

Offshore Structures, Inheritance Tax, and the "sting in the tail"

Historically, non-UK domiciled individuals would often choose to hold UK real estate through an offshore company (which may, in turn, have been held by offshore trustees) in order to avoid a charge to UK inheritance tax ("IHT") on that real estate.

The shares in such an offshore company were non-UK situs assets for the purposes of UK IHT and were therefore classified as 'excluded property' in the hands of the non-UK domiciled individual or trustees. There was no look-through to the underlying UK real estate.

However, changes to the legislation, which became effective from 6 April 2017, now bring all UK residential property whether held directly or indirectly within the scope of UK IHT. The legislation also brings certain loans used to purchase UK residential property within the charge to IHT.

Which UK property and associated interests are now within the charge to UK IHT?

The legislation is very widely drawn, and brings the following assets within the scope of UK IHT:

- Interests in non-UK close companies. This includes shares of and loans made to such companies and overseas partnerships which derive (directly or indirectly) their value from UK residential property. The value for IHT purposes is based on the shareholding or partnership interest and therefore minority interests may be significantly discounted. Interests of less than 5% (when aggregated with interests of connected persons) of the total value of the close company or partnership are disregarded.
- A loan used to acquire, maintain or enhance a UK residential property (a 'relevant loan') in the same way as a direct interest in a UK residential property. This includes loans made by a trust, partnership or an individual. Lenders will therefore need to be aware of what the loans are being used for. If they are being used to invest in UK residential property, this may give rise to an IHT liability in the hands of the lender.
- Any asset given as security, collateral or guarantee by a borrower, or a third party, in connection with a relevant loan, up to the value of the loan.
- The proceeds of a loan used to acquire any asset where that asset is sold and the proceeds reinvested in a UK residential property interest (either directly or indirectly).
- Directly held UK property

What can be done to escape the UK IHT net?

There are still some planning techniques which may reduce or eliminate exposure to IHT.

Individuals or Trustees will need to dispose of their interests in UK residential real estate if they do not wish for them to be within the scope of IHT. Some individuals and trustees may decide to dispose of such interests in order to reduce their exposure.



Even then, however, there is a potentially nasty 'sting in the tail' in the legislation, which states that the proceeds of disposal of certain UK residential property interests will continue to be classified as UK situs assets (and therefore within the scope of UK IHT) for a period of two years following the disposal.

What is the scope of the two-year tail?

In circumstances where the shares of a non-UK company or an interest in a non-UK partnership that holds UK residential property are sold, the sale proceeds remain within the scope of inheritance tax for the following two years.

In addition, where a loan is advanced and used by the borrower to invest in UK residential property, or assets are used as security for such a loan, and the loan is repaid or the security/guarantee released, the consideration received (or any asset purchased with that consideration) will continue to be subject to IHT for a two year period following the loan repayment or release of security.

On the other hand, where the UK residential property itself is disposed of, then different rules apply.

If the non-UK company or non-UK partnership disposes of the underlying UK residential property, the value of those interests will immediately cease to be relevant property for UK IHT purposes and there will be no two-year tail.

Similarly, where loans were advanced or security given and those were invested in UK residential property, such loans or security will cease to be 'relevant loans' (and will therefore cease to be within the scope of IHT) from the date of disposal of the property.

What are the implications of the two-year tail?

The two year tails means that;

- Trustees need to consider disposals more than two years before the occasion of the 10-year anniversary of the Trust or any planned distribution to beneficiaries.
- Individuals will not be able to make so-called "death bed disposals" to avoid IHT.

How can Verfides help?

Our team of experts is ready to help you with:

- Understanding the exposure of existing structures to UK IHT (and other taxes)
- Providing advice on the most effective ways to manage such an exposure
- All aspects of the taxation of UK real estate ownership, acquisition, disposal and succession planning

Please speak to your usual contact if you have any questions about Inheritance Tax or email tax_team@verfides.com .

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