PROPERTY LAW BULLETIN

THE NEW DISALLOWABLE DEBTS REGIME FOR INHERITANCE TAX

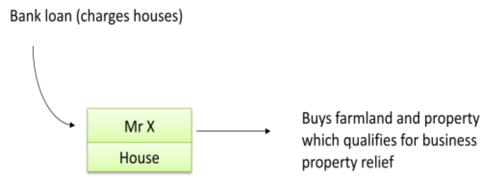
Introduction

The Finance Act 2013 contains provisions which effectively disallow certain debts as deductions from the estate of deceased persons for inheritance tax purposes.

These provisions are in Finance Act 2013 Schedule 36 and that Schedule inserts new provisions (ss. 162A, 162B, 162C and s.175A) into IHTA 1984.

Borrowing to buy farmland etc

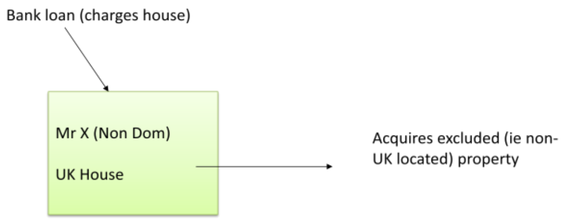
If a taxpayer owns a house and he borrows monies charged against this to buy farmland on which he will obtain agricultural property relief or business property relief for inheritance tax purposes (called “relievable property”), then the effect of the provisions is to treat the debt as deductible from the relievable property and not from the house.This effectively means that the debt is disallowed because there will be no charge to inheritance tax in any event on the agricultural property or the business property if they qualified for 100% relief from IHT. See the new section 162B of IHTA 1984.



Note this provision only has effect with respect to liabilities incurred on or after 6th April 2013 (Finance Act 2013 Schedule 36 paragraph 5(2)). If a loan was taken out some time ago to purchase the relieved properties and the house of the taxpayer was charged it is arguable the provision is still not offended if the loan is now replaced by a new loan because the new borrowing will not have been attributable to financing the acquisition of the relievable property but to replacing a loan originally taken out to finance the acquisition and there was no plan at that time to replace the loan.

Non-Domiciliaries borrowing to buy excluded property

There is also a provision in the new section 162A IHTA which provides that if a taxpayer who is not domiciled in the United Kingdom charges a UK house in order to acquire excluded property the debt is only deductible from the excluded property and not from the UK house. The debt effectively therefore goes unrelieved.



There are exceptions to this rule (IHTA 1984 s.162A(2)-(4)) but the rule does mean that in general it is not possible for non-UK domiciled persons to charge a UK house and buy excluded property and mitigate the inheritance charge on the house.

Note that if a non-domiciliary borrows monies to purchase the property in the United Kingdom and charges the property then there should be no difficulty in the debt being allowable. The problem only arises if the individual already owns a property and takes a charge against it with a view to buying excluded property (including putting his money in an overseas bank account which will be excluded property).

New rule requiring loans to be repaid on death

As well as the above provisions there is a new provision in IHTA 104 s.175A which states that a liability can only be taken into account on the death of an individual to the extent that it is discharged on or after the death out of the estate or our of excluded property owned by the deceased immediately before the death.

This is a major provision which will affect all estates and not just estates of non-domiciliaries or persons owning relievable property.

If the liability is not discharged there is a relieving provision which states that it could be taken into account if there is "a real commercial reason" for the liability not being discharged and the securing of a tax advantage is not the main purpose or one of the main purposes of leaving the liability undischarged.

There is a real commercial reason for not discharging the liability where it is shown that the liability is to a person dealing at arm's length or if the liability were to a person dealing at arm's length, that person would not require the liability to be discharged.

Thus on the death of an individual who owes money to the Nationwide Building Society, if that is not discharged but, for example, the property is transferred to beneficiaries subject to the charge, a deduction would be forthcoming.

Order of priority of discharge of debt rules

Finally it should be noted that if the taxpayer has debts which were taken out to buy relievable property or excluded property and chargeable property, and these are discharged in part (whether before or after the death) then there are order of priority rules in s.162C and s.175A(7) which need to be referred to.

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11 September 2013

Field Court Tax Chambers

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