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technical news

For professionals working with international clients

The future of 'non-doms'

If you were not previously familiar with the phrase 'non-dom' in the UK, you will be now. The recent media coverage surrounding the UK Chancellor of the Exchequer's non-dom wife, Akshata Murty, has certainly brought this 223-year-old legislation under scrutiny.

A non-UK domiciled individual (non-dom) is a term used for a UK resident whose permanent home is outside of the UK. Murty has been claiming the remittance basis of taxation, a favourable tax regime only available to non-doms. As a result, she has been able to shelter foreign income and capital gains—more specifically, significant foreign dividends—from UK tax to the extent that these have not been remitted to the UK.

It is not the first time that this colonial legislation has been criticised, but is the regime in jeopardy now more than ever?

One point often omitted from the debate is that the UK is not the only country that offers a preferential 'expat' tax system. For example, Malta, Cyprus, and Ireland also recognise the non-dom concept and offer favourable tax treatment.

Some of these systems are in fact more generous than the UK's. Malta also offers the remittance basis of taxation for non-doms. There is a flat rate tax at just 15% on income and capital gains derived from Malta and income remitted to Malta; remitted capital gains are, in some cases, tax free. Unlike the UK, there is no annual remittance basis charge; in the UK this starts at £30,000 ($37,500) per year once an individual has been UK tax resident for more than seven out of the previous nine tax years. There are also no deemed domiciled rules, which generally apply after 15 years of residence in the UK.

In Cyprus, along with other tax benefits, non-doms are exempt from taxation on interest and dividends for up to 17 years of residence. Unlike the UK's remittance basis, this is the case even if the income has a Cyprus source or if it is remitted to Cyprus.

Some countries use residence-based, rather than domicile-based, tax systems to entice in foreigners. Portugal, for example, is attracting many high-net-worth individuals and entrepreneurs with its non-habitual resident (NHR) tax regime, which can be accessed for a 10-year period. With NHR status, individuals can enjoy Portuguese tax exemption on almost all foreign source income, 20% flat rate tax on certain Portuguese sources of income, and free remittance of funds to Portugal.

Even the famously adhesive worldwide taxing system of the US offers some short-term visas under which the individual is not regarded as US tax-resident.

Many of these tax systems are not dissimilar to the UK's non-dom regime—other countries just use different names and timescales. The objective is the same, to make these countries a prime choice of destination for foreigners and thus attract inward investment. Why therefore should the UK not compete?

As a result of the recent media coverage, there is pressure on the government to make changes. Significant changes were

introduced in 2008 and 2017, which made the UK's non-dom regime less generous.

The Labour Party have said they will abolish the non-dom system entirely and offer a shorter-term scheme. However, careful thought must be given to the impact this may have on the competitiveness and attractiveness of the UK, particularly coupled with Brexit. Arguably, there are other non-tax related incentives to living and investing in the UK. The US, which offers very limited tax breaks for foreigners, is still home to many of the world's richest individuals.

Perhaps a middle ground could be found whereby adjustments are made to the existing regime to make the system less generous but still attractive. For example, the length of time a non-dom is able to access the remittance basis could be reduced to, say, 10 years from the current 15 years. Rather than changing or abolishing the system, the criteria for being able to access the regime could be narrowed down.

Domicile is currently a very grey area and HM Revenue & Customs (HMRC), advisers, and clients, spend significant amounts of time discussing the domicile status of individuals. A 'statutory domicile test' could be introduced; perhaps a points system based on a wide range of factors that provides a yes/no answer as to whether the remittance basis can be used for any given tax year. This could be linked to immigration law so that the remittance basis is only available to those who do not have Indefinite Leave to Remain in the UK—a link which currently does not exist but could be perceived as fairer. As is the case with the statutory residence test (SRT) introduced in 2013, this could provide some welcome certainty for everyone, particularly when UK tax planning is dependent on a non-UK domicile status.

Alternatively, the UK could scrap its dual-concept tax system and, similar to Portugal, introduce a purely residency-based preferential tax system, available for a set number of years. In which case, rather than developing a domicile test, the SRT could be applied to provide certainty as to whether an individual can access the remittance basis. This is largely what the Labour party have alluded to but for only a very short period of five years.

Given the scale of Murty's foreign dividends (as an example), the recent press coverage has focused on the remittance basis and the income and capital gains shelter this delivers. However, in many cases, the most valuable protection a non-dom status can provide is Inheritance Tax (IHT) shelter on non-UK situs assets.

The main complaint with the present system is that the well advised can protect foreign situs assets from UK IHT for longer than 15 years where these are settled onto a trust created before the 15 years is up. There is even scope to avoid UK IHT on many UK situs assets where these are held by trustees via an offshore company. The IHT rules were changed in 2017 so that UK residential property is subject to UK IHT regardless of the mechanics of ownership and perhaps these rules should go further.

According to the latest figures from HMRC, 75,700 individuals claimed to be non-domiciled on their tax returns in the 2019–20 tax year, which puts the scale of the issue into perspective. The UK tax legislation applicable to non-doms is hugely complex and longstanding, and so the government would need to deploy a large amount of resource in order to abolish, change or reinvent the system.

The non-dom debate is often embroiled in a class war and is perceived as a system used only by the super-rich. This, however, is not always the case. We often advise people with relatively modest means who are in the UK for a short period of time, with, say, some rental income in their home jurisdiction. In these scenarios, the remittance basis is often used not just to save tax but also to simplify reporting.

Avoid IHT while you can

Inheritance Tax planning is particularly important for international clients, whether living in the UK or not. Some are not aware that, even if they are non UK Nationals living overseas, they would still have a tax liability on UK assets.

Governments haven't always looked kindly on the Institute for Fiscal Studies (IFS), the economic think-tank. Its frequent brutal assessments of budgets and spending plans have left ministers reeling. Pension experts will therefore hope that this government does not feel inclined to act on the IFS's assessment of the rules relating to Inheritance Tax (IHT). The "overly generous tax treatment of pension pots at death needs to be swiftly ended", the think-tank argues in a new report.

There is certainly no denying the generosity the IFS refers to. When you die, any money left in your pension can usually be bequeathed to your heirs entirely free of IHT; the money sits outside of your estate for the purposes of calculating any tax that's potentially due.

Moreover, if you die before reaching the age of 75, your heirs will typically inherit your remaining pension savings completely tax-free. You would have had to pay income tax on this money when withdrawing it from your savings. But your heirs will only face an income-tax bill if you made it to age 75 before dying.

These rules were introduced at the same time as the pension freedom reforms of 2015. Previously, most people converted pension savings to income through an annuity, payable until their death. Their heirs got little or nothing, even if the pension saver had received their annuity income for a very short period.

That trap was indeed unfair. But as the IFS points out, the way in which the government chose to remedy it was unusually generous. Today, pension

savings are the only form of substantial wealth that you can pass on with no liability for IHT. And many people receiving such bequests are getting cash that benefited from upfront income-tax relief, but where there is no further income tax to pay.

All of which gives rise to a valuable financial-planning opportunity, particularly with the IHT threshold frozen year after year. If you get to retirement with several sources of savings, it makes sense to leave your pension cash untouched for as long as possible. Run down other sources of money first: cash in individual savings accounts, for example, or from property – because this wealth does fall within the IHT net. By leaving the Inheritance Tax-free pension aside, you'll maximise your heirs' chances of reducing or receiving no tax bill.

The IFS estimates that subjecting pensions to IHT would increase the Treasury's revenues by £1.9bn a year. Turning that statistic around, the implication is that families currently have the potential to save £1.9bn of tax annually by planning their retirement finances carefully.

It's difficult to gauge whether the government will follow the IFS's advice. While every penny of additional revenue is needed at present, successive governments have been reluctant to make pension saving less attractive from a tax perspective. A Conservative administration, which is particularly dependent on older voters, would find such a raid even more politically difficult.

In the meantime, it's important that families take full advantage of the rules as they stand. The current system may not endure, but changes are unlikely to be retrospective. Plan for retirement using a range of tax-efficient vehicles, including Isas and pensions, and then draw down from these funds in a way that optimises your family's tax liability.

Pensions are subject to generous rules on Inheritance Tax. For now...

Expect an increased tax bill

We are already grappling with the soaring cost of living and the prospect of a recession.

To make matters worse, we will now have to hand over more money to the taxman. In his November Autumn Statement, chancellor Jeremy Hunt announced a series of allowance freezes, spending cuts and tax increases worth £55bn. So how exactly will these affect the tax bills of your international clients who have UK interests?

Income Tax
In a bid to rake in more from those who earn more, Hunt lowered the threshold at which the 45% tax rate kicks in. It previously applied to earnings over £150,000 but from April, the 45% tax will be charged on income over £125,140. This will remain the case until 2028. The 20% income tax rate, paid on anything earned over £12,570, and the 40% income tax rate, which kicks in at £50,270, will have their thresholds frozen for the next six years.

The move will cost someone on £150,000 almost £1,250 a year extra in tax – putting an extra 2% on their total tax bill. The reason the government plumped for the strange figure of £125,140 rather than just a straight £125,000 is so that the tax threshold aligns with the personal allowance taper, whereby anyone earning more than £100,000 starts to lose their tax-free allowance. By £125,140 the entire personal allowance is lost.

Capital Gains Tax
Capital Gains Tax (CGT) is paid when you sell an asset that has appreciated, such as shares or property. Hunt also cut the threshold for CGT, meaning you keep less of your profit and hand over more to HMRC.

For the 2023-2024 tax year investors will have to pay CGT on profits over £6,000; the current threshold is £12,300. The threshold will decrease again, to £3,000, at the start of the following tax year, April

2024. The move will mean that investors will pay the government an extra £25m in tax from next year and another £275m the year after.

Dividend tax
The tax-free threshold for dividend allowances has also been cut, forcing more to pay tax. In April 2023 the limit will fall from the current £2,000 to £1,000, and then from April 2024 it becomes £500.

At present, if you earn £5,000 a year from dividends and are an additional-rate taxpayer, you are obliged to cough up £1,181. From April 2023 that figure will rise to £1,574. According to AJ Bell, someone with a portfolio of £20,000 yielding 5% a year will reach the lower tax-free allowance of £1,000 from April next year, while someone with a portfolio of £10,000 producing 5% a year will hit the tax-free allowance of £500 from 2024.

Inheritance Tax
Finally, the chancellor extended the freeze to the Inheritance Tax (IHT) threshold from 2026 to 2028. At present the tax is paid at 40% on the value of any estate worth over £325,000, or £650,000 for a couple. The freeze will mean the IHT threshold will have been frozen for nearly 20 years – it was last changed in 2009.

Outrunning IHT
The government collected £6.1bn in Inheritance Tax (IHT) bills for the 2021-2022 financial year, a 14% increase from the year before. The figure for this year already looks set to breach that, and the Office for Budget Responsibility thinks the bill could reach £8.3bn by 2026.

Last month chancellor Jeremy Hunt announced that IHT, which is charged at 40% of a person's estate above the tax-free allowance (also known as the nil-rate band) of £325,000, will be frozen until 2028. IHT had already been frozen until April 2026 by Rishi Sunak when he was Chancellor. Hunt's announcement means that it has been nearly ten years since there was a change to the IHT allowance. It has remained the same since 2009; following the latest freeze 10,000 more families could be dragged over the threshold.

Rampant inflation, soaring house prices and years of frozen allowances will magnify the tax take in the years ahead. More and more families are going to find themselves hit by death duties they might not have expected. Still, plan carefully and you can avoid or minimise IHT bills to ensure more of your money is passed on to those you choose, rather than being syphoned off by the taxman.

First things first – make sure your clients' write a will. Without one, the estate will be shared according to a set of pre-determined rules. That means the taxman might end up with more than its fair share.

The easiest way to pass your assets on to those you wish is by gifting them, which will be especially welcome now that we are entering a recession. But there are some things to consider. Make sure you know the limits: you can gift up to £3,000 tax-free a year. Gifts of £5,000 to children and £2,500 to grandchildren made in advance of a wedding are also exempt. But anything over these allowances will be taxed if you die within seven years of making the gift.

Another way is to put it into your pension; you can nominate beneficiaries should you pass away before you receive it. The nominations have to be submitted directly to your pension provider, and generally IHT isn't payable. However, if you die after the age of 75 your beneficiaries will need to pay income tax on the money they take out of the pension.

Investing in the London Stock Exchange's Aim (previously the Alternative Investment Market) comes with IHT benefits. Many stocks qualify for business property relief. However not all Aim shares qualify and you must hold the shares for at least two years to be exempt from IHT.

Setting up a trust to hold your assets is another option to consider. But trusts "can be expensive to run and subject to tax charges, which together with their complexity generally makes them worthwhile in only a few circumstances."

You could also buy an insurance policy that covers IHT liability. This should be written in trust, and you should seek help from a financial adviser to do so. However, monthly premiums can be large. "If you die quite young, you probably get a good deal from the insurance policy, but if you live to a ripe old age, you won't."

Finally, you could donate to charity. If you give at least 10% of your estate to charity you could get a discount on your IHT rate for the rest of your estate, lowering it from 40% to 36%.

If any of your clients require assistance here, we would be happy to provide guidance through the complexities involved.

Contact us

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

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