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SESSION EIGHT

DEEMED DOMICILE – THE PROPOSED CHANGES

** LECTURE NOTES **

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THE FUNCTION OF DOMICILE IN UK TAXATION

Connecting Factors

1.1 Governments do not impose taxation on every item of income, or on every person, in the world but only on that income and those persons which or who satisfy connection criteria. The connection criteria applied to individuals tend to fall into two categories:-

- tests of long-term connection; and
- tests of short-term connection.

1.2 In respect of individuals who do not have a connection with the country concerned, whether short or long, governments normally impose taxation only on income, and sometimes on gains, which arise from sources situated in that country. On those individuals with both a long and short-term connection, most governments impose taxation on their worldwide income and many also impose taxation on their worldwide gains. On those who have a short-term but not a long-term connection, a charge is usually imposed on worldwide income and gains but with reliefs to restrict the charge according to further criteria.

UK Connecting Factors

1.3 That is the system which applies in the United Kingdom (the 'UK'). Broadly, long-term connection is determined through the concept of domicile and short-term connection through residence.[1] Again, very broadly, those who are not resident in the UK are

[1] The concept of domicile is a highly imprecise concept of long-term belonging. The United States in contrast uses, as its primary test of long-term belonging, citizenship or the holding of a Green Card conferring the right of long-term residence, statuses which can be determined with certainty

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assessable only on their UK source income[2] and on gains arising on disposals of a limited class of UK assets.[3] Those who are resident in the UK are taxed on their worldwide income and gains.[4] If they are not domiciled in the UK,[5] however, their non-UK income and gains will normally only be taxable if remitted to the UK although, for longer term residents, that privilege may only be obtained at the price of paying the Remittance Basis Charge.[6]

1.4 This general approach is unchanged since Income Tax was introduced by William Pitt the Younger in 1799 to meet the cost of the Napoleonic Wars. It was imposed on income arising from property in Great Britain regardless of whether the person to whom the income arose was resident here, and on the worldwide income of those who were resident here except that income from foreign assets was only taxable if it was remitted to the UK. Since 1914 the Remittance Basis has been gradually restricted. It now applies only to foreign domiciliaries.[7]

The Underlying Justification of Long and Short-Term Connecting Factors

1.5 The theoretical justification of this general pattern is composed of rather inchoate popular ideas about the demands of 'fairness' and a consideration of economic practicality.

2 Simon's Taxes E6.101; *Colquhoun v Brooks* (1889) 2 TC 490 HL
3 TCGA 1992 ss.2 and 10
4 Simon's Taxes E6.101. TCGA 1992 s.2
5 Actually one is domiciled not in the UK but in one of the Kingdoms comprised in the UK but in these notes this form is adopted as a convenient abbreviation
6 ITA 2007 Part 14 Ch A1
7 And in some circumstances, only where a claim is made (ITA 2007 ss.809B-809E)

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Fairness

1.6 It is widely felt that it is 'fair' that those who have a long-term connection with a country should contribute financially to its common life even if that contribution is more than the economic value of the benefits of the connection.

The Economic Argument

1.7 The practical economic justification of differentiating between those with short- and long-term connections with a country is that those who have a short-term connection will more easily move to another country than those who have a long-term one. Those who are contemplating having, or have, only a short-term connection with a country are given tax privileges, in competition with other countries, in order to provide an incentive for them to come to that country and to stay in it so that they bring to that country their wealth, business activities and expertise. Conversely, those with a long-term connection may be taxed more highly than those with only a short-term one because it is less likely that they will move elsewhere.

1.8 If the taxes imposed on those who only have a short-term connection with a country are disproportionate to the advantages of that connection judged against competing jurisdictions, they will have the effect of depriving the country concerned of capital, business activities and expertise. The result of imposing uncompetitive taxation burdens on the internationally mobile will be to make the country that does so poorer than it otherwise would be.

1.9 This essentially pragmatic view of the short-term connecting factor, however, is not accepted by all and at the present time there is considerable public hostility to conferring

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special tax privileges on those with a short term but not a long-term connection to this country.

STABILITY REPLACED BY CONTINUAL CHARGE

2.1 That public hostility led, in 2008, to radical changes[8] in the direct tax regime which applied to non-domiciliaries which, until then, had remained essentially unchanged for many years. It was not just that longer term residents had, for the first time, to pay a fixed amount for the privilege of being taxed on the Remittance Basis,[9] but also that an immensely complicated definition of a 'remittance'[10] was introduced which had the result that foreign domiciled clients were forced first to reconstruct, and then to retain, complex financial records in order to be in a position to demonstrate that they had correctly calculated their remitted income and gains and that, to mitigate the charge in relation to such benign remittances as investment in the UK and the bringing into the country of works of art for temporary exhibition, complex new reliefs were required.[11]

2.2 The Government continued to assert that it valued the contribution that wealthy non-domiciliaries made to the UK but, in spite of promises to maintain a stable regime, changes to the Remittance Basis have continued to be made in every succeeding year.[12] Incremental changes to the taxation of non-domiciliaries have proved too politically tempting a method of garnering headlines about cracking down on tax avoidance for

8 FA 2008 s.25 & Sch. 7
9 ITA 2007 s.809C
10 ITA 2007 ss.809K – 809U
11 ITA 2007 ss. 809UA – 809Z6
12 FA 2009 s.51 & Sch. 27, FA 2010 ss.33 & 34 and Sch. 9, FA 2011 s.26, Sch. 2 paras. 40-43 and 53-59 and Sch. 14 para. 3, FA 2012 s.47 and Sch. 12 paras. 1, 3, 20, FA 2013 ss.20, 21, 218, 219, Sch. 7, Sch. 45 paras. 150 & 152 and Sch. 46 paras. 1 & 2, 22 – 24, 54, 66 & 67, FA 2014 ss.11(8), 52, 296, Sch. 9 para. 29 and Sch. 38 paras. 1, 8 and 9, FA 2015 s.24

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successive Chancellors to resist the temptation to make them; however harmful they may have been to the economic interests of the country.

2.3 In the Summer Budget of last year this trend continued.

THE EXISTING SITUATION

Inheritance Tax

3.1 Since its[13] first enactment in Finance Act 1975, Inheritance Tax has included provisions for a person not actually domiciled in a country of the UK to be treated as if he were so domiciled. They are now found in IHTA 1984 s.267 which provides that:-

> 'A person not domiciled in the United Kingdom at any time (in this section referred to as 'the relevant time') shall be treated for the purposes of this Act as domiciled in the United Kingdom (and not elsewhere) at the relevant time if:-
>
> (a) he was domiciled in the United Kingdom within the three years immediately preceding the relevant time,[14] or
>
> (b) he was resident in the United Kingdom in not less than seventeen of the twenty years of assessment ending with the year of assessment in which the relevant time falls.'[15]

[13] When it was called 'Capital Transfer Tax'. FA 1975 s.19, FA 1986 s.100

[14] We refer to treating an individual as domiciled in the UK if he has been domiciled in the UK in a recent fiscal year as a 'Recently Domiciled Rule'. This is such a rule

[15] We refer to treating an individual as domiciled in the UK if he has been resident in the UK for a specified number of fiscal years during a specified period as a 'Long-Term Residents Rule'. This is such a rule

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Income Tax and Capital Gains Tax

3.2 Income Tax and Capital Gains Tax, however, have never had an extended definition of domicile so for the purposes of those taxes a person's domicile has always been determined under the law of domicile generally. An additional charge (being Income Tax or Capital Gains Tax) is imposed where a non-domiciled individual has been resident in the UK for substantial periods.

3.3 So currently,[16] in respect of an individual who meets one of the Seventeen Year, Twelve Year or Seven Year Residence Tests for a fiscal year, the Remittance Basis will only apply to that individual if he pays the Remittance Basis Charge[17] unless his unremitted foreign income and gains for the year are less than £2,000.[18] The charge, if he satisfies the Seventeen Year Residence Test, is £90,000, £60,000 if he satisfies the Twelve Year Residence Test and £30,000 if he satisfies the Seven Year Residence Test.[19]

3.4 An individual meets the Seventeen Year Residence Test for a fiscal year if he has been UK resident in at least seventeen of the preceding twenty fiscal years.[20] He meets the Twelve Year Residence Test for a fiscal year if he does not meet the Seventeen Year Residence Test and he has been UK resident in at least twelve of the preceding fourteen fiscal years.[21] He meets the Seven Year Residence Test if he does not meet the Seventeen Year Residence Test and the Twelve Year Residence Test and he has been UK resident in at least seven of the nine preceding fiscal years.[22]

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16 Since the introduction of the Remittance Basis Charge in 2008/09, the Residence Tests and the amount of the charge have changed several times
17 ITA 2007 ss.809C, 809D and 809H
18 ITA 2007 s.809C
19 ITA 2007 s.809C
20 ITA 2007 s.809C(1ZA)
21 ITA 2007 s.809C(1A)
22 ITA 2007 s.809C(1B)

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3.5 Where the Remittance Basis Charge applies the individual does not receive certain allowances, reductions and reliefs.[23]

THE CHANCELLOR'S PROPOSALS

The Summer 2015 Budget Speech

4.1 In his Budget Speech on the 8th July 2015 (the 'Summer 2015 Budget Speech') the Chancellor announced:-

> '…It is not fair that people who are born in the UK to parents who are domiciled here, can later in life claim to be non-doms and live here.
>
> It is not fair that non-doms [sic] with residential property here in the UK can put it in an offshore company and avoid inheritance tax.
>
> From now on they will pay the same tax as everyone else.
>
> And most fundamentally, it is not fair that people live in this country for very long periods of their lives, benefit from our public services, and yet operate under different tax rules from everyone else.

[23] ITA 2007 s.809C

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Non-dom status was meant to be temporary, but it became permanent[24] for some people. Not any longer.

I am today abolishing permanent non-dom tax status.

Anyone resident in the UK for more than 15 of the past 20 years will now pay full British taxes on all worldwide income and gains.'

The Briefing Note

4.2 On the day that the Summer 2015 Budget Speech was delivered the Government published two technical briefing notes on these changes.[25] It seems that the Government was concerned that the proposed changes would lead to an exodus of wealthy non-domiciliaries who would take with them their wealth, businesses and considerable commercial acumen. In what seemed to be an attempt to mitigate the effect of the changes on non-UK domiciliaries, one of these two briefing notes, which was entitled '*Technical Briefing on Non Dom Changes announced at Summer Budget 2015*' (the 'Briefing Note') contained the following remarkable paragraph:-

[24] In what sense was 'non-dom' status 'meant to be temporary' but 'became permanent?' Except under IHTA 1984 s.267 an individual's domicile status for direct tax purposes has been determined under the general law for as long as an individual's domicile has been relevant to his direct tax liabilities. It has always been the case, therefore, that a person who resides in the UK and has formed an intention to remain here permanently or indefinitely becomes domiciled here under the general law and thus for direct taxation purposes generally and that a person who does not do so has been able to live in the UK for many years without being domiciled here. It has never been the case that domicile under the general law or for direct taxation purposes generally could be acquired by long-term residence only and I am not aware that any previous Chancellor, or the current one, has suggested that it should be so nor, until the Government's latest proposals, that, other than under s.267, there should be a special domicile status which applies for taxation purposes only. The Chancellor's comment seems to have been written by an individual with either a profound ignorance of taxation or an indifference to accuracy

[25] *Technical Briefing on non-dom changes* announced at Summer Budget 2015

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> 'Non doms who have set up an offshore trust before they become deemed domiciled here under the 15 year rule will not be taxed on trust income and gains that are retained in the trust and such excluded property trusts will have the same IHT treatment as at present (subject to the announcement made at Budget 2015 on UK residential property held through offshore companies and similar vehicles). 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. The government will consult on the necessary changes to the transfer of assets regime and capital gains tax trust provisions. The government recognises that this is a significant change to the current rules and that changes to trust taxation are complex and will need to be considered carefully.'[26]

4.3 Now, of course, the transfer of assets regime does not apply where the taxpayer can show that none of the main purposes of the arrangements concerned was the avoidance of UK taxation.[27] So whilst the Chancellor was announcing complex changes to restrict the tax privileges given to non-UK domiciliaries in the interests of 'fairness', he was also planning to give a special tax privilege to those who had set up offshore structures with the purpose of avoiding UK tax. It would have been unsurprising if there has been a terrible political furore as soon as this element of the proposals was noticed by one of the many tax justice campaigners who are now such a colourful feature of modern political life. A year on, none of them seems to have done so but the penny must surely drop at some time.

[26] Para. 22 of the Technical Briefing
[27] ITA 2007 ss.736-742A

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The 2015 ConDoc

4.4 The Briefing Note was followed on 30th September 2015 by a consultation document (the '2015 ConDoc') which gave a little more detail of the Government's proposals.

The Policy Papers

4.5 The STEP[28] and the CIOT[29] made detailed submissions in response to the 2015 ConDoc but when on 9th December 2015 the Government published a policy paper[30] (the 'IHT Policy Paper') with draft legislation (the 'Draft IHT Legislation') in respect of the Inheritance Tax aspects of the proposals no account had been taken of the professional bodies' submissions.

4.6 This was still the case when the Government published a policy paper[31] (the 'IT/CGT Policy Paper') and draft legislation (the 'Draft IT/CGT Legislation') in relation to the Income Tax and Capital Gains Tax aspects of its proposal on 5th February 2016. Both policy papers[32] promised that the Finance Bill 2016 would include provisions to effect the changes except in respect to the proposals in relation to offshore trusts settled by non-UK domiciliaries who subsequently began to be treated as if they were UK domiciled under the new rules. Those provisions were to be enacted in the Finance Act 2017 which, of course, will not be passed until after the proposed commencement date of 6th April 2017.[33]

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28 A paper published on 12th November 2015 entitled '*STEP Response to the consultation paper. Reforms to the taxation of non-domiciles published 30th September 2015*' (the 'STEP ConDoc Response')

29 A paper dated 12th November 2015 entitled '*Reforms to the taxation of non-domiciles. Responses by the Chartered Institute of Taxation*' (the 'CIOT ConDoc Response')

30 Policy paper entitled *'Inheritance Tax: reforms to the taxation of non-domiciles'* dated 9th December 2015

31 Policy paper entitled *'Domicile: Income Tax and Capital Gains Tax'* dated 5th February 2016

32 The IHT Policy Paper, Proposed Revisions. The IT/CGT Policy Paper, Background to the Measure

33 The IT/CGT Policy Paper

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The 2016 Budget Announcement

4.7 At the time of the Chancellor's Budget Speech on 16th March of this year, however, it was announced (the '2016 Budget Announcement') that all of the proposed changes would not be enacted until the Finance Act 2017 although the implementation date of 6th April 2017 was still to apply.

Stasis

4.8 Since that time nothing further has been published by the Government in the public domain. The referendum period also interrupted the series of informal meetings between the professional bodies, HMRC and the Treasury which had been running in parallel with the formal consultation.

4.9 At the time of writing, it is unclear when and to what extent the consultation process will resume in the light of the new burdens on the civil service arising from the referendum decision. It seems the most likely outcome is that if a further consultation document is not published by the Summer Recess which begins on the 21st July 2016, nothing will be published until the Autumn after the party conference season. This leaves clients and their advisors in the position of having to create contingency plans for the future on the basis of imprecise proposals which lack significant detail and which will certainly be revised to some extent before they are enacted.

4.10 This is particularly difficult in relation to dealing with existing offshore trusts and underlying companies and in deciding whether a non-UK domiciliary should establish such structures before he is treated as if he were domiciled in the UK under the new rules for what little detail the Government has given of its proposals in this area has been

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roundly condemned by the professional bodies as unworkable.[34] It is clear that these proposals will have to be fundamentally redesigned and that implementing them will be enormously complex technically and require very dense legislation. It would not be at all surprising, if in the event, the government found this part of its proposals simply too difficult and dropped them in their entirety leaving the severity of the new rules unmitigated by any relief for existing offshore structures.

THE DRAFT LEGISLATION

The Draft IHT Legislation

5.1 In respect of Inheritance Tax the Draft IHT Legislation provides that a person will be treated for the purposes of IHTA 1984 as domiciled in the United Kingdom when he actually is not in three sets of circumstances:-

(a) where he has been domiciled in the United Kingdom within three years immediately preceding the time (the 'Relevant Time') at which his domicile is to be determined; [35]

(b) he was resident in the United Kingdom for at least 15 of the 20 tax years immediately preceding the fiscal year in which the Relevant Time falls;[36]

(c) he is a formerly domiciled resident for the fiscal year in which the Relevant Time falls.[37]

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[34] The STEP ConDoc Response paras. 8.1 – 8.12. The CIOT ConDoc Response paras. 8.1 – 8.9

[35] This is a Recently Domiciled Rule

[36] This is a Long-Term Residents Rule

[37] We call any rule which treats an individual as being domiciled in the UK if he has previously had a domicile of origin in the UK whether or not further conditions must be satisfied for the rule to apply, a 'Formerly Domiciled Resident Rule'. This is such a rule

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The IT/CGT Draft Legislation

5.2 The IT/CGT Draft Legislation is structured in a different way to the Draft IHT Legislation. A new section is to be inserted into ITA 2007 (section 835BA), which is to have effect only where it is specifically provided that it is to apply to particular provisions of the Income Tax Acts or other enactments. That means that one cannot simply assume that these provisions to treat non-UK domiciliaries as if they were domiciled in the UK will apply in respect of any particular provision of Income Tax or Capital Gains Tax to which domicile is relevant. Instead, one will have to search in the provisions concerned for a specific provision applying the deemed domicile rule.

5.3 It is unclear why the Government has chosen one approach for IHT purposes and another for Income Tax and Capital Gains Tax purposes and it is not yet clear whether it is the Government's intention that the deeming provision will in fact apply to all Income Tax and Capital Gains Tax provisions to which domicile is relevant.

5.4 The draft s.835BA provides that:-

> '(2) An individual not domiciled in the United Kingdom at a time in a tax year is to be regarded as domiciled in the United Kingdom at that time if –
>
> (a) condition A is met, or
>
> (b) condition B is met.
>
> (3) Condition A[38] is that –
>
> (a) the individual was born in the United Kingdom,
>
> (b) the individual's domicile of origin was in the United Kingdom, and

[38] Condition A is a Formerly Domiciled Resident Rule

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(c) the individual is resident in the United Kingdom for the tax year referred to in subsection (2).

(4) Condition B[39] is that the individual has been UK resident for at least 15 of the 20 tax years immediately preceding the tax year referred to in subsection (2).'

5.5 This Condition A is the equivalent of the proposed Long Term Residence Rule for IHT. Condition B is the equivalent of the proposed Formerly Domiciled Resident Rule for IHT. There appears to be no proposed equivalent for Income Tax and Capital Gains Tax purposes of the Recently Domiciled Rule for IHT purposes.

5.6 We shall now look at each element of the proposed deemed domicile rules in turn.

THE RECENTLY DOMICILED RULE

6.1 As we have seen,[40] the Recently Domiciled Rule appears only in the Draft IHT Legislation. In fact, as we have seen,[41] it has always been part of the IHT rules in relation to deemed domicile. The 2015 ConDoc said under the heading 'IHT for UK Domiciles Leaving the UK' that:-

> 'On balance, the government favours a rule which treats a UK domicile as non-domiciled on the later of the date that they acquire a domicile of choice in another country, or the point when they have not been resident in the UK for 6 years.'[42]

[39] Condition B is a Long-Term Resident Rule
[40] See para. 5.5 above
[41] See para. 3.1 above
[42] See 2015 ConDoc

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6.2 If a person were to become non-resident and later lose his UK domicile after the end of the third fiscal year in which he was non-resident he would continue to be treated as if he were UK domiciled under the current version of the Recently Domiciled Rule after the end of his sixth year of non-UK residence. That would seem to suggest that the Government intended to modify or repeal the Recently Domiciled Rule. Yet in spite of this passage in the 2015 ConDoc, the Draft IHT Legislation published on 9th December 2015 over two months later, did not include provisions to repeal the Recently Domiciled Rule.

THE LONG-TERM RESIDENTS RULE

Non-Alignment with Temporary Non-Residence Rules

7.1 The Government has decided not to align the Long-Term Residents Rule in respect of deemed domicile with the temporary non-residence rule in respect of statutory residence.[43] That rule applies where an individual has a temporarily non-resident period of five years or less. A temporarily non-resident period does not necessarily consist of whole fiscal years.

7.2 The maximum period after ceasing permanently to be resident in the UK for which a person can be treated as domiciled here under the Long-Term Residents Rule, however, is six fiscal years although, if the individual has had previous periods of non-UK residence of less than five complete fiscal years they may cease to be treated as domiciled in the UK after a much shorter period. So, for example, if a non-domiciled individual was first resident in the UK in the fiscal year 2000/01 but was non-resident for the fiscal years

[43] 2015 ConDoc, Section 3

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2005/06 to 2009/10, he will be treated as UK domiciled in 2020/21 because he will have been resident in the UK for 15 of the 20 fiscal years between and including 2000/01 and 2019/20. If he is not resident for 2020/21, however, he will not be treated as domiciled in the UK under the Long-Term Residents Rule in 2021/22 because in the 20 fiscal years between and including 2001/02 – 2020/21 he will have been resident in the UK for only 14 fiscal years.

Disapplication of the SRT Transitional Election

7.3 Applying the Long-Term Residents Rule will require an individual to have determined his country of residence over a period of 20 preceding fiscal years. The Statutory Residence Test was introduced in Finance Act 2013[44] in response to the widely held view that it had become almost impossible to determine a person's country of residence with reasonable probability under the previous law. For the purposes of determining where a person is resident in the fiscal years 2014 onwards to which the SRT applies it is sometimes necessary to determine his residence for a prior year in which it did not.[45] It is possible to make an election[46] (the 'SRT Transitional Election') to apply the SRT for this purpose to those prior years.

7.4 It would have been sensible to provide a similar election in determining residence for the purposes of the deemed domicile rules. The Government has chosen instead to restrict, for the purposes of deemed domicile, even the existing restricted application of the SRT Transitional Election. The 2015 ConDoc contained an earlier version of the 2015 Draft Legislation which disapplied the SRST Transitional Election for the purposes of the Long-

[44] FA 2013 s.218 and Sch 45
[45] FA 2013 Sch 45 paras, 12, 13, 17 – 20 and 37 for example
[46] Under FA 2013 Sch 45 para. 154

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Term Residents Rule.[47] The Draft IHT Legislation similarly disapplies the rule. That would leave taxpayers, in determining their residence for 2013/14 and some later fiscal years in respect of the Deemed Domicile rules, having to determine their residence for years prior to 2013/14 under the highly uncertain law which applied in those years.

7.5 The IT/CGT Draft Legislation does not disapply the SRT Transitional Election. It is not clear whether the Government actually intends to disapply the election for Inheritance Tax purposes but not for Income Tax and Capital Gains Tax purposes or whether this is simply an oversight which will be corrected in a later draft.

The Domicile Election

7.6 An individual[48] who is not UK domiciled but has a UK domiciled spouse can elect for IHT purposes to be treated as if he were UK domiciled.[49] Such an election can be beneficial because transfers from a UK domiciled spouse to a non-UK domiciled spouse are only exempt up to a fixed amount which is currently £325,000.[50] Once an election has been made it ceases to have effect if the electing person is resident outside the UK for more than four consecutive fiscal years.[51] The Government proposes to extend that period to six years as a consequence,[52] it claims, of replacing the 17 out of 20 years Long Term Residence Rule with the proposed 15 out of 20 years version of the rule.[53]

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47 2015 ConDoc Section 6
48 The election may also be made in respect of a deceased individual by his personal representatives
49 IHTA 1984 ss.267ZA & 267ZB
50 IHTA 1984 s.18(2) & (2A)
51 IHTA 1984 s.267ZB(10)
52 It is not clear what logical connection there is between the proposed change to the Long-Term Residents Rule and this proposal to change the domicile election
53 See para. 5.1 above

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How are individuals who have already left the UK to be treated?

7.7 It is not clear to what extent a person who has planned his affairs on the basis of the previous rules will be subject to the new ones. Let us consider a person who is not domiciled in the UK, who became UK resident in 2000/01 and was UK resident in all years up to and including 2015/16. He ensured that he was not UK resident in 2016/17 so that he was not treated as domiciled in the UK for the purposes of IHT in that year under the current version of the Long-Term Residents Rule because he was not resident here for 17 out of the 20 fiscal years ending with the year (2016/17) in which his domicile was to be determined. In 2017/18, however, even if he continues not to be UK resident in that year, he will meet the condition of the Draft Legislation that he will have been resident in the UK in 15 of the last 20 fiscal years. Under the Draft Legislation, therefore, it seems that he will be treated as domiciled in the UK in 2017/18 and indeed that he will continue to be so treated until 2022/23. The Briefing Note, however, said that:-

> 'For those who leave the UK before 6 April 2017 but would nevertheless be deemed domiciled under the 15 year rule on 6 April 2017 the present rules will apply.'

7.8 That undertaking was missing in the 2015 ConDoc.

Deemed Domicile in Periods of Non-Residence

7.9 The 2015 ConDoc says at para. 3.4 that, after departure, deemed domicile status will only be relevant for Inheritance Tax purposes. Where an individual has returned after a temporary period of non-residence (which as we have seen is five years or less), however, he will become subject to the temporary non-residence rules.[54] In that case the

[54] FA 2013 Sch. 45, Part 4

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individual will be taxed in the year of return on certain income and gains arising in the years of absence. Whether he was deemed to be domiciled in the UK during the period of absence will affect his liability to Income Tax and Capital Gains Tax on his return because, for example, it will determine whether the Remittance Basis applies.

7.10 Of course, in those circumstances, he may already have realised income or gains on the expectation that he would be taxed on the Remittance Basis.

7.11 One of the oddities of the Long-Term Residents Rule is that a non-UK domiciliary can be treated as domiciled in the UK for the first time after he has become permanently non-resident. If, for example, a UK domiciled individual first became resident in the UK in 2002/03 and remained resident here up to and including 2016/17 but for all succeeding fiscal years was not resident in the UK, he would be treated as being domiciled here for the first time in 2017/18 (after he had permanently ceased UK residence), and would continue to be so treated for all years up to and including 2022/23.

Death

7.12 An individual who has left the UK before 6th April 2017 and who dies in his fourth year of non-UK residence but after that date would not be deemed to be domiciled in the UK for Inheritance Tax purposes under the existing rules. Under the proposed Long-Term Residents Rule he would be treated as if he were domiciled in the UK on his death and his worldwide estate would bear UK Inheritance Tax.[55]

[55] IHTA 1984 ss.4 & 5

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Minors

7.13 Another of the oddities of the new rule is that minors who have a domicile of dependence, which, of course, will follow their father's domicile, may find that they are treated as having a different domicile to their father for Inheritance, Income and Capital Gains Tax purposes. A child, whose father loses his UK domicile under the general law but who continues to be treated as UK domiciled under the Long-Term Residents Rule, may be treated for tax purposes as domiciled in a different country from his father because the child cannot satisfy the Long-Term Residents Rule for the first fourteen fiscal years of his life.

7.14 If a father acquires a foreign domicile during his son's minority but continues to be treated as domiciled in the UK under the Long-Term Residents Rule the son will acquire his father's foreign domicile as a domicile of dependence and he will not be treated as domiciled in the UK under the Long-Term Residents Rule until he has been resident in the UK for fifteen years.

7.15 Conversely, however, where the father acquires a foreign domicile in the 15th or 16th fiscal year of his son's life it will be possible that the father will not satisfy the Long-Term Residents Rule whereas the son will do so. In that case, although he had his father's domicile of dependence in another country, the son would be treated as being domiciled in the UK whereas the father would not.

Redundancy of the Seventeen Year Residence Test

7.16 Another consequence of the introduction of the Long-Term Residents Rule illustrates the instability which non-domiciliaries have had to suffer in respect of the tax regime governing their affairs. The £90,000 Remittance Basis Charge which was only introduced

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with effect from the fiscal year 2015/16[56] will now become redundant because that charge only applies where the individual is not domiciled in the UK (and, under the proposed rules, is not treated as domiciled in the UK) and has been resident in at least seventeen of the twenty fiscal years immediately preceding the fiscal year concerned, whereas a person who has been domiciled in seventeen or more of the twenty fiscal years immediately preceding the fiscal year concerned would be treated, under the proposed rules, as domiciled in the UK.

THE FORMERLY DOMICILED RESIDENT RULE

Born in the UK having a Domicile of Origin Here

8.1 As we have seen,[57] in his Summer 2015 Budget Speech the Chancellor said:-

> '…It is not fair that people who are born in the UK to parents who are domiciled here, can later in life claim to be non-doms and live here.
>
> It is not fair that non-doms [sic] with residential property here in the UK can put it in an offshore company and avoid inheritance tax.
>
> From now on they will pay the same tax as everyone else.
>
> And most fundamentally, it is not fair that people live in this country for very long periods of their lives, benefit from our public services, and yet operate under different tax rules from everyone else.

[56] FA 2015 s.24(4)
[57] See para. 4.1 above

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> Non-dom status was meant to be temporary, but it became permanent for some people. Not any longer.
>
> I am today abolishing permanent non-dom tax status.
>
> Anyone resident in the UK for more than 15 of the past 20 years will now pay full British taxes on all worldwide income and gains.'

8.2 At this stage it appeared that the introduction of a stricter Long-Term Residents Rule was to be the Chancellor's solution to the three situations which he claimed to be unfair. The Briefing Note which was published on the same day as the Chancellor gave his speech, however, explained that each claimed unfairness was to be countered by its own change and that:-

> 'The government … believes that those who have a strong connection with the UK having a UK domicile of origin at birth should not be able to access the remittance basis regime if they return and become UK resident here, even if they have lost that UK domicile as a matter of law.
>
> … 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.'[58]

[58] Briefing Note paras. 7 and 8

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8.3 It will be seen[59] that the Chancellor in his Summer Budget 2015 Speech suggested that it was unfair that individuals who were both born in the UK and have a domicile of origin in the UK should be able 'later in life [to] claim to be non doms and live here.' The Briefing Note, however, suggested that the Formerly Domiciled Resident Rule would apply to any individual who had a domicile of origin in the UK and was resident here regardless of where he was born.

8.4 Commentators assumed that it was the Briefing Note which was written with the greater accuracy and that the Chancellor's comments in his speech reflected the greater informality with which politicians talk about claimed unfairnesses and the rather shaky grasp of the concept of domicile held by the Chancellor or his speech writer. For example the Chancellor had referred to the targets of the change as 'people who … can later in life claim to be non doms and live here,' whereas, of course, although the Remittance Basis must be claimed, whether an individual is domiciled in the UK or not is a question of fact which is not part of the claim but a pre-condition of it.

8.5 When the 2015 ConDoc was published, however, it made it quite clear that the Formerly Domiciled Resident Rule would apply only to individuals who were both born in the UK and had a UK domicile of origin at their birth.[60]

[59] See para. 8.1 above
[60] 2015 ConDoc Section 4

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The Form of the Formerly Domiciled Resident Rule

The Draft IHT Legislation

8.6 We have seen[61] that the Draft IHT Legislation treats a person who is not domiciled in the UK as if he were for the purposes of Inheritance Tax if 'he is a formerly domiciled resident for the tax year in which the Relevant Time falls.'[62] For these purposes:-

> '…. a person is a "formerly domiciled resident" for a tax year if –
>
> (a) he was born in the United Kingdom;
>
> (b) his domicile of origin at the time of his birth was in the United Kingdom;
>
> (c) he was resident in the United Kingdom for that tax year; and
>
> (d) he was resident in the United Kingdom for at least one of the two tax years immediately preceding that tax year.'[63]

The IT/CGT Draft Legislation

8.7 We have seen[64] that under the IT/CGT Draft Legislation an individual who is not domiciled in the UK will be regarded as if he were at a particular time if he meets one of two conditions, A or B. Condition B contains a version of the Formerly Domiciled Resident Rule as follows:-

> 'Condition B is that the individual has been UK resident for at least 15 of the 20 tax years immediately preceding the tax year referred to in subsection (2).'

---

61 See para. 5.1 above
62 Draft IHT Legislation para. 43(1)
63 Draft IHT Legislation para. 43(3)
64 See para. 5.2 above

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8.8 It can be seen[65] that in Condition B, unlike its equivalent in the Draft IHT Legislation, there is no condition as to UK residence in previous years so there will be situations where an individual is treated as if he were domiciled in the UK for Income Tax and Capital Gains Tax purposes but not for Inheritance Tax purposes.

Accidental Differences

8.9 As the following example illustrates, the Formerly Domiciled Resident Rule will result in radically different treatments of taxpayers according to the accidents of events which have happened decades in the past and which would not seem to result in any differences in their circumstances sufficient to justify a difference in tax treatment:-

Example

Bill and Ben were brothers. In 1950, before their birth, their father, who was domiciled in the UK, went to work in Australia and became resident there. Bill was born in Australia in 1951. Ben was born in 1952, his mother having returned to the UK for the birth because of complications in her pregnancy which required treatment by a London specialist. She returned to Australia with her newly born son and until 1st June 2016 neither Bill nor Ben nor their parents ever set foot in the UK again. Their father gradually settled in Australia and acquired a domicile of choice there at the beginning of 1955.

In June 2016 Bill and Ben decided to visit their cousins in the UK for a couple of months but, unfortunately, whilst here they were both involved in a car crash and after a period in which they were in a coma they died on 10th December

[65] See para. 8.7 above

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2017. They were both resident in the UK under the SRT for the fiscal years 2016/17 and 2017/18. Both had had domiciles of origin in the UK but had acquired domiciles of dependence in Australia which had become their domiciles of choice. Whereas Bill had not been born in the UK, however, Ben had. The result was that under the Government's proposals Bill's worldwide estate suffered no UK Inheritance Tax whereas Ben's was fully subject to it.

An Unadmitted Error?

8.10 It is difficult to believe that the Government really intended such drastic effects to flow from such a seemingly irrelevant factual difference. Commentators wondered, perhaps cynically, whether slackness in the drafting of the Budget Speech was compounded by an unwillingness to admit to error. Be that as it may, not only is there an arbitrary distinction between those with domiciles of origin in the UK who are born here and those who were not but the Formerly Domiciled Resident Rule creates an arbitrary risk for those with no substantial connections in the UK who happen to become resident here for a short period. To some extent the Government recognised this latter point and provided for it in that, for Inheritance Tax purposes, the Formerly Domiciled Resident Rule will only apply where the individual concerned has been resident in the UK in either one of the two fiscal years preceding the fiscal year in which his domicile is to be determined.

8.11 This does not apply, however, in determining deemed domicile for Income Tax and Capital Gains Tax purposes. Even in respect of Inheritance Tax, it hardly answers the point. It is very easy to become UK resident for two fiscal years and yet still to have acquired an insubstantial connection with the UK as our example of Bill and Ben

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illustrates. The STEP and the CIOT have suggested[66] that the Formerly Domiciled Resident Rule should be met only if there are three consecutive fiscal years of residence ending with the year in which the individual's domicile is to be determined. As yet the Government has made no response to that suggestion.

Ignorance of the Concept of Domicile

8.12 Indeed, the decision to introduce the Formerly Domiciled Resident Rule seems to be based on a misunderstanding of the very concept of domicile. Where a person has had a domicile of origin in the UK but now has a domicile of choice in another country, his domicile of origin will revive the moment he ceases to intend to reside permanently or indefinitely in the country of his domicile of choice unless he acquires another domicile of choice at that time. By definition, individuals who have had a domicile of origin in the UK who now have a domicile of choice elsewhere but are resident in the UK will intend to remain permanently or indefinitely in the country of their domicile of choice and are likely, therefore, to have only a slight connection with the UK. It would be unlikely that such an individual could be resident in the UK for a long time but continue to keep his domicile of choice elsewhere. Subjecting an individual's worldwide income to Income Tax, his worldwide gains to Capital Gains Tax and his worldwide estate to Inheritance Tax because he resides in the UK for only a short period of time, would be profoundly unjust.

8.13 The class of individuals who continue to have a domicile of choice outside the UK whilst being resident here for extended periods must, therefore, be very limited and yet, in discussions, HMRC has claimed that there is a considerable group of individuals[67]

[66] The STEP ConDoc Response, para. 3.3. The CIOT ConDoc Response, para. 17.3

[67] It is interesting that the Summaries of Impacts published in the Policy Papers show the proposal as having a negligible impact on the Exchequer over the entire planning horizon

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currently resident in the UK who have had UK domiciles of origin but who complete their self-assessment returns on the basis that they are not domiciled here. If that is so, it can only be because HMRC is failing in its duty to identify mistaken and false returns. Is the Government proposing to make bad law because its officials are too incompetent or too idle to investigate and identify mistaken or false assertions as to domicile?

Rapid Changes of Status

8.14 Because the Recently Domiciled Rule, which, as we have seen,[68] applies only for IHT purposes, operates by reference to former actual domicile in the UK the application of that rule will not be affected by the fact that the individual concerned has been treated in a prior year as if they were domiciled in the UK. Because of that, a person who has not actually been domiciled in the UK even though he has been treated as so domiciled will not be subject to the Recently Domiciled Rule and such individuals will be treated, under the Formerly Domiciled Resident Rule as domiciled in the UK or not as their residence status changes. What is more the IHT rules in respect of excluded property trusts are to be changed so that settled property is not excluded property at any time in a fiscal year if the settlor is a formerly domiciled resident for that fiscal year.[69] So if non-UK domiciled individuals who have been born in the UK and had a UK domicile of origin have made relevant property settlements, whether the property in the settlement is excluded property or not will vary with their residence status. Whether and to what extent, therefore, the trustees are subject to decennial and exit charges to Inheritance Tax will depend on the residence status of the settlor from time to time. The 2015 ConDoc merely accepted that that is the case without commenting on the difficulties it will cause saying:-

[68] See para. 5.5 above
[69] Draft IHT Legislation s.43(4)

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> 'Since the residence criteria will be based on the statutory residence test where individuals are either resident or non-resident for the whole year, it will create situations in which property will switch from being excluded property to being liable to IHT under the "relevant property" regime for periods of one or more tax years. If someone is frequently coming and going from the UK, the property in the trust will be excluded property one year and relevant property in the next year. The government accepts this position as it would allow individuals flexibility to move in and out of the UK as and when necessary. However, trustees will need to consider whether a ten year anniversary charge arises at any point during each period the settlor is UK resident.'[70]

How trustees of such settlements are to keep in touch with the settlor's country of residence or indeed, even be aware that they need to do so, is unclear.

TRANSITIONAL PROVISIONS

Offshore Trusts and Companies

9.1 As we have seen[71] the Briefing Note said that:-

> 'Non doms who have set up an offshore trust before they become deemed domiciled in the UK under the 15 year rule will not be taxed on trust income and gains that are retained in the trust and such excluded property trusts will have the same IHT treatment as present (subject to the announcement made at Budget 2015 on UK residential property held through offshore companies and similar vehicles).

[70] 2015 ConDoc, Section 4
[71] See para. 4.2 above

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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. The government will consult on the necessary changes to the transfer of assets regime and capital gains tax trust provisions. The government recognises that this is a significant change to the current rules and that changes to trust taxation are complex and will need to be considered carefully.'

9.2 The Government's intention in proposing a charge based on the benefits received from a trust regardless of the income or gains which the trustees have made seems to have been to relieve non-UK domiciliaries who are UK resident from the administrative burden of maintaining complex financial records. Unfortunately, the Government had not thought through the implications of its proposal which creates far more problems for non-UK domiciliaries than it solves.

9.3 The CIOT has identified[72] four major problems with the Government's proposal.

9.4 First, it will introduce a new and different system which will apply to trusts settled by those deemed to be UK domiciliaries under the new rules but not to trusts settled by those who have been deemed to be domiciled under the existing rules governing deemed domicile and Inheritance Tax.

9.5 Secondly, it will create separate regimes for those treated as if they were domiciled in the UK and those who actually are so.

[72] CIOT ConDoc Response, paras. 8.3 - 8.6

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9.6 Thirdly, the CIOT suggests that the distinction between actual UK domiciliaries and those who are deemed to be UK domiciled under the Recently Domiciled Rule or the Formerly Domiciled Resident Rules on the one hand and those who are treated as UK domiciled under the Long-Term Residents Rule on the other will, arguably, be in contravention of the EU freedoms of establishment and movement of capital. That difficulty may now be time limited but will apply at least until we leave the European Union and cease to be subject to European law.

9.7 Fourthly, it raises the problem of what are known as 'dry trusts'; that is trusts which do not generate income or make capital gains. Consider the example of a non-UK domiciliary who, before becoming resident in the UK, has made a trust of residential property in the country of his domicile, by reference to the succession laws of that country, which confers a life interest on himself with an absolute reversion to his son. Under the Government's proposal, as set out in the 2015 ConDoc, it would seem that, on the reversion falling in, the son would be charged, one presumes, to Income Tax, on the value of the property on his father's death even if it had not risen in value and had generated no income at all.[73]

9.8 Because of these difficulties, the major professional bodies have suggested[74] that the provisions in respect of offshore trusts should be based on an adaptation of the rules for matching benefits conferred on beneficiaries with trust income and gains found in ITA 2007 s.741 in respect of Income Tax and TCGA 1992 s.87 in respect of Capital Gains Tax. Actually creating such a system raises a myriad of technical problems which we

[73] The Government's published material gives no indication as to how the proposal to charge such 'benefits' to tax would interact with Inheritance Tax

[74] STEP ConDoc Response, para. 8.8. CIOT ConDoc Response, paras. 8.8 & 8.9

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shall not examine here, primarily because there is no indication, as yet, that the Government will accede to this suggestion or even seriously consider it.

Rebasing

9.9 Another transitional provision emerged rather obliquely on the day of the March 2016 Budget Speech. The *Overview of Tax Legislation and Rates* which was published on that day included the statement that:-

> 'Budget 2016 confirms that non-doms who become deemed-domiciled in April 2017 can treat the cost base of their non-UK based assets as being the market value of that [sic] asset on 6 April 2017.'[75]

9.10 The Government subsequently confirmed that this rebasing will only apply to individuals who becomes deemed UK domiciled on 6th April 2017 and not to individuals who become deemed UK domiciled in subsequent years. It also confirmed that the element of gain which has accrued up to 5th April 2017 will not be taxed at all, even if the proceeds of sale are subsequently remitted to the UK.

9.11 It also appears that the rebasing will apply to everybody who becomes deemed domiciled on 6th April 2017 whether this is as a result of the Long-Term Residents Rule or the Formerly Domiciled Resident Rule.

9.12 Again this is very odd.

[75] *Overview of Tax Legislation and Rates*, para. 2.1

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9.13 A person currently resident in the UK but not domiciled here who disposes of a foreign situated asset before 6th April 2017 will be taxed on any gain which arises under the Remittance Basis. If he delays his disposal until after the end of this fiscal year and he is treated as if he were domiciled in the UK for the first time as at 6th April 2017 under the Government's proposals the only part of his gain which will be brought into charge to tax will be the increase in value between 6th April 2017 and the date of his disposal. A person who is not treated as domiciled in the UK as at 6th April 2017 but begins to be so treated on 6th April 2018 because, for example, having become resident in the UK for the first time in 2003/04 he only meets the 15 out of the last 20 years condition in 2018/19, and who makes a disposal on or after that date, will be fully and immediately subject to Capital Gains Tax on the entire gain arising on his disposal even if it had accrued predominantly in the period when he was neither domiciled in the UK nor treated as so domiciled.

9.14 It has been suggested that a more rational rule would be to apportion the gains of an individual who is not actually domiciled in the UK but is treated as being so for the purposes of Capital Gains Tax, so that the part of the gain which relates to the disposed asset's increase in value up to the time at which he is first treated as domiciled in the UK would be taxed on the Remittance Basis and that part of the gain which accrues after that time would be taxed on the arising basis.

9.15 Whether the Government will adopt that suggestion it is impossible to say.

WHERE ARE WE NOW?

10.1 If the Government's proposals are enacted without material change, the UK tax liabilities of individuals who are not domiciled in the UK but who will be treated as such on 6th April

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2017 under the proposed rules will be materially affected by whether or not they have established offshore trust structures before 6th April 2017, whether they make disposals of capital assets in this fiscal year or in future years and whether they are resident for 2017/18 and future years. If the rules are enacted, they will be enacted some months after the date at which they will be treated as if they had come into effect.

10.2 Much of the detail of the proposals is still under discussion, some parts of them are plainly impractical and irrational and will require amendment and the proposals in respect of offshore settlements are in such an embryonic stage that the Government can hardly be said to have formulated them at all.

10.3 What is the adviser to do? The only answer is to watch developments closely and be prepared to take action as soon as they have reached a sufficiently settled form. When that will be is now anyone's guess. With our impending exit from the European Union the Government has matters to deal with against which the plight of non-UK domiciliaries will seem a mere minor detail. For the individuals concerned, however, the proposals affect their whole manner of life and, for the UK economy, the loss of a significant group of wealthy and talented individuals will not be without important economic effects.

TIME TO DITCH DOMICILE FROM TAX?

11.1 Domicile, as we said at the beginning, is a method of determining long-term connection with a country. It has always been an imprecise concept. The fluidity of modern population flows makes it increasingly difficult to determine. It is a concept of the English common law, and so countries without a common law tradition do not use it to determine liability to taxation. Indeed, some countries which do have a common law tradition do not

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do so. The United States, for example, determines long-term connection primarily by reference to citizenship and to the possession of long-term rights of residence conferred by the 'Green Card', statuses which can be determined with precision. The introduction of the Long Term Residents Rule is surely a reflection of the fact that the concept of domicile is no longer congruent with the sort of in long-term connection which should result to an individual being fully subject to UK taxation. Is it not time that we simply abandoned domicile as the mark of long-term connection for the purposes of imposing UK tax liability and adopted instead the American model of using citizenship and rights of long-term residence as the long-term connecting factor?

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APPENDIX I

GLOSSARY OF TERMS

App 1.1.1 In these notes we have used various words and phrases which we have defined in the text. This Appendix lists those words and phrases and their definitions.

WORD OR PHRASE	DEFINITION	PARAGRAPH OF THIS REPORT WHICH WORD/PHRASE FIRST USED
2015 ConDoc	Consultation Document dated 30th September 2015 entitled '*Reforms to the taxation of non-domiciliaries'*	4.4
2016 Budget Announcement	The announcement in the Chancellor's Budget Speech on 16th March 2016 that the proposed changes in respect of domicile would not be enacted until the Finance Act 2017	4.7
Briefing Note	A document entitled *'Technical Briefing on Non Dom Changes announced at Summer Budget 2015'* published on 8th July 2015	4.2
CIOT ConDoc Response	A paper dated 12th November 2015 entitled '*Reforms to the taxation of non-domiciles. Responses by the Chartered Institute of Taxation*'	4.5
Domiciled in the UK and similar phrases	Domiciled in one of the constituent Kingdoms of the UK	1.3
Formerly Domiciled Resident Rule	A generic term for a rule treating an individual who is resident in the UK as domiciled in the UK if he has previously had a domicile of origin in the UK whether or not further conditions must be satisfied for the rule to apply	5.1
Draft IHT Legislation	Draft Inheritance Tax legislation published on 9th December 2015	4.5
IHT Policy Paper	Government policy paper dated 9th December 2015 entitled *'Inheritance Tax: reforms to the taxation of non-domiciles'*	4.5

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WORD OR PHRASE	DEFINITION	PARAGRAPH OF THIS REPORT WHICH WORD/PHRASE FIRST USED
Draft IT/CGT Legislation	Draft Income Tax & Capital Gains Tax legislation published on 5th February 2016	4.6
IT/CGT Policy Paper	Government policy paper dated 5th February 2016 entitled *'Domicile: Income Tax and Capital Gains Tax'*	4.6
Long-Term Residents Rule	A generic term for a rule treating an individual as domiciled in the UK if he has been resident in the UK for a specified number of fiscal years during a specified period	3.1
Recently Domiciled Rule	A generic term for a rule treating an individual as domiciled in the UK if he has been domiciled in the UK in a recent fiscal year	3.1
SRT Transitional Election	An election under FA 2013 Sch.45 para.154 to apply the SRT to fiscal years prior to 2013/14 for the purposes of determining an individual's residence for 2013/14 or a later year	7.3
The STEP ConDoc Response	A paper published on 12th November 2015 entitled '*STEP Response to the consultation paper. Reforms to the taxation of non-domiciles published 30th September 2015*'	4.5
Summer 2015 Budget Speech	Chancellor's Budget Speech on 8th July 2015	4.1
UK	United Kingdom	1.3

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