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Reforms to the taxation of non-doms

Will they bring a positive or negative impact to the UK Economy?

Every few years, the UK tax treatment of non-domiciled individuals is raised. The continued existence of a special tax regime for non-doms is questioned, often fiercely, and generally followed by changes to the tax rules that govern the regime.

The last big tussle was in the general election campaign of 2015 and following their election, the new government announced a raft of tax changes that will affect non-doms. The major change was the effective introduction of a limit on the period for which non-doms may claim special tax treatment if they reside in the UK.

The government consulted on the changes and plenty of responses were received, from us and many others, about their substantive content. Any views we expressed on the likely effect of the changes though were necessarily tentative and anecdotal.

Now that we know that the changes to taxation of non-doms are going ahead and what their content will be, it is possible to be less speculative and we wondered whether the effect on tax take is likely to be positive, as the government predicts, or negative.

This report has been produced for Irwin Mitchell Private Wealth by the Centre for Economic and Business Research (Cebr) and analyses the latest statistics and research available in relation to the numbers of non-doms and the tax contributions they make to the UK economy. The research shows that there is a tipping point at which the reforms will have a negative impact on the UK economy. Will that be realised?

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Executive summary

This report for Irwin Mitchell examines the impact of the changes to the tax regime for people who have a foreign domicile ('non-doms') on public finances.

The changes were announced at the Summer Budget 2015 and are due to be implemented in April 2017. The research is conducted using data from a freedom of information request sent to Her Majesty's Revenue and Customs (HMRC), data from the Office for National Statistics (ONS), predictions from the Office for Budget Responsibility (OBR) and Cebr's analysis.

The key findings of the report are:

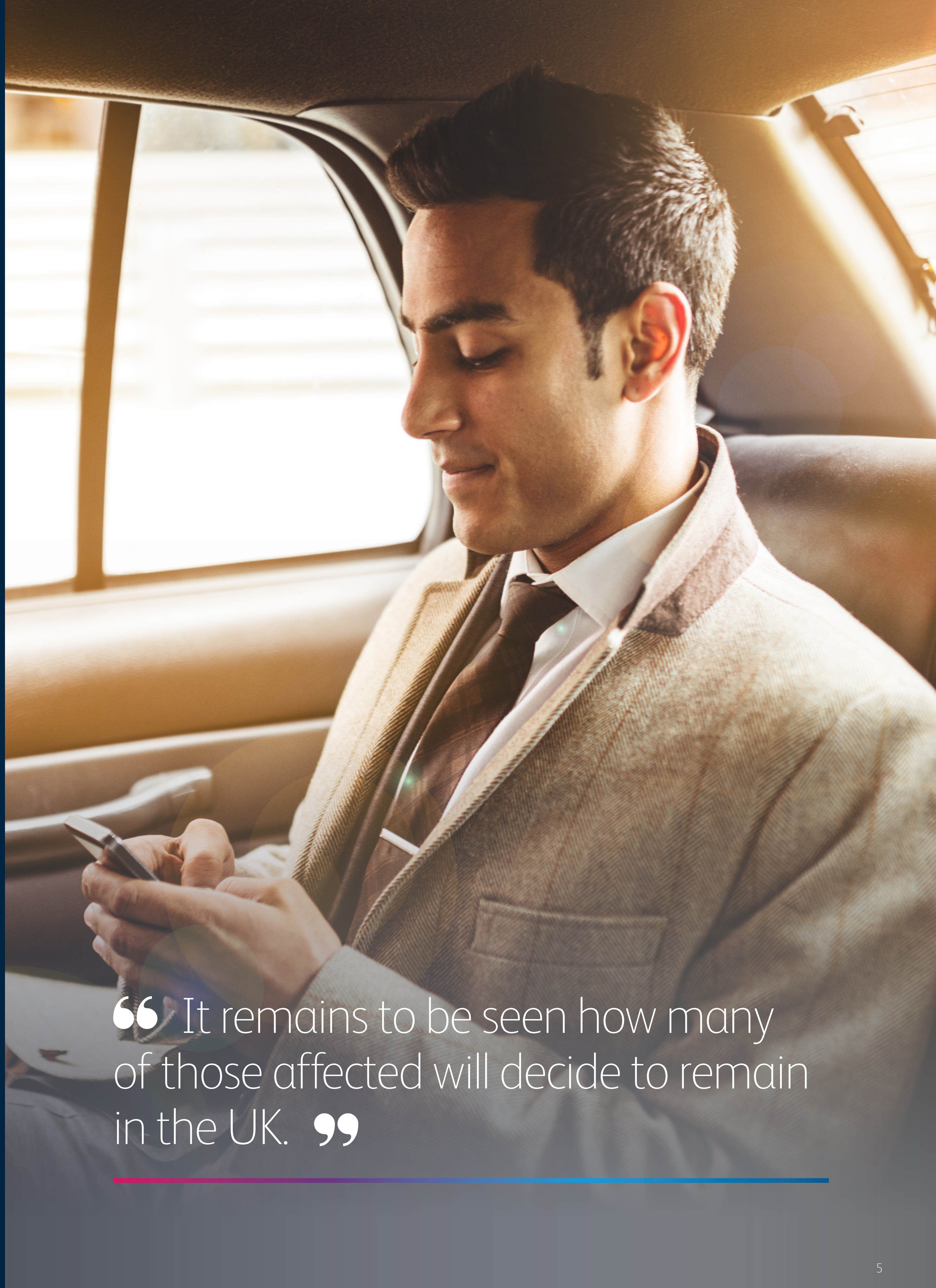
There has been a growing number of individuals claiming non-dom status in recent years. Although the number fell after the introduction of a remittance basis charge for non-doms who have resided in the UK for some time, it has risen from 113,250 in 2011-12 to 119,260 in 2014-15.

However, the number of non-doms is predicted to fall sharply following the implementation of changes to the tax regime applying to long-term resident non-doms. We expect the number of individuals claiming non-dom status to fall from 122,708 in 2016-17 to 107,895 in 2017-18.

Non-doms make a notable contribution to overall UK tax receipts. At roughly £58,000, an average non-dom pays 18 times more income and capital gains tax than the average UK earner. In other words, it takes 2.1 million average UK earners to generate the same amount of tax that 119,260 non-doms contribute.

The Office for Budget Responsibility projects that the changes to non-dom taxation will generate an additional £995 million over the next four years. In order for the OBR's target to be met, individuals who are directly affected by the non-dom reform will have to generate £2.6 billion in tax revenues until the tax year 2020-21. This equals £256,411 per individual per year.

We calculate that if fewer than 38 % of the individuals who currently pay the highest remittance basis charge but will lose their non-dom status leave the UK, the net revenue impact of the reforms will be positive. However, if more than 38 % leave, the reform could have a negative effect.



> The decision on whether or not to leave a country is influenced by many other factors such as economic and political stability, a functioning health system, education, national security and of course personal preference.

Introduction

The differentiation between the UK taxation of UK domiciled and non-UK domiciled individuals goes back to 1914, when David Lloyd George, later Prime Minister of the UK, introduced the principle of the application of UK tax to all income of UK residents, regardless of where such income arose.

However, the government recognised the fact that some business people would reside in the UK only temporarily while their long-term affiliation was to a different country and felt it was unfair to tax them in the same way as permanent residents. The government conceded that "the citizen of the Empire who [...] is not domiciled in this country" would be exempt from the new tax.

In the Summer Budget 2015, the government announced changes to tax rules for individuals who are not domiciled in the UK. It argued that, while the majority of non-doms who come to the UK leave within a few years and will therefore not be affected by the reform, individuals who choose to live in the UK for a long time should pay a" fair" share of tax[1].

Non-doms are defined as UK residents who have their permanent home ('domicile') outside the UK. Under the current UK tax regime, while non-doms have to pay UK tax on UK income and gains, if they claim the 'remittance basis' of taxation, they will only pay UK tax on their foreign income and gains if they are brought to (remitted) to the UK. The remittance basis of taxation is not available to UK domiciled individuals.

In order to claim the remittance basis in relation to their foreign income and capital gains, non-doms must either have less than £2,000 of such income or gains of £2,000 in a year or complete a self-assessment tax return that includes a claim to the remittance basis and reports their UK income and foreign income and capital gains that they have remitted to the UK, so that they can be taxed. In order to claim the remittance basis, non-doms must pay a remittance basis charge of a minimum of £30,000 per year if they have resided in the UK for a certain amount of time. Non-EU non-doms who claim the remittance basis lose their UK tax-free personal allowance.

The non-dom tax changes announced by the government affect non-doms who have been resident in the UK for at least 15 of the past 20 years. After 5 April 2017, they will be deemed UK domiciled for all tax purposes. As a result, they will no longer be able to use the remittance basis of tax and their foreign and UK assets will be subject to inheritance tax (IHT).

This report analyses the absolute and relative contributions that non-doms make to the UK economy and investigates the likely effects of the change to the tax rules for non-doms described above.

[1] https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles/reforms-to-the-taxation-of-non-domiciles

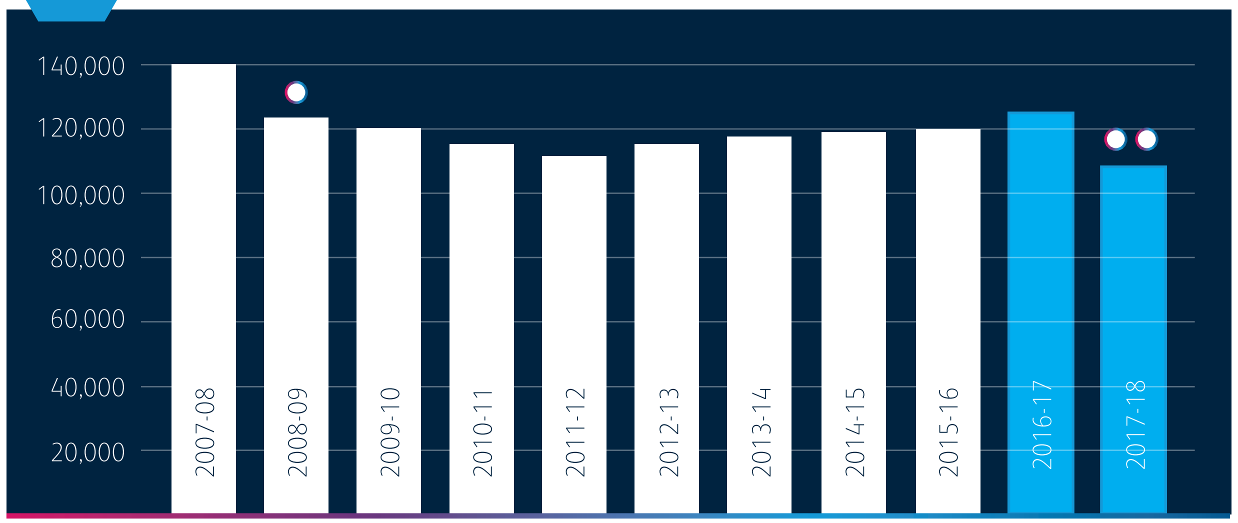
Contribution of non-doms to the UK economy

Non-dom UK residents make a significant contribution to the overall public finances in the form of income and capital gains tax paid.

While a large proportion of non-doms pay tax on all of their income and capital gains around the world, there are also a considerable number of individuals electing to be taxed on the remittance basis.

An estimated 140,000 UK resident individuals claimed non-dom status in 2007-08. In 2008, the government introduced a minimum annual charge of £30,000 to use the remittance basis for individuals who have resided in the UK for seven of the prior nine years. On the introduction of this charge, the number of individuals claiming non-dom status dropped to 123,100 in the following year and to 113,250 in 2011-12. More recently, the number of non-doms has risen steadily to 119,260 in 2014-2015.

Figure 1 Number of individuals claiming non-dom status in a Self-Assessment tax return



○ Introduction of basis charge in 2008
○○ New non-dom reform, from April 2017

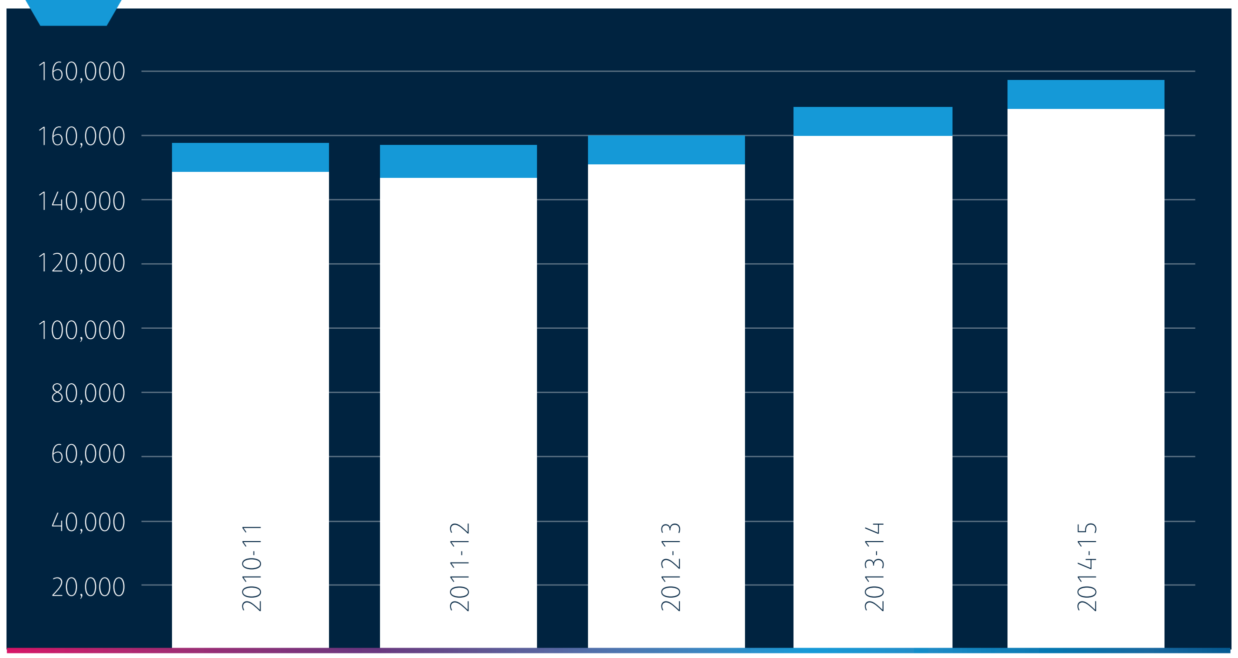
Source: HMRC, Cebr analysis (shaded bars are Cebr forecasts)

Since the introduction of the initial **£30,000** basis charge, several amendments to the way non-doms are taxed have been made.

Individuals who have been resident in the UK for at least 12 of the previous 14 years used to have to pay an annual charge of £50,000 and this charge was increased in April 2015 to £60,000. A new charge of £90,000 was also introduced for those living in the UK for at least 17 of the past 20 years.

Latest figures show that 4.2% of the 119,260 self-declared non-doms paid a remittance basis charge in 2014-15 in order to use the remittance basis, generating revenue of £226 million. This figure was largely unchanged from the prior two tax years[2] (£229 million in 2012-13 and £225 million in 2013-14). It is plausible to assume that individuals paying the remittance basis charge in order to keep their non-dom status would have to pay a higher amount of tax if they had to pay tax on all of their income and capital gains worldwide. However, those 119,260 non-doms in 2014-15 generated income and capital gains tax of £6.9 billion, accounting for roughly 4% of total income and capital gains tax receipts received by the UK government[3]. Let us now put these numbers in context. In 2014-15 every non-dom contributed an average of £58,108 in income and capital gains tax which compares to £3,183 per UK average earner[4]. One non-dom therefore contributes as much as around 18 average earners. In other words, **2.1 million** UK average earners are equivalent to **119,260 non-doms** in terms of tax revenue generated.

Figure 2 UK income and capital gains tax generated, £ million



■ Amount of income + capital gains tax paid by non-doms, £ million
□ UK income + capital gains tax revenue, excl. non-doms, £ million

Source: HMRC, Cebr analysis

Table 1 UK income and capital gains tax generated, £ million

	UK income + capital gains tax revenue, excl. non-doms, £ million	Amount of income + capital gains tax paid by non-doms, £ million	Total
2010-11	150,613	6,430	157,043
2011-12	149,722	6,500	156,222
2012-13	154,900	6,630	161,530
2013-14	162,261	6,920	169,181
2014-15	169,004	6,930	175,934

Source: HMRC, Office for National Statistics, Cebr analysis

[2] HMRC data show that in 2014-15, 1,310 individuals paid an annual charge of £30,000 while 3,730 individuals paid an annual charge of £50,000

[3] Income and capital gains tax receipts for the tax year 2015-16 amounted to £179 billion (data from Office for National Statistics)
[4] Assuming an average annual income of £25,915 (2015, data come from Office for National Statistics)

Potential consequences of the tax reform

Policy changes can often have a significant impact on businesses, households, individuals and the wider economy.

This section analyses the potential impact of the reform to the taxation of non-doms on the wider economy. Specifically, we estimate the impact on government tax revenues under two different scenarios. The first scenario assumes that the reform leads to a decline in the number of non-dom individuals paying tax in the UK and claiming non-dom status for tax purposes, while the second scenario assumes ongoing steady growth in the number of non-doms.

Alongside the 2016 Budget, the Office for Budget Responsibility (OBR) published an independent projection of public finances over the next years. Those forecasts include information on the impact of the non-dom tax reform. While the OBR predicts only a minor positive effect of the changes for the tax year 2017-18, it expects an extra income of £395 million in 2018-19 and a total increase of £995 million between 2017-18 and 2020-21.

Table 2 OBR's forecast of the effect of the non-dom changes, in £ million

		16-17	17-18	18-19	19-20	20-21
Non-doms: abolish permanent status	Tax, in £ million	0	-20	+395	+310	+310

Source: Office for Budget Responsibility

Although it is difficult to forecast exactly how many individuals will be affected by the non-dom tax changes, we predict that the number of non-doms claiming the remittance basis will rise slightly over the current tax year but drop sharply over 2017-2018 after the tax changes are implemented in April 2017. The last time major changes were made (the introduction of a remittance basis charge in 2008), the number of claiming non-dom status fell by 12 %. We predict a decline of a similar magnitude under the new reform. This means that 15,000 people will no longer claim non-dom status for UK tax purposes. However, the majority of these people not have been using their non-dom status to claim the remittance basis. The tax paid by this majority will therefore not be affected by the tax changes.

However, there is likely to be a significant impact on the numbers of and tax paid by non-doms who have been claiming the remittance basis.

Available data from HMRC[5] shows that in 2011-12 there were 5,560 individuals paying a remittance basis charge of £30,000. After the introduction of the £50,000 remittance basis charge in April 2012, of the 5,120 individuals paying the remittance basis charge in 2012-13, 1,360 (or 32 %) paid the lower charge of £30,000 while 3,760 (or 68 %) paid the higher charge of £50,000. In the absence of available data for the proportion of individuals paying the highest £90,000 remittance basis charge in 2015-16, we estimate that 68 % of those individuals who paid a £50,000 charge in 2014-15 moved into the higher bracket in the following year. This follows the trend that was observed after the £50,000 charge was introduced in April 2012.

We therefore estimate that 2,522[6] individuals paid an annual charge of £90,000 in 2015-16 and we assume that these individuals will be directly affected by the reform i.e. they will cease to be able to claim the remittance basis after 5 April 2017.

In order to estimate the potential effects of the government's reform on non-doms over the OBR's forecast horizon we created two scenarios.

Table 3 UK income and capital gains tax generated, £ million

Tax Year	Number of individuals who paid £30,000 charge	Number of individuals who paid £50,000 charge	Number of individuals who paid £60,000 charge	Number of individuals who paid £60,000 charge	Total revenue from remittance basis charge (£m)
2010-11	5500	N/A	N/A	N/A	165
2011-12	5560	N/A	N/A	N/A	167
2012-13	1360	3760	N/A	N/A	229
2013-14	1290	3730	N/A	N/A	225
2014-15	1310	3730	N/A	N/A	226
2015-16*	1310	N/A	1208	1208	339

*Cebr estimate

Source: HMRC, Cebr analysis

Scenario 1: In the first scenario, the introduction of the reform in April 2017 results in a decline in the number of individuals claiming non-dom tax status during the tax year 2017-18. Specifically, we predict that by 2020-21 there will be 13,805 fewer non-doms compared to 2016-17. We also assume that a large proportion of the 3,730 individuals that paid the higher annual remittance basis charge will be directly affected in the tax year 2017-18. We assume that tax will be lost only from a proportion of them, which we estimate at 2,522 individuals in number, who are currently paying the highest remittance basis charge and will therefore lose their non-dom tax status. They will not be able to claim the remittance basis of taxation from 2017 and may therefore remove themselves and their assets from the UK tax system by leaving the UK.

Scenario 1 furthermore assumes that in the years following the reform, non-dom numbers return to marginal growth[7]. Under scenario 1, tax income generated by non-doms falls from an estimated £7.3 billion in 2016-17 to £7.2 billion in 2017-18. Total tax income created by non-doms is estimated to amount to £29.3 billion between 2017-18 and 2020-21[8].

[5] See table 3

[6] 68 % of the 3,730 individuals that paid the highest remittance basis charge in 2014-15
[7] We assume that the number of non-doms increases by 0.3 % per year (average annual change between 2010-11 and 2016-17)
[8] See Table 4 for annual breakdown

Scenario 2: We also created a scenario under which the reform does not result in a decline in the number of individuals claiming non-dom status. Under this scenario, there would be an additional 5,615 individuals claiming non-dom status by 2020-21. Importantly, all of the 2,522 directly affected current non-doms would pay tax on all of their income and capital gains around the world. Tax income generated by non-doms would amount to £7.4billion under scenario 2.

In order to compare the two scenarios, tax income generated by the 2,522 individuals is included in table 4, although technically it would not count as non-dom tax income anymore, as those individuals will lose their special tax status.

Assuming that the tax income generated by non-doms in scenario 2 follows the existing trend, they would generate £30.9 billion in tax income between 2016-17 and 2020-21.

Table 4 UK income and capital gains tax generated in scenarios 1 and 2

	Tax income generated by non-doms (income + capital gains), in £ billion		Potential difference in tax income generated by non-doms
	Scenario 1	Scenario 2	
2016-17	7.3	7.3	0.0
2017-18	7.2	7.4	0.2
2018-19	7.3	7.6	0.3
2019-20	7.4	7.8	0.4
2020-21	7.4	8.0	0.6
Sum 2017-18 – 2020-21	29.3	30.9	1.6

Source: HMRC, Cebr analysis

The difference between the accumulated incomes from both scenarios over the forecast horizon (2017-18 – 2020-21) stands at £1.6 billion[9] and represents the potential shortfall the Treasury could be facing if all of the directly affected individuals (2,522) stop paying any UK income tax.

We have learnt that the OBR forecasts an overall benefit of £995 million under the new measures until 2020-21[10].

[9] £30.9 billion from scenario 2 minus £29.3 billion from scenario 1
[10] See table 2

Therefore an additional tax income of £2.6 billion[11] would have to be generated by the Treasury in order to meet the OBR's projections.

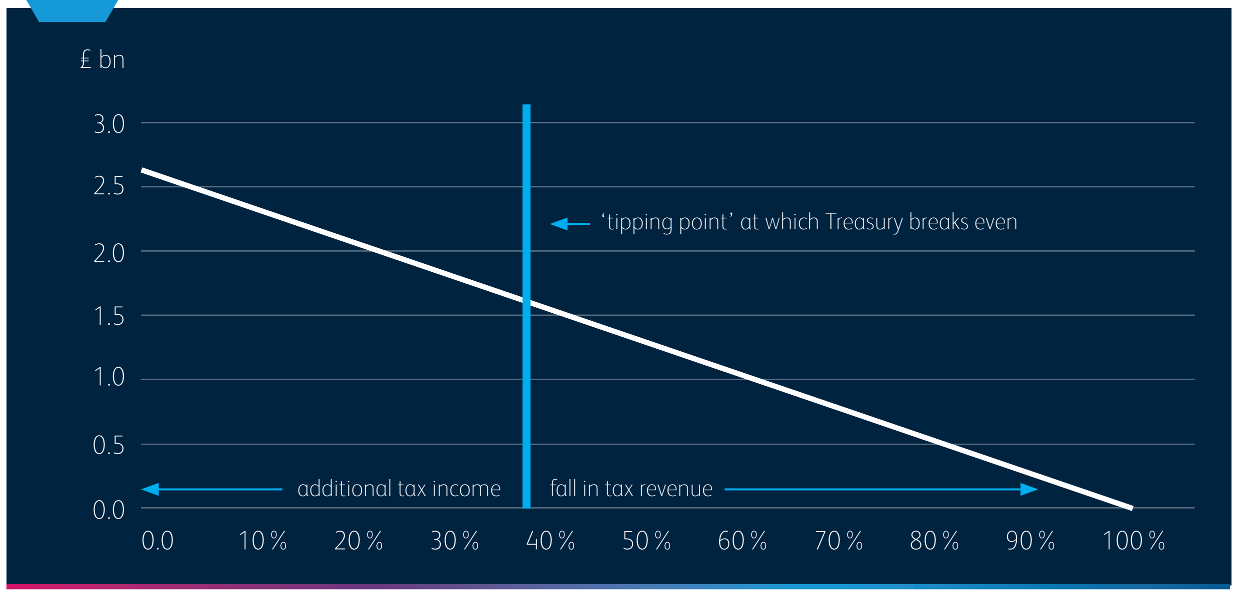
We have estimated the number of non-doms who will be adversely affected by the tax changes at 2,522. Our analysis shows that each of these 2,522 individuals will have to pay income tax amounting to £1,025,643 over the analysed period in order to meet the OBR's forecast[12], on the basis that the OBR projects the alteration of the non-dom tax rules will generate additional revenue for the Treasury of £995 million until 2020-21. On an annual basis, each individual would have to pay an average of £256,411 in tax for the OBR to meet its projections.

We assume that if 100 % of the individuals who will be directly affected by the change (2,522) decide to stay in the UK and pay UK tax on all their income and capital gains around the world, the OBR will meet its target of generating additional revenue of £995 million. However, if 100 % of those individuals leave the UK, the Treasury would miss out on £1.6 billion in tax generated by non-doms over the analysed period (or £0.4 billion per year, on average) compared to scenario 2, under which all of the affected individuals remain in the UK[13].

Using our analyses, we calculate a 'tipping point' of non-doms leaving the UK at which the Treasury would break even despite missing the OBR's projection. As described above, we only account for those individuals that have used the highest remittance basis before the reform to the taxation of non-doms.

The calculations show that this 'tipping point' is at 38 % (see figure 3). In other words: If 959 previous non-doms who used to pay the highest remittance basis charge, but have lost their status under the new reform leave the UK, the Treasury would break even. If less than 959 people decide to leave, the government will gain additional tax revenue and if more than 959 individuals vacate the UK, the Treasury could actually make a loss.

Figure 3 'Tipping point' at which new reform would lead to decline in tax revenue



% of non-doms deciding to leave the UK as a result of the tax reform

Source: HMRC, Cebr analysis

[11] If the 2,522 individuals that are directly affected by the reform, decide to leave the UK, the Treasury could miss out on £1.6 billion in tax revenue between 2017-18 and 2020-21. However, the OBR predicts extra income of £995 million. Therefore, £2.6 billion (£1.6 billion + £995 million) would have to be generated.
[12] We divided the £2.6 billion needed to meet the OBR's forecast by the number of non-doms directly affected by the reform (2,522)
[13] See table 4 for annual tax income under the two scenarios

Besides the direct effect of a loss of non-doms on tax revenues, there are also some potential indirect adverse impacts. As a group, non-doms pay billions of pounds of tax and have a substantial combined spending power. Moreover, it is well documented that some of these individuals are among the UK's richest people[14]. It is therefore plausible to assume that a fair proportion of those individuals likely to lose their non-dom status spend considerably more than the average UK household.

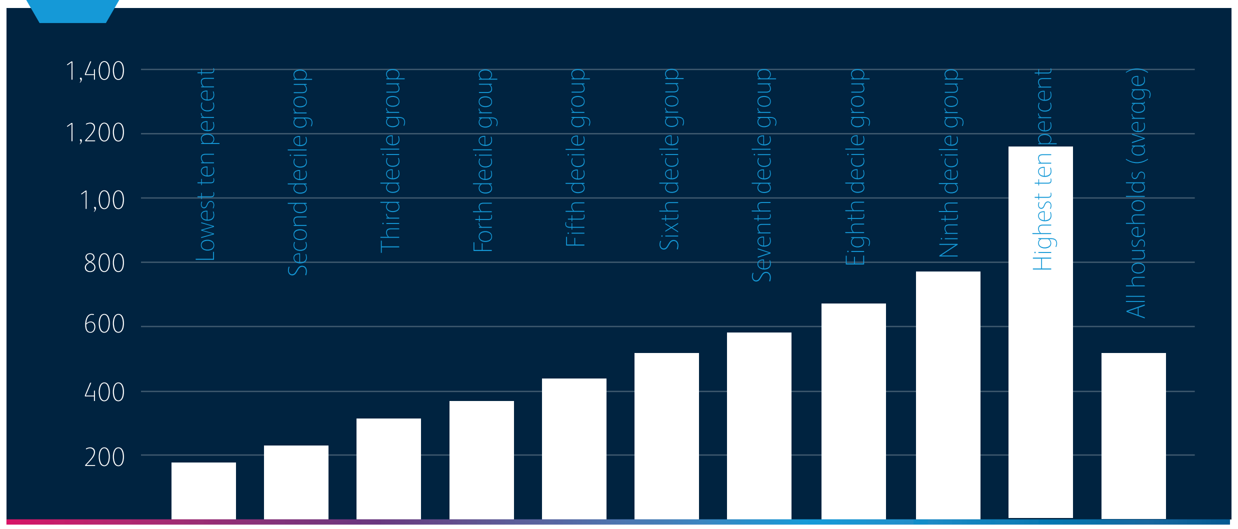
Data from the ONS highlight that in terms of household spending, the highest ten percent of households by income group spend six times more than the lowest ten percent. However, this ratio varies significantly for different commodities and services. Generally, the more inelastic the demand for a good or service, the smaller the difference in spending between the lowest and the highest ten percent of income groups.

The term **inelastic** is used to describe a situation in which the demand for a good or service is largely unaffected by a price change.

Food and non-alcoholic drinks such as milk, potatoes and tea are examples of inelastic goods as a price change will lead to a proportionally small change in the quantity consumed. While the lowest ten percent of households in terms of income spend £30 a week on food and non-alcoholic drinks, the highest ten percent spend "only" three times as much. For elastic goods and service that are not essential to households, however, this ratio between the lowest and highest income groups is a lot higher. Elastic goods and services are not essential to a household and include luxury items, such as jewellery and new cars. For example, the highest ten percent spend 43 times more on new cars than the lowest ten percent and 23 times more on accommodation services such as hotels.

Figure 4 shows that the average UK household spends £531 a week on goods and services. The highest ten percent spend considerably more (£1,156) while the lowest ten percent spend on average just £190 a week. The exodus of a large proportion of these individuals could therefore have far reaching consequences and result in lower consumer spending. This effect is larger for items for which demand is price elastic.

Figure 4 UK household expenditure by disposable income decile group



Source: Office for National Statistics, Cebr analysis

[14] See for example: http://www.managementtoday.co.uk/ditching-non-doms-may-lose-uk-money-its-right-thing/article/1341864 and https://www.theguardian.com/politics/2015/apr/08/non-dom-donors-who-has-given-money-to-which-parties

Conclusions

The research presented in this report shows that there has been a growing number of individuals claiming to be non-doms in recent years, contributing a notable amount of tax income to overall UK tax receipts.

Latest figures from HMRC show that there were 119,260 non-doms in 2014-15, up from 113,250 in 2011-12. The analysis also highlights that at £56,012, one non-dom pays 18 times more income tax than the average UK earner (£3,183). However, the introduction of the non-dom reform in April 2017 is likely to result in a decline in the number of non-doms of up to 15,000, thereby leading to a decline in the overall amount of income and capital gains tax received from this group. We estimate that 2,522 individuals will be directly affected by the reform as they currently pay the highest remittance basis charge.

The OBR expects these changes to lead to an overall increase in tax revenue over the next four years. We estimate that those individuals who are predicted to lose their non-dom status will have to generate roughly £256,411 in each of the next four years (2017-18 – 2020-21) in order for the OBR to meet its forecast.

Under the assumption that the OBR would meet its forecast if all non-doms that will lose their status decide to stay in the UK, we calculated a 'tipping point'. The 'tipping point' shows the percentage of current non-doms that could leave the UK after losing their status without having a negative effect of tax revenue. We found that this point is at around 959 people. If more than 959 people decide to leave, the Treasury will make a loss from the non-dom tax reform, but if less than 959 people leave, tax receipts will be higher than they would have been under the current regime.

Disclaimer

Authorship and acknowledgements

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