

The cover features a background image of three silhouetted figures in business suits standing over a large world map. A large, glowing yellow sun or moon is visible in the upper left corner. The overall color palette is dominated by reds, oranges, and yellows.

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UK inheritance tax exemption for UK homes of French domiciliaries

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The author lends a lucid explanation of the UK-France Inheritance Tax Treaty exemptions available to people of French origin living in the United Kingdom, from inheritance tax liabilities in the UK.

I. Introduction

This article explains how the UK France Inheritance Tax Treaty acts to exempt people with French backgrounds who live in the UK for many years from UK inheritance tax. If assets are parked in an offshore company, there will be no liability of inheritance tax in the UK (which is currently at 40 percent.) on the death of the taxpayer even if he has lived in the UK for more than 17 years. There should be no necessity to have any form of trust or complex structure.

II. Domicile

The concept of 'domicile' plays a very important role in the UK tax system. It is an abstract concept, different from residency, and equates more with 'belonging' to a country rather than merely living there for a certain period. In France it is simpler - one is domiciled where one lives or is resident. In the UK it is possible to be, and a large number of people (over 100,000) are, resident in the UK without being domiciled here. The domicile status of a taxpayer has an impact on his UK tax exposure and there may be significant advantages to being non-domiciled in the UK. Certain provisions in UK law seek to reduce the scope for individuals to claim non-domicile for the purposes of inheritance tax but, helpfully, the UK-France double tax treaty

overrides this which opens up some simple but highly effective tax planning opportunities for individuals with a French background who live in the UK.

III. Concept of 'Domicile'

Under English law, every individual obtains a domicile of origin when they are born. This is determined by the domicile of their father at that time if their parents were married at that date. If the parents were unmarried when the child was born, the child will take the mother's domicile status at that date. The actual place of birth or first home is largely irrelevant for these purposes. It is possible to have a domicile which differs from nationality.

This domicile of origin can be lost only in very limited circumstances. The first is where an individual acquires a domicile of choice in another country. This means that they have moved to another country with the intention to remain there permanently. It is difficult under English law to obtain this domicile of choice and any connection maintained with the country of domicile of origin will, in most cases, be implied to show that the domicile of origin is retained. This is helpful as it is possible for individuals to stay in the UK for long periods without acquiring a domicile of the country. The second circumstance occurs when a child, who is under the age of 16, has a parent (being the parent from whom the child obtained their

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domicile of origin) who changes their domicile whereby the child's domicile automatically changes. In the past, it was possible that a wife would obtain her husband's domicile on marriage, although this rule ceased for marriages taking place from 1974 onwards.

IV. Tax advantages of non-domicile status

From a tax perspective, there are several advantages of not being domiciled in the UK. The most commonly known relate to UK income tax and capital gains tax. Anyone residing in the UK but not domiciled in the country has the option to be taxed on the 'remittance basis' under which they are charged UK tax on their non-UK source income and gains only if the products of these are brought to the UK. They remain taxable on their UK source income and gains. This is an advantage over the general position for UK residents who are taxed on all their worldwide income and gains regardless of whether they are brought to the UK.

This advantage has been reduced recently as, since 2008, any long term residents of the UK must pay GBP 30,000 per year to benefit from this form of taxation. At this time other various knock-on effects of electing this form of taxation were also introduced, including the removal of personal allowances, which make it less attractive than was previously the case.¹⁷

A further, important, tax advantage is that non-UK domiciled individuals are not subject to UK inheritance tax on their non-UK assets. Only their UK based assets will fall within this charge, whereas the estates of UK domiciliaries are taxed on the value of their worldwide assets. This can make a huge difference to larger estates as inheritance tax is chargeable at 40 percent on all assets above the nil rate band, which is currently GBP 325,000.

V. 'Deemed' domicile for inheritance tax purposes

As mentioned above, the UK Revenue recognises that a domicile of origin is very difficult to lose, so in theory a person could live in the UK for their whole life without acquiring a domicile of choice here. To counter this issue there is a provision in UK law which introduces an additional form of domicile specific only to inheritance tax matters. This concept is known as 'deemed' domicile and applies where an individual has been resident in the UK for at least 17 of the last 20 tax years. This means that individuals may have a domicile of origin outside the UK and not have acquired a domicile of choice here but could still fall within the UK inheritance tax net on their worldwide assets due to their long term residency here. There are

planning possibilities for these individuals but these must be carried out before their domicile is deemed to change to a UK one and are likely to involve the use of trusts, which some people are averse to and will, in any case, result in ongoing costs.

VI. Double tax treaties

Importantly, UK law is subject to international law, which includes any bilateral treaties entered into by the UK which overrule UK domestic law. These are often overlooked by practitioners with limited international tax experience. The UK had entered into a limited number of treaties on inheritance tax prior to the introduction of the deemed domicile provisions, including with France. As these treaties were in existence before the UK law was introduced, the UK Law on deemed domicile sets out clearly that the application of the deemed domicile test is precluded in relation to individuals falling within these treaties. Therefore individuals with a domicile of origin in these countries (including France) will not be subject to the deemed domicile test even if they have been resident in the UK for more than 17 of the last 20 tax

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years. It is difficult to see how the UK Revenue could claim that anyone taking advantage of this clear international treaty obligation is abusing the UK tax system. This applies only on death as the treaties do not cover lifetime gifts. Therefore long term residents cannot rely on this position to escape any lifetime inheritance tax which might arise when they transfer a property into a trust for example.

VII. French backgrounds

The non-application of the deemed domicile provisions will be of particular interest to French domiciled individuals, resident in the UK. As explained above, a child's domicile will come from that of their parent and there may well be second or third generation French individuals living in the UK who have never lived in France but who could still be considered as domiciled there. This will only change if they obtain a domicile of choice in the UK by intending to remain here permanently, which, as mentioned above, rarely occurs in the eyes of HMRC. The non-UK assets owned by these individuals should therefore remain outside the 40 percent tax charge in the UK on death.

VIII. Avoid UK inheritance tax

As well as reducing the inheritance tax exposure for French individuals, the UK Revenue's position in relation to acquiring a domicile of choice also raises the possibility of some simple tax planning in relation to UK assets. In most cases, these assets can be taken outside the UK inheritance tax net by owning them via an offshore company, rather than directly. Effectively, this converts assets from UK based to non-UK based (as the new asset owned will be shares in a non-UK company). On death, the gift which will be made will be of the shares in the offshore company and not the underlying UK property itself. Unlike other jurisdictions, there is no provision in UK law to deem such entities as UK based simply because they retain UK assets. In particular, UK tax law does not have the French concept of companies preponderance immobilier. However, the precise circumstances must be examined in each case to ensure that these entities remain non-UK resident for UK tax purposes.

A. Example A

By way of example, a long term UK resident, French domiciled individual is planning to invest GBP 5 million in a UK main residence. If he were to invest directly in the property by buying it in his own name, the UK inheritance exposure is over GBP 1.8 million. This is because on death he will own the property which is a UK situated assets. His domicile is irrelevant because the asset is in the UK (UK situs property) and so taxable. By owning the property via a non-UK company the asset gets translated into the offshore company's shares, which are exempt from UK inheritance tax because the individual is only taxable on non UK assets if he is UK domiciled or deemed domiciled. Assuming he is not UK domiciled which is likely; he cannot be deemed domiciled in the UK under the double tax treaty even if he has lived here for more than 17 years. Accordingly, there can be no UK Inheritance tax on his death. It is possible for individuals who already own their main residence (or a rented property portfolio) in their own names to take these assets outside the scope of UK inheritance tax. People in this position should seek advice on the mechanics of this. It can also be used by people who have been advised they have a relatively short time to live. Stamp duty land tax will be an issue here when the property is put into the offshore company although

this can usually be avoided in this particular scenario. The inheritance tax savings will usually significantly outweigh any stamp duty cost by a factor of about 10. There is technically a benefit in kind issue though this can be avoided and in any event is not a point generally taken by the UK Revenue. There will be no capital gains tax when putting a UK main residence into an offshore company. There is no issue with the occupation of the property as the main residence prior to the owner's death.

B. Example B

A long term UK resident, French domiciled individual owns a holiday home in Spain with a Spanish will. On his death no UK inheritance tax is payable even though he is UK deemed domiciled. In all cases there are tax issues other than inheritance tax, which will need to be considered and a full analysis of the individual's personal circumstances is required. There should be no liability to French inheritance tax as for French purposes, the individual is not domiciled in France and the assets are not located in France.

IX. Avoid a UK domicile of choice and do not use a UK will

It is important if one is resident in the UK and wishes to take advantage of the non-domicile position to refrain from any action, which might result in the person being considered to have acquired a domicile of choice in the UK. Links should be maintained with the country of origin. In particular, the inheritance of any non-UK assets owned should not be dealt with in a UK will. Under international law, the inheritance of non-UK assets should only be governed by UK law and, hence, a UK will, if the individual is domiciled in the UK.

X. Summary

The helpful position under the UK-France tax treaty means people with a French background who have lived in the UK for a considerable period can easily keep their estates in the UK completely from exempted from the net of inheritance tax.

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