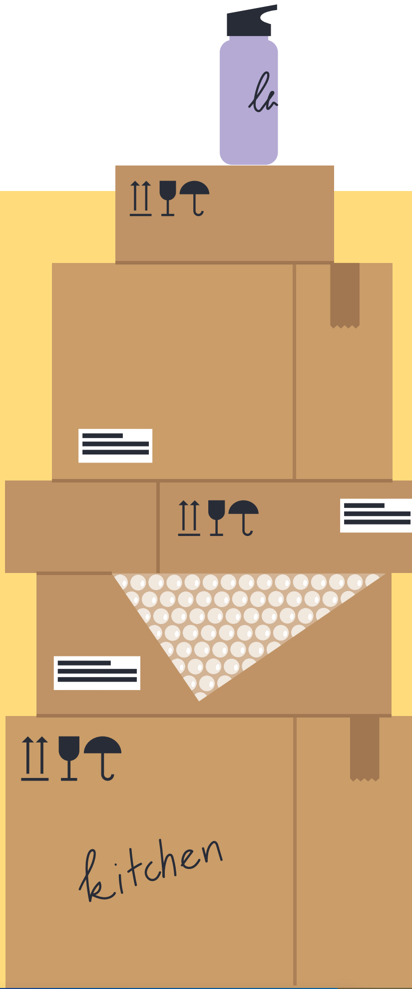
Long-term residence
The new key tax status



We outline the significant changes to UK inheritance tax rules effective from April 2025, replacing domicile with long-term residence as the key tax status.

by Emma Chamberlain

In the second part of this series on inheritance tax, we outline the significant changes to UK inheritance tax rules effective from April 2025, focusing on the replacement of domicile with long-term residence as the key tax status, and detailing the impact on spouses, trusts and treaty relief.

Spouse exemption and deemed domicile election

Spousal exemption under the new long-term residence regime

Normally, there is a full spouse exemption on death. However, under Inheritance Tax Act 1984 s 18, this exemption is limited to £325,000 where, before April 2025, a UK-domiciled individual died leaving assets to a spouse who was not domiciled (and not deemed domiciled) in the UK. From April 2025, where a long-term resident leaves assets to a spouse who is not a long-term resident, the spouse exemption is similarly restricted. Transfers are not restricted between spouses who have the same long-term resident status or where the transfer is from the spouse who is not a long-term resident to the one who is.

Where a spouse has elected under the pre-April 2025 regime to be treated as UK domiciled, that spouse will be treated as a long-term resident after 5 April 2025. Elections can continue to be made after April 2025.

The new legislation introduces several significant changes. The existing provisions in Inheritance Tax Act 1984 ss 267ZA and 267ZB, which permit a spouse to elect to be treated as UK-domiciled for inheritance tax purposes, are repealed with effect from April 2032 to allow for the seven-year run off period for lifetime gifts made before 6 April 2025. At the same time, new sections 267ZC to 267ZE are inserted with effect from April 2025.

The distinction between lifetime and death elections is maintained. Personal representatives of the transferee spouse who is not a long-term resident may make a death election, while the transferee spouse may make either a lifetime or death election. However, because of an anomaly in the drafting (no doubt to be corrected), a death election made by the transferee spouse is currently both irrevocable and permanent in effect, so in practice the transferee spouse should for the moment only make a lifetime election.

References in the legislation that previously referred to domicile are now to be read as references to long-term residence. The transferee spouse in the legislation – who we will refer to here as 'Peter' – who is not a long-term resident may elect to be treated as one if certain conditions are met. These conditions mirror the previous rules, except that references to the domicile of Peter's spouse are now to long-term residence of that spouse.

The principal difference under the new regime concerns the length of time for which an election remains effective. If Peter makes a lifetime election, he must be non-UK resident for a period of ten successive years (calculated no earlier than the date on which the election is made) before he can lose that long-term resident status. Where Peter made an election to be treated as UK-domiciled before 30 October 2024, that election takes effect from 6 April 2025 as an election to be treated as a long-term resident, but it will lapse after a consecutive four-year period of non-residence.

If, however, Peter makes a lifetime election after 30 October 2024 – even if before April 2025 and even if Peter's spouse died before this date – he must complete ten years of consecutive non-residence before losing long-term resident status for inheritance tax purposes. Consequently, a person who makes a spousal election but is non-UK resident by April 2025 faces a longer run-off period than an individual who is deemed domiciled but leaves the UK by that date, as the latter need only remain non-resident for three years to lose their long-term resident status (provided they do not return within ten years of leaving). This difference seems anomalous.

Key Points

What is the issue?
From April 2025, the UK's inheritance tax system replaces domicile with long-term residence (LTR) as the key test. The changes abolish deemed domicile rules, redefine elections between spouses, and align treaty treatment with the new LTR framework.

What does it mean to me?
For mixed-domicile couples, cross-border estates and trustees, the reforms alter who qualifies for full spousal exemption and how long elections remain effective. Trusts and settlements will now come in and out of scope of inheritance tax based on the settlor's residence from time to time.

What can I take away?
Advisers and taxpayers should revisit existing elections, treaty positions, and trust structures to prevent unexpected inheritance tax charges. Early planning will be essential to safeguard reliefs and manage transitions under the new regime.

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From 6 April 2025, unless the settlor has died earlier, non-UK assets comprised in a settlement will be potentially subject to inheritance tax in any period when the settlor is a long-term resident, regardless of when the settlement was created. This means that foreign settled assets will come in and out of charge to inheritance tax, alongside assets owned outright by the settlor, based on the settlor's long-term resident status at the time of the charge.

The inheritance tax status of settled property is therefore no longer fixed by reference to the settlor's domicile status when the property was first placed into the settlement.

This means that all the 2020 resettlement rules found in ss 82 and 82A are no longer needed. From April 2025, resettlement at a later date will no longer affect whether the property qualifies as excluded property – once the settlor becomes a long-term resident, the property will then automatically lose excluded property status anyway.

Death of the settlor before April 2025

If the settlor died before April 2025, the old (pre-2025) inheritance tax rules will continue to apply (see Inheritance Tax Act 1984 s 48ZA(4)). This means that:

- The settled property will remain excluded property for all inheritance tax purposes if the settlor was not domiciled in the UK when the property was placed into the settlement – irrespective of the settlor's domicile at the date of death.
- If the settlor was domiciled or deemed domiciled in the UK when the property was settled, the trust will never qualify as excluded property, even if the settlor died foreign domiciled or after many years of non-UK residence.

Deemed domicile

(Finance Act 2025 Sch 13 para 49)

Section 267 of Inheritance Tax Act 1984, which contains the deemed domicile provisions, is repealed from April 2025. However, it remains relevant for inheritance tax purposes when determining whether a person was domiciled or deemed domiciled at any time before 6 April 2025.

In practical terms, this means that a UK-domiciled individual who has lived abroad for many years and either dies before 6 April 2025 or sets up a trust before that date will still fall within the scope of UK inheritance tax, as will the trust itself. If, however, that individual survives beyond April 2025 and is not a long-term resident under the new rules, both his foreign estate and the trust will fall outside the inheritance tax regime from that point onward (see below).

Treaty domicile

(Finance Act 2025 Sch 13 para 27, inserting Inheritance Tax Act 1984 s 267ZF)

In the first draft of the Finance Bill, domicile – rather than long-term UK residence – remained the relevant test for determining entitlement to treaty relief. However, amendments made at the Report Stage have aligned the position with the new regime.

Under s 267ZF, a person who is a long-term resident is to be treated as domiciled in the UK for the purposes of applying double taxation conventions concluded after 1975. In other words, for inheritance tax treaty relief, long-term residence now effectively replaces domicile as the connecting factor. A brief illustration may clarify this position (see ***Example 1: Treaty relief for Rachelle***).

Settled property from April 2025

(Inheritance Tax Act 1984 s 48ZA)

Permanent inheritance tax protection will no longer apply to foreign situs property settled into trust before 6 April 2025 where:

- the settlor was not domiciled or deemed domiciled in the UK at the time of settlement;
- the settlor was not a formerly domiciled resident; and
- the settled property remains foreign situs.

EXAMPLE 1: TREATY RELIEF FOR RACHELLE

Rachelle is deemed domiciled in the UK for inheritance tax purposes and continues to be resident in the UK after 5 April 2025. She therefore becomes a long-term resident under the new rules. However, under Indian law she remains domiciled in India.

On Rachelle's death, her non-UK situs property passes under a foreign will or disposition to her children. Her executors should still be able to claim treaty relief, as the UK-India estate tax treaty will remain effective in relieving double taxation on non-UK property on death.

If, instead, Rachelle was a long-term resident for inheritance tax purposes but was treaty domiciled in the United States (rather than India) and a US national only, treaty relief could potentially extend not only to her estate on death but also to lifetime transfers and even to settled property.

Finance Act 2025 Sch 13 para 48(1)(b)

EXAMPLE 2: KEN CEASES TO BE A LONG-TERM RESIDENT

Ken had been non-UK resident for 30 years and died in June 2025. HMRC does not accept that he was foreign domiciled when he settled property into a discretionary trust in 2013.

From April 2025, however, the foreign settled property becomes excluded property, as Ken was not a long-term resident at the time of his death. Therefore, no inheritance tax charge arises on his death. Even if he can benefit from the trust, there is no reservation of benefit charge.

If Ken had died in March 2025, the old inheritance tax rules would have apply. In that case, if he had been UK domiciled in 2013, a reservation of benefit charge could have arisen on his death.

There is, however, an exit charge in April 2025 when the property leaves the relevant property regime, which will be calculated based on the number of quarters since the last ten-year anniversary.

EXAMPLE 3: AMANDA'S QIIP AND EXCLUDED PROPERTY

Amanda has lived in New Zealand for the last 20 years. She has two children in New Zealand and two in the UK, and leaves her estate equally between them on discretionary trusts. Amanda dies in 2026 and is a long-term resident at her date of death. There is no estate duty in New Zealand, and therefore no inheritance tax arises in either jurisdiction. At this point:

- the two UK children are long-term resident;
- the two New Zealand children are not long-term resident; and
- the trust qualifies as excluded property on Amanda's death.

Appointment of interests in possession: The trustees decide that it would be convenient to appoint an interest in possession (IIP) to each of the children so that each takes a quarter share of the trust income. They do this within two years of Amanda's death.

Under Inheritance Tax Act 1984 s 144, this is 'read back' as if the IIP was effective immediately from Amanda's date of death. Each child is therefore treated as having a QIIP from that time, as it qualifies as an immediate post-death interest under s 49A.

Inheritance tax consequences: The effect is that:

- On the death or earlier termination of the IIP of the UK-resident children (unless by then they have lost long-term resident status), there is an inheritance tax charge of 40% if the termination occurs on their death; or 20% if it occurs during their lifetime.
- The New Zealand children's shares remain excluded property, and no inheritance tax will be payable on their deaths, provided they never become long-term residents and the trust holds UK-situated property directly.

After each QIIP ends, the trust reverts to excluded property status, as Amanda was not a long-term resident at death. The status of the beneficiary thereafter is irrelevant.

Better planning approach: The trustees should have waited for more than two years after Amanda's death before appointing interests in possession. These interests would then have been non-qualifying. This would have avoided inheritance tax exposure, as the property would have remained excluded property and outside the relevant property regime, given that Amanda was not a long-term resident when she died.

Death of settlor after 5 April 2025

Where the settlor dies on or after 6 April 2025, the excluded property status of the trust will depend on the settlor's long-term residence status at their date of death.

- If the settlor is not a long-term resident when they die, the non-UK settled assets will be excluded property for inheritance tax purposes.
- If the settlor is a long-term resident at death, both UK and non-UK settled assets will be in scope for inheritance tax for the duration of the trust.

Qualifying interest in possession settlements

There is an additional condition for a qualifying interest in possession (QIIP) settlements to obtain excluded property status. Under the new rule (Inheritance Tax Act 1984 s 48ZA(5)), property within a QIIP settlement will only be excluded property if:

- both the settlor and the beneficiary with the QIIP are not long-term resident; and
- the settlor dies after 5 April 2025.

Transitional rules

There is a transitional provision for non-UK assets settled into a QIIP settlement before 30 October 2024. If these assets were excluded property immediately before 30 October 2024 (because the settlor was not UK domiciled when he settled the property and is not a formerly domiciled resident), they will not be subject to inheritance tax when the QIIP comes to an end – whether on a lifetime termination or on the death of the QIIP beneficiary.

This exemption applies irrespective of long-term residence status of either the settlor or the QIIP beneficiary (see s 54(2C) as inserted by Sch 13 para 9).

However, UK assets (other than open-ended investment companies (OEICs) or authorised unit trusts) comprised in the settlement as at 30 October 2024 will not benefit from this protection, even if they are later sold and become non-UK situs, as they were not then excluded property.

If the trustees sell the non-UK property and invest in UK property, the transitional protection is lost if that UK property is still held at the date of death. Trustees can, however, sell the non-UK property and buy replacement foreign property, which will retain protection under transitional rules.

Application of the new rules

Once an existing QIIP comes to an end, or for QIIP settlements created on or after 30 October 2024, the new rules will apply in full. This means that from April 2025:

- A settlor who is not long-term resident should not leave foreign property in their will on interest in possession trusts for a person who is a long-term resident.
- While there will be no inheritance tax charge on the settlor's death, the trust will be within the scope of inheritance tax for as long as the person with the QIIP is a long-term resident.

This represents a significant narrowing of the excluded property regime.

Before April 2025, the residence or domicile status of the QIIP beneficiary was generally irrelevant to the excluded property status of the trust – excluded property status centred round the settlor's domicile when the property became comprised in the settlement. (There were a few exceptions where the settlor/spouse took an immediate QIIP on settlement of the assets or a QIIP beneficiary became non-resident and the trust invested in gilts.)

Following the 2006 changes, a QIIP generally arises only:

- if the settlor leaves an interest in possession to a beneficiary on his death by will; or
- if the beneficiary is disabled and receives an interest under a lifetime gift.

Care is therefore needed to avoid inadvertently creating a qualifying IIP on death, as this may unexpectedly bring the trust within the inheritance tax charge under the post-2025 rules. (See Example 3.)

Relevant property settlements

From 6 April 2025, the excluded property status on non-UK settled property within the relevant property regime will depend on the settlor's long-term residence status:

- If the settlor *is* a long-term resident, the non-UK settled property *will not* be excluded property.
- If the settlor *is not* a long-term resident, the non-UK settled property *will* be excluded property.
(See Example 6.)

UK-domiciled settlor

Where the settlor is UK-domiciled, still alive and not a long-term resident on 6 April 2025:

- The non-UK property within the trust becomes excluded property on that date.
- This change in status triggers an exit charge on 6 April 2025.
- After that date, there will be no further inheritance tax charges, as long as the settlor continues not to be long-term resident and the settled property (i.e. held directly by the trustees, not the underlying property within a holding company) is foreign situs.
(See Example 4.)

Non-domiciled settlor

Where the settlor is non-domiciled but a long-term resident on 6 April 2025:

- The excluded property becomes relevant property on 6 April 2025.
- No immediate inheritance tax charge arises at that time.
- However, charges will arise on any exit after that date (e.g. because property is distributed or the settlor loses long-term residence status); or at each ten -year anniversary of the trust.
- The calculation of the charge will reflect the number of years that the non-UK property was excluded property, resulting in reduced charges in the early years of the new rules.
(See Example 5.)

Settlor ceases to be a long-term resident after 2025

After 6 April 2025, where a settlor ceases to satisfy the long-term resident test, any non-UK relevant property becomes excluded property. This change of status will trigger an exit charge when the property leaves the relevant property regime.

In Part 3, Emma will further explore the impact of the settlor's LTR status.

EXAMPLE 4: HARRY

UK-domiciled, non-resident settlor

Harry settled non-UK assets into a trust in April 2024 while he was non-resident but UK domiciled. By 6 April 2025, Harry has returned to the UK but is not a long-term resident.

On 6 April 2025, the settled property becomes excluded property. This means that there will be an exit charge of 0.6% as the property has been relevant property for one year.

There will be no ten-year anniversary charge in April 2034, assuming that Harry is still not a long-term resident. If, however, he becomes a long-term resident (say, in 2035), there will be an anniversary charge – but at a reduced rat. (Broadly, the charge is 0.6% for every year the settled property is within scope of inheritance tax up to a maximum of 6% after ten years.)

EXAMPLE 5: YETA

Foreign-domiciled settlor who leaves the UK

Yeta was foreign domiciled and not deemed domiciled when she set up a trust in 1992. She left the UK in March 2025 and so is non-resident in 2025/26.

Under the transitional rule in Sch 13 para 46, Yeta ceases to be a long-term resident from April 2028 – the fourth tax year after departure.

She therefore remains outside the inheritance tax 'tail' provided she does not return to the UK.

When she ceases to be a long-term resident in April 2028, the trust property becomes excluded property and an exit charge arises at that time.

EXAMPLE 6: ANITA

Non-domiciled settlor becomes a long-term resident

Anita is non-domiciled and became resident in the UK in 2021/22. In April 2023, she settled non-UK assets into a discretionary settlement for herself, her children and grandchildren. As Anita was not UK domiciled or deemed domiciled when the settlement was made, there was no entry charge in 2023. The trust comprises entirely foreign situated property.

First ten-year anniversary: The first ten-year anniversary of the settlement is in 2033. By then, Anita is a long-term resident (since 6 April 2031). The inheritance tax charge is therefore based on the value of the settled property, reflecting the two out of ten years that the property was relevant property (i.e. $2 \div 10 \times 6\%$ = up to 1.2%).

Death in 2040: If Anita dies in 2040, while still a long-term resident and able to benefit from the trust, no inheritance tax arises on her death because of the transitional relief in Sch 13 para 31 amending Finance Act 1986 s 102. However, after her death, future ten-year anniversaries and exits will be fully within the inheritance tax relevant property regime, each attracting charges of up to 6% since Anita was a long-term resident at death. The settlement is permanently within the inheritance tax regime.

If Anita leaves the UK: If Anita does not die but left the UK in, say, 2045, after more than 20 years of UK residence, she will cease to be a long-term resident in 2055. The relevant property becomes excluded property in 2055, triggering an exit charge when it leaves the inheritance tax regime. The previous ten-year anniversary charge would have occurred in 2053, when the full 6% applied. The exit charge in 2055 will be 1.2% (being two years since the last ten-year anniversary in 2053).

Name: Emma Chamberlain CTA TEP OBE
Position: Barrister
Chambers: Pump Court Tax Chambers
Email: clerks@pumptax.com
Tel: 020 7414 8080
Profile: Emma Chamberlain CTA TEP OBE is a barrister at Pump Court Tax Chambers. The much enlarged 5th edition of *Chamberlain and Whitehouse Trust Taxation and Private Client Tax Planning* was published in April 2024 and an update will be published next year. She is joint chair of the Private Client (International) Committee of the Chartered Institute of Taxation.