NOTICES OF AMENDMENTS

given on

Wednesday 26 June 2013

For other Amendment(s) see the following page(s) of Supplement to Votes:
387-88 *and* 389

CONSIDERATION OF BILL

FINANCE BILL, AS AMENDED

Mr Chancellor of the Exchequer

35

Schedule **34**, page **424**, line **36**, leave out 'subsection (2) or (3)' and insert 'subsections (2) to (3A)'.

Mr Chancellor of the Exchequer

36

Schedule **34**, page **424**, line **38**, leave out 'excluded property' and insert 'property mentioned in subsection (1)'.

Mr Chancellor of the Exchequer

37

Schedule **34**, page **425**, leave out lines 11 to 14 and insert—

'(3) The liability may be taken into account up to an amount equal to the value of such of the property mentioned in subsection (1) as—

(a) has not been disposed of, and

(b) is no longer excluded property.

(3A) To the extent that any remaining liability is greater than the value of such of the property mentioned in subsection (1) as—

(a) has not been disposed of, and

(b) is still excluded property,

it may be taken into account, but only so far as the remaining liability is not greater than that value for any of the reasons mentioned in subsection (3D).

(3B) Subsection (3C) applies where—

(a) a liability or any part of a liability is attributable to financing (directly or indirectly)—

(i) the acquisition of property that was not excluded property, or

(ii) the maintenance, or an enhancement, of the value of such property, and

(b) the property or part of the property—

(i) has not been disposed of, and

(ii) has become excluded property.

(3C) The liability or (as the case may be) the part may only be taken into account to the extent that it exceeds the value of the property, or the part of the property, that has become excluded property, but only so far as it does not exceed that value for any of the reasons mentioned in subsection (3D).

(3D) The reasons are—'.

Mr Chancellor of the Exchequer

38

Schedule **34**, page **425**, line **19**, leave out 'excluded'.

Mr Chancellor of the Exchequer

39

Schedule **34**, page **425**, line **20**, leave out 'subsection (3)(a)' and insert 'this section'.

Mr Chancellor of the Exchequer

40

Schedule **34**, page **425**, line **23**, at end insert—

'"remaining liability" means the liability mentioned in subsection (1) so far as subsections (2) and (3) do not permit it to be taken into account;'.

Mr Chancellor of the Exchequer

41

Schedule **34**, page **426**, leave out lines 12 to 19.

Mr Chancellor of the Exchequer

42

Schedule **34**, page **426**, line **37**, at end insert—

'(7A) Subject to subsection (7B), to the extent that a liability is, in accordance with this section, taken to reduce value in determining the value transferred by a chargeable transfer, that liability is not then to be taken into account in determining the value transferred by any subsequent transfer of value by the same transferor.

(7B) Subsection (7A) does not prevent a liability from being taken into account by reason only that the liability has previously been taken into account in determining the amount on which tax is chargeable under section 64.

(7C) For the purposes of subsections (1) to (4) and (7A), references to a transfer of value or chargeable transfer include references to an occasion on which tax is chargeable under Chapter 3 of Part 3 (apart from section 79) and—

(a) references to the value transferred by a transfer of value or chargeable transfer include references to the amount on which tax is then chargeable, and

(b) references to the transferor include references to the trustees of the settlement concerned.'.

Mr Chancellor of the Exchequer

43

Schedule **34**, page **426**, line **45**, after '162A(1)', insert 'or (3B)'.

Mr Chancellor of the Exchequer

44

Schedule **34**, page **427**, line **13**, after '162A(1)', insert 'or (3B)'.

Mr Chancellor of the Exchequer

45

Schedule **34**, page **427**, line **22**, after 'estate', insert 'or from excluded property owned by the person immediately before death'.

Mr Chancellor of the Exchequer

46

Schedule **34**, page **427**, leave out lines 32 to 34 and insert—

'(b) securing a tax advantage is not the main purpose, or one of the main purposes, of leaving the liability or part undischarged, and'.

Mr Chancellor of the Exchequer

47

Schedule **34**, page **427**, line **42**, at end insert—

'( ) Where, by virtue of this section, a liability is not taken into account in determining the value of a person's estate immediately before death, the liability is also not to be taken into account in determining the extent to which the estate of any spouse or civil partner of the person is increased for the purposes of section 18.'.

Mr Chancellor of the Exchequer

48

Schedule **34**, page **427**, line **43**, leave out from '(2)(b)' to end of line 46.

Mr Chancellor of the Exchequer

49

Schedule **34**, page **428**, line **9**, after '162A(1)', insert 'or (3B)'.

Mr Chancellor of the Exchequer

50

Schedule **34**, page **428**, line **19**, leave out 'The' and insert—

'(1) Subject to sub-paragraph (2), the'.

Mr Chancellor of the Exchequer

51

Schedule **34**, page **428**, line **21**, at end insert—

'(2) Section 162B of IHTA 1984 (inserted by paragraph 3) only has effect in relation to liabilities incurred on or after 6 April 2013.

(3) For the purposes of sub-paragraph (2), where a liability is incurred under an agreement—

(a) if the agreement was varied so that the liability could be incurred under it, the liability is to be treated as having been incurred on the date of the variation, and

(b) in any other case, the liability is to be treated as having been incurred on the date the agreement was made.'.

EXPLANATORY NOTE

CLAUSE 174, SCHEDULE 34: TREATMENT OF LIABILITIES FOR INHERITANCE TAX PURPOSES

AMENDMENTS 35 - 51

SUMMARY

1. Clause 174 and Schedule 34 amend the inheritance tax (IHT) provisions relating to the treatment of liabilities. The schedule brings in restrictions and conditions that must be met before a liability is allowed as a deduction from the value of an estate so as to remove the tax advantage that is achieved by arrangements which exploit the current provisions.

DETAILS OF THE AMENDMENTS

2. Schedule 34, which inserts new sections 162A to C and 175A into Inheritance Tax Act 1984 (IHTA), is to be amended to clarify the interpretation of some of the provisions and to change the commencement date with respect to liabilities incurred to acquire 'relievable property' (property which qualifies for a relief).

3. <u>Amendment 37</u> deals with situations where property which has been acquired, maintained or enhanced by the liability ceases to be excluded property, or becomes excluded property, and where the liability exceeds the value of the excluded property. Property is 'excluded property' if it is situated outside the UK and the individual entitled to it is domiciled outside the UK, or if settled property is situated outside the UK and the settlor was domiciled outside the UK when the settlement was made.

   - Section 162A(3) is directed at cases where property ceases to be excluded property and becomes chargeable to IHT before the question of whether to take the liability into account arises. The deduction may be allowed to the extent that the property has not been disposed of and is subject to tax.

   - <u>New section 162A(3A)</u> applies where the liability exceeds the value of the excluded property. A deduction for the excess liability may be made but only if that excess is not due to any of the reasons given in new section 162A(3D). This subsection ensures that a deduction is not allowed where the excess liability has arisen by a deliberate manipulation of the value of the excluded property or the liability to obtain a tax advantage, as defined in new section 162A(4).

- New sections 162A(3B) and (3C) are aimed at cases where the property financed by the liability, which was chargeable to IHT, becomes excluded property at some stage before the question of whether to take the liability into account arises. A deduction may only be allowed for the amount of any liability that exceeds the value of the excluded property, but only if that excess is not due to any of the reasons in new section 162A(3D).

4. Amendment 40 adds a definition of "remaining liability" to section 162A(4) to deal with the interaction of sections 162A(2) and 162A(3) with section 162A(3A).

5. Amendments 35, 36, 38, 39, 43, 44 and 49 make amendments that are consequential as a result of amendment 37 and ensure that the relevant provisions relating to excluded property also apply to property which becomes excludes property.

6. Amendments 41 and 42 address situations where relievable property is given away in an earlier lifetime transfer and also ensure that the provisions in section 162B apply to settled property.

- New section 162B(7A) provides that once a liability has been taken into account, it cannot be taken into account against another transfer by the same transferor.

- New section 162B(7B) disapplies (7A) for the purposes of a ten year anniversary (TYA) charge, so that a liability can be taken into account again for subsequent TYA charges.

- New section 162B(7C) includes what was previously section 162B(5) and extends the provisions in subsections (7A) to relevant property trust charges.

7. Amendment 45 widens the meaning of 'out of the estate' for the purposes of repaying the liability. A deduction will be allowed if the liability is repaid on or after death out of assets in the estate or from excluded property that the deceased owned.

8. Amendments 46 and 48 clarify one of the conditions to be met before a deduction for a liability that has not been repaid may be allowable. When the liability has not been repaid as part of arrangements that seek to secure a tax advantage, it is the failure to repay the liability which has to give rise to the tax advantage, rather than looking only at whether the liability was part of any arrangements.

9. Amendment 47 clarifies that for the purposes of the IHT exemption for transfers between spouses or between civil partners, where a liability is not repaid and is disallowed in arriving at the value of a deceased's person's estate, the increase in value of the deceased's spouse's or civil partner's estate is treated as the full value without any deduction for the disallowed liability.

10. Amendments 50 and 51 amend the commencement date for the provisions in paragraph 5 of Schedule 34. The provisions in section 162B, which apply to liabilities in relation to relievable property, will only apply to liabilities incurred on or after 6 April 2013.

BACKGROUND

11. IHT is normally charged on the net value of a deceased person's estate after deducting liabilities outstanding at the date of death, reliefs, exemptions and the nil-rate band. The deduction for liabilities is given for the full value due to the creditors and is not limited to the amount actually repaid after death, or restricted if the liability has been incurred to acquire property which also qualifies for a relief or is not chargeable to IHT.

12. Reliefs are available for certain assets which are not chargeable to IHT in certain circumstances. These include business property relief, agricultural property relief and woodlands relief. Property which is situated outside the UK and which belongs to, or was settled by, a non-UK domiciled individual is 'excluded property'. It does not form part of a person's estate and is not chargeable to IHT.

13. IHTA includes limited provisions about when and how a liability should be taken into account. As a result, a tax advantage may arise where a liability is not repaid, or where the borrowed money is used to acquire property that is not liable to IHT.

14. The amendments to IHTA made by clause 174 and Schedule 34 will remove the tax advantage that arises from obtaining a deduction for a liability and either not repaying the liability after death, or acquiring an asset which is not chargeable to IHT. They will make arrangements which allow 'two bites at the cherry' unattractive because the estate will no longer gain the double benefit of a relief or exclusion and the deduction of a liability. The amendments will also ensure that the treatment of liabilities used to acquire relievable property will be consistent for IHT purposes regardless of the nature of the assets acquired or how the loan has been secured.

Inheritance tax: limiting the deduction for liabilities

Who is likely to be affected?

Users and promoters of avoidance schemes and participators in arrangements which take advantage of the current inheritance tax (IHT) treatment of liabilities to reduce the value of an estate.

General description of the measure

The measure will amend the IHT provisions which allow a deduction for liabilities owed by the deceased on death from the value of their estate. In some circumstances, the changes will bring in new conditions for the deduction to be allowable, or will restrict the deduction, so that the tax advantage resulting from the schemes or arrangements does not arise.

For most estates, liabilities owed by the deceased in the normal course of events where the debt has been repaid after death will continue to be deducted as they are now.

Policy objective

The measure will remove the tax advantage that these schemes and arrangements seek to achieve, and it will also remove an anomaly in the current rules that may distort business financing decisions. The measure will ensure that the value of an estate subject to IHT reflects the normal economic consequences of incurring a liability. The measure supports the Government's anti-avoidance strategy and fairness agenda.

Background to the measure

The measure is a response to avoidance schemes and arrangements which exploit the current rules that allow a deduction for liabilities owed by the deceased against the value of an estate regardless of whether or not the debt is paid after death. Some arrangements involve contrived debts which are subsequently not repaid so there is no real reduction in the value of the estate; others involve loans used to acquire assets which are not chargeable to IHT, or which qualify for a relief, so that the value of the estate is doubly reduced. The current rules also allow liabilities to be treated differently depending on how they are secured or the nature of the assets acquired. This can create a tax advantage and can distort business financing decisions.

The measure has not been previously announced. There has been no consultation on the measure.

Detailed proposal

Operative date

The measure will generally have effect for deaths and chargeable transfers on or after the date that Finance Bill 2013 receives Royal Assent. However, for liabilities that have been used to acquire assets which qualify for a relief, the provisions will only apply to liabilities incurred on or after 6 April 2013.

Current law

IHT is normally charged on the net value of a deceased person's estate after taking into account liabilities outstanding at the date of death (section 5(3) IHTA 1984), and after deducting any reliefs, exemptions and the nil-rate band or IHT threshold. The deduction is given for the full value of the liabilities due to the creditors, and not for the amount actually paid to them.

Reliefs are available for certain assets which are not chargeable to IHT in particular circumstances. These include business property relief (BPR), agricultural property relief (APR) and woodlands relief (WR).

Property which is situated outside the UK and which belongs to, or was settled by, a non-UK domiciled individual is 'excluded property' and does not form part of the person's estate. It is not chargeable to IHT.

The current rules describe how a liability should be taken into account but only in some circumstances. For example, a liability secured on any property should first be set against that property.

There are no specific provisions for the deduction of liabilities against settled property.

Proposed revisions

Legislation will be introduced in Finance Bill 2013. The revised provisions will bring in conditions and restrictions in the way that the deduction for liabilities is allowed in the following circumstances:

- A deduction for a liability will only be allowed to the extent that it is repaid to the creditor out of the estate, unless it is shown that there is a commercial reason for not repaying the liability and it is not left unpaid as part of arrangements to get a tax advantage.
- No deduction will be allowed for a liability to the extent that it has been incurred directly or indirectly to acquire property which is excluded from the charge to IHT. However, where the acquired property has been disposed of or where the liability is greater than the value of the excluded property, the deduction may be allowed providing certain conditions are met. If the acquired property ceases to be excluded property, the deduction will be allowed. Conversely, if the acquired property becomes excluded property, the deduction will be disallowed.
- Where the liability has been incurred to acquire assets on which a relief such as BPR, APR or WR is due, the liability will be taken to reduce the value of those assets that can qualify for relief. The deduction for the loan will be matched against the assets acquired and relief will be restricted to the net value of the assets. Any excess liability will be allowable as a deduction against the estate in general subject to the new rule about unpaid debts.

The new rules will also apply to settled property with the exception that the unpaid liabilities rule will not apply to the calculation of the value of the estate for the purposes of the ten year anniversary charge.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td></tr>
<tr><td>+5</td><td>+20</td><td>+15</td><td>+15</td><td>+15</td></tr>
<tr><td colspan="5">These figures are set out in Table 2.1 of Budget 2013 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Budget.

This measure supports the Exchequer in its commitment to protect revenue.</td></tr>
<tr><td>Economic impact</td><td colspan="5">This measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="5">This measure will affect individuals entering into arrangements or avoidance schemes involving debts to acquire excluded property or property which qualifies for a relief, or where debts are not repaid after death to obtain a tax advantage.

The administrative impact of this measure is not on the deceased individual but rather on those acting as executors or administrators of the estate. Personal representatives will need to ensure that any outstanding loans are repaid in order to claim the deduction against the value of the estate.

This measure will affect only a small number of individuals and households as the base of estates that fall within the charge to IHT is fairly small (it is estimated for 2010-11 that there will have been approximately 17,000 estates left on death paying IHT, representing less than 4 per cent of the total). Of the estates left on death a few hundred are likely to be affected by these changes.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">It is not expected that the measure would adversely or disproportionately impact on any equality groups.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="5">The majority of businesses, which are eligible for relief and which have unsecured loans or liabilities secured on business assets, will not be affected.

There will be no impact on businesses which incurred liabilities to acquire property that qualifies for a relief before 6 April 2013. Businesses will only be affected if:

• liabilities are incurred on or after 6 April 2013 to finance assets that qualify for a relief, and those liabilities are charged against non-business assets, or

• liabilities remain unpaid at death, and there is no commercial reason for not repaying them.

The changes may affect the promoters of avoidance schemes and arrangements exploiting the current rules.</td></tr>
<tr><td>Operational impact (£m) (HMRC or other)</td><td colspan="5">The operational impact on HMRC will be insignificant.</td></tr>
<tr><td>Other impacts</td><td colspan="5">Other impacts have been considered and none have been identified.</td></tr>
</table>

Monitoring and evaluation

The measure will be monitored through review of disclosures of new avoidance schemes to circumvent the measure, and through regular communication with affected taxpayers and practitioners.

Further advice

If you have any questions about this change, please contact Danka Wigley on 020 7147 3674 (email: danka.wigley@hmrc.gsi.gov.uk).

Declaration

David Gauke MP, Exchequer Secretary to the Treasury, has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.