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INHERITANCE TAX: KEY STRATEGIES AND INSIGHTS EXPLAINED

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He has been advising clients based in the UK and overseas on taxation matters for over 35 years and has been a prolific speaker at tax conferences around the world.

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About this guide

On 30 October 2024 (when this report was nearly completed), the Chancellor of the Exchequer presented her Autumn 2024 Budget which contained significant proposals with respect to inheritance tax. In particular, she has proposed the abandonment of the concept of domicile as a key determinant of an individual's exposure to inheritance tax, replacing it with residence as the key determinant.

Most of the proposed changes are currently scheduled to take effect on 6 April 2025.

An attempt to incorporate the key Budget 2024 changes in this report has been made, although their full impact and implication will take some time to be worked through. It has been assumed for present purposes that the proposals will be implemented without change but it is inevitable that changes will occur prior to the proposals finally becoming law.

1 A walk through the inheritance tax forest

1.1 Focus: Domicile versus residence

This chapter takes a general canter through some aspects of inheritance tax (IHT) designed to give the reader a flavour of how and when IHT is charged. Some of the key aspects mentioned are dealt with in greater detail in various other parts of the report.

It is important at the outset to draw the reader's attention to the recent Autumn 2024 Budget presented on 30 October 2024 under which the concept of domicile which currently underpins the principles of IHT is to be abolished, effective 6 April 2025. Thus, from 6 April 2025, an individual's exposure to IHT will no longer be determined based on whether the individual is UK (or deemed UK) domiciled *or* non-UK domiciled but based on their residence status.

Post-5 April 2025, IHT will therefore become a residence- (not domicile) based regime.

Pre-6 April 2025, the concept of domicile underpins the extent of an individual's exposure to IHT. For those individuals who are UK domiciled under common law or deemed UK domiciled by legislation (i.e., IHTA 1984), their worldwide assets are subject to inheritance tax (albeit subject to various exemptions and reliefs). For those individuals who are not UK domiciled or deemed domiciled, only their UK situs assets are subject to inheritance tax.

Domicile, as determined under common law, may refer to a domicile of origin, a domicile of choice, or a domicile of dependence. Under the IHTA 1984, domicile may refer to deemed UK domicile. Domicile is an extremely complex concept, and the reader is referred to specialist texts for more information. For the purposes of this report, it is only necessary to determine whether an individual is UK (or deemed UK) domiciled or non-UK domiciled as it is this status which determines the extent of their exposure to IHT.

Effective 6 April 2025, a determination of exposure to inheritance tax will thenceforth depend not upon domicile but upon whether an individual qualifies as a 'long-term UK resident' or not. Worldwide assets of individuals who qualify as long-term UK residents will be exposed to IHT, whereas exposure is restricted to UK situs assets for those qualifying as non-long-term UK residents. The definition in this regard is a little convoluted. In particular, it should be noted that when reviewing an individual's residence status over a number of tax years, it may be consecutive tax years not simply tax years, per se, that are relevant.

A 'long-term UK resident' for a tax year is an individual who has been resident in the UK (as determined under the Statutory Residence Test (SRT) contained in FA 2013) for at least ten tax years out of the 20 tax years immediately preceding the tax year in which the chargeable event (including death) arises. Where an individual has been resident in the UK for at least ten tax years out of the 20 tax years and then becomes non-UK resident, provisions provide

for a shortening of the length of time they remain a long-term UK resident if they had been resident for between ten and 19 tax years out of the last 20. For example, an individual who has been resident between ten and 13 tax years, on leaving the UK will be treated as a long-term UK resident for three more tax years (see table below).

For an individual 20 years old or younger, the test will be whether they have been UK resident for at least 50% of the tax years since their birth. The long-term UK resident test applies irrespective of an individual's common law domicile status.

Transitional provisions provide that an individual who would otherwise be a long-term UK resident will not be treated as such if the following conditions are satisfied: the individual was not UK domiciled on 30 October 2024; has not been resident for any tax year in the period beginning with the tax year 2025/26 and ending with the relevant tax year; and either was non-resident for any of the three tax years immediately preceding the relevant tax year or was not resident for more than 14 of the 20 tax years immediately preceding the relevant tax year.

An individual is *not* a long-term UK resident for a tax year (current tax year) if the individual satisfies one of two tests.

An individual is not a long-term resident for a tax year if the individual is non-UK resident for any ten consecutive tax years during the 19 tax years before that tax year. Alternatively, an individual is not a long-term UK resident for a tax year if the individual was non-UK resident for at least the 'required number' of consecutive tax years ending with the tax year before the current tax year (the 'required number' is ascertained by taking the last 20 tax years ending with the last tax year for which the individual was UK resident and ascertaining the number of those tax years for which the individual was UK resident. The 'required number' is then ascertained from the table below).

Number of tax years of residency	Required number of consecutive tax years
13 or less	3
14	4
15	5
16	6
17	7
18	8
19	9
20	10

Example 1: Non-long-term UK resident

Applying the following steps (as set out in the draft legislation; see above):

Sarah wants to know whether she will be a non-long-term UK resident in the tax year 2029/30 (the current tax year).

i. Sarah was resident for ten tax years out of the last 20 tax years prior to the tax year 2025/26, the 21st tax year being 2025/26. Prior thereto she was non-UK resident.
ii. Her last tax year of residence was the tax year 2025/26.
iii. In the last 20 tax years ending with 2025/26, the number of tax years of residence was 11.
iv. Applying the table to 11 UK resident tax years gives a 'required number' of three tax years.

Thus, Sarah would become non-long-term UK resident after three consecutive non-resident tax years ending in the tax year 2028/29, i.e., non-residency required in tax years 2026/27, 2027/28 and 2028/29. Non-long-term UK residency thus commences in the tax year 2029/30.

After a period of ten *consecutive* tax years of non-UK residence, an individual will no longer be considered a long-term UK resident and will no longer be within the scope of IHT (even if the individual returns to the UK thereafter; the 'clock' is then restarted).

On or after 6 April 2025, it is possible for an individual to elect to be treated as a long-term UK resident (under either a so-called death election or a lifetime election). Care must be exercised as, once made, the election is irrevocable. The election will last until ten consecutive tax years of non-UK residence have elapsed. Pre-6 April 2025, an individual was able to elect to be treated as deemed UK domiciled. Transitional provisions enable pre-6 April 2025 elections to effectively continue after this date but as an elected long-term UK resident. Where such elections may be of value is in connection with inter-spouse or civil partner transfers (see section 3.4).

1.2 Misnomer

Although termed 'inheritance' tax, the name is perhaps a little misleading. The tax is in fact charged not only on an individual's estate (broadly, the value of all assets owned at death) but also on lifetime gifts made by the individual.

1.3 Lifetime gifts: Death within seven years

Having said this, things are not quite as bad as they appear at first glance. The legislation which deals with IHT is primarily contained in an Act, namely, the Inheritance Tax Act of 1984 (this original Act has over time been significantly amended; the latest significant amendments are contained in the Autumn 2024 Budget of 30 October 2024 which are anticipated to take effect from 6 April 2025) and within this Act are various exemptions and reliefs which alleviate the full impact of the tax. For example, with reference to individuals, a lifetime gift made by one individual to another individual is only actually subject to inheritance tax if the donor (i.e., the individual making the gift) dies within seven years of making the gift, otherwise, if the donor survives the seven years, no inheritance tax is charged thereon. Furthermore, any inheritance tax charged, should death occur within the seven-year period, is tapered (i.e., reduced) depending upon how long after making the gift the donor in fact survives within the seven years; this aspect is for ease ignored in the discussion below.