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Further UK anti-avoidance rules relating to offshore trusts expected in April 2018

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Background

The majority of the expected changes to the taxation of non-domiciliaries which were first announced in July 2015 were passed into law in November 2017, with retrospective effect from 6 April 2017. However, the Government promised, as part of the changes to the tax rules for non-UK resident trusts, to try to close perceived loopholes. As the legislation is long and complex, some of the expected provisions were postponed and are due to take effect from **6 April 2018**.

Capital gains tax

At present, gains realised by trustees are attributed to beneficiaries who receive a benefit from a trust whether the beneficiary is resident or non-UK resident. Non-UK resident beneficiaries are not subject to capital gains tax on trust gains. As such, it is possible to avoid capital gains tax in some cases by making distributions to non-resident beneficiaries to "wash-out" the gains before making a distribution to a UK resident beneficiary.

From 6 April 2018, capital payments made to non-UK resident beneficiaries will not be matched with the pool of trust gains and so will not reduce the pool, which can therefore be taxed when benefits are received by UK resident beneficiaries.

This means that the ability to "wash-out" trust gains will effectively be lost from 6 April 2018. As such, if a trust has UK resident and non-UK resident beneficiaries and has maintained accurate records of trust gains, trustees may wish to consider making distributions to non-UK resident beneficiaries now, before the change in the law. After 5 April 2018, it will only be possible to wash out gains to non-UK residents on the winding up of the trust. Taking the opportunity to wash out gains before then, could significantly improve the UK tax position for UK resident beneficiaries in the future.

Going forwards, it may be worth considering setting up separate trusts for UK resident beneficiaries or creating testamentary trusts (i.e. trusts funded on death) for UK resident beneficiaries.

Anti-conduit rules

As of 6 April 2018, where a capital payment or benefit is received by a beneficiary who does not pay tax on the distribution (because the beneficiary is either non-UK resident or is a non-UK domiciled remittance basis user who does not remit the payment) and that person makes an onward gift to a UK resident (who is not necessarily a beneficiary, but who would have paid tax had he or she received a direct distribution from the trust) the UK resident is treated as if he or she had received a capital payment or benefit from the trust equal to the amount of the gift.

This will put an end to the practice of making distributions from offshore trusts to non-UK resident beneficiaries (who are not taxable) who then subsequently make onward gifts to UK residents (who would have paid tax had they received the distribution directly).

The change means that the UK resident recipient of the gift may be subject to income tax or capital gains tax on the amount of the gift, which he or she receives. However, the UK resident will be able to benefit from the remittance basis provided he or she does not remit the gift to the UK.

For these rules to apply there must be an intention to make an onward gift to a person who will be, or is expected to be, UK resident (when he/she receives at least part of what is passed on to him or her) at the time the original distribution from the trust is made; and the onward gift can be traced to the original trust distribution, or the trust distribution was intended to facilitate, or was connected to, the onward gift. There is also a three year period post-gift during which these anti-conduit rules apply. Here, it is worth noting that even if a distribution is made pre-6 April 2018, it may still be caught by the new rules if an onward gift is made after 5 April 2018 but within three years of the date of the distribution (eg (say) the distribution was made on 10 February 2017 and the onward gift on (say) 20 June 2018 – the new anti-conduit rules would apply to the gift). The anti-avoidance provisions are drafted widely and seek to apply the anti-conduit rules where there is a series of gifts between non-residents and/or non-UK domiciliaries before a final gift is made to the UK resident.

In practice, if a non-UK resident beneficiary has received a gift from an offshore trust which he intends to pass to a UK resident person, he may wish to consider making the onward gift before 6 April 2018 to avoid falling foul of the anti-conduit rules.

Close family member rules

For most income tax purposes, a new rule already in effect from 6 April 2017 means that, where benefits are provided to a close family member (that is, a spouse/civil partner (or the unmarried equivalent) or minor child or step child) of a UK resident settlor, and there is income in the trust, the benefits are taxable to income tax as if they were received by the settlor. This provision is intended to subject a UK resident settlor to income tax where a benefit is made to a close family member who is either non-UK resident or a remittance basis taxpayer and, as such, does not pay tax on the benefit.

From 6 April 2018, similar rules will apply for capital gains tax purposes, so as to tax the settlor where a close family member receives a capital payment which can be matched with gains in the trust. The close family member rules for capital gains tax purposes differ to the close family member rules for income tax purposes, as the close family member does not need to be non-resident or a remittance basis tax payer for the provisions to apply.

Deemed domicile

As of 6 April 2017 an individual is deemed UK domiciled for all tax purposes if he: (i) is UK resident and was born in the UK with a UK domicile of origin **('Formerly Domiciled Residents' or 'FDRs')**; or (ii) has been UK resident for 15 out of the previous 20 years (**the '15 year rule'**).

The new deemed domicile rules are important in the context of offshore trusts for a number of reasons:

1. Once an individual becomes deemed UK domiciled, he is no longer eligible to access the remittance basis, which means he cannot receive distributions from an offshore trust outside the UK without a UK tax liability.

2. Under the new “protected” trust regime, those who are not FDRs, and who establish a non-UK resident trust prior to becoming deemed domiciled under the 15 year rule, will benefit from a UK tax-free roll-up on non-UK income, and all gains, in a trust unless the trust is tainted. The trust's non-UK assets will also be protected from IHT. Provided no additions are made to the trust once the settlor has become deemed domiciled, there will be no tax until a distribution or benefit is received from the trust. With this in mind, it is important to review trust structures before a settlor becomes deemed UK domiciled or to consider setting up a trust for a UK resident individual who is likely to become deemed UK domiciled in the future.

3. Non-UK income arising in a protected trust is no longer treated as the settlor's and so there is no need to claim the remittance basis to shelter this trust income from UK tax. Similarly, gains in a settlor interested trust are not taxed as the settlor's, even though he/she is deemed domiciled, provided the protections apply. As such, for those who are approaching seven years of residence in the UK it may be worth considering establishing a trust over non-UK assets (rather than keeping them in the settlor's own name) to avoid paying the remittance basis charge, which must be paid to access the remittance basis after seven years' UK residence.

4. For those individuals who became deemed UK domiciled on 6 April 2017 the new rules have also introduced potentially valuable opportunities for rebasing, or for cleansing for other remittance basis users as well, which may lead to them having more clean capital and/or benefiting from a deemed uplift in the value of non-UK assets to their 6 April 2017 value.

It should be noted that we do not yet have the final form legislation introducing the provisions which are expected to come into effect from 6 April 2018. As such, the above commentary and interpretation of the provisions is subject to change.

If you have any questions in connection with the above please contact Katie Graves.

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