

FB2025 - IHT changes for trusts relating to abolition of domicile status

(Lecture P1475 – 15.50 minutes)

Unsurprisingly, the provisions relating to trusts for IHT purposes are complex. These are contained in Clause 45 and Schedule 13 of the Finance Bill.

Note that none of these provisions affect the rules relating to overseas property with value attributable to UK residential property found in Schedule A1 IHTA 1984.

The provisions will have an impact in various situations:

- Where this is a settlor-interested trust, whether the assets are included within the estate of the settlor on death (as there is a gift with reservation for such a trust);
- Periodic and exit charges for relevant property trusts;
- Whether assets within qualifying interest in possession trusts will be within the estate of the beneficiary on death.

These are subject to transitional provisions which are discussed below.

The current rules for excluded property so far as they relate to settlements, found at s48 IHTA 1984, are amended so that the only categories of property which is excluded is reversionary interests and Treasury securities. For the avoidance of doubt, these rules do not apply to reversionary interests in property held in trust.

A new s48ZA is inserted relating to property in a settlement which is situated outside the UK or is a holding in a unit trust or a share in an open-ended investment company. The normal rules on excluded property do not apply.

The tax impact depends on whether the settlor is alive and if they have died, when they died.

If the settlor is alive, the property is excluded property only if the settlor is not a long-term resident. This means the liability to any tax charge is considered at the point when that charge potentially arises rather than at the point the settlement was made.

If the settlor died on or after 6 April 2025, the property is excluded property if the settlor was not a long-term resident immediately before they died.

If the settlor died before 6 April 2025, the property is excluded property if the settlor was not domiciled when the property entered the settlement. Where the property is income which becomes comprised in the settlement due to not being distributed, the relevant time is when it became comprised in the capital of the settlement, and not when it was first received.

However, these rules are modified if there is an interest in possession in the trust (which is a qualifying interest in possession such that the assets are included within the estate of the

beneficiary). If that is the case, the assets are not excluded property if the beneficiary is a long-term UK resident and the settlor is alive or died on or after 6 April 2025.

If the settlor died before 6 April 2025, and the settlor was not domiciled when the property entered the settlement, it will be excluded property where there is a qualifying interest in possession unless the beneficiary is a long-term resident at any point on or after 6 April 2025 or was domiciled in the UK at any time before that date and they are a beneficiary due to a transaction for money or money's worth on or after 5 December 2005 (given by the beneficiary or anyone else).

There is an anti-avoidance provision at s74A IHTA 1984 which covers a situation where an individual who is domiciled in the UK acquires an interest in settled property and consideration is given in money or money's worth for that interest in circumstances where there is a reduction in the value of that individual's estate.

If the settlor was not domiciled in the UK and the assets in the settlement were outside the UK or the settlor was not an individual or close company at the time of the settlement, then there is a deemed transfer of value at the time of the interest being acquired. It was targeted at some specific planning. If this section applies, the ability for trust property to remain as excluded property (as discussed above) is removed.

Transitional provisions

As noted above, if the gift with reservation rules apply, the worldwide trust assets will be part of the settlor's estate. However, these will not apply to trusts settled before 30 October 2024 by those who are not domiciled at the time, other than where the trust has UK assets.

For qualifying interest in possession trusts, if there were non-UK assets in the settlement which were excluded property before 30 October 2024, they would not be subject to IHT when the IIP comes to an end (or on the death of the beneficiary). This would not apply in relation to any UK assets in the settlement which are sold and become non-UK assets. If a new QIIP comes into place on or after 30 October 2024, that will fall within the new regime.

Additionally, if there is a termination of an IIP which was in a settlement immediately before 30 October 2024 and was excluded property, there will be no IHT charge on the termination as long as it remains excluded property (under the pre-6 April 2025 rules).

There are no transitional provisions for relevant property trusts which fall within the new regime other than where the settlor died before 6 April 2025 when their domicile status at the date of death determines the IHT position, as discussed above.

Example: settlor-interested trust

Johannes transfers assets into a settlor-interested trust on 1 October 2025 at a time when he had no intention of ever living in the UK and had never been resident in the UK.

However, he met his partner and became resident in the UK on 10 May 2027.

Once he becomes a long-term resident, on 6 April 2037, any assets within the trust will form part of his estate for UK IHT purposes, along with any offshore assets held personally.

Example: settlor-interested trust transitional provisions

Felicity is not domiciled in the UK but become resident in 2013/14. She establishes a trust on 1 October 2016, transferring in property she had recently inherited from her mother.

This is a settlor-interested trust as she receives income from this trust. She is a long-term resident as at 6 April 2025 but the assets within the trust will not be part of her estate if she remains within the UK as the trust was created before 30 October 2024 at a time when Felicity was not domiciled in the UK.

Assuming this is a discretionary trust, the trust will have to pay periodic and exit charges as soon as she becomes a long-term resident.

Example: discretionary trust

Michel is not domiciled in the UK but becomes resident in 2019/20. In 2021, he settles offshore property into a discretionary trust for the benefit of his children and grandchildren. He remains within the UK until his death in 2045. In 2047, the trust is wound up and the assets distributed to the beneficiaries.

No IHT arises on the creation of this trust as he is not domiciled or deemed domiciled when the trust is created.

Michel became a long-term resident on 6 April 2029.

The first 10-year charge on the trust arises in 2031, and since Michel is a long-term resident at this point, there is a charge of a maximum of 6% of the trust assets. However, as the trust has not been within scope of UK IHT for the entire 10 years, this will be pro-rated. As the trust has been in scope for 2 years, the maximum charge would be $6\% \times 20\% = 1.2\%$.

A second 10-year charge arises in 2041, this time at a maximum of 6%.

No charge arises on Michel's death in 2045 as this is not a settlor-interested trust.

When the assets leave the trust in 2047, there will be an exit charge as Michel had been a long-term resident at the date of his death. This will be calculated in the same way as if this had been a UK trust.

Example: ceasing to be long term resident

Sofia creates a settlement, which she cannot personally benefit from, in 2020, when she is neither resident in the UK nor domiciled in the UK. She becomes UK resident in 2026/27 but leaves and establishes non-residence in 2047/48.

No IHT arises on the creation of this trust as she is not domiciled or deemed domiciled when the trust is created.

Sofia became a long-term resident on 6 April 2036.

The first 10-year charge on the trust potentially arises in 2030 but no charge arises as Sofia is not a long-term resident at this point. However, the charge in 2040 would arise as she is a long-term resident by 2040. However, as the trust has not been within scope of UK IHT for the entire 10 years, this will be pro-rated. As the trust has been in scope for 4 years, the maximum charge would be $6\% \times 40\% = 2.4\%$.

A second 10-year charge will arise in 2050 because, although Sofia is no longer resident in the UK, she is still a long-term resident.

Sofia will cease to be long-term resident on 6 April 2057 and at that stage there will be an exit charge as the trust leaves the UK IHT regime. The calculation will be on the same basis as if the assets themselves had been withdrawn from the trust, so will be pro-rated since the last 10-year charge.

Example: UK domiciled individual

Frank is a UK domiciled individual who forms a trust in Jersey in 2021 into which he puts his non-UK assets. He cannot benefit from this trust. He becomes non-resident in 2024/25.

A 10-year charge would arise in 2031 as Frank is still a long-term resident at that stage.

Frank will cease to be a long-term resident on 6 April 2034 and at this stage an exit charge will arise as the assets within the trust have ceased to be within the UK IHT regime.

Example: QIIP transitional provisions

Eric is not domiciled in the UK but came to the UK to study in the 1990s and has remained. In 2000, whilst still not domiciled, he created an interest in possession trust for his partner, Francis, who has always been UK resident and domiciled in the UK. The settlement includes non-UK assets. Their daughter, Grace, will then acquire the interest in possession on Francis' death. She has always been UK resident and domiciled.

Francis dies in 2029 and Eric dies in 2032.

The non-UK property in the settlement will not form part of Francis' estate as this would fall within the transitional protection at 30 October 2024 as Eric was not domiciled when the trust was formed.

However, the protection does not apply to the new interest in possession which arises on transfer to Grace. Eric was a long-term resident by the time he died in 2032 and Grace will be too (assuming she does not leave the UK). The non-UK assets will therefore fall within her estate when she dies.

Example: QIIP transitional provisions

Georgina has a life interest in a trust set up by her grandfather's death in 1960, when he was domiciled in Jersey. She did not acquire her interest for consideration in money or money's worth. The trust fund consists of investments held and managed in Jersey.

Although she has a life interest in the assets, the settlor died before 6 April 2025 and therefore it was his domicile status at the date the assets entered the settlement which are relevant. As Georgina's grandfather was not domiciled when the trust was established (on his death), the assets within the trust are not included within her estate when she dies.