United Kingdom Inheritance Tax Changes: To De-Envelope Or Not?

Summary:

» the United Kingdom ("UK") government has recently confirmed that non-domiciles who hold residential property via an offshore company will be subject to inheritance tax from 6 April 2017;

» we understand that this is the latest in a raft of changes to the UK tax regime of non-domiciles designed to eradicate the previous advantages of owning UK residential property via offshore companies;

» we are assisting clients ‘de-envelope’ their UK residential properties (i.e. transferring the property out of the offshore company’s ownership) by way of voluntary liquidation in both the British Virgin Islands ("BVI") and the Cayman Islands; and

» given the imminent date of implementation, and the lead time to complete such transactions, we are seeing an increase in the number of properties being de-enveloped by way of voluntary liquidation in both the BVI and the Cayman Islands.

Consultation

The UK Government’s publication1 on 19 August 2016 of its consultation on further reforms to the taxation of non-domiciles (i.e. those individuals not domiciled in the UK), whether resident or not, make it clear that from 6 April 2017, residential property in the UK held by non-UK companies (and partnerships) will be subject to UK inheritance tax ("IHT").

Changes

We understand that the key changes are as follows:

» UK residential property held through non-UK companies and partnerships will be subject to IHT from 6 April 2017. The value of the shares in the non-UK company will be subject to IHT where all or part of that value derives from UK residential property.

» Both individual shareholders and trustee shareholders will be affected.

» Properties that are let to tenants will be caught.

» Directors of non-UK companies will be personally liable for reporting chargeable events to HMRC and for paying any outstanding inheritance tax.

» Debts relating exclusively to the property (e.g. outstanding mortgages) will be allowable when determining the value chargeable to IHT. However, loans between connected parties will be disregarded when determining the value of the property which will be chargeable to inheritance tax.

De-enveloping the UK residential property

We understand that the changes will mean that investors must now consider the most appropriate long term strategy and holding structures for UK residential property.

It may be that given these changes, clients will decide to ‘de-envelope’ the property by way of voluntary liquidation, for example by distributing the property in specie to the owners of the offshore company. If this option is pursued, Walkers can assist in:

- liaising with UK tax professionals to ensure that the correct arrangement is put in place for your particular needs;
- advising as to the benefits of BVI or Cayman Islands trust structures which may, subject to the facts of the particular matter, provide a suitable alternative holding structure;
- if it is determined that the correct route forward is to ‘de-envelope’ the property, we can advise on the requirements of the company's constitution and BVI or Cayman Islands corporate law with regard to the making of a distribution in specie;
- preparing liquidation documents and arranging for the appointment of a BVI or Cayman Islands qualified insolvency practitioner to act as liquidator of the company; and
- preparing a legal opinion to the UK Land Registry as to whether the voluntary liquidator was validly appointed.

Benefits of BVI and Cayman Islands Companies

There are of course continued benefits for international investors in holding investments through a BVI or Cayman Islands company. These advantages include:

- Ownership remains confidential. An alternative to holding through a company is to hold property through a nominee to protect the confidentiality of beneficial ownership. The BVI or Cayman Islands company's registered agent is required to conduct a robust level of ‘know your client’ enquiries, but this information is not publicly filed or publicly available to third parties.
- When a property is mortgaged, BVI or Cayman Islands holding companies are familiar to lenders, meaning that taking and registering security and obtaining priority over subsequent creditors is cost effective and predictable. Where the property held is subject to a mortgage, and/or is a long leasehold, the liabilities under the mortgage or lease will be those of the company and not the shareholder.
- Using a BVI or Cayman Islands company gives opportunities for succession planning, for example through joint ownership of shares, bespoke class rights and providing for the transmission of shares.
- The BVI, in particular, and the Cayman Islands has low incorporation and annual maintenance costs.

Disclaimer

We are not qualified UK tax lawyers and the above is not intended to be, and should not be read as, UK tax advice. We are Cayman Islands and BVI attorneys at law and can assist on matters concerning those jurisdictions.

The interaction of the various UK taxes involved is complicated and specific advice from UK qualified tax professionals should be sought prior to effecting any changes to current holding structures of UK residential property.
Authors
If you have any questions, please contact a member of the London Insolvency & Dispute Resolution team.

John O’Driscoll
Partner - London
T: +44 (0)207 220 4987
E: john.o’driscoll@walkersglobal.com

Paul Goss
Senior Associate - London
T: +44 (0)20 7220 4985
E: paul.goss@walkersglobal.com

Cate Barbour
Associate - London
T: +44 (0)20 7220 4970
E: cate.barbour@walkersglobal.com

Contacts
Click here for our global Insolvency & Dispute Resolution contacts

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