



INSIGHTS

# The Crucial Role of Reviewing Settlor Domicile and Protected Trust status

For trustees and settlors, the upcoming changes to the UK tax regime pose significant challenges, particularly for those managing settlor-interested trusts. The impending reforms, combined with an intensified focus from HMRC on tax investigations, create a complex environment where strategic planning is more critical than ever.



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As the government tightens its grip on tax compliance, it is essential for trustees to ensure that they are fully prepared for these changes. A key aspect of this preparation is a thorough review of the settlor's domicile status and ensuring that protected trust status is robust. These issues can have far-reaching implications for the trust's tax position, as well as that of the settlor.

## The Impact of Upcoming Tax Reforms on Trusts

As the UK government plans significant tax reforms, trustees managing various trusts must prepare for the implications these changes will bring. Of particular concern are settlor-interested trusts, as the income and gains of such trusts will no longer be “protected” from 6 April 2025, meaning the settlor could be taxed on income and gains as they arise after that time if they remain UK tax resident.

Establishing whether a trust is settlor-interested can be complex because the tests for determining this are different for income tax, capital gains tax and inheritance tax.



For example, irrevocably excluding the settlor will eliminate any exposure to taxation on new income, but if the settlor's children and grandchildren are not irrevocably excluded, the settlor will be exposed to CGT on trust gains.

Although there are potential restructuring options to mitigate such issues, ensuring there is a solid non-UK domicile position before restructuring is implemented is essential to ensure tax liabilities are not created for the settlor by the restructuring itself.

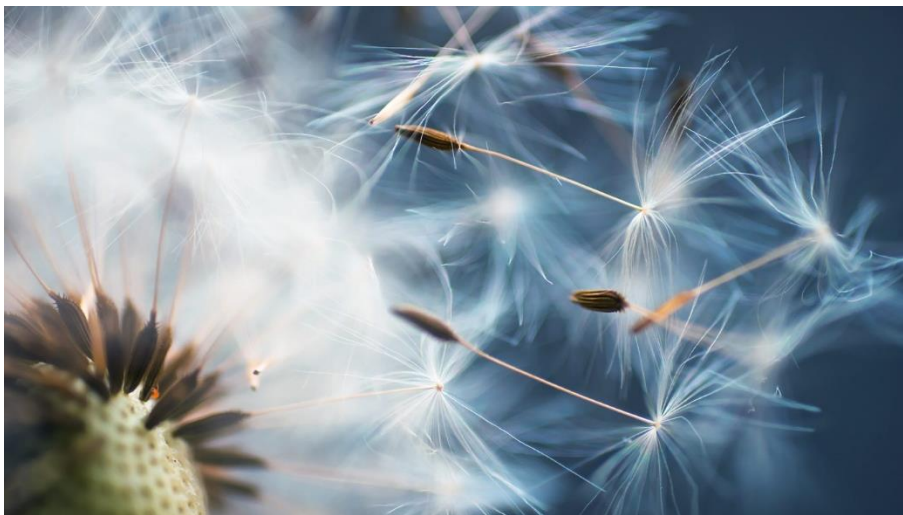
We summarise below the key issues for trustees to review in advance of any restructuring.

## The Critical Importance of Settlor Domicile

For settlor-interested trusts, the settlor's domicile status is a foundational factor in determining the trust's tax liabilities. Despite the best efforts to implement effective

tax planning, if a settlor is found to have acquired a UK domicile of choice, the trust and the settlor could face significant unforeseen tax consequences. Therefore, it is essential that trustees and settlors review and clearly establish the settlor's domicile position before proceeding with any other planning measures.

If the settlor has acquired a UK domicile of choice and the trust is settlor-interested, income and gains arising to the trust since that time will be taxable on the settlor personally. This could mean that there are historic liabilities for the settlor.



It could also mean the trust's income and gains pools need to be recalculated to remove the income and gains that are taxable on the settlor. If other beneficiaries have received benefits or distributions and these have been matched to trust income or gains that are now known to be taxable on the settlor, the beneficiaries' may have overpaid tax, and their positions would need to be reviewed.

## Reviewing Protected Trust Status

If the settlor has acquired a domicile of choice in the UK, protected trust status ceases from that time. However, for deemed domiciled settlors who have not acquired a domicile of choice, trustees still need to be aware that protected trust status can be lost if a deemed domiciled settlor adds property to the trust. In addition



to the obvious act of settling further assets, adding property can be inadvertent; for example, the settlor not being paid interest on loans they have made to the structure.

If protected trust status has been lost, some restructuring steps can also result in tax liabilities for the settlor, so great care is needed over this issue.

Although having UK source income in the structure does not affect protected trust status, such income is not Protected Foreign Source Income (“PFSI”) and is taxable on the settlor if the trust is settlor-interested for income tax purposes. This is the case even where the settlor is not yet deemed domiciled in the UK and is utilising the remittance basis of taxation.

Similarly, offshore income gains from non-reporting funds are chargeable to income tax but fall outside the definition of PFSI and will be taxed on the settlor if they have retained an interest for income tax purposes.

## The motive defences

Although UK resident settlors of settlor-interested trusts will be taxable on trust income and gains from 6 April 2025, the same cannot automatically be said for income and gains that arise below that level in the structure, typically in underlying companies.

Separate “motive defences” may be available to prevent income being taxed on a settlor and, to prevent company gains being attributed to the trust and thereafter to the settlor. The question of whether either or both defences may be available is often complex, requiring a detailed analysis of the origins and history of the structure.

These defences can provide valuable deferral of tax liabilities for settlors and should not be overlooked.

## Upcoming Tax Changes: What Trustees Need to Know

The proposed changes to the taxation of trusts are likely to have a profound impact, particularly on excluded property trusts, protected trusts, and non-doms. Trustees should be aware of the key areas that will be affected and ensure they are prepared to navigate these changes. Some of the critical issues include:

- ▶ **Excluded Property Trusts** - Trustees must ensure that these trusts remain compliant under the new regulations, particularly in terms of asset location and settlor domicile.
- ▶ **Protected Trusts** - The new rules may affect the protection status of these trusts, especially if the settlor’s domicile status is ambiguous or has changed.
- ▶ **Non-Doms** - With non-doms under increased scrutiny, trustees must be vigilant in maintaining accurate records and ensuring that the trust’s tax position is defensible.



## The Role of HMRC and Increased Tax Investigations

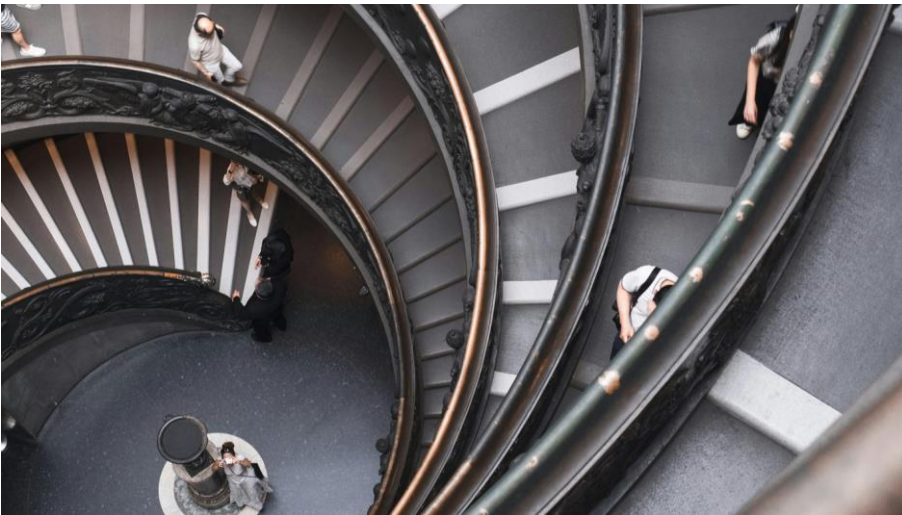
Adding to the complexity of the situation is HMRC's intensified focus on tax investigations. Over the past year, HMRC has significantly ramped up its efforts, opening around 250,000 new enquiries, many of which target high-net-worth individuals and their associated structures, including trusts.

## Why This Matters: Avoiding Costly Mistakes

HMRC's enhanced investigative capabilities, supported by advanced technology and artificial intelligence, mean that any errors or oversights in tax reporting can have severe financial consequences. For trustees, this underscores the importance of

ensuring that all tax-related matters, particularly those concerning domicile and trust compliance, are handled with the utmost care.

We expect that the appearance of new sources of income or gains in the tax returns of settlors are likely to prompt broader HMRC enquiries into the history of the structure and the settlor. Thorough preparation in advance should help identify any potential issues and provide the opportunity to deal with them on a proactive basis.



## Planning Ahead – Key Considerations for Trustees

To mitigate risks and navigate the upcoming changes effectively, trustees should consider the following steps:

1. **Review Settlor Domicile** - Ensure that the settlor's domicile status is clear and accurately reflects their current situation. This should be the first step before any other planning is undertaken.
2. **Review Protected Trust status** - Identify any issues that result in historic tax liabilities for the settlor.
3. **Engage in Strategic Planning** - Identify the specific areas of the trust that will be impacted by the new regulations and develop strategies to address these challenges.
4. **Stay Informed and Vigilant** - Keep up to date with HMRC's latest guidance and ensure that all reporting and compliance requirements are met to avoid triggering investigations or penalties.



5. **Seek Professional Advice** - Given the complexities involved, trustees should seek expert tax advice to ensure that all aspects of the trust's administration are handled correctly and in line with the latest regulations.

## Conclusion – Proactive Steps for Trustees

The upcoming tax changes represent a significant challenge for trustees, particularly those managing settlor-interested trusts. By prioritising the review of the settlor's domicile status, protected trust status and engaging in thorough planning, trustees can position themselves to navigate these changes effectively and avoid the pitfalls of increased tax scrutiny.

# Strategic Trust Tax Compliance & Planning

At Trident Tax, we are experts in guiding trustees and settlors through the complexities of tax compliance and planning, especially considering the upcoming changes. Our team of specialists works closely with professional advisers, financial institutions, and accountants to ensure that your trust is not only compliant but strategically positioned to protect your financial interests.

With our deep understanding of tax regulations and a focus on resolving uncertainty, we offer personalised strategies that cater to your unique needs. Whether you need a thorough review of your trust's domicile status, expert advice on tax-efficient structures, support to make proactive disclosures to HMRC or support during a tax investigation, we are here to secure resolutions and protect your interests.

Recognising possibilities and unlocking your vision, we aim to clarify the tax position and amplify your success. As Code of Practice 8, Code of Practice 9 and Tax Resolutions Experts, we provide the confident, reassuring, and knowledgeable guidance you need to navigate these challenging times.

**Contact us today** to ensure that your trust is prepared for the future and that your financial interests are safeguarded with expert advice and trusted resolutions.

## Contact us today.



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