

# Written Evidence for House of Commons Public Bill Committee

Submitted on 18 October 2017 by Taylor Wessing LLP

## Finance Bill 2017-19 – Clause 33 and Schedule 10

### 1. Introduction

- 1.1 Taylor Wessing LLP is a full service, international law firm, with 33 offices worldwide.
- 1.2 This briefing outlines an issue we have identified in relation to the proposed inheritance tax ("IHT") changes affecting UK residential property held in offshore structures as set out in Clause 33 and Schedule 10 of the Finance Bill 2017-19 (the "**Bill**").
- 1.3 Our concern relates to offshore companies operating private banking businesses that are closely-held being caught by the new IHT rules to the extent that the shares in such companies derive any value from loans made in the ordinary course of a banking business to unconnected borrowers to finance the acquisition, maintenance or enhancement of UK residential property. We outline this further below, at paragraph 3.
- 1.4 We would query whether this application of the new IHT legislation is intended having regard to the stated purpose of the changes, or whether this application is an inadvertent consequence of provisions of the draft legislation included to counter potential methods to avoid the application of IHT to arrangements that are intended to be caught. If this is not the intention then we would request that consideration be given to including within Schedule 10 of the Bill, before it receives Royal Assent, an exemption for companies carrying on banking business that are closely-held and that derive value from loans in relation to UK residential property when made to unconnected borrowers in the ordinary course of carrying on such business.
- 1.5 The aim of including an exemption would be to avoid introducing a financial penalty for any offshore closely-held banks involved in a UK residential property lending business as compared to competitors in the same market that are not closely-held.
- 1.6 If consideration is given to introducing such a targeted exemption, we note that a similar form of exemption forms part of certain existing tax legislation, as we outline further in paragraph 5.

### 2. Changes to IHT regime

- 2.1 Currently, under section 6(1) Inheritance Tax Act 1984 ("**IHTA 1984**"), any property situated outside the United Kingdom constitutes "excluded property" for IHT purposes, if the person beneficially entitled to it is an individual domiciled outside the United Kingdom. This means that shares in an offshore company held by an individual who is foreign domiciled for IHT purposes are not subject to IHT on their death.
- 2.2 Schedule 10 of the Bill, however, extends the scope of IHT to UK residential property held in certain offshore structures (including close companies), regardless of the domicile of the ultimate beneficial owner. It does so by amending the definition of excluded property in the IHTA 1984. The changes mean that shares in an offshore close company which holds an interest in UK residential property will be subject to IHT on the death of a non-UK domiciled shareholder (to the extent that the value of the close company's shares is derived from the UK residential property). These changes will take effect retrospectively from 6 April 2017.

- 2.3 Schedule 10 also brings rights to repayment which relate to certain loans within the scope of IHT. Broadly, the "relevant loans" are loans which are used to finance the acquisition, maintenance or enhancement of UK residential property. To the extent that shares in offshore close companies derive their value from the repayment rights to these loans, they will be within the scope of IHT.

### **3. The issue**

- 3.1 The new IHT rules do not only apply to loans used to finance the acquisition, maintenance or enhancement of UK residential property that are made to connected or related borrowers.
- 3.2 This measure of the new IHT rules is ostensibly designed to prevent UK residential property owners from depressing the value of their UK residential property liable to IHT by using borrowings from connected or related entities. However, as the new IHT rules do not only apply to loans made to connected or related borrowers, shares in offshore close companies will be subject to IHT to the extent they derive any value from any relevant loans, whether the borrowers are unconnected or not to the lenders.
- 3.3 Certain banks, which are privately held close companies, could therefore be caught by these rules, presumably inadvertently. For example, if an individual (who is non-UK domiciled for IHT purposes) owns a private bank (which is an offshore close company or a company that forms part of a group that is ultimately closely held via an offshore holding company) and the bank provides residential mortgage loans as part of its ordinary course of business, and some of the loans in question are made to customers to fund their purchase (etc) of UK residential property, to the extent that the relevant company's shares derive value from these loans, such value will form part of the individual's estate subject to IHT.
- 3.4 The ultimate outcome of the new IHT rules applying in this way would be to distort the banking industry in the UK by introducing a financial penalty for such closely-held banks operating in competition with other banks in offering UK residential property loans to customers as part of their ordinary business.

### **4. Business Property Relief**

- 4.1 It is acknowledged that the IHT rules include a specific relief, namely business property relief ("**BPR**"), which could in principle provide relief from IHT in these circumstances. However, this relies on BPR being available at the relevant time in the future (and not having been removed or restructured in any way) and the relevant shares satisfying the required conditions for the relief to apply.
- 4.2 Relying on BPR may create difficulties where subsidiaries of a holding company are making relevant loans (which will be within the scope of IHT), whilst other subsidiaries of the holding company are carrying on investment and other business activity. The danger here is that, at the relevant time (i.e. on the death of the ultimate shareholder), a group that includes different business and investment activities, including a banking business and trading businesses but also investment holdings, may not be viewed as a whole meeting the requirements for BPR.

### **5. Potential exemption**

- 5.1 On the assumption that it is not the intention of the Government from a policy perspective in enacting the above changes to the IHT regime to catch arm's length banking business activity of this kind, we would suggest that consideration is given to

the inclusion of an exemption for shares in companies to the extent that they derive value from residential property lending to unconnected borrowers in the ordinary course of a banking business, in order that closely-held private banks are not inadvertently caught by the new IHT rules in this way.

- 5.2 We note in this regard that the Government has in the past included a targeted exemption from the operation of the disguised remuneration legislation for banks lending in the ordinary course of business (see section 554F of the Income Tax (Earnings and Pensions) Act 2003). If the Government is minded to include an exemption for closely-held private banks from the operation of the new IHT rules then the exemption in the disguised remuneration legislation may provide a good starting point for the drafting of suitable additional legislation for inclusion in Schedule 10 of the Bill.

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18 October 2017