



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 to the donor's estate that arises by reason of the transfer of value.

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

Certain other events give rise to deemed transfers of value (e.g., deliberate depreciatory transactions), and sales at an undervalue, or where a person's interest in certain trusts comes to an end or where 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

There are essentially three types of transfer for IHT purposes. These are:

Exempt transfers

As noted in 4 below, certain transfers, in lifetime or on death, attract special exemptions such as gifts to charities and spouses. These attract no tax.

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 gift that fall within this category include outright gifts from one individual to another.

It should be noted that the potential tax exposure, which would arise on death, can normally be insured at quite competitive rates.

Chargeable transfers

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

Transfers on death are fully chargeable unless specific reliefs are available (e.g., business property 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 a UK-registered charity).

Transfers by non-UK deemed domiciliaries

With respect to the three types of transfers set out above, it is important to note that where an individual is non-UK deemed domiciled (as set out in section 2.2), then these transfer rules only apply to assets that are UK *situs*.

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 tax consequences on 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 is a beneficiary may trigger a lifetime tax charge at 20% whilst still remaining within the settlor's estate for IHT purposes. The release of the reservation is regarded as the making of a potentially exempt transfer. These provisions can also be triggered by any informal non-binding arrangement made with the recipient of the gift, to provide a benefit in some indirect way to the donor.

Pre-owned assets charge

Although this is not a transfer tax, this income tax charge 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. From 6 April 2005, where a donor has previously owned an asset (either tangible or intangible) and no longer does so, but arrangements have been made to give him/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/her, broadly based on the value of the benefit he or she receives. The charge applies where 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 since then. Gifts of cash can also cause the provisions to apply if made within the prior seven years.

1.2. Gift tax

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

1.3. Real estate transfer tax

The UK levies a stamp duty land tax charge on transfers of land and buildings, at rates ranging from 0% to 5% (for residential properties in excess of £1m). The duty is charged on the purchaser of the land or property. Gifts of land and buildings for no chargeable consideration do not, however, realize a charge.

1.4. Endowment tax

There is no endowment tax in the UK.

1.5. Transfer duty

There is no specific transfer duty in UK law (other than for real estate), 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.



2. Who is liable?

The taxation of individuals in the UK is determined by their residence and domicile status (see below). 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 not domiciled in the UK. Lifetime gifts may also be subject to IHT on the same basis for UK domiciliaries and non-UK domiciliaries. 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 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. Where the tax arises on trust assets, it is normally the trustees who are liable to make payment.

2.1 Residency

From 6 April 2012, a statutory residence test will be implemented in the UK. The test will determine when a person is considered to be UK resident by virtue of analyzing the number of days spent in the UK and the number of connecting factors they have with the UK. Examples of connecting factors are the availability of accommodation, where their family live and UK employment. Broadly the greater number of connecting factors an individual has to the UK, the fewer days they will be able to spend in the UK before being treated as UK resident.

Prior to 6 April 2012, whether a person is UK resident is a question of fact generally determined on principles that are based on case law and the interpretation of the UK tax authorities, HM Revenue & Customs (HMRC), as summarized in the publication HMRC 6. HMRC 6 provides non-binding guidance.

However, broadly speaking:

- ▶ A person physically present in the UK for 183 days or more in the tax year (6 April to the following 5 April) will always be regarded as UK tax resident.
- ▶ If an individual comes to the UK for a settled purpose likely to last for a period of two years or more, or if on arrival he or she owns accommodation or takes a lease for three or more years, the individual is regarded as resident from the date of arrival.
- ▶ If visits to the UK over four consecutive tax years average 91 days or more per year, then an individual is regarded as resident in the UK from the beginning of the fifth year, provided he or she did not originally intend to spend such periods in the UK. However, if he or she does form such an intention, he or she will be resident from the beginning of the tax year in which such intentions were formed or, if he or she always had such an intention, from the date of arrival.

2.2 Domicile

- ▶ Under English Law, 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/her from being domiciled there under English 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. The onus of proving a change of domicile is on the person asserting the change and the burden of proof where the assertion is the loss of a domicile of origin is onerous.
- ▶ For IHT purposes, the concept of domicile is extended to include certain persons who have been resident in the UK in any part of 17 or more of the previous 20 UK tax years (6 April to the following 5 April). This is known as deemed domicile. In reality, this may be less than 17 calendar years as the calculation is by reference to the number of tax years (or part) in which an individual has been UK resident for income tax purposes. In addition, a person who has been domiciled in the UK as a matter of general law, but leaves to reside permanently elsewhere, or otherwise acquire a non-UK domicile is also deemed to be domiciled in the UK for three calendar years thereafter.



3. Rates

Lifetime transfers

Lifetime chargeable transfers are taxed at a rate of 20%. If death occurs within seven years of making a gift, then tax on a PET arises at up to 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 charged at 40%.

Date for payment of tax

Lifetime transfers

On chargeable transfers made between:

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

Transfers on death

On transfers at 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 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 £325,000 for the tax year 2011-12 and fixed until 2014-15. Where two individuals are married or in a civil partnership, any unused nil-rate band on the first death can be transferred to the surviving spouse's/civil partner's estate. As mentioned in section 1.1, chargeable lifetime transfers in excess of this cumulative amount are currently charged at 20% (though 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 £325,000 nil-rate band:

1. Transfers of any amount to a UK domiciled spouse or between two non-UK domiciled spouses or civil partners.
2. Transfers by a UK domiciled spouse or civil partner to a non-UK domiciled spouse or civil partner up to £55,000.
3. Gifts to certain favored bodies (e.g., UK registered charities).
4. Gifts of certain favored types of property (e.g., heritage property).
5. Gifts of agricultural or business property (which 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.

Lifetime gift exemptions

The following exemptions are available for lifetime gifts only:

1. Gifts of up to £250 per donee per tax year.
2. An annual exemption of up to £3,000 on chargeable transfers made in a tax year (this can be carried forward for one year only).
3. Gifts of between £1,000 and £5,000 in anticipation of marriage or civil partnership (depending on the identity of the donor).
4. Payments for family maintenance (e.g., spouse and minor children or children in full-time education).
5. Normal expenditure out of income, which 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, a form IHT400 must be used to deliver an account of a deceased's taxable estate to the Capital Taxes Office. Any tax due must also be paid at the same time. 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. The account should be sent in within 12 months of the end of the month in which death occurred.

Details of lifetime gifts should be submitted on form IHT100 within the following time limits:

Event	Time limit
Gift to a company or trust so that an immediate IHT charge arises	Within one year of making the gift
Gifts received from someone who dies within seven years of making the gift	Within one year of death
Gifts with reservation received from someone who dies within seven years of making the gift	Within one year of death



6. Assessments and valuations

For UK IHT purposes, assets are valued at the price that it 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.

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. Care needs to be taken when making gifts as this can attract a capital gains tax liability on any unrealized appreciation in the asset.

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, who would be absolutely entitled, but for being under a disability (e.g., a minor or a person who is mentally incapacitated). For trust purposes, the trustees have certain duties and obligations, but for UK tax purposes, the trust and gifts to it are treated largely as if the principal 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 potential discretionary distributions of capital. From 22 March 2006, gifts to an interest in possession trust follow that for discretionary trusts (see below).

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, which prior to 22 March 2006 (provided it complied with special rules) had beneficial ongoing 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 new 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 these new categories of trust can only be set up on death.

Creation of trusts 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 creation of an interest in possession trust in favor of a disabled person is an exempt 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 do not otherwise qualify for relief. Additionally, a tax charge of up to 6% of the fund value applies at each 10-year anniversary of the trust's creation and, proportionately, on distributions from the trust between these anniversaries.



Prior to 22 March 2006, the creation of an interest in possession trust and an accumulation and maintenance trust were potentially exempt transfers. Furthermore, prior to 22 March 2006, an accumulation and maintenance trust was a type of discretionary trust, for a class of beneficiaries under 25 years of age, which had beneficial tax treatment.

Since 22 March 2006, only the following gifts into trust should qualify as a potentially exempt transfer:

- ▶ A gift into a trust for a bereaved minor. The transfer is made on the death of a parent, who held an immediate post-death interest in the trust (that is, broadly, an interest in possession that arises on death).
- ▶ A gift into a qualifying disabled person's trust.

Non-UK settlements

Trusts, whether or not UK resident, which are created by UK domiciled individuals, are subject to the UK IHT legislation regardless of the residence of the settlor or the time of their creation or the *situs* of the assets held. Whenever trusts are formed by non-UK persons, care needs to be taken to ensure they are not still deemed to be UK domiciled and so 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 assets, provided they are situated outside the UK at the time of any charge to IHT, will remain outside the scope of IHT, even if the settlor subsequently becomes UK domiciled or deemed domiciled. As the law currently stands, the trust can therefore offer total protection against IHT for such assets. Such trusts are normally non-UK resident trusts since this status can also attract capital gains tax benefits.

It is also possible to take advantage of the excluded property trust status where the assets are sited in the UK. This can be achieved by means of the trust owning the UK assets through the medium of a non-UK *situs* company. The assets of the trust are in these circumstances regarded as being the shares in the company (which are regarded as non-UK *situs* assets) rather than the underlying assets situated in the UK. 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).

8. Grants

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

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 Estate planning

UK domiciliaries and UK deemed domiciliaries

Estate planning for UK domiciliaries and deemed domiciliaries has become more limited since 22 March 2006, but the following remain viable mitigation techniques:

- ▶ 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 main planning that individuals who are not UK domiciled should consider is the creation of an excluded property trust (discussed above in section 7) prior to becoming deemed domiciled in the UK.

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 (Legitim), and these rights are covered below in section 10.3.

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 his or her estate may be made under the Inheritance (Provision for Family and Dependents) Act 1975.

Scotland

However, in Scotland, a spouse, children or grandchildren have automatic inheritance rights irrespective of the provisions in a will (Legitim). These can be claimed instead of any gifts received in a will. If there are no children, Scots law provides a surviving spouse with half of the movable estate (assets excluding buildings and land). If there is no spouse, the children take half of the movable estate. If there are both spouse and children, the spouse and the children (jointly if more than one) each take a third of the estate. The balance can be freely disposed of by will.

These rights under Scots law can be defeated by lifetime gifts to others.

10.4 Matrimonial regimes 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 the UK 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 the UK, the requirement is that the testator signs at the end of the will in the presence of two witnesses and they must sign in his or her presence and in the presence of each other. 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 where 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. Where there are cross-border issues, the Conflicts of Law provisions will be relevant, which are beyond the scope of this book.

The intestacy rules are different depending on whether the individual is domiciled in England and Wales or Scotland on their death. The following tables set out the current rules:

Intestacy rules in England and Wales

	Spouse or registered civil partner and children* survive you	Spouse or registered civil partner survives you but no children or grandchildren*	No spouse or registered civil partner survives you
Personal effects	Spouse or registered civil partner	Spouse or registered civil partner	–
Legacies	£250,000 to spouse or registered civil partner	£450,000 to spouse or registered civil partner	–
	** (a)		
	½ On trust to provide income to spouse or registered civil partner for life then capital to children equally following death of spouse or registered civil partner	½ To spouse or registered civil partner outright	Whole estate in order of priority to the exclusion of all others:
	** (b)		1 Children or grandchildren
	½ To children in equal shares at 18 years old and on trust until that time (surviving grandchildren take the share of a deceased child)	½ To parents outright	2 Parents
		If none:	3 Brothers and sisters (nephews and nieces, if they have predeceased)
		To brother/sisters outright (or their children)	4 Half-brothers and half-sisters (their children, if they have predeceased)
		If none:	5 Grandparents
		To spouse or registered civil partner outright	6 Uncles and aunts (their children, if they have predeceased)
			7 Half-brothers and half-sisters of your parents (and their children)
			8 The Crown

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

** A trust is created and the assets are held for the benefit of the beneficiaries by third parties who are trustees of the fund. In the case of the trust at (a) above, the spouse receives only the income and the children eventually receive the capital. In the case of the trust at (b) above, statutory provisions require that the funds are held on behalf of the children or other issue until they reach the age of 18 or marry under that age. They then receive the assets outright.



Intestacy rules in Scotland

	Spouse or registered civil partner and children* survive you	Spouse or registered civil partner survives you but no children*	Children* survive you but no spouse or registered civil partner	Neither spouse nor registered civil partner nor children* survive you
1. Matrimonial home	To spouse or registered civil partner up to a value of £300,000. Balance per 5 below.	To spouse or registered civil partner up to a value of £300,000. Balance per 5 below.	–	–
2. Contents of matrimonial home	To spouse or registered civil partner up to a value of £24,000. Balance per 4 then 5 below.	To spouse or registered civil partner up to a value of £24,000. Balance per 4 then 5 below.	–	–
3. Legacies	£42,000 to spouse or registered civil partner.	£75,000 to spouse or registered civil partner.	–	–
4. Balance of estate excluding land/buildings	One-third to spouse or registered civil partner. Two-thirds to children	½ to spouse or registered civil partner ½ per 5 below	To children	–
5. Balance of estate (land and buildings)	To children	One-half to surviving parents (all if no brothers/sisters). One-half to brothers/sisters (all if no parents). If none: all to spouse.	To children	One-half to surviving parents (all if no brothers/sisters). One-half to brothers/sisters (all if no parents). If none all to**: 1. Aunts and uncles (or children of those who predeceased) 2. Grandparents 3. Brothers and sisters of grandparents (or their descendants) 4. Remoter relatives 5. The Crown

* Where 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.

** In the following order or priority to the exclusion of others.



10.6 Probate

The granting of probate allows the deceased's estate to be administered and the assets passed to the legatees as named in the will. Probate will only be granted when the tax due under the estate has been settled or, in limited circumstances, where an installment 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 3 above) after which probate may be sought.

11. Estate tax treaties

11.1 Unilateral rules

Where 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 where 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 the 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 the following countries: France, India, Ireland, Italy, the Netherlands, Pakistan, South Africa, Sweden, Switzerland and the United States of America.



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Additional reading materials

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