
Foreign death duties

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Death and gift duties were progressively abolished by Australian states and the Commonwealth around 1980. However, Australia remains one of six out of 34 countries in the Organisation for Economic Co-operation and Development (OECD) that do not have death duties.¹ Australians moving to, or investing in, foreign countries with death duties may be affected. Domiciles of countries with death duties moving to Australia should also be aware of the potential implications.

Core issues

Death duties generally apply to assets owned by a natural person at the time of death. Accordingly, death duties have often been sought to be avoided by holding assets via foreign companies or trusts, which exist in perpetuity or, at least, for a period spanning several decades. This strategy is being actively confronted in the United Kingdom, as discussed below, and there have been several significant changes in recent years.

Australians moving to, or investing in, countries that impose death duties need to be aware of the domestic law in that country in relation to:

- becoming a domicile or deemed domicile of that country for death duty purposes; or
- the application of death duty to assets held in that country, notwithstanding that the owner is not domiciled in that country.

Domiciles of countries with death duties moving to, or investing in, Australia also need to be aware of the above issues, as the domestic law of their country is likely to continue to apply.

This article examines the above core issues in relation to the United Kingdom, the United States and France, and comments on the general situation in Asian countries.

UK inheritance tax

Domicile

UK inheritance tax² applies if, at the time of death, a person is domiciled in the United Kingdom or the person has property in the United Kingdom.³

The concept of domicile is derived from the common law. A person may only have one domicile at any given time.⁴ A person's domicile is the place where they intend to live permanently or indefinitely, which may be different from their nationality or place of residence.

A person's domicile of origin is generally acquired from their father upon birth; however, it is not necessarily the country in which the person is born. For example, a person may be born in Australia to a father whose domicile is in the United Kingdom, whereby the domicile of origin would be the United Kingdom.

A UK person's domicile of origin may change in the following three ways:

- **Dependency:** If the person is legally dependent on another whose domicile changes, then the person's domicile will automatically change.⁵ This applies until the person is able to acquire a domicile of choice when they are no longer legally dependent on another.
- **Choice:** A person may change their domicile by moving to another place with an intention of remaining there "permanently" upon attaining the age of 16 years.⁶ The onus of proving a change of domicile is on the person changing their domicile and it can be onerous.⁷
- **Deemed domicile:** Even if a person is not domiciled in the United Kingdom, they may be deemed to be domiciled in the United Kingdom if they reside in the United Kingdom for 17 out of 20 years prior to their death, or they die within three years of ceasing to be domiciled in the United Kingdom.⁸

Application of UK inheritance tax

If a person is domiciled in the United Kingdom at the time of death, then inheritance tax applies to their worldwide assets.⁹

If a person is not domiciled in the United Kingdom but they have assets sited in the United Kingdom, then inheritance tax applies to those assets only.

Liability for inheritance tax is 40% for estates with a combined net value in excess of the threshold of £325,000 (known as the nil rate band) after taking into account liabilities, reliefs and exemptions.¹⁰

Prior to 2013, an estate could take into account all liabilities at the date of death. As non-UK property of non-UK domiciles is not subject to inheritance tax, liabilities relating to non-UK property could be applied against UK property to reduce the net value of an estate. In 2013, the deduction of liabilities was restricted to exclude liabilities attributable to the acquisition of excluded property or the maintenance of such property.¹¹

Currently, foreign currency bank deposits of non-UK domiciles are exempt from inheritance tax.¹² An anti-avoidance provision is proposed that would disallow any deduction for borrowed funds that have been deposited in a foreign currency bank account either directly or indirectly to avoid tax.¹³

Transfers between domiciled spouses (or civil partners)¹⁴ are generally exempt from inheritance tax.¹⁵ However, inheritance tax applies upon the death of surviving spouses (or civil partners).

As of April 2013, transfers from UK domiciled spouses (or civil partners) to non-UK domiciled spouses (or civil partners) are exempt up to the nil rate band.¹⁶

Also, non-UK domiciled spouses (or civil partners) can elect to be treated as UK domiciled, thus enabling them to access the full spousal exemption. However, such an election makes the entire estates of non-UK domiciled spouses (or civil partners) subject to inheritance tax. An election is irrevocable; however, it will cease to have effect if the electing individual is not an income tax resident for four successive tax years.¹⁷

As noted above, inheritance taxes have been sought to be avoided by non-domiciles holding assets in foreign companies or trusts (known in the United Kingdom as “enveloped entities”). In response to this strategy, without actually changing the IHTA 1984, the UK government has introduced a series of measures in recent years in relation to companies and “non-natural persons” (but not trusts) purchasing, holding and disposing of residential properties:¹⁸

- From March 2012, Stamp Duty Land Tax (SDLT) at a rate of 15% was introduced on purchases of residential property worth over £2 million. From March 2014, the threshold for SDLT is proposed to be reduced to £500,000.
- From April 2013, Annual Tax on Enveloped Dwellings (ATED) was introduced based on a scale with the top levy at £140,000 for properties worth over £20 million.¹⁹ The threshold for ATED is proposed to be gradually reduced to £500,000 from April 2016.²⁰
- From April 2013, capital gains tax (CGT) of 28% upon disposal of such properties was introduced. The threshold for CGT is proposed to be gradually reduced to £500,000 from April 2016.²¹

In addition to the above, the UK government released a consultation paper in March 2014 regarding its proposal to extend the application of CGT on UK residential properties to all non-UK residents, including individuals, companies and trusts, as from April 2015.²²

These measures make it much less attractive to hold UK residential property in a foreign company. Offshore trusts are not much better for holding UK residential property, because the trust may be charged with UK inheritance tax on each 10-year anniversary of the settlement or upon the property leaving the trust at a rate of up to 6% of the value of the property.²³ Australian domiciles acquiring such property may consider holding the property personally. If the property is held personally, then it will form part of the person’s estate for UK inheritance tax purposes, but could be funded by borrowing to reduce the value of the estate.

It should be noted that none of the above changes affects other asset classes, such as commercially real property.

United States

Citizen or resident (domicile)

US estate tax is imposed if, at the time of death, the deceased is a US citizen or resident.²⁴

Residence for US estate tax purposes is not exactly the same as domicile for UK purposes. Domicile for US estate tax has been described as being like “habitual abode”.²⁵ A person is domiciled in the United States by living in the United States (even for a brief period of time) and not evincing any intention of living permanently or indefinitely elsewhere. The test considers factors such as the length of stay in the United States, frequency of travel, size and cost of home in the United States, location of family, participation in US business, and ownership of assets in the United States.

Non-domiciles are subject to US estate tax if they own assets sited in the United States at the time of death.²⁶

Application of US estate tax

For US citizens or domiciles, US estate tax is imposed on the value of the deceased’s worldwide estate on a marginal scale, with the highest rate at 40%.²⁷ The value of the estate is determined by deducting certain allowable items, such as expenses, debts and taxes,²⁸ and the value of property that passes to a US domicile spouse²⁹ from the gross value³⁰ of the estate.

For US citizens or domiciles, there is an exemption threshold, which is applied as a credit against the tax imposed. The threshold is indexed for inflation. For

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2014, the threshold is US\$5.34 million. In general, credit against US estate tax is also given for any corresponding state tax in order to avoid double taxation.³¹

For non-domiciles, US estate tax only applies to assets sited in the United States at the time of death at the same rate as for US citizens or domiciles;³² however, the exemption threshold is only US\$60,000.

Australians moving to the United States must carefully consider the domicile test and any implication it may have upon death. In some circumstances, it may be beneficial to become a US domicile — for example, if the total value of worldwide assets is below the exemption threshold (US\$5.34 million) and US property is to be acquired, as the exemption threshold for US domiciles is significantly higher. However, 19 states and the District of Columbia impose their own estate or inheritance tax in addition to the federal estate tax,³³ so careful planning is essential. If worldwide assets exceed the exemption threshold, then US domicile will not be attractive as the tax rate on the excess over US\$5.34 million is 40%.

Australians investing in US property without any intention of becoming US domiciles must take note of the low exemption threshold (US\$60,000) and factor in the prospect of estate tax at the relevant marginal level, which impacts on non-domiciles.

US citizens moving to Australia will remain subject to US estate tax on their worldwide estate; however, the exemption threshold will continue to apply. Non-US citizens with a US domicile moving to Australia should ensure that their intention to move to Australia is properly documented and implemented (if it is useful to adopt an Australian domicile of choice) to avoid any unnecessary estate tax.

France

Domicile of deceased or beneficiary

French inheritance tax is imposed on the beneficiaries of the deceased's estate in proportion to each beneficiary's entitlement.

When the deceased or the beneficiary is domiciled in France, then French inheritance tax applies to worldwide assets. Otherwise, it only applies to French sited assets.

A person is deemed to be domiciled in France if their home or primary residence is located in France, they are carrying on a non-incidental professional activity in France, or the centre of their economic interests is in France.³⁴

Application of French inheritance tax

The rate of French inheritance tax is determined by the relationship between the deceased and the relevant beneficiary. For 2014, transfers to direct descendants are

taxed on a marginal scale, with the highest rate at 45% for assets worth in excess of €1,805,677. Transfers to siblings are taxed at 35% for assets worth less than €24,430 or 45% for assets worth more. Transfers to remote blood relatives and unrelated persons are taxed at 55–60% (depending on the relationship), irrespective of value.³⁵

Trusts do not provide much protection from French inheritance tax. Foreign discretionary trusts with at least one French tax resident beneficiary are subject to French inheritance tax on their worldwide assets upon the death of the settlor.³⁶ Foreign trusts with non-French tax resident beneficiaries holding French sited property are also subject to French inheritance tax.

Companies or trusts owning French real property are subject to an annual tax of 3% of the market value of the property.

Asia

Death duties are relatively uncommon in Asia and they do not exist in India,³⁷ China,³⁸ including Hong Kong,³⁹ Malaysia⁴⁰ and Singapore.⁴¹

Accordingly, Australians moving to or acquiring assets in these countries do not presently have the risk of being charged death duties on their assets.

Conclusion

Although death duties have not existed in Australia for several decades, they continue to be highly prevalent in other countries, such as the United Kingdom, the United States and France. Given increasing financial interaction and free movement of people around the world, death duties in these countries continue to affect Australians who decide to live or acquire property in those countries. Death duties also remain relevant for people moving to Australia from those countries.

Careful succession planning can greatly reduce the risk of foreign death duties applying to an estate or to the beneficiaries of an estate. Succession planning is a constantly evolving process and should be reviewed regularly to address the potential application of foreign death duties.



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Footnotes

1. Death duties, also called estate taxes, are imposed on the estate of the deceased, while inheritance taxes are imposed on beneficiaries. As at April 2014, the other OECD countries without death duties are Austria, Canada, Estonia, Israel, Mexico and Sweden.
2. Although it is called an inheritance tax, the tax is imposed on the deceased's estate: s 4 of the Inheritance Tax Act 1984 (UK) (IHTA 1984).
3. As s 6(1) of the IHTA 1984 only excludes property situated outside the United Kingdom if the owner is domiciled outside the United Kingdom.
4. *Udny v Udny* (1869) LR1Sc&Div 441 at 448. In Australia, see also s 10 of the Domicile Act 1982 (Cth).
5. Prior to January 1974 in the United Kingdom, a married woman's domicile was the same as that of her husband. A woman who was married just before the abolition of the dependency retains her husband's domicile until it is changed: s 1 of the Domicile and Matrimonial Proceedings Act 1973 (UK).
6. Section 3 of the Domicile and Matrimonial Proceedings Act 1973 (UK). In Australia, the age threshold is 18 years: s 8 of the Domicile Act 1982 (Cth).
7. HM Revenue & Customs has shown continual resistance to claims of loss of UK domicile of origin. See, for example, *Re Clore (deceased) (No 2)*, *Official Solicitor v Clore* [1984] STC 609; *Anderson v IRC* [1998] STC (SCD) 43; *F v IRC* [2000] STC (SCD) 1; *Civil Engineer v IRC* [2002] STC (SCD) 72; *Moore's exec v IRC* [2002] STC (SCD) 463; *Surveyor v IRC* [2002] STC 501.
8. Section 267(1) of the IHTA 1984.
9. Some assets are excluded: see s 5(1) of the IHTA 1984.
10. Net value is determined by taking into account all assets in the estate, as well as jointly owned assets, assets held on trust and non-exempt gifts made within three to seven years of death, less liabilities secured by assets: ss 5(3) and 162(5) of the IHTA 1984. The rate is specified in Sch 1 to the IHTA 1984.
11. Section 162A(1) of the IHTA 1984.
12. Section 157 of the IHTA 1984.
13. HM Revenue & Customs *Inheritance Tax: Liabilities and Foreign Currency Bank Accounts* policy paper 2014, available at www.gov.uk.
14. As from 2005, same-sex couples were able to register as civil partners under the Civil Partnership Act 2004 (UK).
15. Section 18(1) of the IHTA 1984. There is a range of other exemptions under Pt II of the IHTA 1984.
16. Section 178 of the Finance Act 2013 (UK), which amends s 18 of the IHTA 1984.
17. Section 177 of the Finance Act 2013 (UK), which amends s 267 and introduces ss 267ZA and 267ZB of the IHTA 1984.
18. HM Revenue & Customs *Taxation of High Value UK Residential Property Held by Certain Non-Natural Persons* 19 March 2014, available at www.gov.uk.
19. For properties worth between £2 million and £5 million, the charge is £15,000; for properties worth between £5 million and £10 million, the charge is £35,000; for properties worth between £10 million and £20 million, the charge is £70,000.
20. From April 2015, properties worth between £1 million and £2 million are proposed to be liable for a charge of £7000. From April 2016, properties worth between £500,000 and £1 million are proposed to be liable for a charge of £3500.
21. The application will be phased in on the same basis as the ATED. CGT will only apply to that part of the gain that is accrued on or after the introduction of the relevant band.
22. HM Treasury and HM Revenue & Customs *Implementing a Capital Gains Tax Charge on Non-Residents: Consultation* March 2014, available at www.gov.uk.
23. Sections 64 and 65 of the IHTA 1984.
24. 26 US Code § 2001(a).
25. L Collins et al (eds) *Dicey, Morris & Collins on the Conflict of Laws* Sweet & Maxwell, London 2006 para 6-133. This is different from residence for US income tax purposes, which is determined by citizenship or presence in the United States, either by number of days or possession of a "Green Card".
26. 26 US Code §§ 2101, 2106.
27. 26 US Code § 2001(c).
28. 26 US Code § 2053.
29. 26 US Code § 2056.
30. Gross value is defined in 26 US Code § 2031.
31. 26 US Code § 2011(a).
32. 26 US Code § 2101.
33. L Saunders "States you shouldn't be caught dead in" *Wall Street Journal* 25 October 2013, available at www.online.wsj.com.
34. Society of Trust and Estate Practitioners *Directory and Yearbook 2014* London 2014 p 315.
35. Above, n 34.
36. E Berthet "Clarté, légalité ..." *STEP Journal* March 2013.
37. Abolished in 1985, although there have been reports of a death duty being reintroduced: R Shroff, K Savani and R Singh "Budget 2013: will India's proposed inheritance tax be a "heir" raising experience?" *Economic Times* 28 February 2013, available at www.economicstimes.indiatimes.com.
38. There have been reports of an inheritance tax being introduced: S Song "China's proposed inheritance tax meets with widespread disapproval" *International Business Times* 1 October 2013, available at www.ibtimes.com.
39. Abolished in 2006.
40. Abolished in 1991.
41. Abolished in 2008.