INSIGHTS

5 months out – the Fog begins to clear on the new Tax Landscape for Non-Doms

Following years of speculation and Government announcements the draft legislation has now been issued that details the significant changes to the taxation of non-UK domiciled individuals and their trusts, which will take effect from 6 April 2025.

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TRIDENT TAX

We do not expect the analysis to change significantly but aspects of the summary may be varied when the legislation is finalized.

In line with those earlier announcements, personal tax will no longer be linked with an individual's domicile status, but instead will be based on a new "residence based" regime.

Features of the new system

- **"New Arrivals" regime:** applicable for individuals in their first 4 tax years of residency who have not been resident in the UK for any of the last 10 tax years.

- **Worldwide Taxation:** UK residents that have already been UK resident for more than 4 tax years will be subject to tax on their **worldwide income and gains** on an **arising basis** from April 2025.

  NOTE: THE CURRENT TAX YEAR WILL BE THE LAST OPPORTUNITY FOR ANY INDIVIDUAL TO CLAIM THE REMITTANCE BASIS UNDER THE EXISTING NON-DOM REGIME.

- **Temporary Repatriation Facility ("TRF"):** A **3-year amnesty** period that will allow previous remittance basis users to bring their **pre-April 2025 foreign income and gains** into the UK at a reduced rate

- **Long-Term Residents ("LTR"):** Introduced for **Inheritance Tax ("IHT")**, replacing the domicile-based system. This will apply where individuals have been resident in the UK for 10 years or more and will remain for several years once their residency ceases.

- **Trust Structures** settled by UK resident non-doms:

  - The **"protected trust" regime** (introduced in 2017) is abolished, attributing **income and gains directly to the settlor.**

  - Trusts will remain **excluded property trusts** for IHT only if the settlor is not an LTR. The new rules will pull many trusts into the scope of ongoing IHT charges which may continue for a period even where the settlor has become non-UK resident.

    IMPORTANT: TRANSITIONAL MEASURES ARE AVAILABLE IF THE SETTLOR DIES BEFORE 6 APRIL 2025, PREVENTING CERTAIN IHT CHARGES ON DEATH.

Trust structures are discussed further in our article "How will the Autumn Budget change the taxation of offshore trusts?".

New Arrivals Regime

ELIGIBILITY CRITERIA

- **UK resident individuals** must be in their first 4 tax years of UK residency following a ten-year period of non-UK residency.

- Individuals who commenced their UK tax residency 4 tax years ago or more will not qualify for this new regime unless they first have a break of 10 consecutive tax years of non-residence.

EXCLUSION BASED ON PREVIOUS RESIDENCY

- Even **a single year of residency** in the ten years prior to arrival will deny individuals from accessing this regime.

  EXAMPLE: an individual spending a single gap year in the UK, who is then non-resident for 3 subsequent years will be taxed in full if they were to return to the UK in year 5 (even though this is only their second year of UK residence).

KEY FEATURES AND LIMITATIONS

- Unused years cannot be rolled over.
- UK residency during education (e.g., PhD studies) counts as a tax year of residency. – however, if 2025/26 is an individuals' 2nd, 3rd or 4th tax year of residency they will still be able to access the regime until the end of their fourth year of residence.

It should also be noted that it is a tax year of residence is determined by reference to the UK's statutory residence test (SRT) with all tax years of residency, including split years or those covered by a double tax treaty, counting under the regime.

TAX BENEFITS

Individuals who qualify will **not be subject to income tax or capital gains tax** on their overseas income and gains during the 4-year period and importantly - they **will be able to bring these funds to the UK tax free.**

Distributions to qualifying UK individuals **from non-resident trusts** will also be **received tax-free** during the 4-year period, subject to anti-avoidance rules. However, chargeable event gains from offshore insurance bonds remain taxable.

Whilst there was a suggestion that income and gains arising in relation to UK investments might qualify for exemption (to put them on an equal footing with non-UK investments) this is not the case – **UK income and gains will be subject to tax in the normal way.** This may encourage individuals to dispose of UK investments prior to arrival.

POST REGIME CONSIDERATIONS

Once the four years have elapsed the individual will be subject to UK tax on their **worldwide income and gains** on an **arising basis**. As such, qualifying individuals should consider crystallising any gains prior to the end of their fourth tax year of residence, as well as considering the tax efficiency of their overall investment strategy.

It is also worth mentioning that **IHT exposure will remain limited to their UK assets** until such time as they become a 'long term resident' (LTR) at the start of their 10th year of tax residence (see below).

CLAIM PROCESS

In terms of the mechanics, it is worth pointing out that the regime is **not automatic** and must be **claimed each year** on the individual's tax return. If the claim is not made on time the **treatment will be lost**. Furthermore, the foreign income and gains must still be calculated and reported on tax returns, even if it they are not taxable under the new regime.

A claim will result in the loss of the personal allowance, annual exemption and foreign losses for the year in question. Therefore, it may not be worthwhile claiming in every case.

In addition, it is possible to **disapply the claim** for certain items, which could be worthwhile if the resulting UK tax is less than the foreign tax that could be saved through a double tax treaty, although how often this will be the case is questionable.

Having been involved in the consultation process, it is disappointing that the Government has not taken the opportunity to extend this relief in any way. This will have unintended impacts on foreign investment as well as overseas students coming to the UK for education.

Transitional Measures

The Labour government have scrapped the previously proposed temporary reduction in tax rates, they have also adjusted the rebasing rules so that assets held personally will take on a base cost equal to their market value as of 5 April 2017.

ADJUSTMENT TO REBASING RULES

5 April 2017 was already the applicable date for those becoming deemed domiciled under the previous regime change, simplifying the rules, though it is less generous than the initially proposed **2019 rebasing** (which, in hindsight, seems to have been a government typo).

The rebasing only applies to **personally held assets**. Assets held in trust will need to rely on existing rules for rebasing namely to **2008 values** if an election is made or **1982 values** otherwise.

CONDITIONS FOR REBASING

- Individuals must have **never been domiciled or deemed domiciled** in the UK at any point before 5 April 2025; and
- they must have **claimed the remittance basis** at least once – 2024/25 may be the last chance for some.

EXTENSION OF THE TEMPORARY REPATRIATION FACILITY

- The Labour government has **extended the scope of the TRF**, and this will be available for **3 years**, although the rate in year three increases from **12% to 15%**.

DESIGNATION OF REMITTANCES

Under the new rules, **"designated" funds** under the TRF **do not need to be physically remitted** to the UK during the 3-year period. Instead, they can be remitted later without incurring a second charge.

TRIDENT TAX

Individuals **can "designate" cash** in an account **or assets purchased** (fully or partially) **with foreign income and gains.** They can also designate amounts held by a relevant person, such as a spouse or trust, and make partial designations for mixed funds.

UPDATED ORDERING RULES

The **ordering rules have been updated**, adding another layer of complexity. However, broadly any **designated amounts will come out first** when remittances to the UK are made from a mixed fund in the future.

The extension of this facility is welcome and presents an opportunity for clients to review their affairs and determine how they could best take advantage of this opportunity. They may not need to remit their income and gains at all, and it is also worth bearing in mind that **remittances** that are **used for UK business investments** can **still qualify for 100% relief,** although the interaction between this relief and TRF is not straight forward so anyone affected should seek advice.

The extension of this facility is a valuable opportunity for clients to review their affairs and identify ways to optimise its benefits. In some cases, income and gains may not need to be remitted at all. Additionally, remittances used for UK business investments may still qualify for 100% relief. However, the interaction between this relief and the TRF is complex, so professional advice is strongly recommended.

Long Term Residents

The concept of domicile (and deemed-domicile status) will only be relevant for tax purposes up until 5 April 2025. After this date the concept will only be relevant for tax purposes in the historical context, although it will still be relevant for legal purposes.

A Long-Term Resident (LTR) under the new LTR test, an individual who has been **UK resident for 10 tax years within the past 20 tax years.** Individuals will be considered LTR from the beginning of their 11th year of UK tax residence.

EXPOSURE TO UK IHT

Once an individual qualifies as an LTR, their exposure to **UK Inheritance Tax (IHT)** is **extended from their UK situs assets** to include their **worldwide assets.** This is a significant change, particularly for individuals with extensive overseas assets. It means that on death those assets will attract a **40% IHT charge**, to the extent that their value exceeds the available nil rate band and any other available reliefs.

Planning ahead of attaining LTR status is essential and may include lifetime gifts or settling trusts. Transfers of non-UK assets made before achieving LTR status generally avoid IHT, even if death occurs within seven years.

POST UK RESIDENCY - CHARGEABLE YEARS

When an **LTR ceases UK residence**, they will **retain LTR status** for several years after they have left the UK.

The number of post-residency chargeable years depends on the length of UK residency beyond the initial 10 years, with a minimum of 3 years and a maximum of 10 years for those that are resident for 20 consecutive years. For example:

- **13 years of UK residency:** Chargeable for 3 years after departure (3-year tail).
- **20 years of UK residency:** Chargeable for 10 years after departure (10-year tail).

TRANSITIONAL RULES FOR NON-UK RESIDENTS

Non-UK residents can still qualify as LTR when the regime is introduced on 6 April 2025. However, a special **transitional rule applies** for those non-residents during the **2025/26 tax year.** Under this rule, they will only achieve LTR status if they would have been deemed domiciled under the previous rules (i.e., until the start of their fourth consecutive year of non-residence).

DEEMED LTR STATUS

The concept of **deemed-domiciled status will be abolished**, including the '15 out of 20 tax years' test and the classification of Formerly Domiciled Residents. This change removes the category of individuals who were originally from the UK but acquired a foreign domicile before returning to the UK.

Some exceptions to this abolition have been incorporated into the new LTR regime.

1. **Members of Parliament and the House of Lords** will automatically be treated as LTRs, irrespective of their domicile or residence history.

2. When an **LTR individual makes a gift to a non-LTR spouse.** Such transfers will not qualify for the full spouse exemption from IHT and will remain potentially liable if the gifting spouse does not survive for seven years.

   In such cases, the non-LTR spouse can elect to have deemed LTR status to mitigate the IHT implications.

The final **'quirk'** to be aware of is for **individuals younger than 20 years old.** Here the LTR test is modified. Instead of the standard residency calculation, the test is whether they have been UK resident for 50% of the tax years since their birth.

TRUSTS

Under the new regime, any **trusts settled by individuals with LTR status** will fall within the scope of **IHT**. These trusts will be subject to the **Ten-Year Charge (TYC) regime**, incurring principal charges of up to **6% every 10 years**, along with proportional exit charges when assets are distributed.

Trusts **settled by UK-domiciled individuals** who subsequently **cease residency** and do not meet the LTR test **will transition out of the TYC regime**. However, this transition triggers an **exit charge**, effective on **6 April 2025.**

When an individual ceases UK residence and their LTR status lapses, their **personal assets are not subject to exit charges.** However, assets held in trusts will attract an exit charge. As LTR status may remain in effect for several years after 5 April 2025, non-residents in this position should consider taking distributions from trusts during this period. The application of temporary non-resident rules should also be carefully assessed.

If the **settlor of a trust dies before 6 April 2025, the new rules will not apply**, and the trust will continue under the existing regime.

NEW AND EXISTING TRUSTS

For **new trusts settled on or after 30 October 2024**, the assets will be subject to a **40% IHT charge upon the settlor's death** if the settlor retains any benefit from the trust.

However, there is a valuable relief for trusts established before this date. If the settled property **qualifies as excluded property at the time of settlement** and **continues to do so**, the IHT charge on death will be **switched off.** While these trusts remain within the TYC regime, incurring a 6% charge every 10 years, this may be a preferable alternative to the 40% IHT charge on death.

Conclusion: Now let's move forward

For many years, UK resident non-domiciled individuals (non-doms) have mitigated their Inheritance Tax (IHT) exposure by structuring assets outside the UK to avoid tax charges. However, concerns have often arisen over the robustness of their domicile status and the potential for HMRC to challenge it.

The upcoming change, removing domicile as a factor in determining IHT exposure from April 2025, is therefore a **welcome development.** Instead, **IHT liability will be based on the time an individual has spent as a UK tax resident**, providing greater clarity and less uncertainty. However, the **reduction in the threshold from 15 years to 10 years** before individuals fall within the scope of IHT will be unwelcome for some. Those most impacted are likely to be individuals with trust structures established under the protected trust regime, and each case should be carefully reviewed if this has not already been done.

Many affected individuals have already considered their options. While the non-dom announcements in the Autumn Budget contained few surprises, **the grandfathering of some IHT relief for trusts was a positive inclusion.** With other changes now introduced, it is an **opportune moment to reassess the broader picture and review intended strategies** before deciding how to move forward.

The release of detailed guidance provides a more stable foundation for planning. Clients can now proceed with **greater confidence**, knowing there are fewer uncertainties about the new tax landscape.

Want to know more?

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