These notes refer to the Finance Act 2014 (c.26) which received Royal Assent on 17 July 2014

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 117 and Schedule 25: Inheritance Tax

Summary

1. This Schedule makes a number of amendments to the Inheritance Tax Act 1984 (IHTA). The Schedule:

   a. Extends the freeze on the inheritance tax (IHT) nil-rate band at £325,000 until 2017-18.

   b. Ensures that funds in foreign currency accounts in UK banks which are disregarded for inheritance tax (IHT) purposes in determining the value of a person's estate on death are treated in a similar way to excluded property for the purposes of restricting the deduction of a liability.

   c. Introduces a new provision to treat income arising in "Relevant Property" trusts which remains undistributed for more than five years as part of the trust capital when calculating the ten year anniversary charge; and

   d. changes the dates by which trustees must deliver an Inheritance Tax (IHT) account and pay tax due for charges arising under Chapter 3 of Part 3 of IHTA.

Details of the Schedule

Rate bands for tax years 2015-16, 2016-17 and 2017-18

2. Paragraph 2 disapplies section 8 of IHTA for the tax years 2015-16, 2016-17 and 2017-18. Section 8 applies if the consumer prices index (CPI) for September is higher than it was for the previous September, and provides for an increase in the nil-rate band from the following April by the same percentage as the increase in CPI (rounded up to the nearest £1,000). The effect of the section is that the nil-rate band is not increased for the years 2015-16 to 2017-18 inclusive.

Treatment of certain liabilities

3. Paragraph 3(1) inserts new section 162AA into IHTA.

4. New section 162AA sets out how liabilities attributable to financing non-residents' foreign currency accounts will be treated.

5. New section 162AA(1) explains that the section applies where a balance on a qualifying foreign currency account (the "relevant balance") is to be left out of account under section 157 IHTA in determining the value of a deceased person's estate, and that person had borrowed money which was held in that account or had a liability which indirectly financed the funds held in that account. Section 157 provides that balances on UK bank accounts denominated in a foreign currency held by an individual who is not domiciled and not resident in the UK immediately before death will not be taken into account in determining the value of that person's estate.

6. New section 162AA(2) provides that the liability may only be allowed as a deduction to the extent permitted in subsection (3). This subsection therefore disallows the liability if the borrowed money financed the relevant balance, unless it is allowed by subsection (3).

7. New sections 162AA(3) and (4) provide that if the if the liability exceeds the relevant balance, the excess may be allowed as a deduction as long as the excess has not arisen as a result of tax avoidance arrangements as defined in subsection (5) or due to manipulation of the value of the liability.

8. Paragraph 3(2) makes amendments to section 162C of IHTA which contain supplementary provisions for sections 162A and 162B.

9. Paragraph 3(3) and (4) make consequential amendments as a result of the insertion of new section 162AA.

10. Paragraph 3(5) inserts new subsection 162C(1A) which provides a priority order for how a partial repayment of the liability before death should be applied when determining the value of an estate on death. The repayment is applied first to any part of the liability that was not attributable to excluded property or to property which qualifies for relief (relievable property) or to relevant balances, then to any part used to finance relievable property, then to any part attributable to relevant balances, and finally to any part attributable to excluded property. The effect of this subsection is that any part of the liability which might be allowable as a deduction is treated as paid off before any part which would be restricted or disallowed.

11. Paragraph 3(6) makes consequential amendments to section 162C(2) which provides a similar priority rule for partial repayment of the liability in cases other than on death. In these cases, section 157 does not apply so any part of a liability that was attributed to financing a relevant balance is treated as paid off before any part which would be restricted or disallowed.

12. Paragraph 3(7) inserts new paragraph 175A(7)(aa) into section 175A of IHTA which deals with partial repayment of liabilities after death. Where a liability has been partially repaid after death, the new paragraph specifies that any part of the liability attributable to relevant balances is taken to be repaid after any part which is attributable to excluded property, but before any part which is attributable to relievable property.

13. Paragraph 3(8) explains that the amendments have effect for transfers of value made, or treated as made, on or after the date of Royal Assent to Finance Act 2014.

Ten year anniversary charge

14. Paragraph 4 adds new subsections (1A), (1B) and (1C) to section 64 of IHTA.

15. New subsection (1A) sets out the conditions for treating property held by the trustees of a settlement as part of the trust capital when calculating the ten year charge (the deeming rule). Those conditions are that the property is income of the settlement, it arose before the start of the five years ending immediately before the ten year anniversary, it arose from relevant property comprised in the settlement and when the income arose no person was beneficially entitled to an Interest in Possession in the underlying property.

16. New subsection (1B) excludes from the deeming rule (in the case of settlements made by persons not domiciled in the UK) income which arose from relevant property but is at the ten year charge represented by property situated outside the UK or is represented by a holding in an Authorised Unit Trust or Open-Ended Investment Company.

17. New subsection (1C) excludes from the deeming rule income which arose from relevant property but which is reinvested in exempt gilts which would (if properly treated as accumulated income) be excluded property.

18. New subsection (1C)(b) ensures that that exempt gilts within a settlement will only be excluded property where all the beneficiaries who could ever become entitled to capital or income from the settled property meet the necessary condition.

19. Paragraph 4(2) amends section 66 of IHTA and adds new subsection 2A. The effect of the amendment is that income brought within the charge as a result of s 64(1A) is charged to tax at the full rate in section 66(1).

20. Paragraph 4(3) provides for the changes to apply to tax charges arising under section 64 IHTA on or after 6 April 2014.

Delivery of account and payment of tax

21. Paragraph 5(1) adds a new paragraph (ad) to subsection 216(6) of IHTA. The effect of paragraph (ad) is that trustees of settlements on which tax is chargeable under Chapter 3 of Part 3 of IHTA, must deliver the IHT account six months after the end of the month in which the chargeable event occurs.

22. Paragraph 5(2) adds a new subsection (3C) to section 226 of IHTA. The effect of subsection (3C) is that the due date for payment of tax chargeable under Chapter 3 of Part 3 of IHTA 1984, is six months after the end of the month in which the chargeable transfer is made. Subsection (3C) does not affect the provision at section 226(3B) which sets out the payment date where a settlor dies within seven years of a transfer and additional liability arises under Chapter 3 of Part 3 IHTA.

23. Paragraph 5(3) amends section 233 IHTA (interest on unpaid tax) to bring it into line with the new payment date.

24. Paragraph 5(4) provides for the changes to apply to tax charges arising on or after 6 April 2014.

Background Note

Rate bands for tax years 2015-16, 2016-17 and 2017-18

25. The rates of IHT are set out in the Table in Schedule 1 of IHTA. The IHT nil-rate band is the amount below which no IHT is charged. It is automatically indexed in line with inflation each year unless the Government decides otherwise and has generally increased every year up to 2009-10.

26. Section 8 of Finance Act 2010 set the limit of the nil-rate band at £325,000 for the years 2010-11 to 2014-15 inclusive.

27. At Budget 2013 the Government announced that the nil-rate band would remain frozen until 2017-18. This supersedes previous announcements.

Treatment of certain liabilities

28. IHT is normally charged on the net value of a deceased person’s estate after deducting liabilities outstanding at the date of death, reliefs, exemptions and the nil-rate band. Property which is situated outside the UK and which belongs to, or was settled by, a non-UK domiciled individual is ‘excluded property’. It does not form part of a person’s estate and is not chargeable to IHT.

29. New provisions in section 162A IHTA introduced by Schedule 36 of Finance Act 2013 disallow a deduction for a liability if it has been used directly or indirectly to acquire excluded property, or to maintain or enhance such property, except in a few specified circumstances, because the excluded property is not chargeable to IHT.

30. Balances in a UK bank account which is denominated in a foreign currency and which are not taken into account in determining the value of a person’s estate on death are not chargeable to IHT yet are not excluded property. They would therefore not be affected by the provisions in section 162A and could still be used to allow an individual to secure a debt against property situated in the UK to reduce its value for IHT purposes, but retain the borrowed money in such a way that it was not subject to IHT.

31. The amendments made by this section will prevent the use of foreign currency accounts held by an individual who is not domiciled and not resident in the UK as a means of sidestepping the new provisions in section 162A.

Ten year anniversary charge

32. Where income is regularly or formally accumulated there is little doubt about the correct treatment of the accumulations within the calculation of relevant property charges. But it can be different where income remains undistributed for long periods and the trustees have not made any formal accumulation. In such cases there can be uncertainty about how the calculations should be undertaken, resulting in questions to, or correspondence with, HMRC to establish an acceptable treatment.

33. New s64(1A) will treat income that has remained undistributed for more than five years at the date of the ten year anniversary as if it was part of the trust capital for the purposes of the ten year anniversary charge. To avoid the need for trustees to keep very detailed records, tax would be charged on the ten year anniversary at the full rate on any such undistributed income without any proportionate reduction to reflect the period during which the income has been retained.

Delivery of account and payment of tax

34. The time limits for reporting IHT periodic and exit charges arising under chapter 3 part 3 of IHTA that trustees are accountable for differ from the time limits for paying any IHT due under chapter 3 part 3 IHTA.

35. The time limit for delivering an account is currently 12 months from the end of the month in which the transfer is made or if later, three months from the date when the trustee first becomes liable for the tax.

36. The time limits for paying IHT charges are:

    - For chargeable events after 5 April and before 1 October, on 30 April in the following year, and
    - for chargeable events after 30 September and before 6 April, six months after the end of the month in which the chargeable event took place.

37. This change aligns and simplifies the filing and payment dates for these charges.