



Offshore income gains and protected trusts: a survey for trustees

The recent changes to the taxation of trusts settled by non-UK domiciled individuals have given rise to a potentially adverse tax consequence for trusts which invest in funds that give rise to offshore income gains (OIGs).

The Institute of Chartered Accountants in England and Wales (ICAEW) and other professional bodies in the UK are in correspondence with HMRC seeking a change to the legislation to remedy this problem. To assist HMRC and HM Treasury with their discussions with Ministers on the point, the ICAEW is encouraging professional trustees to complete the survey at the link below in order to provide evidence of the potential scope of the adverse tax consequences if the legislation is not amended.

<https://ion.icaew.com/taxfaculty/b/weblog/posts/protected-trusts-and-non-reporting-funds-help-us-gather-evidence>

The purpose of the survey

In April 2017 and 2018, the UK Government introduced significant changes to the taxation of non-UK domiciled individuals resident in the UK, and of non-resident trusts of which they are settlors.

The way the new rules are drafted adversely affects the UK taxation of OIGs arising within 'protected trusts': effectively, trusts established by non-UK domiciled settlors who later become 'deemed domiciled' as a result of their length of residence in the UK. Broadly, OIGs are not subject to the same protection from UK taxation as other forms of foreign source income in protected trusts.



We understand that this is an oversight rather than an intentional consequence of the new rules, but the issue does not appear high on the list of Government priorities.

As you will see, the survey encourages trustees to provide details of how many protected trusts they currently administer, and how many protected trusts they are likely to administer in the next 10 years where the settlors have become deemed domiciled as a result of their period of UK residence. The survey asks how many of these trusts are likely to have non-reporting funds (the disposal of which gives rise to OIGs) within their investment portfolios or those of an underlying holding company.

The professional bodies hope that the information provided by responses to the survey will encourage HMRC to support a change in the legislation once they realise how many trusts are likely to be affected by the anomaly, either now or in the future.

Legislative background

New rules introduced in 2017 and 2018 included changes to the 'deemed domicile' rules, which (among other amendments) now apply to individuals who have been UK resident in 15 of the previous 20 tax years but were not born in the UK (a '**long-term resident**'). The rules for non-UK domiciled individuals who were born in the UK are more punitive and are not covered in this note.

The new rules also revised the taxation of non-resident trusts settled by non-UK domiciliaries. Aspects of the revisions are favourable to non-UK domiciled settlors. In particular, provided a trust does not lose its protected status, non-UK source income arising to the trustees (or to any underlying non-UK resident company) which qualifies as 'protected foreign source income' (**PFSI**) is taxed only to the extent that it is matched against a distribution or benefit received by a UK resident beneficiary.

Under the old rules, such income was treated as arising to the settlor automatically, albeit that if the settlor was a remittance basis user it was only subject to tax if remitted to the UK. Under the new rules, income is attributed to the settlor only if the trust has lost its protected status; this occurs (permanently) if property is added to the trust directly or indirectly by a long-term resident or another trust of which he is a settlor or beneficiary. As a long-term resident is not eligible for the remittance basis, income which does not qualify as PFSI is taxable regardless of whether it is remitted.

Offshore income gains

One of the requirements for income to qualify as PFSI is that it would be 'relevant foreign income' (RFI) if it were income of a UK resident. Most foreign income arising to trustees or underlying non-UK companies would qualify as such. However, due to what we believe to be an oversight, OIGs arising in a tax year in which the settlor is UK deemed domiciled are not protected as they do not fall within the definition of RFI.

The Offshore Funds (Tax) Regulations 2009 (the '**Regulations**') categorise qualifying offshore funds into reporting and non-reporting funds.

Reporting funds: Capital gains realised on a disposal of an interest in a reporting fund are subject to capital gains tax. Only funds that have applied to HMRC for reporting fund status can be taxed as reporting funds.



Non-reporting funds: OIGs are gains realised on the disposal of non-reporting funds, which are effectively all qualifying offshore funds that do not have reporting fund status. Gains on such funds are subject to income tax rather than capital gains tax (and therefore may suffer higher rates of tax).

The apparent oversight is that OIGs are not within the definition of RFI for the purposes of section 830 ITTOIA 2005. Regulation 19 of the Regulations provides that OIGs will be treated as RFI of an individual only if the remittance basis applies to the individual for the tax year in question. Since an individual who is deemed domiciled in the UK does not qualify for the remittance basis, OIGs of a trust settled by him will not be treated as RFI and therefore do not qualify as PFSI. As a result, OIGs realised in a tax year in which the settlor is deemed domiciled will be subject to income tax as they arise.

There is no obvious justification for the distinction between OIGs and other receipts which are subject to income tax. Had the difference in treatment been intentional, we would have expected it to have been mentioned in the guidance which accompanied the new rules. HMRC has indicated that it is aware of the issue and that it is looking at potential remedies. However, officers have pointed out that the question of whether any correction will be made to the legislation is ultimately one for Ministers to decide. The question is whether sufficient evidence of the potential impact of the problem will be provided to Ministers to encourage them to make the necessary correction.

If you have any questions in relation to the ICAEW survey in the link below, the protected settlement rules or OIGs, please get in touch with your usual contact at Forsters.

[Survey](#)

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