Inheritance tax: investments in open ended investment companies and authorised unit trusts

Who is likely to be affected?

Investors switching UK assets from trusts settled by non-UK domiciled individuals to open ended investment companies (OEICs) and authorised unit trusts (AUTs).

General description of the measure

The measure will allow trustees to switch UK assets held in settlement made by non-UK domiciled individuals to investments in OEICs and AUTs without incurring inheritance tax (IHT). It will allow the legislation to work as originally intended at the time legislative changes to the IHT treatment of OEICs and AUTs were introduced in Finance Act 2003 (FA 2003) and does not constitute a new tax incentive for non-UK domiciled individuals.

Policy objective

The measure ensures that the switching of assets in a trust settled by a non-UK domiciled individual to investments in OEICs and AUTs is exempt from IHT charges. It also ensures that no tax will have arisen on those trusts which held OEICs or AUTs when the changes introduced in 2003 came into force.

Background to the measure

The Government announced on 5 December 2012 that this measure will be introduced in Finance Bill 2013 and will create a retrospective amendment.

The measure is wholly relieving and will therefore not be subject to formal consultation.

Detailed proposal

Operative date

The amendment will be retrospectively effective from 16 October 2002, the date from which the original changes to the IHT treatment of OEICs and AUTs in FA 2003 applied.

Current law

Section 186 of Finance Act 2003 introduced section 6(1A) to Inheritance Tax Act 1984 (IHTA 1984). It extended the class of asset which qualifies as excluded property to include holdings by non-UK domiciled investors in OEICs and AUTs. The same act introduced an equivalent provision, S48(3A), to provide a similar exemption for holdings in authorised unit trusts or open ended investment companies held in trust provided the settlor was domiciled outside the UK when the settlement was made. The new provisions came into effect for transfers of value or events occurring on or after 16 October 2002.

Section 65 IHTA 1984 provides for a charge to tax where the property comprised in a settlement ceases to be relevant property. Section 65(7) provides for an exception to this charge where property comprised in a settlement ceases to be relevant property "by reason only that property comprised in a settlement ceases to be situated in the UK and thereby becomes excluded property by virtue of section 48(3)(a)". There is not a similar exception to the section 65 charge in respect of relevant property that is invested in OEIC and AUT fund units and thereby becomes excluded property by virtue of section 48(3A)(a). Consequently, if trustees switch from UK assets to OEICs or AUTs, the trust property switches to excluded property and it ceases to be relevant property and becomes liable to an IHT charge.

When FA 2003 introduced section 48 (3A) to IHTA 1984 making investments in OEIC and AUT fund units excluded property, it was not intended that this should create a section 65 charge. Currently, an IHT liability would be imposed on taxpayers and they would be required to make IHT returns in respect of these transactions. In addition, where relevant property trusts were already holding OEICs and AUTs at the time s48(3A) was introduced these would have ceased to be relevant property from the date the new provisions took effect with a consequent IHT charge.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to provide a further exception to the s65 charge, similar to s65(7), in respect of relevant property that is invested in OEICs and AUTs so that the switching of UK assets in a trust settled by a non-UK domiciled individual, to investments in OEICs and AUTs, is exempt from inheritance tax charges. The amendment will have retrospective effect so that no tax will have arisen in those trusts which held OEICs or AUTs when the changes introduced in s186 to FA 2003 came into effect.

Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	negligible	negligible	negligible	negligible	negligible	negligible
	This measure is expected to have a negligible impact on the Exchequer. Any impact will be set out at Budget 2013.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	This measure will benefit investors switching UK assets from trusts settled by non-UK domiciled individuals to OEICs and AUTs and it will remove the need for them to submit an Inheritance Tax return.					
Equalities impacts	The Government has no evidence to suggest that the measure will have any adverse equalities impacts.					
Impact on business including civil society organisations	This measure is expected to have a negligible impact on businesses and civil society organisations due to the need for trust advisors to familiarise themselves with the change of rules. These are just one-off implementation costs. There are no annual on-going costs.					
Operational impact (£m) (HMRC or other)	The operational impact on HM Revenue & Customs will be negligible.					
Other impacts	Small firms impact test: There will be a negligible impact on small businesses (firms with fewer than 20 employees) involved in the administration of trusts due to the need to familiarise themselves with the change of rules. The measure will benefit investors switching UK assets from trusts settled by non-UK domiciled individuals to OEICs and AUTs. Other impacts have been considered and none have been identified.					

Monitoring and evaluation

The measure will be kept under review through regular communication with the relevant business sector.

Further advice

If you have any questions about this change, please contact Tony Zagara on 020 7147 2861 (email: antonio.zagara@hmrc.gsi.gov.uk).

1 Open- ended investment companies and authorised unit trusts

(1) In section 65 of IHTA 1984 (settlements without interests in possession etc: charge when property ceases to be relevant property etc), after subsection (7) insert—

"(7A) Tax shall not be charged under this section by reason only that property comprised in a settlement becomes excluded property by virtue of section 48(3A)(a) (holding in an authorised unit trust or a share in an open-ended investment company is excluded property unless settlor domiciled in UK when settlement made)."

(2) The amendment made by this section is treated as having come into force on 16 October 2002.

EXPLANATORY NOTE

INHERITANCE TAX: INVESTMENTS IN OPEN ENDED INVESTMENT COMPANIES AND AUTHORISED UNIT TRUSTS

SUMMARY

1. This clause provides for an amendment to existing legislation which will allow trustees to switch UK assets held in settlement made by non-UK domiciled individuals to investments in Open Ended Investment Companies (OEICs) and Authorised Unit Trusts (AUTs) without incurring inheritance tax. The changes made by this clause will have retroactive effect so that no tax will have arisen in those trusts which already held AUTs or OEICs when changes introduced in section 186 to Finance Act (FA) 2003 came into effect. Nor will any tax have arisen in those trusts where UK assets were invested in OEICs and AUTs since the coming into effect of FA 2003.

DETAILS OF THE CLAUSE

2. Subsection 1 adds new section 65(7A) to Inheritance Tax Act 1984 (IHTA) which exempts investments in OEICs and AUTs from a charge under that section.

3. Subsection 2 provides for the new section 65(7A) to have retroactive effect for investments made on and after 16 October 2002.

BACKGROUND

4. Section 186 of Finance Act 2003 introduced Section 6(1A) to Inheritance Act 1984 (IHTA) which treats investments in OEICs and AUTs owned by non-UK domiciled individuals as excluded property. This has the effect of exempting such investments from the charge to inheritance tax under Section 1 of IHTA.

5. The same Act introduced an equivalent provision, Section 48(3A), to provide a similar exemption for holdings in authorised unit trusts or open ended investment companies held in trust provided the settlor was domiciled outside the UK when the settlement was made. The new provisions came into effect for transfers of value or events occurring on or after 16 October 2002.

6. Section 65 IHTA provides for a charge to tax where the property comprised in a settlement ceases to be relevant property. Excluded property is not relevant property and therefore by making investments in OEICs and AUTs excluded property, it automatically created a

charge under section 65 on those investments. Section 65(7) provides for an exception to this charge where property comprised in a settlement ceases to be relevant property "by reason only that property comprised in a settlement ceases to be situated in the UK and thereby becomes excluded property by virtue of section 48(3)(a)".

7. The above clause provides for a further exception to the s65 charge, similar to s65(7), in respect of property that is invested in AUTs and OEIC's and thereby becomes excluded property by virtue of section 48(3A)(a).

8. If you have any questions about this change, or comments on the legislation, please contact Tony Zagara on 020 7147 2861 (email: antonio.zagara@hmrc.gsi.gov.uk).