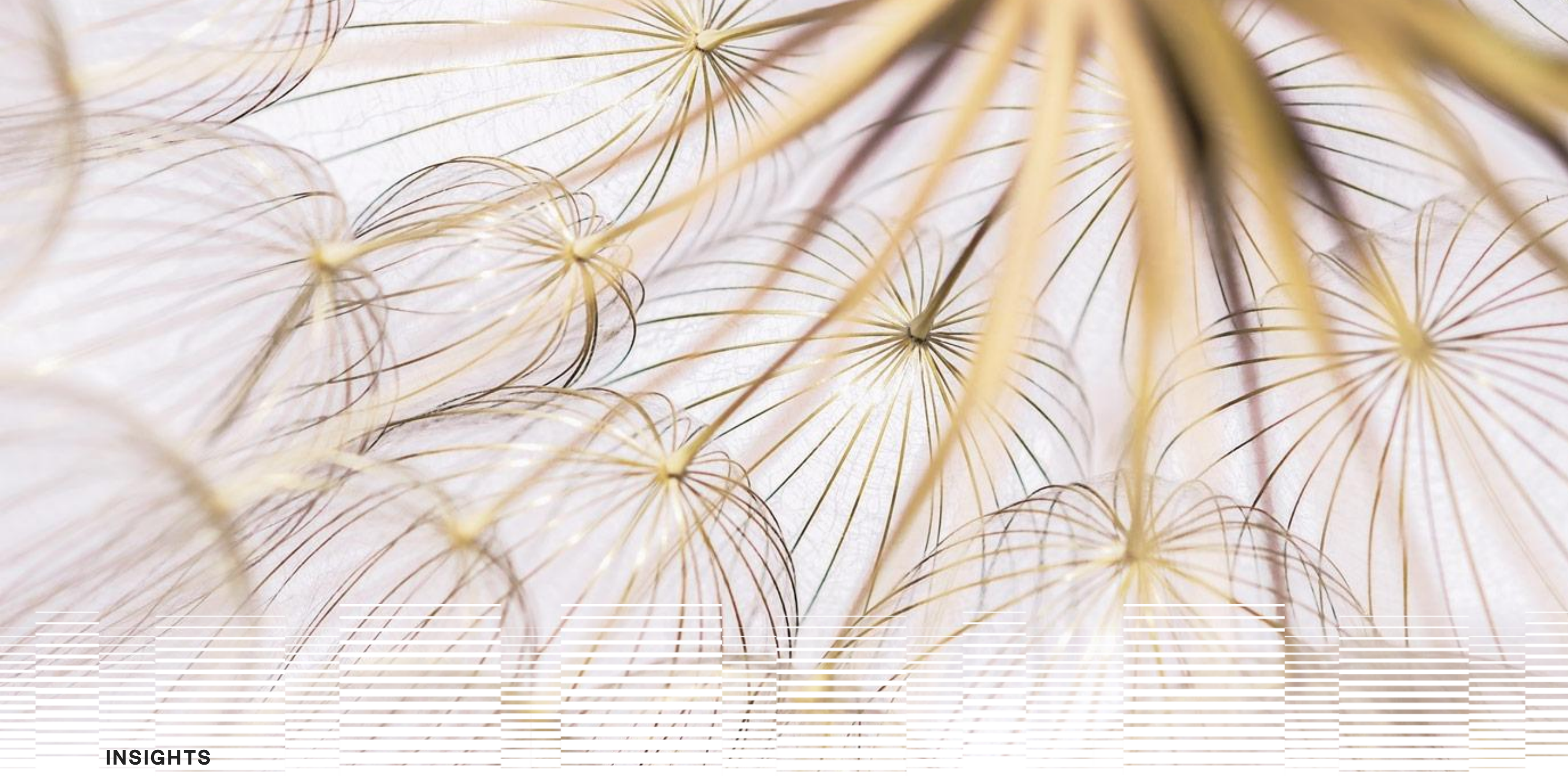

INSIGHTS

How will the Autumn Budget change the taxation of offshore trusts?

The latest budget contained significant changes for the taxation of trusts and their settlors. The impact comes from the changes to the way in which non-UK domiciled individuals are taxed.

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TRIDENT TAX

In this article we discuss the changes raised in the Autumn Budget and draft legislation. We do not expect the analysis to change significantly but aspects of the summary may be varied when the legislation is finalized.

Key Changes

- Most non-doms will be taxed on the income and gains of any offshore trust they previously settled and from which they can benefit.
- There are transitional rules that will allow non-doms to remit their old foreign income and gains to the UK for a flat rate of 12%.
- Excluded Property Trusts will not remain outside the scope of Inheritance Tax. The IHT status of the trust will follow the status of the settlor.
- Many trusts will have an IHT charge even if the settlor is no longer resident in the UK.

End of the remittance basis and protected trusts

Non-doms will no longer be able to be taxed on the remittance basis; it is being replaced with a new "FIG" scheme for individuals coming to the UK.

- These rules are available to individuals, who have not been resident in the UK for any of the previous ten years.
- They will not be taxed on their foreign income and gains for the first 4 tax years.

This change means that the majority of non-doms and deemed doms will be taxable on their worldwide income from 6 April 2025.

The protected trust rules are also being abolished from 6 April 2025.

This means the anti-avoidance charges for settlor interested trusts will apply to non-doms and deemed doms who previously settled offshore trusts from which they can benefit.

The two changes together have the potential to significantly alter the tax position for many individuals with interests in offshore trusts.

An explanation of the background to the remittance basis and protected trust rules is included below.

Transition – reduced tax rates for remitting existing foreign income and gains

Although the remittance basis will no longer be available going forwards, those rules will still apply to the pre-April 2025 income and gains of a former remittance basis user. They will still be taxed if such income and gains are brought to the UK.

The Temporary Repatriation Facility (TRF) allows for a 3-year amnesty period in which former remittance basis users can bring their pre-April 2025 foreign income and gains into the UK and be taxed at a flat rate of 12% rising to 15% in the 3rd year.

The TRF will also extend to pre-April 2025 trust income and gains that is matched to distributions or benefits during the 3-year period.

TRUSTEES WILL NEED TO PLAN CAREFULLY TO ENSURE THAT THE MOST IS MADE OF THIS OPPORTUNITY.

Inheritance Tax (IHT) – changes for individuals

Domicile will no longer be the basis for charging IHT on an individual's estate.

Currently, a non-domiciled individual is chargeable to IHT on their UK assets only; any non-UK assets are outside the scope of IHT.

The basis of charge will now be based on residence and a new category of Long-Term Resident (LTR). An individual will be an LTR if they have been resident for 10 out of 20 years.

The charge continues after an LTR becomes non-UK resident. They will remain an LTR and chargeable to IHT for a further 10 years, if they have been resident for 20 years. The period is less for individuals who have been resident between 10 and 20 years. The minimum period is three years.

Inheritance Tax – changes for trusts

THE CURRENT POSITION

The IHT treatment of excluded property trusts will change dramatically.

- Currently, a trust settled by a non-dom with non-UK assets is outside the scope of IHT – although there is a notable exception for interests in UK residential property. The non-UK assets in the trust are outside the settlor's IHT estate and the property is not subject to the periodic trust IHT charges for relevant property trusts.
- It does not matter whether the settlor subsequently becomes domiciled or deemed domiciled; the trust assets remain excluded property for IHT.

CHANGE TO RELEVANT PROPERTY TRUSTS

The position will change going forwards.

- Excluded property trusts will lose their excluded status if the settlor becomes an LTR. It does not matter whether the settlor is excluded as a beneficiary. It means that trusts settled by an individual who is currently deemed domiciled will become relevant property trusts on 6 April 2025.
- Please note that these rules can apply even if the settlor is no longer UK resident. The LTR test is applied to the settlor of every excluded property trust on 6 April 2025 regardless. Any trust that loses its excluded property status will remain a relevant property trust for at least three years; the minimum period an individual retains their LTR status once they have left the UK.
- Any excluded property trust where the settlor has died before 5 April 2025 will remain an excluded property trust.

PERIODIC CHARGES

- Relevant property trusts are subject to an IHT charge of 6% of the value of the trust's chargeable property on every tenth anniversary.
- Any property leaving the trust between anniversaries is subject to an exit charge unless the property leaving the trust is charged to income tax.
- The exit charge is a proportion of the anniversary charge based on the length of time the property has been in trust e.g. 5 years results in a charge of 50% of the anniversary charge.

NEW TWIST

An unwelcome change is a new IHT exit charge where the settlor ceases to have LTR status and the trust changes from being a relevant property to an excluded property trust.

- Currently, there is no exit charge where a trust's property changes status but does not leave the trust. That will change from 6 April 2025 and the charge will be calculated in much the same way as the proportionate exit charges.

Example

Where an individual has ceased to be resident in the UK but is still an LTR, the trust will become a relevant property trust for at least three years.

- The trust would be subject to an exit charge if it became an excluded property trust after a minimum of three years.
- The charge would be 30% (3 years out of 10) of the 6% anniversary charge or 1.8%. Although if property is distributed before 3 years have elapsed this could be reduced.

Trustees in this position should be considering whether they could make any distributions before or shortly after 6 April 2024 or undertake other planning to mitigate this new charge.

SETTLOR CHARGED TO IHT ON TRUST PROPERTY

Where an individual settles property into a trust and can benefit from the settled property, the GWROB rules treat the property as remaining in the settlor's estate for IHT purposes.

The excluded property trust rules previously allowed the trust's property to retain excluded property status indefinitely and therefore no charge would arise upon the settlor's death.

New rules will apply to any excluded property trust settled after 30 October 2024, where the settlor retains an interest the trust the assets will be treated as part of their estate for IHT purposes and will attract a charge on death if they have LTR status.

Fortunately, there are some grandfathering provisions that will prevent these rules from applying to existing excluded property trusts provided the settled property meets the definition of excluded property at that time and at all times subsequently.

Temporarily investing in UK assets (including loans to UK beneficiaries and interest in UK residential property) could potentially result in a loss of this 'grandfathered' status.

What does this mean for trustees?

The changes are the most significant policy changes towards non-doms and offshore trusts to date. They will affect many current structures and some even where a settlor has left the UK and there are no UK resident beneficiaries.

The government has not decided to grandfather existing structures in an attempt to retain current non-doms. In the future offshore trusts will still have value but they will need to be monitored carefully and tracked against the tax position of the settlor.

Trustees will need to take steps to mitigate the effect of the changes.

INCOME AND CAPITAL GAINS FOR THE SETTLOR:

Trustees can take steps to prevent income and gains being attributed to the settlor.

I. It may be possible to exclude the settlor as a beneficiary to prevent the trust being a settlor interested trust for income tax purposes, however the capital gains tax position is less straightforward.

II. Trustees can also change the way property is held by using financial products or investment structures that prevent income and gains arising to the trustees.

PROVIDE FOR FUTURE FUNDING

The Temporary Repatriation Facility may offer an opportunity for a settlor to receive income and gains now that will be taxed at 12% after 6 April 2025. This could be used to fund their cost of living if they are to be excluded from the trust or the trust will restructure its investments to prevent income and gains from arising.

MITIGATE THE IHT EXPOSURE

It may be necessary to wind up a trust if there will be an unavoidable IHT cost that is too great. That will need to happen before or very shortly after 6 April 2025 if there is to be no IHT cost.

The challenge will be to find another structure that is not a trust, but it will be necessary to manage the risk of income and gains being taxed on the settlor as well as replace any asset protection or succession planning benefits that would be lost.

Alternatively, the trustees may be able to acquire assets that qualify for business property relief. There have been changes to IHT reliefs that will need to be managed, however if the ten-year charges can be limited to 3% to the extent assets exceed relevant thresholds, this may be a price worth paying to prevent IHT charge on death.

NEW TRUSTS

There will be a role for trusts going forward but care will be needed to manage the new rules that affect settlor interested trusts. Certainly, to be effective for IHT and Income tax it will be necessary for the settlor to be excluded.

Key takeaways

Trustees of offshore trusts will need to review any trust that has a current or former link to the UK. The wide-ranging effect of the changes means that a significant number of trusts and/or their settlors will be affected by the new rules. That will probably mean that remedial action will be needed for a significant number of structures before 6 April 2025 with very little time available at the busiest time in the UK tax calendar.

ADDITIONAL NOTES: Background context for the remittance basis and protected trusts

Some background context is helpful for understanding the changes.

Non-UK domiciled individuals (non-doms) can elect to be assessed on the remittance basis: they are taxed on their UK income but not their worldwide income unless it is remitted to the UK. That means that certain anti-avoidance provisions do not result in a non-dom being taxed in the UK if the relevant foreign income or gains is not remitted to the UK.

The anti-avoidance provisions are relevant to settlor interested trusts; the income and gains of such a trust are attributed to and taxed on the settlor.

The rules changed from April 2017, when the concept of deemed domiciled was introduced. A non-UK domiciled individual became taxed as if they were domiciled in the UK once they had been resident in the UK for 15 out of 20 years. This would expose non-doms to the anti-avoidance tax charges for any non-UK resident trusts they settled from which they could benefit.

This situation was mitigated by the introduction of the protected trust rules. Broadly, deemed UK domiciled settlors were taxed on the same basis as a beneficiary when they received a benefit and not as income and gains arose in the trust.

Want to know more?

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