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Client Alert

October 2024

United Kingdom: Autumn Budget 2024 – Overview of announcements

In brief

On 30 October 2024, the Chancellor of the Exchequer delivered the UK government's annual Budget.

This is the first budget from the recently elected Labour government, and follows months of speculation around tax increases, reforms to the taxation of UK resident non-domiciliaries (RNDs or non-doms), and UK inheritance tax (IHT) reform.

The Budget contains a number of far-reaching changes relevant to our clients, and confirms proposed changes previously announced to the RND regime and IHT.

Notably, the Budget also contains a "tax trap" for deemed domiciliaries with "excluded property trusts" who have exited within the current and preceding two tax years. Those who have left in anticipation of the changes to the RND regime should therefore ensure they have not unwittingly been caught by this trap and, if so, explore any potential solutions with their advisers.

We recommend clients take immediate advice on the potential implications for them, their businesses, and any structures through which they hold assets.

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In depth

Summary

In summary, the government has announced/confirmed the following key changes, which we consider are of critical relevance to many of our clients:

- The abolition of the RND regime and remittance basis of taxation.
- A new four-year foreign income and gains (FIG) regime for qualifying individuals.
- The abolition of "domicile" and the associated IHT reform to move to a residence-based system, bringing those who have been UK resident in ten out of the preceding twenty tax years into the scope of IHT on global assets.
- Reform to the taxation of trusts, and the imposition of IHT charges on trusts set up by those who are long-term resident in the UK, including an up to 6% exit tax charge once a settlor ceases to be a long-term resident.

There are some planning opportunities to mitigate the effect of the changes, but clients must take advice urgently before 6 April 2025.

Recap on historic proposition

Historic rules - RNDs

Historically, those who are UK tax resident, but who are not considered domiciled (or deemed domiciled) in the UK (e.g., because they were born outside the UK and/or to foreign parents), have been able to elect to be taxed on the remittance basis of UK taxation.

This meant that such RNDs were only liable to UK income and capital gains tax on their UK source income and capital gains, and not their FIG, unless such FIG were "remitted" to (i.e., brought to) the UK.

RNDs were also able to use trusts as a means of protecting against IHT should they become "deemed domiciled" following residence in the UK for 15 out of the preceding 20 UK tax years.

Previous Conservative government reforms - RNDs

In March 2024, the previous Conservative government announced plans to reform the rules affecting RNDs. These included replacing the remittance basis of taxation with a new "four-year FIG regime".

This proposed regime would be available to individuals for the first four tax years of UK tax residence, after a period of 10 years of non-UK tax residence.

The previous Conservative government had announced that eligible individuals would not pay tax on FIG arising in the first four years of UK tax residence and would be able to remit these funds to the UK free from any additional tax charges.

In addition, the previous Conservative government had announced plans to reform the IHT regime and move from a domicile-based regime to a residence-based one.

This was expected to result in individuals that had been tax resident in the UK for 10 years falling within the scope of IHT on their worldwide assets, with such exposure lasting for a period of 10 years following that individual ceasing to be UK tax resident.

These reforms were also expected to affect the IHT profile of trusts set up after 5 April 2025. However, the Conservative government had announced that, under its proposals, there would be a concession for excluded property trusts set up prior to 6 April 2025.

Broadly, this would have meant that trusts set up prior to 6 April 2025 by a settlor who was not UK domiciled at the time would be outside the scope of various IHT "relevant property" charges. These include an "anniversary charge" (of up to 6%) on each ten-year anniversary of the trust being settled, and an "exit charge" (of up to 6%) when property leaves the trust.

Reforms announced in the Budget

Labour has broadly adopted the proposals put forward by the previous Conservative government, but with a number of significant modifications, particularly around IHT and its impact on excluded property trusts.

We set out the proposals put forward by Labour as follows.

New FIG Regime

From 6 April 2025, the remittance basis will no longer apply for RNDs. Instead, a new regime will apply for individuals in their first four years of UK tax residence after a period of 10 years of non-residence. This is to be known as the "four-year FIG regime" and largely mirrors what the Conservative government set out in its March 2024 proposals.

Individuals who make a claim to use the new regime will not pay tax on FIG arising in their first four years of UK residence, irrespective of whether such FIG are brought to the UK. In many ways this offers benefits over the previous remittance basis rules as individuals can bring funds to the UK without a tax charge. This potentially allows clients relocating to the UK to bring funds to the UK for spending in a straightforward and tax-efficient manner.

A claim for the new regime will need to be made in the UK self-assessment tax return. As part of the claim, individuals will need to quantify the amount of income and gains for which the relief is being claimed. If amounts of FIG are not quantified and included in the tax return, then individuals will remain chargeable and subject to tax at their usual rates. This differs to the existing remittance basis rules, where foreign unremitted amounts are not reported at all.

Crucially, the four-year FIG regime will only be available to individuals within their first four years of UK tax residence following a period of at least ten consecutive years of non-UK residence. An individual's ability to qualify for the regime will be determined by whether they are UK resident under the Statutory Residence Test (SRT), which remains unchanged by these latest rules. Treaty residence under a Double Taxation Agreement (DTA) will not be relevant for the purpose of determining eligibility.

If an individual has previously had a period of ten consecutive years of non-UK residence prior to their arrival in the UK and is still within their first four years of UK tax residence on 6 April 2025, they will be able to access the new regime until they have exceeded the four-year period.

FIG regime and trusts

Labour has confirmed that, where a UK resident individual who is eligible to claim the four-year FIG regime receives a foreign distribution or benefit from a trust, the distribution or benefit can qualify for relief under the four-year FIG regime.

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Therefore, beneficiaries and settlors who are within the four-year FIG regime will be able to receive benefits free from UK tax whether or not the benefits are actually received in the UK. However, it has been confirmed that such benefits will not reduce the pools of unmatched FIG within the trust for matching purposes.

Of particular relevance for existing UK resident settlors of trusts, the protection from tax on FIG arising within settlor-interested trust structures will no longer be available for non-domiciled and deemed domiciled individuals who do not qualify for the new FIG regime. As a result, FIG arising in the trust (whenever established) from 6 April 2025 will be taxed on the settlor as if it were their FIG (unless the settlor is eligible for, and claims, the four-year FIG regime, or such FIG is otherwise not attributable to them).

Inheritance tax reform

From 6 April 2025, the concept of "domicile" for UK tax purposes will be abolished.

Instead, the test for whether non-UK assets are in scope for IHT will be whether an individual has been resident in the UK for at least 10 out of the last 20 UK tax years immediately preceding the tax year in which the chargeable event (e.g., death) occurs. Such persons will be known as "long-term residents".

If an individual has been UK resident for at least 10 out of 20 years and then becomes non-UK tax resident and does not return to the UK before the chargeable event, the government has set out provision to shorten the length of time an individual will remain a long-term resident if they had been UK resident for between 10 and 19 years out of the last 20 years.

For those who are resident between 10 and 13 years, they will remain in scope for three tax years, which broadly mirrors the position for current deemed domiciled individuals. This will then increase by one tax year for each additional year of residence. So, for example, if a person was resident for 15 out of 20 tax years on leaving, they would remain in scope for five tax years; if resident for 17 out of 20 tax years on leaving, they would remain in scope for seven tax years.

An individual will not be treated as long-term resident for IHT purposes in the year following 10 consecutive years of non-UK tax residence, even if they return to the UK. Effectively, the test is reset. This provides advantages to those who may have a UK domicile of origin and are looking to return to the UK.

Impact on excluded property trusts

Under the current rules, if the settlor of a trust was non-UK domiciled at the time the trust was set up, then non-UK assets comprised in the trust are considered excluded property and outside the remit of various IHT charges. Such charges would otherwise include an "anniversary charge" (of up to 6% of the value of the assets held under the trust) on each ten-year anniversary of the trust being settled, and an "exit charge" (again, of up to 6% of the value of the assets held under the trust) when property leaves the trust.

From 6 April 2025, IHT will be charged on non-UK assets comprised in a trust at times when the settlor is long-term resident. This means that settled assets come in and out of the anniversary and exit charges discussed above based on the settlor's long-term residence at the time of the charge, rather than the settlor's domicile at the time the trust was set up.

Where a settlor of a trust dies after 6 April 2025, the future excluded property status of the trust will depend on the settlor's long-term residence status at their death. Therefore, if they were long-term resident in the year of their death, then all UK and non-UK settled assets will be in scope for IHT for the duration of the trust.

In addition, where a settlor ceases to satisfy the long-term residence test, non-UK relevant property will become excluded property, and this will result in an exit charge. This is an announcement about which there was no warning and can have unexpected ramifications for clients with existing trusts looking to leave the UK, or who have already left the UK, as their exit may trigger an exit charge for any trust of which they are the settlor.

The current IHT legislation contains provisions known as the gift with reservation of benefit (GROB) rules. Broadly, these apply when UK resident individuals give away assets but retain some benefit in connection with the gifted asset. GROBs can also occur in the context of settlors settling funds into a trust where the assets represent "relevant property". These rules will continue to apply post April 2025. If an individual is long-term resident at the time of their death (or when the reservation of benefit ceases), non-UK property given away where a benefit has been reserved will remain be chargeable under the GROB rules. This will be the case even if the gift was made when such person was not long-term resident.

However, Labour has carved out an exception for excluded property owned within excluded property trusts as at 30 October 2024, which will not be subjected to the GROB rules. Therefore, while the up to 6% lifetime and exit IHT charges may very well still apply to these trust-owned assets moving forward, there should be no GROB and therefore no 40% charge to IHT in relation to assets that represented excluded property. For many such individuals with excluded property trusts, this will mean that these trusts will be subject to pro-rated exit charges even through they have seemingly made a complete exit from the UK before 6 April 2025.

Business Property Relief (BPR) and Agricultural Property Relief (APR)

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Less of a surprise was the watering down of BPR and APR. Labour has announced that, from April 2026 onwards, individuals will be limited to IHT relief on the succession of their business and agricultural assets up to a cap of GBP 1,000,000 in asset value. Anything above this limit will be taxable to IHT, albeit at 50% of the usual 40% rate, leaving an effective rate of 20% for business and agricultural assets above GBP 1,000,000. For those who qualify for both BPR and APR on their assets, the reliefs will be applied connectedly (i.e., if you die with GBP 500,000 of business assets and GBP 500,000 of agricultural assets, these will still qualify for 100% exemption from IHT).

These newly announced restrictions will apply to trusts that are subject to the relevant property regime. It appears the GBP 1,000,000 cap will also extend to the 10-year anniversary charges (at up to 6% of the value of the assets under trust) that become due on these trusts, with any qualifying property above that cap being subject to a 50% relief.

For our client base, the potential offloading of businesses and agricultural property to fund the increasing IHT may provide attractive purchasing opportunities.

It should be noted that the current relief on shares in trading companies not listed on a recognized stock exchange (e.g., AIM listed shares) will qualify for 50% relief only, without the GBP 1,000,000 allowance with effect from 6 April 2026.

Capital Gains Tax (CGT) rebasing

The government has announced a useful rebasing relief for individuals who do not qualify for the new four-year FIG regime and will be subject to CGT on foreign gains after 6 April 2025. Such eligible individuals will be able to rebase personally held foreign assets for CGT purposes to their market value as at 5 April 2017.

Temporary Repatriation Facility (TRF)

From 6 April 2025, a new TRF will be introduced to encourage individuals to remit their FIG which previously arose under the old remittance regime.

Where individuals previously have unremitted FIG, these could not be brought to the UK without incurring a tax charge.

To encourage the migration of these funds to the UK, a TRF will be available for three tax years from 6 April 2025 (up from the two-year period that the Conservative government initially put forward in its March 2024 proposals).

Designated amounts brought to the UK will be charged to tax at a rate of 12% in tax years 2025/26 and 2026/27, with the rate rising to 15% in tax year 2027/28. This is a welcome concession and represents a good opportunity for client's wanting to increase funds being held in the UK and could not previously do so without tax charges of up to 45%.

Other reforms

Carried interest

A call for evidence was published in July confirming the government's intention to "take action against the carried interest loophole". Following engagement with stakeholders over the summer, Labour has announced a package of reforms to the taxation of carried interest.

As an interim measure, the existing CGT rates of 18% and 28% that apply to carried interest will be consolidated into a single rate of 32% with effect from 6 April 2025.

This will be followed by further reform pursuant to which the government intends to bring the taxation of carried interest into the income tax framework from 6 April 2026. The government will establish a working group with stakeholders to explore points of technical detail in connection with the proposed reform ahead of publishing draft legislation in 2025.

The new regime for carried interest will include special computational provisions for qualifying carried interest, which recognise the unique characteristics of the reward. The government is considering introducing further qualifying conditions to access the regime: a minimum co-investment requirement and a minimum time period between a carried interest award and receipt. These potential qualifying conditions are the subject of a further consultation, which closes on 31 January 2025.

Corporation Tax

Labour has confirmed that corporation tax will remain at 25% (which remains the lowest headline corporation tax rate of any G7 country), with no further plans of an increase in future.

SDLT on second properties (effective from 31 October 2024)

Labour has announced an additional 3% SDLT to the existing 2% SDLT surcharge on second home ownership (where the second home is not replacing your main home). This 5% surcharge, along with the additional 2% surcharge for foreign buyers, means that

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foreign property purchasers will be facing SDLT surcharges of 7% (along with the usual rates applicable to the property, depending on value). This change will be effective as at 31 October 2024.

SDLT paid by companies and other non-natural legal persons acquiring UK properties with a value of greater than GBP 500,000 will increase from 15% to 17%. This will also be effective as of 31 October 2024.

CGT

Labour has confirmed that CGT rates will rise from 10 to 18% at the lower rate, and from 20% to 24% at the upper rate. CGT levels on residential property will remain the same (24% at the lower rate and 28% at the upper rate).

Fee-paying schools

Labour has confirmed the highly anticipated imposition of VAT (at 20%) on private school fees, effective from January 2025. This will catch any fees which were paid from 30 October 2024 onwards in relation to school terms which start on or before 1 January 2025. The Budget also confirms that "anti-forestalling" measures will be included in the next Finance Bill, which will seek to catch those parents who may have pre-paid private school fees from 29 July 2024 onwards in anticipation of these announcements.

Labour has also announced that they are going to end business rates relief for such schools. This will be subject to a consultation process and draft legislation on the VAT changes (which was published following the Budget announcement yesterday).

IHT on inherited pensions

Private pensions, which were historically exempt from IHT, are now brought within the remit of IHT (at a rate of 40% for any surplus pension funds worth over the current GBP 325,000 tax free allowance, which remains the same).

National Insurance Contributions (NICs)

While Labour remained committed to freezing employee-contributions to NICs, it has announced a 1.2% increase in the employer-mandated contribution.

Business Asset Disposal Relief (BADR)

Labour has confirmed that BADR (a relief which applies on the sale proceeds of core business assets) will remain up to a value of GBP 1,000,000. Anything above this threshold will be taxed at a rate of 10% for the current tax year, rising to 14% for 2025 and 2026, finally to 18% for 2027.

Additional staffing at HMRC

Labour has confirmed that it will be introducing new measures to crack down on tax avoidance schemes and late-filing payments to save HMRC a projected GBP 6.5 billion. This would include a ramp-up in hiring of HMRC enforcement staff, the exact number of which is unconfirmed, and a 1.5% increase in interest levied on unpaid tax bills.

Conclusion

The UK Budget will clearly have widespread implications for many, most obviously RNDs who have benefited from the remittance basis of taxation and the use of excluded property trusts for their UK tax planning objectives.

While these new measures are seemingly quite punitive in nature, new features such as the extended TRF create valuable windows of opportunity for those non-doms wishing to remain in the UK to minimize the increased tax burden. For more internationally mobile non-doms, the UK Budget may have provided them with further conviction to exit the UK in search of more suitable tax and succession regimes for their families and businesses.

In any case, the Budget has provided some much-needed certainty and the opportunity to put into place clear and purposeful planning.

Clients impacted by these changes should seek guidance on the best path forward.

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