

IHT Spouses and Civil Partners domiciled outside the UK Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 The Chartered Institute of Taxation (CIOT) sets out below its comments on the comments on the draft clauses and Technical Note published on 11 December 2012.
- 1.2 The proposal to tie the Non-Domiciled Spouse (NDS) exemption limit to the Nil Rate Band for Inheritance Tax (IHT) makes sense. It has some underlying logic and makes it less likely that its value will wither in the same way as the £55,000 threshold has.

2 Executive summary

- 2.1 We have three areas of concern:
 - We do not believe that the current proposals are EU-compliant;
 - The practicality of electing into deemed domicile status at or before a lifetime transfer;
 - The practicality of the two year window following a death.
- 2.2 The unfairness arising from rigid time limits could be mitigated by flexibility to permit 'such longer period as an officer of Revenue and Customs may in the particular case allow'.

3 Non-compliance with EU law

- 3.1 The proposed changes do not appear to us to be compliant with EU law. It is disappointing that the Technical Note fails to address this aspect at all.
- 3.2 Although, from an EU perspective, the availability of an election, which allows a non-domiciled spouse to elect to be UK-domiciled for IHT purposes, appears to level the playing field, this is a disproportionate response to the perceived problem of assets escaping the inheritance tax net because an election will have the effect of bringing all of the non-domiciled spouse's assets within the UK IHT net.

- 3.3 The European Court has held (*Case C-440/08 F. Gielen v Staatssecretaris van Financiën*) that discrimination cannot be countered by the availability of an election to be treated in particular way if the making of the election, while alleviating the specific issue causing the discrimination, puts the taxpayer in a worse position in some other respect.
- 3.4 In our view a more proportionate response to the discrimination faced by non-domiciled spouses would be to provide for an election which, if made, would apply only to the assets being transferred, that is there would be no inheritance tax on the transfer of value to the spouse, but that the assets would then be caught by UK inheritance tax on a subsequent transfer of value by the non-domiciled spouse regardless of where they are situated.
- 3.5 It will also be important to retain the draft provision allowing the non-domiciled spouse to lose the deemed domiciled status by going non-resident. Without this, there would again be discrimination against them – because unlike those acquiring a deemed domicile under s 267 IHTA 1984 they would not be in a position to lose their deemed UK domicile by going non-resident.

4 Lifetime elections

- 4.1 We cannot see that it is reasonable where, if Adam (UK domiciled) is giving property to Eva (NDS) in Adam's lifetime, it is thought necessary that Eva has to make an election effectively in advance. Our experience is that in real life, gifts are made and advice is sought afterwards (if at all). For example, a common situation is where a house is bought in the names of Adam and Eva as joint tenants. Where Adam has provided all the purchase price, the correct analysis is that he has made a gift to Eva. A retrospective election for lifetime gifts would seem appropriate, sufficient to cover the full seven year PET period.
- 4.2 A transfer should be electable for that period because it is a basic feature of the PET regime that the status of a transfer cannot be determined as chargeable or not until it has ceased to be a potentially exempt transfer, or the death of the donor has occurred.
- 4.3 For lifetime gifts retrospection would also be desirable to cover circumstances such as:
1. Where the donor has miscounted, and thought their spouse already deemed domiciled, or had not realised that they, the donor, had become deemed domiciled.
 2. Where the parties have misunderstood the application of s 102 FA 1986 if the transferee spouse is not UK domiciled.

Either of these situations could have resulted from protracted discussions with HMRC over the residence status of one of the spouses.

5 Death transfers

- 5.1 Is two years sufficient retrospection for death transfers? Probably in most cases but we fear that the timing has been based upon the s 142 Deed of Variation limit without further consideration of the circumstances of a NDS who may well not know soon enough that UK IHT is an issue. What happens if there is a claim under the Inheritance (Provision for Family and Dependents) Act 1975 – where time limits run from the date of the Grant, not death? That might not be resolved until some considerable time later. Similarly, Eva (in the lifetime example) may well not identify the problem until after the two years have elapsed.

- 5.2 Consider a further example of the difficulty which a short, inflexible time frame would produce: Jim leaves the UK to go to India where he marries Dhana (Indian resident, domiciled and never had anything to do with the UK). They plan to spend the rest of their life in India and never come back to the UK. Jim has no relatives in the UK, sells up and goes to India permanently. Unfortunately Jim dies within three years so is caught by s 267 as still being domiciled in the UK. Dhana knows nothing about this as she has no idea how the UK tax system works. Five years' later she receives a demand for UK IHT on the money she has inherited from Jim.
- 5.3 Further examples where two years from the death may be insufficient include an unexpected IHT liability arising because:
- Business property relief is denied
 - A gift with a reservation of benefit is discovered
 - Other lifetime chargeable transfers emerge (particularly if seven year retrospection is denied for transfers to a NDS)
 - Other chargeable bequests emerge (a later Will or codicil)
 - A valuation argument is 'lost'
 - The deceased spouse is discovered to be UK, perhaps deemed, domiciled
 - There is a dispute over beneficiaries (proprietary estoppel; validity of lifetime gifts; capacity).
- 5.4 We suggest that the difficulties raised by the various circumstances outlined above could be met by adopting a more flexible approach (similar to that contained in s 8B(3)(b) IHTA 1984 in relation to a claim to the transferable NRB) to permit 'such longer period as a officer of Revenue and Customs may in the particular case allow'.
- 5.5 The draft clause does not address the problem of making an election where spouse 1 has died, spouse 2 could have made the election but has also died within the two-year election period, and the PRs of spouse 2 now need to do so: the ability to make an election (and the longer period to do so) must be made available to those PRs.

6 Implementation

- 6.1 We wonder why the revised NDS provisions are being delayed to apply only to transfers of value made on or after 6 April 2013. It would be more appropriate and in accord with the spirit of the legislation, to link implementation to the date of enactment so that an election made on or after that date could apply to (on HMRC's suggestion) deaths up to two years previously and (on our suggestion) PETs up to seven years previously.
- 6.2 In any event, HMRC's current mechanism would be unworkable: how could an 'on or before' election be validly made in respect of a lifetime gift made, say, on 7 April 2012, but before the draft legislation received royal assent? What is the form of election?

7 Conclusion

- 7.1 We are willing to explore all or any of these issues with you further.

8 The Chartered Institute of Taxation

- 8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 16,500 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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