Charlton House
WEALTH MANAGEMENT

UK Inheritance Tax Guide

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In 2017/18, estates in the UK paid the highest ever amount of Inheritance Tax (IHT), with the latest figures showing the bill totalled £5.4 billion.

UK Inheritance Tax is a notoriously complicated tax, governed by many rules and regulations. In this guide we will explain the basics of the UK's Inheritance Tax system and how this applies to UK connected individuals.

The basics of the United Kingdom (UK) Inheritance Tax (IHT)

Put simply, the key basic points of the UK's inheritance tax system are as follows:

- The UK IHT rate is typically 40% of your chargeable estate, although this can be reduced to 36% if you gift over 10% of your estate to charity
- The extent to which your estate is liable to IHT depends upon your domicile status and the location of your assets upon death
- There are two inheritance tax free bands available – firstly there is a £325,000 per person nil rate band which everyone is eligible for (although this can temporarily be lost!) and a further £175,000 'Residence nil rate band' if the individual owns a main residence and gifts this to a direct descendant at death (however it is easy to fall foul of the rules regarding this tax band and it will begin to be tapered away once an estate is worth over £2m).
- Some assets are exempt from inheritance tax
- An individual can make gifts during their lifetime to reduce the size of their assets however they typically have to live for 7 years after the gift I made for their estate to be fully reduced for inheritance tax purposes.
- Gifts and transfers between spouses / civil partners are free from inheritance tax, unless the receiving spouse is non-UK domiciled
- Gifts to registered charities and political donations are free from inheritance tax, during your lifetime or upon death

The Nil Rate Band (NRB)

All individuals are eligible for a Nil Rate Band in which they do not pay Inheritance Tax on the first £325,000 on their chargeable estate. If not fully used at death, the full or remaining NRB can be inherited by the spouse/civil partner of the deceased.

If an individual has made a lifetime gift and does not survive for seven years after the gift was made, then this gift will begin to use the NRB before it can be applied to the chargeable estate on death.

Residence Nil Rate Band (RNRB)

An additional Inheritance Tax free band called the Residence Nil Rate Band (RNRB) is available to individuals who pass their main residence onto their direct descendants, such as their children (including foster, adopted and stepchildren) and grandchildren.

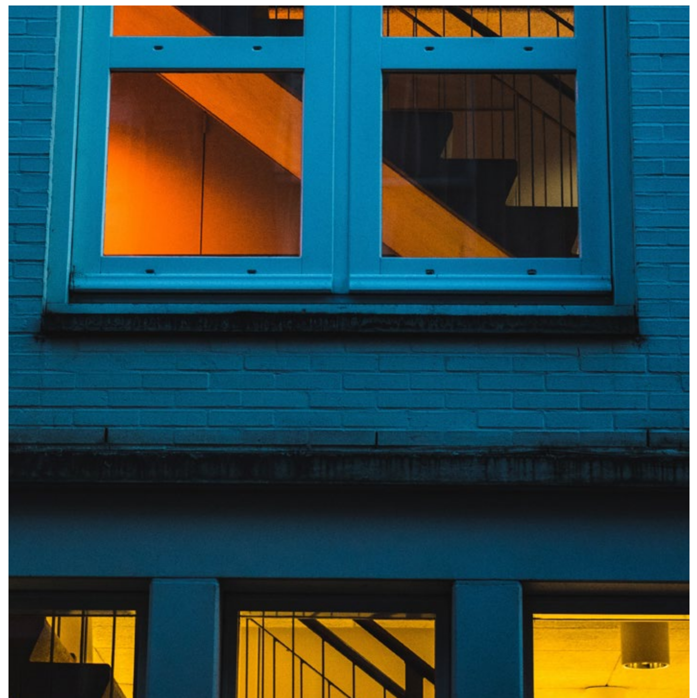
This band is worth up to £175,000 and applies on top of the NRB. The RNRB will be reduced at a rate of £1 for every £2 worth of chargeable estate over £2 million and therefore an individual with an estate over £2.35 million will not be eligible for the RNRB.

Again, the RNRB can be transferred or inherited by a surviving spouse/civil partner.

Lifetime Gifts

You can make certain gifts free from Inheritance Tax implications during your lifetime, as follows:

- Gifts between spouses/civil partners – these are always free from Inheritance Tax as long as both spouses have the same domicile i.e. both UK domiciled or both foreign domiciled (the same also applies upon death). A gift from a non-UK domiciled spouse to a UK domiciled spouse is also fully free for Inheritance Tax purposes.
- Gifts from a UK domiciled spouse to a non-UK domiciled spouse are free up to £325,000. This limited spousal exemption for transfers to non-UK spouses is only available once, so once used, will no longer be available. Any gifts above this will be 'potentially exempt transfers', where the seven-year rule will apply (see the section below).
- Combined gifts which total up to £3,000 per tax year (6th April to 5th April) e.g. three gifts of £1,000 to three separate individuals. You can carry back your unused allowance for one tax year. This is called your annual exemption.
- £250 per individual to as many individuals as you wish per tax year (if you have not used any other exemption for that individual).
- Wedding or civil ceremony gifts of up to £1,000 per person (£2,500 for a grandchild or great-grandchild, £5,000 for a child).
- Normal gifts out of your income, for example, Christmas or birthday presents - you must be able to maintain your standard of living after making the gift.
- Payments to help with another person's living costs, such as an elderly relative or a child under 18. This also includes payments made for the purpose of educating a child.
- Gifts to charities and political parties.



Potentially Exempt Transfers (PET)

Any gift to an individual or a bare trust for which an exemption (see previous page) does not apply will be classed as a Potentially Exempt Transfer (PET). An individual does not need to pay any tax upon making this gift and no limits apply to the amount which can be gifted.

Chargeable Lifetime Transfers (CLT)

A gift made to a relevant property trust such as a discretionary trust will be classed as a Chargeable Lifetime Transfer (CLT). An individual can gift up to £325,000 to a relevant property trust (every seven years) without paying any tax charges. However, if this limit is exceeded an immediate 20% lifetime tax charge will apply to any excess above £325,000.

The seven-year rule

Both PETs and CLTs will remain in your estate for Inheritance Tax purposes for seven years from the date of the gift. Where the donor dies between three and seven years from the date of the gift, any Inheritance Tax which becomes payable can be reduced by taper relief (the value of the transfer does not reduce, therefore, a £325,000 gift would still use up the full NRB available even in year six of the gift). Taper relief is given at 20% increments for each year from year three onwards.

It is important to note that any beneficiary of a gift may need to pay Inheritance Tax themselves on gifts made to them in the last seven years, even if they have already spent the money or tied it up in property.

Gifts with reservation of benefit

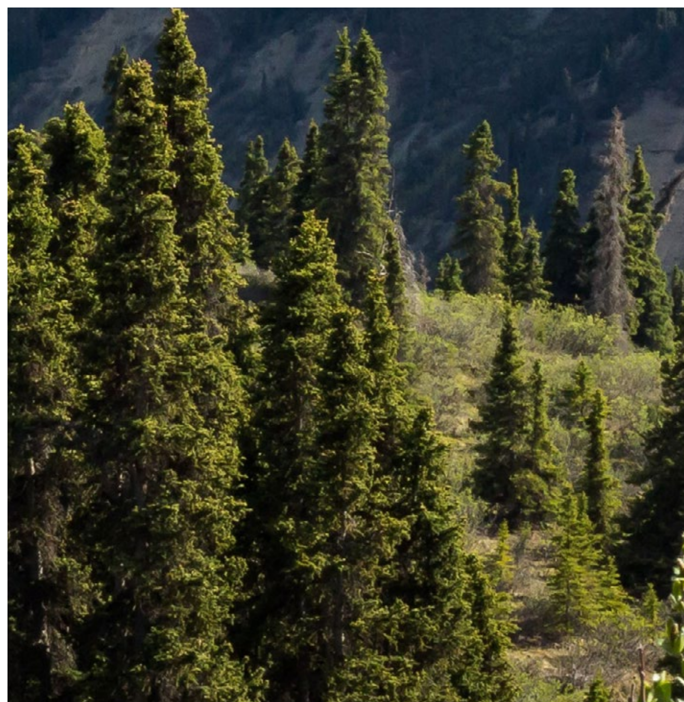
The gift with reservation of benefit rules apply when an individual gifts an asset to another person but continues to enjoy some benefit from the asset themselves.

An example would be where an individual gifts a property to another person but they continue to live in the property for free. In this scenario, the donor will be deemed to have made a gift with reservation of benefit and therefore the gift will be deemed to still be inside their estate for Inheritance Tax purposes (the length of time of the gift does not matter).

One way to mitigate this issue in this scenario would be for the donor to pay the recipient the market rental value.

Which assets are exempt from Inheritance Tax?

- Some business assets, including shares in privately-owned companies are fully outside the remit of Inheritance Tax if they have been held for at least two years. This is called Business Relief (previously called Business Property Relief). This also includes shares in some UK AIM-listed companies.
- An individual can pass on some types of agricultural property free of Inheritance Tax, either during their lifetime or as part of their will.
- Heritage assets – such as buildings and art of outstanding importance.
- Monies held in most UK registered pension schemes.
- Monies held in a discretionary trust, as even if you are the beneficiary of the trust you are not technically the owner of the assets held within the trust.
- Overseas assets (non-UK) for non-UK domiciles (more on this later in the guide).



What does ‘domicile’ mean?

For internationally mobile individuals, the question over your domicile can be complex to answer and we would always advise speaking to a specialist to help assess this.

In this section of the guide, we will provide basic guidance about what domicile means and the types of domicile. The below is based on the HMRC’s viewpoint on domicile and should be used for guidance purposes only.

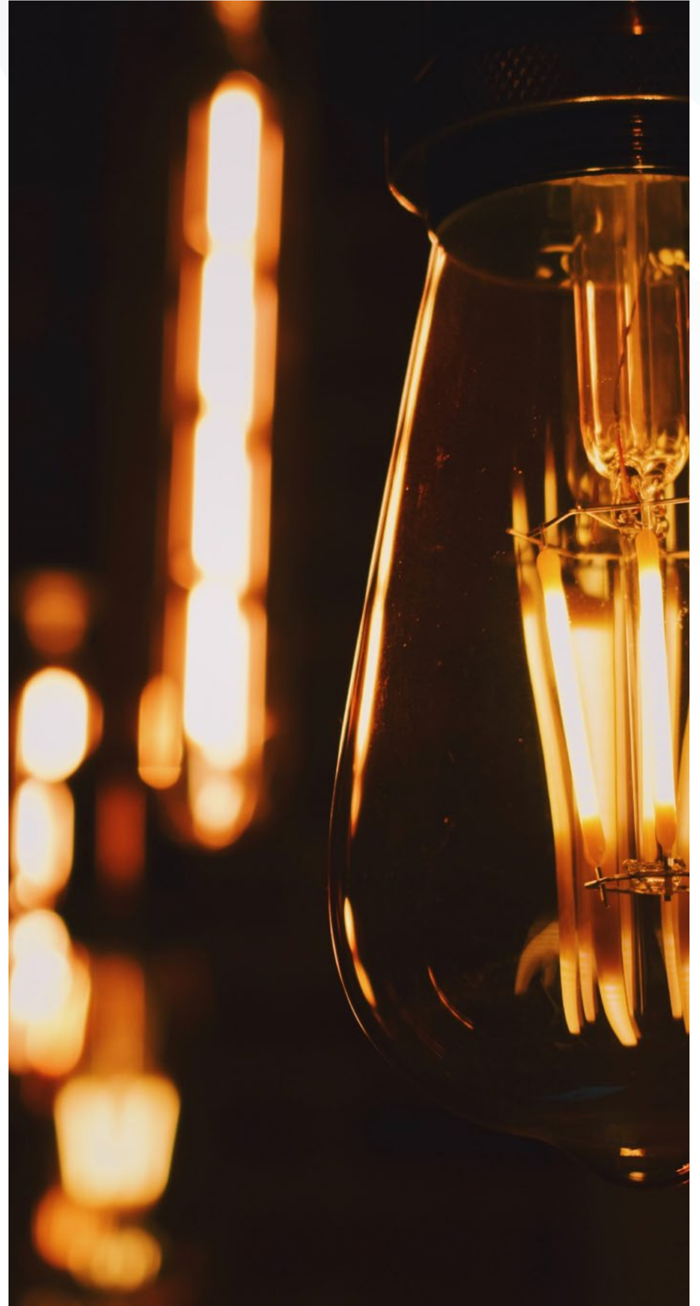
HMRC states that an individual’s domicile status is decided under general law, which means it must be interpreted according to previous rulings of the courts. There are many things which affect a person’s domicile and some of the main points are:

- You cannot be without a domicile
- You can only have one domicile at a time
- You are normally regarded as domiciled in the country where you have your permanent home
- Your existing domicile will continue until you acquire a new one
- Your domicile is distinct from your nationality, citizenship, and your residence status, although these can have an impact on your domicile.

There are different types of domicile. The most relevant types of domicile for Inheritance Tax purposes are as follows.

Domicile of origin

You normally acquire a domicile of origin from your father when you are born. Your domicile of origin will often be the country in which you were born. However, if you were born in a country and your father was not domiciled there at the time you were born, then your domicile of origin may be your father’s country of domicile.



Domicile of choice

An individual has the legal capacity to acquire a new domicile at the age of 16. Broadly, to acquire a domicile of choice, they must leave their current country of domicile and settle in another country.

Once a person reaches age 16, they can acquire a domicile of choice if they are already living in a country other than that of their domicile of origin, and intend to remain there permanently or indefinitely.

Domicile of dependence

Until you have the legal capacity to change it, your domicile will follow that of the person on whom you are legally dependent, for example, your father. If the domicile of that person changes, you will automatically acquire the same domicile as that person. If their domicile changes your domicile of origin will become dormant.

If you are a woman who married before 1st January 1974, you would automatically have acquired your husband's domicile as a 'domicile of dependency'.

Deemed domicile

An individual who is not domiciled under English common law will be treated as domiciled in the UK for tax purposes if they meet one of two conditions.

Condition 1 – the individual:

- Was born in the UK
- Their domicile of origin was in the UK
- Was resident in the UK* for the 2017/18 tax year or later tax years.

Condition 2 – the individual:

- Has been UK resident* for at least 15 of the 20 years immediately before the relevant tax year.

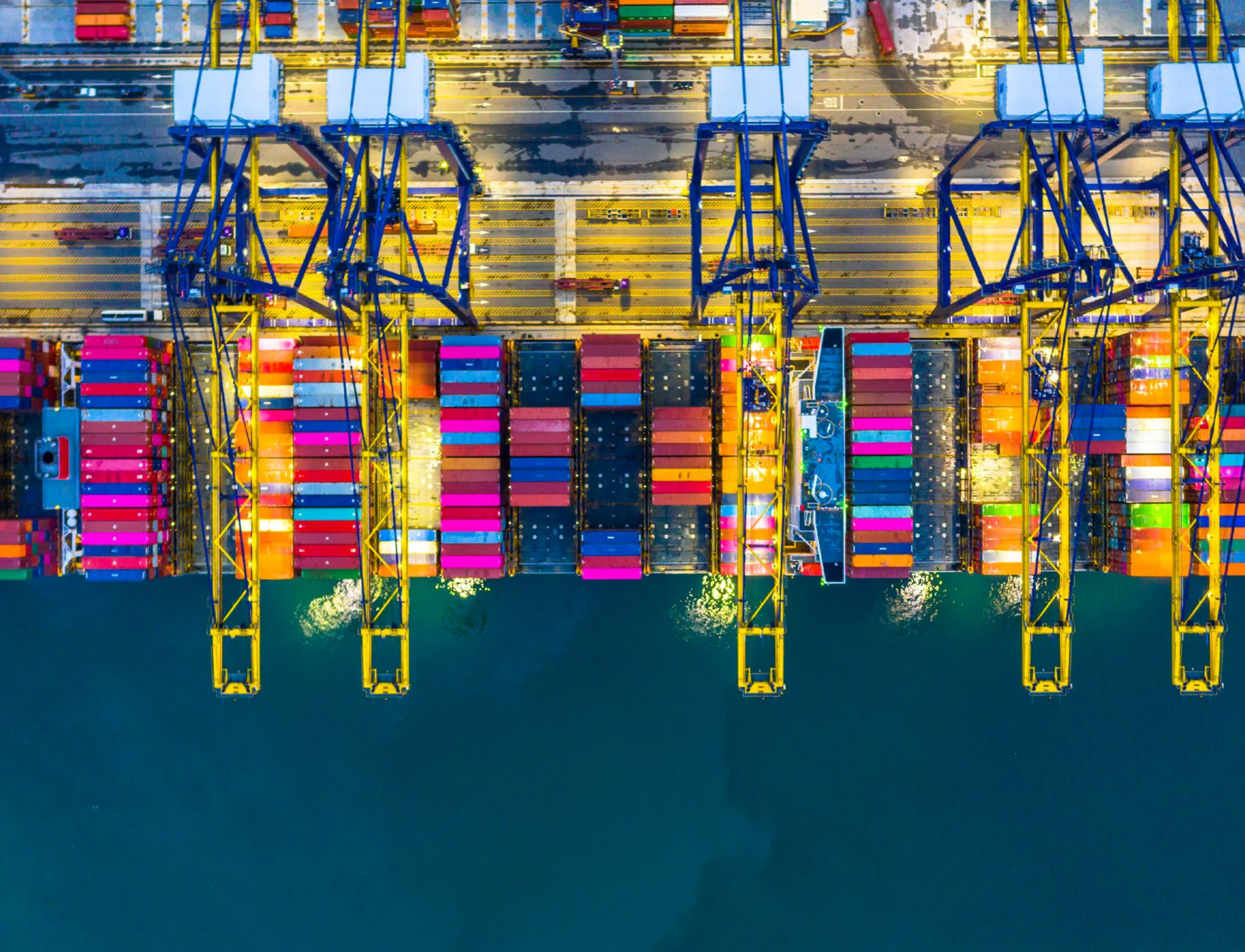
*To understand if you were resident in the UK you should refer to the Statutory Residence Test.

FAQ - Who is a UK resident?

If you are deemed to have spent more than 183 days (i.e. more than half the tax year) in any tax year in the UK, you will usually be automatically classed as a UK tax resident.

If you meet either the Automatic UK test or the Sufficient Ties test and you do not meet the Automatic Overseas test, then you will be classed as a UK resident for tax purposes.

For more detailed information on UK residency and the Statutory Residence Test please download our **'Understanding UK Residency'** guide.



Implications for UK Inheritance Tax if you are a UK resident and UK domicile

You will be caught by UK Inheritance Tax on all your non-exempt worldwide assets and gifts. You should strongly consider planning to reduce or eliminate your Inheritance Tax burden. There are a wide variety of options available to you and you should seek specialist advice on the matter.

Please see below a non-exhaustive list of some options which may be available to you:

- Arrange or review your wills to ensure you have maximised your available Nil Rate Bands
- Consider making regular gifts out of your income (ensuring this does not affect your normal standard of living)
- Use your annual and periodic small gift exemptions
- Consider lifetime gifts from capital in excess of the limited exemptions
- Assess the possibility of gifting money to charity
- Consider the use of a variety of trust structures
- If you require an income and are in good health, consider a discounted gift trust for an immediate reduction in IHT
- Assess whether other investment holding structures, such as a privately-owned company, would be beneficial
- Make contributions into a UK pension scheme or a qualifying non-UK pension scheme, if appropriate
- Invest in Business Property Relief or Agricultural Property Relief assets
- Set up a whole of life policy held in a discretionary trust.

Implications of UK Inheritance Tax if you are a UK resident, but are not UK domiciled

Rather strangely, an individual can be a UK resident and have UK citizenship but not be classed (or importantly 'deemed') a UK domicile.

You will be classed as non-UK domiciled (referred to as a 'non-dom') if you intend to cease being a UK resident at some point in the future (such as at the end of employment). However, this does have to be credible and, if challenged you or the personal representatives of your estate, will have to present good evidence to show you intended to leave the UK in the future.

Being a non-dom can be very advantageous for Inheritance Tax purposes and such a status is therefore a valuable commodity.

The main benefits for Inheritance Tax purposes of being a non-dom are:

- Your estate liable to IHT will generally be limited to the value of your UK assets as well as any non-UK assets from which a UK asset has derived its value. A typical example of this would be when an overseas asset is used as collateral to purchase a UK residential property only. As such, all other worldwide assets will not be liable to IHT.
- You will be able to access pre-exemptive domicile planning such as putting your non-UK assets into an 'excluded property trust' to ensure the assets are held outside of the scope of the UK Inheritance Tax regime even if you become a UK domicile in the future.

Aside from IHT, non-doms can also benefit from claiming the remittance basis of taxation, thereby limiting UK income and Capital Gains Tax on offshore assets.

FAQ – Are there any issues with being a UK non-dom for Inheritance Tax purposes?

A possible issue (touched upon earlier in this guide) may come about if the spouse of the 'non-dom is UK domiciled or deemed UK domiciled (therefore their worldwide assets are within the scope of UK Inheritance Tax) and passes away before the non-dom and passes their estate to their non-dom spouse or civil partner.

This is an issue as transfers between spouses (or civil partners) are usually wholly free for Inheritance Tax, however, in this instance the Inheritance Tax free limit will only be limited to the available Nil Rate Bands.

To get around this tax charge some non-doms in this situation will apply to be treated as a UK domicile and therefore will receive their spouse's estate wholly free from Inheritance Tax. However, this will mean that they will be deemed to be a UK domicile themselves which will mean they will have to pay UK Inheritance Tax on their worldwide estate when they pass away unless they can break their deemed domicile status before they die.

To help alleviate this situation, it may be suitable to set up specialist wills and/or, if possible, to place non-UK assets in an excluded property trust before the spouse becomes UK domiciled or deemed domicile.

FAQ - What is an excluded property trust?

An excluded property trust is a trust which can be set up by a person not domiciled in the UK to shelter their non-UK assets from the UK Inheritance Tax regime for if and when they become a UK domicile or deemed UK domicile.

Unlike a similar UK based discretionary trust, the person who adds the assets to the trust can be a beneficiary of the trust. The assets held in the trust remain outside of the UK Inheritance Tax regime even after the settlor's death. These trusts are sometimes also referred to as an excluded property settlement and they are typically set up as a discretionary trust.

Implications of UK Inheritance Tax if you are non-UK resident but are a UK domicile

As mentioned above in this guide, you may be a UK domicile based on your domicile of origin, your domicile of choice or your domicile of dependence.

This is clearly a very confusing topic! However, the fact is that you can be long term non-UK resident but still technically be classed as a UK domicile. So, what are the implications of being in this situation and is there anything you can do about it?

Unfortunately, even though you are non-UK resident, as you are a UK domicile your worldwide assets will be within the scope of the UK's Inheritance Tax regime. You may also have to pay taxes in the country in which you are resident, however a double taxation treaty may exist which will prevent your estate being taxed twice.

You should either seriously consider planning to reduce or eliminate your UK Inheritance Tax burden or you may consider trying to change your domicile of choice so that you are no longer a UK domicile.

You would need to genuinely have the intention of permanently settling somewhere else and there are many considerations that need to be taken. Obtaining a domicile of choice is not an easy thing to achieve in the eyes of HMRC!

FAQ – Can I change my domicile to become a non-UK domicile?

Yes, you can change your domicile of choice (although you can never change your domicile of origin) to a non-UK country. You will need to settle permanently in a new country and must have no intention of ever returning to the UK.

HMRC may be fairly sceptical if you have only just moved to a new country, even if you can show evidence that the move is permanent. However, if you have lived and worked in the new country for a long period of time then it is more likely HMRC will accept that your new domicile of origin is outside of the UK.

HMRC will consider many aspects of your situation before accepting your new domicile of origin. Here are a few examples:

- Have you sold your UK property and bought a property in the new country, or at least is your most substantive property now in the new country and how does it compare to your UK property(s)?
- Have you moved your family to the new country – how much of your family has moved with you?
- How much time do you spend in the UK and what is the purpose of your visits?
- Where have you made your will?
- Where do you have any business interests, investments and bank accounts? (Note – you are allowed to retain UK based assets etc. as well access UK-based professionals such as accountants and financial advisers to deal with your UK financial and tax matters)
- Do you have many social connections in your new country or are your social connections still in the UK?
- What nationalities do you hold?

It is important to note that for Inheritance Tax purposes, you will remain "deemed domiciled" for a further three years from the time you acquire a new domicile of choice.

Implications of UK Inheritance Tax if you are a UK resident, with a non-UK domicile of origin but who has been deemed a UK domicile for tax purposes

Even if you are a non-UK domicile, you may also be deemed to be a UK domicile for tax purposes. This is usually due to long-term residence in the UK.

Unfortunately, even though you are non-UK domicile as you are deemed as a UK domicile for tax purposes, your worldwide assets will be within the scope of the UK's Inheritance Tax regime. You may also have to pay taxes in the country you are classed as domicile within, however, a double taxation treaty may exist which will prevent being taxed twice on the same asset.

You should either seriously consider planning to reduce or eliminate your UK Inheritance Tax burden or, if appropriate, you may consider trying to lose your deemed domicile status.

Implications of UK Inheritance Tax if you are a non-UK resident, a non-UK domicile and are not deemed UK domicile

There is a common misconception that if you have no 'connections' to the UK i.e. you are not UK resident and not UK domicile (whether legally domicile or just deemed domicile) then you will not be within the scope of the UK's Inheritance Tax regime. This is generally correct unless you happen to own UK assets.

Some UK assets are exempt from IHT for non-doms, including UK gilts (government bonds), holdings in UK unit trusts and even UK bank accounts holding foreign currency. However, assets that are subject to IHT for a non-dom include most commonly UK property (even if owned through an offshore company) as well as GBP held in a UK bank account and UK listed shares, even if those shares are custodied offshore.

You may also have to pay taxes on your UK and non-UK assets in your domicile or country in which you reside. A double taxation treaty may exist to ensure you do not pay taxes twice on your UK assets. This is a complex matter and, if you are in this situation, we would always recommend that you speak to a professional adviser.

FAQ - Can I lose my UK 'deemed' domicile status?

If you have been deemed domicile under 'condition 2' (see the deemed domicile section of this guide) and wish to lose your UK 'deemed' domicile, you will typically have to have spent at least six tax years outside of the UK in the last 20 tax years (before the relevant year the assessment is made) or by not being a UK resident for the last four tax years (ending with the relevant year).

You must be very careful to ensure you remain a non-UK resident during the time period required to lose the deemed domicile status. You should refer to **our guide** for more information regarding assessing UK resident status.

Double taxation treaties

Sometimes also referred to as double taxation agreements, these agreements are set up between two countries and detail how tax should be paid if income or wealth (in the case of Inheritance Tax) would be due to be taxed separately in both countries party to the agreement, if no agreement were in place.

The aim of the agreement is to ensure that an individual does not have their income and wealth taxed twice which even the tax authorities of many countries deem to be unfair treatment.

If a double taxation agreement does not exist between the UK and another relevant country, then an individual may get some UK Inheritance Tax relief under the UK's unilateral relief provisions.

The unilateral relief provisions work by HMRC giving credit against UK Inheritance Tax for the tax charged by another country on assets sited in that country.

For this purpose, UK law determines the location of the asset. If the tax that is charged on the asset by the other country exceeds the UK Inheritance Tax payable on that asset, HMRC limit the credit to the amount of Inheritance Tax payable.

Disclaimer

The information provided in this guide is for information purposes only and to understand your individual situation and the implications of this you should always speak to a professional financial adviser.

For more information regarding UK Inheritance Tax and any related matters, please contact us by **email** or, if you would prefer to speak to us, you can reach us in the UK on +44 (0) 208 0044900 or in Hong Kong on +852 3903 9004.

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