

## **Changes to the taxation of non-UK domiciled individuals - inheritance tax**

Synopsis: The detail of the reforms to the taxation of non-UK domiciled individuals as set out in the technical guide published alongside the Autumn Budget. We look at the inheritance tax impact for long-term resident individuals and settlors of excluded property trusts. This is the first of a series of three papers examining the reforms.

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Historically, the extent to which IHT has applied to a person's estate has been based on their domicile status with UK domiciles being subject to UK inheritance tax (IHT) on worldwide assets; and non-UK domiciles being subject to UK IHT on their UK situs assets only.

The concept of deemed domicile (which applied only for IHT purposes until and was then extended to all taxes from that date) has meant that those resident in the UK over the long-term (15 out of the last 20 years since) have been treated in the same way as UK domiciles for IHT purposes.

Non-UK domiciles who were resident but not deemed domiciled in the UK could settle their 'excluded property' (essentially their non-UK assets but also authorised unit trusts and OEICs) into trust prior to becoming deemed UK domicile and this excluded property would then remain outside of the UK IHT net regardless of any future changes to the settlor's domicile status.

This meant that the excluded property would not be included in the estate of the settlor (who would typically be a beneficiary of the trust) as a gift with reservation, even if he died domiciled or deemed domiciled in the UK; and the excluded property would also not be subject to IHT periodic and exit charges even if the trust was a discretionary or post-2006 interest in possession trust.

### **Position from 6 April 2025**

From 6 April 2025, the concept of domicile will cease to exist for tax, including IHT, purposes and a new system of taxation based on residence status will apply. For main features of the new regime as it applies to IHT are as follows...

- The test for whether excluded property (whether held outright or within a trust structure) is within scope for UK IHT will depend on whether the taxpayer/settlor is a 'long-term resident' at the material time;
- A 'long-term resident' ('LTR') for IHT purposes is someone resident in the UK for at least ten out of the last 20 tax years immediately preceding the chargeable event;
- Someone who is an LTR at the point of their death will be subject to UK IHT on their worldwide assets regardless of their domicile status. Likewise, someone who transfers non-UK assets into a discretionary trust at a time

when they are an LTR will make an immediately chargeable transfer for IHT purposes;

- Trusts established by LTRs – regardless of whether the settlor was an LTR at the time of establishment – will also be in scope for UK IHT. This means that if a chargeable event – such as death or a tenth anniversary – occurs at a time when the settlor is an LTR, the trust assets (even if non-UK situs) will be included in the settlor’s estate as a gift with reservation if the chargeable event is death and the settlor is a possible beneficiary under the trust; and the trust assets (even if foreign situs) will be subject to a periodic charge if the chargeable event is a ten-year anniversary.
- Settled assets may therefore come in and out of charge depending on the residence status of the settlor from time to time and IHT exit charges may apply where trust assets cease to be relevant property as a result of a change in LTR status of the settlor. For example, if someone who was non-UK domiciled when they established the trust (pre-April 2025) but who is now UK deemed domicile ceases to be an LTR post 6 April 2025, an IHT exit charge will apply. A similar situation could arise where an individual, who establishes e.g. a discretionary gift trust holding an offshore bond at a time when they are both UK resident and domiciled, ceases to be an LTR because they retire abroad.

### **Exceptions for certain trusts**

- Where the trust settlor dies before 6 April 2025 and was domiciled outside the UK when the trust was established, the trust will not be subject to the relevant property regime for the duration of its existence provided that it contains to hold excluded property;
- Where the trust assets comprised excluded property before 30 October 2024, no gift with reservation will arise on death of a settlor who is an LTR at the date of their death (although the trust will still be subject to the relevant property regime);
- Where a settlor dies after 6 April 2025, the excluded property status of the trust going forward will depend on the settlor’s residence position at the point of his death. If the settlor was not an LTR at the date of his death, non-UK situs assets will be excluded property – and so not subject to the relevant property regime – for the duration of the trust.

### **LTR status**

As mentioned above, a LTR for IHT purposes is someone resident in the UK for at least ten out of the last 20 tax years immediately preceding the chargeable event.

However, for IHT purposes the term ‘long-term resident’ also includes someone who leaves the UK after having acquired LTR status. The length of time that they remain in scope for UK IHT will depend on how long they were resident in the UK before leaving...

- Those resident in the UK between ten to 13 years before leaving, remain in scope for three tax years;
- This then increases by one tax year for each additional tax year of UK residence. For example, someone resident in the UK for 15 years before leaving, remains in scope for five years; whereas someone resident in the UK for 17 years, remains in scope for seven years.

Someone who is resident outside of the UK for ten full tax years and then returns to the UK has their 'clock reset'.

Transitional rules apply for non-domiciled or deemed domiciled individuals not resident in the UK in 2025/26. These individuals will be LTRs only if they satisfy the existing 15 out of 20 deemed domicile test and are or have been resident for a least one of the last four consecutive tax years ending with the relevant year.

Residence status for a tax year is determined in accordance with the Statutory Residence Test (SRT), although where an individual has split year treatment under the SRT, this will count as a year of UK tax residence for IHT purposes.

### **Other IHT considerations**

**Lifetime transfers** – the test for whether a lifetime transfer is in scope for IHT is the status of the property/transferor at the date the transfer is made. If when the gift is made, the transferor is not an LTR and the assets transferred are excluded property, the gift will not be brought into account for IHT on death within seven years even if the transferor is by that point an LTR.

Similarly, if the transferor is within the scope of IHT when the transfer is made, the usual rules for calculating tax/additional tax on the failed transfer will apply on death within seven years even if the transferor has ceased to be an LTR by that point and the property transferred was foreign property.

**Spouse exemption and election** - Where an individual is UK domiciled and their spouse or civil partner is non-domiciled, transfers of value are only exempt from IHT up to a limit equal to the current nil rate band (£325,000). Since 17 July 2013, the non-domiciled spouse or civil partner of a UK domiciled individual has been able to elect to be treated as deemed UK domiciled for IHT purposes.

This would mean that they were then subject to UK IHT on their worldwide assets, but they would be able to benefit from an uncapped spouse/civil partnership exemption which would be useful if, for example, their UK domiciled spouse/civil partner pre-deceased them. Once made, an election cannot be revoked but will cease to have effect when the electing individual leaves the UK and is non-resident for four consecutive tax years.

From 6 April 2025, the election rules will continue to allow a spouse or civil partner of a LTR who is not themselves a LTR to elect to be treated as such for IHT purposes, but with an amendment that lengthens the time that the electing spouse

or civil partner will remain within the IHT net after ceasing to be non-resident to ten years.

### **Comment**

The new residence-based regime certainly has the advantage of simplicity – and determining someone’s residence status – and therefore their exposure to UK IHT – will be easier than determining their domicile status in many cases.

While the exemption from the gift with reservation rules for excluded property trusts settled before Budget Day will be welcomed by non-doms planning to remain UK resident for the foreseeable future; advisers will need to be mindful of the fact that clients’ trusts may slip in and out of the relevant property regime – potentially giving rise to exit charges that might be unexpected – as their long-term residence position changes.

This may be difficult to monitor, especially in cases where UK domiciled, UK resident individuals have set up discretionary trusts holding offshore bonds without any expectation that the assets may become excluded property if they, for example, retire overseas!

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