IHT: enveloped UK residential property

A curious result appears to follow from HMRC's recent guidance on the new inheritance tax rules in relation to enveloped UK dwellings.

It is well known that where a foreign domiciled person has shares in an offshore company which owns a UK asset, the shares have always been excluded property. The shares are foreign assets in the beneficial ownership of an individual not domiciled in the UK (IHTA 1984 s 6(1)). Analogous rules apply for settled property.

Not any more – at least not quite. Since 6 April 2017, the shares in the offshore company are no longer excluded property to the extent that their value is attributable to UK residential property.

It is not always easy to identify how much of the value of a company's shares is attributable to the UK residential property. You have to enter the dim world of share valuation – but the general idea is clear enough. In a simple case where you have an offshore company which holds a single asset, such as a flat in the UK worth £2m (and no loans), the value of the shares in the company will probably be about £2m. The whole of that value will be attributable to the UK property and the shares will no longer be excluded property.

It was with these thoughts in mind that I read the HMRC guidance note of 2 February 2018 (see bit.ly/2GQuBKU).

The note gives an example of a non-dom who owns all the shares in a Jersey company which has only one asset, a flat in London worth £2m. HMRC explains that the whole of the value of the shares in the company is attributable to the UK residential property and the shares are not excluded property since 6 April 2017. OK, fine. No surprises there.

However, it goes on to say: 'if the company had other assets that were the same as the UK residential property, then the amount attributable to the UK residential property would be halved and only £1m …would be within the scope of IHT.'

I think something has gone wrong here.

If the company has other assets that were the same as the UK residential property, which would seem clearly to mean other assets worth £2m, then the company would have assets of £4m. So how much of the shares in this company worth £4m is attributable to the UK residential property? Leaving aside refinements over valuations, that would still be £2m.

Unless I have misunderstood, the guidance note has gone a bit awry and a correction will be along soon.

However, if the guidance note is correct, an odd conclusion arises. If, immediately before an occasion of charge, you add lots of other assets to the company, the proportion relating to the UK residential property goes down. Following HMRC's example, if you put in other assets totalling £10m, then the proportion of the assets representing UK property goes down to 16.67% – which would be just about the amount of the nil rate band, and might be rather helpful.

But, as HMRC is fond of saying: if it looks too good to be true, it probably is.

One question seems to be missing here: what is it a proportion of? It may have gone down but it is a smaller proportion of a correspondingly more valuable company, and you end up with the same value attributable to the residential property. ■

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Beware! Leases: LBTT three-year review

A new reporting mechanism is required every three years for leases in Scotland.

Land and Buildings Transaction Tax (LBTT) was originally heralded as a new and progressive tax for Scotland that set itself apart from its UK counterpart, SDLT, having jettisoned the old 'slab system' of charging in favour of a more progressive version. The Land and Buildings Transaction (Scotland) Tax Act 2013 came into effect from 1 April 2015. As things have turned out, however, SDLT and LBTT have become more and more closely aligned: both now use a 'progressive' basis of tax rates; both have introduced a 3% additional charge for homes that are not the main residence of the owner; and it is expected that both will have a first-time buyer relief. However, there is one notable difference in Scotland's LBTT: a reporting mechanism that is required every three years for leases.

Three-year reviews: The LBTT(S)A 2013 sets out the legislative requirement for a tax return to be submitted for leases in Scotland in specific circumstances, including:

- every three years from the effective date of the lease (see Revenue Scotland's LBTT 6015);
- on assignation; and
- on termination.

Less common in Scotland than in England, leases are used for commercial property. The LBTT legislation does not require a further LBTT return to be submitted to Revenue Scotland every time a change to the lease takes place. Instead, LBTT(S)A 2013 Sch 19 para 10 requires the tenant, unless the lease has been terminated or assigned, to submit a further LBTT return on every third anniversary of the effective date of the lease (see Revenue Scotland's LBTT 6016) and any additional LBTT paid or overpaid LBTT reclaimed. Revenue Scotland concerns itself with changes in the original nature of the lease, such as variations, extensions, rent reviews and tacit relocation. The obligation to report applies equally to variations to leases which were treated as new leases under the Land and Buildings Transaction Tax (Transitional Provisions) (Scotland) Order, SSI 2014/377, by virtue of LBTT(S)A 2013 s 29.

With LBTT reaching its third birthday on 1 April 2018, it is only now that the three-yearly review starts to become effective. Clients need to be reminded of this – and that the responsibility sits with the *tenant* to make the return.

Assignations and terminations: A qualifying lease which is later assigned or terminated must be reported by the outgoing tenant (the assignor) within 30 days of the 'relevant date' – this being the date on which the lease was assigned or terminated (see Revenue Scotland's LBTT 6017).

Timetable for declarations and payments: Wherever a return is required under Sch 19, any tax payable must be paid at the same time the return is made – within 30 days, beginning with the day after the review date. The tax rates and bands to be applied at the review of the tax chargeable are those that were in force at the effective date of the transaction. If the review calculations reveal that less tax is due, the overpaid tax will be repaid by Revenue Scotland. Note, however, that the return is required even if there is no tax at stake or there have been no variations to the lease.

Tenants based outside Scotland: Revenue Scotland has provided guidance in LBTT 6014, but care will be needed in particular for tenants from outside Scotland who may not be aware of this requirement. Non-compliance can be expensive, even if no tax is due, and Revenue Scotland notes in its annual report for 2016/17 that it issued notices charging penalties and interest of £507,000, demonstrating that it is not shy of adopting a punitive stance.

Exemptions: According to LBTT 6014, exemptions to the three-yearly review are:

- leases which have never been subject to LBTT (i.e. leases which were and continue to be subject to SDLT or stamp duty); and
- leases which have been subject to LBTT but exempted from charge because full relief is claimed on the first LBTT return. ■

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