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INHERITANCE IN CROSS BOARDER SETTINGS BETWEEN SWITZERLAND AND THE UK

[**Daniel Gatenby**, LL.M. Tax, lawyer in Pully-Lausanne and Geneva, Python]
[**Philippe Kenel**, Doctor of Law, lawyer in Pully-Lausanne, Geneva and Brussels, Python]

Inheritance tax can be the source of problems at an international level when several states claim competence for taxing inheritance. The main issues arise in relation to the criteria applied by different tax jurisdictions to levy inheritance tax, which result in disputes over fiscal sovereignty. Some states link inheritance tax to the heir, based on their domicile and/or their nationality, some use the same criteria in relation to the deceased, while other states link inheritance tax both to the deceased and the heir. Although at first glance the criteria used by Switzerland and the United Kingdom may seem similar, they have, as we shall see, a largely different scope which may in some cases lead to double taxation.

In this article we look at inheritance tax in Switzerland and in the UK highlighting different principles that can result in double taxation. We will then present the application of the agreement signed on 17 December 1993 between the Swiss Confederation and the United Kingdom and Northern Ireland on the avoidance of double taxation with respect to inheritance tax (DTA).

Inheritance tax in Switzerland

In Switzerland, inheritance tax is a purely cantonal matter and every canton has great freedom with regard to its implementation, which means there are as many systems as there are cantons. Generally, cantons do not levy inheritance tax in relation to the heir, who is nevertheless liable for the payment of the tax. The criteria used to levy inheritance tax are in fact linked to the deceased. Some cantons, such as Geneva, refer to the domicile of the deceased while others, such as canton Vaud, to the place where the succession is opened. Swiss cantons also levy a tax at the place where real estate belonging to the deceased is located. Under Swiss tax law, the domicile is the place where the deceased had a physical presence with the intention of permanently settling there. Such intention must be recognisable by third parties and the

Daniel Gatenby, LL.M. Tax, lawyer in Pully-Lausanne and Geneva, Python

authorities will not simply rely on a taxpayer's declarations. If several places meet these two criteria, the domicile will be the place with which the deceased had the closest links, meaning the place where the centre of their interests is located. The place where the succession is opened is in principle the same place as the domicile, as civil law stipulates that the succession is opened at the deceased's last place of domicile for all assets (art. 538 para. 1 CC). Canton Vaud nevertheless has a very broad interpretation of this concept as it accepts that the succession of a deceased person not domiciled in the canton, but originally from a municipality in canton Vaud, whose succession is opened there in accordance with art. 87 para. 1 or 2 of the Federal Act on International Private Law (IPLA), can be taxed in canton Vaud. This article provides for the competence of the Swiss civil authorities at the deceased's place of origin to settle their succession if it is not being settled in their state of domicile or if the deceased has elected by will for their succession to be governed by Swiss law. In the first scenario, the opening of the succession will only take place in the canton of origin if the parties provide evidence that the law of the country of domicile does not permit its authorities to settle the successions of foreign residents or that, in this specific case, the authorities are in fact not dealing with the succession. However, in the second scenario, the competence of the Swiss civil authorities to open and settle the succession is automatic, which presents a significant risk that the two states deem themselves competent to settle the succession. In these two cases, despite the absence of domicile in the canton, canton Vaud levies tax on the entire estate, with the exception of real estate located outside of the canton.

The tax rates are generally determined based on the degree of relationship between the deceased and the heir as well as the amount received. The surviving spouse is exempted in all cantons, with the exception of canton Geneva if the deceased was taxed based on expenditure in one of the last three years before his death. Direct descendants are exempted in most cantons but canton Vaud taxes them at a maximum rate of 7%. In contrast, third parties are subject to a much heavier tax which can rise to 50% in canton Vaud and 54.6% in canton Geneva.

Inheritance tax in the United Kingdom

Inheritance tax in the UK is extremely complex and explaining it in detail goes beyond the scope of this article. We will nevertheless look at the main principles, which allow comparison with the Swiss system and highlight the points which present a risk of tax jurisdiction dispute. In the UK, inheritance tax actually covers – in contrast to what its name suggests – much more than the transfer of wealth upon death. It covers all transfers resulting in a reduction of the value of the estate of the transferring party, unless the law provides for an exception. A person's estate consists of all their assets, rights and debts. The tax is generally levied in three situations. Firstly, it is due upon a person's death. Secondly, where the deceased transferred certain gifts inter vivos in the seven years preceding their death. These gifts are known as potentially exempt transfers (PET), because had the donor lived beyond the aforementioned period, the gift would have been exempt of tax. If, however, the death occurs within this seven-

year period, this is known as a failed PET, which is taxable. The rates are regressive based on the time that has elapsed between the gift and the death. Finally, tax is also levied in the event of a lifetime chargeable transfer (LCT) which is a transfer made by a person while alive to certain types of trusts or to a company. These transfers are taxed immediately when they are carried out. Additional tax may be due in the event of death in the seven years following an LCT. Trusts subject to the LCT are also liable for a periodic charge every ten years and an exit charge if the trust ends or ceases to be subject to certain specific rules.

With regard to inheritance tax, the Inheritance Tax Act 1984 stipulates two criteria used to levy tax: the domicile of the deceased or, if there is no domicile in the UK, the place where the assets are located. In the first case, the tax will be levied on the deceased's global estate, including property located outside of the UK, whereas, in the second case, tax will only be levied on moveable and immoveable assets located in the UK.

In Swiss tax law, the concepts of domicile and residence are so similar that these two terms are often used interchangeably to refer to the same situation. Under UK law, these two terms have completely different meanings and tax consequences.

Residency in the UK is determined based on tests, which take account of the time spent in the UK and certain relationships with the UK. Anyone who has spent over 183 days during a fiscal year will automatically be considered a tax resident. In the event of a shorter period of presence, three tests – called the "overseas test", the "automatic UK test" and the "sufficient ties test" – are used to establish whether a person is deemed resident in the UK. These tests take account of the number of days of physical presence, having a full-time employment in the UK or abroad as well as and having a home in the UK or abroad. If these criteria are not sufficient, certain personal ties to the UK are used. A person can have several residences under UK law. Residence is therefore based on objective criteria, recognisable externally, which is not necessarily the case with one's domicile. A resident in the UK is in principle taxed on their global income. There is nevertheless a particular status known as "Res Non Dom", for "resident non-domiciled", whereby the resident is only taxed on the income remitted to the UK (remittance basis). In relation to inheritance tax, a Res Non Dom, as a person who is not domiciled in the UK, will only be taxed on moveable and immoveable assets located there.

The concept of domicile is very different to that applied in Switzerland. There are three types of domicile: domicile of origin, domicile of choice and domicile of dependence. Under certain conditions, a presumption of domicile may also exist which is called a deemed domicile. Everyone obtains a domicile of origin upon birth, which is generally the domicile of their father at the time when the child is born. A person never loses their domicile of origin but it can be temporarily suspended by a domicile of choice or a domicile of dependence. This suspension is deemed temporary because if the domicile of choice or the domicile of dependence no longer exist, the domicile of origin is re-established. This is due to the fact that a person must always have a domicile, but can only have one at any given time. In order to establish a domicile of choice, a person must be physically present in a different state to their domicile of origin and have a firm intention to reside there permanently or for an indefinite period. The domicile of choice will in principle only be recognised if it is established that it is the place where the person wishes

to establish their permanent home or the place where they wish to go at the end of their life. The domicile of dependence is the domicile of a minor child which is connected to that of their father (be it his domicile of origin or domicile of choice). The law also creates a domicile in several cases. Firstly, a taxpayer who was domiciled in the UK will continue to be deemed domiciled in the UK for three years from the time when a domicile in another state is established (three-year rule). A second case covers the Res Non Doms in particular. If they were resident in the UK for 15 of the last 20 years, they will be deemed to be domiciled in the UK (15-year rule). Finally, a person born in the UK who has their domicile of origin there, but who has established a domicile of choice in another state will be automatically deemed domiciled in the UK upon their return to the UK, even if they maintain a domicile of choice outside of the UK.
There is a big difference between the concept of domicile under Swiss law and UK law. According to the latter, it is possible to be resident in the UK for many years without being deemed as domiciled there. It is also possible to be domiciled in the UK without necessarily having a physical presence there.

If the deceased is not domiciled in the UK according to the rules outlined above, only the moveable and immoveable assets located in the UK are subject to inheritance tax. Common law stipulates special provisions on the situs of assets. In particular immoveable assets and tangible moveable assets are situated where they are physically located; shares in companies where they are registered or traded; bank accounts in the location of the branch holding the account; and receivables in the place of residence of the debtor. Some assets, while situated in the UK according to these rules, are not subject to tax, such as accounts denominated in foreign currencies when the deceased was not UK domiciled.

Just like in Switzerland, the surviving spouse is exempt from any tax. However, the share of the estate left to children or any other beneficiaries is taxed at a rate of 40% after certain deductions.

The elimination of double taxation

The risk of double taxation exist mainly because of the fact that the two states could claim that the deceased was domiciled in their territory. The DTA contains provisions to establish in which state the deceased was domiciled ("treaty-domicile"; art. 4 § 2 DTA). These criteria, known as tie-breaker rules, are more similar to the concept of domicile under Swiss law, which would often lead to the deceased being treaty domiciled in Switzerland thus excluding the UK's right to tax. For this reason, representatives of the UK government negotiated and obtained subsidiary rights of taxation. Such rights exist, for example, with regard to shares in a company registered in the UK even when the UK does not claim that the deceased was domiciled in the UK (art. 8 § 2 DTA). The other subsidiary rights apply when the two states claim that the deceased was domiciled in their jurisdiction. In particular, the UK reserves the right in such cases to tax assets located in Switzerland or in third states if the treaty domicile was established in Switzerland, but at any point in the last five years the deceased – of British nationality who does not hold Swiss nationality – was domiciled in the UK. These subsidiary rights of taxation mean that the UK can tax the assets in question but must eliminate any double taxation by deducting any tax paid on the same assets in Switzerland.

Switzerland does not have any subsidiary taxing rights. This is explained by the fact that the primary rights granted to Switzerland under the treaty are more or less in line with taxing rights of the cantons under their internal laws. While the granting of these subsidiary rights to the UK may seem unfavourable to Switzerland, they actually aim to allow the UK to retain most of its internal taxing rights while eliminating any double taxation. Switzerland eliminates any double taxation by exempting assets for which the UK has a primary taxing right. The UK eliminates double taxation through the tax credit method. This means that, even if there is no double taxation per se, the UK's subsidiary rights can significantly increase the tax bill of an inheritance, as the UK rates are generally higher.

The DTA does not apply to Res Non Doms. This could lead to double non-taxation where, from the Swiss perspective, a resident in the UK will usually not be deemed as domiciled in Switzerland. However, in such situations, UK advisers of Res Non Doms often tend to draw up a will for them only covering assets located in the UK, advising them to draw up a Swiss will for assets located in Switzerland. It is instinctive for common law lawyers who believe that a local will automatically enables the settlement of the succession to be carried out more efficiently and rapidly. Res Non Doms who are originally from canton Vaud should however be cautious. If they draw up a will electing for their estate to be governed by Swiss law, the cantonal tax administration will deem – according to art. 87 para. 2 IPLA – the succession to be opened in the canton which means that it will be taxed there. In this case, the DTA will apply. However, this will be of little consolation to someone who thought they were only liable to pay inheritance tax in the UK and only on assets located there. It is also worth noting that even though the DTA deems the deceased whose inheritance is settled in Switzerland to be domiciled there, canton Geneva will not consider that the succession was opened in Geneva and will therefore not tax it. Under Geneva law, no such taxing right exists and DTAs cannot establish taxing rights that do not already exist under domestic law. This means that Res Non Doms originally from canton Geneva will not be taxed there even if they draw up a will electing Swiss law. Unless tax competence is claimed by a third state, they will be subject to a tax only on immoveable and moveable assets located in the UK and on immoveable assets and certain moveable assets located in canton Geneva, with neither taxing assets located elsewhere.