes – see <a href="#">here</a></td>
</tr>
<tr>
<td>Details of the special rules for trusts established before becoming deemed domiciled</td>
<td>Partial. Legislation has been published with amended capital gains tax and income from settlor interested trust provisions. Amendments to the transfer of assets abroad provisions are still awaited. See <a href="#">here</a>.</td>
</tr>
<tr>
<td>Details of the changes to IHT and residential property</td>
<td>Partial. Legislation has been published on the main proposals but much of the detail (e.g., regarding debt and mixed use property) is missing. See <a href="#">here</a>.</td>
</tr>
<tr>
<td>Rebasing provisions</td>
<td>No legislation – some further details in the condoc of 19 August 2016, but for precise mechanics we will have to wait for legislation.</td>
</tr>
<tr>
<td>Mixed fund provisions</td>
<td>No legislation – first announced in condoc of 19 August but for precise mechanics we will have to wait for legislation.</td>
</tr>
</tbody>
</table>
Useful links

► Further consultation document published 9 August 2016

► Joint CIOT, ICAEW, STEP and the Law Society discussion paper - click here

► Policy document and draft income tax and capital gains tax legislation published 2 February - click here

► Policy document and draft IHT legislation published 9 December - click here

► Consultation document published 30 September - click here

► Previous versions of this newsletter are available - click here

► HMRC's Technical Briefing on the main changes to non-dom regime - click here

► HMRC's Technical Briefing on changes to IHT for UK property - click here

► HMRC's 15 October 2015 announcement on loan collateral - click here

► Questions - for contacts click here
Expected timetable of main provisions

- Policy announced: 6 July 2015
- Informal consultation meetings with interested parties: July and August 2015
- Consultation document published (including some draft legislation): 30 September 2015
- Consultation closes: 11 November 2015
- Further draft legislation published: Autumn Statement/FB clauses 25 November/9 December 2015
- Finance Bill Consultation closes: 2 March 2016
- Budget: 16 March 2016
- New consultation published with some draft legislation: 19 August 2016
- Consultation responses due: 20 October 2016
- Draft Finance Bill published: March 2017
- New rules come into force: 6 April 2017
- Bill makes its way through Parliament/Committee stages: April/July 2017
- Bill receives Royal Assent: July 2017
Act now

The changes noted in the consultation document will only come into effect from 6 April 2017. But the clear message to non-doms is to act now. Non-doms should review their position in light of the further details now provided. Potential action points include:

► Consider impact of rebasing rule and how helpful this may be in the circumstances of investment holders. How far should assets be restructured? For example, if one spouse will be deemed domicile in 2017 but the other not, the spouses may wish to transfer assets (perhaps temporarily) to the tax-favoured spouse. Similarly, trustees may wish to appoint assets to beneficiaries who will be deemed domiciled (although clearly the wider tax status of the trust must be considered). Wait for draft legislation before transferring assets.

► Those with mixed funds should review their records now and, where necessary, begin to reconstruct a record of income and gains. This will allow them to take advantage of the proposed one year window to cleanse such funds.

► Review and confirm domicile status and, in particular, the domicile of origin of family members. Establish now the precise date on which you will become deemed dom.

► For those resident and non-domiciled in the UK, consider establishing and funding trusts ahead of 6 April 2017.

► For those with existing trusts, review their terms and assets. For example, consider rebasing and extracting assets which provide a benefit (e.g., homes or luxury assets) outside the trust structure. Also, consider whether trusts have sufficient levels of funding in view of the fact that protections will be lost if assets are added after 6 April 2017.

► For those holding carry in trusts, consider whether this is now the most appropriate structure.

► If assets are owned in a corporate structure but not via a trust, consider the potential introduction of a trust.

► For those who have left the UK and expect to be non-resident for less than five years, consider timing of return to the UK.

► Capital losses are likely to be increasingly accessible moving forward so investment advisers need to look at investment portfolios on a wider basis.

► Plan now for periods outside the UK - as they will need to be for six years to breach the deemed-dom status for all taxes except IHT.

► Those with ‘mixed’ marriages (i.e., UK dom of origin spouse and non-UK dom origin spouse) may wish to consider allocation of assets, who establishes the family trust etc. when the spouse with a UK dom of origin has a non-UK dom of choice. There is a premium on having a spouse with a non-UK domicile of origin.

► Those becoming deemed domiciled on 6 April 2017 may wish to consider whether it is appropriate to make potentially exempt transfers (PETs) ahead of that date.
► Individuals may wish to review their investments in UK trusts in light of the proposed new rules for protected settlements.

► Trustees need to review the information they hold on their settlor and beneficiaries. Some information, such as where a settlor was born, will be needed for the first time. Trustees will need to keep track on the residence status of their beneficiaries. For trustees, Know Your Client is about to take on a whole new dimension.

► Trustees will also need to review the benefits they provide - if a beneficiary resides in a trust property will that taint the trust post 2017 - if so, is restructuring necessary?

► The new IHT charges on residential property will need thought too. If the settlor is a beneficiary, will there be a gift with reservation and so an IHT charge on the settlors' death if there is UK residential property in the trust? Trustees and others will also need to review existing borrowings to see if they are a valid deduction against trust property.

► Have a plan. Don’t let D-Day sneak up on you.

► See also the action list found in issue one of our non-dom newsletter.
After a long wait for further detail of the proposed changes to the taxation of non-domiciled individuals, the Government has published the promised further consultation document.

The new document is a mammoth work which serves many purposes. The contents include:

- The Government’s views on the responses to the original consultation document
- New proposals for the taxation of trusts set up before individuals became domiciled in the UK (protected settlements)
- A number of transitional and rebasing provisions for those becoming deemed domiciled
- Details of the proposals to extend the scope of IHT to include UK residential property held by non-UK companies
- A new consultation considering the expansion of business investment relief (‘BIR’)

Draft legislation has also been published for some of the above with further legislation expected to be published later in the year. Here we give you a summary of the key proposals.

The basic proposals

The main proposals to introduce a new deemed domiciled concept are to be introduced unchanged. There is to be no relaxation of the rules for those born in the UK with a UK domicile of origin to take account of those who left the UK while children.

As a reminder, the main proposals are:

- Individuals with a non-UK domicile of origin will be deemed domiciled in the UK for all taxes once they have been resident here for 15 out of the previous 20 years.
- Individuals born in the UK with a UK domicile of origin who have acquired a non-

UK domicile of choice will be deemed domiciled in the UK whenever resident here.

Protected settlements

The original proposal to tax deemed domiciled individuals on the value of benefits paid out of trusts, regardless of the levels of income and capital gains in those trusts, has been significantly amended. The protections will only apply to those becoming deemed domiciled under the 15 out of 20 rule and will not apply to settlements settled by those born in the UK with a UK domicile of origin.

The new proposals provide differing levels of protections for income and capital gains. In both cases, trusts will only be protected settlements where they were established before an individual became deemed domiciled under the new rules and have not been tainted by funds being added to the settlement once the individual has become deemed domiciled.

In the case of capital gains tax, the settlement will only remain protected until a benefit is paid out to the settlor or a family member. Once a benefit has been paid out, it appears that the trust will lose its protection and the settlor will be taxable on gains in the trust as they arise, as is currently the position for UK domiciled settlors.

The position for income is more complex. UK income will be taxable as it arises, as now. Foreign income will be protected while it remains in the trust. Protection will be retained for future income once benefits are paid out but the benefits will be matched with the income of the trust and will, in many cases, be taxed on the settlor (not on the person receiving the benefit). Legislation that amends the provisions taxing income from settlor interested trusts so as to facilitate this has been published, but further amendments needed to the transfer of assets abroad provisions are still awaited.

The fact that adding property or receiving a benefit from a trust may fatally wound its capital gains tax protection will make it vitally important to ensure that all transactions with the trust are carefully reviewed and take place on an arms-length basis. Careful consideration should be given now both to the future funding needs of the trust and to the
future cash-flow needs of the beneficiaries to ensure that the protection can be maintained as long as possible. Trustees and settlors will need to be careful not to fall into traps, for example, settlors failing to reclaim tax paid from trustees or settling tax bills on their behalf.

Transitional provisions, rebasing and mixed funds

The Government has confirmed that rebasing will apply to individually owned assets held by those becoming deemed domiciled under the 15 out of 20 rule on 6 April 2017. The rebasing will only apply to assets which were foreign situs at the time of the Summer Budget (8 July 2015). It is not clear whether the assets must have been owned by the individual on that date, although it seems likely.

Any deemed gains on rebasing will not be subject to UK tax even where the proceeds are remitted to the UK. This means that where clean capital has been used to acquire assets and these assets are sold shortly after 6 April 2017, it may be possible to remit the proceeds with no UK tax charge. This will not apply to those born in the UK with a UK domicile of origin and will only be available to those who have made a claim for the remittance basis. We will need to wait for the legislation to understand precisely how the rebasing relief will work.

A new and welcome announcement will give individuals a one year window, beginning on 6 July 2017, in which to separate their mixed funds into their constituent parts. This will only apply to mixed funds in the form of bank accounts or similar, not to assets derived from or representing mixed funds. This window would allow individuals to remit funds in a more favourable order, e.g., clean capital first, but there is no obligation to make such a remittance in the one-year window.

This cleansing of mixed funds will only be available where an individual has sufficiently good records to determine the constituent parts. For this reason it may be advisable to begin reviewing these records now in order to allow individuals to take advantage of the one-year window.

Where individuals became non-resident before the date of the Summer Budget (8 July 2015) and have sold non-UK assets, the Government has confirmed that these individuals will be able to benefit from the remittance basis in respect of any gains on these assets which come into charge on the individuals’ return, even if those individuals have become deemed domiciled in the intervening period.

UK residential property held through companies

The consultation gives us a little more detail of the proposals to bring UK residential property within the scope of IHT. The intention is to remove property from the excluded property definition to the extent that its value reflects an interest in residential property.

Such property will be subject to IHT in the same way as other UK property - e.g., on death, on the 10 year anniversary of a settlement, when a potentially exempt transfer comes into charge.

The consultation suggests that the definition of an interest in residential property and the meaning of ‘dwelling’ will be taken from the non-resident capital gains tax (NRCGT) legislation but the draft legislation published in fact refers to the Annual Tax on Enveloped Dwellings (ATED) definition. Essentially the definition is the same and will include any property which is used as or capable of being used as a dwelling. The main difference is that the NRCGT definition has exclusions for certain types of properties e.g., student accommodation, which the ATED definition does not.

The legislation also does not contain much of the additional detail which the consultation document includes regarding mixed use property, property which has not been used as a dwelling throughout and any debt relating to the property.

It is intended to treat property as a dwelling for this purpose where is has been used as a dwelling at any time in the two years before the transfer. Where a property has a mixed use throughout, the value will need to be apportioned.

The value of the residential property held by the company will be reduced to the extent that there is debt, but only to the extent that the debt relates exclusively to the property - the consultation uses the example of a mortgage taken out to purchase the property. Debts to related parties will be disregarded. This means that loans from a trust to a company or between trusts, for example, are likely to be disregarded.
Where the company owns other assets in addition to the UK residential property, it will be necessary to value all of these assets to determine the extent to which the shares are subject to UK IHT.

There will be a targeted anti-avoidance rule to ensure that any arrangements with a whole or main purpose of avoiding these provisions will be disregarded.

Crucially, despite suggestions to the contrary, there will be no transitional provisions to allow individuals to unwind property holding structures without a tax charge. This is extremely disappointing and leaves individuals needing to decide whether to unwind now, and possibly pay an up-front tax charge, or remain in a structure in which they may pay ATED for many years with ultimately no CGT or IHT benefit. In one sense though, the position is now easier, since many individuals may feel they no longer need to wait to see the details of the proposed transitional relief in order to make a decision.

It is also proposed that liability for IHT will be extended to directors of offshore companies with UK residential properties and HMRC may receive other extended powers to ensure the tax due in respect of UK residential property can be collected.

Other IHT considerations
The Government has listened to concerns raised at the time of the individual consultation and will be reducing the tail during which individuals remain resident in the UK for IHT to four years from the proposed six (this broadly maintains the existing provision).

Disappointingly, there is no intention to extend the brief grace period during which a returning dom is not subject to IHT. At present the proposal is that an individual who returned to the UK and who would otherwise be subject to IHT immediately would not be treated as being domiciled in the UK for inheritance tax purposes unless they had been resident for at least one of the two tax years prior to the year in question. Effectively this gives only a one year grace period before those born in the UK with a UK domicile of origin who become resident in the UK become subject to UK IHT on their worldwide estate.

Business Investment Relief
Finally, the document also includes a new consultation on a possible expansion and amendment of BIR. The consultation is at an early stage but recognises that there is currently a low take-up rate for the relief and seeks input on ways the relief could be amended and simplified to encourage its use, while protecting against potential for tax avoidance.
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© YYYY [local member firm entity name]
All Rights Reserved.

EDMMYY Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

© 2015 Ernst & Young LLP. Published in the UK. All Rights Reserved.

In line with EY's commitment to minimise its impact on the environment, this document has been printed on paper with a high recycled content.

Information in this publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Ernst & Young LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

ey.com/uk