

Foreign aspects of IHT

Synopsis: The relevance of domicile, situs of assets and double tax relief for IHT.

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Domicile

Domicile is a concept of general law, which is extended for the purposes of inheritance tax (IHT).

Broadly speaking, a person is domiciled in the country of their permanent home. Domicile is distinct from nationality or residence. A person may be resident in more than one country, but at any given time can be domiciled in only one (although it is possible to be 'deemed' domiciled in the UK despite having a legal domicile elsewhere – please see below). A person acquires what is known as a domicile of origin at birth.

In England and Wales, this is normally the father's domicile (domicile follows the mother in the case of illegitimacy) and so not necessarily the country of birth. A person retains this domicile until a different domicile is acquired - a domicile of choice or a domicile of dependence.

The domicile of a married woman is not necessarily the same as her husband's. It is decided by reference to the same factors as in the case of any other individual capable of having an independent domicile. Prior to 1 January 1974, the rules in England on this were different.

For this reason, where, immediately before 1 January 1974, a married woman had her husband's domicile by dependence, she retains that domicile until it is changed by the acquisition or revival of another domicile. From the same date, any person in England, Wales or Northern Ireland who is married or over sixteen years of age is capable of acquiring an independent domicile.

In Scotland, the Family Law (Scotland) Act 2006 abolished the status of illegitimacy from Scots law, and s.22(2) now provides that a child (a person under the age of 16) shall be domiciled in the same country as the child's parents or, if not applicable (e.g. if parents are domiciled in different countries or the child has home with neither parent), the child is domiciled in the country with which they have for the time being the closest connection. From age 16, the child can acquire a different domicile of choice.

To acquire a domicile of choice, a person must sever all ties with the country of their domicile of origin and settle in another country with the clear intention of making their permanent home there. Being long-term resident in another country is not enough in itself to prove that a person has acquired a domicile of choice there, unless it can be regarded as indicating intention. There has to be evidence of a firm intention to live there permanently.

Such evidence may include establishing a business there, voting there, acquiring citizenship, making a local will and burial arrangements and having family there.

Registration and voting in the UK as an overseas elector will not be taken into account in determining whether an individual is domiciled in the UK, unless the taxpayer wishes such an action to be taken into account.

If a domicile of choice is abandoned, the domicile of origin is revived and will continue until another domicile of choice is established.

Deemed domicile

Prior to 6 April 2017, the concept of deemed domicile only existed for IHT purposes and provided that a person who was not domiciled in the UK under general law was treated as domiciled in the UK at the time of a transfer if...

- They were domiciled in the UK within the three years immediately preceding the transfer;

or

- They were 'resident' in the UK in at least 17 of the 20 income tax years of assessment ending with the year in which the transfer is made.

For tax years 2017/18 onwards, a person who is not domiciled in the UK under the general law, will nevertheless be deemed to be UK domiciled for all tax purposes (i.e income tax, capital gains tax (CGT) and IHT) if certain conditions are satisfied.

Different conditions apply to income tax and CGT rules and to IHT.

For IHT purposes, an individual will be deemed UK domiciled if at the time of the transfer they...

- Were domiciled in the UK within the three years immediately preceding the transfer;
- Are a formerly domiciled resident in the tax year in which the transfer falls;
or
- Were resident in the UK for at least 15 out of the 20 tax years immediately prior to the tax year of the transfer, and for at least one of the four years ending with the tax year of the transfer.

A formerly domiciled resident is a person who...

- Was born in the UK with a UK domicile of origin;
- Has subsequently become domiciled abroad; and
- Is UK resident for at least the tax year in which the transfer falls as well as for one out of the two tax years preceding tax years.

Under the new rules, long-term residents of the UK will therefore become deemed domiciled a year sooner than they would have done under the previous position and the rules have been tightened for those returning to the UK.

'Resident' has the same meaning as for income tax purposes.

Example

Andrew, who is non-UK domiciled, became resident in the UK in 2003/04. He remains continuously resident but retains his foreign domicile (in the usual legal sense) throughout. Andrew will have been deemed to be UK domiciled for IHT purposes on 6 April 2018 (i.e. in his 16th year of UK tax residency)

Since 6 April 2013, spouses and civil partners domiciled outside of the UK who have UK domiciled spouses/civil partners have been able to elect to be treated as domiciled in the UK for IHT purposes thereby enabling them to benefit from the unlimited spouse/civil partner exemption.

The new provisions were introduced by Finance Act 2013 and are now contained in section 267ZA IHTA 1984.

An election is irrevocable so long as the spouse/civil partner making the election remains UK resident for tax purposes. Therefore, the downside of making an election is that, from the date of the election, the worldwide assets of the otherwise non-UK domiciled spouse/civil partner will be subject to IHT.

The election will cease to have effect if the elector subsequently becomes non-UK resident for four successive tax years. In such circumstances, their non-UK assets will fall outside of the scope of IHT after the end of the fourth year of non-residence, provided that the IHT deemed domicile rules do not continue to treat them as UK domiciled for IHT purposes.

An election may be made by a non-UK domiciled individual either during the lifetime of their UK domiciled spouse/civil partner (a "lifetime election") or following the UK domiciled spouse's/civil partner's death (a "death election").

Generally, death elections must be made within two years of the spouse's/civil partner's death (although HMRC has discretion to extend this period).

Territorial scope

Non-settled property

If a donor is domiciled, or deemed to be domiciled, in the UK, IHT applies to their property wherever it is situated. If they are domiciled abroad, the tax applies only to their property in the UK - S6(1) IHTA 1984.

The tax does not however apply to 'excluded property'.

'Excluded property' is, broadly, property that is situated outside of the UK and some specific UK assets listed below with the exception, since 6 April 2017, of shares in

an offshore company or trust interests which derive their value from UK residential property.

Settled property

Settled property situated in the UK is within the scope of the tax.

However, IHT does not apply to settled property situated outside the UK unless the settlor was domiciled, or deemed to be domiciled, in the UK when the settlement was made - S48(3) IHTA 1984; or – since 6 April 2017 – the settled property derives its value from UK residential property.

This means, for example, that shares in an offshore company – even if transferred to trustees at a time when the settlor was neither domiciled nor deemed domiciled in the UK - will not be ‘excluded property’ (and may therefore be subject to IHT ten-yearly and exit charges) to the extent that those shares derive their value from a UK residential property.

The charge to tax does not depend upon the domicile of a life tenant, or of the beneficiaries of a discretionary trust.

It should also be noted that if someone with a UK domicile of origin acquires an overseas domicile and sets up an offshore trust while non-UK domiciled, once that individual becomes UK resident (and so becomes a ‘formerly domiciled resident’ – please see above) the assets in that trust will not qualify as excluded property and so could be liable to IHT charges if, for example, a ten-year anniversary occurred while the settlor met the definition of a formerly domiciled resident.

Since the residence criteria will be based on the statutory residence test where individuals are either resident or non-resident for the whole year, this could create situations in which property will switch from being excluded property to being liable to IHT under the “relevant property” regime for periods of one or more tax years and trustees will therefore need to consider whether a ten-year anniversary charge arises at any point during each period the settlor is UK resident.

Situs of assets

Whether or not property is situated in the UK is determined in accordance with general law subject to any special provisions in a double taxation agreement. The following outline sets out the normal rules for the more common types of asset...

- Rights or interests in or over immovable property and chattels are situated where the property is located.
- Coins and bank notes are situated wherever they happen to be at the time of the transfer.
- Registered shares or securities are situated where they are registered.

- Bearer securities are situated where the certificate of title is located at the time of the transfer.
- Goodwill is situated where the business to which it is attached is carried on.
- An interest in a partnership is situated where the partnership business is carried on.
- Debts are situated where the debtor resides.

A life insurance policy is treated as a debt. When the policy is written “under hand” the policy monies are situated where the debtor (company) is resident (generally the head office of the company).

Policies written under seal (i.e. impressed with the seal of the company and signed) are “specialty debts” locally situated where the policy document is found at the time of the transfer, e.g. if the policyholder keeps a policy document written under seal in their home in Australia, then that is where the policy is situated when the policyholder dies.

- Bank accounts are situated at the branch where the account is kept.

Government securities

Certain British Government securities are exempt from taxation if owned by persons who are not domiciled in the UK. They are then excluded property, so that no IHT is chargeable on them - S6(2) IHTA 1984.

If such securities are settled property, they are not excluded property unless...

- The individual beneficiary entitled to an interest in possession in them is not domiciled in the UK;

or

- If no such interest in possession subsists, all past, present and future potential beneficiaries are not so domiciled.

For the purposes of this provision 'domicile' means domicile under general law and does not have the extended meaning given to it for IHT purposes (S267(2) IHTA 1984).

Authorised unit trusts and OEICS

Finance Act 2003 extended the class of asset which qualifies as excluded property to include holdings by non-UK domiciled investors in OEICs and authorised unit trusts (section 6(1A) to IHTA 1984).

An equivalent provision (S48(3A)) exists to provide a similar exemption for holdings in authorised unit trusts or open-ended investment companies held in

trust provided the settlor was domiciled outside the UK when the settlement was made.

Visiting forces and staff of allied headquarters

Emoluments and tangible movable property of members of visiting forces (other than British citizens, British Dependent Territories citizens or British Overseas citizens) and certain staff of allied headquarters are exempt as excluded property - S155 IHTA 1984.

Periods spent by such persons on duty in the UK are disregarded in determining whether a transferor is resident, domiciled or deemed to be domiciled here for the purpose of the tax.

Foreign currency bank accounts

Balances on non-sterling accounts with the Bank of England, the Post Office or an 'authorised institution' within the meaning of the 1987 Banking Act held by...

- An individual not domiciled or resident in the UK,

or

- Trustees not domiciled or resident in the UK on behalf of such an individual with an interest in possession in the account provided that the settlor was not domiciled in the UK when they made the settlement,

are excluded from the tax charge on death - S157 IHTA 1984.

Double taxation relief

Where a transfer is liable to IHT and also to tax imposed by another country, relief may be available under a double taxation agreement or under 'unilateral' provisions - S159 IHTA 1984.

The UK has a number of bilateral Double Taxation Agreements for taxes on estates, gifts and inheritances. Their purpose is to relieve any double taxation, which would otherwise result if each of two states has the right under its law to tax the same property when a death occurs or a gift is made.

Where unilateral relief is allowed, credit is given against UK tax for the tax charged by another country on property situated in that country.

For this purpose, the location of the property is determined by UK law. If the tax charged on that property by the other country exceeds the UK tax on that property, the credit is limited to the amount of that UK tax.

Credit is given where both the UK and another country impose tax on...

- Property situated in a third country;

or

- Property which is situated both in the UK under UK law and in the other country under that country's law.

In these cases, the credit is for a proportion of the tax. The proportionate credit is computed by the formula...

$$(A / (A+B)) \times C$$

Where...

- A = the IHT
- B = the overseas tax
- C = the smaller of A and B

Notice of creation of a lifetime offshore settlement

Any person, other than a barrister, who in the course of a profession or trade has been concerned with the making of a lifetime settlement, and that person knows or has reason to believe that the settlor was domiciled in the UK for IHT purposes, and the trustees are not resident in the UK, is obliged, by virtue of S218 IHTA 1984, to make a return to HMRC.

This return must be made within three months of the making of the settlement and must state the names and addresses of the settlor and trustees.

The trustees are regarded as non-resident if the general administration of the settlement is carried out overseas and if the trustees, or a majority of them, are non-resident.

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