WHAT DO THE DEEMED DOMICILE RULES MEAN FOR US INDIVIDUALS?

There have been numerous articles published which address the new 'deemed dom' regime which, subject to the 2017 second finance bill being passed, will retrospectively come into effect from 6 April 2017.

Through such articles, the UK tax impact on long-term UK residents as well as the opportunities the regime may bring with regards to the announced reliefs - rebasing and cleansing of offshore accounts - have been extensively examined.

As a firm which specialises in providing co-ordinated US and UK advice it is key that we consider the interaction of the US and UK for our clients with respect to these rules. Upon closer inspection and with our extensive US client base in mind, the headline opportunities of rebasing and account cleansing may not hold quite the same tax benefits they give other non-US individuals. In addition, there are many additional issues that our US clients need to be aware of.

WE MUST CONSIDER THE INTERACTION OF THE US AND UK TAX POSITIONS WITH RESPECT TO THE NON-DOM RULES.

QUICK RECAP ON THE 'DEEMED DOM' RULES

Prior to the new regime, 'deemed dom' status applied solely for UK Inheritance tax (IHT) when non-domiciled individuals (Non-Doms) had been UK tax resident for at least 17 out of 20 UK tax years. Planning for this event would often be undertaken in the 18 months or so leading up to the trigger date.

The new 'deemed dom' regime has had 2 major effects – firstly, to accelerate the IHT exposure to apply after 15 years of residency rather than 17, but secondly, and more significantly, the new regime will remove the option for non-doms to claim the remittance basis thus moving to an obligatory 'arising' basis of taxation on worldwide income and gains. This can have a material impact on the UK tax position for those who may have historically benefitted from claiming the remittance basis.

For more on the general provisions relating to deemed domicile see links at the end of this article.

REBASING AND ISSUES FOR A US TAXPAYER

It is not always appreciated but the rebasing provision only applies to those becoming deemed dom on 6 April 2017 who have at one point paid the Remittance Basis Charge. It allows qualifying taxpayers to calculate subsequent gains made on personally held non-UK assets with reference to that asset's fair market value as of 6 April 2017, as opposed to the original cost basis when acquired.

As such, if assets held at that date have appreciated, in GBP terms, then the taxable gain for UK tax purposes will be reduced. If it has instead decreased in value then an election to opt out of the rebasing is available – maintaining the original cost basis.

Frank Hirth PLC London | **Frank Hirth LLC** New York | **Frank Hirth LTD** Wellington **www.frankhirth.com** | t: +44 (0) 207 7833 3500 | mail@frankhirth.com

This document has been written for the general interest of our clients and contacts to stimulate further thought and enquiry. It does not contain answers to specific situations and it is therefore essential to treat it as a prompt to take specific advice on any real and particular issues. We believe that the facts as summarised in this document are correct as at the time of going to press in October 2017. If we discover that the document might be read in a way that conveys a misleading impression (whether by tone, content, error or omission) we will make the necessary changes and draw attention to what has been changed once we become aware of the need to do so. We will not be responsible for any action taken by a reader who relies on the document but does not seek further advice to answer any specific query. Frank Hirth PLC Registered in England and Wales: Number 03945095. © 2017 Frank Hirth

frank hirth

The movement in foreign exchange rates can have a significant impact on whether rebasing an asset is beneficial.

A great benefit to the rebasing, aside from a reduced UK capital gains tax exposure, is that the 'rebased' amount – ie the uplifted basis – may be remitted to the UK free of UK tax.

ILLUSTRATION

To illustrate – a foreign stock was bought in 2010 for £20, its fair market value on 6 April 2017 was £50 and it was subsequently sold in 2019 for £90. In this scenario, the UK taxable gain would be £40 as the asset would be rebased to £50. In addition, the £30 that constitutes the uplift in base cost may be remitted to the UK free of any additional UK tax. Thought would be required to determine what the initial cost basis funds of £20 were considered from a UK tax perspective.

In this scenario, if the fair market value at 6 April 2017 was £10 then the option to not rebase would likely be taken and the taxable gain would be £70 rather than £80.

SOURCING AND USE OF THE US/UK TAX TREATY WILL NEED REVIEW.

Whilst the above appears very positive, the potential downside to rebasing assets for US individuals relates to the ability to claim a credit in the US for UK taxes suffered on the 'same gain'. The US federal tax rate on long term gains made (ie assets owned >12 months) is currently 20% which mirrors the UK capital gains tax rate (excluding real estate and carried interest) and so without any rebasing there may already be a natural offset of taxes deeming it unnecessary, ignoring any foreign exchange movement.

The US domestic sourcing rules for personal property, which includes stocks and shares, are such that if the foreign tax suffered is lesser than 10% then the gain is technically considered US source, thus there is no provision to allow a credit for the UK taxes suffered. Should this be the case there may be an ability to utilise the US/UK income tax treaty to mitigate double taxation, however, it may not guarantee a full offset, depending on the asset and rate of tax suffered. Given this, it is therefore vital that consideration is given to the US interaction as it may be that an election to not rebase an asset could provide a more favourable global tax answer.

It should also be pointed out that the rebasing provision only applies while an individual is regarded a 'Deemed Dom'. Should a client subsequently acquire a domicile of choice in the UK under common law principles then the provision ceases to apply and the base cost of assets owned at 5 April 17 and still unsold will revert to the amount paid. If a client wishes to benefit from the rebasing provision it will be more important than ever they avoid acquiring a domicile of choice in the UK, or sell rebased assets before doing so.

For individuals where rebasing may be very valuable but who do not currently qualify (as they never paid the remittance basis charge) then consideration could be given to potentially amending a prior year return to pay this. Advice should of course be taken if any taxpayer is interested in this.

This document has been written for the general interest of our clients and contacts to stimulate further thought and enquiry. It does not contain answers to specific situations and it is therefore essential to treat it as a prompt to take specific advice on any real and particular issues. We believe that the facts as summarised in this document are correct as at the time of going to press in October 2017. If we discover that the document might be read in a way that conveys a misleading impression (whether by tone, content, error or omission) we will make the necessary changes and draw attention to what has been changed once we become aware of the need to do so. We will not be responsible for any action taken by a reader who relies on the document but does not seek further advice to answer any specific query. Frank Hirth PLC Registered in England and Wales: Number 03945095. © 2017 Frank Hirth

CLEANSING MIXED FUNDS

A further opportunity is available to all non-doms who, at some point, have claimed the remittance basis – namely the ability to cleanse any mixed funds (ie contain more than one source/type of income, gain, etc) they may have maintained overseas. The aim being to enable more tax efficient remittances to the UK by those who have not segregated their accounts to date. This window of opportunity is only open for a set period and ends on the 5 April 2019 but does provide non-doms with an ability to cleanse and segregate offshores funds that are mixed.

The UK has statutory ordering rules when monies are remitted from mixed funds which often result in the least favourable (highest tax bracket) items being deemed to be remitted first. Clean capital, which in theory can be remitted free of tax, can also be trapped offshore in an unfavourable order to the taxpayer.

Being able to unmix accounts enables the taxpayer to clearly identify what source they wish to bring into the UK and do so in the most UK tax efficient manner, particularly if they do have an amount of 'clean capital'.

US taxpayers should be mindful that what may appear to be the desired order for remitting funds to the UK for a regular non-dom may not necessarily be the case for them. Consideration should be given to how the US and UK tax credits will align and which jurisdiction, under the US/UK income tax treaty, has the primary right to tax and who will allow credit to alleviate potential double taxation.

For instance, it may appear that the remitting of capital gains may be most UK tax favourable as it may attract a lower rate of tax. However, for a US taxpayer who has already suffered tax on such a gain this may lead to double taxation given the mechanics of how the treaty applies and the ability to claim credits. In addition, remitting of US partnership profits which would attract UK tax of up to 45% may in fact be the most tax efficient as the UK will allow a credit for US federal and state taxes suffered – which may in fact be greater than the UK rate of 45%, therefore allowing such funds to be remitted without an additional UK tax charge.

US TAXPAYERS SHOULD BE MINDFUL OF THE ALIGNMENT OF TAX CREDITS WHEN DETERMINING WHAT TO REMIT.

OTHER AREAS TO CONSIDER

US taxpayers who would have previously claimed the remittance basis will now have to navigate not one, but two very complex tax regimes as well as the interaction between them.

The ability to effectively manage the tax position from both sides of the Atlantic will become ever more crucial and valuable. Those US individuals who have managed their assets and income streams in keeping with US tax law will now need to ensure that they have considered the impact of this from a UK tax perspective also.
Some examples of areas that will often require further consideration:

- US investments – are they UK tax friendly? US mutual funds may be considered Offshore Income Gains (OIGs) in the UK, suffering income tax rates rather than capital gain tax rates. Also, municipal bond interest is not UK tax free in the same way it is in the US.

This document has been written for the general interest of our clients and contacts to stimulate further thought and enquiry. It does not contain answers to specific situations and it is therefore essential to treat it as a prompt to take specific advice on any real and particular issues. We believe that the facts as summarised in this document are correct as at the time of going to press in October 2017. If we discover that the document might be read in a way that conveys a misleading impression (whether by tone, content, error or omission) we will make the necessary changes and draw attention to what has been changed once we become aware of the need to do so. We will not be responsible for any action taken by a reader who relies on the document but does not seek further advice to answer any specific query. Frank Hirth PLC Registered in England and Wales: Number 03945095. © 2017 Frank Hirth

- **US real estate** – if rented, the US have far more generous allowable deductions such as deprecation and mortgage interest than the UK which may result in a greater UK tax liability. Also, sale of real estate attracts a 28% UK capital gains tax charge which may be greater than the US.
- **Trusts** – the US and UK tax treatments and point of recognising income and gains may differ which could result in temporary or permanent double taxation.
- **Carried Interest** – asset managers who receive carry should be aware of the US/UK interactions including potential timing differences.
- **Tax Elections** – the US have various elections which may be made for tax purposes which the UK will not recognise and can lead to mismatches between the 2 jurisdictions.
- **Dual Qualified Charitable giving** – for those paying both UK and US income taxes on their worldwide income it will be more important than ever to ensure that any charitable giving is undertaken in the most tax efficient way

THE ABILITY TO EFFECTIVELY MANAGE THE TAX POSITION FROM BOTH SIDES OF THE ATLANTIC WILL BECOME EVER MORE CRUCIAL AND VALUABLE.

Where both US and UK taxes are being paid the need for specialist guidance is greater now than ever. Consideration should be given to having a 'tax health check' to ascertain the exposure to these new rules and determine what, if any, steps should be taken. It is likely that some practical administrative steps could be useful or that there is the opportunity for some advanced planning (currently beyond the scope of this article).

Please do ensure that you look to discuss the above issues with your regular Frank Hirth contact or email us at mail@frankhirth.com to arrange a preliminary consultation.

For more on the general provisions relating to deemed domicile see links below.

- SEPT 2017 - DRAFT LEGISLATION ON NON-DOM TAX CHANGES
- JUNE 2017 - FINANCE BILL 2017- NON-DOMICILE TAX CHANGES
- DEC 2016 - UPDATED NON-DOM CHANGES / DRAFT LEGISLATION ON THE NON-DOM CHANGES
- JUNE 2016 - TAX CHANGES FOR NON-DOMICILED INDIVIDUALS
- MARCH 2016 - APRIL 2017 CHANGES TO THE TAXATION OF NON-DOMS
- FEB 2106 - PLANNING FOR DEEMED DOMICILE IN THE UK
- OCT 2015 - HMRC CONSULTATION DOCUMENT: CHANGES TO THE TAXATION OF NON-DOMS

This document has been written for the general interest of our clients and contacts to stimulate further thought and enquiry. It does not contain answers to specific situations and it is therefore essential to treat it as a prompt to take specific advice on any real and particular issues. We believe that the facts as summarised in this document are correct as at the time of going to press in October 2017. If we discover that the document might be read in a way that conveys a misleading impression (whether by tone, content, error or omission) we will make the necessary changes and draw attention to what has been changed once we become aware of the need to do so. We will not be responsible for any action taken by a reader who relies on the document but does not seek further advice to answer any specific query. Frank Hirth PLC Registered in England and Wales: Number 03945095. © 2017 Frank Hirth