NAVIGATING DISCLOSURE REGIMES AND MITIGATING INHERITANCE TAX

STRATEGIES FOR INDIVIDUALS RETURNING TO THE UK AND FOR INVESTORS IN UK PROPERTY

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INTRODUCTION

For individuals who are non-UK resident and are planning to become resident in the country, there are important considerations regarding recent disclosure regimes and their implications. Hubbis recently spoke to Laurence Lancaster, Group Head of Tax for Sovereign Group, who elucidated on the considerations vital to an individual planning on returning to the UK. This piece will explore how the Trust Registration Services (TRS) and the Register of Overseas Entities (ROE) apply to individuals returning to the UK and the options available to them. In addition, there will be discussion of strategies to potentially mitigate inheritance tax (IHT) and navigate the UK tax landscape for non-residents.

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» Trust Registration Services (TRS) and the Disclosure Obligations

The TRS requires the registration of trusts, including those established overseas but which hold UK assets or receive UK income. This means that non-UK resident settlors and beneficiaries of foreign trusts directly holding UK-listed assets, may need to be disclosed by the trustee on the TRS. Registration on TRS becomes mandatory if the UK assets have triggered taxable income for the trustee. If the asset is UK land then registration is mandatory if acquired after 5 October 2020 (even if no UK tax liability has arisen to date). It's important to note that the burden of registration falls on the trustee, not the clients (settlors/beneficiaries) themselves.

Register of Overseas Entities (ROE) and the Disclosure Requirements

The ROE applies to any form of UK property owned by overseas entities (unless acquired before 1 January 1999!). Non-compliance with the ROE can result in severe consequences, including criminal offenses and significant penalties. The registration process involves the property-owning overseas company appointing a UK agent for data verification who then normally completes the registration application process for the company with Companies House (being the Registrar of the ROE). Not only will failure by the overseas company to register on the ROE attract criminal penalties, the company will be unable to sell the property until it registers and becomes ROE compliant.

planning. Although their becoming UK resident does not generally affect the TRS position or ROE treatment of the structure, HMRC are more likely to scrutinise a structure with UK resident beneficial owners so this HMRC enquiry risk needs to be factored in before the individual becomes UK tax resident.

For many non-UK domiciled individuals considering moving to the UK, overseas trust structures remain attractive for tax planning purposes. Typically, these trusts, known as excluded property trusts (EPTs), will only hold non-UK assets. However, UK investments (with the exception of residential property) may be held through some type of investment wrapper at the trust level (such as an overseas fund, overseas life policy or foreign company). This type of planning ensures that a foreign asset is held at the trust level so the trust should still qualify as an EPT. An EPT is outside the scope of TRS as it holds no UK assets directly and receives no UK income.

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For UK domiciles, trusts are generally no longer attractive from a tax planning perspective, following the changes that were introduced by the UK government in March 2006. If any UK domicile has an overseas structure in place, it must be urgently reviewed from a UK tax and UK disclosure perspective before they become UK resident.

Disclosure Regimes and the Options

It will be important for any individual to take advice on the disclosure implications of holding UK assets through any specific structure. This is now a separate analysis to the tax advice itself.

Any individual who is returning to the UK with an overseas structure in place should check its ROE and TRS position as part of their pre-arrival

It's important to note that these options should not be pursued with the intention of avoiding registration. The correct approach is to go through the acceptable tax planning options and advise on the disclosure requirements attached to each option. Clients should be aware that unintentional exposure to these registers can occur due to investment choices. Seeking professional advice and ensuring compliance with the relevant disclosure regimes is essential.

Implications and Context

The recent expansion of disclosure regimes and the introduction of the TRS and ROE in the UK are part of a global trend towards transparency and increased disclosure. While the UK's implementation of the ROE aligns with this trend, it may have gone further than necessary, deviating from the original purpose of the legislation. Trust registers and disclosure requirements are becoming the norm in many countries, and the European Union.

For individuals returning to the UK, it's crucial to be aware of the implications of these disclosure regimes. Non-compliance, especially in respect of the ROE, can have severe consequences for the structure itself, those who manage it and for its beneficial owners.

Mitigating Inheritance Tax (IHT) upon Returning to the UK

Individuals returning to the UK and seeking to mitigate inheritance tax (IHT) can consider various strategies. If the individual returning to the UK is UK domiciled any lifetime gift will require them to survive for 7 years for it to be fully effective for IHT planning purposes. If they are looking to make a gift of assets, such as an investment portfolio, the gift may trigger UK capital gains tax if they wait until they become UK resident to make the gift. They will normally want to ensure that they make gifts of assets that are pregnant with capital gains before becoming UK resident (subject, of course, to checking the tax position in their current country of tax residence).

For non-UK domiciles considering moving to the UK, making lifetime gifts or settlements before they become UK resident is also prudent planning as their non-domicile status should be clear-cut while non-UK resident. Often the child to whom any gift will be made is already UK resident."

One approach is to make a cash gift to adult children, who may then use the gifted funds to purchase a UK property (or any other asset they wish to buy). Timing is crucial, and it is advisable for non-UK domiciled parents to make the gift when the funds are overseas, preferably from a non-UK bank account, to the child's overseas bank account. This technique eliminates the need for the parent who makes the gift (known as the donor) to survive for seven years for it to be effective for IHT planning (as would be required for transfers between UK bank accounts). The child can then remit the funds to the UK and purchase the property in their own name, assuming the associated IHT liability.

Utilizing the Property and Minimizing Inheritance Tax

Clarity on the property usage by the donor is crucial for successful

IHT planning. When gifting an existing UK property to a child, the donor (who may be UK domiciled or non-domiciled) must survive for seven years for it to be an effective potentially exempt transfer. This is the first hurdle that must be cleared. However, the donor must ensure that they do not use the property for the plan to be effective for IHT purposes. It is often wrongly assumed that this issue fades away after 7 years - it doesn't. The donor must ensure they avoid using the property until their death. While occasional usage of the gifted property by the donor may be permissible (say a maximum of 2 weeks each year), it is best to steer clear of any usage at all. This approach simplifies inheritance tax planning and leads to discussions about stamp duty implications.

Stamp Duty Land Tax (SDLT) Considerations and Benefits for UK Resident Children

SDLT considerations play a role when a child is purchasing the property. Non-residents are subject to a 2% additional stamp duty charge in the UK, but this charge does not apply if a non-domiciled parent gifts funds to a UK resident child who is 18 or older. The key here is the child's UK residency, which requires them spending 183 days in the UK out of the previous 365 days measured on the completion date of the property purchase. Citizenship, / holding a UK passport is not a requirement for the SDLT advantage. Seeking tax advice is crucial to navigate the complexities of the residency test and ensure eligibility for this potential SDLT saving.

SDLT and Trust Benefits

SDLT now encompasses three types of charges: standard SDLT at the tapered rates, a 3% flat charge for individuals who own another property (which may be located in the UK or overseas), and an additional 2% charge for non-resident buyers. Structuring property ownership through trusts involving UK resident children (who must be 18 or over) can provide opportunities for SDLT savings. It should be stressed that this option will only be suitable for non-UK domiciled persons. Purchasing the property through a fixed interest trust, for example, can potentially prevent the application of both the 3% and 2% additional charges. This option appeals to non-domiciled parents who wish to protect their assets from potential mismanagement or excessive spending by making outright gifts. The parent (the settlor) establishes an interest in possession trust which is treated as if the child is buying the property directly. Assuming the child is UK resident and owns no other property, the additional 3% and 2% SDLT charges should not apply. While trusts involve more intricate planning, they offer advantages beyond tax efficiency, such as asset protection and controlled asset utilization.

For non-UK resident UK domiciled clients in this position and interested in this SDLT planning, a cash gift to their UK resident child/ children would be the better option than a trust.

Structuring Property Ownership Through Trusts and Inheritance Tax

In appropriate cases structuring UK property ownership through trusts, whether UK or overseas-based trusts, is a viable option for non-UK domiciled purchasers. The trusts can be structured to maximize tax benefits while providing greater asset protection than outright gifts. However, it is crucial to consider the disclosure requirements, the TRS and ROE positions as part of the due diligence process before the purchase. When UK property is held in trust generally the settlor must be excluded from benefiting to ensure effectiveness for inheritance tax planning. Their exclusion should be done when the trust is

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established. Trusts involve periodic charges every ten years which must be factored in before deciding on whether to purchase through a trust or individually.

Final Considerations and Implications for Investment Planning

When considering buying UK property for personal use, non-domiciled individuals should carefully evaluate whether to invest in their own name or through a trust. Factors to consider include the property's value, the value of any other UK property they own and whether multiple family members, such as children, are expected to use the property over time. Trust structures may offer advantages, particularly for capital gains tax (CGT) planning over individual ownership. Holding a property in trust may ensure the application of full main residence relief from CGT if different beneficiaries use it consecutively during the ownership period by the trust. The CGT benefits of a trust will be less obvious where the property is used by a a single child/beneficiary, limiting the relief to their period of usage. While trusts are not necessary in in many cases, they are still utilized by high net worth individuals planning to purchase UK properties for family use.

Managing Tax Liability and Enforcement

Considering the implications of a property owner's death and the resultant tax bill is crucial. When a property is held through a trust and the settlor passes away, properly structured arrangements ensure that there are no inheritance tax consequences (as explained above this generally requires the exclusion of the settlor). Death of the settlor (or any beneficiary) does not trigger any IHT liability, so their death is a non-event for UK IHT purposes. However, if the property is owned directly by the parent and their spouse has already passed away, this situation becomes a trigger event for inheritance tax which may have been prevented with sound lifetime planning The payment of IHT is due no later than 6 months from the end of the month in which death occurred. The payment of IHT is a pre-condition to the grant of UK probate which means late payment will delay the administration of the UK estate until the tax is settled (it may also of course attract penalties). Consequently, the property cannot be transferred until the inheritance tax is paid.

Since 6 April 2017, non-UK domiciles holding residential property through overseas structures have been exposed to UK IHT, with the legislation applying retroactively to structures set up before the rules took effect. This has meant that non-UK domcield shareholders / beneficial owners of such companies are within the UK IHT net with all the above points now applying to them (in terms of IHT planning, liability, payment and enforcement). Enforcement mechanisms differ depending on whether the property shares are held directly by non-domiciled non-residents or through other structures.

Capital Gains Tax and SDLT Implications of gifting

It is essential to note that when gifting a property, capital gains tax (CGT) may be triggered. CGT is broadly calculated based on the difference between the original purchase price (including stamp duty) and the market value of the property at the time of gifting. The current CGT rates for residential property are18% and

28%. Therefore, individuals need to consider the potential capital gains tax implications and seek professional advice to ensure effective tax planning.

Holding UK property through Real estate investment trusts (REITs) and through non-close companies

For individuals looking to purchase UK property as an investment rather than for personal use, the UK offers generous tax exemptions for REITs, most notably the REIT's property income and gains are exempt from UK corporation tax (CT); furthermore, if the investor is non-UK domiciled then with careful planning their shares in the REIT can be structured to ensure there should be no exposure to UK IHT. However, the conditions which must be met for a company to qualify as a REIT are onerous – for example it must be a UK resident company and listed on a recognised stock exchange. Distributions from the REIT itself are also likely to be taxable.

Another option for IHT planning is to purchase property through a non-close company registered overseas. Typically this could be investing in an overseas fund which holds UK property or a policy issued by an life insurance company which invest in UK property. By purchasing a UK property through such a structure beneficially owned by a non-domicile, the property can potentially remain outside the scope of inheritance tax (at least on paper). However, it is crucial to note that such arrangements can be subject to the General Anti-Abuse Rule (GAAR), a special Targeted Anti-Avoidance Rule (TAAR) and/ or to the Disclosure of Tax Avoidance Schemes (DOTAS) rules, raising concerns about aggressive tax planning. Any such structure which is set up for tax avoidance reasons will likely be susceptible to one or more of these anti-avoidance rules.

Life Insurance for Covering Inheritance Tax Liabilities

Life insurance can be used to cover potential inheritance tax liabilities, a solution which is far more acceptable to HMRC. By calculating the estimated tax bill based on the value of the estate, the individuals can take out life insurance policies to cover the tax due in case of death (generally whole of life polices) or within a specified period (fixed term policies). The latter can be a useful complement to lifetime gifting by insuring against the risk of dying within 7 years. The insurance premiums will vary depending on the IHT exposure, health of the insured and the type of policy. It is important to note that life insurance does not eliminate the tax liability but provides funds to pay the tax, offering certainty and the ability to plan accordingly.

The UK Tax Landscape and Implications for Non-Residents

The UK tax landscape has undergone changes that may impact non-resident individuals and companies, but the UK still offers advantages for non-resident investors. The increase in corporation tax (CT) rates from 19% to 25% has immediate implications for overseas companies owning UK investment property, subjecting them to the flat 25% rate. In contrast, UK companies with property holdings may still benefit from the lower 19% CT rate (if their profits are £50,000 or less), with marginal relief available to UK resident companies with profits between £50,000 and £250,000. Despite tax increases

and regulatory changes, the UK maintains advantages such as exemptions from capital gains tax on most assets (excluding UK property) and the ability to freely move capital in and out of the country. The UK's liberal approach to property ownership and its recognition of trust structures also remains attractive, allowing investors to choose the most suitable entity for property ownership. However, concerns surrounding Brexit, economic downturn, and tax changes have led some individuals to question the UK's investment appeal. To maintain attractiveness, the UK may need to consider measures to encourage inward investment and enhance its corporate tax regime. Changes to the remittance basis and increased complexity in tax rules for non-domiciled individuals may also affect the willingness of high net worth individuals to reside or invest in the UK.

Closing the discussion

Returning to the UK and navigating the tax implications requires careful planning and consideration of the disclosure regimes, such as the Trust Registration Services (TRS) and the Register of Overseas Entities (ROE). Individuals should seek professional advice to understand the obligations and explore options to structure investments effectively while complying with the relevant disclosure requirements. Mitigating IHT can be achieved through strategies such as gifting funds to children or utilizing trusts (for non-UK domiciles), but it is crucial to consider planning objectives and all relevant taxes. Understanding the UK tax landscape and its implications for non-residents is essential for making informed investment decisions. By proactively managing tax liability, and seeking professional advice, individuals can effectively navigate the complexities of returning to the UK and managing their tax planning. ■

Mini-Checklist for Minimizing Tax Liability upon Returning to the UK

Individuals planning to return to the UK and minimize tax liabilities should consider a pre-arrival tax planning checklist, including the following key points:

1. Resignation from overseas directorships to prevent overseas companies from becoming UK resident and subject to UK corporation tax.

2. Extraction of income from assets before becoming UK resident to ensure the income extracted is not subject to UK income tax once UK resident.

3. Identifying assets with latent gains and utilizing rebasing techniques, such as transferring assets to children before becoming UK resident, to reset the cost basis and minimize capital gains tax.

4. Reviewing the asset portfolio for non-compliant assets, such as personal portfolio bonds and offshore funds, which may trigger tax consequences upon becoming UK resident.

5. Evaluating any outstanding loans to avoid creating taxable sources upon UK residency.

By considering these aspects and seeking professional tax advice, individuals can proactively plan their return to the UK and minimize potential tax burdens.

Find out more about Laurence Lancaster

Laurence (LLB, LLM, TEP) is a non-practising UK barrister, specialising in UK private client and pensions taxation. His typical clients are high net worth individuals who require tax mitigation strategies and tax advice. His specialist areas include advising on individuals' UK residence and domicile status; UK tax treatment of trusts and other structures including close companies and life insurance policies; the UK's pension tax regime; taxation of UK residential property; estate planning; and double taxation treaty advice. As Head of Tax for The Sovereign Group, he helps devise internal tax policies and strategy with a particular focus on UK tax compliance.

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