Excerpt from Inheritance Tax 2019/20 – Chapter 2 – Domicile

'ELECTIVE' AND 'DEEMED' DOMICILE FOR IHT PURPOSES

Election to be treated as domiciled in the UK

2.6
As intimated at **2.2** above, for transfers between spouses (or civil partners), it is important to know the domicile of both spouses. If the transferor spouse is domiciled in the UK but their spouse is domiciled abroad, the spouse exemption is limited to the prevailing nil rate band (£325,000 for 2019/20). The statutory limit was increased from £55,000 following changes introduced (in *FA 2013*) with effect in relation to transfers of value made on or after 6 April 2013 (*IHTA 1984, s 18(2), (2A)*) (see **1.20**).

A facility (introduced in *FA 2013*) is available for non-UK domiciled individuals with a UK-domiciled spouse or civil partner to elect in writing to HMRC to be treated as UK domiciled for IHT purposes (*IHTA 1984, ss 267ZA, 267ZB*).

If no election is made to be treated as UK domiciled, the overseas assets of the non-UK domiciled spouse or civil partner generally continue to be excluded property for IHT purposes, but transfers from their UK domiciled spouse or civil partner are subject to the 'capped' spouse exemption limit.

The effect of the election is that transfers from a UK-domiciled spouse (or civil partner) are exempt from IHT without limit. However, the electing spouse's worldwide estate becomes liable to IHT.

2.7
An election may be made if:

- the non-UK domiciled spouse had a UK-domiciled spouse at any time on or after 6 April 2013 and within the seven-year period before the election is made (*IHTA 1984, s 267ZA(3)*) (a 'lifetime election'); or
- the deceased was, at any time from 6 April 2013 and within seven years before death, UK domiciled and the spouse of the person who would (by virtue of the election) be treated as UK domiciled (*IHTA 1984, s 267ZA(4)*) (a 'death election').

The above provisions effectively allow for a retrospective election following a change of domicile status, in the circumstances outlined. They also allow individuals whose marriage has ended to retrospectively elect to cover the period when they were married to a UK-domiciled person.

Those spouses making a lifetime or death election may choose the date from which it applies, up to a maximum of seven years previously. However, the earliest date that may be specified is 6 April 2013 (*IHTA 1984, s 267ZB(4)(a)*).

A lifetime election can be made at any time (but see below), whereas elections following a death must be made within two years of the death, or such longer period as HMRC may allow (*IHTA 1984, s 267ZB(6)*). The personal representatives of non-domiciled individuals may make death elections on their behalf (*IHTA 1984, s 267ZA(2)*).

An election has only been possible since 17 July 2013, but as indicated above it could take effect before that date. The lifetime and death elections are irrevocable. However, a lifetime election will cease to have effect if the electing person is later resident outside the UK for more than four full consecutive tax years (*IHTA 1984, s 267ZB(10)*).

HMRC guidance on elections for non-UK domiciled spouses and civil partners to be domiciled in the UK is included in the Inheritance Tax Manual (at IHTM13040 and following), including details of how to make an election (IHTM13043).

Note that it is only the domicile of the *transferee* spouse which is relevant in the above context of the exemption limit in *IHTA 1984, s 18(2)*. Thus the limit does not apply if both the transferor and spouse are not domiciled in the UK, or if the transferor is domiciled outside the UK but their spouse is domiciled in the UK.

'Deemed' domicile

2.8 Focus
For IHT purposes, a person can be *deemed* to be domiciled in the UK in certain circumstances, even though he is domiciled elsewhere under general law (*IHTA 1984, s 267*).

See also **2.2** above regarding the deemed domicile status of MPs and members of the House of Lords.

The election for a person to be treated as domiciled in the UK is discussed at **2.6–2.7** above. In determining whether the person making the election is (or was) domiciled in the UK, the deemed domicile provisions in *IHTA 1984, s 267* are ignored (*IHTA 1984, s 267ZA(8)*).

However, the election does not prevent the deemed domicile provisions applying in the normal way if a person who has elected to be treated as domiciled in the UK becomes deemed domiciled in the UK while the election is in force, by meeting the conditions in *IHTA 1984, s 267* (IHTM13040).

The government reformed the deemed domicile rules for IHT purposes (in *F(No 2)A 2017*), with the aim of restricting non-UK domiciled individuals from being able to claim non-UK domicile status for an indefinite period of time. The changes included an additional deemed domicile test (in *IHTA 1984, s 267*)

in relation to a 'formerly domiciled resident' (see **2.13**), and the replacement of another test (ie the 'long term residence' or '17 out of 20' rule; see **2.12**) to reduce the number of years that an individual is resident in the UK before becoming deemed domiciled (see **2.10**).

Separate domicile reforms were also introduced for income tax and capital gains tax purposes.

In relation to times following the introduction of the above changes, separate and alternative time-based tests potentially apply for determining deemed domicile status for IHT purposes (*IHTA 1984, s 267(1)*); a 'three-year rule' and a long-term residence (or '15 out of 20') rule.

As to a third category of deemed domicile status in relation to a formerly domiciled resident, see **2.13** below.

The 'three-year' rule

2.9
A person is treated as domiciled in the UK if he or she was domiciled in the UK at any time in the three years immediately preceding the time at which the question of his domicile is to be decided.

HMRC's guidance at the time of writing states in the context of the above 'three-year rule' (IHTM13024): 'For the rule to apply the taxpayer must have been domiciled in the UK on or after 10 December 1974 and at any time within the three *calendar* years before the relevant event (the death or gift)' (emphasis added). However, the legislation refers to the three-year period immediately preceding the 'relevant time' (*IHTA 1984, s 267(1)*).

It is assumed that HMRC's guidance means the third anniversary of the relevant time (and not the alternative interpretation of three calendar years from 1 January to 31 December preceding that date), although the guidance could be clearer.

The 'three-year rule' was retained notwithstanding the changes to deemed domicile introduced in *F(No 2)A 2017*.

Example 2.1—'Deemed' domicile: the 'three-year' rule
Christine is aged 40 and has been resident and domiciled in England all her life. She left the UK on 31 March 2016 and settled in Spain permanently, acquiring a domicile of choice in Spain under general law. She did not subsequently return to the UK.

Christine ceased to be domiciled in the UK for IHT purposes under the 'three-year' rule on 1 April 2019.

Care will be needed in some cases, as it may be unclear when an individual has actually abandoned his or her domicile in one territory in favour of another, for the purposes of determining when the three-year period begins and ends.

Example 2.2—'Deemed' domicile: in two minds
Davor, who was born in Croatia, came to live in England at a very early age and established a domicile of choice. Some years later, his lawyers found it difficult to establish whether he had acquired a new domicile of choice in France as soon as he left England in March 2015. The lawyers used a Latin tag for this situation: *sine animo revertendi* (loosely translated as: 'I really haven't yet made up my mind whether or not to return to England').

The lawyers came to the conclusion that Davor had probably retained his domicile of choice in England whilst he made up his mind. On that basis, any delay on his part could postpone the start of the relevant three-year period in *IHTA 1984, s 267(1)(a)*, because he would not lose his domicile in England straight away.

Long-term residence (or '15 out of 20') rule

2.10
As part of the domicile reforms (introduced in *F(No 2)A 2017*) (see **2.8**) the '15 out of 20' long-term residence rule for deemed domicile purposes replaced a '17 out of 20' rule (see **2.12**), thereby potentially bringing more individuals within the scope of IHT.

The '15 out of 20' rule (in *s 267(1)(b)*) generally applies in relation to times after 5 April 2017 (subject to transitional rules; see below). It contains two conditions, both of which must be met. The first condition is that the person was resident in the UK for at least 15 of the 20 tax years immediately preceding the 'relevant tax year' (see below). The second condition is that the person was resident for at least one of the four tax years ending with the relevant tax year.

As indicated, both conditions must be met for the person to be deemed domiciled in the UK under the '15 out of 20' rule. Thus, an individual who has been UK resident for at least 15 out of the 20 tax years immediately preceding the relevant tax year, but who was resident in the UK for none of the four tax years ending with the relevant tax year, will not be deemed UK domiciled under *IHTA 1984, s 267(1)(b)*).

Example 2.3—'Deemed' domicile: the '15 out of 20' rule
Nick has a Bulgarian domicile of origin. He came to live in the UK in June 2004 and was resident in the UK for the tax years 2004/05 to 2018/19 inclusive (ie 15 tax years).

Nick becomes deemed domiciled in the UK in 2019/20, even if he leaves the UK and becomes non-UK resident in that tax year.

It should be noted that the first of the above conditions in the '15 out of 20' rule would be satisfied if the person is UK resident for at least 15 of the 20 tax years *immediately preceding* the relevant tax year (see below). The 'relevant tax year' for these purposes is the tax year in which the 'relevant time' falls (ie the time at which the person's domicile status falls to be determined).

By contrast, the '17 out of 20' rule (see **2.12**) refers to UK residence in not less than 17 out of the 20 tax years *ending* with the tax year in which the relevant time falls. Thus there is a difference in the way that tax years are counted for these purposes. The overall effect of the '15 out of 20' rule is that an individual's deemed UK domicile status can commence significantly sooner than under the '17 out of 20' rule it replaced.

As indicated above, the '15 out of 20' deemed UK domicile rule applies to times after 5 April 2017, subject to certain transitional provisions. Those leaving the UK before 6 April 2017 are not subject to the '15 out of 20 rule' if they were not UK resident for the relevant tax year and for any tax year beginning after 5 April 2017 and preceding the relevant tax year (*F(No 2)A 2017, s 30(10)*).

Example 2.4—'Deemed' domicile: transitional rule
Suppose that Nick (see **Example 2.3**) was resident in the UK for the tax years 2002/03 to 2016/17 inclusive (ie 15 tax years) but left the UK on 31 March 2017 and was non-UK resident in 2017/18.

Nick would normally be deemed domiciled in the UK under the '15 out of 20' rule in 2017/18, even though he had already left the UK. However, as 2017/18 was the first year in which he would otherwise have been deemed domiciled in the UK, the effect of the transitional provisions is that Nick will not become deemed domiciled in the UK under this rule if he does not resume UK residence.

In addition, the '15 out of 20' rule is not relevant for certain purposes in respect of settled property, including in determining the excluded property status of property which became comprised in the settlement before 6 April 2017 (*F(No 2)A 2017, s 30(11)*).

It should be noted that a non-UK domiciled person (who was not born in the UK with a UK domicile of origin; see below) becomes deemed domiciled in his 16th year after 15 out of 20 years of UK residence, even if he is not resident in the UK in the 16th year (unless he left the UK before 6 April 2017 and remained non-resident thereafter). Consequently, an individual would generally need to leave the UK in the 14th tax year of UK residence to avoid becoming deemed UK domiciled in the 16th tax year under this rule.

2.11
The domicile reforms also include a third category of deemed UK domicile for IHT purposes, in relation to a 'formerly domiciled resident' (see **2.13** below).

The 'long-term residence' (or '17 out of 20') rule

2.12
In relation to times prior to the domicile reforms introduced in *F(No 2)A 2017* having effect, a '17 out of 20' rule generally needs to be considered instead of the '15 out of 20' rule that replaced it.

The '17 out of 20' rule broadly provides that a person who is not domiciled in the UK under general law

is treated as UK domiciled for IHT purposes if he is resident in the UK for 17 out of 20 years of assessment ending with the one in which the relevant time falls. This rule is the most relevant to someone who has come from abroad to live in the UK.

As indicated, this rule was replaced (in *F(No 2)A 2017*) with the '15 out of 20' rule from 6 April 2017, subject to transitional provisions (see **2.10**).

Example 2.5—'Deemed' domicile: the '17 out of 20' rule
Joseph came to the UK to stay on 1 May 2000. The Inland Revenue (as it then was) treated him as UK resident for the tax year 2000/01 (ie Joseph was resident in the UK for more than 183 days in that tax year). He remained resident in the UK for 2001/02 and all later tax years up to and including 2015/16.

The tax year 2016/17 is the seventeenth tax year. If Joseph remained resident in the UK during 2016/17, he would have become deemed domiciled in the UK under the above rule. A transfer of foreign situs assets by Joseph would then have been caught for IHT purposes, unless exempt or potentially exempt.

As indicated at **2.10**, the changes to the deemed domicile provisions in *IHTA 1984, s 267* included the replacement of the '17 out of 20' rule with a '15 out of 20' rule, subject to transitional provisions. The latter test is met if the person was UK resident for at least 15 out of 20 tax years immediately preceding the relevant tax year, and for at least one of the four tax years ending with the relevant tax year.

The 'formerly domiciled resident' rule

2.13 Focus
The government's stated intention when the domicile reforms were announced was to make it more difficult for individuals with a domicile of origin in the UK to claim non-UK domicile status if they left the UK and acquired a domicile of choice in another country, but subsequently returned to the UK and maintained that they had retained a foreign domicile of choice.

The reform of the deemed domicile provisions for IHT purposes (introduced in *F(No 2)A 2017*) include an additional category of deemed domicile in the UK, such that a person is treated as domiciled in the UK if he is a 'formerly domiciled resident' for the relevant tax year (*IHTA 1984, s 267(1)(aa)*).

A 'formerly domiciled resident' for a tax year is defined (in *IHTA 1984, s 272*) as a person who was born in the UK, whose domicile of origin was in the UK, who was resident in the UK for that tax year, and who was resident in the UK for at least one of the two tax years immediately preceding that tax year.

In such circumstances, the person would fall to be treated as a deemed UK domiciliary on their return to the UK (subject to the short period of grace mentioned above), irrespective of their domicile status under general law. It should be noted that the one-year period of grace refers to residence for a tax year, and that a person's arrival in the UK during the tax year can in practice result in UK residence after a much shorter period than one year.

In addition, if the settlor of a settlement was not domiciled in the UK when the settlement was made, the property would nevertheless not be excluded property (within *IHTA 1984, s 48(3)* or (*3A)*; see **1.13**) at any time in a tax year if the settlor was a formerly domiciled resident for that tax year (*IHTA 1984, s 48(3E)*).

The IHT regime for certain settled property was amended accordingly as a result of the formerly domiciled resident rule in relation to:

- ten-year anniversary charges for relevant property trusts (*IHTA 1984, s 64(1B)*);
- exit charges from such trusts (*IHTA 1984, s 65(7B)*);
- initial qualifying interests in possession in favour of the settlor (or spouse or civil partner) which become relevant property trusts; and
- property moving between settlements (*IHTA 1984, s 82*).

It should be noted that the above provision relating to exit charges is a trust protection measure. It broadly provides that an exit charge does not arise solely because of the trust property becoming excluded property (and therefore no longer being relevant property) by virtue of *IHTA 1984, s 48(3E)* ceasing to apply to it, upon the settlor becoming non-UK resident again.

Furthermore, the domicile reforms for IHT purposes amended the definition of 'foreign-owned' property (in *IHTA 1984, s 272*) to include settled property where the settlor is not a formerly domiciled resident for the tax year and was domiciled outside the UK when the property was settled.

Example 2.6—'Deemed' domicile: the 'formerly domiciled resident'
James was born in April 1962 in London. His domicile of origin is in the UK. In March 1984, he left the UK to live in Ruritania, and acquired a domicile of choice there. In December 2006, he settled non-UK assets (ie three industrial units situated in Ruritania) on trust. The settled property was excluded property (within *IHTA 1984, s 48(3)(a)*).

In May 2017, James returned to the UK. He became UK resident in the tax year 2017/18 and remained UK resident in subsequent tax years. James therefore became a formerly domiciled resident in 2018/19. The property settled in 2006 therefore ceased to be excluded property. Furthermore, the trust becomes subject to IHT charges under the relevant property regime.

Exceptions to deemed domicile

2.14
There are some exceptions to the application of the 'deemed domicile' provisions. The deemed domicile provisions (in *IHTA 1984, s 267(1)*) do not apply in certain circumstances including the following:

- specified government securities in the beneficial ownership of persons not resident (ordinarily resident for securities issued before 6 April 2013 – see below) (and in certain cases not domiciled) in the UK (*IHTA 1984, ss 6(2), 48(4)*);

- certain types of savings by persons domiciled in the Channel Islands or the Isle of Man (*IHTA 1984, s 6(3)*);
- certain pre-CTT double taxation agreements still in force by virtue of *IHTA 1984, s 158(6)*. Those agreements contain their own rules for domicile and for resolving the issue where both countries claim domicile (*IHTA 1984, s 267(2)*);
- for the purposes of deciding whether property settled before 10 December 1974 is excluded property, and for certain other purposes (see *IHTA 1984, s 267(3)*). The deemed domicile changes introduced in *F(No 2)A 2017* (see **2.8**) include the repeal of *IHTA 1984, s 267(3)*, but transitional rules also include a preserving provision in relation to such property (see *F(No 2)A 2017, s 30(12)*).

In addition, as indicated at **2.8** above, the deemed domicile rules are ignored for the purposes of determining whether a spouse or civil partner making an election to be treated as domiciled in the UK (see **1.20**) is or was domiciled in the UK (*IHTA 1984, s 267ZA(8)*). Furthermore, the election provisions (in *IHTA 1984, ss 267ZA, 267ZB*) are ignored for the purposes of determining whether a person is or was domiciled in the UK under the deemed domicile rules (*IHTA 1984, s 267(5)*).

Following legislation introduced in *FA 2013*, the concept of 'ordinary residence' is generally removed for tax purposes. However, the government stated (in its explanatory notes to the *Finance Bill 2013* legislation) that the above IHT provisions in *IHTA 1984, ss 6(2)* and *48(4)* will continue to apply to securities issued on the basis of exemption for persons not ordinarily resident if the beneficial owner acquired them before 6 April 2013. All UK government securities acquired on or after 6 April 2013 will be exempt provided the beneficial owner is resident outside the UK; domicile is relevant only to the issue of 3.5% War Loan (IHTM27241).

With regard to the third bullet point above, HMRC accept that domicile issues exclude deemed domicile when considering the double tax agreements with France, Italy, India and Pakistan. However, if there is a common law domicile in those countries, the deemed domicile rules can apply to chargeable *lifetime* transfers (IHTM13024).

For more information about Inheritance Tax 2019/20: