

Clause 1 and Schedule 1: Inheritance tax on overseas property representing UK residential property

Summary

1. This clause and Schedule extend the scope of Inheritance Tax (IHT) to residential properties situated in the UK where they are held or financially supported by or through overseas structures by trustees or individuals domiciled outside the UK. It does so by amending the definition of excluded property in the Inheritance Tax Act (IHTA) 1984 which has the effect of excluding any property of such trustees and individuals from IHT where it is situated outside the UK.
2. The extended charge will be effective from 6 April 2017.

Details of the clause

3. Clause 1 introduces Schedule 1.

Details of the Schedule

4. Paragraph 1 of Schedule 1 inserts new Schedule A1 to IHTA.
5. Paragraph 1 of new Schedule A1 provides that property is not excluded property to the extent that it falls within paragraphs 2 and 3 of Schedule A1. It applies where :
 - the beneficial owner of the property is an individual domiciled outside the UK; and
 - the property is held in a settlement where the settlor was domiciled outside the UK when the settlement was made.
6. Paragraph 2 applies to property which is an interest in a close company or partnership where the value of that interest is attributable to a UK residential property interest.
7. Subparagraph 2(1) provides that paragraph 2 applies to any interest in a close company or a partnership to the extent that the interest meets the conditions in paragraph 2(2).
8. Subparagraph 2(2) sets out the condition referred to in paragraph 2(1). The condition is that the value of the interest in a close company or partnership is either directly attributable to a UK residential property interest, or indirectly attributable by virtue of an interest in a close company, an interest in a partnership or by virtue of loans and security, collateral or guarantees for loans within paragraph 3 of Schedule A1. The term ' UK

residential property interest' is defined in paragraph 8 of the Schedule A1.

9. Subparagraph 2(3) provides that, for the purpose of determining whether subparagraph 2(1) and (2) apply, any interest in a close company or partnership will be ignored where its value is less than 5% of the total value of the rights or interests in that company or partnership.
10. Subparagraph 2(4) provides that when determining whether to disregard a person's interest in a close company or partnership in subparagraph 2(3) any connected persons' interest in that close company or partnership should be included in valuing the person's interest.
11. Subparagraph 2(5) provides that, in determining the value of the interest in a close company or a partnership that is attributable to a UK residential property interest for the purpose of subparagraph 2(1), the liabilities of the close company or partnership are to be attributed to all the property it holds on a rateable basis. This means that, where a close company or partnership holds a UK residential property as well as other property any liabilities of that company or partnership will be attributed to each property in proportion to its value.
12. Paragraph 3 applies to any rights of a creditor in a relevant loan and to money or money's worth which is used or made available as collateral or security for a relevant loan but only to the extent that the money or money's worth does not exceed the value of the relevant loan. The term 'relevant loan' is defined in subparagraph 4(1).
13. Subparagraph 4(1) defines the term 'relevant loan' for the purposes of Schedule A1 as any loan to the extent that it makes money or money's worth available to finance the acquisition of a UK residential property interest, or any property to which paragraph 2 applies, by an individual, partnership or trustee. It also includes any loan used to finance the acquisition, either by an individual, a partnership or a trustee, of an interest in a close company, or an interest in a partnership and the acquisition by that close company or partnership of a UK residential property interest or any property to which paragraph 2 applies.
14. Subparagraph 4(2) provides that paragraph 4 also applies to a loan made to acquire any property which is sold and the proceeds used to acquire a UK residential property interest or the making or repayment of a loan to purchase such property.
15. Subparagraph 4(3) provides that references to the acquisition of a UK residential property interest includes the maintenance, or the enhancement of the value of a UK residential property interest.
16. Subparagraph (4) provides that a loan ceases to be a relevant loan where the UK residential property interest which made it a relevant loan is disposed of.
17. Subparagraph 4(5) provides that where there is a partial disposal of a UK relevant property interest, the loan ceases to be a relevant loan on a proportionate basis.
18. Subparagraph 4(6) provides that references to a loan also include an acknowledgement of a debt, such as an IOU, or any other arrangement where a debt arises. In such cases, it also provides that references to money or money's worth made available under the loan

should be taken as the amount of the debt.

19. Paragraph 5 makes provision for the treatment of certain disposals and repayments.
20. Subparagraph 5(1) provides that paragraphs 5 applies to:
 - property representing the consideration for the disposal of an interest or right in a close company or an interest in a partnership or of a relevant loan, whether in money or otherwise;
 - any money or money's worth which is paid in relation to a creditor's interest in a relevant loan; and
 - any property which directly or indirectly represents the consideration for a disposal of an interest or right in a close company or an interest in a partnership or a relevant loan or paid for a creditor's interest in, a relevant loan.
21. Subparagraph 5(2) provides that where paragraph 5 applies to any property, such property is not excluded property for a two-year period. Where that property is held within a qualifying foreign currency account as defined in section 157 IHTA, that section does not apply for the two-year period. This will mean that the property will be included in determining the value of a person's estate at death. The two-year period is defined in subparagraph 5(3).
22. Subparagraph 5(3) defines the term 'two-year period' as the period of two years starting with the date of a disposal or the date of a payment made for a creditor's interest in a relevant loan.
23. Subparagraph 5(4) provides that the value of property directly or indirectly representing property within subparagraphs 5(1)(a) and (b) shall not exceed the relevant amount which is defined in subparagraph 5(5).
24. Subparagraph 5(5) defines the relevant amount as :
 - where the property within subparagraph 5(1)(c) directly or indirectly represents consideration in money or money's worth for the disposal of an interest or right in a close company or an interest in a partnership or of a relevant loan applies, the value of that consideration at the time of the disposal; and
 - where the property within subparagraph 5(1)(c) directly or indirectly represents any money or money's worth paid for a creditor's interest in a relevant loan, the amount of money or money's worth paid.
25. Paragraph 6 introduces a targeted anti-avoidance rule which applies where arrangements are entered into where the sole or main purpose of doing so is to avoid or minimise the effect of paragraphs 1 or 5.
26. Subparagraph 6(2) defines the term 'tax advantage' as having the meaning given in section 208 of the Finance Act 2013. It also defines 'arrangements' as any scheme , transactions, agreement or understanding and any associated operations, no matter whether they are legally enforceable and whenever they were entered into.

27. Paragraph 7 provides for the application of double taxation arrangements.
28. Subparagraph 7(1) provides that nothing within any double taxation arrangement between the UK and another jurisdiction will prevent a person from being liable for IHT by virtue of paragraphs 1 or 5 where no similar tax is charged under that jurisdiction or where there is such a tax but its effective rate is 0%. For these purposes, an effective rate of 0% does not include cases where the rate which applies is 0% as a result of a relief or exemption.
29. Subparagraph 7(2) defines the terms 'double taxation relief arrangements' as arrangements having effect under section 158(1) IHTA and 'effective rate' as the rate found by expressing the tax chargeable as a percentage of the amount by reference to which it is charged.
30. Part 3 of Schedule A1 is an interpretation section and provides the definitions of certain terms as used in Schedule A1.
31. Subparagraph 8 defines a UK residential property interest for the purposes of the new Schedule A1.
32. Subparagraph 8(1) provides that a "residential property interest" is any interest in UK land which consists of or includes a dwelling or which subsists under a contract to purchase a dwelling off-plan.
33. Subparagraph 8(2) provides that the extent to which land includes a dwelling is to be determined on a just and reasonable basis.
34. Subparagraph 8(3) defines certain terms used in subparagraph 8(1). An 'interest in UK land' has the meaning given by paragraph 2 of Schedule B1 to TCGA; 'the land' in relation to an interest in UK land which is an interest subsisting for the benefit of land, is a reference to the land for the benefit of which the interest subsists; 'dwelling' has the meaning given by paragraph 4 of Schedule B1 to TCGA and 'contract for an off-plan purchase' has the meaning given by paragraph 1(6) of Schedule B1 to TCGA.
35. Paragraph 9 defines the term 'close company' as a company within the meaning of the Corporation Tax Acts which is a close company for the purpose of those Acts or would be a close company if resident in the UK. It also defines the term 'participator' as any person who is (or would be if the company were resident in the UK) a participator in relation to a close company within the meaning given by section 454 of the Corporation Tax Act 2010. Finally, it provides that any rights and interests in a close company include references to rights and assets of the company available for distribution among the participators in the event of a winding-up or in any other circumstances.
36. Paragraph 10 defines the terms 'partnership' as a partnership within the Partnership Act 1890, a limited partnership registered under the Limited Partnership Act 1907, a limited liability partnership formed under the Limited Liability Partnerships Act (Northern Ireland) 2002 or a firm or entity of a similar character formed under the law of a country or territory outside the United Kingdom.
37. Paragraphs 2 to 8 of Schedule make consequential amendments to IHTA.

38. Paragraph 5 of Schedule provides that tax will not be charged under section 65 only because property ceases to be property to which paragraph 2 or 3 of the new Schedule A1 applies and so becomes excluded property under section 48(3)(a). It also provides that tax will not be charged where property in a settlement is not excluded property for the two year period as per subparagraph 5(2)(a) but then becomes excluded property at the end of that period.
39. Paragraph 7 of Schedule provides that where tax is charged under the new Schedule A1, references to 'property to the value of which the value transferred is wholly or partly attributable' in section 237(1)(a) includes the UK residential property interest that the charge relates to.
40. Paragraph 9 of Schedule provides the commencement provision for the new clause and Schedule.
41. Subparagraph 9(1) of Schedule provides that the amendments made by the Schedule to IHTA have effect on or after 6 April 2017.
42. Subparagraph 9(2) of Schedule provides that subparagraph 5(1) of Schedule A1 does not apply to disposals of property before 6 April 2017 or to payments of money or money's worth made before 6 April 2017.

Background note

43. At summer Budget 2015, the government announced its intention of extending IHT to UK residential property held by a non-domiciled individual through an overseas structure. This was the subject of public consultation between 19 August and 20 October 2016 and the government published its formal response on 5 December.
44. Under IHTA, an individual who is domiciled outside the UK is not liable to tax on any property they own which is situated overseas, unlike UK domiciled individuals who are liable to IHT on their worldwide property. This difference in treatment has been used by some non-doms as a means of avoiding IHT by holding UK residential properties indirectly through overseas structures such as companies, trusts and partnerships. This clause and Schedule extends the scope of IHT to include such properties.
45. Some minor drafting and technical changes have been made to the legislation since it was first introduced in March 2017, as outlined below:
 - There is a new paragraph 2(4) that introduces provisions to tackle potential avoidance using the 5% rule in paragraph 2(3).
 - Paragraph 4(6) - Drafting change to make clear that references to a loan include any arrangement under which a debt arises and the references to money or money's worth are to the amount of the debt.
 - Paragraph 5(1)(a) - Technical change to make clear that the disposal and repayments rule in paragraph 5 applies to the disposal of relevant loans (paragraph 3(a)).

- Section 237(2A) - Minor drafting change.

46. If you have any comments on this legislation please contact Aidan Close on 03000 585255
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