FORSTERS

ISSUES IN US-UK ESTATE AND TAX PLANNING

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12th Annual International Estate Planning Institute

New York, March 10-11 2016

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Issues in US/UK Estate and Tax Planning

The purpose of this paper is to provide a summary of the UK tax issues that ought to be considered where an individual plans to move from the US to the UK, or vice versa. In these scenarios, integrated US/UK planning will be vital to ensure that opportunities are optimised and potential pitfalls avoided. There are significant traps for the unwary, but it should be possible to navigate them effectively by seeking appropriate advice in good time.

US PERSON MOVING TO THE UK

1. RESIDENCE AND DOMICILE

1.1 Becoming UK resident

An individual's exposure to UK tax depends on whether he or she is resident and/or domiciled in the UK for tax purposes in a given UK tax year[1]. Citizenship is not a determinative factor, except that it may occasionally be relevant in the context of applying tax treaties.[2]

A person moving to the UK is likely to become resident for tax purposes immediately. Tax residence is determined by a statutory test, which was introduced in April 2013. Full details of the statutory residence test ("**SRT**") are contained in ***Appendix 1***. Importantly, if a person spends 183 days or more in the UK during the tax year, he or she will become UK resident automatically for that year. Taking up full time work in the UK, or having their only home in the UK, will also make a person UK resident automatically.

Residence is assessed on a tax year by tax year basis. However, "split year" treatment (which allows a person to be treated as UK resident for part of the tax year only) will be available in certain circumstances. The conditions for split year treatment (which are laid down by statute[3]) are complex, but in broad terms they include where a person:

(a) comes to live in the UK;

(b) comes to work in the UK full time; or

(c) acquires a home in the UK and continues to be resident in the UK the following tax year.

It follows that a person moving to the UK will become UK resident from the beginning of the tax year during which they arrive in the UK (i.e. 6 April) unless they can claim split year treatment, in which

[1] The UK tax year runs from 6 April to 5 April.
[2] This is discussed further in ***paragraph 6.4***, below.
[3] Paragraphs 44-51 of Schedule 45, Finance Act 2013

case they will be resident from the date on which they first meet the conditions for that treatment[4].

1.2 The common law concept of domicile

Aside from residence, domicile status is the next most important factor in determining the UK tax treatment of an individual. In particular:

(a) Non-UK domiciliaries ("**non-doms**") are able to avail themselves of a beneficial tax regime, known as the "**remittance basis**", which applies to the assessment of income tax and capital gains tax ("**CGT**") on foreign income and gains (as discussed further below).

(b) Non-doms are exposed to UK inheritance tax ("**IHT**") on their UK assets <u>only</u> (whereas UK domiciliaries are exposed to IHT on worldwide assets).

Under English law, domicile has a more technical meaning than in most other jurisdictions, and particularly continental European jurisdictions where the concept is closer to that of habitual residence. A person is domiciled in a jurisdiction rather than in a country, which means that in a federal system (like the US) a person is domiciled in a particular state. Generally speaking, an individual is domiciled in the jurisdiction with which he or she is most closely connected (which may be different from the jurisdiction in which he or she is resident for the time being). Unlike in the case of residence, an individual must at all times be domiciled somewhere, but can only be domiciled in one jurisdiction at any one time.

Further detail on how to determine a person's domicile for UK tax purposes is contained in ***Appendix 2***. It is likely that a US person moving to the UK for the first time will be non-UK domiciled on the basis that he will have a non-UK domicile of origin. He will remain non-UK domiciled provided he does not acquire a domicile of choice in the UK by forming an intention to remain permanently or indefinitely.

In practice, HMRC does not tend to challenge the foreign domicile of those who have recently moved to the UK from abroad (particularly where they are US citizens and so are not escaping tax completely). Nevertheless, a person moving to the UK should be able to point to as much objective evidence as possible to demonstrate continued connections with their domicile of origin in the US and an intention to return there at some point in the future.

While no factor will be conclusive in isolation, such US persons would be advised to observe as many of the following guidelines as possible:

(a) To be able to point to clear reasons for being in the UK (such as employment) which demonstrate the temporary and "fixed purpose" nature of their presence.

[4] Depending on the heading under which split year treatment is claimed, this might be (for example) the first day of work in the UK, or the date on which the UK home is acquired.

(b) To return to the US (ideally, the state of their domicile of origin) as frequently as possible, and keep a record of the visits.

(c) To retain US citizenship (although the acquisition of a UK visa or UK passport will not of itself prevent a person from maintaining his or her non-UK domicile).

(d) To retain a bank account in the US.

(e) To maintain involvement in any business activities, clubs, or other organisations in the US.

(f) To have a US will, which ideally should include a statement of wishes regarding burial or cremation in the US.

(g) To continue, as far as possible, to exercise political rights in the US.

It may not be practical to observe all of these guidelines, but the more factors that support a person's US domicile (and the more paperwork that is available to prove the US connections), the better.

1.3 Deemed domicile for tax purposes

Under current rules, a person will become "**deemed domiciled**" in the UK for IHT purposes when he/she has been resident in the UK for tax purposes in 17 or more of the past 20 tax years, including the year of assessment. It is worth noting that the test does not require a person to be resident for the *whole* of each tax year, so it is possible to become deemed domiciled in the UK for IHT purposes after only 15 years and one day of tax residence (which can come as a surprise to some!). For example, if a person became UK resident on 5 April 2001 (during the 2000/01 tax year), they will become deemed domiciled for IHT purposes on 6 April 2016.

Under new rules announced by the UK government in the Summer Budget 2015, with effect from 6 April 2017, a person will become deemed domiciled for all tax purposes when they have been UK resident in 15 or more of the past 20 tax years (i.e. from the beginning of their 16th consecutive year of residence).

2. OVERVIEW OF THE UK INCOME TAX AND CAPITAL GAINS TAX REGIME

2.1 The remittance basis of taxation

UK resident but non-UK domiciled individuals are eligible to be taxed on the "**remittance basis**" in respect of income and capital gains arising from sources outside the UK. In most cases, this will need to be expressly claimed[5]. If a person is taxed on the remittance basis while he is UK resident:

(a) he will be subject to income tax on UK source income and CGT on UK source capital gains as the income and gains arise; <u>but</u>

(b) he will only be taxed on non-UK source income, or gains from assets which are situated outside the UK, if the income or gains are "remitted" to the UK.

If he is not taxed on the remittance basis in respect of a given tax year, all income and gains arising to him in that year will be subject to tax regardless (in the case of non-UK income or gains) of whether they are remitted to the UK. This is known as the "**arising basis**".

From 6 April 2017, it will no longer be possible for an individual to be taxed on the remittance basis after he has been resident in the UK for 15 or more of the past 20 tax years (as he will become deemed domiciled for all tax purposes at that point, as noted above).

What constitutes a remittance?

The remittance rules are complex, and the definition of what constitutes a remittance is extremely wide. In very simple terms, income or gains will be remitted to the UK if they are brought to the UK or used in the UK by the remittance basis user, or persons connected with him. Most forms of direct or indirect enjoyment of income or gains in the UK will be caught.

<u>The remittance basis charge</u>

During the first 7 tax years of UK residence, the individual can elect to be taxed on the remittance basis free of charge. However, after he has been resident in the UK for 7 out of 9 tax years, he can only claim the remittance basis if he pays a £30,000 annual charge, rising to £60,000 after he has been resident in the UK for 12 out of 14 tax years[6].

The IRS has ruled that US taxpayers resident in the UK who have elected to pay tax on the remittance basis may claim credit (under section 901 of the Internal Revenue Code) for the remittance basis charge against their US income tax liability[7].

The decision whether to claim the remittance basis will be a mathematical exercise, to determine whether it will cost more to be taxed on the arising basis, or to be taxed on the remittance basis and pay the annual charge. The following points will need to be taken into account:

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[5] There are some exceptions to the requirement to make an express claim for the remittance basis. For instance, no claim is required if the aggregate amount of the individual's unremitted income and gains for the year is less than £2,000. Neither is a claim required (during the first seven years of UK residence) for tax years in which the individual has no UK source income or gains and none of his foreign income or gains are remitted.

[6] Under current rules, the remittance basis charge increases to £90,000 where a person has been resident in the UK for 17 of the past 20 tax years. However, this will become redundant from 6 April 2017, from which date an individual will become deemed domiciled for all tax purposes where he or she has been UK resident for 15 or more of the past 20 tax years, as explained at ***paragraph 1.3***, above.

[7] Revenue Ruling 2011-19

(a) Remittance basis users are not able to take advantage of certain allowances and exemptions that are available to arising basis taxpayers, including:

   (i) the income tax personal allowance (of £11,000[8] in 2016/17), which can be received free of income tax; and

   (ii) the annual exemption (of £11,100 in 2015/16[9]) for capital gains, which can be realised free of CGT.

(b) Individuals who do not claim the remittance basis are also eligible for lower income tax rates on dividend income (as detailed in ***footnote 11***).

In the case of a RND couple, it may be worth considering whether their affairs can be restructured so that only one of them is required to pay the remittance basis charge.

<u>Additional considerations for US taxpayers</u>

Although US persons who claim the remittance basis will avoid UK income tax and CGT on non-UK source income and gains which are not remitted to the UK, they will remain subject to US federal income tax on worldwide income and capital gains. Therefore, claiming the remittance basis may not significantly reduce the overall rate of tax incurred, and the reduction could be limited further still by the application of state income taxes.

Income and gains that are remitted to the UK will attract UK tax in full, although a credit may be available for US tax paid. This credit would need to be claimed in the individual's UK tax return for the relevant UK tax year.

While the remittance basis can be claimed free of charge (i.e. for the first seven years of UK tax residence), it is likely to be worthwhile to claim it, provided the individual does not plan to remit their non-UK income and gains to the UK. Even if the overall tax saving is marginal, claiming the remittance basis will avoid the administrative burden of having to claim a credit for US tax incurred on unremitted income and gains.

Furthermore, certain types of investments that are treated favourably for US tax purposes are subject to considerably higher tax rates in the UK. With regard to such investments, claiming the remittance basis may offer substantial savings. For example:

(a) US municipal bonds

It is noted that US municipal bonds are exempt from US income tax and state income tax for residents of the state that issues them. However, they do not enjoy any equivalent exemptions from

[8] It should be noted that the personal allowance (available to persons who are taxed on the arising basis) is reduced by £1 for every £2 income received in excess of £100,000.
[9] The amount of the annual exemption for 2016/17 has not yet been announced at the time of writing.

UK taxation.

(b) US mutual funds

Most US mutual funds do not have "reporting" status for UK tax purposes. Disposal proceeds arising from this type of investment will be characterised as "offshore income gains" ("**OIGs**") from a UK perspective. Instead of being subject to tax at CGT rates (i.e. a maximum rate of 28%), OIGs are taxed at the higher income tax rates (i.e. up to 45%).

(c) Qualified dividend income

It is understood that this is taxed in the US at 23.8%. In the UK, the equivalent income tax rate for a top rate remittance basis taxpayer is 45%[10], so the difference is significant.

2.2 Rates of tax

<u>Income tax</u>

The rates of income tax for the 2016/17 tax year (beginning 6 April 2016) are as follows:

(i) 20% (the "basic rate"): for income up to £32,000.

(ii) 40% (the "higher rate"): for income between £32,000 and £150,000.

(iii) 45% (the "additional rate"): for income over £150,000.[11]

<u>CGT</u>

The current rates of CGT calculated on capital gains realised each tax year, are as follows:

(i) 18%: for gains that fall within the available basic rate income tax band (which for 2016/17will be calculated as £32,000 less taxable income for the year).

(ii) 28%: for gains exceeding the basic rate income tax band.

3. PRE-IMMIGRATION PLANNING

A person who plans to move to the UK should take UK tax advice several months in advance, to ensure that his or her affairs are arranged efficiently from a UK tax perspective. This can be far more difficult to achieve if advice is not taken until after the event.

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[10] This is based on the new rules applicable to the taxation of dividend income from April 2016.

[11] Individuals who are <u>not</u> taxed on the remittance basis are eligible for lower rates on dividend income, which are as follows for the 2016/17 tax year:

(i) 7.5% on income over £5,000 and up to £32,000;
(ii) 32.5% on income between £32,000 and £150,000; and
(iii) 38.1% on income over £150,000.

3.1 **Maximising clean capital**

The meaning of "clean capital"

Funds that can be remitted to the UK free of tax by a remittance basis user are referred to as "clean capital". Sources of clean capital include:

(a) foreign income and gains realised prior to becoming UK resident; and

(b) *bona fide* gifts and inheritance from individuals[12] (even if these are received during the period of UK residence).

The opposite of clean capital is non-UK income and gains earned while a person is UK resident and claiming the remittance basis, which will be subject to income tax or CGT if remitted to the UK.

It follows that (to the extent possible) the UK spending of a remittance basis user should be funded out of clean capital.

Generating clean capital

In order to maximise the level of clean capital available, it may be beneficial (where possible) to trigger income and gains in advance of becoming UK resident. This will, of course, be subject to other considerations, including tax liabilities that may be incurred elsewhere.

Preserving clean capital

There are a number of things that can be done in order to preserve clean capital. Two key examples of this are as follows:

(a) Bank account structuring

Clean capital will only remain "clean" to the extent that it does not become "contaminated" with non-UK income and gains arising while the individual is UK resident and claiming the remittance basis. This will occur, for instance, if interest is added to existing clean capital accounts during that period, creating a "mixed fund".

Where a "mixed fund" is created, special rules apply to remittances from those funds, which work against the taxpayer. Essentially, taxable income is deemed to be remitted in priority to clean capital. Bank accounts and investment accounts should therefore be structured in such a way as to avoid creating mixed funds. Broadly, this will involve segregating clean capital from post-residence income and gains.

[12] Gifts or inheritances received by a UK resident individual in the form of a distribution from a non-UK resident trust may be subject to UK income tax and/or CGT if there is accumulated income and/or gains in the trust at the time of the distribution, or subsequently.

The only way to "clean up" mixed funds after they have become contaminated is to remit the "dirty" post-residence income and gains to the UK and pay tax on them.

(b) Loan trusts

If a remittance basis user invests in his own name while he is UK resident and realises capital gains;

(i) gains on UK assets (if any) will be immediately chargeable to CGT; and

(ii) gains on non-UK assets will be chargeable if all or part of the proceeds are remitted to the UK.

For the purpose of identifying what has been remitted, the sale proceeds are treated as comprising a "mixed fund" of the original clean capital and the capital gain, which means the proceeds cannot be brought to the UK without incurring tax. Only after the entire gain has been remitted (and tax paid on it) will the underlying clean capital be accessible in the UK tax-free.

Establishing a loan trust can offer a solution to this issue. It would operate as follows:

(i) The individual would establish a trust (which could be a US revocable trust if that was desirable from the US perspective).

(ii) He would then make a loan to the trust using clean capital.

(iii) The trustees would use the borrowed funds to make investments.

(iv) If the assets were eventually sold at a gain, the loan from the settlor could be repaid out of capital and the funds repaid would continue to represent "clean" capital in the settlor's hands.

(v) The balance left in the trust would represent capital gain, which would be taxable if remitted to the UK. However, it could be paid out to the individual outside the UK free of tax, and could then be used to fund non-UK expenditure. Alternatively, if could be "rolled up" within the trust and extracted free of UK tax after the individual has ceased UK residence.

3.2 **Existing LLCs**

A person moving to the UK from the US should also seek advice in relation to any US LLCs in which they will retain an interest while they are UK resident.

<u>Income tax treatment</u>

The UK income tax treatment of LLCs has been a hot topic in recent times, especially following the judgment of the UK Supreme Court in the case of *Anson*[13] in July 2015.

Mr Anson was a UK resident non-dom remittance basis user, who was not a US citizen or income tax resident. He was a partner in a Delaware LLC and his share of the profits of the LLC were subject to withholding tax in the US as they arose. When Mr Anson's share of the profits was remitted to the UK, this triggered UK income tax. Mr Anson was denied a credit for the US tax that had already been paid, as HMRC took the position that the distribution of profits to Mr Anson was akin to a dividend from a company. Therefore, they argued that the UK income tax was not computed by reference to the "same profits" as had been subject to tax in the US, so no credit would be available. However, the Supreme Court held in favour of Mr Anson and concluded that he should be allowed a credit for the US tax paid because, <u>based on the terms of the LLC agreement and the applicable local (i.e. Delaware) law</u>, he was entitled to the profits as they arose, and not only when they were distributed to him. Therefore, the tax charges arising in the US and the UK both related to the "same profits" and a credit was due.

The Supreme Court based its decision on the specific question of whether the US and the UK tax was computed by reference to the same income, rather than the traditional analysis of whether the entity was opaque or transparent for tax purposes. Therefore, the conclusion reached in this case does not mean that all LLCs will now be regarded as transparent for US income tax purposes. In fact, HMRC has made clear that its starting point is still to treat LLCs as opaque entities for income tax purposes, and it has been quick to say that the *Anson* case must be confined to its facts. Therefore, this is an area of some uncertainty. If clients wish to rely on the outcome of the *Anson* case to claim a credit, then they will need to review the terms of their LLC agreements (in light of the applicable local law) to determine whether the decision applies, or whether changes need to be made to align them more closely with the facts of the case.

A more straightforward solution for a UK resident remittance basis user, if it is practical, would be to keep the profits outside the UK (i.e. not to remit them), in which case no UK income tax should be triggered.

<u>Corporate residence</u>

A US (or other) person moving to the UK should also consider what companies (including LLCs) that they exercise control over, either as director/manager or "shadow director/manager"[14]. If a company or LLC is found on the facts to be managed and controlled from the UK, it will be subject to UK corporation tax.

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[13] *Anson v Commissioners for HMRC* [2015] UKSC 44

[14] Broadly speaking, this includes any person in accordance with whose directions or instructions the directors of a company (or managers of an LLC) are accustomed to act, who is not in fact a director or manager themselves.

4. ACQUIRING A HOME IN THE UK

4.1 Structuring the ownership

A person moving to the UK should seek advice on how to structure the purchase of their new home. Based on current rules, personal ownership will generally be the most appropriate choice.

In the past, thought might have been given to structuring the purchase through a company (or a US LLC). However, following numerous changes in the law since 2012, company ownership of the home will rarely (if ever) be attractive from a UK tax perspective. To give a flavour of those changes:

(a) A flat rate of 15% stamp duty land tax ("**SDLT**") was introduced in 2012, which applies where high value UK residential property[15] is acquired by a company. (This is compared to progressive rates of up to 12% that apply to acquisitions by individuals.)

(b) High value residential properties owned through companies are also subject to an annual tax, known as the 'annual tax on enveloped dwellings' ("**ATED**"). The level of the ATED charge is determined by the value of the property, but the top rate is currently £218,200 on properties worth £20m or more.

(c) Non-UK resident companies (which previously fell outside the scope of CGT) are now taxed on gains realised on the disposal of UK residential property. Unlike an individual owner, the company will not benefit from 'principal private residence' relief, discussed below.

(d) The government announced in the Summer Budget 2015 that, with effect from 6 April 2017, ownership through a non-UK company will no longer provide an effective "situs blocker" for IHT purposes (which was often the main driver behind using a corporate structure in the first place).

4.2 Principal private residence ("PPR") relief

The UK allows full tax relief for gains realised on the sale of an individual's main home. However, US citizens will not be able to take full advantage of PPR relief, as the equivalent US income tax relief is limited to $250,000 per individual. Therefore, if a property is to be acquired by a couple where one spouse is not a US citizen (or US income tax resident), then it should be acquired in the name of the non-US spouse, or held beneficially for him/her alone, in order to allow the availability of the relief to be maximised.

(Where the funding for the property is to be provided wholly or partially by the US spouse, it is clear that the US gift tax consequences of acquiring the property in the name of the non-US spouse will need to be considered.)

[15] Initially, these rules affected properties worth £2m or more. However, this threshold was lowered to £1m in April 2015 and will be lowered further to £500,000 with effect from April 2016.

4.3 SDLT on the acquisition of 'additional residential properties'

SDLT is a transaction tax that is payable by the purchaser on the acquisition of UK real estate. In the Autumn Statement 2015, the UK government announced that higher rates of SDLT are to be introduced for certain transactions with effect from 1 April 2016. Although the detail of the legislation is not yet clear, we are told that the higher rates will apply to purchases by individuals of 'additional residential properties', such as second homes or buy-to-let properties.

The higher rates will be 3% above the current SDLT rates, as follows:

Portion of the purchase price (£)	Current rate of SDLT on main residence	Proposed rate of SDLT on 'additional residential properties'
0 – 125,000*	0%	3%
125,000 – 250,000	2%	5%
250,000 – 925,000	5%	8%
925,000 – 1,500,000	10%	13%
>1,500,000	12%	15%

** Transactions with a value below £40,000 will not be subject to the higher rates.*

If a person moves to the UK from the US and acquires a property here but also retains a property in the US at the time of the purchase, it seems likely that the new higher rates will apply. If the new UK property is intended to replace the main home in the US and the US home will be sold, the government's published consultation paper indicates that it may be possible to claim a refund of the additional SDLT following the sale, although the detail on this process remains unclear. The government is currently consulting on the changes and the final detail of the policy will be announced in the Budget on 16 March 2016.

5. UK TAX TREATMENT OF TRUSTS

A person moving to the UK may be concerned by how existing trusts of which they are the settlor or beneficiary will be treated.

5.1 Trust residence test

The residence status of a trust will determine how the settlor, beneficiaries and trustees of the trust will be treated for income tax and CGT purposes. It is dependent on the residence of the trustees and, in some cases, the settlor.

A trust is **UK resident** for income tax and CGT purposes where either:

(a) all the trustees are resident in the UK; or

(b) there is a mixture of UK resident and non-resident trustees <u>and</u> the settlor was resident or domiciled in the UK when the trust was funded.

It follows that a trust will be **non-UK resident** for income tax and CGT purposes where either:

(a) none of the trustees is UK resident; or

(b) there is a mixture of UK resident and non-resident trustees <u>and</u> the settlor was *not* resident or domiciled in the UK when the trust was funded.

5.2 Taxation of non-UK resident trusts

<u>Income tax</u>

The income tax treatment of a non-UK (i.e. "offshore") trust will depend on the nature of the trust. It will also depend on whether the settlor can benefit from the trust.

(a) Bare trusts

A bare trust is not regarded as a "real" trust for UK tax purposes, as the trustees are effectively nominees for the beneficiaries, who are absolutely entitled to the trust assets. Therefore, bare trusts are normally transparent for tax purposes[16].

US revocable trusts may (depending on their terms) be treated as bare trusts for UK tax purposes. Depending on the circumstances this could be beneficial or disadvantageous. As discussed below, those who are settlors or beneficiaries of US trusts should take advice on this prior to becoming UK resident.

*(b) Interest in possession ("**IIP**") trusts*

IIP trusts are trusts where at least one beneficiary has a right to receive the trust income as it arises. If the settlor or his spouse is the life tenant (or can otherwise benefit from the trust), the income will be treated as belonging to the settlor for income tax purposes. This will also apply if the settlor's minor children are life tenants. If the income is not treated as belonging to the settlor, then it will be treated as arising to the actual life tenant and will be taxable on him or her (subject to the remittance basis).

[16] There is an exception to this where the beneficiaries are minor children of the settlor. In that case, the income is treated as belonging to the settlor for income tax purposes.

(c) Discretionary trusts

These are trusts in which no beneficiary has the right to receive either the income or the capital from the trust.

If the settlor is UK resident and he or his spouse can benefit from the trust, the general rule is that the income will be treated as belonging to the settlor (whether or not he actually receives it). If the settlor is a remittance basis user, then the income will be taxed on the remittance basis, so it will remain tax-free provided it is not remitted to the UK.

If neither the settlor nor his spouse can benefit from the trust, trust income may still be attributed to the settlor if:

(i) income is paid to or for the benefit of the settlor's minor children; or

(ii) he or his spouse receive a "capital sum" (e.g. a loan or loan repayment) from the trust.

The trustees of an offshore trust with UK resident beneficiaries (from which neither the settlor nor his spouse can benefit) will prima facie be taxed on all UK source income arising at trust level. However, they will not be liable for tax on non-UK source income. In the absence of anti-avoidance legislation, this would clearly offer an opportunity for UK residents to use offshore trust structures to avoid tax on non-UK income. Therefore, if the settlor is not taxed on the income as it arises, then the trust income will form a "pool", which will be taxable on UK resident beneficiaries as and when they receive a benefit[17] from the trust.

The **proposals announced in the Summer Budget 2015** relating to the taxation of non-doms also include proposed changes to the taxation of trust distributions received by them. Broadly, the announcements indicate a move away from the existing "matching" system (whereby pooled trust income and gains are matched with distributions) and towards a system that will tax the value of benefits received, without reference to underlying trust income or gains. It is not yet clear which trusts or which individuals will be affected by the changes, as the detail remains subject to consultation and no draft legislation is currently available.

<u>CGT</u>

From 6 April 2015, offshore trustees became liable to CGT in respect of gains realised on the disposal of UK residential property. However, they remain outside the scope of CGT in respect of other assets.

To avoid this being exploited, capital gains realised on assets other than UK residential property will be added to a "gains pool" and may be attributed to beneficiaries who receive "capital payments" (i.e. non-income distributions, including the free use of property and other capital benefits) from the

[17] The term "benefit" is not defined in the legislation, but would include (among other things) a distribution from the trust, an interest-free loan, or rent-free use of trust property.

trust[18].

The process by which capital gains are currently "matched" with distributions is complex and goes beyond the scope of this paper. Again, it is proposed that the taxation of non-UK trusts will change with effect from 6 April 2017, so that distributions are no longer taxed by reference to trust gains.

IHT

A trust (assuming it is a "real" trust, and not a bare trust or nominee arrangement) will not be subject to IHT if it is an **'excluded property trust'**. A trust will be an excluded property trust if:

(a) when the trust is funded, the settlor is neither domiciled nor deemed domiciled in the UK for IHT purposes; and

(b) the trust does not directly hold any UK assets.

If the trust is not an excluded property trust, it will be subject to IHT. With some exceptions, the majority of trusts that are subject to IHT will be taxable under the '**relevant property regime**'. Broadly, this means that the assets will be subject to IHT charges of 6% every ten years and a charge of up to 6% on distributions of capital between ten year anniversaries.

It is worth noting that, if the settlor can benefit from the trust (i.e. he is not irrevocably excluded) then the trust assets will continue to be treated as forming part of his estate for IHT purposes under the "gift with reservation of benefit" rules[19]. However, if the trust assets consist of excluded property (i.e. non-UK assets settled into trust when the settlor was not domiciled or deemed domiciled in the UK) then they will not be subject to IHT on his death.

5.3 Taxation of UK resident trusts

Income tax

Income tax is charged on income arising from worldwide sources. Again, different regimes apply to different types of trusts.

(a) Bare trusts

Bare trusts are generally[20] transparent for tax purposes, so that the beneficiary is regarded as the owner of the trust assets.

[18] This assumes that the settlor is not resident and domiciled in the UK in the tax year of the gain (in which case the gain would be attributed to him under section 86 of the Taxation of Chargeable Gains Act 1992).
[19] Broadly, the "gift with reservation of benefit" rules are the UK equivalent of s2036 of the US Tax Code.
[20] See ***footnote [13]***.

(b) IIP trusts

For IIP trusts, the trustees are required to pay income tax at the basic rate. If the IIP beneficiary is a higher or additional rate taxpayer, then he or she will be required to pay the balance of the tax due on the income (with a credit for tax already paid by the trustees). In practice, it can often be easier for the trust income to be mandated directly to the beneficiary, who will assume responsibility for declaring it on their personal return.

(c) Discretionary trusts

Discretionary trusts suffer income tax at a higher rate, known as the "trust rate" (being the same as the highest personal rate applicable to individuals)[21]. A beneficiary who receives a distribution from a discretionary trust, but whose personal tax rate is lower than the trust rate, can generally reclaim some or all of the tax paid by the trustees.

(d) Settlor-interested trusts

If the settlor is UK resident and he or his spouse can benefit (or if his minor children *actually* benefit) from the trust, then the income will be taxed on the settlor, irrespective of whether it is distributed to him. He will generally be able to claim a credit for tax already paid by the trustees on the same income. However, he is technically required to transfer the repayment/reduction of tax back into the trust.

<u>CGT</u>

The trustees of UK resident trusts are subject to tax on worldwide capital gains at a flat rate of 28%.

<u>IHT</u>

The IHT treatment of UK resident trusts is the same as described above for offshore trusts.

5.4 Reviewing existing trusts – action required?

Issues can arise where US persons moving to the UK are trustees of their own revocable trusts. If they are the sole trustee (or if all the trustees become UK resident), the trust will become UK resident. This will cause the trust's worldwide income and gains to become subject to UK income tax and CGT as they arise and the remittance basis of taxation will not be available.

Furthermore, if the position is subsequently adjusted after the trust has become UK resident to make it non-UK resident (i.e. by a change or appointment of additional trustees), this will trigger a deemed disposal and reacquisition of all the trust assets at market value, and therefore a 28% CGT charge on the "exit" from the UK.

[21] As an exception to this, the first £1,000 of trust income is exempt from the special trust rates, and is taxed at normal tax rates.

This issue can be addressed in advance of the settlor's move to the UK, by appointing an additional (non-UK resident) trustee of the trust. This should be sufficient to ensure that it will remain non-UK resident following the move (assuming the settlor was not domiciled or deemed domiciled in the UK at the time the trust was funded).

6. ESTATE PLANNING

6.1 Overview of the IHT regime

Subject to what is said below, IHT is charged at a flat rate of 40% on the value of a person's estate on death.

UK domiciled (and deemed domiciled) individuals are subject to IHT on their *worldwide* assets, whereas non-UK domiciliaries are subject to IHT on their *UK* assets only.

Spouse exemption

Assets passing to a surviving spouse on death will generally pass free of IHT, provided they pass outright or on life interest trusts (i.e. trusts in which the surviving spouse has an immediate entitlement to the income from death). However, where assets pass from a UK domiciled or deemed domiciled spouse to a non-UK domiciled spouse, there is only a limited spouse exemption of £325,000 available (in addition to the NRB amount – see below).

For deaths on or after 6 April 2013, an election can now be made for the non-UK domiciled spouse to be treated as UK domiciled for IHT purposes, in order to benefit from the full spouse exemption. However, the consequences for the surviving spouse's estate must be factored into the decision. If the election is made, her worldwide estate will become subject to IHT on her death. Effectively, she will be bringing her non-UK situs assets into charge. It should also be noted that the election is irrevocable, although it will "fall away" after four tax years[22] of non-UK residence.

The 'nil rate band' ("**NRB**")

Each individual has a NRB of £325,000 available to him, which can pass free of IHT to non-exempt beneficiaries. If some or all of the NRB is used up by lifetime gifts that become taxable on death (see below), then the available amount will be reduced accordingly.

The NRB is transferable between spouses. Therefore, if all or part of it is left unused on the first death (e.g. because all assets pass to the surviving spouse free of IHT under the spouse exemption), then the unused portion will be available for use on the second death, in addition to the NRB of the second to die.

[22] It is proposed that this will be increased to six years from 6 April 2017.

Other key exemptions

*(a) Business property relief ("**BPR**") / Agricultural Property Relief ("**APR**")*

BPR and APR offer significant relief from IHT on certain types of assets. Where the relevant conditions are met, BPR and APR operate to reduce the value of the assets by either 50% or 100% in computing the charge to IHT (effectively providing a full exemption in the latter case).

BPR can apply to an interest in a partnership or shares in unquoted companies, among other types of business property. However, it is important to note that the relief will not be available where the relevant business consists of one or more of the following:

(i) dealing in securities, stocks or shares;

(ii) dealing in land or buildings; or

(iii) making or holding investments.

APR will generally be available in respect of the "agricultural value" of agricultural land and buildings. Both APR and BPR require a minimum period of ownership in order to claim the relief.

As there are no equivalent reliefs available for US estate tax purposes, it can be important in the case of mixed-citizen couples for the relievable assets to be held in the name of the non-US spouse. The relief should then be "banked" on the death of the non-US spouse, using appropriately drafted trusts to prevent the assets passing into the estates of a surviving US spouse or beneficiaries.

(b) Charitable gifts

The UK generally offers an unlimited exemption from IHT on charitable gifts, although only gifts to UK or EU registered charities will qualify.[23]

(c) Normal expenditure out of income exemption

A transfer will be exempt from IHT if, or to the extent that:

(i) it was made as part of the donor's "normal expenditure"[24];

(ii) it was made out of his income; and

(iii) the donor was left with sufficient income to maintain his usual standard of living.

[23] Gifts that qualify for charitable exemptions in both the US and the UK can be made via the CAF American Donor Fund.
[24] For expenditure to be "normal" it must be typical of the donor according to a settled pattern of expenditure adopted by him or her.

Whether or not these conditions are met is a question of fact in each case. The exemption must be claimed and the burden of proof is on the taxpayer to show that the exemption is due. This can be a useful exemption, especially as there is no statutory limit on the amount of the transfer. In the US/UK context, it might be used (for example) where annual transfers are made to a life insurance trust to fund premiums, but its potential application is far broader than that.

Lifetime gifts

(a) Gifts to individuals

Outright gifts to individuals are 'potentially exempt transfers' ("**PETs**") for IHT purposes. A PET will pass free of IHT provided the donor survives the gift by seven years. If the donor dies within seven years of making the gift, it will be taxed as if it continued to form part of his estate for IHT purposes (although a reduced rate of IHT will apply if he survives the gift by at least three years).

(b) Gifts into trust

Gifts into trust are immediately chargeable transfers for IHT purposes. They will give rise to an immediate IHT charge of 20% (increasing to 40% if the donor dies within seven years of the transfer) on the value in excess of the available NRB. **This can be a significant trap for the unwary with potentially catastrophic tax consequences, and it reinforces the need to take UK advice on any occasion where a US person wishes to make a transfer to a trust and either the donor or the asset is connected to the UK.**

This is an issue that arises frequently in relation to revocable trusts set up by US persons for probate avoidance. However, if a trust is revocable and the proper law of the trust follows Section 603 of the Uniform Trust Code[25], it may be possible to take a position that the "trust" is in fact a nominee arrangement for UK tax purposes. That being so, there may not be a trust for the purposes of IHT. Everything will depend on the drafting and the applicable law.

6.2 **Key estate planning considerations**

The two key objectives for estate planning in a US/UK scenario are as follows:

(a) To make optimum use of available exemptions and reliefs in both countries; and

(b) To defer estate taxes until the second death.

In the case of a married couple, it will be essential to ensure that the UK spouse exemption will be available on the first death for assets passing to the surviving spouse (to the extent that those assets are exposed to IHT based on the individual's domicile status). This will be straightforward where

[25] Section 603 of the Uniform Trust Code provides that where a trust is revocable and the settlor has capacity to revoke the trust, the rights of the beneficiaries are subject to the control of, and the duties of the trustees are owed exclusively to, the settlor.

assets are passing outright, but will require greater care to be taken where trusts are involved. Although a QDOT or QTIP trust should generally qualify for the spouse exemption, it is usually the case that the terms of a credit shelter trust need to be amended in order to qualify. Essentially, they must provide that the surviving spouse has an automatic entitlement to the income, which arises immediately on the first death.

We often recommend that the terms of a credit shelter trust are also amended to give the trustees an overriding power of appointment, by which they can take away all or part of the spouse's income right in order to advance principal to the children. Because the assets of the credit shelter trust will be in the surviving spouse's estate for IHT purposes, an advancement of principal will be regarded as an outright gift from her. This will be a PET for IHT purposes, and therefore pass free of IHT if she survives the gift by seven years or more. In the right circumstances, this can be an extremely effective way of passing assets to the next generation free of estate taxes in both countries.

Is an English law will required?

It is not generally considered necessary for a US person in the UK to have an English law will. If they do not, then there will be some additional administrative requirements at the time of the person's death before the UK assets can be administered. An affidavit will generally be required from a US lawyer confirming the validity of the will as a matter of local law and confirming who is entitled to administer the estate (although, in our experience, where primary probate has already been take out in the US, the UK Probate Registry will generally admit a court-exemplified copy of the US will to probate without the need for an affidavit). Either way, the process is not overly cumbersome and should not deter clients from having a US will to govern worldwide assets if that is what they already have, or what they are advised to put in place from the US perspective.

6.3 Excluded property trusts

It is possible for a non-UK domiciled individual to shelter his or her non-UK assets from IHT by transferring them to an "excluded property trust".[26] To recap, in order for a trust to qualify as an excluded property trust, it must meet the following key criteria:

(a) The settlor must be non-UK domiciled at the time the trust is made; and

(b) The trust must not directly hold any UK assets[27].

Provided these conditions are met, the assets in the trust will be shielded from IHT indefinitely, even if the settlor subsequently becomes domiciled or deemed domiciled in the UK. The trust can be a

[26] For a detailed discussion of excluded property trust planning for US citizens with UK connections, see "*Uncle Sam or Aunt Elizabeth: Who will get your client's tax dollars?*" by Patrick Harney and Emma Cooper (Trusts & Estates magazine, November 2015).

[27] UK assets (except UK residential property from 6 April 2017) may be held within the trust without adverse IHT consequences if they are acquired and held by a non-UK registered holding company. The company will effectively block the UK situs of the underlying investments, shielding them from IHT.

revocable trust for US purposes.

The question might be asked whether there is anything to be gained by creating an excluded property trust for a US citizen to save 40% IHT when they are going to have to pay 40% US estate tax anyway. The answer is yes. For US citizens, the benefit of funding an excluded property trust is to save 40% on the difference between the UK NRB amount (£325,000) and the US estate tax exempt amount ($5.45m). This offers a saving of almost $2m per individual (or $4m per couple)[28].

6.4 The 1978 UK-US Estate and Gift Tax Treaty ("the Treaty")

<u>Key provisions</u>

The Treaty is known as a "domicile treaty", meaning that in most cases it will give exclusive taxing rights to the country of treaty domicile. The key articles of the Treaty are as follows:

Article 4 – Fiscal domicile: If an individual is domiciled in both the US and the UK (under the domestic rules of each country) then it is necessary to look at the fiscal domicile article of the Treaty to determine how that individual will be taxed. Article 4 provides "tie-break" rules for dual domiciliaries, as follows:

(a) A UK national is domiciled in the UK if he has not been resident in the US for income tax purposes in seven out of the ten US tax years ending with the year of the transfer.

(b) A US national is domiciled in the US if he has not been resident in the UK in seven of the ten years ending with the year of the transfer.

(c) If a single treaty domicile cannot be determined in line with the statements above, then the standard OECD tie-break provisions apply, which look at the location of a person's permanent home, centre of vital interests, place of habitual abode and nationality (in that order).

Article 5 – Taxing rights: Article 5 provides that individuals who are domiciled in one state under the Treaty are not taxable on property situated in the other state, except for immoveable property and 'business property of a permanent establishment' in that other state. However, the Treaty preserves the rights of both countries to tax their citizens as if the Treaty had not come into effect. This is discussed further below.

Articles 6 and 7 – Immoveable property and 'business property of a permanent establishment': The taxing rights of the country of situs are always preserved in respect of these asset classes.

Article 8 – Deductions, exemptions, etc.: Article 8 provides for various relieving provisions. In particular, Article 8(4)(a) can in certain cases reduce the IHT on assets passing from a UK domiciled

[28] This is based on a GBP/USD exchange rate of 1:1.5, which gives a nil rate band amount of $487,500. $5.45m - $487,500 = $4,962,500. Based on a 40% tax rate, this produces a saving of $1,985,000.

spouse to a non-UK domiciled spouse by 50% where the non-UK spouse is a US citizen or domiciliary.

Relevance of UK citizenship

As noted above, UK citizenship is not generally relevant to the UK tax treatment of an individual. It is merely one of the factors that may be taken into account in determining whether a person is domiciled in the UK.

However, Article 5(1)(b) of the Treaty is an example of where UK citizenship may in some cases confer a tax liability on an individual based purely on his UK citizenship. It provides as follows:

'*Sub-paragraph (a)* [which states that only the country of domicile can tax property other than immoveable property or business property of a permanent establishment] *shall not apply if at the time of the death or transfer the decedent or transferor was a national of the other state*.'

Example: Charles is a US citizen and domiciliary. Years ago he worked in the UK and during that time he acquired a UK passport. He died owning shares in Tesco Plc., a UK company. Under Article 5(1)(a), only the US (i.e. Charles' country of domicile) can tax the shares. However, Article 5(1)(b) disapplies this rule and allows the UK to tax the shares. Because the UK effective rate of IHT is generally a lot higher than the US estate tax rate, the acquisition of the UK passport by Charles has led to an increased tax liability for his estate.

7. UK LASTING POWERS OF ATTORNEY

A UK lasting power of attorney ("**LPA**") is a special type of power of attorney, which enables the donor to appoint one or more persons (the 'attorneys') to make decisions and sign documents on his or her behalf if he or she becomes incapable of doing so.

There are two types of LPA: one relating to financial decisions and another relating to health and care. A 'financial decisions' LPA can be used by the attorneys to make a range of decisions on behalf of the donor, including buying and selling property, operating bank accounts and dealing with tax affairs. Decisions about health and care are delegated under a separate LPA, which enables the donor to give his or her attorneys power to make decisions in relation to the type of healthcare and medical treatment he or she receives, as well as day-to-day matters such as diet and daily routine. The donor can also give the attorneys authority to consent to or refuse life sustaining treatment on his or her behalf.

Where individuals have substantial assets in the UK and/or spend a lot of time in the UK, it will generally be important for them to put LPAs in place, even if they already have the equivalent documents in place in the US. This is because banks, hospitals and other institutions in the UK should be familiar with the format of LPAs. Even if the individual's US documents are technically valid in the UK, matters should be far more straightforward in administrative terms if UK documents are put in place as well. After all, LPAs will often need to be used in difficult circumstances, where the attorneys involved will want to manage matters as effectively and efficiently as possible (without having to demonstrate the technical validity of their documents).

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<u>UK RESIDENT PERSON MOVING TO THE US</u>

8. CEASING UK RESIDENCE

Whether or not a person ceases UK residence will be determined under the statutory residence test (see ***Appendix 1***). He will be automatically non-UK resident following his departure if:

(a) He spends no more than 15 days in the UK in each tax year (increasing to 45 days from the fourth consecutive year of non-residence); or

(b) He takes up 'full time work abroad' (as defined in the SRT).

If neither of these tests is met, then his residence status will be determined in accordance with the 'sufficient ties' test. The sufficient ties test (explained in detail in ***Appendix 1***) determines residency based on a combination of (i) the number of specified ties the person has to the UK and (ii) the number of days he spends in the UK in the relevant tax year. As discussed at ***paragraph 1.1*** above, split-year treatment may be available for those who leave the UK part of the way through the UK tax year. Otherwise, they will cease residence on April 5th at the end of the tax year of departure.

8.1 "Re-starting the clocks" for non-doms

If a non-UK domiciliary moving from the UK to the US intends to return to the UK at some point in the future, they should be aware of the following key time periods:

(a) Under the current law, once the individual has been non-UK resident for <u>three complete tax years</u>, they will have "restarted the clock" for the purposes of the remittance basis. Importantly, this means that on their return to the UK, they can claim the remittance basis free of charge for another seven tax years. Under the new rules to be introduced from 6 April 2017, this period will extend to <u>six complete tax years</u>.

(b) Currently, four tax years of non-UK residence is sufficient to "restart the clock" for the purposes of the '17 out of 20 year' deemed domicile rule for IHT. From 6 April 2017, this will also increase to six tax years.

8.2 Temporary non-UK residence

If the period of non-UK residence is five calendar years or less, then the 'temporary non-residence rules' may apply for UK income tax and CGT purposes. These rules operate to tax capital gains and certain types of income that were realised during the period of non-UK residence as if they were realised in the tax year of the person's return to the UK. If this is relevant, it may be advantageous to delay the individual's return to the UK until this period has passed.

8.3 Existing trusts

It will be important to give some consideration to any UK resident trusts of which the person leaving the UK is a trustee. If the individual becoming non-UK resident will cause the trust to become non-resident, then this will trigger a deemed disposal and reacquisition of all the trust assets at market value, and therefore a 28% CGT charge on the "exit" from the UK. The emigrating trustee(s) might therefore consider retiring in favour of UK resident trustees before they cease UK residence.

Any existing trusts (whether UK resident or not) should be reviewed to determine how they will be treated for US income, gift and estate tax purposes.

9. BREAKING UK DOMICILE

9.1 Acquiring a domicile of choice in the US

Most UK domiciliaries will have a UK domicile of origin. The domicile of origin is highly adhesive in nature and it may be many years before it is lost. It will also revive by default at any time when the individual does not have a domicile of choice outside the UK. From the UK perspective, a domicile of choice will be acquired in a particular state in the US when the individual is resident in that state and intends to remain there permanently or indefinitely. This is a question of fact, which will be evidenced by factors such as those listed at ***paragraph 1.2***, above.

Even after a person has acquired a domicile of choice outside the UK, he will remain *deemed* domiciled in the UK for IHT purposes for a further three calendar years. As noted at ***paragraph 9.2*** below, it is proposed that this period will be extended to six years from 6 April 2017.

It is also worth noting that, under another of the rules announced in the Summer Budget 2015 (due to come into effect from 6 April 2017) a person who was born in the UK with a UK domicile of origin but who acquires a domicile of choice outside the UK will nevertheless be *deemed* domiciled in the UK for all tax purposes during any future tax year in which they are UK resident. During this time, they will be treated as if they had never acquired a non-UK domicile in the first place. It is not yet clear what this will mean in practice, but it is suggested that any trusts settled by the individual while they were non-UK domiciled using non-UK assets will lose their 'excluded property trust' status and will be exposed to IHT.

9.2 Losing deemed UK domicile

For persons who have become deemed domiciled in the UK under the '17 out of 20 year' rule, they will cease to be deemed domiciled after three full tax years of non-UK residence.

Under the new rules to be introduced from 6 April 2017, this period is expected to increase to six years. The UK government notes this will mean that an individual who is domiciled in the UK but who leaves and acquires a domicile of choice elsewhere could potentially become non-UK domiciled more quickly than those individuals whose UK domicile status is only deemed. It acknowledges that this would be unreasonable and suggests introducing a rule which would make a person non-UK domiciled on the later of (i) the date when they acquire a domicile of choice in another country and (ii) the point when they have not been resident in the UK for six years. This remains subject to consultation.

9.3 Treaty domicile

It is clear from what is said above that, even after a person becomes a US income tax resident and domiciliary, he or she may also remain domiciled in the UK for a period. Depending on the circumstances, the Treaty might consider the person to be domiciled in the UK (and not the US), allowing him or her to make transfers of non-US property without exposure to US gift tax. This could present an attractive planning opportunity from the US perspective, but the UK tax consequences would need to be considered carefully, as discussed below.

10. PRE-IMMIGRATION PLANNING (US)

Pre-immigration planning can present a variety of opportunities to improve an individual's US tax position. For immigrants with UK connections, integrated US/UK planning will be essential to ensure optimum structuring and avoid potential pitfalls.

From the US perspective, the immigrant might be advised to engage in the following types of planning (among others):

(a) To realise income and gains before becoming US resident for income tax purposes;

(b) To make pre-immigration gifts (either outright or in trust); or

(c) To fund a "drop-off" trust.

In doing so, there will be a number of important points to bear in mind from the UK perspective:

10.1 Disposals of assets

While there may be advantages to avoiding exposure to US tax on pre-immigration income and gains, this planning may have limited merit for an individual who is still resident in the UK at the time when the income and/or gains are triggered. The effective tax rates in each country should be considered and, generally speaking, the UK rates of income tax and CGT are currently higher than the equivalent US rates.

That said, the individual may in some cases be well advised to trigger gains while they remain UK resident, before they become US income tax resident. A good example of this would be the sale of their UK home, which (as noted above at ***paragraph 4.2***) should be possible to achieve free of CGT by virtue of the PPR relief.

Another way of overcoming the UK tax issues may be for the individual to arrange his or her affairs in such a way as to cease UK residence for a period prior to becoming US income tax resident, and to trigger income and gains during this period.

10.2 Outright gifts

As noted above at ***paragraph 6.1***, the UK rules permit various opportunities to make outright gifts without triggering IHT. In particular:

(a) Unlimited outright gifts can be made between spouses (provided both spouses are non-UK domiciled or the recipient is UK domiciled[29]) and this will generally be a 'no gain, no loss' transfer for CGT purposes, so the recipient will take over the donor's base cost but no CGT will be triggered on the transfer.

(b) Outright gifts to other beneficiaries (such as children) will be PETs and will pass free of IHT if the donor survives the gifts by seven years.

10.3 Use of trusts

Particular care should be taken in respect of trusts. An IHT event will be triggered where:

(a) any assets are transferred into trust by a UK domiciliary (or deemed domiciliary); or

(b) UK assets are transferred into trust by a non-UK domiciliary.

This is because gifts into trust are immediately chargeable transfers for IHT purposes. They will give rise to an immediate IHT charge of 20% (increasing to 40% if the donor dies within seven years of the transfer) on the value in excess of the available NRB.

Furthermore, the trust will be subject to the relevant property regime. Broadly, this means that the assets will be subject to IHT charges of 6% every ten years and a charge of up to 6% on distributions of capital between ten year anniversaries.

The take away point here is that pre-US residence drop-off trusts are a "no-go area" for UK domiciliaries (or deemed domiciliaries).

Forsters LLP
February 2016

[29] Where gifts pass from a UK domiciled or deemed domiciled spouse to a non-UK domiciled spouse, there will only be a limited spouse exemption of £325,000 available (subject to the option for the non-domiciled spouse to elect to be deemed UK domiciled for IHT purposes). Outright gifts in excess of this exempt amount will be PETs.

APPENDIX 1

The Statutory Residence Test ("SRT")

1. **THE BASIC RULE**

1.1 An individual will not be resident in the UK in the tax year if one of the "automatic overseas" tests is met.

1.2 If none of the automatic overseas tests are met, the individual will be resident in the UK in the tax year if:

(a) the "automatic residence" test is met; or

(b) the "sufficient ties" test is met for that year.

(Each of these tests is described below.)

2. **LEAVERS AND ARRIVERS**

The SRT distinguishes between the treatment of "leavers" (those who have been resident in one or more of the previous three tax years) and "arrivers" (those who have not been UK resident in any of the previous three tax years).

3. **AUTOMATIC OVERSEAS TEST**

An individual will be automatically non-resident in a tax year if he:

(a) is a leaver and spends no more than 15 days in the UK;

(b) is an arriver and spends no more than 45 days in the UK; or

(c) carries out full time work abroad (see ***paragraph 6.1*** below).

4. **AUTOMATIC RESIDENCE TEST**

If an individual does not meet the automatic overseas test, he will be automatically resident in the tax year if he:

(a) spends 183 days or more in the UK;

(b) has his only home in the UK (see ***paragraph 6.3*** below); or

(c) carries out full time work in the UK (see ***paragraph 6.2*** below).

5. **SUFFICIENT TIES TEST**

5.1 If an individual is neither automatically non-resident, nor automatically resident under the tests set out above, he will nevertheless be resident in the UK under the SRT if the sufficient ties test is met.

5.2 The test considers the individual's existing ties to the UK and, depending on the extent of those ties, dictates how may days that individual can spend in the UK that year without becoming resident.

5.3 The relevant ties for arrivers are as follows:

(a) The family tie

An individual will have this tie if he has a UK resident spouse, civil partner or minor child (although limited exceptions can apply in relation to minor children, for example where they are in full time education).

(b) The accommodation tie

An individual will have the accommodation tie if he has a place to live in the UK which is available for a continuous period of at least 91 days during the year (provided that he spends at least one night there). The individual need not own the property nor have a legal right to occupy it.

However, he is allowed to stay at the home of a close relative (not including his spouse) for up to 15 nights without acquiring this tie.

(c) The work tie

An individual will have the work tie if he works in the UK for at least 40 days in the year. For this purpose, a working day is any day where the individual does more than three hours' work.

(d) The 90-day tie

An individual will have the 90-day tie if they were present in the UK for more than 90 days in either or both of the two preceding tax years.

5.4 Leavers also have the following additional tie:

(a) The country tie

An individual will have the country tie if the country in which he is present for the greatest number of days during that year is the UK.

5.5 The table below sets out the number of days an individual can spend in the UK without becoming resident under the sufficient ties test:

Number of ties	Days an ARRIVER can spend in the UK <u>without</u> becoming UK resident	Days a LEAVER can spend in the UK <u>without</u> becoming UK resident
0	182	182
1	182	120
2	120	90
3	90	45
4	45	15

6. KEY CONCEPTS

6.1 <u>Full time work abroad</u>

An individual will carry out full time work abroad for the purposes of the SRT if he:

(a) undertakes an average of 35 hours' work per week overseas (which is calculated using special rules laid down by the legislation);

(b) is present in the UK for fewer than 91 days;

(c) has fewer than 31 UK working days (days of more than three hours' work); and

(d) has no significant break from overseas work (being a period of more than 30 days) in the relevant year.

6.2 <u>Full time work in the UK</u>

An individual will carry out full time work in the UK for the purposes of the SRT if :

(a) he undertakes an average of 35 hours' work per week in the UK (again calculated using special rules) for 365 days, at least part of which is in the relevant tax year;

(b) he has no significant break from UK work (being a period of more than 30 days);

(c) more that 75% of his workdays in the 365 day period are UK work days; and

(d) one of the UK work days fall within both the 365 day period and the relevant tax year.

6.3 **<u>UK home</u>**

For the purposes of the automatic residence test, an individual will have his only home in the UK if:

(a) he has a home in the UK during all or part of the year;

(b) he is present in the UK home on at least 30 days in the year;

(c) while he has the UK home, there is a period of 91 consecutive days (at least 30 days of which fall into the relevant tax year) where he has no overseas home*.

*Any overseas home in which the individual has been present (at any point in the day) on fewer than 30 days in the tax year shall be disregarded for the purposes of this test.

6.4 **<u>Days spent in the UK</u>**

(a) For the purposes of the SRT, a day will be counted as a day spent in the UK where the individual is present in the UK at midnight (subject to the limited exceptions discussed below).

(b) A day where the individual arrives in the UK as a passenger and leaves the following day will not be counted, provided he does not engage in any activity substantially unrelated to his passage through the UK, such as a business meeting.

(c) Days spent in the UK due to exceptional circumstances beyond the control of the individual that prevent him from leaving the UK do not count for the purposes of the SRT (provided they do not exceed 60 days). Examples of such circumstances are national or local emergencies, or sudden or life-threatening illness or injury.

(d) Anti-avoidance rules apply to prevent abuse of the "midnight rule". These rules are targeted at individuals who:

(i) have been UK resident in at least one of the preceding three tax years;

(ii) have three or more ties to the UK (see 5.3 and 5.4 above); and

(iii) are present in the UK but leave before midnight on more than 30 occasions during the year.

Where the conditions are met, all further days on which the individual is present in the UK but leaves before midnight (i.e. from and inclusive of the 31st occasion) will count as days spent in the UK.

6.5 <u>Work days</u>

For the purposes of determining whether an individual has spent more than 3 hours working in the UK on a given day, the definition of "work" is broad and includes business travel and training. It can also include time spent on call or on standby.

7. SPLIT YEAR TREATMENT

Split year treatment (allowing an individual to be treated as UK resident for part of the tax year only) may be available where an individual:

(a) begins full-time work overseas (or accompanies a spouse who is doing so);

(b) leaves the UK to live abroad;

(c) comes to live in the UK;

(d) comes to work in the UK full time;

(e) returns to the UK after leaving to work abroad (or accompanies a spouse who does so); or

(f) acquires a home in the UK and continues to be resident in the UK the following tax year.

This briefing offers general guidance only. The circumstances of each case vary and the summary above should not be relied upon in place of specific legal advice.

APPENDIX 2

The English common law concept of domicile

1. **DOMICILE OF ORIGIN**

The starting point is that every individual is born with a "domicile of origin", which is generally the domicile of that individual's father at the time of his or her birth (although a child will take the domicile of their mother if the child's parents are unmarried or divorced when the child is born or the father has died before the child is born). A person's domicile of origin is very resilient in English law and it continues to apply by default if no other form of domicile displaces it.

2. **DOMICILE OF DEPENDENCY**

While a child is under the age of 16, his or her domicile remains determined by the domicile of the child's father (or mother, as the case may be). Where the domicile of the father (or mother) changes before the child reaches 16, the child's domicile of origin is replaced by the new domicile acquired by the father or mother. This is known as a "domicile of dependency".

Until 1974, a married woman did not enjoy an independent domicile but took her husband's domicile. A married woman's domicile is now determined independently. However, a woman who on 1 January 1974 had her husband's domicile as a domicile of dependency retained that domicile as a domicile of choice and must abandon it before she can acquire, or reacquire, her own domicile.

3. **DOMICILE OF CHOICE**

After the age of 16, an individual is free to replace his or her domicile of origin (or dependency) with a new domicile. Acquiring a domicile of choice requires two distinct elements; residence in a new jurisdiction, and an intention to reside there permanently and indefinitely. These elements must both be present at the same time. Conversely, to lose a domicile of choice, a person needs to (a) cease residence in a jurisdiction and (b) intend to cease residence permanently and indefinitely. Both of these elements must again be present at the same time, otherwise the domicile of choice will not be lost.

'Residence' in this context is not the same as residence for tax purposes. It requires a person to inhabit a country, rather than have a casual presence there. All of the circumstances of that person's life will be taken into account to determine whether they are truly inhabiting a country, rather than paying visits. The more connecting factors a person has in the new country, the more likely it is that a domicile of choice has been acquired.

It should also be noted that HMRC guidance states that acquiring a "domicile of choice" is primarily a matter of fact, not of intention. Although this is guidance and not law, it is an indication of the stance HMRC are likely to adopt. If the facts overwhelmingly point to a domicile of choice being lost, there is a risk that they may challenge a claim to the contrary.