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HM TREASURY

Budget 2024 - IHT, Pensions and CGT

Writing in her 2018 book "The Everyday Economy", the now Chancellor, Rachel Reeves, criticised loopholes left by the Conservatives through which the "healthy, wealthy and well-advised" can avoid paying tax.

Having advised that Inheritance tax needed to be either reset or "shifted wholesale", it is hardly surprising that some of the most significant changes announced in the 2024 Autumn Budget surrounded inheritance tax.

Inheritance tax ("IHT")

The Technical Note and the draft legislation released confirm that, as previously indicated, IHT will be levied according to a residence-based test rather than the current domicile-based system, with effect from 6 April 2025, subject to certain transitional rules.

Long term residents

Broadly, the test for IHT purposes from 6 April 2025 will be whether an individual is a "long term resident" at the time of any IHT events (i.e. if they have been UK resident in at least 10 out of the previous 20 tax years). Those who are "long-term" residents will be subject to IHT on all assets (UK and foreign). Those who are not "long-term" residents will only be subject to IHT on UK situs assets and assets deriving value from UK residential property.

For young persons (under age 20), the period of 20 tax years is reduced to the number of whole tax years during which they have been living and the threshold of 10 tax years is reduced to half the number of full tax years in their lifetime.

Impact on Trusts

Assets (other than UK assets or assets deriving value from UK residential property) held in trusts will only have excluded property status at times when the settlor is not a "long-term" resident. Otherwise, all assets will be in scope of IHT charges (i.e. 10-year charges and exit charges). Therefore, trust assets will potentially move in an out of the scope of IHT according to the settlor's "long-term" residence status. Where trust assets that are chargeable to IHT move out of the IHT regime (i.e. if the settlor ceases to be "long-term" resident), an IHT exit charge will apply.

For Qualifying Interest in Possession trusts, the trust assets will only be excluded property if both the settlor and the life tenant (if different persons) are not "long-term" residents.

Transitional rules will apply to the application of the Gift with Reservation of Benefit ("GWROB") rules and the Qualifying Interest in Possession rules for settled property. To the extent that the trust assets were excluded property in the trust on Budget Day (30 October 2024), no charges to IHT will subsequently arise under either of these provisions thereafter in respect of those assets (e.g. if the settlor or life tenant dies after 5 April 2025). Trust assets that are not excluded property on 30 October 2024 but thereafter become so, will only have protection from IHT if the settlor or life tenant is not a "long-term" resident at the time of the IHT event (e.g. on death).

For trusts with a deceased settlor, who died before 6 April 2025, the excluded property status of the trust assets will be determined under the current domicile rules (i.e. based on his domicile when the assets were settled). If the settlor dies after 5 April 2025, the test will be whether he was a "long-term" resident at the time of death and this will determine the IHT status of the trust thereafter, ad infinitum. Therefore, elderly settlors who are not of UK origin and intend to leave the UK at some stage should be mindful of the timing of their departure and the potential long-term implications.

Leaving the UK - The 10-year tail

There had been much concern around the proposed introduction of a "ten-year tail" for IHT purposes, whereby assets would remain in scope of IHT after the individual had left the UK. However, the original proposals have been softened a little by the introduction of a tapering system.

A person will not be treated as "long-term" resident at the time of an IHT event if they have either been non-UK resident for a period of 10 consecutive tax years during the preceding 19 tax years or, if they have been non-UK resident for the required number of years under the tapering system. Under the tapering rules, a person who had been UK resident for between 10 and 13 tax years during the 20-tax years ending with their last tax year of UK residence, the "tail-period" will be 3 tax years (i.e. after 3 consecutive tax years of non-UK residence they will fall out of scope of IHT on foreign assets). This "tail" period will increase by 1 tax year for each additional tax year that the person was UK resident (i.e. from 14 years to 19 years out of the 20-year period), so a person who has been UK resident for 17 out of the 20 year period, would have a "tail" period of 7 tax years. The full 10-year "tail" will apply to those who were UK resident throughout the 20-year period.

Therefore, those that leave the UK after becoming a "long-term" resident (whether this is before or after 6 April 2025), will still have exposure to IHT for a period of up to 10 years thereafter, but for some, the period of exposure could be as little as three tax years.

Transitional provisions will apply to those "non-doms" that are non-UK resident in the 2025/26 tax year. Such individuals will only remain within scope of IHT as "long-term" residents whilst they meet the criteria of the current "15-year deemed domicile" test (i.e. if they have been UK resident for at least 15 of the previous 20 tax years and they have been UK resident for one or more of the previous 4 tax years). As deemed domicile will be lost at the start of the 4th year of non-UK residence, these provisions may shorten the IHT "tail" period (which could otherwise be longer under the taper rules outlined above), providing the individual remains outside the UK.

Lifetime gifts & PETs

The rules for lifetime gifts that are Potentially Exempt Transfers ("PET") will remain in place and assets that were excluded property when gifted will not come into charge if the PET fails (i.e. if the donor dies within 7 years), even if he is a "long-term" resident at the time of death. Equally, a PET of non-excluded property that fails will be within the scope of IHT, even if the donor is not a "long-term" resident at the time of death.

Agricultural Property Relief (APR) and Business Property Relief (BPR)

It was also announced that the government will be amending these reliefs from 6 April 2026. Currently, relief of up to 100% is available for qualifying assets on their entire value. It is proposed that for individuals, the 100% rate of relief will continue, but only for the first £1 million of combined agricultural and business property. Thereafter, the only 50% relief will be available.

The government will also reduce the rate of BPR available from 100% to 50% in all circumstances for shares designated as "not listed" on the markets of recognised stock exchanges, such as AIM.

For assets held in trusts, there will be a combined £1 million allowance on the value of qualifying property to which 100% BPR/APR relief applies, on each ten-year anniversary charge and exit charge. Where multiple trusts have been settled, it is intended that the £1 million allowance will be divided between the trusts. The government will be publishing a technical consultation in early 2025 on the detailed application of the new proposals for trusts.

Pension matters

As had been mooted in the lead-up to the Budget, the IHT treatment of pension schemes was targeted by the Chancellor and from 6 April 2027, the remaining value of unused pension funds (and death benefits) comprised in UK registered pension schemes or Qualifying Non-UK Pension Schemes ("QNUPS") will be brought into the scope of IHT on death. These new rules will be subject to a period of consultation which will end on 22 January 2025.

The new rules have been introduced partly in response to the increased use of pensions as products for transferring wealth free of IHT, rather than as a genuine retirement provision, with individuals accumulating funds in their pensions (especially following the abolition of the Lifetime Allowance) and using other means to fund their retirement so that their pension funds can be passed to their beneficiaries free of IHT.

For UK registered pension schemes, the pension scheme administrator is to be responsible for the reporting and payment of IHT due (i.e. on the death of the member). For QNUPS, the manner in which the IHT is to be reported and paid will be considered during the consultation period.

Older individuals may wish to consider making withdrawals from their UK pensions or QNUPS, perhaps with a view to gifting funds to the next generation (which will remain outside the scope of IHT if the donor survives 7 years), although there would be an arbitrage between the income tax payable on extraction and the potential IHT saving.

Certain other types of pension schemes which are currently exempt from IHT, such as old- style employment related "FURBS" benefitting from the transitional exemption rules for sponsored superannuation schemes or offshore "s.615" schemes are outside the scope of the new provisions.

Overseas Transfer Charge

Also announced were changes to the Overseas Transfer Charge (which can apply when transfers are made to a QROPS), to remove the exclusion from the charge in relation to QROPS established in the EEA and Gibraltar (where the member is either UK resident or resident in any EEA country). However, the rules relating to Guernsey based QROPS are unaffected by these changes.

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