INHERITANCE TAX PROPOSALS POST-APRIL 2025

INTRODUCTION

1. In this memo the CIOT refers to its submission of 19 April 2024 as the *First Memorandum*. It refers to those who become UK resident having not been UK resident in ten prior years as *New Arrivers* and to those who give up UK residence having been UK resident for 10 years as *Leavers*. We refer to the (10 year) continuing period of exposure for Leavers after their departure as the *tail*.

RESIDENCE BASIS

2. For the reasons given in its First Memorandum the CIOT supports the ending of domicile as a connecting factor. The advantage of residence as the sole connecting factor is that the test is simple and, as a result of the enactment of the SRT, the law is, with one or two exceptions, clear. It is important that all taxpayers or potential taxpayers are treated in the same way after 5 April 2025 so the CIOT would not support the addition of any other connecting factors.

3. The CIOT considers that for New Arrivers, 10 years' residence may be too short a period of residence to result in full exposure to IHT on a worldwide basis. the CIOT would urge investigation as to whether a longer period, say 15 years, would encourage more people to move to and settle in the UK and thereby generate additional income tax and CGT and additional spending in the economy.

4. In the rest of this submission, it is assumed that 10 years is retained as the required period of residence for New Arrivers to become exposed to IHT on worldwide assets. the CIOT considers the test should be 10 years up to and including the current year rather than 10 years up to and including the immediately prior year. This should avoid the present situation where an individual can come within the regime for the first time in a year in which they have ceased residence. Many clients find this illogical.

5. Consideration should be given as to whether the prior year's UK residence should be 10 continuous years or say 10 out of the last 15. If the latter approach is chosen, the taxpayer should have the option of using the statutory residence test in determining residence in 2012 – 13 and prior tax years. (See para 154 schedule 45 Finance Act 2013 for a previous example).

6. It should be clarified whether years of non-residence under the tie breaker clause of a treaty should be excluded in counting the 10 years insofar as such years would otherwise be years of residence under the SRT. We note that under the current regime years of treaty non-residence are included in determining whether someone is deemed domiciled for IHT purposes; we generally favour adopting the same approach for counting years of UK residence between all the taxes. Either way clarity is needed.

7. In general the CIOT believes that a 10 year tail for someone who has been resident for 10 years (but no tail for someone who has been resident for 9 years) creates an unfortunate cliff-edge. This may result in an exodus of people after 9 years of residence. The CIOT considers that it would be better for the length of the tail to vary according to the length of the previous stay. A simple version of this would be that the tail equalled the number of years in excess of 10 in the previous stay. So someone resident for 12 years would have a 2 year tail and someone resident for 15 would have a 5 year tail etc. (up to a maximum tail of, say, 10 years). Obviously other variants and starting points would be possible. On any view there should not be any difference between the tax treatment of UK domiciliaries and the treatment of foreign domiciliaries.

TRANSITIONAL ISSUES

8. In what follows the CIOT assumes the first year of the new regime will be 2025 – 26. It deals with Leavers who ceased to be UK resident in 2024 – 25 or prior and then with New Arrivers who first became UK resident in 2024 – 25 or prior. the CIOT considers an overriding objective should be to minimise occasions on which an individual's domicile has to be investigated under the new rules but this is subject to certain transitional issues set out in para 15 below.

<u>Leavers</u>

9. Under current law four categories of Leaver have to be considered:

(1) UK domiciled at common law as a result of that domicile being the domicile of origin.
(2) UK domiciled at common law as a result of that domicile being a domicile of choice.
(3) Non UK domiciled at common law but deemed UK domiciled.
(4) Non UK domiciled and not deemed UK domiciled.

10. Under current law, the fourth of the above categories is never exposed to worldwide IHT. Under IHTA 1984 s 267(1)(aa) the third category of Leaver ceases to have worldwide exposure once he has been non UK resident for at least three complete tax years (although he will be immediately deemed domiciled again if he resumes residence in fourth fifth and sixth years)

11. Leavers in the first and second categories only cease to have worldwide exposure if they both satisfy this rule, and have been non UK domiciled at common law for at least three calendar years (s 267(1)(a). They thus have to cease to be UK domiciled at common law and then wait a further three years. In the first category, the onus is on the taxpayer to show common law domicile (i.e. the UK domicile of origin) has been lost.

12. The CIOT assumes and asks that it be confirmed that individuals who have been non-resident for ten tax years by 5 April 2025 will cease to have worldwide exposure to IHT whatever their domicile under current law. The CIOT also assumes and recommends that those whose last year of residence is 2024 – 25 will be fully within the new rules. On this basis Leavers that require consideration are mainly going to be those whose last

year of residence was between 2015 – 16 and 2023 – 24. Amongst such Leavers the fact patterns that need looking at include the following:

(1) Leaver never either UK domiciled at common law or deemed UK domiciled who thus never had exposure to worldwide IHT.
(2) Leaver who did have worldwide exposure to IHT but under current law such exposure has ceased by the time the new rules come into effect on 6 April 2025.
(3) Leaver whose exposure to worldwide IHT under current law ceases at some point after 5 April 2025 at a time when he has been non-UK resident for less than 10 years.

13. There is clearly scope for injustice and possible issues as to enforcement if under (1) or (2) above a Leaver is clawed into worldwide IHT on 6 April 2025. The injustice exists on a lesser scale in the third fact pattern if an individual who left the UK thinking worldwide exposure would end on one date albeit after 5 April 2025 finds on 6 April 2025 it will end on a much later date. the CIOT is strongly of the view that cases where an individual's common law domicile has to be investigated should be minimised after 2025 but this does have to be balanced against fairness and the reasonable expectation of particular individuals.

14. Some Leavers whose last year of residence was between 2015 – 16 and 2023 – 24 may resume UK residence after 6 April 2025, whether for a short period accidentally or deliberately. The CIOT considers that once this has happened exposure of the individual to worldwide IHT should be solely governed by the new rules.

15. The CIOT considers the issues of fairness and expectation referred to in para 13 might be weaker where someone who left between 2015 – 16 and 2023 – 24 has a UK domicile of origin. This is because, evidentially, it can be difficult to prove acquisition of a domicile of choice where the period of non-UK residence is relatively short. The CIOT can thus see a case for applying the new rules to all Leavers with a UK domicile of origin regardless of when departure occurred or what their actual domicile is. It does however have to be recognised that using domicile of origin as the factor determining whether the new rules apply to pre 2024 Leavers will, on occasion, require an investigation of domicile for chargeable events arising after April 2025, as the Leaver's father could have been an individual with a non UK domicile of origin, with the result the father's domicile would have to be investigated to determine whether he had acquired a UK domicile of origin by the time the Leaver was born. But on any view these cases will be a minority among the overall population of Leavers.

16. The CIOT considers that from 6 April 2025 the worldwide IHT exposure of New Arrivers who became resident in or before 2024 – 25 should turn solely on the new rules. This will mean some New Arrivers in scope to worldwide IHT in 2024 – 25 (because UK domiciled) may temporarily fall out of scope. But the categories involved are small, being confined to New Arrivers within the 10 years prior to 2024 – 25 who acquired a UK domicile of choice before 6 April 2025 or those who have always retained a UK domicile or those within Condition A. The CIOT considers the simplicity inherent in having residence as the sole connecting factor for Arrivers outweighs the potential for advantage to these individuals. In addition, it should be remembered that some non-

domiciled individuals who became non-resident for less than 10 but more than 6 years and are now UK resident again thinking they have lost deemed domicile will be in scope for IHT from April 2025 and this may well be a larger category of individuals.

RELIEFS

17. The CIOT assumes that treaty relief will continue to operate. Consideration will need to be given as to whether the legislation should provide that references to UK domicile in treaties should be construed as references to residence in the UK for such period as results in worldwide assets being in scope to IHT.

18. Consideration needs to be given to the position of domicile by election under s267ZA where different time limits apply. It is suggested that as from 6 April 2025 all existing elections fall away and the person's IHT status is determined solely by whether they have worldwide exposure to IHT under the new rules.

SETTLEMENTS

19. If the decision is made to bring the non-UK assets of settlements into the scope of IHT, the CIOT supports the proposal that the chargeability of non UK assets in a settlement should be governed by the residence status of the settlor. Specifically, it agrees the worldwide assets of the settlement should be in scope if at whatever date is selected to be material the settlor's worldwide personal assets were or are in scope.

20. The CIOT considers that in relation to liability under FA 1986 s 102 the date that should be material is the date of the event occasioning the IHT charge. In other words:

    (1) In the case of liability under FA 1986 s 102(3) it should be the date of the settlor's death.
    (2) In the case of liability under s 102(4) it should be the date on which the reservation ends.

21. Under current law, a settlement can be both within the gift with reservation legislation in s 102 and subject to relevant property charges. This may have made sense as a deterrent in the 1980s when s 102 was enacted, when virtually all settlements likely to be affected were settled by settlors who were resident and domiciled in the UK throughout their lives and likely to be trying to use the PET regime to avoid IHT. But it will be quite inappropriate in the context of the current proposals, for many of the settlements brought into scope will have been settled by settlors with only limited connection to the UK. Some longer-term thought is required in relation to these rules duplicating IHT liability. But among possible solutions are:

    (1) Settlements where a reservation exists are not relevant property at all during the subsistence of the reservation, with no entry charge when the settlement is created but an entry charge when the reservation ends.

(2) The present regime continues, but with relevant property charges during the subsistence of the reservation being a credit against IHT payable on the ending of the reservation.

22. The CIOT considers there are four possibilities for determining the excluded property status in relation to relevant property charges:

(1) The residence status of the settlor when the settlement was created (or, if later, when it ceases to be subject to a reservation).
(2) The residence status of the settlor at the time of the relevant property charge or, if earlier, on the date of his death.
(3) The residence status of the settlor at the time of the relevant property charge or, if he is dead, his residence status at the date when the settlement was created or, if later when it ceases to be subject to a reservation.
(4) The residence status of the beneficiaries.

23. The CIOT does not consider it would be practical to use the residence status of the beneficiaries given that the class can in some cases be wide and uncertain and in many cases comprises individuals resident in multiple jurisdictions. The first option would in one sense be the most logical as it would fix excluded property status at the moment when the settlor ceases to have any interest in the settled property. In other words the worldwide assets of the settlement would stay in scope if and only if at that time his personal worldwide assets are in scope.

24. The CIOT considers that any of the possibilities canvased in para 23 above should enable s 82A to be dispensed with. This should certainly be the position with the second and third options.

25. The CIOT considers that whatever approach is taken to determining excluded property status for relevant property charges should also apply in determining excluded property status where a qualifying interest in possession ends. Almost all such cases entail an IPDI within IHTA 1984 s 49A.

SETTLEMENTS: TRANSITIONAL ISSUES

26. The CIOT supports the proposal that the issue of whether worldwide assets of existing settlements are excluded property should continue to be governed by the present law. The CIOT considers such grandfathering accords with normal practice where significant changes to a tax regime are made. Further many existing settlements are of some antiquity and there would often be practical difficulties in applying the new rules to long distant events where most if not all participants with recollection are dead. A particular issue would arise if the settlor's historic residence had to be investigated under pre SRT law, given the uncertainty and unjust nature of that law.

27. If this approach is taken it is regrettably inevitable that ss 81B and 82A would have a continuing role in relation to grandfathered settlements. The CIOT considers that where either of those sections applies the issue of whether the worldwide assets of the

settlement come into scope should be determined by whether or not on the occasion the section applies the worldwide personal assets of the settlor are in scope.

28. The CIOT considers grandfathering should not extend to property becoming settled between 6 March 2024 (or at least 6 April 2025) and 5 April 2025. The Budget announcements were widely publicised but it is difficult to think of many cases where new settlements have been made in reliance on the proposed extension of grandfathering to 5 April 2025. This is particularly so in view of the Labour party proposal published on 8 April.

29. The CIOT recognises there is one exception to the above, namely where a death between 6 March 2024 and 5 April 2025 has resulted in a testamentary settlement. Here the Will may well have been drawn on the expectation of the current law continuing. The CIOT would favour giving testamentary settlements resulting from death in the period 6 March 2024 to 5 April 2025 the right to elect into grandfathering.

30. The CIOT recognises that the issue as to grandfathering is ultimately one for political choice. It would also suggest attention be given to settlements created by Leavers within 10 years of leaving the UK but at a time when they had neither a common law nor a deemed UK domicile.

31. More generally, the CIOT notes that successive governments have provided deliberate statutory incentives to encourage the establishment of trusts by non domiciliaries. Such trusts may not be able to be wound up without significant income tax and CGT charges and yet such trusts will under the proposed new rules be exposed to worse IHT charges than if the settlor had continued to own the assets personally. The CIOT suggests that if there is no grandfathering of existing trusts something akin to the temporary repatriation facility should be offered to encourage the winding up of the trusts.

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