UK Inheritance Tax – Appropriate Tax Planning Steps for UK and Non-UK Residents

By **Paul Webb**, 7th May 2020

Background

UK inheritance tax should be carefully considered, and appropriate tax planning should be taken by all individuals who have assets in the UK, not just those that live in the UK.

What is UK Inheritance Tax?

On death, UK inheritance tax (IHT) is at a rate of 40%.

IHT is a tax on money or assets held at death, and on some gifts made during a lifetime (most importantly those gifts made less than 7 years prior to death).

A certain amount can however be passed on tax-free. This is known as the 'tax-free allowance' or the 'nil rate band'.

Each individual has a tax-free inheritance tax allowance of £325,000. This allowance has remained the same since 2010-11. In the case of a married couple this tax-free allowance can be passed onto a surviving spouse, which means that, following their death, the estate will enjoy a £650,000 tax free allowance.

Additional Nil Rate Allowance

Individuals who died after 6 April 2017, with an estate value greater than their tax-free allowance of £325,000, due to the value of their home being passed to their children, may pass on an additional tax-free allowance. In tax year 2020 – 2021 this additional amount is £175,000 per estate.

Lifetime Gifts

Gifts made more than seven years prior to death, without the retention of a benefit (such as continuing to live in a gifted property rent free), will not be included in the deceased's estate. Any gifts made within seven years will, in most circumstances, form part of the estate.

Gift Allowances

There are certain gift allowances that can be used year on year, where the seven-year rule is not applicable. The six key gift options are detailed below. These options, if planned for properly across several years, can reduce the inheritance tax liability considerably.

Dixcart recommends that a record of all gifts made is kept with the Will.

- **Give away money each year** – each year an individual can give away up to £3,000. This gift can be to anybody or split across any number of people.

- **Wedding presents** – parents can each give a wedding gift of up to £5,000 to their children. This gift allowance must be made before the ceremony.

- **Unlimited small gifts** – an unlimited number of gifts of up to £250 each in any tax year can be made as long as they are to different people.

- **Charitable donations** – charitable gifts are free from inheritance tax. If at least one-tenth of net wealth (calculated as a percentage of the estate, on death) is donated, the Government has the discretion to cut an individual's inheritance tax rate from 40% to 36%.

- **Contributing to living costs** – money used to support an elderly person, an ex-spouse, and/or a child under the age of 18 or in full-time education is not considered to be within the deceased's estate on death, whatever amounts have been paid.

- **Payments from surplus income** – an individual with surplus income should not ignore the opportunities provided by this provision. If the criteria, detailed below are met, the seven-year period is not relevant:

1. it was made as part of the usual expenditure of the transferor; and

1. the transferor retains sufficient income to maintain his usual standard of living, having taken account of all the income transfers that form part of his usual expenditure.

Does UK Inheritance Tax Apply to a Non-UK Tax Resident?

The UK inheritance rules are different depending on a person's domicile. The concept of domicile is based on a complex set of laws (outside the scope of this note). However, as a broad overview, an individual is domiciled where they consider themselves to be indefinitely settled and "at home". There may also be estate or inheritance tax liabilities in other jurisdictions. Therefore, local advice should be taken in any jurisdiction where taxes might be chargeable.

For UK IHT purposes, there are three categories of domicile:

- UK Domiciled – the worldwide assets of the individual will be subject to UK inheritance tax, whether the individual is UK resident or not.

- Non-UK Domiciled ("non-dom") – the assets of this individual, situated in the UK, will be subject to UK inheritance tax irrespective of whether the individual is UK resident or not.

- Deemed UK Domiciled – where an individual is a non-dom but has lived in the UK in 15 out of the previous 20 tax years (prior to their death). According to UK inheritance tax rules he is considered to be UK domiciled and his worldwide assets will therefore be subject to inheritance tax on his death. The rules are slightly different if the individual has fulfilled this requirement but is no longer resident at the date of their death although IHT may well still be chargeable in this instance.

When an individual moves to the UK, dependent on all of the circumstances of the move and the new life adopted in the UK, there may be an argument that an individual has immediately become UK domiciled. Even if this is not the situation, once an individual has lived in the UK for 15 years, he/she will be deemed domiciled for UK inheritance tax.

As is often the case, a complex set of laws is best considered through explanatory examples.

Tax Planning Opportunities for Non-UK Tax Residents

Tom is an Australian citizen; he was born in Australia and has always lived and worked there. He is a UK non-dom and has a net worth of £5m. He is divorced with one child aged 19.

Tom's child, Harry, chooses to study at a university in the UK and Tom is aware that UK real estate has over the last few years shown some good returns.

Tom purchases a property in his sole name, mortgage free, near to his son's university in the UK for £500,000 for his child to live in while studying in the UK.

Planning Opportunity 1: Property Ownership

Even though Tom is not UK tax resident and is non-dom, any assets that he has in his own name situated in the UK are subject to UK inheritance tax on his death. If Tom dies while owning the property, leaving his whole estate to Harry, there will be a tax liability of £70,000 on his death. This is 40% of the value of the property above

the £325,000 nil rate band, assuming that Tom has no other UK assets.

- Tom could have considered purchasing the property jointly in the name of himself and his son. Had he done so; on his death the value of his UK asset would have been £250,000. This is below the nil rate band threshold and therefore no UK inheritance tax would be payable.

Planning Opportunity 2: Remittance of Money

Tom is getting close to retirement and decides to move to the UK to be with his child, who has settled in the UK after finishing university. He sells his Australian home but keeps his Australian bank accounts and other investments. He sends £1m over to a newly opened UK bank account before moving to the UK, to live on once in the UK.

- Tom would be better advised to remit these funds to a tax neutral, sterling jurisdiction, such as the Isle of Man. If Tom was to die before becoming domiciled for UK inheritance tax purposes, these funds would be outside the inheritance tax net.

- By structuring such an account correctly, Tom could bring capital only to the UK and thereby avoid any obligation to pay income tax. Please contact Dixcart to take advice on this topic, prior to moving to the UK.

Planning Opportunity 3: Use of a Trust

Tom dies having lived in the UK for 25 years of his retirement. He leaves his whole estate to his son. As Tom was deemed domiciled at death, his entire worldwide estate, not just his UK situated assets, will be subject to UK inheritance tax at 40%, except for the nil rate band at the time of his death. If his estate is still worth £5m, the inheritance tax payable will be £1.87m at current rates and nil rate band.

- Before Tom became deemed domiciled in the UK, he could have settled the non-UK assets he still had into a non-UK resident discretionary

trust (traditionally in a tax neutral jurisdiction). This would place those assets outside his UK estate for UK inheritance tax purposes. Following Tom's death, the trustees could distribute the trust assets to Harry; achieving the same results as a will but passing on the assets free from inheritance tax liabilities.

Planning Opportunity 4: Distribution of Assets from a Trust

Following Tom's death, his son decides to leave the UK for New Zealand, having lived in the UK for the previous 30 years. He sells all of his properties and other assets and deposits the proceeds in a New Zealand bank account. He dies within a year of moving to New Zealand.

As Harry only left the UK a year prior to his death, he will still have been UK resident for more than 15 of the previous 20 years. He will therefore still be considered UK deemed-domiciled at death and his entire estate would be taxable to UK inheritance tax at 40%, even though he had no assets in the UK on his death.

- Rather than the trustees distributing the assets to Harry on his father's death, it might have been prudent for the trustees to only distribute assets as needed by Harry over time. This would mean that the entire estate would not be in his name on his death and would not therefore be subject to inheritance tax in the UK. The assets would remain in the trust and be available for future generations of the family. Advice should be taken on distributions from a trust to ensure that these are as tax efficient as possible.

Summary and Additional Information

UK inheritance tax is a complex issue. Careful consideration and advice need to be taken regarding the best manner to structure the holding of UK assets.

It is important for both UK and non-UK tax residents to take advice, as early as possible, and this should be reviewed regularly to allow for any changes in the law and/or family circumstances. A number of important tax planning steps can be put in place, in particular for non-UK tax residents.

If you require additional information on this topic, please contact Paul Webb at the Dixcart office in the UK: advice.uk@dixcart.com.