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Knightsbridge Wealth

technical news

For professionals working with international clients

UK's 2016 Budget extends 'deemed domicile' rule beyond Inheritance Tax

The base cost of personally held foreign assets will be the market value of the asset at 6 April 2017 for capital gains tax (CGT) purposes.

It was announced last July that the indefinite nature of UK non-domicle status will end in April 2017. At that point, 'non-doms' who have been UK-resident for more than 15 of the past 20 years will no longer be able to elect for the remittance-basis of taxation (under which they currently do not pay tax on income and assets kept offshore). Instead they will be deemed domiciled and will become liable to UK tax – including capital gains and inheritance tax – on all overseas assets.

The rebase date is more generous than many thought likely and the opportunity to opt for a rebasing of assets could reduce both the tax and administrative burden for those becoming deemed UK domiciled.

Non-Dom departures driving down London property values

Britain's review of non-dom rules appears to be frightening some away from London as a financial centre of choice.

The number of central London properties fetching more than £5m in 2015 fell by a third on the previous year, according to LonRes, a research company. This year is set to be worse. Morgan Stanley, the financial services firm, has forecast that the price of new upmarket flats in the UK capital could fall by a fifth this year. Experts cite several reasons – changes to stamp duty, concerns about a possible UK exit from the EU and suggestions that the housing market is overheating. There is another factor: the looming change to a special tax status for non-doms.

"Foreign buyers are not buying in the numbers that they were because of uncertainty and lack of clarity around the changes to the non-dom regime," according to Property Buying agent, Charles McDowell.

The slowdown is just one sign of the anxiety among UK residents with non-domicile tax status. The changes were set in motion last July when the Chancellor, George Osborne, unveiled an overhaul of a system in place since 1799.

The regime was originally created in part to shelter those with foreign property from wartime taxes. It has meant that, for more than 200 years, individuals claiming non-dom status have been able to live and work in Britain without being subject to tax on gains and income earned and kept outside the country.

The Conservative government has declared that the rules can give rise to 'unfair outcomes' and Mr Osborne has set out to overhaul them. On the face of it, it seems like an odd thing for a Tory government to focus on. But Mr Osborne, sensing voter concerns about inequality, has taken one of the flagship policies of the opposition Labour party and made it his own.

The big question is whether non-dom reform will lead to the flight of some of Britain's wealthiest individuals – many of whom claim to be significant job creators – and how that could affect the UK's fragile economic recovery.

Non-dom status has been part of the cocktail of attractions that has contributed to the 'internationalisation' of London. The city competes with New York, Hong Kong and others to capture the wealth and brains of the mobile elite.

Asia has been a magnet for western wealth in part for tax reasons. Hong Kong levies a rate of about 15 per cent and there is no tax on offshore earnings brought in to the territory. By contrast, the US taxes residents on global income.

In the 2013-14 tax year, 114,300 non-doms were registered in the UK. The group range from relatively low-paid to prominent businessmen like Lakshmi Mittal, the steel magnate, media baron Viscount Rothermere and Roman Abramovich, owner of Chelsea football club.

The government has said that previously established offshore trusts will be protected but details of their treatment have been deferred until the 2017 finance bill, which non-doms say makes it difficult for them to plan their affairs.

Even people who see the benefit of non-dom status appreciate why the regime might be perceived as offering an unfair advantage. "Osborne is trying to make the system more fair," says Johannes Huth, head of KKR's European operations. "I don't think the new rules will increase government revenues because it will mean that a number of people will change their tax planning, but politically it's tough to argue that it's not the right thing to do."

Critics of the rules argue that they allow foreigners who have benefited from living in the UK, or even those born in the country to a foreign father, to pay significantly lower levels of tax compared with other residents – and relative to their means. They add that wealthy foreigners have turned much of London into a playground for the super-rich that is inaccessible to all but the highest earners.

Proponents of the non-dom regime say it has given London a huge competitive advantage. They argue that it has created jobs by encouraging everyone from shipping magnates, industrialists and property entrepreneurs to use the UK as a base to build their businesses. In 2013-14, non-doms paid £6.6bn in income tax in Britain, up 7 per cent on the previous 12 months, according to law firm Pinsent Masons.

Critics of the reforms warn of unintended consequences. Far from raising revenues, they say the proposed changes will result in a 'negative tax yield': an ensuing flight of talent and cash from the UK that will leave the exchequer worse off.

Conversations with members of some of London's richest foreign families and their advisers reveal that they are making plans to leave London for Monaco, Switzerland, France, Israel, Spain, Portugal or Dubai. These people, many of whom have lived in London for decades, represent sectors including shipping, steel, property, manufacturing and finance.

To access the tax advantages, non-doms must pay a levy called the remittance-based charge, which is set at £30,000, £60,000 or £90,000 depending on the length of residence. The bulk of the UK's non-doms opt not to use the special status because their foreign earnings are not high enough. In 2013-14, only 5,000 people opted to pay the levy to keep their foreign earnings out of the UK tax net. They paid a total of £223m in remittance-based charges. The 5,000 remittance taxpayers paid £4.91bn in income tax on their UK earnings in 2013-14 – three-quarters of the £6.6bn total paid by the 114,300 non-doms. This is money the Treasury would lose if these people moved their primary domicile out of the UK.

Parliament propose closure of Tier 1 (Investor) Visa scheme

Liberal Democrat peers Baroness Hamwee and Lord Paddick have tabled an amendment to the 2015 Immigration Bill proposing the abolition of the Tier 1 (Investor) visa scheme. Their proposal would see the route closed from 1 January 2017.

It is not clear what has prompted this proposal. It may be that there are continuing doubts around the economic benefit of the route to the UK and speculative concerns around whether the investor visa is being used by criminals.

Transparecy International recently published its report "Gold rush: Investment visas and corrupt capital flows into the UK," and highlighted how the UK's Tier 1 Investor scheme can be vulnerable as a tool to launder the proceeds of corruption from around the world.

It concluded that it is highly likely that substantial amounts of corrupt wealth stolen from China and Russia have been laundered into the UK through the programme.

In return for £2m of qualifying investments, a foreign investor can receive the right to live in the UK and after five years, permanent residency.

The Tier 1 Investor scheme is open to abuse through the lack of effective, up-front and transparent checks on Tier 1 Investor visa applicants by the UK authorities.

If illicit money has entered the UK economy through the scheme, there are also widespread doubts as to whether the UK's system of anti-money laundering checks can be relied on to ensure that suspicions of money laundering of corrupt wealth are reported and acted upon in an effective manner.

According to the Government's own assessment, the UK's anti-money laundering system has significant weaknesses in its supervisory structure and in terms of the level of compliance and reporting standards across relevant private sectors.

To help prevent corrupt wealth from entering the UK through the scheme, Transparency International recommended that the Government:

- Establish greater integrity and transparency in the Tier 1 Investor visa scheme
- Improve mechanisms for international cooperation to identify and recover corrupt assets
- Improve law enforcement capacity and the effectiveness of AML supervision in the UK.

Why this proposal is being tabled now though, is unclear. 2015 saw a tiny number of investors applying to come to the UK down from around 1,172 in 2014, to around 200 last year. In addition, historical concerns about how the route could be used by those whose wealth was dubious have largely been addressed by a 2015 immigration rule change, which now requires extensive due diligence to be undertaken on the source and origin of funds by UK banks (as having a UK investment account is a precondition).

What is clear is that the popularity if the Tier 1 Investor route has been badly affected by the increase in the minimum investment from £1 million to £2million in November 2014 and geopolitical and economic factors affecting the two main source countries for these visas, China and Russia.

There are clearly now enough safeguards in place to ensure the integrity of the Tier 1 (Investor) route. Contrary to popular belief, the Investor route is not a 'passports for sale' visa – it requires an extended period of residence with significant presence before someone can obtain permanent residence in the UK and only a year later would they become eligible for British Citizenship, subject to security and character checks.

What the UK now needs to do, rather than closing the route, is to think about how to attract a greater number of investors and to put their investments to work in the UK economy and in wider UK society. Knightsbridge Wealth has extensive experience and rigorous processes in place, to help clients evidence Source of Wealth from international sources, where documentary evidence will not always meet accepted norms.

Will US election drive down investment returns?

The US presidential primaries are receiving blanket coverage worldwide. This is due in large part to the unexpected success of unconventional candidates in both the Republican and Democratic parties.

So far, the results suggest that former Secretary of State Hillary Clinton is on a course to win an outright majority of delegates at the July Democratic convention. On the Republican side, businessman Donald Trump leads the delegate count but is less certain to claim the needed majority, as a handful of other candidates remain in the race.

When the nominees of the two major parties are determined, it should become easier to discern clear policy differences and gauge the likely outcome of the election. In addition to the presidency, control of both houses of Congress is up for grabs, and the ultimate balance of power will dictate next year's legislative activity.

Are investors right to worry about how the election's outcome could affect the US economy and financial markets, given the popularity of unconventional candidates like Trump and Senator Bernie Sanders?

While there will certainly be clear differences between the two parties' candidates on important issues like tax reform, trade policy and regulation, control of the US government is likely to remain divided in some way between Republicans and Democrats. A shared power arrangement leads either to compromise or gridlock on contentious issues, and the latter can indeed roil the economy and/or markets.

The statistics suggest an election year alone does not derail US stock performance – S&P 500 annual total returns during voting years (11.2%) differ little from the long-run 12% yearly average since 1926.

High policy uncertainty is a different risk, and has historically affected asset market performance.

Current policy uncertainty is muted, and the perceived risk of owning stocks versus bonds (equity risk premium) is high. US equities look attractively valued compared to bonds, though not as starkly as they did.

A volatile US election with an uncertain outcome should not deter investors from holding diversified risk assets. There is little reason to expect lower US equity returns solely due to the reaction.

Contact us

If you require further information about our services and how we can assist your clients, then please call us on the number below, or send us an email about how and when we can contact you.

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