Draft FB 2017 Cl 42 Sch 13: IHT on enveloped overseas property with value attributable to UK residential property

Inheritance Tax and trusts

01 March 2017

Improving the practicality of the draft legislation.

On 5 December the Government published a response to the further consultation on the reforms to the taxation of non-domiciles issued in August 2016, together with draft clause 42 and Schedule 13 for Finance Bill 2017 to introduce an inheritance tax (IHT) charge where UK residential property is held in offshore structures.

To achieve that aim, the definition of 'excluded property' for IHT purposes is modified. From 6 April 2017 it will no longer take three categories of property out of charge: a right or interest in a close company where its value is attributable to a UK residential property interest; a similar interest in a partnership; and a loan (including giving collateral security and guarantees) to finance the acquisition of UK residential property directly, or through a close company. An offshore trust holding such property is, to that extent, brought into the IHT net.

We suggested various amendments, including:

- to avoid the possibility of a close offshore company holding an 'open' fund investing in UK residential property being caught;
- raising (for practical reasons) the de minimis disregard from 1% of the value of the relevant interest being attributable to UK residential property;
- aligning the rules for partnerships to exclude partnerships in circumstances where an equivalent company would fall outside the close company definition;

- aligning the taxability of a loan with the availability of a deduction for that debt against the UK residential property or against the asset which derives its value from UK residential property for IHT purposes: without this, circumstances of double taxation could arise where both the loan and the full value of the UK property are subject to IHT;
- similarly, limiting the impact on connected party loans and collateral generally, so that the total value brought into charge to IHT does not exceed the value of the relevant UK residential property: this is a significant concern as a commercial lender may require collateral security to be considerably greater than the value of the advance;
- to recognise the position of non-resident settlor-interested trusts, which are common overseas for non-tax reasons and which, by their very nature, will fall within the Gift with Reservation regime. We expressed our disappointment that this particular difficulty had not been addressed, although raised earlier. Such offshore trusts with a UK residential property interest will become subject to 10-yearly IHT and exit charges under the new code, but as they also remain within the GWR regime, they face an additional charge on the settlor's death;
- to recast the anti-avoidance provision imposing a continuing two year liability after disposal of a UK residential property interest so that it only applies where there is a sale (whether of the property or of the interest in the company/partnership) to a connected person. Similarly, the two year tail should not apply to the repayment of a loan where the repayment results from the sale of the property in question to an unconnected person.