



CORNERSTONE WILLS

DOMICILE & INHERITANCE TAX

Although there are other taxes (income tax, capital gains tax, stamp duty land tax, etc), none of these are affected by domicile. The only tax that is affected by domicile is Inheritance Tax (IHT) and one frequently overlooked aspect of IHT is that relating to transfers between spouses where one is non-UK domiciled.

Under normal circumstances any assets transferring to one's spouse, during lifetime and on death, are fully exempt from UK IHT, but in cases where one of the spouses has a foreign domicile then the amount that can be transferred to the non-domiciled spouse during their lifetime and on death is limited to £325,000. (This was increased from £55,000 in the 2013 Finance Bill which received Royal Assent in July 2013.) Additionally they have a "Nil Band Allowance" of £325,000 (for 2013/14). Hence any transfers over £650,000 will then be taxed at 40%.

In order to appreciate the significance of this it is important to understand what is meant by domicile.

Domicile is a very complex concept in law but essentially there are four forms of domicile acknowledged in the UK: domiciles of origin, dependency, choice and also that of deemed domicile. Further and more detailed discussion of domicile can be found in our Briefing Note "[Detailed Discussion of Domicile](#)".

Domicile of Origin

Domicile of origin is determined at birth and is inherited from one's father regardless of where one is actually born. This domicile will remain throughout life unless one elects another domicile of choice or is considered to have done so.

Domicile of Dependency

Domicile of dependency is a term which applied in the dark days when a woman was considered to be little more than a chattel of her husband and thus acquired his domicile automatically upon marriage. This ceased to be the case from 1st January 1974. Domicile of dependency still applies to minors under the age of 16.

Domicile of Choice

Whatever one's domicile of origin, an alternative domicile of choice can be adopted. A domicile of choice is acquired where one resides in a particular country with the express intention of remaining there permanently. Any suggestion that one intends to reside in another country at any future date or in a particular circumstance would not ordinarily allow for a domicile of choice in any of the countries in the UK. In many cases the final decision on whether or not a domicile of choice has been adequately evidenced is not made until death and this can make it difficult to plan one's affairs and arrange the tax-efficient distribution of assets.

Deemed Domicile

Deemed domicile affects those who live in the UK for a long period of time without acquiring domicile of choice here. Once one has lived in the UK for 17 out of the last 20 years one is deemed domiciled for IHT purposes only. At this stage a non-domiciled spouse would benefit from the same IHT treatment as a fully domiciled spouse, i.e. all transfers to that spouse upon the death of their husband or wife would be exempt from IHT, but up to that point a very onerous tax burden could arise.

The Inheritance Tax Bill

For foreign domiciliaries, their own liability to UK IHT is limited to that in relation to their UK assets, including land, bank accounts and investments. Their assets in other countries will be taxed under the tax regimes of those countries and/or the country of their domicile. However, once deemed domicile is acquired, their worldwide assets become subject to UK IHT.

Inheritance Tax could end up being paid twice – once in the UK and again in the country of domicile. Double taxation treaties do exist between some countries and the UK so that one may be offset against the other. It would be wise to appoint a professional executor in the Will to ensure that the tax isn't double-paid!

It is important to reiterate – as it is often misunderstood or misinterpreted – that everyone has their tax-free allowance, regardless of their domicile. Hence the total amount that can be left free from tax to a foreign domicile spouse is the Nil Rate Band PLUS the £325,000 allowance, i.e. £650,000 (2013/14).

The following table shows the allowances for transfers between couples where one or both or non-domiciled.

| Domicile of 1 st to die | Domicile of survivor | Marital Status | Personal Allowance (£325,000) | Full Spousal Exemption | £325,000 Spousal Exemption | Amount tax-free on 1 st death |
|------------------------------------|----------------------|----------------|-------------------------------|------------------------|----------------------------|--|
| UK | UK | Married | √ | √ | X | All |
| UK | Non-UK | Married | √ | X | √ | £650,000 |
| Non-UK | UK | Married | √ | √ | X | All |
| Non-UK | Non-UK | Married | √ | √ | X | All |
| UK | UK | Unmarried | √ | X | X | £325,000 |
| UK | Non-UK | Unmarried | √ | X | X | £325,000 |
| Non-UK | UK | Unmarried | √ | X | X | £325,000 |
| Non-UK | Non-UK | Unmarried | √ | X | X | £325,000 |

So, as an example for a married couple that has an estate comprising of property, bank accounts and investments with a net value of £1.5M split equally, then the inheritance tax bill(s) will be as follows:

| Domicile of 1 st to die | Domicile of survivor | Tax on 1 st death - sum | Tax on 1 st death | Tax on 2 nd death - sum | Tax on 2 nd death |
|------------------------------------|----------------------|------------------------------------|------------------------------|------------------------------------|------------------------------|
| UK | Non-UK | (£750k-£650k) * 40% | £40,000 | (£1.5M-£40k-£325k) * 40% | £454,000 |
| All other <i>married</i> cases (*) | | | NIL | | £340,000 |

(*) Assuming two Nil Rate Bands can be claimed by the executors on 2nd death.

Of course, non-domiciles could have tax-efficient Wills drafted for them that incorporate the Nil Rate Band Discretionary Will Trust in order to utilise their two Nil Rate Bands. This would wipe £130,000 off the above tax bills. Please refer to our website page www.cornerstonewills.co.uk/nrbdt-iht for further information.

Further Temporary Protection?

For anyone who feels that they might be caught by the non-domiciled spouse rule it could be possible to establish a domicile of choice in this country. In the absence of confirmed domicile of choice, however, another option could be to take out temporary life assurance on the life of the UK-domiciled spouse enabling funds to be passed to the survivor in trust with which to settle the IHT bill. The term of the policy would only have to be such as to cover the unexpired portion of the '17 out of 20 years' test for acquiring deemed domicile in the UK.

Cornerstone Wills

E-mail: info@cornerstonewills.co.uk

Web: www.cornerstonewills.co.uk

Camberley Office

Kings Court, 91-93 High Street, Camberley GU15 3RN

T: 01276 482850