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1. Types of tax

1.1 Inheritance tax and tax on gifts during lifetime

The United Kingdom (UK) has a unified estate and gift tax called inheritance tax (IHT). IHT applies to the value of an individual's estate when he or she dies (in which case he or she is deemed to make a transfer of the whole estate immediately before such time) and to certain transfers or gifts made during the individual's lifetime. The tax applies on the basis of the loss of value to the donor's estate that arises by reason of the transfer of value.

Adjustments are made to take account of property that increases or decreases in value by reason of an individual's death (e.g., life insurance policies that mature on death and form part of the deceased's estate).

Certain other events may give rise to deemed transfers of value, including deliberate depreciatory transactions, sales at an undervalue, when a person's interest in certain trusts comes to an end, and when a close company (broadly, one in the control of five or fewer persons) makes a disposition. In addition, certain trusts are subject to 10 yearly inheritance tax charges and charges when an asset is distributed out of trust.

Types of transfer

Essentially, there are three types of transfers for IHT purposes. These are:

Exempt transfers

As noted in Section 4, certain transfers, in a lifetime or on death, attract special exemptions, such as gifts to charities and between spouses. These attract no tax either immediately or upon the individual's death.

Potentially exempt transfers (PETs)

These are certain lifetime transfers that only become chargeable if the transferor dies within seven years of making the gift. Types of gifts that fall within this category include outright gifts from one individual to another (other than between spouses, which are exempt as noted above).

It should be noted that the potential tax exposure, which would arise on death, can normally be provided for via bespoke insurance policies that are often available at competitive rates depending on an individual's specific circumstances.

Chargeable transfers

These are immediately chargeable when made and will use the nil-rate band (see Section 4 below) and any available annual allowances, with any excess being liable to IHT at 20% (and potentially higher taxes if death occurs within the following seven years). Common lifetime chargeable transfers include transfers to most trusts or to a company that is not 100% owned by the transferor.

Transfers on death are fully chargeable at 40% to the extent they exceed the available nil-rate band and, if applicable, the residence nil-rate band for an individual's main home, unless specific reliefs are available (e.g., business relief) or the transfer is exempt (e.g., a bequest to a spouse (to the extent that the spouse exemption is unlimited – see Section 4) or to an exempt person such as an EU charity)). IHT on death is generally levied on the deceased's estate, rather than the beneficiary(ies) thereof.

Transfers by non-UK domiciliaries

With respect to the three types of transfers set out above, it is important to note that when an individual is non-UK domiciled and not deemed UK domiciled (as set out in Section 2.2), special rules apply.

With effect from 6 April 2017, the Government introduced new deemed-domiciled rules for IHT (and other personal taxes not covered in this guide), as set out in Section 2.2.

UK residential property held via offshore structures

From 6 April 2017, UK residential property held via a non-UK resident structure (e.g., a non-UK company or a non-UK partnership) will now be subject to UK IHT. Interests in loans provided for the acquisition, maintenance or enhancement of a UK residential property, or to acquire a qualifying interest in a close company or partnership that owns UK residential property, will be within the scope of IHT for most creditors, with only limited exceptions. Such debts are generally deductible for the debtor in calculating the value liable to IHT, and restrictions on the deductibility of connected party debts have been removed. When an entity holding a UK residential property has been sold, or a loan relating to that property has been repaid, the proceeds will continue to be within the scope of IHT for two years after the sale/repayment. When the UK residential property is held within a non-UK trust (e.g., with a non-UK company between the trust and property), the trust will be treated as holding "relevant property," meaning the trust falls within the scope of the 10 yearly charges and exit charges. When a company is in place, that company may also be paying the annual tax on enveloped dwellings (ATED) charges.

Gifts with reservation

A gift where the donor has reserved or retained some direct or indirect benefit or enjoyment over the property given away is treated as being part of the donor's estate for tax purposes until the reservation is removed. It should be noted that this does not affect the normal IHT consequences of making the gift; although, if ultimately this causes potential double taxation, regulations provide appropriate offset to avoid this. For example, a gift to a trust of which the settlor (the person adding property to the trust) is also a beneficiary may trigger a lifetime tax charge at 20%, while the asset gifted would still remain within the settlor's estate for IHT purposes, subject to 40% IHT on death. The release of the reservation is regarded as the making of a potentially exempt transfer. These provisions can also be triggered by any informal, nonbinding arrangement made with the recipient of the gift to provide a benefit in some indirect way to the donor.

Pre-owned assets charge

This is an income tax charge that depends on whether or not property is included in a person's estate for IHT purposes. The provisions were introduced to counter planning measures that gave the donor continued benefit from the assets given away, but which did not fall within the gifts-with-reservation legislation outlined above. From 6 April 2005, when a donor has previously owned an asset (either tangible or intangible) and no longer does so, but arrangements have been made to give him or her continued enjoyment of such property without the asset forming part of his or her estate for IHT purposes, an income tax charge is imposed on him or her, broadly based on the value of the benefit he or she receives. The charge applies when there was previous ownership by the donor at any time since 17 March 1986, and complex rules cover situations where substitutions and replacements have been made by the donee (the recipient of the gift) since then. Gifts of cash can also cause the provisions to apply if made within the prior seven years. The pre-owned assets charge on intangible property affects assets that are neither land nor chattels placed in a settlement where a settlor still has an interest and where certain other conditions are also met.

1.2. Gift tax

There is no separate gift tax in the UK, although the above sets out circumstances when lifetime gifts can trigger an IHT charge. Additionally, lifetime gifts (other than to a spouse) are generally treated as disposals for capital gains tax purposes.

1.3. Real estate transfer tax

Stamp Duty Land Tax (SDLT)

SDLT is charged on transfers of real estate interests located in England and Northern Ireland and certain partnership transactions, at rates ranging from 0% to a total of 17% (the highest rate currently payable on certain purchases of residential property by so-called foreign purchasers).

SDLT on residential property

SDLT arises on transfers of residential property at progressive basic rates up to 12% on the VAT-inclusive consideration provided or, in certain cases (e.g., if buyer is a company that is connected to the seller), the consideration chargeable to SDLT may be substituted with the market value of the transferring property. SDLT is the liability of the purchaser.

On 1 April 2016, the UK Government introduced higher SDLT rates on certain purchases of additional residential property (and any purchases of residential property by "non-natural" buyers, defined below) that complete on or after 1 April 2016 (subject to transitional provisions). This imposes an additional three percentage points of SDLT above the standard SDLT rates.

Subject to certain exclusions, a flat SDLT rate of 15% is payable on certain acquisitions of residential properties with a market value above GBP500,000 by "non-natural buyers," such as companies, collective investment schemes and partnerships where at least one of the partners is a company (irrespective of whether these are UK or non-UK entities). This will be relevant for many individuals who use Special Purpose Vehicles (either directly or via offshore trusts) to hold UK residential property and will not be limited to those who have engaged in SDLT planning.

A further 2% SDLT surcharge may be added on top of the rates mentioned above on purchases of residential property in England and Northern Ireland by "non-UK residents" from 1 April 2021. The definition of what constitutes a non-resident for the purposes of SDLT is complicated and can include entities incorporated or formed in the UK.

From 22 November 2017, relief has been available for purchases by first-time buyers up to GBP500,000 where the buyer intends to occupy the purchased dwelling as their sole or main residence. For first-time buyers paying up to GBP300,000, no SDLT is payable. For purchases between GBP300,000 and GBP500,000, only the purchase price in excess of GBP300,000 is chargeable to SDLT at the rate of 5%. There is no entitlement to any relief where the purchase price exceeds GBP500,000.

On the grant of a new residential lease, SDLT also applies at a rate of 1% on the net present value of the rent under the relevant lease in excess of GBP125,000.

Temporary rates for purchases of residential properties in England and Northern Ireland (including the grants of leases) apply for purchases, which occurred between 8 July 2020 and 1 July 2021. These have temporarily increased the nil rate band from GBP125,000 to GBP500,000 (subject to the additional 3% rate mentioned above). The nil rate band is then reduced to GBP250,000 from 1 July 2021 until 1 October 2021, at which point, it returned to its original level of GBP125,000.

SDLT on non-residential or mixed-use property

SDLT is charged on transfers of non-residential or mixed use property at progressive rates up to 5% on the VAT-inclusive consideration provided or, in certain cases, the consideration chargeable to SDLT may be substituted with the market value of the transferring property.

On the grant of a new non-residential (including mixed use) lease property, SDLT also applies at a rate of 2% on the net present value of the rent under the relevant lease that exceeds GBP5 million (below this, the rate applying on the net present value of the rent that is between GBP0 and GBP150,000 is 1%).

Gifts of land and buildings for no chargeable consideration do not, however, generally incur a charge, although a charge by reference to the market value of the property may arise in certain circumstances.

Land and Buildings Transaction Tax (LBTT)

From 1 April 2015, transfers of certain real estate interests situated in Scotland and certain partnership transactions involving Scottish property are subject to Land and Buildings Transaction Tax (LBTT). This, too, is a progressive charge levied on the value of the (VAT-inclusive) consideration provided or, in certain cases (e.g., if the buyer is a company that is connected to the seller), the consideration chargeable to LBTT may be substituted with the market value of the transferring property.

For transfers of non-residential (or mixed-use property), LBTT applies at a rate of 1% on the amount of chargeable consideration that is over GBP150,000 and at a rate of 5% on the amount of chargeable consideration that is over GBP250,000.

For transfers of residential property, LBTT applies at progressive rates up to 12%.

A surcharge known as Additional Dwelling Supplement (ADS) can apply to purchases of additional residential property (and certain first purchases of residential property by corporate buyers and certain non-natural persons) in Scotland. Prior to 25 January 2019, the surcharge was 3%. This, however, increased for transactions entered into on or after 25 January 2019 to 4% (with transitional rules for the contract entered into prior to 12 December 2018). The effective top rate for residential property is thereby currently 16%.

First-time buyers' relief for LBTT applies to increase the nil-rate band for first-time buyers from GBP145,000 to GBP175,000, thereby providing a relief of up to GBP600.

The temporary rates for purchases of residential properties in Scotland apply for purchases occurred between 15 July 2020 and 31 March 2021, which temporarily increased the nil rate band from GBP145,000 to GBP250,000 (subject to the additional 4% rate mentioned above).

Similar to SDLT and LTT, there are special LBTT rules regarding lease transactions. With regards to the grant of a lease over non-residential property in Scotland (taking place on or after 7 February 2020), LBTT applies at a rate of 1% on the net present value of the rent under the relevant lease between GBP150,000 and GBP2m and at a rate of 2% on the net present value of the rent in excess of GBP2m. Any non-rent chargeable consideration provided for the grant of the lease will be charged at the non-residential rates up to 5% as outlined above.

Generally, leases of residential property are exempt from LBTT.

Land Transaction Tax (LTT)

From 1 April 2018, transfers of certain real estate interests situated in Wales and certain partnership transactions involving Welsh property are subject to Land Transaction Tax (LTT). This, too, is a progressive charge levied on the value of the (VAT-inclusive) consideration provided or, in certain cases (e.g., if the buyer is a company that is connected to the seller), the consideration chargeable to LTT may be substituted with the market value of the transferring property.

For transfers of residential property, LTT applies at progressive rates up to 12%. As with SDLT and LBTT, a surcharge can apply to purchases of additional residential property (and certain purchases of residential property by corporate buyers and certain non-natural persons) in Wales. Prior to 22 December 2020, the surcharge was 3%. This, however, increased to 4% for transactions entered into on or after 22 December 2020. The effective top rate for residential property is thereby currently 15%. There is no equivalent first-time buyers' relief for LTT as there is for LBTT and SDLT.

For transfers of non-residential property, LTT applies at progressive rates up to 6%.

Similar to SDLT and LBTT, there are special LTT rules regarding lease transactions. With regards to the grant of a lease over non-residential property in Wales, LTT applies at a rate of 1% on the net present value of the rent under the relevant lease in excess of GBP150,000 and 2% over GBP2m. Any non-rent chargeable consideration provided for the grant of the lease will be charged at the non-residential rates up to 6% as outlined above.

The temporary rates for purchases of residential properties in Wales (including the grant of a lease) apply for purchases occurred between 27 July 2020 to 30 June 2021, which temporarily increased the nil rate band from GBP180,000 to GBP250,000 (subject to the additional 4% rate mentioned above).

With regards to the grant of a lease over residential property in Wales, there is no LTT on the net present value of the rent under the relevant lease, although LTT is still payable on any premium or non-rent chargeable consideration in the normal way.

Annual tax on enveloped dwellings (ATED)

ATED starting at GBP3,800(2022-23), but increasing depending on the property value (capped at a maximum of GBP244,750 per annum in 2022-23), applies to those interests held by non-natural persons (as defined above) in a UK dwelling (broadly, an individual residential unit) over GBP500,000. This charge is separate to SDLT, LBTT or LTT and applies to residential properties situated anywhere in the UK. The tax is subject to certain reliefs (e.g., property developers, property rental businesses and qualifying housing cooperatives).

For disposals made from 6 April 2019, ATED-related CGT was abolished and any gain made by a company from this date will be liable to corporation tax and must be declared on the company's corporation tax return.

1.4. Endowment tax

There is no endowment tax in the UK.

1.5. Transfer duty

In addition to the potential charge of SDLT, LBTT or LTT in relation to the acquisition of UK real estate mentioned above, UK stamp duty is chargeable on documents transferring stock or "marketable securities" (e.g., shares and certain debt instruments) and transfers of certain partnership interests; duty is generally charged at the rate of 0.5% (rounded up to the nearest GBP5) on the consideration given. If no consideration is given, there is no charge to stamp duty.

UK stamp duty reserve tax (SDRT) arises on an agreement to transfer “chargeable securities” (e.g., shares, stock and loan capital) and is also charged at the rate of 0.5% on the consideration paid. It is essentially an alternative tax to stamp duty and, subject to meeting certain conditions, when the relevant document of transfer is duly stamped, this will cancel the charge to SDRT that would otherwise arise on the agreement to transfer the relevant chargeable securities. SDRT is therefore generally payable when the chargeable securities are transferred electronically.

With appropriate implementation, these taxes broadly do not apply in practice to transfers of shares in non-UK-incorporated companies.

There is not otherwise any specific transfer duty in UK law, although the above sets out circumstances when lifetime gifts can trigger an IHT charge.

1.6. Net wealth tax

There is no net wealth tax in the UK. However, the annual ATED charge (mentioned in Section 1.3) has applied since April 2013 for certain residential properties held by “non-natural persons.”

2. Who is liable?

The taxation of individuals in the UK is determined by their residence and domicile status (see below), although residence is less important for IHT. IHT is levied on the worldwide estate of a decedent who was domiciled in the UK and on the UK-sited assets of a person who was neither domiciled nor deemed domiciled (see below) in the UK. Lifetime gifts may also be subject to IHT on the same basis. The decedent’s personal representative (i.e., the person charged with administering his or her estate under the terms of his or her will or under the intestacy laws) or the donor of a lifetime gift is normally liable for payment of IHT (rather than the donee), but various provisions exist for recovery of unpaid tax from other persons (e.g., the recipients of gifts or the trustees of settlements). However, in the case of a failed potentially exempt transfer (see below), where tax only arises if the donor dies within the following seven years, the donee is the person primarily liable to pay the tax. When the tax arises on trust assets, it is normally the trustees who are liable to make payment.

2.1 Residence

From 6 April 2013, a statutory residence test (SRT) has been implemented in the UK. The SRT is a three-part test:

1. Automatic overseas test
2. Automatic residence test
3. Sufficient ties test

The sufficient ties test determines whether a person is considered to be UK resident by analysing the number of days spent in the UK and the number of connecting factors he or she has with the UK, which are set out in statute. Examples of connecting factors are the availability of accommodation, where his or her family live and substantive time working in the UK. The greater number of connecting factors an individual has to the UK, the fewer days he or she has to spend in the UK before being treated as a UK resident.

2.2 Domicile

- Under the law of England and Wales, an individual’s domicile is the country considered to be their permanent home, even though they may be resident in another country. Every person is born with a domicile of origin, which is normally that of their father at the date of their birth. The fact that a person does not live in the country he or she regards as his or her permanent home for many years does not preclude him or her from being domiciled there under English and Welsh law, provided he or she has not formed an intention to make any other country his or her permanent home.

- ▶ A person may, however, acquire a domicile of choice that displaces his or her domicile of origin by moving from one country of residence to another and living there with the intention to remain in the new location permanently or indefinitely. The onus of proving a change of domicile is on the person asserting the change and the burden of proof when the assertion is the loss of a domicile of origin is onerous.
- ▶ From 6 April 2017, an individual with a non-UK domicile of origin will be deemed domiciled in the UK once he or she has been resident in the UK in at least 15 out of the previous 20 tax years. Where an individual has claimed "split-year" treatment (e.g., when moving to or leaving the UK partway through a tax year), the split years will count as years of residence for this purpose. Individuals born in the UK with a UK domicile of origin (returning doms) will be deemed domiciled in the UK for any tax year in which they are UK resident, and will be within the scope of UK IHT if they were UK resident in one of the two prior tax years. In addition, a person who is domiciled or has become deemed domiciled in the UK, but leaves to reside permanently elsewhere, or otherwise acquires a non-UK domicile of choice, will continue to be deemed to be domiciled in the UK for three calendar years thereafter.
- ▶ When one spouse is UK domiciled and the other is non-UK domiciled, there is a lifetime limit of the prevailing nil-rate band (currently GBP325,000) on the assets which can be passed to the non-UK-domiciled spouse under the spouse exemption. As of 6 April 2013, the non-UK-domiciled spouse is able to elect to be treated as UK domiciled for the purpose of IHT. This allows an unlimited exemption for transfers of property between spouses but brings the whole estate of the non-UK-domiciled spouse into the UK inheritance tax net. An election of this type should relate only to inheritance tax and should not have an impact on their domicile for other purposes (so it would not, for example, prevent them from claiming the remittance basis). The election may be made either during lifetime or on death (by the personal representatives of the decedent's estate). While the election is defined as being irrevocable, there are circumstances under which the election, while not revoked, will nevertheless cease to be effective. This occurs once the person making the election ceases to be UK tax resident for four consecutive tax years.

3. Rates

Lifetime transfers

Lifetime chargeable transfers are taxed at a rate of 20%.

Potentially exempt transfers (PETs) are only subject to a tax charge if the donor dies within seven years of the PET. If death occurs within seven years of making a PET, then tax on a PET arises at up to a rate of 40% and further tax on a previous chargeable gift may arise, at up to 20%, subject to the following reductions:

Number of years after gift made	Percentage of death tax due
0-3	100%
3-4	80%
4-5	60%
5-6	40%
6-7	20%
7 or more	0%

In the case of a lifetime chargeable gift where higher tax becomes payable at death, the tax previously paid is offset against the death taxes due.

Transfers on death

Transfers on death are generally charged at 40%.

When a will contains a charitable legacy leaving at least 10% of the net value of an individual's estate to a UK-registered charity, this will reduce the inheritance tax rate applied to that estate by 10% – meaning that the effective tax rate will be reduced to 36%.

The new lower rate will apply automatically to any component of an estate that meets the 10% condition. However, the legislation contains a provision to allow the “appropriate persons” in relation to that component to opt out of the provisions. They may choose to do this when it is expected that the benefit of the low rate will be reduced and they do not wish to incur the cost of valuing assets donated to charity.

Trusts

Certain trusts are also liable to IHT (see Section 7 below) on each 10-year anniversary of the trust’s creation, and on distributions to beneficiaries between these anniversaries. The maximum rate charged at these events is 6% of the fund value.

Date for payment of tax

Lifetime transfers

For chargeable transfers made between dates:

6 April and 30 September	Payment is due on 30 April of the following year.
1 October and 5 April	Payment is due six months after the end of the month in which the chargeable transfer was made.

From 6 April 2014, the tax payment and filing dates for certain trust charges changed so that they must be reported within six months of the transfer and any tax must be settled within the same timeframe.

Transfers on death

For transfers on death, and extra tax becoming payable on chargeable lifetime transfers and potentially exempt transfers made within seven years of death, payment is due six months after the end of the month in which death occurred.

4. Exemptions and reliefs

IHT is charged on a cumulative basis so that the values of all gifts made within the previous seven years, which do not qualify for exemptions or reliefs, are added together. IHT is charged at a zero rate on an amount known as the nil-rate band, which is currently GBP325,000. The Chancellor stated in his Budget of 3 March 2021 that the nil rate band is to remain fixed at this level until April 2026.

In the tax year 2017-18, the UK Government introduced the “main residence nil-rate band,” which has been introduced as an additional nil-rate band when a residence is passed on death to a direct descendant. The residence nil-rate band has been phased since 6 April 2017. The residence nil-rate band has increased by GBP25,000 increments each tax year since 2017-18, and as of 6 April 2020, it will be GBP175,000. The Chancellor stated in his Budget of 3 March 2021 that the residence nil-rate band will remain fixed at this level until April 2026. Any percentage of the unused nil-rate band on first death can be transferred to a surviving spouse or civil partner. Furthermore, the residence nil-rate band is now also available when a person downsizes to a lower-value home or ceases to own a home and assets of an equivalent value, up to the value of the residence nil-rate band, are bequeathed to a direct descendant on death. If an individual’s estate has a net value (after the deductions of debts) of more than GBP2 million, the residence nil-rate band will have a tapered withdrawal of GBP1 for every GBP2 over the GBP2 million threshold.

As mentioned in Section 1.1, chargeable lifetime transfers in excess of this cumulative amount are currently charged at 20% (although if death occurs in the following seven years, this figure may be increased). Transfers on death are charged at 40%. Certain lifetime transfers are regarded as exempt (see below) and others as potentially exempt (see Section 1.1).

There are a variety of exemptions and reliefs available to prevent a charge to tax arising on transfers of property. These include the following:

Asset/purpose-related exemptions

During lifetime or at death, the following gifts can be made tax-free without affecting the GBP325,000 nil-rate band:

- ▶ Transfers of any amount to a UK-domiciled spouse or civil partner, or between two non-UK-domiciled spouses or civil partners
- ▶ Transfers by a UK-domiciled spouse or civil partner to a non-UK-domiciled spouse or civil partner up to the current nil-rate band and unlimited if election made (see Section 2.2)
- ▶ Gifts to certain favored bodies (e.g., UK-registered charities)
- ▶ Gifts of certain favored types of property (e.g., heritage property)
- ▶ Gifts of agricultural or business property (that can qualify for 50% or 100% relief depending on the nature of the property)

From 5 December 2005, same-sex couples were able to register as civil partners under the Civil Partnership Act 2004 and benefit from the same exemptions and reliefs as married couples, and the Marriage (Same-Sex Couples) Act 2013 gave further rights to same-sex couples.

Lifetime gift exemptions

The following exemptions are available for lifetime gifts only:

- ▶ Gifts of up to GBP250 per donee per tax year
- ▶ Annual exemptions of up to GBP3,000 on chargeable transfers made in a tax year (this can be carried forward for one year only)
- ▶ Gifts of between GBP1,000 and GBP5,000 in anticipation of marriage or civil partnership (depending on the identity of the donor)
- ▶ Payments for family maintenance (e.g., spouse and minor children or children in full-time education)
- ▶ Normal expenditure out of income that does not affect the donor's standard of living

Quick succession relief

In addition, if a person inherits assets and dies within five years thereafter, a form of quick succession relief allows a proportion of tax on the earlier death to be set against the tax at the later death.

5. Filing procedures

In England and Wales, Form IHT400 must be used to deliver an account of a deceased's taxable estate to HM Revenue & Customs' (HMRC) Capital Taxes Office within 12 months of the end of the month of death. Any inheritance tax due must also be paid within six months after the end of the month in which the deceased died. This is normally done simultaneously with the application for a grant of probate to administer the estate, as the tax must be paid before this is issued.

In Scotland, the rules are slightly different. An inventory of the estate must be completed and presented to the local Sheriff Clerk or Commissary Office in Edinburgh for the issue of Confirmation (which is the equivalent of grant of probate) along with a C5 Form if the estate qualifies as either an excepted estate or an exempt excepted estate. If the estate does not qualify, Form IHT400 must be submitted to HMRC. All the accounts should be sent in within 12 months of the end of the month in which death occurred.

Periodic and exit charges for trusts are reported on Form IHT100 and the form must be submitted within six months of the charge. Chargeable lifetime events (except those that are excepted transfers or settlements) must be reported on Form IHT100 within one year of the event. A Form IHT100 should also be submitted where an individual has made PETs (and any lifetime chargeable transfers) in the previous seven years that exceed the value of the nil rate band.

6. Assessments and valuations

For UK IHT purposes, assets are valued at the price that they would be reasonably expected to fetch if sold in the open market.

There is specific guidance that applies to the valuation of shares and securities, where there are two possible valuation methods:

- The quarter-up method
- The average of the highest and lowest marked bargains

In addition, an adjustment will be required when the share or security is quoted ex-dividend or ex-interest.

In some circumstances, liabilities (e.g., loans secured on the asset) can reduce the value subject to IHT. It should be noted that the deductibility of loans is disallowed when they have been taken out to acquire or enhance excluded property, relievable property and where there is no intention to repay the loan on death (subject to limited grandfathering provisions).

From 2014, this rule has been extended to disallow the deductibility of borrowed funds deposited into a foreign currency account with a UK bank. Such accounts are now included in the definition of “excluded property.”

7. Trusts, foundations and private purpose funds

From an estate planning point of view, trusts are often used as a means of making lifetime gifts to enable the donor to place constraints on the donee. Property will normally be gifted at a time when it does not attract an IHT liability and any growth in value of assets held by the trust is outside of the donor’s estate, provided that the donor and donor’s spouse cannot benefit from the trust. Care needs to be taken when making gifts, as this can attract a capital gains tax liability on any unrealized appreciation in the asset.

Under the new non-domicile rules, the UK Government has changed the IHT regime for trusts (please see the summary of the key changes below in this section).

Types of UK trust

Bare trust

A bare trust is the simplest form of trust where property is held effectively as nominee for another person. For legal purposes, the trustees have certain duties and obligations, but for UK tax purposes, the trust and gifts to it are treated as if the beneficiary were the owner of the assets themselves.

Interest in possession trust

An interest in possession trust, or life interest trust, is one that confers on one or more persons a right to receive the income with, in some cases, potential discretionary distributions of capital. From 22 March 2006, gifts to an *inter vivos* interest in possession trust have followed the tax treatment that applies to discretionary trusts (see below), whereas those that are created as an immediate post-death interest (an IPDI) will not be part of the relevant property regime (see below). An IPDI will arise where an interest in possession is created on the death of a testator/testatrix (either pursuant to the terms of a will or on intestacy). However, it is important to note that, depending on the identity of the life tenant, the creation of an IPDI may still result in an inheritance tax charge arising for the testator/testatrix’s estate on their death.

Discretionary trust

A discretionary trust is one where the trustees have discretion over distributions of capital and income, including accumulation and maintenance trusts.

An accumulation and maintenance trust is a type of discretionary trust, for a class of beneficiaries under 25 years of age, which prior to 22 March 2006 (provided it complied with special rules), had beneficial ongoing inheritance tax treatment. This tax treatment is no longer available and the tax treatment follows that of a discretionary trust, as set out below. In place of accumulation and maintenance trusts, there are two trust regimes: trusts for bereaved minors and 18-25 trusts, and, provided certain conditions are met, each trust has a more beneficial inheritance tax treatment than a normal discretionary trust. However, as far as new trusts are concerned, both of these new categories of trust can only be set up on death.

Creation of trusts during lifetime and transfers of assets in

The creation of an interest in possession trust or a discretionary trust, or the transfer of property into such a trust, is, generally speaking, a chargeable lifetime transfer.

The gift to a trust may therefore incur a lifetime IHT charge of 20% if the value of assets given over the seven-year cumulative period exceeds the nil-rate band or the transfer does not otherwise qualify for relief. Additionally, trusts that are in the relevant property regime will be subject to periodic and exit charges. This means that a tax charge of up to 6% of the fund value applies at each 10-year anniversary of the trust's creation (the periodic charge) and, proportionately, on distributions from the trust between these anniversaries (the exit charge). Income that has not been accumulated but remains undistributed for more than five years at the date of a periodic charge will now be deemed to be capital for the calculation of the charge. In 2015, legislation was introduced that targets the use of multiple trusts by the settlors on death, thus preventing the use of the multiple nil-rate bands. Prior to 22 March 2006, the creation of an interest in possession trust and an accumulation and maintenance trust were potentially exempt transfers. Since 22 March 2006, only the following gifts into trust should qualify as a potentially exempt transfer:

- ▶ A gift into a qualifying disabled person's trust
- ▶ A gift into a bare trust created for an individual beneficiary

Non-UK settlements

Trusts, whether or not UK resident, which are created by UK domiciled or deemed-domiciled individuals, are subject to the UK IHT legislation, regardless of the residence of the settlor at the time of their creation or the *situs* of the assets held. Whenever trusts are formed by non-UK-resident persons, care needs to be taken to ensure they are not still deemed to be UK domiciled and thus subject to the UK IHT provisions.

Excluded property settlements

If a trust is established by a settlor when he or she is non-UK domiciled (and when he or she is also not deemed domiciled in the UK) and the trust assets are sited outside the UK, the trust is an excluded property trust. This means that the non-UK assets, provided they are situated outside the UK at the time at which a charge to IHT could arise, will remain outside the scope of IHT, even if the settlor subsequently becomes UK domiciled or deemed domiciled as the law currently stands, provided that they do not add assets to the trust at that point. Such trusts are normally non-UK-resident trusts since this may also be important for capital gains tax purposes. Non-UK assets settled on trust once an individual becomes deemed domiciled will not benefit from the excluded property settlement provisions for IHT.

Excluded property settlements established by non-UK-domiciled persons should retain their UK tax-privileged status even when the non-UK-domiciled settlors become deemed domiciled for UK tax purposes (under the "15 out of the 20 years" deemed-domicile rule; please see Section 2.2 above), providing the non-domicile status is maintained under common law and the trust is not "tainted." However, trusts established by returning doms (as defined above) and holding non-UK *situs* assets will no longer be excluded property (and therefore may be exposed to UK IHT on 10-year anniversaries and in distributions of capital from the trust) if the settlor is UK resident at the relevant time.

UK sited assets, except those mentioned in the paragraph below, owned by a non-UK incorporated company held by an excluded property trust, will also remain outside the scope of IHT. However, certain assets should typically not be held in this way, as there may be other UK tax disadvantages (e.g., UK real estate occupied by a beneficiary).

All UK residential property owned by non-UK companies and other entities (for example, partnerships or foundations) are now all within the scope of UK IHT. The value of the interest in the entity holding the property will be within the scope of IHT to the extent it derives its value from UK residential property (less any relevant borrowings), thus negating the planning outlined above. Interests in loans provided in relation to the acquisition, maintenance or enhancement of a UK residential property or to acquire a qualifying interest in a close company or partnership that owns UK residential property will also be within the scope of IHT for the creditor. Such debts are generally deductible for the debtor, and restrictions on the deductibility of connected-party debts have been removed. The relevant chargeable events for UK IHT purposes may include the following:

- The death of the individual, wherever resident, who owns the company shares
- A gift of the company shares into trust
- The 10-year anniversary of the trust
- Distribution of capital (such as company shares) out of trust
- The death of the donor within seven years of having given the company that holds the UK property away to an individual
- The death of the donor or settlor when he or she benefits from the gifted UK property or shares within seven years prior to his or her death

8. Grants

With regard to estate taxes, there are no specific rules in the UK.

9. Life insurance

The proceeds from a life insurance policy will fall into an individual's estate on death and trigger an IHT charge on assets passing. It is possible, however, to write the policy into trust so that it falls outside the estate and, consequently, the value is not chargeable on death.

10. Civil law on succession

10.1 Summary of measures that may reduce IHT

UK domiciliaries and UK-deemed domiciliaries

The following measures may help to reduce IHT liabilities for UK domiciliaries and deemed domiciliaries.

- Lifetime gifts that constitute PETs or annual gifts out of income
- Lifetime gifts that are exempt
- Investing in assets that qualify for reliefs, such as business property relief or agricultural property relief
- Settling assets into trust to create a nil-rate band trust

Non-UK domiciliaries

The extent to which excluded property trusts may reduce IHT for individuals who are not UK domiciled is discussed in Section 7 above.

10.2 Succession

There are no compulsory succession rules in England and Wales, other than the statutory rules of intestacy covered below in Section 10.5.

In Scotland, however, members of the family have automatic inheritance rights irrespective of the provisions in a will (legal rights), and these rights are covered below in Section 10.

10.3 Forced heirship

England and Wales

There are no compulsory inheritance rules or forced heirship rules in England and Wales. However, if no provision has been made for his or her spouse or for other persons financially dependent on the deceased, a claim against a UK-domiciled individual's estate may be made under the Inheritance (Provision for Family and Dependents) Act 1975.

Scotland

In Scotland, a spouse and children (and grandchildren, if his or her parent has predeceased) have automatic inheritance rights irrespective of the provisions in a will (legal rights). These can be claimed as an alternative to accepting any inheritance under the will. It is not possible to accept both. If there are no children, Scots law provides a surviving spouse with half of the net movable estate (assets excluding buildings and land). If there is no spouse, the children take half of the net movable estate to be divided equally between them. If there are a spouse and children, the spouse and the children (jointly if more than one) each takes one-third of the net movable estate. The balance can be freely disposed of by will or by the laws of intestacy if there is no will.

These rights under Scots law can be defeated by lifetime gifts to others or to trusts of the individual's movable estate. It is difficult to completely defeat legal rights, however, as there is almost always some movable property remaining in an individual's estate on the date of death.

10.4 Matrimonial regulations and civil partnerships

There is no concept of matrimonial or community property in the UK.

10.5 Intestacy

Testamentary documents and intestacy

A will is a legal document that regulates an individual's estate after death. Subject to what is said above with regard to Scotland, in England and Wales an individual generally has complete freedom of disposition.

The UK will normally accept the formal validity (i.e., of the document itself) of a will drawn under the laws of the deceased's domicile, nationality or place of residence at the time of making the will or at death. In England and Wales, the requirement is that the testator sign at the end of the will in the presence of two witnesses, who must sign in his or her presence and in the presence of each other. In Scotland, the testator must subscribe the will and sign every page in the presence of one independent witness, who must also sign his or her presence. A will can generally be revoked and replaced, save in limited circumstances where mutual wills have been written.

Whether he or she has the personal legal capacity to make the dispositions in the will is generally governed by the law of the deceased's domicile. In the case of the UK, this means the law of the *situs* of the assets will be relevant when real estate is concerned, and the law of the deceased's domicile will be relevant in the case of other assets.

If there is no valid will at death, then the deceased is intestate and his or her estate passes under the statutory rules of intestate succession. When there are cross-border issues, the conflicts-of-law provisions will be relevant, which are beyond the scope of this chapter.

The intestacy rules are different depending on whether the individual is domiciled in England, Wales or Scotland on his or her death.

The following tables set out the current rules:

Intestacy rules in England and Wales

	Spouse or registered civil partner and children* survive decedent	Spouse or registered civil partner and parents survive decedent but no children, grandchildren or great-grandchildren	No spouse or registered civil partner survives decedent
Personal effects	Spouse or registered civil partner	Spouse or registered civil partner	–
Legacies	GBP250,000 and personal possessions to spouse or registered civil partner		–
	One-half of the rest To spouse or registered civil partner outright	To spouse or registered civil partner outright	Whole estate in order of priority to the exclusion of all others
			Children (at 18 years old or when married if before) and on trust until that time (surviving grandchildren take the share of a deceased child)
	One-half of the rest To children in equal shares at 18 years old (or when married if before) and on trust until that time (surviving grandchildren take the share of a deceased child)		Parents in equal shares
			Brothers and sisters (and nephews and nieces, if they have predeceased)
			Half-brothers and half-sisters (and their children, if they have predeceased)
			Grandparents in equal shares

	Spouse or registered civil partner and children* survive decedent	Spouse or registered civil partner and parents survive decedent but no children, grandchildren or great-grandchildren	No spouse or registered civil partner survives decedent
			Uncles and aunts (and their children, if they have predeceased)
			Half-brothers and half-sisters of decedent's parents (and their children if they have predeceased)
			The Crown

* Children of a predeceased child of the intestate parent take their parent's share.



Intestacy rules in Scotland

	Spouse or registered civil partner and children* survive decedent	Spouse or registered civil partner survives decedent but no children*	Children* survive decedent but no spouse or registered civil partner	Neither spouse nor registered civil partner nor children* survive decedent
1. Dwelling house right	To spouse or registered civil partner, up to a value of GBP473,000; balance per #5 below	To spouse or registered civil partner, up to a value of GBP473,000; balance per #5 below	–	–
2. Furniture and furnishings	To spouse or registered civil partner, up to a value of GBP29,000; balance per #4 then #5 below	To spouse or registered civil partner, up to a value of GBP29,000; balance per #4 then #5 below	–	–



	Spouse or registered civil partner and children* survive decedent	Spouse or registered civil partner survives decedent but no children*	Children* survive decedent but no spouse or registered civil partner	Neither spouse nor registered civil partner nor children* survive decedent
3. Financial provision	GBP50,000 to spouse or registered civil partner	GBP89,000 to spouse or registered civil partner	–	–
4. Legal rights	One-third of net movable estate to spouse or registered civil partner; one-third to children	One-half of net movable estate to spouse or registered civil partner	One-half of net movable estate to children	–
5. Balance of estate (heritable and movable) s2 of 1964 Act (i.e., Succession (Scotland) Act 1964)	To children	One-half to surviving parents and one-half to surviving siblings. If no surviving parents, all goes to siblings. If no surviving siblings, all passes to parents. If no surviving siblings or parents, all passes to spouse or registered civil partner.	To children	One-half to surviving parents and one-half to surviving siblings. If no surviving siblings, all passes to parents. If no surviving parents, all passes to siblings. If none of the aforementioned, all passes to aunts and uncles. If no aunts and uncles, all passes to grandparents. If no grandparents, all passes to brothers and sisters of grandparents. If none of the aforementioned, all passes to remoter relatives and if none of those, ultimately to the Crown.**

* When a child would have had a claim had he or she not died before the intestate parent, his or her descendants may claim that child's share.

** When a relative would have had a claim under these rules had he or she not died before the intestate individual, that relative's descendants may claim that relative's share. In this way, an intestate's nieces and/or nephews could have a claim if the estate (or part of it) was due to pass to the intestate individual's brothers and sisters, but one or more of the brothers or sisters died before the intestate leaving children.

10.6 Probate

In England and Wales, the granting of probate (when there is a will) or letters of administration (when there is no will) and, in Scotland, the obtaining of Confirmation, allows the personal representatives to administer the deceased's estate and for the assets to be passed to the beneficiaries as named in the will or by the laws of intestacy. Probate will only be granted when the tax due under the estate has been settled or, in limited circumstances, when an instalment option has been agreed with the authorities. The payment date for tax due is six months after the end of the month in which death occurred (see Section 5 above), after which interest will be charged on the outstanding sum. In England, the estate can be distributed as soon as a grant has been received. In Scotland, the personal representatives (executors) must wait six months from date of death before distributing in order to deal with any creditor claims (otherwise, they may be legally liable for any unpaid debts).

11. Estate tax treaties

11.1 Unilateral rules

When an asset is subject to tax overseas in a jurisdiction that does not have an estate tax treaty with the UK, unilateral rules will apply. Unilateral credit is given when inheritance tax and overseas tax are chargeable by reference to the same event and attributable to the value of the same property. In addition, the overseas tax must be similar in character to inheritance tax. The amount of tax relief given is capped at the lower of overseas tax paid and UK tax due.

11.2 Double-taxation treaties

The UK has concluded estate tax treaties with France, India, Ireland, Italy, the Netherlands, Pakistan, South Africa, Sweden, Switzerland and the United States.