IHT DEDUCTION FOR DEBTS ATTRIBUTABLE TO EXCLUDED PROPERTY POST 2013

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References in footnotes are to Taxation of Non-Residents & Foreign Domiciliaries (12th Ed, 2013)

Section 162A IHTA, introduced by Finance 2013, provides:

> (1) To the extent that a liability is attributable to financing (directly or indirectly)—
>
> (a) the acquisition of any excluded property, or
>
> (b) the maintenance, or an enhancement, of the value of any such property,
>
> it may only be taken into account so far as permitted by subsections (2) to (4).

I refer to this as **"the excluded property disallowance"**.

The disallowance can apply to individuals and to trustees, on death and on other occasions of charge.

1. *Commencement of excluded property disallowance*

Para 5 Sch 36 FA 2013 provides:

> (1) Subject to sub-paragraph (2),[2] the amendments made by this Schedule have effect in relation to transfers of value made, or treated as made, on or after the day on which this Act is passed [17th July 2013].

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2 This relates to the business/agricultural property disallowance: see 65.16.4 (Commencement of BPR/APR disallowance).

So the new rules applies to pre-2013 debts, if the transfer of value is after enactment. This is an unfair commencement rule as in many cases, including those without any tax avoidance, existing liabilities will have been incurred in reliance of the pre-2013 rules. But there it is.

"Financing" the acquisition of excluded property

What is meant by the expression "financing" an acquisition? It is suggested that it should be widely construed.

Suppose T enters into a contract to purchase excluded property and the purchase price remains outstanding. The liability is attributable to financing the acquisition of the excluded property. It appears that HMRC agree. The IHT Manual provides:

> **IHTM28018 Restricted deductions: meaning of 'indirectly' where money has been borrowed to acquire excluded property**
> …
>
> *Example 2* (Florence)
>
> F, who is domiciled outside the UK, agrees to buy a property overseas. The vendor agrees that the purchase price does not need to paid immediately and can be treated as loan from the vendor to the purchaser. F secures the loan against a property she owns in the UK. The consideration for the liability owed to the vendor is the foreign property, so the liability has directly financed the acquisition of excluded property and cannot be deducted against the UK property.

What about borrowing to pay the incidental costs of acquiring excluded property, such as foreign stamp duty? It is suggested that this is not disallowed.

If a person borrows to pay for services, the debt is not disallowed (unless the services relate to maintenance/improvement of excluded property).

Suppose:

(1) T borrows to acquire excluded property ("debt 1").

(2) T borrows to pay interest on debt 1 ("debt 2").

It is tentatively suggested that debt 2 is not incurred in financing the acquisition.

More commonly, the interest will be added to the acquisition debt, i.e. there will be one single debt; it is arguable that the debt is disallowed to the extent it reflects the acquisition cost, but not to the extent it reflects interest. However the drafter seems to have assumed that an increase in the debt due to interest is in principle caught: see 65.22.5 (Disallowable reason 2: increase in liability).

Maintenance/enhancement of the value of excluded property

The IHT Manual provides:

> **IHTM28012 Restricted deductions: meaning of 'maintain' and 'enhance'**
>
> The words 'maintain' and 'enhance' extend the scope of the provisions beyond simply buying either excluded property (IHTM28013) or assets that qualify for relief (IHTM28019).
>
> Both words have their normal meaning and you should not try to extend their meaning just to apply the restrictions on deducting liabilities. 'Maintain' means to keep in good or proper order, and 'enhance' means to improve or augment. These words are most likely to be used in connection with borrowing money to maintain or enhance buildings.
>
> Where a person borrows money instead of using their own money to acquire assets, it could be said that they have 'maintained' the value of their own assets. So if they were not domiciled in the UK and held most of their assets abroad, borrowing against UK assets could be said to be 'maintaining' the value of excluded property.

The suggestion is far-fetched, and HMRC agree:

You should not disallow the deduction of a liability on these grounds.

"Indirectly" financing

The IHT Manual provides:

> **IHTM28018 - Restricted deductions: meaning of 'indirectly' where money has been borrowed to acquire excluded property**
>
> The word 'indirectly' at IHTA/S162A(1) significantly broadens the scope of the provisions. It reduces the possibility of avoiding the restrictions at IHTA/S162A(1) by inserting a step or steps in the process of acquiring excluded property with the borrowed funds. As with the pre-owned assets charge (IHTM44005),[3] it is not necessary to show any intention that the funds should eventually be converted into excluded property when a loan was taken out. Inserting steps in an attempt to disguise the true nature of a transaction will be a strong indicator of indirect financing. And the acquisition of assets of any nature as part of a sequence of transactions that ends with the acquisition of excluded property will not necessarily be sufficient to prevent the deduction being disallowed.

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3 This relates to the meaning of the word "provide": see 76.6 ("Provide"). That sheds no light on the issue discussed here.

"Not necessarily" is not exactly guidance. HMRC go on to cite a case:

> In *IRC v Stype Investments (Jersey) Ltd* (1983) Unreported, but see Capital Taxes News & Reports, March 1987 Vol 7, No.17; Vinelott J observed that the word 'indirectly' was used to make it clear that the (Inland Revenue) charge extended not only to the proceeds of sale of property subject to the charge and to property purchased with those proceeds (which may be said to represent that property 'directly') but also to any property into which the property subject to the charge or the proceeds of sale can be traced. Whilst this view may (?) have been expressed in connection with an administrative process, it shows the potentially broad scope of the word. There is no number of steps or a timescale beyond which borrowing money can be regarded as safe from being attributed to the acquisition of excluded property. And there is no statutory let-out where the taxpayer can show that at the time the loan was taken out; there was no intention to convert the borrowed funds into excluded property. But although the word 'indirectly' has a broad meaning, in the context of this provision, it must be possible to reasonably attribute the acquisition of the excluded property to the borrowed funds before the deduction of the loan is disallowed. Each case will turn on its own facts.

This is an important question. Suppose:

(1) T borrows to acquire an asset ("asset 1").

(2) T sells asset 1 and uses the proceeds to acquire another asset ("asset 2").

Is it the case that the liability is "attributable to financing indirectly the acquisition of asset 2? I would have thought that was the case if the steps formed part of an arrangement, but not otherwise.

The case cited does not shed any light on our issue. The article in Capital Taxes News and Reports provides:

> The fourth case, which was decided on 15 November 1983 but was not immediately reported, is *CIR v Stype Investments (Jersey) Ltd*, CTTL 26. This was an application by the defendant company ('Stype Investments') to vary a Mareva injunction freezing its assets in the United Kingdom. The company wished to use its assets to discharge a judgment debt in favour of the Official Solicitor.... The Inland Revenue opposed the application, on the ground that the company's UK assets were insufficient to meet the claims for CTT, so that the company ought to pay the Official Solicitor out of its other assets. The case is primarily concerned with enforcement procedure, an arcane subject well outside the mainstream of CTT law; but it contains some interesting points, particularly with reference to the Inland Revenue charge under IHTA 1984, s 237. ...

Section 237 IHTA provides:

> (1) Except as otherwise provided, where any tax charged on the value transferred by a chargeable transfer, or any interest on it, is for the time being unpaid a charge for the amount unpaid (to be known as an Inland Revenue charge) is by virtue of this section imposed in favour of the Board on—
>
> (a) any property to the value of which the value transferred is wholly or partly attributable…
>
> (2) References in subsection (1) above to any property include references to *any property directly or indirectly representing it*.

The passage continues:

> The Inland Revenue had a charge under s 237(1) on the company's shares which Sir Charles had settled on himself for life, and under s 237(2) on 'any property directly or indirectly representing' those shares. [The Revenue] argued that s 237(2) must be read as extending the charge to the underlying assets of the company.

This was a hopeless argument and met with no success:

> Vinelott J was not persuaded that this was a tenable construction. In his judgment subs (2) was not intended and was not apt to create a double charge in such circumstances.

Then comes the comment on which HMRC rely:

> The word 'indirectly' was used in subs (2) to make it clear that the charge extends not only to the proceeds of sale of property purchased with those proceeds (which may be said to represent that property 'directly') but also to any property into which the property subject to the charge or the proceeds of sale can be traced.

This is quite right, but the passage sheds no light on the meaning of "indirectly financing"; "indirectly" is a word which is very context dependent.

Tracing borrowed money mixed in bank account

The first set of examples concern borrowed money mixed in an account with non-borrowed money:

> *Example 1* (Marianne)
>
> M, who is domiciled outside the UK, owns a property in the UK.

> She borrows some money which she charges against her property and puts the money in her UK bank account.
>
> Some time later, she use some of the money in the account to buy some UK listed shares and some foreign shares.
>
> On her death, the liability is still charged against her property. The extent to which the liability may be disallowed will depend on the facts.

The scenario is far-fetched, as one normally draws down a loan facility when the funds are needed, not before. Impatient readers may skip to the next section.

HMRC consider three permutations of facts.

> [*Example 1(a)*]
>
> If M had borrowed £100,000 and added that to her UK account which already contained £50,000 (that had not been borrowed) and had then used that money to buy £75,000 worth of UK shares and £75,000 worth of foreign shares, it might be reasonable to say that one half of the liability was attributable to acquiring excluded property and disallow £50,000.

The author of the passage seems somewhat unsure. The moral is that M should not mix borrowed money and other money: she should:

(1) use her existing £50k to purchase foreign shares, and

(2) borrowed £100k to purchase £75k UK shares and £25k foreign shares.

Then only £25k would be disallowed. But of course before 2013, M was not in a position to have known that.

In the next example the bank account holds (more or less) only the borrowed money:

> [*Example 1(b)*]
>
> Had the account contained very little other money and £100,000 of foreign shares had been acquired, the whole liability should be disallowed.

That seems straightforward.

The next example is similar to example 1a, but the HMRC analysis is unknown:

> [*Example 1(c)*]
>
> On the other hand, had the account contained, say, £400,000 and £100,000 of foreign shares had been acquired the position will depend on circumstances. You should obtain details of the amount in the account

> before the borrowed funds were added and details of how the funds in the account were used afterwards.
>
> Where the funds were borrowed specifically to acquire the excluded property, then they should be treated as being used wholly for that purpose and the liability disallowed. But if the facts indicate that the funds in the account were mixed, it might be more appropriate to apportion the amounts used to purchase the excluded property. If the position is unclear, or if the parties don't agree with your apportionment of the liability, refer to Technical.

This is not exactly "guidance".

Tracing borrowed money through a series of purchases and sales

It is convenient to coin some terminology. In the following discussion:

"A debt-financed asset" is one purchased out of borrowed funds.

"A partly debt-financed asset" is one purchased partly out of borrowed funds and partly out of other funds.

"Chargeable property" is property which is not excluded property within the IHT definition.

The IHT Manual provides:

> **IHTM28018 - Restricted deductions: meaning of 'indirectly' where money has been borrowed to acquire excluded property**
>
> … *Example 3*
>
> The trustees[4] of an excluded property trust borrow £1m which is charged against existing UK property worth £1.5m (property 1).
>
> They use the borrowed funds to purchase a second UK property for £1m (property 2).
>
> At this point, if the liability were to be taken into account in arriving at the value subject to tax, the £1m liability would be allowed as a deduction because the money has been used to acquire UK property. IHTA84/S162A does not apply, so the chargeable value would be £1.5m (£2.5m chargeable UK assets less £1m allowable liability).

4 This set of examples concern trustees whereas the first set concerned an individual. Is there any difference between trustees and individuals? Trustees are more likely to keep good accounts and a trust has more of a unity of purpose. I wonder if HMRC intend to suggest that.

> Property 2 is later sold for £1m and all the proceeds are transferred offshore to become excluded property.

This is therefore a case where:

(1) A debt-financed asset is chargeable property.

(2) The chargeable property is sold.

(3) Excluded property is purchased with the proceeds.

The HMRC analysis is as follows:

> The liability would now be disallowed by IHTA84/S162A. This is because the liability has been incurred to indirectly acquire excluded property - the funds now held offshore. The chargeable value is still £1.5m (£1.5m of UK assets and no deduction for the liability).

In the next example:

(1) A debt-financed asset is chargeable property.

(2) The chargeable property is sold.

(3) Excluded property is purchased with part of the proceeds.

> *Example 4*
>
> The trustees of an excluded property trust borrow £1m which is charged against existing UK property worth £1.5m (property 1).

They use the borrowed funds to purchase a second UK property for £1m (property 2).

> Property 2 is later sold for £1m,

So far the facts are the same as example 3, but the proceeds of sale are used in a different manner.

> £400,000 of which is used to acquire UK listed shares and the £600,000 to acquire foreign shares.

The HMRC analysis is as follows:

> £600,000 of the liability is disallowed by IHTA84/S162A(1) having been used to acquire indirectly the foreign shares which are excluded property, with the result that only £400,000 of the liability is allowed as a deduction.
>
> The value of the UK assets is £1.9m (£1.5m, plus the additional £400,000 in shares) from which can be deducted the allowable part of the liability of £400,000, leaving £1.5m chargeable.

In the next example:

(1) A *partly* debt-financed asset is chargeable property.

(2) The chargeable property is sold

(3) All the proceeds are used to purchase excluded property.

Example 5

The trustees of an excluded property trust own £1.5m of UK listed shares.

They borrow £1m and use a further £600,000 from sale of some of the shares to purchase a UK property for £1.6m.

The property is subsequently sold for £2.5m and all the sale proceeds are invested in foreign shares.

The whole of the £1m liability has been used indirectly to acquire excluded property, so it is disallowed by IHTA84/S162A(1).

The chargeable value is £900,000 (the original £1.5m less the £600,000 worth of the shares used to purchase the property).

In the next example:

(1) A partly debt-financed asset is chargeable property.

(2) The chargeable property is sold.

(3) Part of the proceeds are used to purchase excluded property.

Example 6

The trustees of an excluded property trust own £1.5m of UK quoted shares.

They borrow £1m and use a further £600,000 from sale of some of the shares to purchase a UK property for £1.6m.

The property is subsequently sold for £2.5m.

So far the facts are as in example 5.

This time £750,000 of the sale proceeds are used to reinvest in UK quoted shares and £1.75m is used to acquire foreign shares.

IHTA84/S162A(1) disallows the liability to the extent that it has been used indirectly to acquire excluded property.

Part of the £1.75m of excluded property has been acquired indirectly from the £1m borrowed at the outset; this part is established as follows.

The £1m borrowed made up 62.5% of the purchase price of the £1.6m UK property purchased by the trustees.

When this property was sold, 70% of the sale proceeds (£1.75m out of £2.5m) were used to acquire the foreign shares. Of the original £1m borrowed therefore, £437,500 (£1m × 70% × 62.5%) is attributable indirectly to financing the acquisition of excluded property.

Only the remaining £562,500 of the liability can be taken into account.

The value of the UK assets is £1.65m (the original £1.5m less £600,000 used to buy the property plus the additional £750,000 reinvested in UK shares) from which can be deducted the allowable part of the liability of £562,500, leaving £1,087,500 chargeable.

Borrowing to repay debt (refinancing)

Suppose:

(1) T borrows to purchase excluded property ("debt 1").

(2) T borrows to repay debt 1 ("debt 2").

Is debt 2 indirectly attributable to financing the acquisition of excluded property? What if T borrows to purchase non-excluded property but later sells that property and uses the proceeds to repay debt 1? It is suggested that debt 2 is attributable to financing excluded property if the steps form part of an arrangement, but not otherwise.

Acquisition by third party

The position becomes more complex if a second person is involved. Suppose:

(1) A (an individual) borrows.

(2) A gives the borrowed funds to B.

If A borrows and acquires *excluded* property, and gives it to B the debt is forever disallowed.

A may borrow and acquire *chargeable* property and give it to B; in the hands of B the property may (a) be excluded or (b) become excluded. A's gift may be a PET or qualify for the IHT spouse exemption or it may be a chargeable transfer.

In the expression "attributable to financing (directly or indirectly) the acquisition of any excluded property" does "acquisition" mean acquisition by the person who has the liability? or does it mean acquisition by anyone? It is tentatively suggested that A's liability is attributable to financing the acquisition by B, if the steps form part of an arrangement, but not if they are independent.

Similar issues arise if trustees borrow and appoint the borrowed funds to B.

Outline of excluded property disallowance reliefs

Statute provides the following reliefs (exceptions to disallowance of debts attributable to excluded property):

(1) Disposal of debt-financed excluded property (disposal relief)

(2) Property ceasing to be excluded property

(3) Liability exceeding value of excluded property

Disposal of debt-financed excluded property

Section 162A IHTA provides:

> (2)[1] Where the property mentioned in subsection (1) has been disposed of, in whole or in part, for full consideration in money or money's worth, the liability may be taken into account
>
> [2] up to an amount equal to so much of that consideration as—
>
> (a) is not excluded property, and
>
> (b) has not been used—
>
> (i) to finance (directly or indirectly) the acquisition of excluded property or the maintenance, or an enhancement, of the value of such property, or
>
> (ii) to discharge (directly or indirectly) any other liability that, by virtue of this section, would not be taken into account.

I refer to this as **"disposal relief"**.

"Dispose" is not defined so will bear its normal meaning, not the extended CGT meaning.

For the meaning of "consideration" see ("Chargeable consideration"). Strictly speaking, the liquidation of a company does not give rise to a disposal for consideration but it appears that HMRC do not take this point. The IHT Manual provides:

> **IHTM28014 - Restricted deductions: disposal of acquired assets where money has been borrowed to acquire excluded property**
>
> … Example 2 (Axel)
>
> A, who is not domiciled in the UK, owns shares in an overseas company, which owns a UK property.
>
> A acquired the company by borrowing £1m.
>
> The company is liquidated and the UK property is transferred to A.
>
> IHTA84/S162A(2) refers to the disposal of excluded property for consideration in money or money's worth. You may accept that liquidating the company and transferring the property to A meets that requirement so the liability may be allowed as a deduction against the UK property, although the allowable liability cannot exceed the value of the UK property that was transferred to the A.

Suppose:

(1) T borrows to acquire excluded property ("asset 1").

(2) Asset 1 is sold and other excluded property purchased instead ("asset 2").

(3) Asset 2 is sold and chargeable property is purchased.

Disposal relief can apply, as the debt is attributable to financing the acquisition of asset 2. HMRC agree. The IHT manual provides:

> **IHTM28014 Restricted deductions: disposal of acquired assets where money has been borrowed to acquire excluded property**
>
> Example 3 (Basha)
>
> B, who is not domiciled in the UK, borrows £1m which she uses to invest in an overseas company (Company A).
>
> Company A in turn owns another overseas company (Company B) which owns a UK property.
>
> Company A is liquidated so B receives the shares in Company B. Company B is then liquidated and B becomes the owner of the UK property.
>
> Here the liability is attributable to indirectly financing acquiring the shares in Company B that owned the UK property. So excluded property was disposed of for full consideration in money's worth and as the consideration (the UK property) is not excluded, the liability may be allowed as a deduction against it.[5]

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5 The example goes wrong at the end: The deduction (if allowable) is not set against the UK property (unless it is charged on the property, which the author of the example has perhaps assumed to be the case). But that does not affect the main point of the example.

Debt-financed property ceases to be excluded property

An item of property may be excluded property at one time and subsequently become chargeable property, for instance:

(1) The owner of foreign property may become UK domiciled; or

(2) Foreign property (such as a chattel or a bearer security) may be brought to the UK.

Section 162A IHTA provides:

> (3) The liability may be taken into account up to an amount equal to the value of such of the property mentioned in subsection (1) as—
>
> (a) has not been disposed of, and
>
> (b) is no longer excluded property.

If T borrows to acquire excluded property but the property becomes chargeable, the debt becomes allowable under 162A(3) up to the value of the property.

The IHT Manual gives this example:

> **IHTM28015 - Restricted deductions: property is no longer excluded where money has been borrowed to acquire excluded property**
>
> … Example (Chandra)
>
> C, who is not domiciled in the UK borrows £750,000 and buys a property abroad for £1m.
>
> The interest due on the loan is allowed to accumulate instead of being repaid.
>
> C subsequently becomes deemed domiciled in the UK so the property is now subject to tax. On C's death, the property is worth £1.2m and the sum owed under the liability is £1.3m.
>
> As the property is now subject to tax, the liability may be allowed; but only up to the value of £1.2m. The remaining £100,000 may not be deducted.

Had C bought property in the UK the £100k would not be disallowed. The breach of EU law seems clear, so in the case of property in the EU/EEA, C should not accept the disallowance.

It is open to question whether the interest part of the debt is disallowed.

Liability exceeds value of excluded property

"Remaining liability"

Statute uses the term "remaining liability" which is defined in s.162A(8) IHTA:

> "remaining liability" means the liability mentioned in subsection (1) so far as subsections (2) and (3) do not permit it to be taken into account;

The label is not entirely apt: "disallowed liability" might have been clearer.

Liability exceeds value of excluded property

Section 162A IHTA provides:

> (4) To the extent that any remaining liability is greater than the value of such of the property mentioned in subsection (1) as—
>
> (a) has not been disposed of, and
>
> (b) is still excluded property,
>
> it may be taken into account, but only so far as the remaining liability is not greater than that value for any of the reasons mentioned in subsection (7).

The IHT Manual gives a straightforward example:

> **IHTM28016 Restricted deductions: Excess liability over value of excluded property where money has been borrowed to acquire excluded property**
>
> Example 1 (Dominique)
>
> D, who is not domiciled in the UK, borrows £800,000 which is charged on UK assets worth £1.5m.
>
> She uses the £800,000 to acquire a villa in Spain, which is excluded property.
>
> The open market value of the Spanish villa falls to £500,000 by the date of her death.
>
> The £800,000 liability has been incurred to directly acquire excluded property, so would normally be disallowed by IHTA84/S162A(1). However, the reason for the liability being greater than the value of the excluded asset is not due to:
>
> – it being part of an arrangement to secure a tax advantage, or

- an increase in the value of the liability, or
- a disposal of the whole or part of the excluded asset.

So £300,000 of the liability (£800,000 liability less the £500,000 value of the excluded asset) is allowed and reduces the chargeable value of the UK assets to £1.2m.

Example 2

If, in the example above:

- the money had been borrowed from abroad,
- it had not been charged on UK property, and
- the deceased had also owned assets in France,

the £300,000 should first be set against the French assets[6] before any balance is then set against UK assets.

Liability exceeds value of property which becomes excluded

Section 162A IHTA provides:

(5) Subsection (6) applies where—

(a) a liability or any part of a liability is attributable to financing (directly or indirectly)—

(i) the acquisition of property that was not excluded property, or

(ii) the maintenance, or an enhancement, of the value of such property, and

(b) the property or part of the property—

(i) has not been disposed of, and

(ii) has become excluded property.

(6) The liability or (as the case may be) the part may only be taken into account to the extent that it exceeds the value of the property, or the part of the property, that has become excluded property, but only so far as it does not exceed that value for any of the reasons mentioned in subsection (7).

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6 More accurately, the deduction is against D's *foreign* assets; but the author has perhaps assumed that D's French assets are her only foreign assets.

The IHT Manual provides a straightforward example:

> **IHTM28017 Restricted deductions: excess liability over property that has become excluded where money has been borrowed to acquire excluded property**
>
> … Example (Roberto)
>
> R who is not domiciled in the UK borrows £500,000 which he uses to buy two paintings which he keeps in his London house.
>
> He subsequently takes one of the paintings, worth £300,000, to keep in his house in Florida. This painting is now excluded property.
>
> The £300,000 painting has not been disposed of but has become excluded property. The liability of £500,000 is therefore allowed to the extent that it exceeds the value of that painting. In other words, £200,000 of the liability is an allowable deduction (£500,000 less £300,000).

It was not necessary to have a separate relief for this case. Relief should have been available under s.162A(4).[7] But it does no harm.

Disallowable reason 1: tax avoidance purpose

Section 162A(7) IHTA sets out three disallowable reasons. They override the reliefs in:

(1) s.162A(4): see 65.22.2 (Liability exceeds value of excluded property).

(2) s.162A(4): see 65.22.3 (Liability exceeds value of property which becomes excluded)

The first is a tax avoidance purpose:

> (7) The reasons are—
>
> (a) arrangements[8] the main purpose, or one of the main purposes, of which is to secure a tax advantage …

Section 162A(8) defines tax advantage:

> (8) In this section …
>
> "tax advantage" means—

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7 See 65.22.2 (Liability exceeds value of excluded property).

8 Section 162A(8) IHTA provides the standard (unnecessary) definition: "arrangements" includes any scheme, transaction or series of transactions, agreement or understanding, whether or not legally enforceable, and any associated operations.

(a) the avoidance or reduction of a charge to tax, or

(b) the avoidance of a possible determination in respect of tax.

"Tax" is not defined here, so it means IHT: see s.272 IHTA.

Disallowable reason 2: increase in liability

The second disallowable reason is set out in s.162A(7)(b):

(7) The reasons are…

(b) an increase in the amount of the liability (whether due to the accrual of interest or otherwise)…

An increase in the debt due to interest or index-linking is disallowed. So inflation will whittle away the value of the allowable debt over time.

In the case of a foreign currency debt the debt is valued at the time it is taken out and an increase in the value of the debt due to currency fluctuations is disallowed.

Disallowable reason 3: disposal

The third disallowable reason is set out in s.162A(7)(c):

(7) The reasons are…

(c) a disposal, in whole or in part, of the property.

I do not understand the purpose of (c): how can a liability be attributable to a disposal. Is this to disallow borrowing to cover the incidental costs of disposal?

Planning for excluded property disallowance

Planning is needed at the time of the acquisition of UK property. Suppose T owns £1m foreign property and wishes to purchase a UK home work £1m:

(1) If T borrows to purchase the UK home, the liability is deductible

(2) If T sells the foreign property to purchase the home, and subsequently borrows £1m to purchase foreign property, T is (more or less) in the same economic position. But in this case the liability is disallowed.