

# UK RESIDENTIAL PROPERTY: PERSONAL USE

## BACKGROUND

---

Until recently non-UK domiciles would typically acquire UK residential property through offshore companies, even where the property was for personal occupation rather than investment. For UK domiciles offshore companies, and offshore structures generally, have been ineffective for tax planning in this area for many years. Holding a UK residential property through an offshore company effectively provided a non UK domicile with a mechanism to avoid UK inheritance tax (IHT). It also meant that a future buyer could purchase the shares in the offshore company and avoid stamp duty land tax (SDLT). But since April 2015 the Government has introduced new capital gains tax (CGT) and IHT charges which affect all types of foreign purchaser be it a company, trust, partnership or individual.

## PLANNING

---

### UK Domiciles

Structures should generally be avoided save in exceptional cases. As a general rule, UK domiciles should acquire property that they will use personally in their own name.

### Non UK Domiciles

The position is different for non-domiciles as they are able to contribute an unlimited amount of overseas capital into a trust without consequence to UK IHT. Non domiciles who are non UK resident can set up an overseas trust with overseas assets without any UK tax or UK reporting issues. The position should be the same for a non UK domicile who is UK resident and not deemed domiciled.

## THE CARVE OUT TRUST SOLUTION

---

The settlor (i.e. the client) will establish an interest in possession (IIP) trust under which he is the life tenant. He will settle 35%- 50% of the purchase price into the IPP. He will also transfer the funds required for the administration, legal fees and SDLT for the purchase. The settlor will be the life tenant which provides the right to use the property but he will be excluded as a capital beneficiary which means he has no right to receive any of the proceeds from a future property sale. His wife and children would typically be discretionary beneficiaries with the right to use the property and receive distributions of capital at the trustee's discretion.

The trustees of the IIP trust will take out a loan from a third party bank which will provide the remaining funding for the prospective property (i.e. between 50% to 65% loan to value). This lender will hold first legal charge over the property. The trustees of the IIP trust will acquire the property using the monies from both the bank loan and the settlement into the IIP.

The beneficiaries will use the property from the date of acquisition. The ideal solution is from a number of family members to use the property as their main residence over time, thereby maximising the availability of main residence relief from CGT.

## SUMMARY OF THE TAX TREATMENT OF THE PURCHASE BY THE TRUSTEE

---

- **SDLT** at the progressive rates. The 3% surcharge will apply unless the life tenant does not own any other property around the world or the purchase of the UK property by the trustee replaces the life tenant's main residence sold within 3 years before the date of the UK purchase.

- **No ATED**
- **CGT at 28%** in the future but the gain may be reduced or extinguished by the application of main residence relief.
- **Ten year anniversary charge** but only if the property is still held by the trust at that date. No charge if the property is sold before the ten year date and proceeds of sale deposited overseas. No exit charge either. If the property is held at the 10 year date then the charge will be on the property minus bank debt. Rate is likely to be 3-4% in most cases; max rate is 6%.
- **Should be no IHT** on the settlor's death under the carve-out principle. Should not be affected by the new IHT provisions as the IIP trust is not an excluded property trust. No IHT on the death of any other beneficiary.

## CASE STUDY

---

Mr Hopkins has resided in Hong Kong for the past 30 years. He obtained a domicile ruling from HMRC in 2005 that he had acquired a HK domicile of choice. He has not owned a UK property during that period but he is interested in acquiring a property in the UK which his three children can use while they study at university, expected to be in the UK. Mr Hopkins and his wife will use it sparingly and their intention is to remain in HK, in the family home. He is advised by UK tax counsel that the acquisition of a UK property in these circumstances will not affect his domicile status provided he remains resident in HK and does not become UK resident.

Mr Hopkins establishes an interest in possession trust (the IIP trust) with £1.8m and he is the life tenant of the IIP Trust but excluded as a capital beneficiary; his wife and children can benefit from the trust income and capital.

The IIP trust acquires a UK residential in central London property for £3.2m (which is comprised of £1.3m of capital settled and £1.9m from the bank loan in March 2018). The trustees pay the SDLT and SDLT surcharge which in total amounts to £393,750, plus £50,000 to cover legal expenses and for future administrative expenses. Hence the total settled into the trust is £1,750,000.

On the ten year anniversary of the trust, the property is worth £4m and the bank debt is £1.6m. The trustees pay the ten year charge of £74,712.00 (£2,400,000 taxed @ 3.113%).

The IIP owns the property for 12 whole tax years. Two of the three children study in the UK and use it as their main residence for a period totalling seven years (from April 2018 to April 2025). In two tax years (2028/2029 and 2029/2030) Mr Hopkins and his wife combined spend 92 and 94 days in the property. The trustees are advised that 75% of the capital gain will benefit from main residence relief. The trustees sell the London property for £5m realising a capital gain of £1.8m of which £450,000 is taxed @ 28% (tax to pay of £126,000).

The IIP purchases a new property in the Cotswolds for £4m and advances the £1m surplus to Mrs Hopkins.

Two years later Mr Hopkins dies and his interest in possession ends. There should be no UK IHT charge on his death. The IIP is now a discretionary trust, the beneficiaries of which are the three children and Mrs Hopkins.

The trustees sell the UK property a year later and realise no gain. The £4m is deposited overseas without any charge. The trust is now a standard excluded property trust that will permanently be outside the scope of UK IHT.

---

<sup>4</sup> £4,000,000 less £1,600,000 = 2,400,000 less £325,000 = £2,075,000 taxed @ 20%.

£415,000 / £4m x 100 = 10.375 (effective rate)

10.375 x 0.3 = 3.113% (actual rate)

