DOMICILE

A non-UK domiciliary (sometimes called a "non-dom") is an individual who is domiciled outside the UK for the purposes of UK common law.

"Domicile" is a concept in UK law which is different from the UK tax concept of residence. It is possible for an individual to be resident in one country, domiciled (for UK law purposes) in a second country, and a national of a third.

Non-UK domiciled status can persist for a long time after an individual has become resident in the UK. Under UK common law, an individual may have been UK resident for decades, and may even have acquired British nationality, and yet have a domicile outside the UK. This will be the case if the individual had a "domicile of origin" outside the UK and he or she has never acquired a "domicile of choice" in the UK.

Domicile of origin

At birth an individual acquires a domicile of origin. That domicile is retained until an individual abandons that country and moves to another country with the intention of remaining there permanently or indefinitely. That country then becomes the individual's domicile of choice.

Under UK law the burden of proof regarding a change of domicile falls on the person alleging the change. Under English law the standard of proof is more onerous than in most civil law matters and if the question of a change of domicile had to be considered by the court the necessary elements of residence and intention have to be shown with "perfect clearness and satisfaction" to the court.

An individual with a non-UK domicile of origin will remain non-UK domiciled for as long as he can credibly say that he intends to cease residing in the UK at some point in the future. For example, it is common for individuals with foreign domiciles of origin to intend to leave the UK when their children cease to be in full-time education in the UK, on the termination of an employment with a UK employer, on their retirement, etc. As long as the intention to leave the UK is reasonable, the domicile of origin will be retained in these scenarios. However, if an individual moves to the UK late in life, an assertion of a foreign domicile will be more liable to challenge.

Acquiring a domicile of choice

It is also possible for an individual with a domicile of origin in the UK to become a non-UK domiciliary, by residing in another country and forming the intention to reside there permanently or indefinitely. This will result in the acquisition of a domicile of choice in the other country. In principle such a domicile of choice may be retained if the individual ceases to reside in the other country, and even if he begins to reside again in the UK.

However, if an individual who has a UK domicile of origin and was born in the UK becomes UK resident, he will be "deemed domiciled" in the UK and therefore ineligible for the remittance basis (see heading below). Further, after a "grace period" of one tax year, he will be deemed domiciled in the UK for inheritance tax (IHT) purposes, and therefore ineligible for the IHT benefits of being a foreign domiciliary, both personally and in connection with settlements that he/she may have settled when a non-dom.

Once a domicile of choice is acquired, that domicile is retained until that country is abandoned by the individual with the intention of never returning there. However, once a domicile of choice has been acquired it is not lost simply because an individual subsequently changes his mind and intends to leave that country at some future date.

Further, once the domicile of choice is abandoned, unless another domicile of choice is immediately acquired, the domicile of origin reverts automatically even if the individual never sets foot there again.

The UK Self Assessment system requires that taxpayers have to decide whether they are resident or domiciled in the UK and how that may affect their liability to UK tax. Where a taxpayer claims to have a foreign domicile, H M Revenue & Customs (HMRC) may enquire whether or not that is correct. By its nature this sort of enquiry will be an in-depth examination of the taxpayer's background, lifestyle and intentions over the course of their lifetime. The enquiry will extend to wide areas of the taxpayer's life and that of his family and will ask questions and ask for information in support of the claim. One question that may be asked is "did you ever form the intention of remaining in the alleged domicile of choice permanently (or at least indefinitely)?" Unless that question can be answered in the affirmative a domicile of choice will not have been established.

As already noted, under the current rules an individual who has a domicile of origin outside the UK will remain non-UK domiciled, and therefore eligible to use the remittance basis, for as long as he has not formed an intention to reside in the UK permanently or indefinitely (subject to becoming "deemed domiciled" see below). This will be the case if he intends to leave the UK at some reasonably definite point in the future. However, it can be helpful in discussions with HMRC to point to a particular country, which may not be the individual's domicile of origin.

An individual's domicile of origin is regarded as hard to lose, but the longer an individual remains in the UK, the more risk there is of his or her status as not domiciled in the UK ("non-dom") being challenged by HMRC. Such a challenge may occur in the individual's lifetime or (more commonly) after his death, when his or her personal representatives will have to gather evidence regarding the deceased's intentions.

HMRC are becoming more aggressive in challenging filing positions based on a domicile outside the UK, not only in relation to individuals who have died as UK residents, but also in relation to living taxpayers. In view of this, it makes sense to take steps, in advance of any such possible challenge, to ensure that the evidence of foreign domicile is as strong as possible.

It is often advisable, therefore, for non-UK domiciled individuals to prepare a domicile statement. The purpose of a domicile statement is to set out supporting evidence of the individual's claim to be a non-dom. This is very useful in the event of a domicile challenge by HMRC. Such a statement is often enough to make HMRC back down and concede that non-dom status was retained until death, and should be kept up to date. In a dispute with HMRC about domicile, a recently written domicile statement has a lot more force than one written ten or twenty years ago.

Why is domicile important?

In English law, the significance of domicile goes beyond tax. In particular, a foreign domicile can affect succession to "movable" assets. The succession law of a country of domicile may contain "forced heirship" provisions which prevent the individual from disposing of their assets on death in the way that they wish. However, the most immediate impact of a foreign domicile is in reduced exposure to UK taxation, in recognition of the fact that the person is less closely connected to the UK. The tax advantages of being a non-dom are as follows:

- the remittance basis of taxation;
- the restriction of inheritance tax (IHT) to UK assets; and
- the scope to create a non-resident trust from which the individual can benefit, without the creation of the trust giving rise to IHT, and without various anti-avoidance rules applying to the trust's assets and income/gains generated within the trust.

The deemed domicile concept

The concept of deemed domicile in the UK limits the length of time for which the tax advantages apply. A deemed domicile is typically acquired by a non-UK domiciled individual once he has been UK resident in 15 of the 20 preceding tax years. It follows that an individual with a foreign domicile typically becomes deemed domiciled for IHT purposes at the beginning of his 16th tax year of residence in the UK.

It is important to count tax years of residence correctly for these purposes. Under the rules which applied before the UK introduced its current statutory residence test, it was not uncommon for an individual moving to the UK to become taxable as a resident in a given tax year even if he only started spending time in the UK towards the end of the tax year. This can also happen under the statutory resident test, for example if the individual becomes UK resident on commencing full-time work in the UK. There is no doubt that, where an individual became UK resident partway through a tax year, that whole tax year must be counted for the purposes of the deemed domicile test (even if he was taxable as a resident, in that tax year, for just a few days). Deemed domicile can therefore arrive sooner than expected, sometimes little more than 14 years after the individual's "arrival" in the UK.

The effect of being deemed domiciled in the UK is that the remittance basis no longer applies, and the scope of IHT extends from UK assets to all assets on a worldwide basis. This is relevant not only in the event of the individual's death, but also if the individual makes lifetime gifts, especially gifts to trusts or trust-like entities.

However, where an individual has not yet become deemed domiciled, this unwelcome extension of the scope of IHT can be countered by putting non-UK assets into what is known as an excluded property settlement. This is a trust, usually in discretionary form, of which the non-dom himself can be a beneficiary. The trust must be created and funded before the non-dom becomes deemed domiciled. If so, it can function as an indefinite shelter from IHT, not just in the non-dom's lifetime but potentially for many generations after his or her death.

"Breaking" actual and deemed domicile for IHT purposes

The "three year rule" applies to individuals previously actually domiciled in the UK. Such an individual is deemed to remain UK domiciled for three calendar years after he has in fact lost his UK domicile. However, the "long-stayer rule" imposes deemed domicile on such individuals for the three tax years following departure, so both these rules need to be considered, often meaning that domicile for IHT purposes is not lost until the fourth tax year of non-UK tax residence.

Where an individual has already become deemed domiciled for IHT purposes, his deemed domicile can in principle be "broken" by a period of non-UK residence. In a typical case, six entire tax years of non-UK residence are required if the individual plans to resume residence in the UK after the non-resident period. But if return is not contemplated then "breaking" is achieved after three tax years of non-UK tax residence.

If an individual plans to "break" his deemed domicile, close attention must be paid to the provisions of the UK's statutory residence test, to ensure that he will qualify as a non-UK resident throughout the required period. Deemed domicile will not be "broken" if the individual resumes UK residence too soon.

Contacts

If you would like further advice or information in relation to the issues outlined within this document, please do not hesitate to get in touch with your usual BDO contact or any of the individuals listed below:

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