LEAVING THE UK - BUT ARE THEY LEAVING UK TAXES?

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When clients permanently leave the UK, they expect to leave behind their liability to UK taxes.

Although with suitable planning this can be the case for income tax and capital gains tax, which largely depend on the client's tax residence, liability for UK inheritance tax (IHT) is another story.

Whether a client's estate will be liable for IHT is not based on their residency or nationality; instead it revolves around the less precise concept of their 'domicile'.

Domicile is different from tax residency and nearly always stays with someone, wherever they go. Therefore, if a person has a UK domicile when they die, regardless of where they are living, their worldwide assets will be subject to IHT.

THE BOTTOM LINE FOR IHT – PLAY IT SAFE

The rules about domicile are among the most difficult in tax law. It is not just a question of their technical complexity. There is a lack of definition and formality in this area that means it is effectively one in which the outcome is subjective.

You cannot know for sure whether a non-UK resident client still has UK domicile or not, since this is determined by HM Revenue & Customs (HMRC) after the person dies, taking into account any continuing links they have with the UK and what their intentions were. HMRC can even put the client's legal representatives and beneficiaries under oath to learn the 'intentions' of the deceased.

If there is any doubt, it makes sense to assume that a client will be judged to have retained their UK domicile (and therefore liability to IHT), and plan accordingly using the many established IHT planning tools and techniques.

This document describes the concepts of 'residency' and 'domicile' and explains why it is so important for clients to make appropriate inheritance tax plans.

NON-RESIDENT OR RESIDENT?

Anyone leaving the UK to live and/or work abroad – either permanently or for at least one full tax year – must inform HMRC by completing form P85 'Leaving the UK – getting your tax right', which can be accessed from the gov.uk website.

The answers to these questions enable HMRC to carry out their Statutory Residence Test, to determine whether that individual will become 'non-resident' for tax purposes or will remain 'resident'.

It asks for information such as:

› the individual's reasons for leaving the UK
› what they will be doing while they are abroad
› any assets or income they will leave in the UK
› how often they will visit the UK after they have left
› the purpose of their visits to the UK
› what connections they will be keeping in the UK, such as family, property, work or business connections.

INDIVIDUALS CONSIDERED NON-RESIDENT

If HMRC decides that the person moving overseas will be 'non-UK resident' when they move abroad, then UK tax will only be due on income arising in the UK and on capital gains made on UK property.

INDIVIDUALS CONSIDERED RESIDENT

If HMRC decides they are UK resident they will remain liable to UK taxes as if they were still living in the UK. The full legislation details can be found in Schedule 45 of the Finance Act 2013.

DOMICILE – A STICKY ISSUE

Unlike residency, which looks at where an individual is actually living, domicile is broadly based on where their permanent or habitual home is and where they intend to live indefinitely. This may or may not be the country in which they are currently resident.

At birth, an individual acquires a domicile of 'origin'. This is their father's domicile if their parents are married and their father is alive at the time of their birth. Otherwise, they acquire their domicile of origin from their mother. An adopted child acquires their domicile of origin from their adoptive parent. Until an individual is 16, their domicile changes automatically if their legal guardian's domicile changes. This is a domicile of 'dependency', as is the situation where a woman who married before 1 January 1974 automatically acquired her husband's domicile on marriage. A husband's and wife's domiciles are determined independently for all marriages from 1 January 1974.

Unfortunately, domicile is not defined in UK tax legislation and, unlike residency, there is no statutory test. It can be difficult for UK clients to lose their UK domicile and this is why it is often referred to as 'sticky'.

EFFECT OF DOMICILE ON TAX LIABILITY

Most people born in the UK are UK domiciled, which means they are liable to UK inheritance tax at 40% on all their assets worldwide, (with the exemption of the nil rate band (NRB) – currently at £325,000 plus any available residence nil rate band) regardless of where they are resident.

If they become non-UK domiciled, they are only liable to UK inheritance tax on their UK assets.

The unlimited exemption from inheritance tax on gifts between spouses, which is enjoyed between UK domicile spouses, is limited where a UK domiciled spouse transfers assets to their non-UK domiciled spouse. In this instance, the relief is restricted to £325,000, as well as the NRB of £325,000.

CHANGING DOMICILE

So, can a client moving overseas change their UK domicile of 'origin' or 'dependency' to a different one (their 'domicile of choice') and thus avoid IHT?

There are four considerations involved here; two of which are largely subjective and not laid down in legislation but taking instead a 'common law' approach. HMRC will look at all considerations and decide whether they offer valid and compelling evidence – not just about a client's actions but also their intentions.

1. ACQUIRING A DOMICILE OVERSEAS

Acquiring a domicile of choice in the client's new home country, through whatever formal process, may be available and should first be considered. Unfortunately, this can be as elusive and ill-defined a process as losing UK domicile status. Some countries, such as Spain, have a 'day-count' test. Some countries don't allow their domicile to be acquired at all. And even if someone is successful in losing UK domicile, it revives immediately when they permanently leave the country in which they have acquired the new domicile of choice.

2. ESTABLISHING OVERSEAS RESIDENCY

This involves spending a minimum of three tax years living outside the UK. However, time spent outside the UK is not indicative in isolation. Residing overseas even for many decades, will be futile if the remaining conditions are not met.

3. SEVERING ALL LINKS WITH THE UK

It is not enough to go and live in a different country for three years. It is not even enough to acquire a domicile there. HMRC will look at whether an individual has also severed all their links to the UK. Whilst there is no formal or comprehensive list of links for a client to sever, they should include disposing of property and investments, sale of chattels, ceasing subscription to clubs and societies, educating children overseas and minimising business interests. And on the flip side, it is important in their new home country to establish roots and have local business interests, maintain local bank accounts and investments, be able to speak and read the local language and be involved with community organisations as well as making a local will, and even organising a burial plot there.

4. HAVING NO INTENTION OF RETURNING TO THE UK

Intent is a state of mind which, if expressed inappropriately, can be damning as well as helpful, and even emotional connections with the UK can be used as evidence should HMRC choose. And in their own words they will look for any indications of an individual's intentions for the future. What plans have they made and what contingencies have they taken into account? What would cause a change of residence? What provision has been made for the future? What has the individual actually done that provides evidence for the answers to these questions?

The case of actor Richard Burton is interesting to note as it cost his estate £2.4 million in taxes when he was judged to have failed the 'intent test'. Although he lived in the USA for 27 years before dying, he was known to have bought burial plots in Wales for himself and his wife, Elizabeth Taylor, though he was ultimately buried in Switzerland.

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FORMERLY DOMICILED RESIDENTS

Extra care is needed where an individual with a domicile of origin returns to the UK, even if it is for the short term. These returning individuals are referred to as formerly domiciled residents. If the individual meets the following criteria, HMRC will view them as a domicile for all tax purposes:

- they were born in the UK with a UK domicile of origin
- they have previously acquired another non-UK domicile of choice
- they are resident in the UK and were resident in the UK in at least one of the two previous tax years

SO, HOW ARE THE ODDS STACKED?

It used to be possible, until 2009, to seek a provisional ruling from HMRC, effectively asking them to confirm whether – at the time of the request – enough had been done to satisfy their tests. This confirmation is no longer possible so it is important to know that the burden of proving a change of domicile rests with the party asserting the change.

This burden and standard of proof required, as well as the information and documents required from the deceased's executors, are outlined in the extensive Residence, Domicile and Remittance Basis – RDRM23000 series of HMRC manuals, which can be found for reference online at gov.uk

To summarise, in the words of RDRM23030: 'A change of domicile is never to be lightly inferred, particularly a change from a domicile of origin to a domicile of choice, which is regarded by the courts as a serious step requiring clear and unequivocal evidence. The standard of proof in this area is the civil one, on the balance of probabilities, but discharging it requires suitably cogent and convincing evidence.'

With that in mind, a policy of 'plan for the worst but hope for the best' is the most sensible option. As mentioned earlier, by assuming ongoing UK domicile when managing a client's potential IHT exposure, any posthumous determination by HMRC cannot then worsen the position for their beneficiaries.

This document is based on our interpretation of the law and HM Revenue and Customs practice as at November 2021. Tax rules may change and depend on individual circumstances.

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