

Inheritance tax on UK residential property and related finance

Private Client update

October 2017

Note: The summary below is based on the Finance Bill 2017-19 provisions published on 8 September 2017 which if and when enacted will be effective from 6 April 2017.

From 6 April 2017 UK residential property owned through certain non-UK structures will be within the charge to UK inheritance tax (IHT) regardless of the residence and domicile status of the ultimate owner. Any debt used to finance such property will itself be subject to IHT in the lender's hands.

To the extent that shares (or other interests, including loans) in non-UK close companies and interests in overseas partnerships derive their value from UK residential property, from 6 April 2017 that value will be within the scope of IHT. Offshore ownership structures which previously shielded the value of UK residential property ultimately owned by non-UK domiciled individuals (non-doms) from IHT, will be liable to the tax for the first time. IHT charges will potentially arise on the death of and following certain gifts made by non-doms as well as during the life of certain trusts established by them ('ten year anniversary' and 'exit' charges). This will be the case regardless of whether the individual is UK resident or non-UK resident. The new rules will override all double tax treaties.

In addition, loans to finance UK residential property and any security given for such a loan will be brought within the charge to IHT.

Close companies and partnerships

The following assets will be subject to IHT to the extent that their value is attributable to UK residential property:

- Shares (or other interests) in non-UK companies that would be close companies if they were UK resident (meaning, broadly, that they are controlled by five or fewer persons); and
- Interests in overseas partnerships (whether of limited or unlimited liability).

Interests whose value is, when amalgamated with interests of 'connected persons', less than 5% of the total value of a close company or partnership will be disregarded.

Value subject to IHT and debts

Where an IHT charge arises on shares etc. under the new rules, the IHT liability will be calculated on the open market value of the shares (or other interest) to the extent that their value is attributable to UK residential property. In determining the value of an interest in a close company or partnership so attributable, the liabilities of the close company/partnership will be attributed to all of its property pro rata. The liabilities attributable to the UK residential property will be deductible in determining the value within the scope of IHT.

Loans and security for loans

Any debt used to finance the acquisition, maintenance or enhancement of value of UK residential property will, from 6 April 2017, be an asset subject to IHT in the hands of the lender (known as a Relevant Loan), with look through provisions where the lender is itself a non-UK close company or partnership. These provisions are widely drafted and catch many different circumstances. The debt will cease to be a Relevant Loan and accordingly cease to be subject to IHT under the new rules if and when the UK residential property is disposed of.

Where a loan is initially made to acquire any property (for example an investment portfolio) which is subsequently sold and the sale proceeds are used to acquire a UK residential property interest or to make/repay a loan to purchase the same, the debt owed to the original loan creditor will be within the scope of IHT.

In addition, any assets given as security, collateral or guarantee for such a debt will be within the scope of IHT in the estate of the provider of the security (subject to normal valuation principles including the deduction of any secured liabilities), up to a maximum of the value of the debt.

UK residential property

The rules will apply where the shares' (or other interest's) value is attributable to any UK residential property, whether that property is occupied or let and whatever the property's value (subject to limited exceptions such as care homes). A property which is being constructed or adapted for residential use will be treated as UK residential property.

The rules will not apply to the extent that the asset's value is derived from commercial property. Where property is used for both residential and non-residential purposes, a just and reasonable approach will apply. Only the use of the property at the time that the IHT charge arises will be relevant.

Two year tail

Following sale of close company shares or partnership interests which would have been within the scope of the new IHT rules, or repayment or disposal of a Relevant Loan, the consideration received (or anything which represents it) will continue to be subject to IHT for a two year period following the sale or repayment. The value subject to IHT will be capped at the amount of the consideration or repayment, where there is a subsequent increase in value. These tracing provisions may give rise to an IHT charge in normal commercial situations even where UK residential property is no longer held.

Targeted anti-avoidance rule

Any arrangements whose whole or main purpose is to avoid or reduce the IHT charge on UK residential property will be disregarded. This anti-avoidance provision is extremely widely drawn.

If you would like KPMG to assist in considering any of the issues that could arise for you from the new rules on the taxation of non-domiciled individuals, please contact one of the KPMG Private Client specialists below.

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Liability for the IHT

In the event that a liability to IHT (plus any interest due) under the new rules remains unpaid, a charge will be imposed in favour of Her Majesty's Revenue and Customs (the UK tax authority) on the UK residential property.

Unwinding existing structures

There are no reliefs from other taxes, notably capital gains tax and stamp duty land tax, where existing property structures are unwound. Those considering alternative ownership options in light of the changes will need to fully understand the tax implications of so-called 'de-enveloping'.

Timing

The new rules apply to IHT chargeable events on or after 6 April 2017, with some minor concessions on interest for late payment of tax and timing for the filing of certain IHT accounts in light of the delays in the new rules becoming law. Certain gifts made before that date may become liable to IHT where the donor dies on or after 6 April 2017. The two year tail will only apply where the sale or loan repayment occurs after 5 April 2017.

For further information see:

kpmg.com/uk/ukresidentialproperty

kpmg.com/uk/nondoms

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