The rules of domicile: what issues can impact an individual’s tax status?

Inheritance tax and trusts | Personal tax



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Domicile may determine not only how a person is taxed in the UK, but also how an individual’s estate passes on death. How is domicile determined and what issues can impact an individual’s tax status?

Key Points

What is the issue?

Non-UK domiciled individuals may not be subject to UK tax on foreign income and gains if a remittance is not made to the UK; and their assets may not be liable to UK inheritance tax in the event of their death or where they set up particular tests.

What does it mean for me?

There are three main types of domicile – domicile of origin, of dependence and of choice – and there are separate rules which deem an individual to be UK domiciled in certain circumstances.

What can I take away?

Point to watch in practice include losing deemed domiciled status for inheritance tax purposes under the three-year rule, and restriction of the inheritance tax nil rate band on a transfer from a UK domiciled individual to a non-UK domiciled spouse.

The concept of domicile links an individual to a particular jurisdiction. Domicile is a legal concept, which may determine not only how a person is taxed in the UK, but also how an individual's estate passes on death; whether a person has the legal capacity to marry; and whether a person is able to start certain legal proceedings in the English courts.

The concept of 'domicile' and the 'remittance basis' have been a part of the UK tax system for a very long time. When income tax was first introduced in 1799, UK residents were only subject to UK tax on their foreign income to the extent that it was 'remitted' to the UK. In 1914, the remittance basis was restricted only to those residents who were not domiciled in the UK or not ordinarily resident in the UK. Over the years, the rules around remittances and domicile have changed but the fundamental concept remains the same.

Non-UK domiciled residents may elect to be taxed on the remittance basis of taxation, so they are only taxed on foreign income or gains to the extent that they are remitted to the UK (Inheritance Tax Act 2007 s 809B). There is a charge of £30,000 for non-domiciled individuals who have been resident in the UK for at least seven of the previous nine tax years immediately before the relevant tax year, and £60,000 for those resident in the UK for at least 12 of the previous 14 tax years. Furthermore, non-UK domiciled individuals may not be subject to UK inheritance tax on their non-UK assets (Inheritance Tax Act 1984 s 6(1)). This is subject to a non-UK domiciled individual not also being UK 'deemed domiciled' for tax purposes (see below).

Image

EXAMPLE: THE IMPACT OF RESIDENCE AND INTENTION

Dmitri and his younger brother Ivan were born in Russia with Russian domiciles of origin. Dmitri came to the UK to work in 2004 and has been living here ever since. During 2006, Dmitri called his brother Ivan to work in the UK with him. Together they set up a partnership.

Dmitri has a wife and child in Russia. He intends to work in the UK for ten years to save enough money to buy a small hotel in Russia to run with his wife. Dmitri does not acquire a domicile of choice in the UK.

Ivan marries a British woman in 2007. They agree to settle in the UK. Ivan plans to dissolve the partnership and remain in the UK after Dmitri returns to Russia. Ivan has acquired a domicile of choice in the UK.

The law of domicile under general law

Usually, an individual is domiciled in the country that he or she considers to be their permanent home or homeland. Domicile is a more permanent concept than residence. Unlike residence, an individual can only have one domicile at a time. Every individual has domicile. It is not possible to have no domicile.

Domicile is a separate concept to nationality. Strictly, an individual is domiciled in a territory which has a single legal system. Consequently, an individual is not domiciled in the UK but in England and Wales, Scotland or Northern Ireland. A number of states are composed of several local territories. Common examples include the USA, Canada, Australia and Switzerland – an individual may be domiciled in Florida but not in the USA. For brevity, I will refer to UK domicile, which strictly means domiciled in either England, Wales, Scotland or Northern Ireland.

There are three main types of domicile:

- domicile of origin;
- domicile of dependence; and
- domicile of choice.

Domicile of origin

An individual acquires the domicile of origin at birth. In most cases, an individual's domicile of origin is the domicile of their father at the time of birth. However, where the individual's parents were not married at the time of birth, or the mother was

widowed, the domicile of origin will follow where the mother was domiciled at the time of birth. The Adoption and Children Act 2002 provides that an adopted child is treated as having acquired a new domicile of origin from the relevant adoptive parents. Their domicile of origin will follow the domicile of the adoptive father (or if there is no adoptive father, the domicile of the adoptive mother at the time of his adoption.

Domicile of dependence

Where individual does not have legal capacity and is dependent on another, his or her domicile follows the domicile of the person on whom he is dependent. This is known as a domicile of dependence. The most obvious examples of a dependent individual are minor children and individuals who lack sufficient mental capacity. Historically, married women were also regarded as dependent persons. Although the rules changed in 1974, these rules may still apply to women who married before 1974.

The domicile of a minor child usually follows that of the person on whom they are legally dependent. Under current rules, the term minor means any individual under the age of 16. However, under previous rules the term minor referred to individuals under the ages of 18.

Usually, where a minor individual's parents were married at the time of his birth and their father changes his domicile, the minor loses his domicile of origin and acquires a new domicile of dependence. The domicile of dependence will match the father's new domicile of choice. If the individual's parents never married, the individual's domicile may follow that of the mother.

Domicile of choice

An individual with legal capacity can acquire a new domicile (a domicile of choice) in any country. In order to acquire a domicile of choice, a person must:

- be resident in that country ('the residence element'); and
- intend to remain there on a permanent or indefinite basis ('the intention element').

In the event, that an individual has the intention to acquire a new domicile but does not become resident in that new territory, their domicile remains unchanged.

Conversely, an individual may also lose their domicile of choice and either acquire a domicile of choice in a new country or revert to this domicile of origin. In order to lose their domicile of choice, a person must cease being resident in that country and cease to intend living there on a permanent or indefinite basis. It is not enough for an individual to simply stop wanting to live in a country on a permanent or indefinite basis: they must also stop residing there.

The residence element

In most cases the question of an individual's residence should not cause any difficulties. Where an individual is resident in more than one country, they will be treated as resident in the country in which their chief residence lies (*Plummer v IRC* [1987] STC 698).

The intention element

In order to acquire a domicile of choice in a new country, the individual must intend to remain there on a permanent or indefinite basis. Deciding the issue requires a review of 'the whole of the [person's] life, at what life has done to him and at what were his inferred intentions' (*Gaines-Cooper v HMRC* [2007] STC (SCD) 23).

Where, for example, an individual comes to the UK to work for a limited period of time and intends to return to his homeland at the end of that period, they would usually lack the required intention element to acquire a domicile of choice in the UK. Where, however, while living in the UK, the individual changes their intentions and intends to remain in the UK permanently or indefinitely, they would acquire a domicile of choice in the UK on the date intentions changed.

The key question is in what event would the individual leave the UK. If that event is definitive and precise – for example, in the event that a work contract comes to an end – they are likely to lack the required intention element to acquire a domicile of choice in the UK.

In contrast, if the timing of the event is vague, such as 'making my fortune in business', the contingency may be found to be imprecise and the individual may be found to have acquired a domicile of choice in the UK.

In practice, strong evidence is required to prove to HMRC that an individual has acquired the intention to live in the new country on a permanent or indefinite basis (

Cyganik v Agulian [2006] EWCA Civ 129). Merely living in the new country for a long time is not sufficient; a person must also show that they have severed their ties with their country of origin.

While each case is determined on the facts, the following factors are normally considered:

- residence;
- nationality and citizenship;
- where any homes are;
- where family lives;
- where any business interests are;
- where any employment is held;
- where social connections are (e.g. club memberships and societies); and
- the law governing the individual's will.

Deemed domicile

For tax purposes, an individual may be deemed to be domiciled in the UK, even though for common law purposes they are not in fact domiciled in the UK. A deemed domiciled individual is taxable as a UK domiciled individual (Income Tax Act 2007 s 835BA(1)).

Until 5 April 2017, the concept of deemed domicile only applied to inheritance tax. Under these rules, an individual resident in the UK for 17 of the previous 20 tax years would be deemed to be domiciled in the UK and subject to inheritance tax on their worldwide assets. They would therefore be taxable to inheritance tax in the same as an individual domiciled in the UK.

From 6 April 2017, the domicile rules changed. The deemed domicile rules were extended to apply to *all* taxes. Under these new rules, an individual would become deemed UK domiciled if:

- they are UK resident, have a UK domicile of origin and were born in the UK ('formerly domiciled resident'); or
- they have been UK resident for more than 15 of the 20 previous tax years ('the 15/20 rule') (Income Tax Act 2007 s 853BA).

In addition, an individual may be treated as domiciled in the UK for the purposes of inheritance tax where:

- they were domiciled in the UK at any time three calendar years before the date of their death or the date of the relevant gift; or
- have a domiciled spouse and have made an election to be treated as UK domiciled under Inheritance Tax Act 1984 s 267ZA.

Points to watch in practice

Counting years: When counting how many tax years an individual has been UK resident for the purposes of the '15/20 deemed domicile rule' include all tax years and any split years the individual was resident in the UK even if under the age of 18 at the time.

Losing deemed domiciled status for inheritance tax purposes: An individual who is not domiciled in the UK under common law is deemed UK domiciled for the purposes of inheritance tax if domiciled in the UK within the three years immediately preceding the relevant time. The relevant time for this purpose is usually the date of death or date of gift. The 'three-year rule' applies to individuals who are actually domiciled in the UK and lose their UK domicile (Inheritance Tax Act 1984 s 267(1)(a)).

Domicile rulings: Prior to 2010, HMRC provided domicile rulings. It may be possible to rely on these old rulings to support that the individual did not have a UK domicile of origin and the individual did not acquire a UK domicile of choice before the date of HMRC ruling. However, it is possible that the individual acquired a domicile of choice in the UK after the date of the HMRC ruling.

Election by non-UK domiciled spouse: As a general rule, a transfer between spouses (or civil partners) is exempt from inheritance tax. There is an exception. Where a transfer is from a UK domiciled (or deemed domiciled) individual to a non-UK domiciled spouse (or civil partner), the exemption is restricted to the nil rate band that applies at the date of transfer (Inheritance Tax Act 1984 s 18(2)).

For example, Paul was married to Saskia. Paul was domiciled in the UK. Saskia is not UK-domiciled. In April 2017, Paul transferred a property worth £500,000 to Saskia. Paul died in March 2021. Of this transfer £325,000 is exempt under the spousal exemption (Inheritance Tax Act 1984 s 18(2)). The remaining £175,000 of value is

chargeable on Paul’s death.

Where the individual wants to qualify for the unrestricted inheritance tax spousal exemption, they may make an election to be treated as if they were UK domiciled for inheritance tax purposes. An individual may make such an election where: they were not domiciled in the UK; and they are or have been married or in a civil partnership with a UK domiciled individual (Inheritance Tax Act 1984 s 267ZA).

The election only applies to transfers or deaths made on or after 6 April 2013. An election is irrevocable. This means that from the date of the election the worldwide assets of the non-UK domiciled elector will be subject to inheritance tax. However, the election ceases to have effect where the elector is not resident in the UK for four successive tax years beginning with any time after the election is made.

Recent decisions

Recent decisions show us that domicile remains a hot topic. Two recent decisions are particularly noteworthy.

The first, *Henkes v HMRC* [2020] UKFTT 159 (TC), demonstrates that it is not sufficient to simply assert that you intend to leave the UK. The facts must support your assertion. In this case, the taxpayer claimed that he had not acquired a domicile of choice in the UK as he intended to leave the UK. The facts of the case contradicted this intention.

He was 76 with no current plans to retire. He had few links to his domicile of origin or any other country outside the UK – a Dutch passport and a holiday home in Spain. In contrast, he had lived for over 50 years in the UK, where his wife, children and grandchildren were settled. This decision is of limited importance. It does not change the fact that an individual has to intend to remain in the UK on a permanent or indefinite basis to acquire a domicile of choice. Furthermore, as an FTT decision, it is not binding.

The second is the Court of Appeal’s decision in *Embiricos v HMRC* [2022] EWCA Civ 3 (see Keith Gordon’s article ‘*Embiricos*: the scope of partial closure notices’, *Tax Adviser*, March 2022). This case addressed the question of how much information HMRC needs to close a domicile enquiry – and in particular, whether it needs to know the amount of tax at stake before it decides whether an individual is domiciled outside the UK. One might have thought that the rules on domicile applied on the

facts regardless of the amount of tax at stake and so it would be sensible for HMRC to first decide the individual's domicile position. Then, if it decides the individual is UK domiciled, it would review their worldwide income and gains to assess the amount of tax due.

The Court of Appeal in *Embiricos* decided that: 'HMRC do not have the power to issue a [partial closure notice] in respect of Mr Embiricos' domicile and remittance basis claim without specifying (assessing) the increased tax due in consequence of that conclusion.' Tax practitioners should therefore be prepared to provide HMRC with the amount of tax at stake in the event that HMRC opens a domicile enquiry.

Final thoughts

Domicile has been a hot topic in more recent years, notwithstanding significant reform in 2008 and 2017. Each reform has resulted in more complex rules and increasing pitfalls for taxpayers. With current discussions about the domicile rules in the press and among the political parties, one can assume that these rules will continue to change and become more complex still.