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KPMG in the Channel Islands

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Inheritance tax on UK residential property

From 6 April 2017, UK residential property owned through certain non-UK structures will be brought within the charge to UK inheritance tax ("IHT") regardless of the residence and domicile status of the ultimate owner. IHT charges will potentially arise on the death of non-domiciled individuals ("non-doms") following certain gifts made by them, or as settlors of trusts, as well as during the life of certain trusts established by them ('ten year anniversary' and 'exit' charges). This will be the case regardless of whether the individual is UK resident or non-UK resident.

Close companies and partnerships

Offshore companies will no longer provide an IHT shield for non-doms using them to hold UK residential property. The following assets will be subject to IHT to the extent that their value is attributable to UK residential property:

- Shares (or other interests e.g. loans) in non-UK companies that would be close companies if they were UK resident (i.e. controlled by 5 or fewer persons);
- Interests in overseas partnerships (whether of limited or unlimited liability); and
- Certain loans used to directly or indirectly finance UK residential property (see below).

Value subject to IHT and debts

Where an IHT charge arises on shares/ other interests under the new rules, the IHT will be calculated on the open market value of the shares/ other interests (to the extent that their value is attributable to UK residential property).

In determining the value of an interest in a close company, the liabilities of the close company will be attributed to all of its property pro rata. The liabilities attributable to the residential property will be deductible in determining the value within the scope of IHT.

Under the original proposals, debts that relate exclusively to the property were to be deductible when calculating the value for IHT purposes, unless the borrowing was from a connected party. However, the legislation published on 5 December 2016 stated that any debt used to finance the acquisition, maintenance or repair of UK residential property should be treated as an asset subject to IHT in the hands of the lender, with look through provisions where the lender is itself a non-UK close company/ partnership.

UK residential property

The rules will apply where the value of shares/ other interests is attributable to any UK residential property, whether that property is occupied or let and whatever the property's value (subject to limited exceptions such as care homes). A property which is being constructed or adapted for residential use will be treated as UK residential property. However, the rules will not apply to the extent that the asset's value is derived from commercial property.

Two year tail

Following the sale of close company shares/ partnership interests or repayment of a lender's loan which would have been within the scope of the new IHT rules, the consideration received (or anything which represents it) will continue to be subject to IHT for a 2 year period following the sale or repayment.

Targeted anti-avoidance rule

Any arrangements whose whole/ main purpose is to avoid or reduce the IHT charge on UK residential property will be disregarded. This anti-avoidance provision is extremely widely drawn.

Liability for IHT

Proposals to impose a liability for any outstanding IHT charge onto the directors of a company which holds a UK residential property have been dropped following the consultation.

Unwinding existing structures

There are no reliefs from other taxes, notably Capital Gains Tax and Stamp Duty Land Tax, where existing property structures are unwound. Those considering alternative ownership options in light of the changes will need to fully understand the tax implications of so-called "de-enveloping". In many cases, it will be advisable to de-envelope before 5 April 2017.

Timing

The new rules will apply to IHT chargeable events on or after 6 April 2017. Chargeable events will include the death of a shareholder of a company, a ten year anniversary of the creation of a trust, or in some cases the death of the settlor of a trust, where the settlor can benefit from the trust.

Conclusion

The proposed rules are widely drawn and encompass what previously appeared to be accepted planning and provide no relief to help people simplify complex property ownership structures.

Channel Island residents and trustees owning UK residential property through non-UK structures will need to identify them and consider the implications of these rules.

Should you wish to discuss this or any of the wider implications of the reform to the UK's non-dom regime, please contact your usual KPMG contact.

Contacts

John Riva
Head of Tax
KPMG, Channel Islands
jriva@kpmg.com

Jason Laity
Chairman
KPMG, Channel Islands
jlaity@kpmg.com

Tony Mancini
Tax Partner
KPMG, Channel Islands
amancini@kpmg.com

Paul Beale
Senior Manager, Tax
KPMG, Channel Islands
paulbeale@kpmg.com

www.kpmg.com/channelislands

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