

# A Primer on the New U.K. Non-Dom Rules

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# SPECIAL REPORTS

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## A Primer on the New U.K. Non-Dom Rules

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As announced in its budget of 2008, the United Kingdom is to implement controversial proposals for individuals who are U.K. tax resident but not domiciled there.<sup>1</sup> Numerous concessions have been made to dampen the impact of the proposals on the City of London and those who are internationally mobile.

The basics of the current rules, a summary of the key proposed changes, and definitions for tax residency and domicile are set out below.

The flow chart below is based on the draft of the legislation issued on January 18, 2008, as amended by the proposals announced in the budget on March 12, 2008. The final text of the legislation relating to the proposal will be available when Finance Bill 2008 is issued.

### Current Rules

U.K. tax resident individuals (defined below) are subject to tax in the United Kingdom on all their worldwide income and gains wherever they arise. Tax for the tax year (April 6 in any one year to April 5 in the next) in which that income or gain arises is payable by the following January 31 under normal U.K. tax concepts. U.K. tax residents who are nondomiciliaries (defined below) pay tax on overseas investment income

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<sup>1</sup>Although these proposals have caused an uproar, they do not change the position of those who are (i) both tax resident and domiciled in the United Kingdom, (ii) neither tax resident nor domiciled in the United Kingdom, and (iii) not tax resident but domiciled in the United Kingdom. The key changes only affect those who are tax resident but not domiciled in the United Kingdom. This summary and attached flow chart focuses only on those individuals.

and gains only if remitted to the United Kingdom; any U.K. income and gains are taxable in the United Kingdom.<sup>2</sup>

In the case of U.K. tax resident individuals domiciled in the United Kingdom, overseas investment income and gains are taxed as they arise — hence the term “arising basis” of taxation. Those U.K. tax residents who are not domiciled in the United Kingdom are taxed on income and gains as they remit them to the United Kingdom — hence the term “remittance basis” of taxation.

### Key Proposed Changes

Each nondomiciliary who is over the age of 18 and has been tax resident in the United Kingdom for at least 7 out of the last 10 tax years must pay an annual fee of £30,000 to avail himself of the remittance basis of taxation, otherwise he must pay taxes on worldwide

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<sup>2</sup>Separate from tax residence, the United Kingdom also has an ordinary residence concept, which broadly means habitual residence. The United Kingdom’s tax authority also regards those who satisfy the 91-day rule (discussed below) as being ordinarily resident in the United Kingdom. Thus, an individual who is not tax resident in any one year because of, say, a secondment overseas, may still be ordinarily resident.

An individual who is not tax resident or domiciled in the United Kingdom but is regarded as ordinarily resident there is subject to tax on his overseas investment gains (but not overseas investment income) in the United Kingdom on remittance basis under the current rules.

While the proposals contain rules that would affect those who are ordinarily resident, because there are relatively few of these individuals, the flow chart does not describe the rules applicable to them.

income on an arising basis. When an individual chooses the remittance basis of taxation, he loses his annual income tax allowance and annual capital gains tax exemption. Nondomiciliaries who are under the age of 18 or who have been tax resident in the United Kingdom for fewer than 7 out of the last 10 tax years can avail themselves of the remittance basis of taxation without paying the annual fee of £30,000, but, if they choose to do so, they lose their annual income tax allowances and capital gains tax exemptions. Each nondomiciliary must make the determination independently every year, so the determination may vary from one year to another and between individuals in the same household in any one year.

Also, in computing days for tax residency purposes for both the 183-day rule and the 91-day rule (both defined below), any day on which an individual spends midnight in the United Kingdom must be counted beginning April 6, 2008.

### Tax Residency

An individual is regarded as tax resident in any particular tax year if he is present in the United Kingdom for 183 days or more (the 183-day rule). In that case, he is regarded as tax resident from the beginning of that tax year. A regular visitor to the United Kingdom whose visits average 91 days a year or more over a period of four years (the 91-day rule) is regarded as tax resident in the United Kingdom from the beginning of the fifth tax year. Other rules may result in his being tax resident earlier than set out in the above-mentioned rules.

### Domicile

Domicile is a concept that differs from tax residency and nationality. The domicile of an individual generally is the jurisdiction an individual regards as his natural home. In contrast to tax residency and nationality, an individual can only have one domicile at a time.

There are essentially three types of domicile.

The first is domicile of origin: the domicile of an individual's father when the individual was born.

The second is domicile of dependency: Until an individual has the capacity to change his domicile, the

domicile changes automatically with any change in the status of the individual on which the child is dependent.

The last is domicile of choice: An individual has a right to change his domicile after he reaches the age of 16. To do so, the individual has to leave a country, settle elsewhere, and sever ties that he has with the domicile of origin or dependency. The United Kingdom's tax authority usually requires evidence of the following before a claim of a change of domicile from the United Kingdom will be accepted<sup>3</sup>:

- disposal of all property in the United Kingdom;
- acquisition of residence in the new country;
- moving family to the new country;
- acquisition of nationality or citizenship of the new country, including a passport of that country;
- cancellation of memberships in all U.K. clubs and societies;
- execution of a new will under the laws of the new country;
- reservation of a burial plot in the new country; and
- the closure of all bank accounts in the United Kingdom.

The above list is not exhaustive, and in practice it is usually very difficult for individuals whose domicile of origin or dependency is the United Kingdom to satisfy the tax authority that their domicile has been changed.

### The Flow Chart

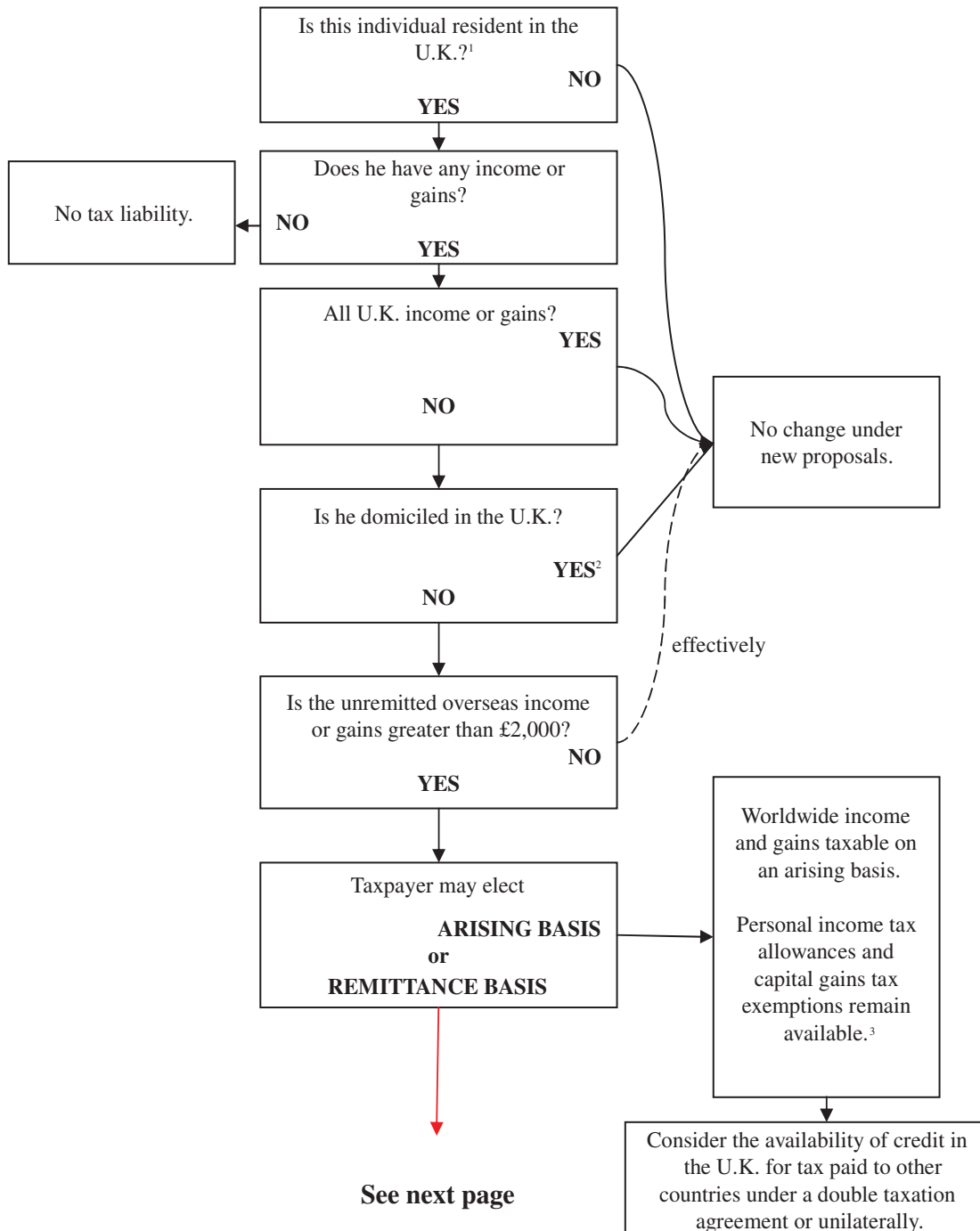
The flow chart should assist in determining whether the new proposals apply. The chart also deals with the implications for the three main types of foreign assets held by nondomiciliaries — shares in nonresident companies, interests in nonresident trusts, and cash in non-U.K. bank accounts. ◆

<sup>3</sup>See, e.g., *IRC v. Bullock* [1976] STC 409; *Re Mohammed Bheekhun, deceased* 1998/99 1 ITEL 491; and *Official Solicitor v. Clore* [1984] STC 609.

## Nondomiciliaries

**Rules come into effect on April 6, 2008.**

**Do the new nondomiciliary rules apply, and what are their effects?**



<sup>1</sup> This flow chart does not deal with those who are regarded as "ordinarily resident."

<sup>2</sup> While the treatment of income and gains of those who are tax resident and domiciled in the U.K. from nonresident trusts has changed, such changes are beyond the scope of this flow chart.

<sup>3</sup> The personal income tax allowance is £5,435 and the capital gains tax exemption is £9,600 for the tax year beginning April 6, 2008.

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