CHAPTER 17

DEEMED DOMICILE AND DOUBLE TAX RELIEF

17.1 Introduction

In this chapter we shall explore the concepts of **domicile** and **deemed domicile**, and look at how individuals receive **credit for any foreign inheritance tax** suffered. Before we do this we will recap on the significance of an individual's domicile status for IHT purposes.

If an individual is domiciled in the UK, he is **subject to inheritance tax on transfers of worldwide assets** – i.e. all assets, regardless of where they are situated. Therefore as far as a UK domiciliary is concerned, any chargeable transfers, whether during life or on death, will be subject to IHT.

The position is different for individuals who are domiciled outside the UK.

Individuals domiciled outside the UK are **only subject to inheritance tax on transfers of assets situated in the UK**. If a non-domiciled individual owns assets which are situated outside the UK, those assets are "excluded property" and are outside the scope of IHT. IHTA 1984, s.6(1)

For non-domiciliaries, only chargeable transfers of **UK situs assets** are subject to inheritance tax.

17.2 Types of domicile

Booklet HMRC 6

There are 3 types of domicile. An individual normally acquires a **domicile of origin from his father when he is born**. An individual is not necessarily domiciled in the country in which he or she is born.

For example, if a baby is born to British parents whilst they are on holiday in Australia, the child will be domiciled in the UK and not domiciled in Australia. Domicile of origin usually follows the father, although it could follow the mother or a legally appointed guardian.

A child will have a **domicile of dependency until he or she is legally capable of changing it**. A person has a legal capacity to change their domicile on reaching the age of 16. Until then, if a parent or guardian changes their domicile, the domicile status of the child automatically changes with them.

Before 1 January 1974, a woman automatically acquired the domicile status of her husband on marriage. For marriages after January 1974, this is no longer the case. It is possible for a husband and wife to have different domicile statuses, although in most cases as their permanent home will be the same, so will their domiciles.

The term "**domicile of choice**" is slightly misleading as it seems to imply that taxpayers can alter their domicile at a whim. All a taxpayer can do is **change his or her personal circumstances** in such a way so as to lead HMRC to conclude that he or she is **no longer domiciled in the UK**.

To lose a domicile of origin in the UK and establish a domicile somewhere else, the individual must **leave the UK and settle permanently in another country**. The key word here is the word "permanently". If an individual is trying to persuade HMRC that he has established a domicile of choice somewhere other than the UK, HMRC will require evidence that the individual has abandoned his ties with the UK, and settled permanently abroad.

Such evidence will include the sale of UK properties and the acquisition of property abroad, moving the centre of one's social, family and economic interests to another country, and keeping return visits to the UK to a minimum.

This failure to establish a "settled intention to permanently reside abroad" was a deciding factor in the case of *Sir Charles Clore*.

Sir Charles Clore was a very wealthy, UK domiciled individual who spent the latter few years of his life living in Monaco. Even though he was not resident in the UK and not ordinarily resident in the UK, HMRC argued, and the Courts agreed, that Sir Charles had **not formed a settled intention to live permanently** in Monaco. For this reason, when Sir Charles died, he died domiciled in the UK.

As a result, the whole of Sir Charles' worldwide assets, including substantial assets held in Jersey and Monaco, were subject to UK inheritance tax.

17.3 Location of assets ("lex situs")

TCGA 1992, s.275

The location of an asset for inheritance tax purposes is therefore very important for individuals who are **not domiciled in the UK**. For non-domiciliaries, assets situated outside the UK are excluded property, and are not charged to inheritance tax.

In many instances, the location of an asset will be obvious.

For example, assets such as **land and buildings are located for tax purposes in the place they are physically situated**. The same is true for chattels such as paintings etc, and for assets such as cash or money held in a bank account. A bank account is located in the place that the bank is located.

Shares are located where the Register of Shares is kept. For example, shares that are listed on the London Stock Exchange, are situated in the UK.

Note that shares are **not necessarily located in the country in which the company is resident for tax purposes**.

A company is resident in the UK for Corporation Tax purposes if it is "managed and controlled" in the UK. Therefore many companies whose shares are registered outside the UK, are treated as UK resident for tax purposes. However, for inheritance tax purposes, as the shares in these companies are registered abroad, the shares are regarded as foreign assets.

"Bearer shares" are situated where the relevant share certificate is located.

A debt is a chargeable asset for inheritance tax purposes. The **debt is located where the debtor resides**, (i.e. the person from whom the debt is owed). For example, if a French domiciliary is owed money by a UK individual, the debt is an asset of the estate for UK IHT, and is treated as a UK asset as the debtor lives in the UK.

Judgement debts are located where the relevant judgement is recorded. Therefore if a US citizen is owed money under a Court Judgement issued by a Court in the UK, the debt is a UK asset for IHT purposes.

Therefore if you are dealing with the inheritance tax affairs of an individual who is not domiciled in the UK, it is very important that you establish the location of each asset for IHT purposes.

17.4 Excluded property

IHTA 1984, s.6

Transfers of "excluded property" are outside the scope of IHT. Excluded property essentially means the **non-UK assets of an individual who is not domiciled in the UK**. There are some exceptions to this general rule.

(i) *S.6 IHTA 1984*

A holding in an **authorised unit trust** or shares in an **open ended investment company** (OEIC) should not be excluded property as they are situated in the UK. However, if such assets are beneficially owned by an individual who is **domiciled outside the United Kingdom**, under s.6(1A) **they will be excluded property**.

Similarly, assets such as 3½% War Loan, National Savings Certificates, Premium Bonds and National Savings & Investments Accounts are also **UK situated assets and should not be excluded property**. In this case, if they are beneficially owned by an individual who is **domiciled either in the Channel Islands or the Isle of Man**, under s.6(3), these assets are regarded as **excluded property**.

Note this second exception only applies to individuals domiciled in the Channel Islands or the Isle of Man. Therefore if a Japanese domiciled individual dies owning National Savings Certificates or Premium Bonds etc,. those assets are chargeable to IHT.

(ii) *S.157 IHTA 1984*

If an individual holds a foreign currency account in the UK, **under normal circumstances the account is a UK asset** and is subject to IHT.

However if the holder of the account is **neither resident in the UK nor domiciled in the UK**, the UK foreign currency account is regarded as excluded property.

Therefore if a US national holds a US Dollar account with a UK bank, on his death the value of the account is ignored for IHT purposes.

17.5 Deemed domicile

IHTA 1984, s.267

The concept of "deemed" domicile is extremely important for IHT purposes. In certain instances, **an individual who is not domiciled in the UK can be treated as UK domiciled for inheritance tax purposes only**. These "deemed domicile" rules only apply for IHT – they do not apply for capital gains tax or income tax.

It is therefore possible for an individual to be treated as not domiciled for income tax or CGT purposes, but to be regarded as deemed domiciled for IHT only. The effect of pretending that an individual is domiciled in the UK for IHT purposes, is to **bring an individual's worldwide estate into the charge to inheritance tax**.

For many non-UK domiciliaries, a common tax planning exercise is to restrict their UK estate to a level at or around that of the IHT nil band. This ensures that if they die, the amount of Inheritance Tax payable is kept to a minimum. This type of tax planning does not work if the non-domiciliary is treated as being domiciled in the UK, because the whole of their worldwide estate would then be chargeable.

The deemed domiciled rules are contained at S.267 IHTA 1984. An individual is **deemed to be domiciled in the UK under two circumstances**.

(i) An individual is treated as UK domiciled if he or she has **actually been domiciled at any time in the 3 years** preceding a chargeable transfer.

(ii) Secondly an individual is **deemed domiciled in the UK if he has been resident in the UK for at least 17 of the 20 tax years** ending with the year of transfer. This is the only time when the concept of residence is important for inheritance tax.

Illustration 1

Ray leaves the UK permanently on 27 August 2010, and sets up home in Australia. HMRC accept that Ray has left the UK to settle permanently abroad. Ray will therefore be treated as not domiciled in the UK from 27 August 2010. However for inheritance tax purposes, Ray is treated as being domiciled in the UK for the next 3 years – i.e. until 27 August 2013.

Therefore if Ray makes a chargeable transfer before August 2013, UK IHT may be payable. A chargeable transfer means either a gift to a trust or Ray's death.

Therefore if Ray were to die before August 2013, he would die domiciled in the UK and his worldwide estate would be subject to UK inheritance tax. Essentially an individual will **remain domiciled in the UK for IHT purposes for 3 years after losing his normal UK domicile**. This rule is designed to prevent individuals from taking steps to acquire a domicile of choice outside the UK just before they die, purely in order to save UK IHT.

Illustration 2

Mario is domiciled in Italy. Mario came to live in UK in June 1995 and has been resident and ordinarily resident in the UK ever since.

Once a non-domiciled individual has been **resident in the UK for 17 tax years**, he **automatically becomes domiciled in the UK for IHT purposes**. Therefore Mario will acquire a domicile in the UK for IHT purposes with effect from 6 April 2011 (i.e. from the 2011/12 tax year). As Mario is deemed to be domiciled in the UK, any transfers of worldwide assets after this date are subject to UK IHT.

Therefore in practice it is important that you review the files of clients who have been resident in the UK for a long period of time, but who are continuing to submit tax returns on the basis that they remain domiciled outside the UK. In this instance, if Mario can convince HMRC that his permanent home is in Italy rather than in the UK, he can continue to be treated as a non-domiciled for income tax and for capital gains tax, but for Inheritance Tax purposes he will be caught under S.267 and his worldwide estate will be subject to IHT.

17.6 Excluded property trusts

A common tax planning scheme for non-domiciliaries, involves the use of an "excluded property trust". This is particularly useful for individuals who are about to become deemed domiciled under S.267, such as with Mario in the previous example. IHTA, s.48(3) & s.82

A trust is a **separate legal person** and, as such, will have its own domicile. The **domicile status of the trust is the same as that of its settlor at the creation** of the trust. Therefore if a non-domiciled individual sets up a trust, the trust is also non-UK domiciled. If that trust holds non-UK assets, those assets are "excluded property".

Returning to the previous example, Mario will become deemed domiciled in the UK on 6 April 2011. Assume that **before he acquires a UK domicile, Mario puts his non-UK assets into a trust**. As Mario was non-UK domiciled at the time that he set up the trust, the **trust itself is regarded as not domiciled** in the UK. As this trust will hold **foreign assets**, this trust is called an "excluded property trust".

Excluded property trusts are outside the scope of IHT. This will be the case even if Mario subsequently acquires a UK domicile. Therefore if Mario were to die whilst domiciled in the UK, **the assets in the trust would be protected from inheritance tax**.

This is a common tax planning device used by non-UK domiciliaries, as it enables the individual to have access to the property in the trust whilst keeping the assets outside the scope of UK IHT.

17.7 Relief for overseas taxes

IHTA 1984, s.158 & s.159

Relief for overseas tax is either given under the provisions of a tax treaty or, more commonly, is given unilaterally under S.159 IHTA 1984. Double tax relief (DTR) is most commonly given where a **UK domiciled individual dies with foreign assets in his death estate**.

If overseas tax has been charged in respect of the foreign asset, the asset has been charged in two places at the same time, so "unilateral relief" will be given. In this instance, the foreign tax is given as a credit against UK inheritance tax in the IHT computation.

UK IHT on Estate	X
Less DTR	(X)
IHT due	X

In certain instances, not all of the foreign tax will be credited against UK tax. The amount of double tax relief allowed under S.159 is the **lower of**:

(i) the foreign inheritance tax suffered; and
(ii) the UK inheritance tax charged on the foreign asset.

HMRC has recognised that certain overseas countries do not necessarily have an inheritance tax regime as we know it, and have confirmed that credit will be given for foreign tax which is broadly equivalent to IHT.

To calculate the UK tax on the foreign asset, we use an average rate or "estate rate".

If the actual foreign tax suffered exceeds the UK inheritance tax on the foreign asset, any excess foreign tax credits are wasted. Therefore if the overseas country charges inheritance tax at a rate in excess of 40%, there will be some overseas tax credits which become unrelieved.

Illustration 3

Robert died in February 2011. He had made total lifetime transfers (after exemptions) of £140,000. He died domiciled in the UK. The assets in Robert's estate are as below:

Estate;	£
House in UK	400,000
Villa in Spain	200,000
UK share portfolio	185,000
Total	785,000

All these assets are chargeable because Robert is UK domiciled. The Spanish Authorities charge death tax on the villa of £70,000. The effective rate of tax on the foreign property is therefore 35%.

We will calculate the UK Inheritance Tax payable.

	£
Total worldwide estate	785,000
Nil band (325,000 – 140,000)	(185,000)
Taxable	600,000
IHT @ 40%	£240,000

IHT, before DTR, is £240,000. As Robert's estate included foreign property on which overseas tax has been suffered, double tax relief will be given.

The double tax relief will be the lower of:

(i) the overseas tax suffered (£70,000); and

(ii) the UK inheritance tax charged on the villa in Spain.

To calculate the IHT on the foreign asset, we must first work out an **estate rate**. The UK IHT is £240,000. When expressed as a fraction of the total estate of £785,000, this gives us an estate rate of 30.573%. Note that the maximum estate rate can never exceed 40%.

$$\text{“Estate rate”} = \frac{240000}{785000} \times 100 = \underline{30.573\%}$$

The UK inheritance tax on the villa in Spain is the value of the villa in the death estate, multiplied by the estate rate.

UK tax on villa in Spain = 30.573% x £200,000 = £61,146

As this is less than the overseas tax actually suffered, the double tax relief available will be £61,146.

	£
IHT	240,000
Less DTR	(61,146)
IHT due	178,854

You will see that the UK tax on the villa in Spain is less than the overseas tax suffered. In this instance, the excess foreign tax credit will be wasted.

Example 1

Clare is domiciled and resident in Guernsey. She died owning the following assets:

	Yes ✓	No X
House in Guernsey		
House in London		
UK premium bonds		
Shares in French Company		
Bank account in Guernsey		
Bank account in London		
US $ account in London		
£100,000 owed to her by friend in UK		

Which of these assets are chargeable to IHT in the UK?

Example 2

Gunther is domiciled in Germany. He has lived in the UK for 20 years. He died in March 2011. His estate consisted of:

	£
UK shares	500,000
Jersey bank account	90,000
Property in Germany	300,000
Total	890,000

The German authorities charged death taxes of £100,000 in respect of the property. Gunther made no lifetime transfers.

Calculate the UK IHT due on Gunther's death.

Answer 1

	Chargeable ?		
House in Guernsey		X	Non-UK
House in London	✓		
UK Premium Bonds		X	S.6
Shares in French Co.		X	Non-UK
Bank account in Guernsey		X	Non-UK
Bank account in London	✓		
US $ account in London		X	S.157
£100,000 owed by friend	✓		UK debtor

Answer 2

Chargeable estate	£
UK shares	500,000
Jersey bank account	90,000
German property	300,000
Total	890,000
Less nil band	(325,000)
Taxable estate	565,000
IHT @ 40% (before DTR)	226,000
Less DTR (W1)	(76,179)
IHT due	£149,821

DTR – lower of:

(i) Foreign tax suffered	£100,000
Or	
(ii) UK tax on German property	
Estate rate = $\frac{226000}{890000} \times 100$	25.393%
UK tax on German property = £300,000 x 25.393%	£76,179