



## Offshore income gains and “not-so-protected” settlements: an unwelcome announcement from HMRC

### What has happened?

HMRC has surprised many with a statement that the government does not intend to remedy a defect in recently introduced legislation relating to the tax treatment of non-resident “protected settlements”.

The defect means that gains realised by non-resident trustees on the disposal of offshore funds that are not registered with HMRC as having “reporting status”, will be subject to income tax as they arise once the settlor is deemed domiciled in the UK (assuming that the settlor and/or the settlor’s spouse can benefit from the trust and the “motive defence” does not apply). The treatment of so-called offshore income gains (OIGs) is at odds with that of ordinary trust gains and income, both of which are now “protected” from tax unless they are matched with a distribution or benefit received from the trust by a UK resident beneficiary.

It was generally understood that the intended result of the new legislation should be that all forms of income and gains (other than UK source income, and subject to certain conditions) should be protected, both before and after a settlor becomes deemed domiciled.

However, the legislation that emerged seemingly arbitrarily singled out OIGs realised after a settlor becomes UK domiciled, making them taxable as they arise. The apparent error seems to have been caused by a failure to correctly bridge the protected settlement legislation and the regulations containing the tax code for OIGs. In our August 2018 briefing [\[link here\]](#) we explained the technical issue in detail, and noted that the absence of any mention of the quirk in the guidance that accompanied the legislation, suggested that it was not deliberate.



Professional bodies, supported by evidence from trustees, have been corresponding with HMRC seeking an amendment to the legislation. This firm has been part of that lobbying, and wrote to HMRC independently in July. In its reply to our letter, HMRC stated that it was aware of the issue and was looking at potential remedies. However, in what now seems to have been a hint as to what would come next, HMRC also noted that any amendments to the legislation would be a matter for parliament to decide.

HMRC's statement last week was as follows:

*"A decision has been made not to amend the current legislation to include income arising in offshore non-reporting funds in the foreign trust exemptions at this time.*

*The current demands placed on parliamentary resource make it difficult for the government to justify returning to the legislation at this time to add to the generous package of protections which the government has already legislated for in the extensive reform of the non-dom rules last year.*

*Going forward, HMRC will continue to monitor this situation and engage with stakeholders."*

As a result of HMRC's statement, and contrary to what was expected when the protected settlement regime was announced, it seems that deemed domiciled settlors have, since 6 April 2017, been subject to income tax on OIGs realised in their non-resident trusts. Many non-resident trusts with investment portfolios, including those with holdings in US mutual funds, are likely to be affected.

For settlors who became deemed domiciled in April 2017 or April 2018, liabilities may have been triggered already. Although some trustees may have taken steps to accelerate or defer disposals, this will not always have been possible or desirable.

In addition, because the protected settlement legislation only materialised in its final form in the autumn of 2017, but took effect retrospectively from 6 April 2017, in many cases OIGs will have been realised before the legislation was passed. Those falling in that category will find HMRC's announcement particularly unsatisfactory.

## What to do?

Settlors who became deemed domiciled in the 2017/18 or (current) 2018/19 tax year whose trusts realised OIGs in those years will need to consider how to complete their self-assessment returns. The deadline for 2017/18 tax returns is 31 January 2019. However where the settlor is a US taxpayer the UK tax may have to be paid by 31 December 2018 in order to ensure that a credit is available when filing the US tax return.

Those who are in this position should not delay in consulting their tax advisors.

Where settlors are expected to become deemed domiciled in April 2019 or a future tax year, trustees should review their investment portfolios with their tax advisors and investment managers. If portfolios include non-reporting funds, consideration should be given to whether any action is needed – for example, adjusting investment policy, or triggering disposals before the settlor becomes deemed domiciled. In all cases, tax will need to be weighed against commercial concerns.



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Where non-reporting funds are unavoidable, it may be possible to avoid income tax charges for a deemed domiciled settlor if there is another UK resident beneficiary who can claim the remittance basis and who can receive regular distributions or some other benefit from the trust. Advice would be essential for this to be effective.

## What next?

It is not surprising that the tax treatment of OIGs realised by non-resident trustees features low on the list of the government's current priorities. There are, no doubt, more pressing demands on parliamentary time.

It may still be hoped that the government will revisit the position, but in view of HMRC's statement, it would be optimistic to expect that to happen any time soon. If the problem is eventually addressed, an obvious question will be whether relief will be given retrospectively for tax already paid.

Arguably, it would have been simpler for HMRC to resolve the issue, even if only temporarily and by concession, before the January 2019 deadline for the submission of tax returns for 2017/18. Now that that opportunity has been turned down, resolving the problem will become more messy, making it more likely that it will be put on the "too difficult" list.

That said, HMRC has stated that it wants to continue to "engage with stakeholders". There are many of them. Not just settlors and trustees, but also a funds industry that stands to lose clients as a result of this announcement. It is hoped that continued concerted efforts by those affected, with help from the advisors and professional bodies that represent them, will eventually prove fruitful.

If you have any questions in relation to the protected settlement rules generally, or the tax treatment of OIGs specifically, please get in touch with your usual contact at Forsters.

## Key contact



**Xavier Nicholas** Partner  
Private Client  
E: [xavier.nicholas@forsters.co.uk](mailto:xavier.nicholas@forsters.co.uk)  
T: +44 (0)20 7863 8578

