

Excluded Property Trusts



Excluded Property Trusts are a mechanism for non-UK domiciled individuals to shield excluded property from Inheritance Tax in the event that they become UK domiciled.



For Inheritance Tax (IHT) the notion of domicile is the overriding determinant on whether assets fall within the scope of IHT or not. There is no specific definition of domicile for tax purposes and it should not be confused with residency although residency may be a factor in determining domicile.

Upon death, IHT is chargeable on the worldwide assets of a UK domiciled individual.

For non-domiciled individuals assets held within the UK are within the scope of IHT. Assets held overseas are referred to as excluded property and are outside the scope of IHT

It is possible for a previously non-domiciled individual to become deemed domiciled in the UK. From the point they become deemed domiciled in the UK, IHT is chargeable on their worldwide estate and the subsequent IHT charge on their death could rise significantly. There is a method for non-domiciled individuals to 'shield' their overseas assets from IHT by placing them in an 'excluded property trust' prior to becoming deemed domiciled.

The trust is a separate legal entity and takes on the domicile of the settlor at the time the trust is created. Most importantly, the trust keeps its original domicile status regardless of what subsequently happens to the domicile of the settlor. Thus, assets held within an excluded property trust will remain outside the scope of IHT in situations where the settlor subsequently becomes domiciled in the UK.

It is very important to maintain the excluded property status of any trust set up in this manner. Generally, no further assets should be settled into the trust by the settlor once his domicile has changed as this could 'taint' the trust which could then lose its excluded property status.

Care should also be taken to avoid the trust holding investments in certain overseas companies which themselves invest in UK residential property as these investments may remain within the scope of IHT regardless of the domicile of the trust.

If an individual does have a UK domicile of origin, which was subsequently lost, he can still set up an excluded property trust. However, the foreign assets within the trust will not be considered excluded property in any tax years the

settlor is also resident in the UK. If the settlor remains non-UK resident the same tax advantages apply.

Once set up excluded property trusts are not subject to the on-going IHT charges (10-year charges and exit charges) suffered by UK domiciled relevant property trusts.

Any income earned by the trust can be capitalised and retained within the trust and will also be excluded property.

How to determine domicile for UK IHT

You may be domiciled in the UK under general law or by virtue of the deemed domicile rules. Below is a brief overview of the rules for illustrative purposes but in reality they are a lot more nuanced than this and professional advice should be sought when determining domicile.

General Law

Under general law you can have a UK domicile of origin, a domicile of dependency or a domicile of choice.

- Domicile of origin - Everyone has a domicile of origin, usually it is that of your Father. Your domicile of origin takes precedence until it is superseded by a domicile of dependency or choice.
- Domicile of dependency - your domicile may change to that of a person on whom are dependent although this generally only applies to minors or those lacking mental capacity.
- Domicile of choice – You can become UK domiciled by choice. You must demonstrate that you intend to reside permanently in the UK and have cut ties with your prior country of domicile.

Deemed Domicile

If you are not domiciled in the UK under general law you may become deemed UK domiciled for tax purposes if any of the points 1 to 3 apply

1. You were domiciled in the UK under general law at any point in the last 3 years.
2. You have been UK tax resident for at least 15 out of the last 20 years and for at least 1 out of the last 4 years.
3. You are 'formerly domiciled' which is defined as someone who satisfies all of the below:
 - a. You were born in the UK
 - b. You have a UK domicile of origin
 - c. You are tax resident in the UK in the year in question
 - d. You were tax resident in the UK in 1 of the 2 preceding years.

The deemed domicile rules do not apply to individuals who would otherwise be treated as being domiciled in France, Italy, India or Pakistan due to the nature of the double tax treaties between these countries and the UK.

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