FIELD COURT TAX CHAMBERS

Non-doms and UK residential property [1]

The latest announcement about the IHT treatment of UK residential property contains some interesting features, particularly regarding loans

We all know that where a UK asset is owned by an offshore company, the shares in the company are foreign assets and excluded property for IHT purposes in the hands of a foreign domiciled individual.

HMRC announced last year that it intends to remove this excluded property treatment in respect of UK residential property from next April – but it did not say how this would be done. It has now.

The idea is that the shares in the offshore company will no longer be excluded property to the extent that the value of its shares is attributable directly or indirectly to residential property in the UK.

Because it is the shares in the offshore company which will not be excluded property, it will be the value of those shares (to the extent that that value is attributable to UK property) which will be chargeable. It will therefore be necessary to value the shares, which will give rise to lots of really interesting arguments here – and opportunities.

Where the shares in the company are in a trust, some serious problems arise because of the ten-year charge and the gifts with reservation rules. Once the offshore company's shares cease to be excluded property, the reservation of benefit may apply, so that the settled property will be chargeable as part of the settlor's estate – plus (in many cases) the ten-year charge. Foreign trustees are going to love that.

A significant issue (more of a spectre) appears in connection with debts. The normal deduction for debts against the property will continue – although certain debts on UK residential property are now disallowed, particularly where the property is refinanced. Continuing this theme, it is now proposed that loans between connected parties will be disregarded when determining the value of the property chargeable to tax.

You have to feel sorry for trustees who own UK residential property purchased for (say) £5m from funds borrowed from somebody connected with the settlor. They have property which is worth zero, but they will be charged inheritance tax on the basis that they have assets worth £5m. HMRC may deem them to have this value – but that does not mean that they have money to pay the tax. I do not know what (foreign) trustees are supposed to do when faced with such a demand for tax which they obviously have no means of being able to pay.

And what if the lender was domiciled in the UK? The loan would be an asset in their estate but it would not be deductible as far as the trustees are concerned. So the trustees would be liable

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to inheritance tax on an asset worth £5m; and the lender would also be liable to inheritance tax on an asset worth £5m. The amount chargeable to inheritance tax is doubled. What a great trick. Do this a few times and The Deficit will disappear completely.

Maybe Mr. Hammond has seen a conjuror finding a £1 coin behind his ear and thinks it really is magic.

Peter Vaines

Field Court Tax Chambers