PAYNE HICKS BEACH LLP
10 New Square, Lincoln's Inn, London WC2A 3QG

Telephone: +44 (0)20 7465 4300
Fax : +44 (0) 7465 4400
DX 40 London/Chancery Lane

IHT Liabilities of non-UK resident domicilaries

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Private Client Partners Alice Palmer and Frederick Bjørn consider the scope of the UK Inheritance Tax regime.

Gone but not forgotten.... Inheritance Tax liability of non-UK resident domicilaries

The conversation went like this:

> *'Unfortunately non-UK residents who are UK domiciled are still liable to UK inheritance tax on their worldwide assets on death'*, we explained.
>
> *'But I'm married to a Dane and have been living in Copenhagen for the best part of 30 years!'*, our client protested.
>
> *'Yes', we replied, 'but you continue to have a property in the UK, your adult children are studying there and your mother still lives there, so there is an argument that you continue to have a UK domicile'.*

The surprise expressed when confronted with this position is not uncommon - intuitively, long-term non-residents feel that they are no longer part of the UK and therefore are outside the scope of all UK taxes. However, this is a dangerous assumption to make.

The UK Inheritance Tax ("IHT") rules are based on the UK concept of domicile and provide that a UK domiciliary is liable to IHT at 40% on his/her worldwide assets. Domicile, for UK purposes, is a subjective concept which is wholly distinct from residence and the rules for which are not set down in legislation so that there is no framework from which any person can say definitively that they are, or are not, domiciled in the UK. The law is based on how the courts historically have interpreted the issue and therefore each case is dependent on its facts. Generally, a person's domicile is either the domicile of their father at the time of their birth (domicile of origin), or the domicile they acquire as a result of being resident in a particular country and having an intention to reside in that country permanently and indefinitely (domicile of choice). It is perfectly possible to be domiciled in the UK for UK tax purposes but domiciled in another country for that country's tax purposes and in this case the UK implications of being domiciled here will remain relevant.

For many long term non-UK residents the hope will be that they have acquired a domicile of choice in their country of residence (Denmark - in the case above), and are therefore outside of the IHT net (except in relation to assets situated in the UK). However, the burden of proof is on the individual

claiming to have lost their domicile of origin and it is therefore not sufficient simply to claim that the intention is to remain permanently and indefinitely in the country of residence - there must be objective supporting evidence of this. A practical difficulty is that for most people their domicile will be relevant only after they have died, by which time they are no longer in a position to stand up in court and make a persuasive case for having lost their UK domicile. Unfortunately, it is no longer possible to obtain a ruling from the Revenue during lifetime. A domicile statement may assist but may also be regarded as self-serving.

Returning to the case above, it would be difficult on this individual's death to prove that he had lost his UK domicile given the links he continues to have with the UK. Consequently, having thought that he was free of the UK IHT net it is inevitably a shock for him to learn that his worldwide estate may in fact suffer tax at 40% following his death. Initially he is consoled by his assumption that this will only be an issue on the death of the survivor of him and his wife on the ground that her estate would be eligible for spouse exemption if he died first. However, this is another incorrect assumption. Where assets of a UK domiciliary pass to a non-UK domiciled spouse there is only a limited spouse exemption of £325,000 (which is a lifetime allowance, so includes gifts) and therefore any spouse exemption available in the country of the deceased's residence would be of little or no benefit. The ability since April 2013 of the non-domiciled spouse to elect to be treated as if domiciled here so as to claim the full exemption is not an automatic panacea.

Although our client may have heard enough unwelcome news for one day, we feel obliged at the end of the meeting to point out that unless he manages to shed his UK domicile before his children reach age 16, they will face the same issues going forward as him, because they will also have a UK domicile of origin.

So, at a time when Sweden and Norway have abolished Inheritance Tax and Denmark's rates are down at 15% for assets passing to descendants (so that no, or limited, credits would be available to set off against UK tax), IHT on worldwide assets is a real cost. Not only that, but it is often overlooked that the UK rules apply even to the deceased's interest in jointly owned assets so that if our client were to die first (and owned the matrimonial home jointly with his wife), cash would need to be made available to pay the tax on his half of that home. In an extreme situation the property may even have to be sold to meet that tax!

The rate of IHT in the UK is one of the highest estate taxes in the world and the complications surrounding the vague concept of domicile means that many more are caught by the rules than one might think. However, with the right planning in both the UK and your jurisdiction of residence these issues can be planned around. We have extensive experience in advising individuals with Scandinavian links to achieve the most efficient outcome for their needs and we would be happy to advise on all aspects of UK tax and trusts.

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For advice in this area and in the event that you do not have a usual contact at Payne Hicks Beach, please contact the author Frederick Bjørn by email.

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DX 40 London/Chancery Lane
Tel: 020 7465 4300 Fax: 020 7465 4400 www.phb.co.uk

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Fax : +44 (0) 7465 4400
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