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Sweet & Maxwell
5 Canada Square
Canary Wharf
London
E14 5AQ
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Section 33 and Schedule 10: inheritance tax on overseas property representing UK residential property

Introduction and background to the changes

In July 2015 the Government announced that from 6 April 2017 there would be a major change to the taxation of "enveloped" UK residential property held by foreign domiciliaries.[1] Until April 2017, foreign domiciliaries (wherever resident) were only chargeable to UK inheritance tax (IHT) on UK situated property which was directly owned either by the individual or by a trust set up by the foreign domiciled settlor. The obvious solution was therefore not to hold UK situated property directly but instead insert a foreign incorporated company above the relevant UK property (whether UK art, shares, cash, commercial or residential property). This was called "enveloping". The foreign domiciled individual or trust would then be treated as holding shares in a foreign company and these were classified as "excluded property" and outside the scope of IHT.[2]

The new rules change this in relation to UK residential property. They provide that if the foreign domiciled individual or trust set up by a foreign domiciled settlor owns:

1. any interests in non-UK structures or entities which derive their value directly or indirectly from UK residential property; or
2. any loans (whether held directly or through companies) to acquire, maintain or improve UK residential property,

then such property is not excluded property for IHT purposes.

Schedule 10 of the Finance (No.2) Act 2017 (F(No.2)A 2017) introduces Schedule A1 to the Inheritance Tax Act 1984 (IHTA).[3] The Schedule has effect with regard to any transfers of value occurring on or after 6 April 2017.[4]

Schedule A1 IHTA therefore represents the first major inroad into the favourable IHT position of foreign doms. Whether it will be extended to apply to UK commercial property (as some in the Labour Party called for in Parliamentary Committee) or to UK assets more generally remains to be seen but this Government has said that it has no plans to extend the principle of looking through enveloped vehicles.

[1] A foreign dom is taken here to mean someone who is not settled in the UK permanently even if they have been UK resident for some years. They will generally have a foreign domicile of origin and have not acquired a UK domicile of choice. Alternatively (albeit less common) an individual with a UK domicile of origin may have acquired a foreign domicile of choice if they have left the UK to live in a particular state abroad permanently. A UK domicile of origin cannot be lost merely by emigration. The individual must intend to settle permanently or indefinitely in a particular country.

[2] Although there were rules in place before April 2017 to "deem" the individual to be domiciled for IHT purposes in the UK in the 17th year of UK residence it was possible to avoid the adverse effect of such rules by putting the assets into trust before the individual acquired a deemed domicile.

[3] IHTA Sch.A1.

[4] F(No.2)A 2017 Sch.10 para.9.

The charges affect not only individuals (wherever resident in the UK) but also trusts set up by settlors who may have no connection to the UK other than holding UK residential property. The impact of the changes can be seen briefly as follows:

Example 1

1. H, a settlor domiciled and resident in the Middle East, sets up a discretionary trust in 2002 that now holds a valuable portfolio of let and occupied London property through overseas companies. He and his children (none of whom are UK resident) are beneficiaries of the trust. Prior to April 2017, there was no IHT payable. From April 2017 IHT can arise on the following occasions:
   (a) On the death of H at 40 per cent if he is still a beneficiary by virtue of the reservation of benefit rules. HMRC deny that spouse exemption is possible under the reservation of benefit rules even if the settled property passes outright to the spouse on H's death. The only exception would be if the trust was not discretionary but H had a qualifying interest in possession[5] in which case spouse exemption may be available if the spouse takes a transitional serial interest on his death or takes the property outright such that the trust ends.
   (b) On the 10 year anniversary in 2022 at 6 per cent.
   (c) On any distribution of a company from the trust at up to 6 per cent.
2. H owned a company that holds a London flat. In February 2017, he gave it to his son. This is not a potentially exempt transfer (PET) as it is excluded property. Even if he dies within seven years (and after April 2017) there is no IHT charge. If the gift was made on or after 6 April 2017, this is a PET and H will need to survive seven years.
3. H made loans to his son in 2010 to enable the son to purchase a London flat. The loans are not charged on the property and are not UK situated. They remain outstanding after April 2017. On the death of H the loans are chargeable assets for IHT purposes as they are not excluded property. If H writes the loans off during his lifetime this is a PET. If the son sells the UK property the loans cease to be chargeable assets and become excluded property. If the son repays the loans before selling the property the loan proceeds are not excluded property in the hands of H for two years under new anti-avoidance rules.[6]

What land does the legislation catch?

The legislation is only intended to catch holdings of UK residential property. A UK residential property interest is defined in paragraph 8 of Schedule A1 IHTA as an interest in land that consists of a dwelling but it also includes contracts for an off-plan purchase.[7] If land has a mixed use (for example, an office space with a flat above it), then the extent to which the land should

[5] As defined in IHTA s.49.
[6] IHTA Sch.A1 para.5.
[7] IHTA Sch.A1 para.8.

be treated as including a dwelling is to be determined on a just and reasonable basis. The term "dwelling" has the same meaning as under non-residents capital gains tax (CGT) and the same exclusions for student and institutional accommodation apply. The definition also includes interests in dwellings held as trading stock by dealing or property development companies (although in relation to property development companies business property relief may be available to protect the individual or trust from an IHT charge).

The scope of the IHT provisions is wider than the Annual Tax on Enveloped Dwellings (ATED) as there is no minimum value specified and the charge applies not only to residential property occupied by the individual or trust beneficiary but to any residential property even if it is let on a commercial basis to third parties.

When does the charge apply?

If the UK residential property interest is held directly by the individual or trust then under general principles the individual or trust is subject to IHT anyway and Schedule A1 IHTA will not apply. Schedule A1 IHTA applies to UK residential property interests that are held *indirectly*, for example, through a foreign close company or foreign partnership.[8] In addition, loans which fall within the definition of "relevant loan" are subject to IHT.[9]

The legislation does not impose a separate IHT charge so all the usual reliefs such as business property relief and spouse exemption can still apply. It simply removes the protection of excluded property status from assets that would otherwise be outside the IHT net.

Paragraph 2 of Schedule A1 IHTA—companies and partnerships

Paragraph 2 of Schedule A1 IHTA states that "property" is not excluded property if and to the extent that the interest in a close company or partnership is directly or indirectly attributable to a UK residential property interest. The legislation is framed so as to include subsidiary companies and "close company" has the same meaning as for corporation tax except that non-UK resident companies are included.

When looking at the value of a person's interest in a close company you consider not only their shareholder rights but also their position as loan creditor. Thus a trust holding 100 per cent of the share capital of a company and also lending funds to the company will be a participator as to both the shares and the loan. The legislation encompasses directly and indirectly held subsidiaries.

The legislation does not attempt to look through the company and tax the land itself. This would have disrupted the position of UK domiciliaries holding land interests within commercial companies. It simply disapplies excluded property to the extent that the value of the company is attributable to UK residential property or (broadly) to loans that are used to purchase such property.

As the value subject to IHT is the value of the shareholding or partnership interest and not the value of the underlying UK residential property interest it is likely that the value of the shares or partnership interest will be less than that of the underlying residential property. Even a 100

[8] IHTA Sch.A1 para.2.
[9] IHTA Sch.A1 paras 3 and 4.

per cent shareholder would be entitled to some discount for potential liquidation costs. Shareholders who each own less than 50 per cent would be able to apply a significant discount to the value of their shareholdings even if the company was invested entirely in UK residential land. When valuing shareholdings there is no provision in the IHT legislation for aggregating holdings of connected persons. Hence a family comprising a father and four sons owning equal shares will each be able to claim a significant discount on their 20 per cent shareholdings. The same is true if one company is split between several different trusts with a common settlor. The one exception is that spousal interests are aggregated as related property under section 161 IHTA. This seems a gap in the legislation.

An interest in a close company can be caught by Schedule A1 IHTA even if the company does not own residential property but instead holds a partnership interest that owns residential property or a relevant loan (discussed below).

Partnership interests are included in Schedule A1 IHTA because for IHT purposes the partner's asset is their interest in the partnership rather than the underlying assets. The situs of the asset is where the partnership business is carried on. In order to stop arguments about whether partnerships owning UK residential property can be foreign situated the legislation catches interests in such partnerships. However, it may be doubted whether it is common for partnerships to be carrying on a business of letting UK residential property outside the UK.

Corporate liabilities

Valuation issues become more complicated if the company owns other non-residential property assets or has debts. The legislation does not lay down any criteria on how to value a close company holding both residential and non-residential assets. It simply imposes a charge on the shares to the extent the value is attributable to UK residential property interests. It is assumed that when valuing those interests it is necessary to work out the proportion a residential property interest bears in relation to the other assets. In order to stop manipulation of liabilities the legislation does, however, lay down a specific rule in paragraph 2(5) of Schedule A1 IHTA:

> "In determining whether or to what extent the value of an interest in a close company or in a partnership is attributable to a UK residential property interest … liabilities of a close company or partnership are to be attributed rateably to all of its property …."[10]

This is good news where the company has borrowed to acquire non-residential property as a proportion of that borrowing can be deducted when valuing the residential property. It will be bad news where the company has borrowed to purchase UK residential property. Note that the purpose for which the loan is taken out or where it is secured is entirely irrelevant and this is a major difference compared with borrowing incurred by trusts or individuals. Loans to companies are not relevant loans within paragraph 3 of Schedule A1 IHTA but simply mean the creditor has an interest in the company within paragraph 2.

[10] IHTA Sch.A1 para.2(5).

Example 2

A company owned by a trust with a foreign dom settlor holds a UK residential property worth £2 million and borrows £10 million from X (a foreign dom) to invest in equities. Its gross assets are £12 million and its liabilities are £10 million. In order to determine the tax position on the trust's shares and on X's loan work out how much of the liability is attributable to the UK residential property (£10 million x £2 million/12 = £1.6 million). On that basis X's loan is valued at face value but taking into account the company holds residential property with a net value of £400,000. Therefore a proportion of the loan will be chargeable on X's death even if it was used entirely for the purchase of equities. The fact that the loan may be secured on the equities or on the residential property is irrelevant.

De minimis exemption

Paragraph 2(3) of Schedule A1 IHTA provides that where the value of the interest in the close company or partnership is less than 5 per cent of the total value of all the other interests in the close company or partnership it is ignored for the purposes of Schedule A1 IHTA. Curiously this de minimis provision does not value the minority shareholding and then compare it with the value of the company as a whole. Instead it compares the value of the interest with the value of other interests in the company. This could lead to odd results. For example, if the company is owned by two people, one of whom holds 80 per cent and the other 20 per cent, that 20 per cent interest might well be worth less than 5 per cent of the total value of the 80 per cent interest. If on the other hand five people owned 20 per cent each then it is unlikely the de minimis exemption will apply. Note that this provision *does* aggregate connected party interests.[11] "Connected" bears its normal IHT meaning so includes not only parents, children, trusts where the settlor is alive, etc. but also nephews, nieces, uncles and aunts.

Note that there is no de minimis exemption just because the company only owns a very small amount of residential property.

Paragraphs 3 and 4 of Schedule A1 IHTA—relevant loans

Schedule A1 IHTA has been made more complicated because it needed to deal with borrowing taken out to purchase UK property. Otherwise it would have been easy for a foreign dom to avoid the effect of the new provisions by simply borrowing from a trust or connected party to purchase the property and reducing the value of the UK property with the borrowing. The borrowing would then be held by the lender (whether trust or other individual) as an asset situated abroad or owned through a foreign company.

The legislation therefore needed to deal with debt either by disallowing it entirely or by bringing such loans into IHT. In the event, the draftsman chose the latter course. Hence debt can be deducted against the value of UK residential property but in the hands of the lender such loans can also be chargeable under paragraphs 3 and 4 of Schedule A1 IHTA.

Paragraph 4(1) of Schedule A1 IHTA defines "a relevant loan" as a loan where money or money's worth is made available under the loan and is used to finance directly or indirectly *the*

[11] IHTA Sch.A1 para.2(4).

acquisition, enhancement or maintenance by an individual, a partnership or the trustees of a settlement of UK residential property or the acquisition by such individual, partnership or trust of a close company which owns or acquires such property. A loan includes an acknowledgment of debt by any person as well as any other arrangement under which a debt arises. The legislation not only catches a person making a relevant loan but also charges any cash or other money's worth made available as security, collateral or guarantee for a relevant loan. Hence a settlor who borrows £1 million from a bank offering his or her portfolio of shares (£2 million in value) as security and buys a property worth £1.5 million with the borrowing, can claim a deduction of £1 million against the house leaving £500,000 chargeable but will find his or her portfolio is also charged to IHT up to £1 million in value. Therefore, overall the £1.5 million value represented by the house is still charged to IHT.

In determining whether a loan is a relevant loan it is necessary to look at: 1. the status of the borrower: is the borrower an individual, trust or partnership?; and 2. what the loan is being used for.[12] When looking at the purpose of the loan one has to consider if the loan is used to finance directly or indirectly the acquisition, maintenance or enhancement of a UK residential property interest. The legislation is drawn widely enough to catch loans initially used to acquire one asset such as foreign property which is then sold and replaced by a UK residential property interest. A loan taken out by a trust, partnership or individual to finance the acquisition of a company which already owns or acquires UK residential property is also a relevant loan.[13]

The residence status of the borrower is irrelevant. Thus a loan from one non-resident trust to another is a relevant loan if the borrowing trust uses the monies to purchase a UK residential property.

A loan ceases to be a relevant loan once the residential property interest is disposed of even if the loan is not then repaid. If the borrower uses the proceeds to buy another UK residential property then the loan resumes its status as a relevant loan. Otherwise on sale of the UK house the loan becomes excluded property again immediately.

If, however, the UK residential property is not sold but the loan is still repaid (or the company holding the property is sold and the loan is repaid) then the proceeds of the loan repayment in the hands of the lender will not be excluded property for two years.[14] If the loan remains outstanding but the borrower disposes of the company holding the UK residential property rather than selling the house itself, then the loan arguably still remains a relevant loan. It is only if the house itself is disposed of that the loan ceases to be a relevant loan.

The requirement that a loan is only a relevant loan and chargeable to IHT if it is taken out to purchase, enhance or maintain residential property generally prevents the same value being chargeable to IHT twice, once by reason of the relevant loan and once by reason of the gross value of the underlying UK residential property. The loan will be a deductible liability of the borrower and therefore reduce the value of the residential property that is charged to tax. Section 162A IHTA imposes a restriction on loans taken out to purchase excluded property but if the

[12] As noted above, corporate borrowing is not a relevant loan and instead the lender is a participator in the company and charged under IHTA Sch.A1 para.2.
[13] IHTA Sch.A1 para.4(1)(a)(ii) and (b) following a change from the original draft legislation.
[14] IHTA Sch.A1 para.5(1).

loan is taken out to purchase, maintain or enhance UK residential property or a company holding UK residential property then a deduction should be available.

Example 3

1. Mr A borrows from Lending Ltd which is owned by a trust of which Mr A is a beneficiary. He uses the loan to buy UK land. The loan is a relevant loan and Lending Ltd is therefore not excluded property. If the land is later sold by Mr A the loan immediately ceases to be a relevant loan even if not repaid. If Lending Ltd is sold before the property is sold the proceeds are not excluded property for two years.[15]
2. Mr B lends to a trust to enable it to buy property. The trust can deduct the loan against the value of the property when calculating its IHT position but the loan held by Mr B is a relevant loan.
3. Mr C lends to his son to buy an interest in a company which buys a property. This is a relevant loan. Note that if Mr C lent to the company direct to buy property this would not be a relevant loan but Mr C would have a loan creditor interest under paragraph 2 of Schedule A1 IHTA.
4. Mr D owns a company, D Ltd, which lends to his son to finance his business. Mr D's son grants a charge to the company over his UK house for the loan. This is not a relevant loan as it was not taken out to acquire UK residential property. The son already owned the UK property. The company holds the loan and it is excluded property.
5. Mr E lends to his non-domiciled son who already owns the UK land. This is not a relevant loan and the loan is not deductible for the son against the value of the UK property.[16]
6. Mr F lends to his son who is deemed domiciled in the UK. The loan is not a relevant loan and is not chargeable in Mr F's hands as it was not taken out to purchase UK property but it is deductible in the hands of Mr F's son against the property although the cash borrowed by the son will be an asset in his hands unless it is spent by the time of the son's death.
7. Mr G lends to his non-dom son to buy UK property. This is a relevant loan whether or not the property is charged. The son sells the UK property and buys a property in Portugal not repaying the loan. This is no longer a relevant loan. If the son does not sell the UK property but nevertheless repays the loan, the proceeds of the loan will cease to be relevant property and become excluded property in the hands of Mr H after two years.
8. A private closely controlled bank in Switzerland lends to unconnected investors to enable them to buy UK houses. These would seem to be relevant loans and the value of the company shares attributable to those relevant loans is chargeable on the death of each shareholder. Although unusual it is not unknown for banks to be

[15] IHTA Sch.A1 para.5.
[16] IHTA s.162A.

closely controlled and to avoid the impact of the new legislation the bank would need to check what the borrowing is used for and prevent customers borrowing to purchase an interest in UK residential property. Although it may be argued that business property relief is available in these circumstances to protect the participators from a charge on death the position may be more complicated and, of course, will require reporting to HMRC.

Collateral

A controversial area has been the extension of IHT to collateral that is given for a relevant loan. The wording of paragraph 3(b) of Schedule A1 IHTA is not entirely clear but presumably includes assets pledged or charged in support of a relevant loan or money made available as support for a guarantee. It is not entirely clear whether the asset in question has to be *formally* pledged or charged or needs simply to be available by way of set-off for the lender.

The provisions could operate unfairly in certain circumstances. For example, assume a company lends to an individual to enable them to purchase a house. The shareholder of the company offers security for the borrowing which is collateral. The individual owner of the house can deduct the loan from the value of their property but the company has made a relevant loan within the charge to IHT. In addition the collateral provided by the shareholder is also within the charge to IHT.

The legislation therefore really envisages that most collateral is offered to banks rather than close companies. For example, a bank lends to a trust to enable it to purchase property and the settlor offers some collateral in order to obtain the bank loan on more favourable terms for the trust. In these circumstances the trust will get a deduction for the loan but the collateral held by the settlor would be subject to IHT.

Note that collateral provided to support a loan *to* a close company is not caught as it is only collateral to support *relevant loans* that is within the scope of the charge. So, for example, if a company borrows from a bank to purchase residential property and that is backed by collateral from the shareholder such collateral is not subject to IHT. The bank loan is not a relevant loan as it is not taken out to purchase UK residential property by an individual trust or partnership and the bank is a loan participator but outside the scope of IHT (if not close).

The two year rule does not apply to collateral. For example, if a father provides collateral for bank borrowings taken out by his son to purchase residential property, once that collateral is released the father is outside the scope of IHT.

Paragraph 5 of Schedule A1 IHTA—disposals and repayments

Without paragraph 5 of Schedule A1 IHTA, it would be relatively easy to circumvent the legislation in certain deathbed situations. For example, suppose a father wholly owns a company which in turn owns a valuable London flat. The father, aware of his impending death, could give the company shares to his son but this would require him to survive seven years as the property is not excluded property. Instead the father sells the company shares to his son at full market value having first given the son cash abroad (which is a gift of excluded property) to enable the son to purchase the shares. Paragraph 5 aims to prevent this sort of deathbed planning.

Similarly, it would be relatively easy for a trust to avoid a 10 year anniversary charge by ensuring that just before the 10 year anniversary the relevant asset (the company holding the residential property) was sold to a beneficiary at full market value. No Stamp Duty Land Tax (SDLT) or non-residents CGT arises on such a sale so this can be done relatively easily.

Paragraph 5(1) of Schedule A1 IHTA therefore provides that where:

1. shares or loans in companies or partnerships holding UK residential property interests and relevant loans are disposed of for money or money's worth; or
2. relevant loans held by an individual or trust are sold for money or money's worth or are repaid,

such property is not excluded property for two years. If, however, by the time the company or partnership interest is sold or the loan is sold or repaid the UK residential property interest has been sold then the two year rule will not apply. The policy reason is clearly to encourage the sale of UK houses direct rather than the sale of companies. Sale of the property direct brings SDLT and CGT for the Government.

Example 4

1. A trust holds a company which owns residential property. The company sells UK residential property and the trust sells company shares shortly before the 10 year anniversary. The sale proceeds are excluded property as are the company shares because at the date of sale the company no longer held a UK residential property interest.
2. One year before the 10 year anniversary a trust sells a company holding UK property or a relevant loan to another trust for full market value receiving cash in full. The two year rule applies. The proceeds are not excluded property.
3. If the trust sold the company two years and one day before the 10 year anniversary then the two year rule would not apply and the proceeds are excluded property (subject to the provisions preventing tax avoidance arrangements—see below).
4. A trust holds cash from a sale per Example 2, above. The sale price of the company shares was £5 million and the trust invests the funds in a non-UK share portfolio. At the 10 year anniversary the portfolio is worth £6 million. The £5 million is not excluded property being caught by the two year rule but the additional £1 million growth is excluded property. If at the 10 year anniversary the portfolio is worth £4 million only £4 million is charged.
5. A father sells his company shares to his son and puts the proceeds on deposit in a separate bank account. He then spends the money buying a house in Hong Kong. The Hong Kong house is not excluded property for two years. If, however, the father immediately spent the money at the horse races or on medical care or entertainment the two year rule is not engaged.

It is not entirely clear what happens if the funds are mixed with other funds and then some funds are withdrawn. A tracing rule would appear to apply. It is therefore sensible that an individual who receives funds caught by the two year rule puts the proceeds into a separate account and spends them as soon as possible.

Paragraph 6 of Schedule A1 IHTA—tax avoidance arrangements (TAR)

The draftsman was not content to rely on the General Anti-Abuse Rule in the Finance Act 2013 (GAAR) but has inserted a specific anti-avoidance provision which is widely drawn:

> "In determining whether or to what extent property situated outside the UK is excluded property, no regard is to be had to any arrangements the purpose or one of the main purposes of which is to secure a tax advantage by avoiding or minimising the effect of paragraph 1 or 5."[17]

This therefore catches not only tax avoidance but tax minimisation. It is assumed this would not catch "ordinary" arrangements such as an individual choosing to borrow from a bank to purchase UK property rather than using their own cash resources.

Paragraph 7 of Schedule A1 IHTA—double taxation relief arrangements

The UK has only 11 double tax treaties covering IHT but without amendment it would have been possible for some to use these treaties to avoid the new charge. For example, someone domiciled in India may hold UK property through a foreign company. Under the treaty with India,[18] taxing rights would be given to India if the deceased individual was domiciled in India rather than the UK provided the company shares passed under a foreign disposition as the company is foreign situs. This is the case even though the property is not excluded property under Schedule A1 IHTA. India imposes no IHT on death despite having taxing rights.

Paragraph 7 of Schedule A1 IHTA therefore provides that double tax treaty arrangements cannot prevent a person from being liable under Schedule A1 IHTA if no tax of a similar character to IHT is charged by the treaty partner or tax is charged but the effective rate is 0 per cent otherwise than by virtue of relief or exemption. Thus the Indian, Swedish[19] and Pakistan[20] treaties which have no IHT or estate duty on death would not operate to protect the individual from an IHT charge under Schedule A1 IHTA. If the individual is domiciled in one of the cantons in Switzerland which imposes an IHT charge on assets passing to relatives on death then treaty protection should be available on enveloped UK residential property.

Enforcement and collection

Section 237 IHTA is amended to enable HMRC to impose a charge on the underlying UK residential property. This could bring some odd results.

[17] IHTA Sch.A1 para.6(1).
[18] The Double Taxation Relief (Estate Duty) (India) Order 1956 (SI 1956/998).
[19] Convention between the United Kingdom of Great Britain and Northern Ireland and the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains signed on 26 March 2015.
[20] Convention between the United Kingdom of Great Britain and Northern Ireland and the Islamic Republic of Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains signed on 24 November 1986.

Example 5

A mother who is resident in Hong Kong guarantees a loan from the bank to her son which is made in order to enable the son to buy a property in the UK. The mother gives security to the bank over non-UK investment assets and then dies. On the death of the mother HMRC will have a charge over the property owned by the son as security for the payment of IHT on the collateral even though the parent has no interest in the property and is not owed any money by the son and the son may not even inherit anything from his mother.

Future action points

The legislation does not catch gifts or transfers of value made prior to April 2017, even if the transferor dies within seven years. So, for example, if the settlor of a trust added a company holding residential property to a trust prior to April 2017, there is no IHT event at that point albeit the trust will now be within the relevant property regime. If the trust writes off loans made to a beneficiary to purchase residential property before April 2017, no exit charge will arise. However, if a trust writes off loans to beneficiaries taken out to purchase UK residential property after April 2017 (even if the loan was made prior to that date), an exit charge will arise as the loan is now a relevant loan or an interest in a close company. Therefore trustees should take particular care before dealing with loans.

Foreign doms will now need to consider the sort of IHT planning that has been followed for some years by UK domiciliaries, albeit foreign doms will have slightly greater freedom if they are not UK resident. This is because pre-owned assets income tax only applies to UK residents and it may therefore be easier for non-residents to avoid the reservation of benefit provisions.

For example, while HMRC have accepted that reversionary leases in principle work for IHT purposes (where the individual grants a long 300 year lease to take effect in, say, 20 years over their freehold interest and occupies the freehold rent free for the next 20 years), pre-owned assets income tax usually operates to deter the UK resident individual from implementing such a plan. A non-resident holding a London flat may be more interested in this sort of planning if, for example, they wish to retain the flat within the family but feel they are only likely to use it for the next few years.

For some foreign doms, trusts will still be attractive particularly where the settlor is dead or has been excluded and there is no reservation of benefit problem. The 6 per cent charge every 10 years may be seen as better than the 40 per cent charge on death and avoids certain succession issues imposed by forced heirship laws in those countries.

Where investment properties are purchased it may be worth considering using a widely held company, that is, getting together with other investors. The legislation only applies to close companies. Other suggestions may include insurance wrappers or cell companies but these are likely to fall foul of the new rule mentioned above[21] stopping tax avoidance arrangements or even GAAR.

Emma Chamberlain

[21] IHTA Sch.A1 para.6(1).

Close companies; Foreign domiciliaries; Inheritance tax; Loans; Residential property; Trusts