

## UK TAX REFORMS MAKE BERMUDA TRUSTS APPEALING

by Vanessa Schrum

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The Bermuda trust is a popular estate planning vehicle for private clients wishing to structure their affairs in a tax efficient manner. There are a whole host of reasons why this is so, including asset protection, preservation of wealth for future generations, confidentiality, settlor reservation of control, ensuring business continuity, protection of vulnerable heirs and prudent succession planning.

Now, there is another reason.

On 6 April 2017 widespread reforms to UK tax rules for UK resident but non-domiciled individuals and their property holding structures are scheduled to take effect. From 6 April (the beginning of the new UK tax year), individuals who have been resident in the UK for 15 of the previous 20 tax years will become “deemed domiciled” for all UK tax purposes under the proposed changes. These individuals will become subject to UK tax on their worldwide personal income and gains. In addition their worldwide personal assets will become subject to UK inheritance tax on their death.

An individual wishing to break the deeming provisions will need to leave the UK for six complete tax years before returning to the UK and restarting the clock, or three years (for inheritance tax purpose only) where there is no intention to return to the UK.

Many UK advisors are recommending the use of offshore trusts settled with suitable assets before an individual becomes UK deemed domiciled on April 6 under the so called "protected trust" rules. A Bermuda trust is one such example.

The settlor of a protected trust will generally be exempt from UK income tax (on the trust's foreign income) and UK capital gains tax (on the trust's UK or non-UK gains). This benefit can be incredibly attractive to a non-UK domiciliary who subsequently acquires UK deemed domicile status and wishes to protect assets from UK tax.

However, the key proviso in order to benefit from these tax exemptions is that the settlor may not subsequently add property or income to the trust ('tainting' rules), with some very limited exceptions. The settlor will be subject to tax if they receive amounts from the trust as will other beneficiaries. Care needs to be taken if there have been capital distributions prior to April 6 2017 as these can come into charge in certain circumstances. Anti-avoidance measures are being introduced to tax the settlor on distributions to 'close family members' (essentially minor children and spouse/civil partner/cohabitee) if the amount does not come into charge because, say, the recipient is non-UK resident.

Trusts established by an individual before becoming UK deemed domiciled also provide UK inheritance tax savings. Generally the settlor will not be subject to UK inheritance tax on the non-UK assets of the trust provided that no funds are added to the trust by the settlor (after becoming deemed domiciled) in any way. UK assets will be protected if held via a non-UK company except for UK residential property, which will always be subject to UK inheritance tax under new rules to be introduced in April.

Protected status is only available to offshore trusts and not to directly-held investments or offshore companies. This creates a planning opportunity for non-domiciled individuals who risk becoming deemed domiciled in April. Where they hold offshore investments, either directly or through an offshore company, they could consider settling these assets into a Bermuda trust prior to April 6 in order to benefit from prudent tax planning.

Unfortunately, returning former domiciliaries (that is, individuals born in the UK with a UK domicile of origin) will be treated as domiciled in the UK for all tax purposes on their return to the UK, although there will be a short grace period with respect to inheritance tax exposure on their worldwide assets. These individuals will also not be able to benefit from the new protected trust regime -- and worse, trusts of which they are settlor effectively fall into the UK tax net, including for inheritance tax.

The upcoming rules are creating quite a stir in the private client and trust community. Advisors and trustees are busy restructuring existing trusts with a view to benefiting different family beneficiaries who may be materially affected as a result of the April tax changes. Splitting of existing trusts may also be desirable in order to separate trust portfolios with different investment strategies. It may be prudent to review whether past income should remain in or be distributed out of existing trust structures before the April tax changes. If UK tax is a concern then these changes should all be implemented prior to April 6 2017.

Time is fast running out for individuals who will soon become deemed domiciled under the April deeming provisions to get their affairs in order. If appropriate, and subject to receiving suitable UK tax and Bermuda legal advice, a Bermuda trust to hold non-UK assets settled prior to an individual becoming UK deemed domiciled, can be incredibly attractive in light of the looming UK tax changes.

The author would like to thank Gill Smith of Moore Stephens LLP for her contribution.

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