OFFSHORE TRUSTS FOR NON-UK DOMICILIARIES – TAX ISSUES

Still a useful tool for wealth management

Offshore trusts remain tax efficient vehicles for wealth management through a number of generations despite recent changes in relation to UK Inheritance Tax (IHT) and Capital Gains Tax (CGT).

This article summarises the continuing tax advantages of offshore trusts for UK resident but non-domiciled individuals.

Inheritance Tax

A non-domiciled settlor can create a settlement with no IHT charge on the transfer of funds into the trust providing the transfer is of "excluded property", i.e. of non-UK assets. Depending on the type of trust created, the trust assets can be outside the charge to UK IHT for the entire lifetime of the trust. UK assets held in the trust via an offshore company 100% owned by the trustees will also be excluded property for IHT purposes.

Great care needs to be taken where the settlor has been UK resident for some years. A non-UK domiciliary who has been resident in the UK for 17 out of 20 years of assessment will be deemed to be UK domiciled and all gifts into trust from then onwards will be chargeable transfers within UK IHT rules, and will not be excluded property. Therefore gifts of non-UK assets into an offshore settlement should be made before the year of assessment in which the UK resident but non-domiciled settlor becomes deemed domiciled in the UK.

Offshore discretionary trusts can retain excluded property status throughout the trust period provided the trust property remains situated outside the UK. This is the case even though the settlor subsequently becomes UK domiciled or deemed UK domiciled.

A non-UK domiciled settlor can create a lifetime non-resident trust giving the settlor or his/her spouse or civil partner an initial life interest. Following the death of the life tenant, even if he/she has become UK domiciled or deemed domiciled in the meantime, and even if the trust continues, it will continue to be excluded property for IHT purposes if invested in non-UK assets.

However, such trusts which existed before 22 March 2006 may not be excluded property at the death of the life tenant, and this will depend on the domicile of the life tenant at date of death. If the life tenant is then UK domiciled or deemed domiciled the trust will from then on be within the relevant property regime, even if successive life interests exist. This means there will be ten year anniversary charges and exit charges when capital is paid out.

Capital Gains Tax

Foreign gains realised personally by a UK resident, non-domiciled individual are liable to UK CGT on a remittance basis if the individual is a remittance basis user; otherwise on an arising basis. However, settling non-UK assets into an offshore trust provides an opportunity to subsequently avoid UK CGT completely in respect of trust assets. This is because gains realised by offshore trustees will only be liable to UK CGT if paid out to a UK resident beneficiary.

No UK CGT charge will arise if gains are accumulated or paid to non-UK resident beneficiaries. If paid out to a UK resident non-domiciled beneficiary such gains will be taxed in the year of receipt, unless the capital has not been remitted and the remittance basis has been claimed. However, gains realised after 6 April 2008 but relating to an increase in value in the period prior to 5 April 2008 may be exempt from CGT when distributed to a non-domiciled UK resident beneficiary, but only if the trustees have made a "rebasing" election which effectively splits the gains into those that relate to before and those after 5 April 2008. Gains relating to an increase in value in the period post 6 April 2008 paid out to a UK resident non-domiciliary will be taxed in full unless the recipient has made a claim for the remittance basis to apply.

Great care needs to be taken if funds are settled by a UK resident non-domiciliary after 5 April 2008 and comprise untaxed foreign income or gains. These will be considered to have been remitted to the UK if the trustees subsequently invest in UK assets, and this will give rise to a UK CGT charge in the hands of the settlor, if he or other family members can benefit from the settlement.

Income Tax

In general, there are no significant UK income tax advantages in holding assets through an offshore trust, at least whilst the settlor is alive and can benefit from the settlement. However offshore trusts can in some circumstances provide a means of deferring income tax if income is accumulated and not distributed for some years.

This is just a brief summary of the position. Please ask us for advice specific to your own circumstances.

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