

Executive summary

Trusts set up by non-doms enjoy significant UK inheritance tax advantages. If the trust holds only non-UK assets there will usually be no inheritance tax charges on the assets held in the trust or on distributions to beneficiaries.

However, care needs to be taken if further assets are added to the trust. Here we provide a guide to the rules, and what to be careful of.



TAXATION OF NON-UK DOMICILED INDIVIDUALS: UK INHERITANCE TAX POSITION OF TRUSTS SET UP BY NON-DOMS

A trust set up by a non-UK domiciled and not deemed domiciled individual (non-dom) which only holds non-UK assets will not, generally, be subject to UK inheritance tax (IHT). This is the case even if the individual (the settlor) subsequently becomes domiciled or deemed domiciled in the UK. Trusts of this type are often referred to as “excluded property trusts” as the property held by the trust is excluded from the charge to IHT.

UK INHERITANCE TAX CHARGES ON TRUSTS

Broadly, all discretionary trusts (and all trusts set up since 22 March 2006) are potentially subject to a charge to IHT:

- > every 10 years on the value of the property in the trust immediately before the 10 year anniversary; and
- > on any trust property ceasing to be held on trust (for example, on assets being distributed to beneficiaries).

However, whether a charge arises on those occasions depends on the domicile status of the settlor and the location of the trust assets, as set out below. In particular, from 6 April 2017, different rules apply if the settlor was born in the UK with a UK domicile of origin, is UK resident and was UK resident in one of the two previous tax years.

In addition, trusts set up before 22 March 2006 under which someone has a right to the income arising to the trust, are subject to different IHT rules.

NON-UK DOMICILED SETTLOR WHO WAS NOT BORN IN THE UK WITH A UK DOMICILE OF ORIGIN

If:

- > the settlor of a discretionary trust:
 - was non-dom and not UK deemed domiciled at the time he set up and funded the trust
 - was not born in the UK with a UK domicile of origin; and
- > the trustees only hold non-UK assets

no charge to IHT will arise on the assets held in the trust or on any distribution of those assets to beneficiaries of the trust (subject to special rules which apply to UK residential property interests).

This is the case even if the settlor later becomes UK domiciled or UK deemed domiciled. The position is no different if the settlor is also a beneficiary (or potential beneficiary) of the trust.

Holding UK assets

The trustees will be subject to IHT on:

- > any UK assets they hold directly (they can hold UK assets indirectly – for example, through a non-UK company – without a charge to IHT arising on those assets); and
- > (from 6 April 2017) any interest in UK residential property (or certain loans used to finance UK residential property) held directly or indirectly.

Adding property to the trust

No further property should be added to the trust:

- > by the settlor once he has become domiciled or deemed domiciled in the UK; or
- > at any time by an individual who is domiciled or deemed domiciled in the UK.

Any property added to an excluded property trust by a UK domiciled or deemed domiciled individual will not be protected from IHT.

Distributions to beneficiaries

No charge to IHT will arise on a distribution of non-UK assets to a beneficiary. So, if the trustees make a distribution of cash from the trust's foreign bank account to a foreign account of a beneficiary there will be no charge to IHT.

Transfer of assets between trusts

If non-UK assets are transferred from the trust to another trust (Trust 2) the transferred assets will remain outside the charge to IHT in Trust 2 provided that the settlor of Trust 2 was also non-dom and not deemed domiciled in the UK at the time Trust 2 was made and funded.

This will be the case even if the settlor of either of the trusts has become domiciled or deemed domiciled in the UK by the time of the transfer of assets between the two trusts

NON-UK DOMICILED SETTLOR - WITH UK DOMICILE OF ORIGIN

From 6 April 2017, all assets (including non-UK assets) held in a trust set up by a non-dom who was born in the UK with a UK domicile of origin are subject to IHT if the individual (the settlor) is UK resident and was UK resident in one of the two previous tax years. This means that a charge to IHT may arise on the assets of the trust if:

- > there is a 10 year anniversary of the commencement of the trust
- > assets are distributed out of the trust to beneficiaries; or
- > where the settlor is a beneficiary of the trust, the settlor dies.

If the settlor becomes non-UK resident again, the non-UK assets held in the trust will become "excluded property" – and so not subject to IHT - from the start of the first tax year in which the settlor is non-UK resident.

These rules apply to all non-doms who were born in the UK with a UK domicile of origin and return to the UK, whether they returned before, or return after, 6 April 2017. While this point will only affect a limited number of people, where it does apply the impact will be significant.

This note is a general guide only and is not a substitute for proper legal and tax advice.



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