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Chapter 1

Inheritance tax: introduction

BACKGROUND

1.1 Inheritance Tax (IHT) replaced the previous regime of Capital Transfer Tax (CTT) in *Finance Act 1986*, with effect from 18 March 1986. CTT in turn replaced Estate Duty, which was repealed in *Finance Act 1975*. The IHT regime continued the basic framework and administrative provisions of CTT, whilst following the estate duty principle of only charging tax on lifetime gifts made within seven years of the donor's death. The primary IHT legislation is contained in the *Inheritance Tax Act 1984* (*IHTA 1984*), as amended by subsequent Finance Acts.

IHT is a tax on chargeable transfers (*IHTA 1984, s 1*). It applies to chargeable transfers made by an individual during lifetime, and on the value of his estate on death, subject to various exemptions, exclusions and reliefs. IHT also applies to certain chargeable events relating to settled property. This chapter provides a brief introduction to the IHT system, the main principles of which are expanded upon in subsequent chapters. Unless otherwise stated, all statutory references are to *IHTA 1984*.

WHO IS LIABLE?

1.2 Individuals domiciled in Scotland (or any other country in the UK) are liable to IHT on chargeable worldwide property. Non-UK domiciled individuals are also liable to IHT, but only on chargeable UK property (*IHTA 1984, s 6*(*1*)).

DOMICILE

Introduction

1.3 As a general rule, an individual is domiciled in the country (or state) considered his permanent home. There are three different types of domicile:

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domicile of origin, domicile of dependence and domicile of choice. It should be noted that both a domicile of origin and a domicile of dependence are acquired by operation of law rather than by choice. In addition to the general law concerning domicile, there is also a 'deemed domicile' rule for IHT purposes. Domicile is also of relevance in considering Prior Rights and Legal Rights (see **3.1**).

Domicile of origin

1.4 A person's domicile of origin is first acquired at birth. In Scotland, for children under 16 the *Family Law* (*Scotland*) *Act 2006* provides that the child shall be domiciled in the same country as its parents if the parents are domiciled in the same country and the child has a home with one/both of them. Otherwise for children under 16 their domicile shall be the country which, for the time being, the child has the closest connection. This remains the person's domicile until it is replaced by a domicile of dependence or a domicile or choice. A domicile of origin can revive when a domicile of choice is lost. A person's domicile of origin is his father's domicile at the time of his birth unless he was illegitimate or his father died before he was born. In those cases, his domicile of origin will be his mother's domicile. This will often be the country in which he was born, but need not be so. A domicile of origin will only be displaced if a person acquires a domicile of choice or a domicile of dependence.

Domicile of choice

1.5 A domicile of choice is acquired by an intention to settle permanently, and actual physical presence. Thus, it will not be acquired if the intention is conditional, or by going to work in another country unless there is a definite intention to remain permanently when the work has ceased. A domicile of choice can be lost by leaving the country without any definite intention of returning. A new domicile of choice will be acquired if a person moves to another country with the intention of settling there permanently. If a domicile of choice is lost and a new one is not acquired, the person's domicile of origin will revive. A person seeking to establish that a domicile of origin has been lost and a domicile of choice acquired, or that a domicile of choice has been replaced, must establish the change with very clear proof. HMRC consider that personal declarations are generally given a low weight when considering this proof as a whole and, if a domicile of choice cannot be established clearly, then the person's current domicile does not change (IHTM 13022).

Case law has underlined the potential difficulties faced by those wishing to shed a domicile of origin in favour of a domicile of choice (see *Re: Clore* (*No. 2*) [1984] STC 609, and more recently *Cyganik v Agulian* [2006] EWCA Civ 129).

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Domicile is essentially a concept of general law rather than tax law, and a detailed consideration of the principles involved is outside the scope of this book.

Domicile of dependence

1.6 The domicile of a minor initially follows that of the person on whom he is dependent. A domicile of dependence only affects children under 16 and persons of unsound mind. However, prior to 1 January 1974, a married woman acquired her husband's domicile on marriage, and her domicile changed with his. This rule was abolished by the *Domicile and Matrimonial Proceedings Act 1973*. For women who were married before 1 January 1974, their domicile of dependence was reclassified as a domicile of choice on 1 January 1974. However, this rule has no relevance to women married on or after 1 January 1974, and a woman can have a different domicile than that of her husband. For transfers between spouses, it is important to know the domicile of both spouses. If the transferor spouse is domiciled in the UK but their spouse is domiciled abroad, the spouse exemption is limited to £55,000 (*s 18*(*2*)).

IHT and domicile

1.7 For IHT purposes, a person can be *deemed* to be domiciled in the UK if either of the following two rules apply, even though he is domiciled elsewhere under general law (*s 267*):

- *The '3 year' rule*—A person is treated as domiciled in the UK if he or she was domiciled in the UK at any time in the three years immediately preceding the time at which the question of his domicile is to be decided;

Example 1.1—The '3 year' rule

Christine is aged 40, and had been resident and domiciled in Scotland all her life. She leaves the UK on 31 March 2004 and settles in Spain permanently, acquiring a domicile of choice in Spain under general law. Christine will cease to be domiciled in the UK for IHT purposes under the '3 year' rule on 1 April 2007. However, she will not lose her deemed domicile under the '17 out of 20' rule (see below) until she has been non-resident in the UK for three tax years and the fourth has begun. Her three years of non-residence would be 2004/05, 2005/06 and 2006/07. She will lose her deemed domicile under the latter rule on 6 April 2007 (ie at the start of the 2007/08 tax year).

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- *The '17 out of 20' rule*—A person will be deemed domiciled in the UK when he has been resident for 17 out of the 20 years of assessment ending with the present one (income tax rules generally apply for the purposes of determining residence in the UK for any particular tax year). This rule is the most relevant to someone who has come from abroad to live in the UK.

Example 1.2—The '17 out of 20' rule

Joseph came to the UK to stay on 1 May 1991. The Inland Revenue (as it then was) considered him to be UK resident for the tax year 1991/92 (ie Joseph was resident in the UK for more than six months in that tax year). He remains resident in the UK for 1992/93 and all later tax years up to and including 2006/07. The tax year 2007/08 is the seventeenth tax year. If Joseph remains resident in the UK during 2007/08, he becomes deemed domiciled in the UK. A transfer of foreign situs assets by Joseph would then be caught for IHT purposes unless exempt or potentially exempt.

1.8 However, there are exceptions to the 'deemed domicile' rule. The rule does not apply to the following:

- specified government securities in the beneficial ownership of persons neither domiciled nor ordinarily resident in the UK (*ss 6*(*2*)*, 48*(*4*));
- certain types of savings by persons domiciled in the Channel Islands or the Isle of Man (*s 6*(*3*));
- certain pre-CTT double taxation agreements still in force by virtue of *s 158*(*6*). Those agreements contain their own rules for domicile and for resolving the issue where both countries claim domicile (*s 267*(*2*));
- for the purposes of deciding whether property settled before 10 December 1974 is excluded property (*s 267*(*3*)).

With regard to the third point above, HMRC accept that domicile issues exclude deemed domicile when considering the double tax agreements with France, Italy, India and Pakistan. However, if domicile under general law is in Italy, India or Pakistan, the deemed domicile rules can apply to chargeable lifetime transfers (IHTM 13024).

Prior Rights, Legal Rights and Domicile

1.9 Prior Rights and Legal Rights are only relevant to those individuals who, at the time of their death, are deemed to be domiciled in Scotland (see **3.1**). Additionally, the right of co-habitees under *s 29 of the Family Law* (*Scotland*) *Act 2006* to make an application for provision on death only applies when, immediately before death, the deceased was domiciled in Scotland (see **Table 3.1**).

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WHAT IS CHARGEABLE TO IHT?

1.10 IHT is a direct tax on transfers of capital (eg gifts) made on or after 18 March 1986. It is broadly a cumulative tax charge on the following:

- the value transferred by a chargeable transfer made by an individual during his lifetime within the preceding seven-year period (ie broadly the loss to the donor), and on the value of his estate on death. A 'chargeable transfer' is any 'transfer of value' (see below) made by an individual, other than an exempt transfer (*s 2*); and
- certain events relating to settlements (eg gifts to a discretionary trust).

The IHT charge on death (and in respect of certain settled property) is brought into charge by deeming a transfer of value to have been made immediately before death, equal to the value of the person's estate (and value of the settled property, if appropriate). (*ss 4*(*1*)*, 52*(*1*)). The IHT legislation specifically precludes certain property from charge (see below).

CUMULATION AND THE IHT THRESHOLD

1.11 Chargeable transfers within the seven-year period ending with the date of the latest chargeable transfer are cumulated, for the purposes of determining the IHT rate (*s 7*). Where chargeable lifetime transfers and the individual's death estate do not exceed the IHT threshold (or 'nil rate band', as it is more commonly known) there is no IHT liability.

The nil rate band can normally be expected to increase annually by reference to the retail prices index. The increase in the retail prices index in September in each year is to apply to the rates of chargeable transfers made on or after 6 April in the following year (*s 8*). However, the UK Parliament (not the Scottish Parliament) may determine the nil rate band otherwise than by reference to the retail prices index, and in recent Finance Acts have done so for 2006/07 and later years as follows (*Sch 1*):

Table 1.1—The 'nil rate band'

Transfer of value	*Threshold* £
2006/07	285,000
2007/08	300,000
2008/09	312,000
2009/10	325,000
2010/11	350,000

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Following the Pre-Budget Report 2007, unless amended, the rules will provide that married couples and civil partners are able to amalgamate their nil rate band amounts:-

- The second spouse or civil partner must die on or after 9 October 2007.
- The death of the first to die can have occurred or occur at any time.
- The relevant test is the proportion of the then Nil Rate Band unused on the first death.
- The reciprocal proportion of the nil band current at the time of the second death is then added to the available nil band of the second to die.
- All this applies whether the estate of the first to die was left outright or in surviving spouse Trust.
- The second to die can have been in a series of marriages and/or civil partnerships, carrying forward the used proportion from each – but in total never more than one whole nil band can be added to the NRB of the second to die.
- All relevant estate has to be taken into account – for example liferented assets may have used up all the nil band on the first death even if everything under that Will was left to a surviving spouse or civil partner.

RATES OF IHT

Lifetime

1.12 Chargeable lifetime transfers are charged at half of the rate on death. The 'death rate' of IHT for 2007/08 is 40%, and, therefore, chargeable lifetime transfers above the nil rate band are charged at 20%.

Death

1.13 Transfers made within seven years of death are charged at the rate on death, subject to taper relief for transfers made between three and seven years from death—see **Example 1.3** below.

Grossing-up

1.14 IHT is based on the loss in value of the donor's estate as the result of a chargeable transfer. If the donor also pays the IHT on a gift, that payment results in a further loss to his estate. The tax must, therefore, be taken into account in

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the transfer of value. The gift (net of IHT) must be 'grossed-up' to determine the actual chargeable transfer.

Example 1.3—Lifetime transfers

Mr A transfers £129,000 to a discretionary trust on 1 May 2007, £194,000 on 31 December 2007 and a further £35,000 on 1 February 2008. He bears the tax and he has made no other chargeable transfers. His inheritance tax position is as follows:

	amount in £	amount in £	amount in £
Gift on 1 May 2007		129,000	
Deduct Annual exemption	3,000		
—2006/07			
—2007/08	3,000	6,000	
		123,000	
Covered by nil rate band of £300,000			
Gift on 31 December 2007		194,000	
(Note: Annual exemption already used for 2007/08)			
Cumulative net transfers		£317,000	
Tax thereon			
0—300,000			
300,001—317,000 (£17,000 × $^{1}/_{4}$)		4,250	
Tax on gift		£4,250	
Gift on 1 February 2007			
	Gross	Tax	Net
Cumulative totals	321,250	4,250	317,000
Add Latest net transfer of £35,000	43,750	8,750	35,000
	£365,000	£13,000	£352,000
Tax on £352,000			
0—300,000			
300,001—352,000 (£52,000 × $^{1}/_{4}$)		13,000	
		13,000	
Deduct Tax on previous transfers		4,250	
Tax on latest gift		£8,750	

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TRANSFERS OF VALUE

1.15 A transfer of value is a disposition by a person resulting in the value of his estate immediately after the disposition being less than it would be but for the disposition. The amount by which his estate is reduced is the measure of the transfer of value. This is sometimes referred to as the 'loss to the donor' principle.

However, the transfer of 'excluded property' (see below) does not count (*s 3*). In addition, some 'dispositions' (eg gifts or transfers) are not treated as transfers of value, where certain conditions are satisfied. These can include gifts without gratuitous intent (*s 10*), transfers for family maintenance (*s 11*), dispositions which are allowable for income tax or corporation tax purposes (*s 12*) and waivers of remuneration and dividends (*ss 14, 15*).

POTENTIALLY EXEMPT TRANSFERS

1.16 Most types of gifts made during lifetime are potentially exempt transfers (PETs). A PET is broadly a lifetime transfer of value that satisfies the following conditions (*s 3A*):

- it is made by an individual on or after 18 March 1986;
- the transfer would otherwise be a chargeable transfer;
- before 22 March 2006, if it is either a gift to another individual or a gift into an accumulation and maintenance trust or a disabled person's trust;
- from 22 March 2006, if the transfer of value is made to another individual, a disabled person's trust or a 'bereaved minor's' trust on the ending of an 'immediate post-death interest' (see Chapter 7), ie a lifetime gift into an accumulation and maintenance trust is no longer a PET from that date.

A PET made more than seven years before death becomes an exempt transfer. On the other hand, a PET becomes a chargeable transfer if made within seven years of death.

CHARGEABLE LIFETIME TRANSFERS

1.17 A lifetime transfer is broadly a disposition (eg a gift) made by a person resulting in a reduction in the value of the person's estate. A chargeable transfer is a transfer of value by an individual, other than an exempt transfer (*s 2*). As mentioned, most lifetime transfers are PETs, which are assumed will prove to be exempt when made, and which only become chargeable if the transferor dies

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within seven years of making it. However, a lifetime transfer that does not qualify as a PET will, therefore, be immediately chargeable to IHT. Examples include:

- transfers to a company;
- gifts to a discretionary trust; or
- gifts to interest in possession or accumulation and maintenance settlements created on or after 22 March 2006.

Other transfers of value prevented from being PETs include transfers by a close company, and deemed dispositions on the alteration of share rights or capital of close companies (*ss 94, 98*(*4*)).

With regard to lifetime transfers in general, see Chapter 2.

IHT ON DEATH

1.18 IHT is charged on the deceased's estate as if, immediately before his death, he had made a transfer of value. The value transferred is deemed to equal the value of his estate immediately before death (*s 4*(*1*)). The estate for IHT purposes includes the value of all property to which the deceased was beneficially entitled, and any gifts with reservation of benefit (see Chapter 5), but not any excluded property.

Changes in the value of the estate caused by the death may be taken into account (*s 171*). Liabilities of the deceased may generally be deducted if imposed under a legal obligation, or if incurred for valuable consideration (*s 5*), together with reasonable funeral expenses (*s 172*).

The amount of IHT chargeable on the death estate is subject to any IHT reliefs and exemptions to which the deceased's estate may be entitled (eg business or agricultural property relief, or the spouse or civil partner exemption), and depends on the total chargeable lifetime transfers and potentially exempt transfers made within the seven years before death.

With regard to IHT on death in general, see Chapter 3.

EXCLUDED PROPERTY

1.19 Some types of property are outside the scope of IHT. Such property is known as 'excluded property', which include the following:

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- Property situated abroad (and investments in an authorised unit trust or open ended investment company) if the beneficial owner is a non-UK domiciled person (*s 6*(*1*)).
- Settled property situated outside the UK, if the settlor was non-UK domiciled when the settlement was made (*s 48*(*3*)). However, if a UK domiciled person acquires an interest in possession in the settled property from 5 December 2005 for valuable consideration, that interest is not excluded property.
- Settled property (situated abroad or not) consisting of investments in an authorised unit trust or open ended investment company, if the settlor was non-UK domiciled when the settlement was made (*s 48*(*3A*)). However, if a UK domiciled person acquires an interest in possession in settled properly it from 5 December 2005 for valuable consideration, that interest is not excluded property (*s 48*(*3B*)).
- A 'reversionary interest' (ie a future interest under a settlement) subject to certain anti-avoidance provisions (eg if the interest has previously been acquired for valuable consideration; see *s 48*(*1*)).
- Certain government securities owned by persons not domiciled or ordinarily resident in the UK (*s 6*(*2*)).
- National Savings certificates, war savings certificates, premium savings bonds or deposits with the National Savings Bank or a trustee savings bank of persons domiciled in the Channel Islands or Isle of Man (*s 6*(*3*)).

There is also an exclusion from the death estate in respect of foreign (ie non-sterling) currency bank accounts of a person who was not domiciled, resident or ordinarily resident in the UK immediately prior to death (*s 157*). In addition, certain other types of property are left out of account for IHT purposes, by Concession:

- decorations for valour, if never transferred for consideration in money or money's worth (ESC F19); and
- certain compensation for World War II claims (see ESC F20).

Settled property

1.20 The excluded property legislation refers to the settlor's domicile when the settlement was made. HMRC take the view that, in the case of added property, a further settlement was made when that property was transferred. If the settlor was domiciled in the UK at that point, the property will not be excluded property. HMRC's Inheritance Tax Manual gives the following example (IHTM 4272):

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Example 1.4—Foreign settled property

'S, when domiciled abroad, creates a settlement of Spanish realty. Later he acquires an UK domicile and then adds some Australian property to the settlement.

The Spanish property is excluded property because of S's overseas domicile when he settled that property. However, the Australian property is not excluded property as S had a UK domicile when he added that property to the settlement.'

IHT is not charged on lifetime transfers of excluded property. Nor does excluded property form part of a person's estate on death (*ss 3*(*2*), *5*(*1*)(*b*)). However, excluded property is taken into account when measuring the loss in value of a person's estate following a transfer of non-excluded property.

EXEMPTIONS—SUMMARY

1.21 The following types of property are exempt and, therefore, outside the IHT charge:

- **Transfers between spouses or civil partners** (*s 18*)
- There is a complete exemption for all transfers (ie lifetime and on death) between UK domiciled spouses. However, where the transferor spouse is UK domiciled but the transferee spouse is foreign domiciled, the exemption is restricted to a cumulative total of £55,000. If the non-domiciled spouse subsequently becomes UK domiciled, unfortunately any preceding transfers to them are still subject to the £55,000 restriction. Following the *Civil Partnership Act 2004*, same-sex couples who enter into a civil relationship are given parity of tax treatment with married couples.
- **Annual exemption** (*s 19*)
- Lifetime transfers of a value up to £3,000 per tax year are completely exempt from IHT. Any unused part of the exemption may be carried forward for one tax year only, and deducted after the annual exemption has been fully used in that later year. If the value of the gift or transfer exceeds the annual exemption, the excess will either be a potentially exempt transfer or an immediately chargeable transfer.
- **Small gifts to same person** (*s 20*)
- Lifetime gifts in a tax year with a total value not exceeding £250 to any one person are exempt from IHT. If the total value of gifts to that person exceeds £250 in the tax year, the exemption is completely lost, eg it cannot be set against part of a larger gift. The gifts must be outright. For

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example, they cannot be gifts of premiums on a life policy that has been written in trust (although the exemption for normal expenditure out of income in *s 21* might well apply (see below)).

- **Normal expenditure out of income** (*s 21*)

  The exemption applies to lifetime gifts which:

  (a) form part of the normal expenditure of the person making it;

  (b) were made out of income (taking one year with another); and

  (c) left the donor with sufficient income to maintain their normal standard of living.

- Unlike other lifetime exemptions (eg the annual exemption), the normal expenditure out of income exemption is not subject to an upper maximum, and is only restricted to the extent that the donor's gifts satisfy the above conditions.

- **Gifts in consideration of marriage or civil partnership** (*ss 22, 57*)

  Marriage gifts are exempt within certain limits. The amount of the exemption depends on the donor's relationship to the bride, groom or civil partner. Gifts of up to £5,000 by a parent of a party to a marriage or civil partnership are exempt. In the case of gifts by a grandparent or remoter ancestor, or by one party to the marriage or civil partnership to the other, the exemption limit is £2,500. For marriage gifts made by any other person, the upper limit is £1,000. These exemptions apply per marriage/civil partnership. The gifts must be made on or shortly before the marriage or civil partnership, and must become fully effective on the event taking place.

- **Gifts to charities** (*s 23*)

  Gifts to charities established in the UK which have been recognised by HMRC (but not necessarily by The Office of the Scottish Charity Regulator – see Overview), or have been granted charitable status by the Charity Commission for England and Wales and/or the Charity Branch of the Department for Social Development in Northern Ireland are exempt from IHT. The exemption applies to outright gifts to charity or to certain UK charitable trusts, and applies to lifetime gifts or transfers on death with no upper limit.

- **Gifts to political parties** (*s 24*)

  Gifts to qualifying political parties are exempt transfers for IHT purposes without limit. To meet the qualifying status the parties must, at the last UK General Election, have had two members of that party elected to the House of Commons or had one member elected to the House of Commons and obtained not less than 150,000 votes for their party candidates.

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At present, the rules do not allow for political parties to qualify under their achievements at a Scottish Parliamentary Election (see Overview **A7**).

- **Gifts to housing associations** (*s 24A*)

  Gifts of UK land and buildings to a registered housing association or registered social landlord are exempt without upper limit.

- **Gifts for national purposes** (*s 25*, *Sch 3*)

  An unlimited exemption applies to qualifying gifts to those bodies designated in *IHTA 1984, Sch 3* which include the National Museums of Scotland, Scottish Natural Heritage, the National Trust for Scotland for Places of Historic Interest or Natural Beauty, and any university or college.

- **Gifts for public benefit** (*s 26*) (repealed)
- Gifts within certain specified categories to bodies not established for profit were exempt from IHT if the Board so directed. This exemption was repealed for gifts made from 17 March 1998.
- **Maintenance funds for historic buildings, etc** (*s 27, Sch 4*)
- Transfers (during lifetime or on death) into settlement for the maintenance, repair or preservation of historic buildings and assets of outstanding scenic, historic or scientific interest, etc are exempt subject to certain conditions, where HMRC so direct (under *IHTA 1984, Sch 4*). The exemption must be claimed within two years after the date of the transfer concerned or within such longer period as HMRC may allow.
- **Employee trusts** (*s 28*)
- Transfers, by an individual, of shares or securities in a company to 'trusts for the benefit of employees' of the company (within *IHTA 1984, s 86*) are exempt if certain conditions are satisfied.
- **Other exemptions**

  — Annuities payable on a person's death under a registered pension scheme or superannuation fund within *ICTA 1988, s 615*(*3*) (or prior to 6 April 2006, either a retirement annuity contract or a personal pension scheme) to a spouse or dependant, where a capital sum might at the deceased's option have become payable instead to his personal representatives (*s 152*).

  — "Killed in war" exemption (ie property of an individual passing after death on active service (*s 154*) or if the individual had previously contracted a disease which was generated by such service as in the case of *Barty-King v Ministry of Defence 1979*).

  — Foreign currency bank accounts held on the death of an individual not resident, ordinarily resident or domiciled in the UK (see **1.19**).

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TAPER RELIEF: OUTLINE

1.22 IHT on all lifetime transfers (chargeable lifetime transfers and PETs) made within seven years before death is subject to a potential reduction for taper relief, if the lifetime transfer was made more than three years before death.

Tax on chargeable lifetime transfers is calculated at lifetime rates. If the transferor dies within seven years the tax is recomputed at full death rates, subject to taper relief where the death is more than three years after the gift. However, taper relief cannot reduce the tax payable below that originally charged.

In addition, IHT at full death rates is calculated at the time of death on any PETs made within seven years prior to death, subject to the availability of taper relief. The value of the transfer stays the same for taper relief purposes, but the full rate(s) of IHT charged are reduced to a percentage of those rates on the following scale (*s 7*(*4*)):

Table 1.2—Taper relief rates

Transfer:	3—4 years before death: rate reduced to:	80%
	4—5 years before death:	60%
	5—6 years before death:	40%
	6—7 years before death:	20%

1.23 However, if IHT on a chargeable lifetime transfer is recalculated on death with taper relief and produces a lower tax figure than the tax originally calculated at lifetime rates, the original figure stands (*s 7*(*5*)). In other words, no IHT repayments result from the application of taper relief. See Chapter 10.

QUICK SUCCESSION RELIEF: OUTLINE

1.24 Relief is available on the death of an individual whose estate has increased in value as the result of a chargeable transfer (ie during lifetime or a transfer on death) made within five years before his death (*s 141*). If the conditions for relief are satisfied, the tax charge on the later transfer is calculated in the normal way. The relief is then given by reducing the IHT on death by a percentage of the tax attributable to the net increase in the deceased's estate from the original transfer. It is not necessary for the asset in question to be retained. The percentage varies according to the length of time between the dates of transfer and death, as follows:

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Table 1.3—Quick succession relief

Period between transfer and death	*Relief percentage*
One year or less	100%
1—2 years	80%
2—3 years	60%
3—4 years	40%
4—5 years	20%

The earlier transfer can be, for example, a failed PET on which IHT becomes payable. The same rates of quick succession relief apply to successive IHT charges within five years on trust property with an interest in possession. See Chapter 10.

DOUBLE TAXATION RELIEF

1.25 Where IHT is chargeable in the UK and tax of a similar nature (or which is chargeable by reference to death or lifetime gifts) is charged in another country on the same property, double taxation relief may be available.

Treaty relief

1.26 Relief is given if the UK has a double taxation agreement with the overseas territory containing provisions to eliminate the double taxation chargeable by reference to death or lifetime gifts (*s 158*).

A person can be deemed domiciled in the UK for IHT purposes even though he is domiciled elsewhere under general law (ie if resident in the UK for 17 out of the 20 tax years, or if domiciled in the UK within the previous three years). That person may also be domiciled elsewhere under the domestic law of another state. The 'deemed domicile' IHT rule does not apply in all cases, such as where certain pre-CTT double taxation agreements are still in force (ie by virtue of *s 158*(*6*)*;* see *s 267*(*2*)). Those agreements contain their own rules for domicile and for resolving the issue where both countries claim domicile. HMRC accept that domicile issues exclude deemed domicile when considering the double tax agreements with France, Italy, India and Pakistan, although if domicile under general law is in Italy, India or Pakistan, the deemed domicile rules can apply to chargeable lifetime transfers (IHTM 13024).

Unilateral relief

1.27 Where relief is not provided under a double tax agreement, credit is available against UK tax for tax suffered in an overseas territory, on the same

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property (*s 159*). Unilateral relief may also be claimed if it provides greater relief than by applying treaty relief (*s 159*(*7*)).

If the property is situated in the overseas territory and not in the UK, credit is available on the whole amount of overseas tax. However, if the overseas tax exceeds the UK tax, the excess is not repayable. A measure of relief is also available if the property is situated as follows (*s 159*(*3*)):

- in a third territory; or
- both in the UK and the overseas territory (ie due to different laws on the situs of assets in the UK and that territory).
- Relief similarly applies if tax is imposed in two or more overseas territories if the property is situated as follows (*s 159*(*4*)):
- neither in the UK nor those territories; or
- both in the UK and in each of those territories.

TRANSFERS OF VALUE BY CLOSE COMPANIES

1.28 Anti-avoidance rules apply to transfers of value (eg sales at undervalue) by close companies. Only individuals can make a chargeable transfer for IHT purposes (*s 2*(*1*)). However, if a close company makes a transfer of value, the transfer is apportioned between the participators in that company (*s 94*). Each participator is deemed to have made an immediately chargeable transfer of value (ie not a PET) equal to the amount so apportioned. The company is primarily liable to pay any IHT liability arising (*s 202*).

However, if the participator's estate increases as a result of the transfer, that increase may be deducted from the amount so apportioned. The balance reflects the net decrease in value of the person's estate. Therefore, a transfer of value to a participator with a 100% interest in the close company should not normally result in an overall decrease in the value of his estate.

A transfer of value is not apportioned to participators in the following circumstances (*s 94*(*2*)):

- if the amount is liable to income tax (or corporation tax) in the recipient's hands, eg as employment income or dividend income of the individual; or
- the participator is not domiciled in the UK, and the relevant asset is situated abroad.

1.29 If the participator has less than 5% of the transfer apportioned to him, the transfer is not added to his cumulative total of transfers for IHT purposes

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(*s 94*(*4*)), and no IHT liability attaches to that person in respect of the transfer. However, the tax is calculated by reference to his IHT position at that time, although he cannot be held liable to pay the IHT if the company is in default (*s 202*(*2*)). The annual IHT exemption may be deducted (if not already used elsewhere) from the value of any amount apportioned (*s 94*(*5*)).

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