Non-resident trusts: the end of tax trust protections

International Tax | Personal tax

17 May 2024

With the current income tax and capital gains tax trust protections for non-resident trusts due to cease from 6 April 2025, we consider the options open to non-doms.

Key Points

What is the issue?

For all existing and future non-resident trusts, the current income tax and capital gains tax trust protections will cease from 6 April 2025. This will affect all those settlors who are UK resident from 2025/26 and are not new arrivers.

What does it mean for me?

They will be taxed on the same basis as UK domiciled settlors, so gains realised by the trust will be chargeable on the settlor unless **all** of the settlor, children,

grandchildren and their respective spouses or civil partners are excluded from any benefit.

What can I take away?

The four year exemption has been heavily criticised as too short for anyone to put down roots and will simply result in ‘tax tourists’ with the cliff-edge from 0% to 45% after four years more likely to increase the likelihood that people will leave.

In the article ‘Resident non-domiciles: the end of the line?’ (*Tax Adviser*, April 2024), the key changes affecting non-doms announced on 6 March 2024 in two Budget Notes were summarised by Anthony Whatling. These changes will affect the taxation of:

- foreign domiciled individuals who are already UK resident;
- ‘new arrivers’, wherever they are domiciled; and
- individuals who have already left the UK.

The term ‘new arrivers’ in this article means those who have not been UK resident during the previous ten tax years and who have been tax resident in the UK for less than four tax years by 6 April 2025.

Many points of detail remain unclear at present and the uncertainty has been highlighted by a Labour statement in early April noting the following:

‘While Labour supports most aspects of the proposed replacement to the non-dom rules, including the four-year arrival window and the principle of a ten-year window for inheritance tax, we are concerned that major loopholes remain. That is why Labour will include all foreign assets held in a trust within UK inheritance tax, whenever they were settled, so that nobody living here permanently can avoid paying UK inheritance tax on their worldwide estates.’

In addition, Labour has indicated the following:

- It will not give a 50% discount for foreign income in 2025/26. Nothing has been said about the 2019 capital gains tax rebasing option that is intended to be available to those not domiciled or deemed domiciled as at 5 April 2025.

- It will consider whether UK investment income, as well as foreign investment income and gains, should be free of UK tax in the first four years for new arrivers.
- The two-year transitional window to remit historic foreign income and gains at a favourable rate (12% under the new temporary repatriation facility) may be extended or other incentives given (whether carrot or stick) to encourage people to remit historic foreign income and gains.

In this article, I concentrate on the trust protections and the next article will consider the inheritance tax aspects of the proposals announced in the Budget and by Labour.

For full details of the CIOT submissions on the temporary repatriation facility, and capital gain tax and income tax, readers are referred to: tinyurl.com/ye9br6dt

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The position from April 2025 for non-resident trusts

For all existing and future non-resident trusts, the current income tax and capital gains tax trust protections will cease from 6 April 2025. This will affect all those settlors who are UK resident from 2025/26 and are not new arrivers.

In effect, they will be taxed on the same basis as UK domiciled settlors, so gains realised by the trust will be chargeable on the settlor unless **all** of the settlor, children, grandchildren and their respective spouses or civil partners are excluded from any benefit. It may be common to exclude the settlor and spouse from a trust but excluding the issue of the settlor will be very rare.

In these circumstances, a useful legislative improvement would be to impose primary or concurrent liability on the trust to pay the capital gains tax, rather than requiring the settlor to claim reimbursement which will be difficult if they have been excluded from all benefit. The settlor can remain secondarily liable but most professional trustees (even those outside the UK) will pay capital gains tax when sent a demand. After all, the inheritance tax provisions do this without relieving the settlor of a non-resident trust from liability (see Inheritance Tax Act 1984 ss 201-203; also *Re Clore (deceased) (No. 3), IRC v Stype Trustees (Jersey)* [1985] STC 394.

The alternative option is for settlors to make the trust UK resident, which will not affect the inheritance tax position and will move the capital gains tax liability to the

trustees. However, a settlor may not be keen on doing this if they plan to leave as the trust cannot then be exported later without an exit charge. Importing the trust may have other implications which should be considered carefully; for example, in relation to loss relief and loss of the tax pool.

Settlors of non-resident trusts who have been UK resident for longer than four years (or were not non-resident for ten years prior to arrival here) will also be subject to income tax on an arising basis on all trust and corporate income and offshore income gains within the trust if they or their spouse/civil partner can benefit.

It may be possible to exclude the settlor and spouse/civil partner so as to avoid a charge under the transfer of assets and settlement provisions. The difficulty will be if the settlor has in the past received a capital distribution, in which case technically exclusion under current rules may not be effective to avoid a continuing tax liability.

At face value, if there has been a capital receipt there is a continuing liability to income tax on the basis that Income Tax Act 2007 s 727 is engaged even after exclusion (as s 728(1)(a)(ii) refers to the capital receipt conditions being met if, in the relevant year or any earlier year, the transferor receives or has received a capital sum).

There are arguments against this and HMRC indicates in its International Manual at INTM601020 that: ‘If entitlement to a capital sum ends completely and there are no other grounds for the income tax charge, the liability under this charge **will not normally** be extended beyond the tax year in which this entitlement ceases.’ However, this is hardly an unqualified statement. Clarification is needed on this point. As a matter of principle, a transferor should not be taxed on income and offshore income gains if there is no longer ‘power to enjoy’.

The loss of trust protections obviously has no direct impact on those beneficiaries who are not settlors. Once they have been in the UK for more than four years, they will be taxed on a worldwide basis on all trust benefits, but if the settlor is dead or non-UK resident, income and trust gains can continue to be rolled up tax-free.

Second-generation trusts will therefore continue to offer advantages. However, beneficiaries on the remittance basis who have received unmatched capital payments or benefits will need to consider their position very carefully before 6 April 2025. If a beneficiary has received an unmatched capital payment abroad and the

trust is not within Taxation of Chargeable Gains Act (TCGA) 1992 s 86 and later realises gains after 2025 when the beneficiary is no longer on the remittance basis, those gains would be matched and taxed on the beneficiary.

This is a problem that already faces beneficiaries who are about to become deemed domiciled and have unmatched capital payments. The solution may be to resettle the assets into a new trust. (TCGA 1992 s 90 carries across the s 1(3) amounts but it does not carry across the excess unmatched capital payments.) However, this may have inheritance tax implications.

Options for settlers

For those settlors affected by the changes what are their options?

1. Become non-UK resident

Settlors can become non-UK resident at any time and provided they remain non-resident for more than five tax years, trust gains and income will not be taxable on them in that non-resident period. Of course, if they wind up the trust while non-resident and receive the trust fund personally, the assets will then fall within the inheritance tax net until they have been non-resident for at least ten years.

2. Consider a different investment strategy

Trusts which are affected by the changes because the settlor has been UK resident for more than four years should consider a different investment strategy.

For example, if the settlor and spouse but not their issue are excluded, consider moving out of equities. Instead, the trustees could invest in offshore funds where gains are not chargeable on the settlor under TCGA 1992 s 86 and charges on the settlor/transferor under the settlements and transfer of assets abroad codes can be avoided subject to the capital receipt rules above. The trustees may move into an offshore investment bond wrapper and rely on not withdrawing more than 5% each year.

3. Do nothing

The settlor may do nothing. After all, if he owned the asset personally he would pay tax, so holding it in a trust set up prior to April 2025 does not make the position materially worse from the income tax and capital gains tax perspectives, except in relation to the reimbursement of tax liabilities and possible treaty relief claims.

There are also non-tax reasons for using trusts such as succession planning, protection of children and asset protection, which may mean that they remain attractive vehicles. The trust may invest in a long-term roll-up fund and just avoid realising gains and income at all while the settlor is alive and UK resident. However, the inheritance tax disadvantages need to be considered carefully (see the next article in this series).

Following the Labour Party announcement in April, such a trust could be subject to inheritance tax at 6% every ten years and a 40% inheritance tax charge on death without the benefit of spouse exemption.

4. Sell or rebase assets

Non-resident trustees of protected trusts will no doubt sell or otherwise rebase assets prior to April 2025 to realise the maximum tax free gains possible and have a high base cost going forward. (Trusts could rebase by making a sub-fund election and triggering a deemed disposal.)

Such a move will then increase the stockpiled gains available for matching to distributions (and the supplemental charge starts to run earlier). On the other hand, future distributions can be deferred or managed – for example, by making interest free loans and minimising the taxable benefit – and it reduces immediate tax on future gains while the settlor is alive and UK resident.

5. Make the trust UK resident

Trustees may decide to make the trust UK resident which will have no impact on the inheritance tax treatment but avoids tax on the settlor on future trust gains under s 86. The companies could be made UK resident, reducing the tax rate to 25% corporation tax and avoiding tax under the transfer of assets rules.

Loss rules will need to be considered carefully here. Indeed, if a trust moves from the s 87 regime to the s 86 regime from April 2025, the loss rules will need to be

considered carefully as s 87 losses cannot be used against s 86 gains.

Transfer of assets abroad

Non-UK resident trusts will continue to be used where the settlor is dead or likely to remain non-UK resident as the trust income and gains can still be rolled up.

The greatest problem is likely to arise in the context of the transfer of assets abroad regime, exacerbated by the draft changes introduced in the Finance (No. 2) Bill (clause 22). The transfer of assets abroad regime found in Income Tax Act 2007 Chapter 2 is complex, wide-ranging and uncertain. It dates back to the 1930s and was really designed to stop UK domiciled residents from moving assets abroad into foreign companies and trusts and thus avoiding income tax. An income tax charge is imposed on the UK individual ‘transferor’ who has the ‘power to enjoy’ (widely defined) the income belonging to the person abroad.

Although a ‘motive’ defence is available under transfer of assets abroad for genuine commercial transactions and for transactions where there was no UK tax avoidance purpose, the burden is on the taxpayer to prove this. The difficulty is that once the remittance basis and trust protections disappear after 5 April 2025, far more people will be drawn into the transfer of assets abroad charge, despite having genuine commercial operations abroad.

Foreign doms are precisely the people who are most likely to have established or been involved in funding foreign companies whether by loan or share subscription and whether before or after coming to the UK. It may not always be easy to prove the motive defence applies and there is no de minimis provision comparable to the provisions in TCGA 1992 s 3.

In the absence of the motive defence, the transferor who has power to enjoy (other than new arrivers) will have to pay income tax on the profits arising within the foreign companies, even if the same is never distributed to them and even though such profits would only be subject to corporation tax if the company was UK resident.

In some cases, foreign exchange restrictions operating in countries such as India may make it impossible to extract the profits from the companies by way of dividend and there is no statutory right of reimbursement.

Clause 22 of the Finance (No 2) Bill is presumably a response to the decision of the Supreme Court in the case of *HMRC v Fisher* [2023] UKSC44. The Supreme Court held that as the UK company had transferred the business abroad to a Gibraltar company, rather than the individual shareholders, the latter could not be assessed as transferors. Clause 22 aims to 'correct' this by extending the code to cover avoidance of any tax through a transfer made by a closely-held company if (broadly) the individual is involved in that decision. This proposed legislation is retroactive as there is no cut-off date where transactions made before a certain date are unaffected. All income arising after April 2024 is caught, even if the relevant transaction took place many years ago.

Conclusions

The proposed changes are likely to mean that at least some foreign doms leave earlier than originally anticipated. Others may not come here in the first place, given that other countries such as Italy, Switzerland, France and Spain have a more attractive regime for certain types of wealthy or high earning non-doms. Or they may come here for a short period and then leave in the first four years.

The four year exemption has been heavily criticised as too short for anyone to put down roots and will simply result in 'tax tourists' with the cliff-edge from 0% to 45% after four years more likely to increase the likelihood that people will leave.

The government has estimated that overall the changes will raise £2.6 billion revenue by 2028/29. The Institute for Fiscal Studies was more circumspect. It is difficult to predict behavioural change but the Office for Budget Responsibility assumes that about 5,500 individuals will be affected in April 2025 (see tinyurl.com/bdhn84sk). As academic research shows, the UK does attract and retain high net worth individuals for reasons other than tax, so people may not leave or arrive here solely for tax reasons (see tinyurl.com/h84ar4m4).

There are winners as well as losers. The principal winners are those UK doms who have been non-UK resident for more than ten years. It appears likely that they will be able to benefit from the new four year income tax and capital gains tax exemption and the ten year inheritance tax exemption if they return here.

Overall, the changes will not affect existing trusts with no living or UK resident settlors, although there may be some lesser impact on beneficiaries who have been UK resident for more than four tax years and therefore cannot claim the remittance basis on trust benefits after April 2025.

Perhaps the greatest losers are those who have been UK resident for between four and 15 years and were expecting to obtain the remittance basis for some years. For these people, the new regime looks particularly tricky and they are often the most economically productive members of this non-dom club – typically, being younger and here for work purposes. The problems around the transfer of assets abroad code are likely to be of particular relevance to them. It will not be easy to get treaty relief for a tax charge on the transferor under the transfer of assets abroad code and there is no right of reimbursement.

In a future article, Emma Chamberlain will consider the inheritance tax changes on trusts, non-doms and UK doms. The views expressed in this article are her own and should not be attributed to the CIOT.