

Non-Domiciliaries Tax Planning for UK Homes

Non-UK domiciled individuals (“non-doms”) moving to the UK need to consider carefully how their UK homes will be owned. The ideal solution will provide exemption from capital gains tax (“CGT”) on a sale, from inheritance tax (“IHT”) on death, and may also provide a degree of confidentiality. But current practice applied by the UK Revenue (“HMRC”) means that combining these two aims may inadvertently give rise to substantial income tax charges unless proper advice is taken.

The Traditional Approach

Non-doms are not subject to IHT on death on their non-UK assets. Many non-doms have therefore traditionally held their (often valuable) UK properties through an offshore company. Owning the property through an offshore company ensures that the asset in the estate of the non-domiciled individual is the non-UK company shares, rather than the property itself. Those shares are therefore not subject to UK IHT. However, on its own, the company no longer offers an effective shield for capital gains tax on the sale of the property (and the normal exemption for a principal private residence is not available).

In many cases, individuals therefore arrange for the company to be owned by a trust. This preserves the IHT advantage and also ensures that any capital gain on sale of the property is not immediately chargeable on the individual. Such a structure has routinely been used by non-domiciled individuals to own their main homes.

Challenge from HMRC

However, in recent years this type of structure has been targeted by HMRC using income tax legislation. There is a charge to tax when an employee receives free or subsidised accommodation from his employer. But as well as applying to employees, this charge applies to directors of a company, and crucially, to “shadow directors”. Shadow directors are persons “in accordance with whose directions or instructions the [actual] directors of the company are accustomed to act.” If a non-dom owns his house through a UK company, one can easily imagine a situation where the non-dom makes all the decisions regarding repairs, redecoration or sale, and arranges all these aspects himself, with the actual directors limited to a role of passive acquiescence. HMRC may well then argue that such a degree of control makes him a shadow director.

If HMRC were to be successful with this argument, the potential tax consequences could be severe. The individual would be charged on the basis of the deemed benefit of free use of the house, each year. The value of this benefit is calculated in accordance with a formula which factors in the market rent and the original purchase price of the property. Where the property is worth millions of pounds, the formula can give rise to deemed benefits of six figures or more. This sum would be charged to income tax (at 40%) every year.

Solutions

The presence of a trust which owns the company will give some protection against the shadow director argument, provided the trust is properly set up and administered. However, it is not a guaranteed solution in every case, and may not always be the most appropriate for a client's circumstances. All options should be considered starting from a basic decision to own the house directly and insure against the exposure to UK IHT, to more complicated leasing or trust arrangements. But in all cases, proper advice at the outset may save substantial liabilities later.

If you would like to discuss any aspect of the matters discussed in this note, please contact your usual advisor or the trust and tax team at Wilsons on +44 1722 412412.

This note is intended only as general guidance and should not be relied on without taking specific advice in relation to particular facts and circumstances.