Analysis

Resetting the clock and the six-year itch: non-domiciliaries resuming UK tax residence

Speed read

The changes to the taxation of non-UK domiciled individuals introduced with effect from April 2017 caused many to rethink their connections with the UK. For those who departed, the framework of the legislation allows for the 're-setting' of the domicile clock thus permitting a return to the UK with a favourable tax profile. But is this possible in reality? It is not just a matter of years of non-residence, there are the underlying principles of the common law concept of domicile to navigate. If individuals do decide to return, the temporary non-residence rules can defeat the best planning for new non-taxable sources of funding. The future of the remittance basis is also in doubt ahead of the forthcoming general election.

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It is now more than six and half years since the introduction of the deemed domicile rule for income tax and capital gains tax purposes and changes to the equivalent concept for inheritance tax purposes. In light of these rules, some UK tax resident individuals who retained a non-UK domicile as a matter of common law, chose to cease UK tax residence and thereby remove themselves from the scope of UK income tax and capital gains tax on a worldwide basis. For individuals who did so with effect from 6 April 2017, they have now been non-UK tax resident for six complete tax years. As a result, they may be able to resume UK tax residence in circumstances where they have 'reset the domicile clock' and are again eligible for the remittance basis of taxation for a further 15 tax years (ITA 2007 Part 14 Chapter A1). In this article, we refer to such individuals as 'returners'.

The purpose of this article is to explore the possible traps for unwary returners when embarking on such a change of tax residence status and the planning that could be considered in advance.

(Note that this article does not consider the position of non-domiciled individuals who were born in the UK with a UK domicile of origin and are deemed domiciled under the rules in ITA 2007 s 835BA(3) and IHTA 1984 s 267(1)(aa) and defined as 'formerly domiciled residents' for the purposes of the IHTA 1984.)

Preliminary note: the future of the remittance basis

The elephant in the room is of course the pending UK general election. The Labour Party continues to state that it will 'abolish the non-dom tax status' (see Rachel Reeves' speech at the Labour Party Conference 2023, by way of example); although 'abolish' seems to be shorthand for a pledge to replace the current rules with a shorter-term scheme for temporary visitors. The Conservative Party has not said anything on the future of this regime, although there will be considerable pressure from the Opposition.

Returning to the UK after a period of non-tax residence is not for the faint hearted!

The threat of such reforms may be enough to persuade anyone with the 'six year itch' that now is not the right to time to contemplate a return to the UK and that it would be preferable to wait until after the election, when more is known about the next government's plans. However, there are of course those individuals who have already resumed UK tax residence with effect from 6 April 2023 or those for whom there are wider non-tax reasons why they may not wish to delay a return to the UK.

Resetting the deemed domicile clock

The first question is what does it actually mean to reset the domicile clock? An individual who has a non-UK domicile as a matter of common law is deemed to be UK domiciled once he has been UK tax resident for 15 out of the immediately preceding 20 tax years (ITA 2007 s 835BA(4); IHTA 1984 s 267(1)(b)) (the 15 year rule). For these purposes, split year treatment and treaty relief are both irrelevant.

As a result of the operation of the 15 year rule, a non-resident period of six complete tax years will mean that, for the next 15 years, the individual cannot satisfy the requirement to have been UK tax resident for 15 out of the immediately preceding 20 tax years. If the period of non-residence is five tax years or fewer, deemed domicile revives at the beginning of the first tax year of residence after the non-resident period.

An aside: inheritance tax

It is worth noting that the 15 year rule for IHT purposes is slightly different: there is a further requirement that the individual was resident in the UK for at least one of the four tax years ending with the relevant tax year (IHTA 1984 s 267(1)(b)(ii)). This is intended as a relieving provision so that an individual who ceases UK tax residence will be outside the scope of IHT in the fourth consecutive year of non-residence. They must, however, remain non-UK tax resident for the whole six

Example: Resetting the deemed domicile clock

Maurice became UK tax resident in 1997/98. He decides to leave the UK in light of the reforms to the taxation of non-domiciliaries and his final year of tax residence is 2017/18. When considering 2018/19, he is non-resident in that year, but had been resident for 20 of the preceding 20 years (1998/99 to 2017/18 inclusive). But in 2019/20, he had one year of non-tax residence (the preceding year) and only 19 years of residence in the preceding 20 (because 1998/99 has fallen out of account as it is no longer in the preceding 20 tax years). With each passing year of non-residence, he adds one year of non-residence and loses one of residence. He remains deemed domiciled for IT/CGT for the next six years, but loses this status for IHT in the fourth year of non-residence.

After six years of non-residence, he does not meet the 15 year rule. He can therefore resume UK tax residence and choose to be taxed on the remittance basis from the start of 2024/25, being the seventh tax year after his departure. In each of the next 15 years of tax residence: he will add a year of tax residence, but one of the earlier years of tax residence will fall out of account so that the total number of years of tax residence in the preceding 20 remains at 14 and the 15 year rule is not satisfied.

Tax year under consideration	Residence status in that tax year	Preceding 20 years	Years of residence in preceding 20 years	Years of non-residence in preceding 20 years	15/20 year rule satisfied?	IHT deemed domicile?
2017/18	Final year of residence	97/98 to 16/17	20	0	Yes	Yes
2018/19	Non-resident year 1	98/99 to 17/18	20	0	Yes	Yes
2019/20	Non-resident year 2	99/00 to 18/19	19 (99/00 to 17/18)	1 (18/19)	Yes	Yes
2020/21	Non-resident year 3	00/01 to 19/20	18 (00/01 to 17/18)	2 (18/19 to 19/20)	Yes	Yes
2021/22	Non-resident year 4	01/02 to 20/21	17 (01/02 to 17/18)	3 (18/19 to 20/21)	Yes	No
2022/23	Non-resident year 5	02/03 to 21/22	16 (02/03 to 17/18)	4 (18/19 to 21/22)	Yes	No
2023/24	Non-resident year 6	03/04 to 22/23	15 (03/04 to 17/18)	5 (18/19 to 22/23)	Yes	No
2024/25	New residence period year 1	04/05 to 23/24	14 (04/05 to 17/18)	6 (18/19 to 23/24)	No	No
2025/26	New residence period year 2	05/06 to 24/25	14 (05/06 to 17/18 and 24/25)	6 (18/19 to 23/24)	No	No
2026/27	New residence period year 3	06/07 to 25/26	14 (06/07 to 17/18 and 24/25 to 25/26)	6 (18/19 to 23/24)	No	No
Etc. for new residence period years 4 to 14						
2038/39	New residence period year 15	18/19 to 37/38	14 (24/25 to 37/38)	6 (18/19 to 23/24)	No	No
2039/40	New residence period year 16	19/20 to 38/39	15 (24/25 to 38/39)	5 (19/20 to 23/24)	Yes	No

tax years if they wish to avoid being deemed domiciled immediately upon the resumption of UK tax residence.

Temporary non-residence rules

The second reason for a returner to ensure that the period of non-UK tax residence was six complete tax years is the 'temporary non-residence' (TNR) regime. Where the regime applies, certain income, gains and remittances from the period of non-residence are treated as arising/received/made in the year the individual resumes UK tax residence.

The TNR rules apply where:

(a) an individual was UK resident (and not treaty non-resident) in at least four of the seven tax years prior to the year of departure; and

(b) there is a period of 'five years or less' in which the individual does not have sole UK residence (where sole UK residence is determined by reference to the statutory residence test, split year treatment and treaty non-residence) (FA 2013 Sch 45 para 110).

The requirement for 'five years or less' includes a period of exactly five years. As a result, where the individual is not, at any point, treaty resident in another country and is not eligible for split-year treatment in the year of arrival or departure, a non-resident period of six complete tax years will be required.

Testing assumptions

1. Tax resident

The first point for any returner to check is that they have in fact managed to remain non-UK tax resident for six complete tax years (or more). (Many readers of this article will have experience of cases where the best, most carefully considered (possibly technically brilliant) tax planning has failed in the implementation.) This will involve confirming, for example, that the day count limits have been strictly followed, with appropriate evidence retained. If the individual has accidentally slipped into tax residence, such that the non-resident period is in fact less than six tax years, they will have failed to re-set the clock (and may be subject to the TNR regime).

2. Common law domicile

The second point to check is that the returner does not in fact have a UK domicile, whether that is a domicile of origin acquired at birth or a domicile of choice. (Strictly speaking, an individual is domiciled in England, Wales, Scotland or Northern Ireland rather than 'the UK', although this article refers to 'UK domicile' for ease of reference.)

It is not unusual for an individual to inform us with absolute confidence that they are 'non-dom' as they are focused on years of residence. On closer examination, it becomes clear that they do not actually understand what

this means. For those who do not have a UK domicile of origin, rarely are they aware that the lack of any fixed or contingent intention will result in the acquisition of a domicile of choice. Any assertions of a particular domicile must therefore be carefully checked.

It is also important to check that a domicile of choice was not in fact acquired during the original residence period. If such a domicile of choice was acquired, there is a risk that the intervening period of non-residence will not have resulted in the loss of that domicile and that HMRC would argue that returning to the UK is evidence of its retention.

The experience of most practitioners is that HMRC have been taking a robust approach to investigating claimed non-domiciliary status. While many hoped that the introduction of the deemed domicile provisions might have led to a reduction in lengthy factual enquiries, it has not had that effect. It is further likely that HMRC will be emboldened by its three recent successful challenges in the First-tier Tribunal: *Strachan v HMRC* [2023] UKFTT 617 (TC), *Coller v HMRC* [2023] UKFTT 212 (TC) and *Shah v HMRC* [2023] UKFTT 539 (TC).

As we are only in the seventh tax year since the reform of the deemed domicile regime, it is not yet clear what HMRC's approach to such individuals will be, although it would be prudent to expect enhanced scrutiny

Creating 'clean capital'

Having ensured that the TNR rules do not apply and that they have remained non-UK tax resident, the priority for many returners will be the creation of a pot of 'clean capital' (i.e. funds that may be remitted to the UK without a tax charge and noting that this is a term of art, rather than a statutory definition).

This will usually involve the same considerations as will apply to any non-UK domiciliary relocating to the UK in anticipation of being taxed on the remittance basis. It will include cash representing income and gains of the non-resident period.

Income and gains of a prior period of residence

A point that can be easily overlooked as a matter of practice is that foreign income/gains (including offshore income gains) of a remittance basis user ('prior period FIGs') do not lose their character as such if the individual ceases to be UK resident (regardless of the length of the non-resident period). As a result, prior period FIGs will be taxed if they are remitted to the UK following the resumption of residence.

It is therefore important that the returner (having treble checked that the TNR rules do not apply and that they are non-tax resident at the time) considers the option of remitting the prior period FIGs before resuming tax residence. Where this is done, the prior period FIGs should be clean capital (see ITA 2007 s 809L and s 809P(12)).

Distributions from trusts and 'back matching'

For returners who are beneficiaries of trusts, one option for the creation of clean capital may be a trust distribution before resuming UK residence. Unfortunately, this option carries a number of risks that must be considered. These include the following, all of which apply where the returner is the settlor of the trust:

- Where the transfer of assets abroad code applies to the trust (ITA 2007 Part 13 Chapter 2), there is scope for pre-arrival benefits to be matched to protected foreign source income (PFSI) that arises after the settlor resumes UK tax residence. There are strategies to mitigate this risk, including terminating the trust before resuming UK tax residence, but these require careful planning.
- If the trust was settled using 'prior period FIGs', they could be comprised in the distribution.
- The trust could also include income/offshore income gains that arose during the prior period of residence and which were deemed to be their income and which could again be comprised in the distribution.

Settling 'protected settlements'

Some returners may wish to explore the option of creating a so-called 'protected settlement' before the resumption of UK tax residence (i.e. a settlement that benefits from the trust protections introduced by F(No.2) A 2017). Under the current rules, such a trust can be used to prevent the attribution of income and gains to the settlor (and this could even obviate the need to elect to be taxed on the remittance basis if the settlor does not have any personal foreign income and gains).

However, where the returner satisfied the requirements of the 15 year rule, they will be deemed domiciled for income tax and capital gains tax purposes for the following six years (during which they will continue to satisfy the 15 year rule), regardless of the fact that they are non-UK tax resident. As a result, any trusts settled during those six years will not satisfy the requirement of the protected trust rules that the settlor was non-UK domiciled when the trust was created (ITTOIA 2005 s 628A(5); ITA 2007 s 721A(3)(d), (4)(f) and s 729A(3)(d), (g); TCGA 1992 Sch 5 para 5A). In these circumstances, a seventh year of non-residence would be required if it was desirable to settle a protected settlement.

There is a transitional relief for those who left the UK before 6 April 2017: the 15 year rule does not apply and such individuals can therefore create protected settlements while they are non-UK resident.

Conclusions for returners

Returning to the UK after a period of non-tax residence is not for the faint hearted! As we are only in the seventh tax year since the reform of the deemed domicile regime, it is not yet clear what HMRC's approach to such individuals will be, although it would be prudent to expect enhanced scrutiny. Having said that, for individuals with a robust domicile position, careful planning can result in a highly favourable tax outcome. At least under the current rules... ■

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