UK IHT planning for non UK residents

Effective planning is essential to minimise the impact of this potentially substantial levy

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Raising tax on gifts or estates is neither universal nor, in the countries where it occurs, popular. To many, it seems to be an unacceptable further levy on assets which have already suffered tax and many countries have abandoned the idea. The UK, though, still clings to the concept of Inheritance Tax (IHT) and it is likely to survive even the change of Government which is expected to occur within the next year.

But what is it? And could it affect you? If you have no connections of any sort with the UK, do not live here and do not have any UK-sited property (for example, land, or shares in UK companies) then you will be relieved to hear that the tax is unlikely to affect you.

But if you have UK connections or investments, live here (or intend to come to the UK) or have property here, you may find that some or all of your assets are subject to IHT. And, as it is levied at a flat rate, after allowances, of 40%, it can seriously affect your family's wealth.

It is important to bear in mind that the tax is mis-named. It is not a tax on inheritance. Where it applies, it is charged on what a person owns at the date of his death and what he or she has given away in the previous seven years. It is also charged on any asset given away at any time since 1986, where the deceased continued to enjoy the benefit of the property he or she has given away. Such gifts are called gifts with reservation of benefit. A transfer into a trust during one's lifetime can also attract the tax, although the rate then would be 20% rather than 40%, with a top up to 40% if one does not survive the transfer by seven years.

A major criterion for the application of the tax is that it applies to UK property only – unless (and this is a crucial proviso which sometimes has unexpected results) the deceased or donor was "domiciled" or "deemed domiciled" in the UK. In that case it is charged on all assets worldwide.

These words "domiciled" and "deemed domiciled" have a deceptively simple ring to them. Domiciled sounds like residence, so if you are not resident in the UK, you may think you are outside the scope of the tax, unless you have UK-sited assets. But you might be wrong.

The concept of domicile broadly comes down to the idea of "home being where your heart is". If you are UK domiciled, it will potentially affect not only your tax status, but the rules that apply if you die with (or without) a Will, or if you marry, divorce, or, for example seek custody or adoption of a child. In other words, in UK law your domicile is what determines which country's rules for private individuals and families you are most closely connected with.

In many jurisdictions, that would be determined by your citizenship or nationality. But domicile is quite distinct from both of those concepts. It is quite possible to be a citizen of one country, a national of another, resident in a third and still domiciled in the UK. You start off with a domicile of origin – based on your father's domicile at the time you were born. You can choose to change your domicile, and whether you have done so or not would depend on numerous factors which go to build up a picture of which country you are most closely associated with.

So, if, like the fictitious retired tennis champion, Roger Nadal, you were born in Spain of Swiss parents and you live most of the time in the US, educate your children there, intend to be buried there (when the time is right) but spend two months of every year in UK, you are not likely to be regarded as domiciled here in the UK.

On the other hand, if you were born in the UK you might have to work harder to shake off your UK domicile of origin.

And there is also the somewhat sneaky concept of “deemed domicile”. This is a concept which exists only for IHT. It does not apply to other UK taxes or to family matters or Wills. You can be actually non-domiciled in the UK but still “deemed domiciled” here. And that will happen if you have been resident in the UK for 17 out of 20 of the last UK tax years (6th April to 5th April). So if Roger Nadal had lived in the UK within the last twenty years and had not been non-UK resident (usually judged by the rules applicable for UK income tax purposes) for at least four tax years, then his worldwide assets will still be caught in the UK IHT net on his death.

The starting point for calculating the tax when someone dies is that the first £325,000 of the estate is free of tax. The word “estate” includes all real and personal property and, as mentioned above, gifts made within the seven years prior to death and gifts with reservation of benefit. There are exemptions and reliefs where it is a charity which received the gift or legacy. Currently only UK registered charities benefit from the exemption but, as a result of a recent European court ruling, that is expected to be widened to include some non-UK charities. Gifts or legacies to spouses are also free of tax, subject to the tax status of the couple involved. If you and your spouse do not have the same UK tax status advice should be taken to establish the correct position. Gifts to a civil partner under the UK’s Civil Partnership Act are treated as gifts to a spouse but unless the partnership is one registered under the Act, again advice should be taken.

Where the assets are business property (only trading businesses and not, for example, investment companies) or UK agricultural property (again likely to be widened to include some non-UK assets) there is some relief from IHT but the reliefs are not straightforward or necessarily what one would expect.

So how can you avoid UK IHT if, say, you want to buy property in the UK to use on an occasional basis? A combination of buying the property through an offshore company and holding the shares in the company in an offshore trust, is worthwhile to minimise UK IHT, subject to the value of the property justifying the expense of the structure. For lower value properties buying it in joint names with your spouse or another member of the family can ensure that the IHT threshold is not exceeded.
Or if you are planning to come to live more permanently in the UK, you can shield your worldwide assets by putting them into a trust before you come. Assets which are not sited in the UK and which are in a trust set up by someone (called the Settlor) who was not domiciled or deemed domiciled in the UK at the time they set the trust up, are excluded from IHT, even if the Settlor can benefit from the trust and even if he or she subsequently becomes UK domiciled or

deemed domiciled.

Other simple steps, such as having one’s bank account offshore, will keep the balances out of the range of UK IHT unless and until one becomes UK domiciled or deemed domiciled.

There are other steps which can be taken to reduce the impact of IHT and other taxes, although one should always be aware of the impact of any arrangements for any taxes in the country in which you live or of which you are a citizen.

If you are not used to a concept of a tax on death it can be difficult to envisage how it works, and many taxpayers in the UK find the interaction between IHT and CGT (Capital Gains Tax) confusing. This is partly because capital gains tax (which is broadly a tax on the increase in value in an asset which one has disposed of) can apply to gifts, as well as IHT. So it is possible to pay both IHT and CGT on the same gift.

Another cause for confusion is that it is the tax status of the person making the gift which determines whether these taxes apply, and the relevant tax status is different for the two taxes. For CGT, the relevant criterion is whether you are resident or ordinarily resident in the UK, whereas for IHT as indicated above it is all a question of domicile.

Whatever arrangements one makes, taking timely advice well before you move to, or invest in the UK, can make a very significant difference to your UK tax bill.

And it is also worth bearing in mind that a failure to account for tax in the UK is a criminal offence which can bring one under the purview of the stringent anti money laundering regulations. So getting good professional advice can not only save you tax, but it can also protect you from embarrassing and potentially costly mistakes.

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This article is not intended to be a full summary of the law and advice should be sought on all issues.