Summer Budget 2015 – overview of private client measures

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On 8th July 2015, the Chancellor, George Osborne, delivered his first Budget of this Parliament containing unadulterated Conservative policy. Although many measures were widely expected, there were also a few surprises.

Non-dom changes

Currently, individuals who are resident and domiciled in the UK are taxed in the UK on their worldwide income and gains. However, foreign domiciled persons (non-doms), are able to claim the remittance basis of taxation, so that foreign income and gains are exempt from UK taxation so long as they are not remitted to the UK. Longer term non-doms must pay an annual remittance basis charge to access the remittance basis. In addition, non-doms are only subject to Inheritance Tax (IHT) in respect of their UK assets (as opposed to individuals domiciled in the UK who are subject to IHT on their worldwide assets, subject to reliefs and exemptions).

Changes to the non-dom regime in respect of (mainly) long term resident non-doms include:

- introduction of a 15 year rule - from April 2017, those who have been resident in the UK for more than 15 of the past 20 years will be treated as deemed UK domiciled for all tax purposes (the £90,000 remittance basis charges payable by non-doms who have been resident for 17 out of 20 years will be redundant and they will be deemed UK domiciled two years earlier for IHT purposes);
- introduction of a 5 year rule - once a non-dom who has become deemed UK domiciled under the 15 year rule leaves the UK and spends more than 5 tax years outside the UK, they will lose their deemed UK domicile status (currently, a UK domicile is lost after 4 years outside the UK). If at a later date the non-dom returns to the UK, but still intends to eventually leave the UK (so remains foreign domiciled) they will be able to spend another 15 years as a resident non-dom for tax purposes before becoming deemed UK domiciled again;
- those who had a domicile in the UK at the date of their birth will revert to having a UK domicile for tax purposes whenever they are resident in the UK, even if under general law they have acquired a domicile in another country;
- non-doms who have set up an offshore trust before they become deemed UK domiciled under the 15 year rule will still not be taxed on trust income and gains that are retained in the trust. However, such long term residents will, from April 2017 be taxed on any benefits, capital or income received from any trusts on a worldwide basis.

Currently, IHT is only charged on UK property held by non-doms directly. Therefore, non-doms often own such property through an offshore vehicle so as to secure an IHT advantage on UK property in a way not available to a person domiciled in the UK. This is called enveloping the property and led to the Government introducing Annual Tax on Enveloped Dwellings (ATED) two years ago.

Where a non-dom settles foreign assets into a trust (known as an **excluded property trust**), prior to becoming domiciled or deemed domiciled in the UK, there was previously no IHT charge on such excluded property (it was common for UK property to be held by an offshore company this way as the settled property is the foreign shares, rather than the UK property).

Changes to the UK residential property and excluded property trust regimes affecting non-doms include:

- IHT will be payable on the value of all UK property held by non-doms, including property owned through an offshore company, partnership or other opaque vehicle;

- the Government has announced that it does not intend to change the IHT position for non-doms or excluded property trusts in relation to UK assets other than residential property, or for non-UK assets; and
- individuals who have a UK domicile at the date of their birth (i.e. a UK domicile of origin) may emigrate, becoming non-dom, at which point they are able to set up excluded property trusts. These individuals will lose any favourable tax treatment in respect of such trusts when they become UK resident again.

IHT – carving out the family home

A new family home allowance will be introduced into the IHT regime allowing a main residence to be passed on death to direct descendants, such as children or grandchildren. The allowance will start at £100,000 in 2017-18, gradually increasing to £175,000 in 2020-21. Any unused allowance may be transferred to a surviving spouse or civil partner.

The new family home allowance will also be available when a person downsizes or ceases to own their home on or after 8 July 2015 and assets of an equivalent value are passed on death to direct descendants. There will be a tapered withdrawal of the allowance for estates with a net value of more than £2 million. The new family home allowance is in addition to the existing IHT nil-rate band which is set at £325,000 for the estates of individuals.

IHT – use of multiple trusts

New “same day addition rules” included within the Summer Finance Bill (but not specifically mentioned by the Chancellor) are aimed at stopping people from creating a number of separate trusts on different dates and funding them with substantial assets on the same day (so that each trust benefits from its own IHT nil rate band). The value of assets added to the trusts on the same day will now be aggregated for the purposes of calculating the IHT charge on each trust.

Will trusts – removal of the Frankland trap

Amending legislation will now allow for appointments to be made out of a will trust within the first three months, without an IHT charge arising. This removes what has become known as the Frankland trap.

Taxation of UK dividend income

From April 2016, the Dividend Tax Credit will be removed and replaced with a new tax-free Dividend Allowance of £5,000 per annum for all taxpayers. The dividend tax rate for dividends above the allowance will be set at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

Corporate tax rates

The rate of corporation tax will be cut from the current 20% to 19% in 2017 and 18% in 2020.

Landlords – restrictions on allowable deductions

Currently landlords may deduct costs they incur when calculating the tax they pay on their rental income, at the landlord’s current tax rate. However, this is seen as distorting the UK economy and posing a risk to the UK’s financial stability. Accordingly, from April 2017, relief on finance costs of residential property will be restricted to the basic rate of income tax, phased in over 4 years. In addition, the allowable deduction of 10% of rental profit for wear and tear (regardless of the level of expenditure actually incurred) will be replaced with a new system whereby landlord of residential property can only deduct the costs they actually incur.

UK investment managers – taxation of carried interest receipts

Currently investment fund managers are able to structure transactions to avoid the full 28% capital gains tax charge. From 8 July 2015, legislation will ensure that carried interest receipts are charged at the full rate of CGT with only limited deductions being permitted. Whilst this will obviously have an impact on the amount of CGT that individuals will pay, 28% is still better than the top rate of income tax. Also, it will not impact on the sheltering opportunities afforded by holding these interests in a non-resident trust. If anything, for non-doms, holding their carried interest in a non-resident trust whilst they remain in the UK will be the most tax efficient course.

Conclusion

Mr Osborne’s first budget post-coalition is perhaps more radical than many anticipated. The proposed changes to the non-dom rules are a step change from the status quo. Critically, these changes will be subject to a period of consultation and it would be prudent to wait until that process has concluded before taking any long-term structuring decisions. The introduction of ATED showed that the Government was prepared to recognise and correct fundamental shortcomings with its original proposals. Re-structuring undertaken before the consultation process was concluded proved to be expensive and in many cases unnecessary. We will know more about the latest proposals in the autumn and will publish a further update once we have a degree of clarity on what changes the consultation process will produce.

Please note that this briefing is intended for general information purposes only. Nerine does not give legal or tax advice and no reliance may be placed on this briefing. Clients are strongly advised to obtain specific legal and tax advice from their advisers. We work with a large number of advisers that we would be happy to recommend to those clients who do not have their own adviser in place.