CHAPTER 15

GIFTS WITH RESERVATION OF BENEFIT AND PRE OWNED ASSETS

15.1 Introduction

FA 1986, s.102

The "gifts with reservation" rules were introduced in FA 1986, as an anti-avoidance measure to prevent a donor from **giving away an asset, but continuing to derive some benefit from that asset after the gift had taken place**.

The rule is designed to prevent a donor from making a gift and hoping to survive 7 years so the PET would be exempt. In the meantime, the donor could still have full enjoyment of the asset that he had given away.

If an individual gives away an asset, but **continues to be able to benefit** from that asset, the transfer is called a "gift with reservation of benefit". The effect of a gift with reservation, is to **treat the asset as still forming part of the donor's estate at the date of death** – i.e., we pretend that the donor still owns the asset at his death.

Probably the most common example of a gift with reservation, is where a donor **gives away a house, but continues to occupy the property** after the gift.

Illustration 1

Assume that a donor gives away his house to his daughter when it is worth £300,000. This is a PET and will become completely exempt if the donor survives 7 years.

The donor continues to occupy the property after he has given it away. This is a typical "gift with reservation" situation and the anti-avoidance rules will apply.

Assume that the donor continues to live in the property until the date of his death. The effect of the rules is to **treat the house as still being in the death estate of the donor**. Therefore the **market value of the house at the date of death** will be charged to IHT in the normal way.

15.2 Exceptions

The gift with reservation rules will **not** apply in a couple of situations.

If the donor continues to use an asset after he has given it away, but the **donor pays a full market rent to the donee for the use of the asset**, the gift with

reservation provisions do not apply. HMRC has stated that the rent should be a **full commercial rent** (i.e. a rent that would be charged to an unconnected third party) and the rent paid should be reviewed at "appropriate intervals to reflect market changes".

There are a couple of problems with this arrangement. Firstly, the payment of rent to the donee for the use of the asset will give rise to an **income tax charge in the hands of the donee**. Secondly, it can be difficult to persuade a client to pay a market rent to the donee for the use of a property he still regards as his own.

The gift with reservation rules do **not** apply where the donor is "**virtually" excluded from benefiting from the asset** given away. There are certain situations where the donor may retain a **limited benefit** in the asset he has given away, without triggering a charge.

HMRC has confirmed that where the benefit to the donor is "insignificant" in relation to the gifted property, a gift with reservation will not arise.

HMRC has published an interpretation as to how they would apply this "de-minimis rule". HMRC's practice in this area is stated in a Tax Bulletin from November 1993.

The interpretation contains examples of where the benefit would be regarded as insignificant in relation to the gifted property, and as such the gift with reservation rules would not be applied. In particular, the interpretation looks at situations where a house is given by a donor to a donee, and the donor can have some access to the house, without triggering the provisions.

For example if a donor gives a **house to a donee** and the **donor stays with the donee for less than 1 month a year,** in HMRC's opinion **no gift with reservation applies**. Similarly if the donor stays in the house **in the absence of the donee for less than 2 weeks a year**, once again this would not trigger a gift with reservation.

If a donor gives a house to a donee and either **visits the house for domestic reasons or for some short term purpose**, the donor is not treated as having made a gift with reservation of benefit.

In this context "domestic reasons" would include babysitting for the donee's children. A "temporary short term purpose" may cover examples where the donor is staying with the donee either because his house is being redecorated or repaired, or where the donee is looking after the donor (or vice versa) after medical treatment.

HMRC's Bulletin also identifies other situations which would not give rise to a gift with reservation. For example a donor can give a car to a donee and accept "occasional" lifts from the donee. "Occasional" in this context means less than 3 times a month. As you will appreciate, HMRC obviously has difficulties in policing and enforcing this interpretation.

15.3 "Double charges"

A more important rule to be aware of with regard to gifts with reservation of benefit, is the possibility of an imposition of a double charge to tax. A double charge will arise in a few situations.

The most common instance of a double charge, is when the **original gift becomes a chargeable transfer** – i.e. a donor gives a house to a donee thereby making a PET and the donor dies within 7 years.

If the donor is **still occupying the property at the date of death, the donor has a reservation of benefit**. Therefore, as well as the **house being treated as forming part of the donor's death estate** for IHT purposes, the **PET on the original gift has become chargeable**.

There could therefore be two IHT charges on the same transfer.

Illustration 2

Assume a donor gives a house to a donee and continues to occupy the house. The donor has therefore made a gift with reservation.

If the donor dies within 7 years of the gift, **the PET becomes a chargeable transfer** and tax on the PET is payable by the donee.

However, if the donor is still occupying the property at the date of death, the **house is still treated as forming part of the donor's death estate**.

If HMRC tax **both** the PET **and** the house in the death estate, two charges to inheritance tax have arisen on the same transfer.

The next thing to consider is the effect of the double charge.

To prevent two charges being levied on the same transfer, "double charges relief" is available. Having identified a double charge, **HMRC will prepare two inheritance tax computations**.

SI 1987/1130

HMRC will calculate tax on the PET, ignoring the gift with reservation. Alternatively, HMRC will treat the asset as still forming part of the donor's death estate, and ignore the fact that a PET was made in the previous 7 years.

Having prepared two IHT computations, **HMRC will use whichever gives the most tax**. In most circumstances, taxing the house in the death estate and ignoring the PET will produce a higher tax charge for a couple of reasons.

First of all, assets such as houses usually **increase in value** so the amount charged in the death estate is higher than the amount of the PET.

Secondly, the value of a PET might be reduced by annual exemptions, and the tax on the PET could be further reduced by taper relief.

This is not a hard and fast rule, and factors such as the donor's cumulative total will also need to be taken into consideration.

15.4 Releasing a reservation

Another way for the donor to avoid a gift with reservation of benefit, is for the donor to **release the reservation before he dies**. An asset is only treated as forming part of the donor's death estate, if the **donor has retained a benefit at the date of death**.

Therefore if the donor releases his benefit (i.e. the donor moves out of the house) there is no charge in the death estate.

However, in order to avoid "death bed" releases of benefits to prevent an IHT charge, HMRC **treat the release of a gift with reservation as being a potentially exempt transfer at the date of release**.

The PET is the **value of the asset at the date the donor releases his benefit**. HMRC has stated that **no annual exemptions** are available to reduce the value of this "deemed PET". The release of a reservation could be another situation when a double charge to inheritance tax may arise.

Illustration 3

Assume that a donor has a house, which in 2005 is valued at £200,000. The donor gives the house to a donee, but after the gift he continues to occupy the house. He has therefore made a PET and also a gift with reservation of benefit.

In 2008 when the house is worth £300,000, the donor moves out of the property. At this date, the donor is treated as having made another PET, this time of £300,000.

Assume the donor dies within the next year. Two things will happen.

1. First the original PET in 2005 (£200,000 less available annual exemptions) becomes a chargeable transfer.

2. Second, the PET in 2008 (£300,000 on release of the reservation) also becomes chargeable to inheritance tax.

Once again there is the possibility of there being two charges to inheritance tax on one transfer, and double charges relief will apply.

Again HMRC will prepare 2 computations:

1. Tax the original PET, ignoring the PET on the release of the reservation.

2. Tax the PET on the release of the reservation, ignoring the original gift.

HMRC will take whichever produces the **higher liability**.

In most circumstances this will be the PET on the release of the reservation. This is because the later PET will usually be higher as prices naturally increase over time, but also because more taper relief is available on earlier transfers than later transfers. Again the donor's cumulative total would need to be taken into consideration.

15.5 Special rules for land

FA 1986 s.102A & s.102B

In FA 1999, HMRC introduced special rules to deal **with gifts of land where the donor or donor's spouse retained an interest**.

These rules were specifically designed to block an imaginative tax planning scheme that was being used by many practitioners, whereby land and buildings could be given away and a benefit retained without triggering the gift with reservation rules. This planning scheme was first used by a taxpayer called Lady Ingram in the 1980s.

Lady Ingram was an elderly lady who owned a substantial freehold property. In 1987, Lady Ingram gave the **freehold of her home to a trust** for her family. This was a **potentially exempt transfer** for IHT purposes.
Having given away the freehold of the property, Lady Ingram **granted herself a lease** which gave her the right to occupy the house for the next 20 years. Essentially Lady Ingram had given away her home, but was thereafter still able to live in the property under the terms of the lease.

Lady Ingram died 2 years later in 1989. Lady Ingram's Executors disclosed that a PET had been made in the 7 years prior to Lady Ingram's death, and IHT on the PET should be borne by the trustees of the family trust.

HMRC argued that this situation gave rise to a **gift with reservation of benefit**, and therefore the value of the property at the date of death should be charged to inheritance tax in Lady Ingram's estate. Charging the house in Lady Ingram's death estate would produce a higher IHT liability.

The Courts were asked to consider whether this arrangement constituted a gift with reservation.

The solicitors for the taxpayer argued that Lady Ingram had given away the **freehold** of the property, but after the gift had taken place Lady Ingram only had a **lease** and was therefore **unable to benefit from the asset she had given away**. Essentially a freehold interest and a leasehold interest are different assets, and only where a taxpayer retains a benefit in the asset actually given away do the gift with reservation rules apply.

In December 1998 the House of Lords agreed with the taxpayer that **this situation did not give rise to a gift with reservation of benefit**. The Lords decision thereby gave legal authority to these "lease carve out" schemes which imaginatively managed to side step the gift with reservation rules.

As a direct reaction to the House of Lords decision, HMRC drafted legislation to block these type of tax planning schemes. The legislation took effect from 9 March 1999 and is contained at S.102A FA 1986. Under the rules, **if the donor or donor's spouse enjoy "a significant right or interest in relation to land", a gift with reservation of benefit will arise**.

A "significant right or interest" is one which entitles either the donor or the donor's spouse to **occupy or to enjoy land in any material form**. For example, if the donor gives away land or buildings, but after the gift either the donor or the donor's spouse is able to occupy or enjoy the land under a lease, licence or other arrangement, the gift with reservation rules will take effect.

The rules did not apply retrospectively, so any taxpayers who had given away the freehold of their property before March 1999 and are still able to enjoy the property under the terms of the lease, do not have a gift with reservation. Therefore when the donor dies, the value of the freehold property is not treated as forming part of their death estate. The rules in S.102A only apply to schemes – i.e. schemes set up on or after 9 March 1999.

15.6 Gifts of a share in land

FA 1986 s.102B

S.102B FA 1986 applies where (on or after 9 March 1999) a share of land is gifted (eg, part of a house).

Under S.102B the **gift with reservation rules will not apply to transfers** of a **share** of an interest in land if either;

(i) the donor does not occupy the land; or
(ii) the donor occupies the land to the exclusion of the donee in return for full consideration.

The above appears to follow the normal gift with reservation doctrine.

However, an additional relief was introduced in S.102B(4).

S.102B(4) applies where a **donor gives away a share of land, but the donor and donee thereafter share occupation** of the land.

In this instance, if the donor and donee jointly occupy the land and the donor does not receive any other benefit, **there is no gift with reservation**. HMRC would regard (for example), the donee paying all bills connected with the property as an instance in which the donor would receive a benefit from his gift. Therefore if bills are shared (or are fully borne by the donor), there is no benefit.

S.102B therefore allows (for example) a parent to give a half share in the family home to a son or daughter and thereafter share occupation with the son or daughter without the gift being a gift with reservation of benefit. S.102B does not require the donor and donee to share occupation on a full time basis – there just needs to be some degree of shared occupation.

Illustration 4

Ann is widowed and owns a house worth £600,000. She transfers a half share in the house to her daughter Jill. Ann continues to live in the house. Jill has her own flat but spends 3 days a week living with Ann. Ann continues to pay her share of all the household costs.

S.102B(4) applies. Both Ann and Jill occupy the land. As Ann pays a fair share of the bills, she is not receiving any benefit by reason of the gift to her daughter. The transfer is, therefore, not subject to gift with reservation rules. The PET will be exempt if Ann survives 7 years.

However, if Jill stops living in the house, Ann will be occupying the property by herself. S.102B(4) will therefore cease to apply. Therefore unless Ann starts to pay full consideration to Jill for the use of Jill's proportion of the property, the original gift will become subject to the gift with reservation rules.

15.7 "Settlor interested" trusts

If a donor sets up a trust, and the **donor is a beneficiary of the trust**, the donor has given away assets from which he is potentially able to benefit after the transfer. This situation would therefore give rise to a gift with reservation of benefit.

Therefore if donor is still a beneficiary of the trust when he dies, the **trust assets are deemed to form part of his death estate for IHT purposes**. Even though this situation is a gift with reservation, HMRC still regard the creation of the trust as a **chargeable lifetime transfer** so when the trust is set up, lifetime inheritance tax may be payable.

Again there are double charges regulations to prevent two IHT charges if the donor dies within 7 years of the CLT.

15.8 Pre-owned assets

Since the inception of the gifts with reservation rules in Finance Act 1986, there have been many (sometimes very elaborate) **tax avoidance schemes set up in an attempt to get around these rules.** Some of these schemes have been successful and have allowed taxpayers to give away assets while still being able to benefit from those assets without falling foul of the gifts with reservation rules.

For example, cash gifts were not caught by the gifts with reservation provisions as there were no "tracing rules" in FA 1986. A donor could therefore give cash to a donee. The donee could then buy an asset (eg, a house) and allow the donor rent-free use of that asset. The cash gift was a PET but was not a gift with reservation of benefit.

Over the years the Government had dealt with these schemes on a "case by case" basis by amending the existing rules to plug specific loopholes. The "Lady Ingram" scheme was one such example where the carve-out of a leasehold interest out of a freehold was initially held by the courts to successfully avoid a gift with reservation but was subsequently nullified by anti-avoidance legislation in FA 1999.

However, in a consultation document in December 2003, HMRC signalled a **change of approach to tax avoidance in this area**. As part of what they called "a wider strategy to protect tax revenues", HMRC stated that:

> "Income tax will in future be charged on the benefit people enjoy when they have arranged free continuing use of major capital assets they once owned".

Also, with particular reference to schemes like the "double trust" scheme and to cases such as *IRC v Eversden (2003)*, HMRC announced that:

> "Arrangements like this are often made to get around the IHT gifts with reservation (GWR) rules. Essentially these GWR rules are intended to stop people from giving their assets away so that, for IHT purposes, they are out of their estate when they die, while still continuing to enjoy the practical benefits of owning them during their lifetime".

The consultation document was followed up by the "Pre Owned Assets" legislation in Schedule 15 Finance Act 2004 as a direct response to what was seen by HMRC to be the setting up of artificial structures whose only motive is to avoid inheritance tax.

15.9 The POA rules

The POA rules took effect from **6 April 2005** (i.e. from the tax year 2005/06). HMRC deliberately delayed the introduction of the provisions for one year to give time for taxpayers and their advisers (if they so wished) to unravel schemes previously introduced and to return the taxpayer to the situation he would have been in had the planning scheme not been implemented.

For those taxpayers who chose not to unscramble previously successful planning schemes, such arrangements are now likely to fall within the tax on pre owned assets (POA).

The POA rules **impose an income tax charge on benefits received by the former owner of the property**. This is unusual in itself as HMRC has introduced an income tax charge to protect themselves against the tax lost as a result of inheritance tax planning. HMRC seem to have preferred this route to any further attempts to tighten up the existing IHT rules which taxpayers and their advisers seem to have found too easy to flout.

The income tax charge is levied on a **notional amount of income broadly equivalent to the annual rental value of the asset concerned**. This "notional" income will then be declared on the taxpayer's self-assessment return and income tax paid in the normal way (presumably at 40% (or 50%) as most taxpayers caught by the rules are likely to be higher rate taxpayers). This notional income will be taken into account in determining payments on account for the following tax year.

FA 2004, Sch 15 Para 4

Note that the income tax charge will **only fall upon those taxpayers** who continue to benefit from an asset given away after March 1986, but are **not caught by the GWR rules**. If a gift is subject to the GWR rules and is therefore still in the donor's estate for IHT purposes, there will be no POA charge.

FA 2004, Sch 15 Para 11

15.10 POA charges on land

A POA charge will apply where a person occupies land if, on or after 16 March 1986, he had disposed of that land (or an interest in it). The POA rules will also apply if the donor owned other property whose sale proceeds have been used to buy land which the donor now occupies, or if the donor provided the consideration for the owner to buy the land.

FA 2004, Sch 15 Para 3(2)

The amount charged to income tax will be:

The appropriate rental value	A
Less: payments made by the "chargeable person" to the owner of the land	(B)
"Notional income"	C

The "appropriate rental value" of the land is the rent that the owner might reasonably be expected to obtain from a letting from year-to-year (i.e. a typical commercial rent). This **commercial rent** is calculated by assuming that the property is let unfurnished, the tenant is responsible for taxes, rates and charges (for instance, utilities, council tax etc) and the landlord bears repair and insurance costs. The rental value should be reviewed on a regular basis to reflect market changes and will be subject to agreement with the Revenue.

FA 2004, Sch 15 Para 4(3)

FA 2004, Sch 15 Para 5

Payments made by the "chargeable person" (i.e. the original donor) to the owner are **deductible if they are in pursuance of a legal obligation** (for example, under the terms of a formal lease). Such rental payments made by the occupier to the owner will be taxable income under the rental income rules.

FA 2004, Sch 15 Para 4(1)

A loss cannot be created if payments exceed the rental value.

15.11 POA charges on chattels

Schedule 15 para 6 imposes a POAT charge on chattels (paintings, antiques etc) in a similar way to the charge on land. Once again a charge is imposed if a donor gave away a chattel after March 1986 and is still in a position to enjoy or benefit from the chattel. The rules do not apply if the gift is subject to the IHT GWR rules.

FA 2004, Sch 15 Para 6

However, under para 7, the POAT charge is calculated by taking a **notional interest rate** rather than taking the annual rental value of the chattel. This is likely to produce a significantly higher POA charge, as the annual rental value of chattels is typically quite low.

FA 2004, Sch 15 Para 7

The amount charged to income tax will be:

Notional interest payable for the period	X
Less: payments made by the chargeable person to the owner of the chattel	(Y)
"Notional income"	Z

The "notional interest" is the interest that would be payable for the tax year if interest was payable at **HMRC's prescribed rate** on an amount equal to the **value of the chattel at the "valuation date".**

FA 2004, Sch 15 Para 7(2)

The "valuation date" is 6 April in the first tax year or the date on which the taxpayer first becomes liable to pay the income tax charge. The income tax charge is based on that value for the first and the following four tax years. A **new valuation is required after the first five tax years.**

For example, a taxpayer who became liable to the income tax charge for 2005/06 would value the property first at 6 April 2005, then at 6 April 2010 and thereafter every five years, as long as they continue to benefit from the pre-owned asset.

SI 2005/724

A taxpayer who becomes liable to the charge (say) on 6 October 2010, would value the property first at 6 October 2010, and then on 6 April 2015 and every five years after that.

Payments made by the "chargeable person" must again in pursuance of a legal obligation and will be taxable income for the recipient. A loss cannot be created if payments exceed the notional interest.

Illustration 5

Mr Lord gave away a valuable painting in 2007 to a family trust. The arrangement was structured in such a way so as to avoid falling foul of the GWR rules in s.102 FA 1986. The painting continues to hang in Mr Lord's dining room.

When given away the painting is worth £500,000. Mr Lord pays a "rent" of £200 per month to the trustees. HMRC's prescribed interest rate is 4%.

The POA charge for 2010/11 will be:

	£
Notional interest payable for the period (£500,000 x 4%)	20,000
Less: payments made by Mr Lord (£200 x 12)	(2,400)
"Notional income"	£17,000

In 2010/11 Mr Lord is deemed to have received income of £17,600. This will be included in his 2010/11 self-assessment return and the income tax thereon paid by 31 January 2012. It will also be considered when calculating payments on account for 2011/12.

15.12 POA charges on "intangible property"

Schedule 15 para 8 imposes a POA charge on intangible property of a trust where the settlor is a beneficiary and the income of the trust is thereby taxed on the settlor under s.624 ITTOIA 2005.

FA 2004, Sch 15 Para 8

The POA charge is the **value of the intangible trust property multiplied by HMRC's prescribed interest rate**. A **deduction** (not a tax credit) is available for any **income tax** paid on the intangible property, for example, under s.624 ITTOIA 2005.

Value of intangible property in trust x %	X
Less: IT paid by Settlor on intangible property	(Y)
"Notional income"	Z

15.13 *Cash gifts*

Under the gifts with reservation rules, there is no "tracing" rule for cash gifts. It is not possible to reserve a benefit if cash is given away.

FA 2004, Sch 20 para 2(2)(b)

Illustration 6

Henry gives cash of £500,000 to his son Toby. Toby uses the cash to buy a house. Henry subsequently sells his own house and moves into the house previously bought by Toby.

The gift of cash by Henry is a PET (exempt if Henry lives for another 7 years). However this does **not** gives rise to a gift with reservation, as the subject of the gift was cash. It is irrelevant that Henry is benefiting from an asset purchased with his cash gift.

There are tracing provisions under the POA rules (called the "contribution condition").

FA 2004, Sch 15 para 3(3)

Under Sch 15 para 3(3), a POAT charge will arise where

> "the chargeable person has directly or indirectly provided… any of the consideration given by another person for the acquisition of

(i) an interest in the relevant land, or
(ii) an interest in any other property, the proceeds of disposal of which were (directly or indirectly) applied by another person towards the acquisition of the relevant land….."

Illustration 7

Henry owns a house. For IHT planning purposes, he wishes to give the house to his son Toby, but still be able to live there. He is aware that if he does so, he will make a GWR for IHT purposes. This will make the gift ineffective for IHT as the house will still form part of his estate.

Henry therefore sells the house for £500,000 and gifts the cash to Toby. Toby uses the cash to buy another house which he allows Henry to occupy rent-free.

This is not a GWR for IHT purposes.

However **this is caught under the POA rules** in Sch 15 para 3(3). Henry will therefore have an income tax charge based on the rental value of the land he is now occupying.

There is an **apportionment provision** where a person provides **part** of the funds towards the acquisition of relevant land.

FA 2004, Sch 15 para 4(2)(c)

Illustration 8

Henry gifts cash of £500,000 to Toby in 2008. Toby uses the cash to buy another house for £750,000 which he allows Henry to occupy rent-free. The annual rental value of the house is £4,000 per month.

The POA charge for 2010/11 will be:

	£
Appropriate rental value (£4,000 x 12)	48,000
Apportioned under Sch 15 para 4(2)(c)	
£48,000 x 500,000 / 750,000	£32,000

Similar rules apply where the asset in question is a chattel.

HMRC has confirmed that **cash gifts before 6 April 1998 will not give rise to a POA charge** using the tracing rules, as the original PET would have become exempt by the time the POA rules were introduced in April 2005. This will be the case even if 7 years had not elapsed between the cash gift and the cash thereafter being applied in acquiring the land or the chattels.

HMRC has also confirmed that **a loan of cash** (rather than an outright gift) **will not fall within the contribution condition**. This is because the lender will have the asset of the outstanding debt in his estate for inheritance tax purposes and therefore the anti-avoidance POA provisions should not apply.

15.14 Excluded transactions

A POA charge is levied where the chargeable person originally disposed of land and/or chattels "otherwise than by way of an excluded transaction". Therefore if the donor can still benefit from an asset he gave away, but the original gift was "excluded", there is no POA charge.

FA 2004, Sch 15 Para 10

Para 10 of Schedule 15 defines an "excluded transaction" as including any of the following:

- **Disposal on an arm's length basis** (e.g. for consideration equal to its market value);
- **Disposal to a spouse** (or interest in possession trust for spouse);
- **Gift of cash** more than 7 years before the donor first used the asset purchased.
- Gifts covered either by the **small gifts exemption** (£250) or **annual exemption** (£3,000) or a gift for the **maintenance of family** within s.11 IHTA 1984.
- **Jointly occupied land** which is exempt from the gift with reservation rules under FA 1986 S.102B(4) as detailed in para 15.6 above.

FA 2004, Sch 15 Para 11(5)

15.15 The "£5,000" exemption

No income tax charge will arise if the **aggregate of POA charges** (before payments made by the chargeable person) in the tax year **do not exceed £5,000**. If taxable values exceed £5,000, the full amount is taxed.

FA 2004, Sch 15 Para 13

Illustration 9

Mr Earl gave away some land in 2007 to his son. The arrangement was structured in such a way so as to avoid falling foul of the GWR rules in s.102 & s.102A FA 1986. The land is used by Mr Earl to graze his horses. The rental value of the land is £6,000. Mr Earl pays rent of £100 per month to his son.

The POA charge for 2010/11 will be:

	£
The appropriate rental value	6,000
Less: payments made by Mr Earl (£100 x 12)	(1,200)
"Notional income"	£4,800

The £4,800 is taxable and will be reported on Mr Earl's 2010/11 return. The £5,000 de-minimis rule does not apply as the annual rental value exceeds £5,000.

Other exemptions

No POA charge arises if the gift falls within the existing GWR rules. Also no POA charge arises if the gift would be within the GWR rules but for the "de-minimis" exemptions outlined in HMRC's Tax Bulletin of November 1993.

For example, no GWR arises if the donor gifts an asset and is "virtually excluded" from benefit. Therefore he could have some limited benefit / limited access to the gifted property without triggering a GWR. The fact that he is not within the GWR rules in this instance does not therefore leave the donor subject to a POA charge instead.

FA 2004, Sch 15 Para 11(5)

14.16 Territorial scope

The POA charge will **not apply** in a tax year in which the individual is **not resident** in the UK. Therefore if a non-resident becomes UK resident, the POA charge will apply from the time he becomes UK resident.

FA 2004, Sch 15 Para 12(1)

If the individual is resident in the UK but is **not UK domiciled**, the POA charge will **only apply to assets situated in the UK**. If the donor subsequently acquires a UK domicile, the scope of the POA charge will thereafter be extended to his worldwide assets.

FA 2004, Sch 15 Para 12(2)

However, non UK assets held in a trust set up at a time when the donor was not UK domiciled (an "excluded property trust") will continue to be outside the POA regime even if the donor subsequently becomes UK domiciled (this point is examined further in a later chapter).

14.17 Electing out of the POA charge

Where an individual is caught by the POA rules, he **can make an election** under Schedule 15 para 21. The effect of the election is that:

FA 2004, Sch 15 Para 21

1. **No income tax charge** will arise under the POA rules in respect of land or chattels he previously owned but continues to benefit from; but

2. The donor will **instead be treated as having made a GWR** under the inheritance tax rules, such that the asset now forms part of his estate for IHT.

The election should be made no later than 31 January following the tax year in which the individual first becomes liable to a POA charge. However, HMRC have discretion to accept a late election in a particular case. The **election can be revoked or varied at any time** until the filing date (but cannot be withdrawn thereafter). The election applies on an **asset-by-asset basis.**

FA 2004, Sch 15 Para 23

In effect, taxpayers who have previously been successful in devising schemes to avoid coming within the GWR rules for IHT (and have no doubt incurred accounting and legal fees for the privilege of such IHT protection), now found themselves with an interesting dilemma. They could either:

a. maintain their IHT protection (and not have the asset forming part of their estate on death), but at the price of an annual income tax charge for the remainder of their lives based on the annual rental value of the asset; or

b. elect to avoid the annual income tax charge, but at the expense of effectively unravelling the previously successful IHT planning scheme and having the asset brought back within their estates for IHT.

One would expect the more elderly taxpayers may take the view that an annual income tax charge for the rest of their lives may be the "lesser of two evils" and will work out to be a cheaper alternative than bringing a valuable asset back into their death estates.

On the other hand, younger taxpayers may find that a "one-off" charge to IHT on death will not be as penal as an annual income tax charge for what could be a significant number of years going forward. Such taxpayers may be better advised to make an election and avoid a POA charge at the expense of coming within the GWR rules.

This is a broad generalisation and taxpayers will make their minds up based on factors such as life expectancy, annual rental values (or notional interest charges) and potential future IHT liabilities.

Example 1

Which of the following situations give rise to a gift with reservation of benefit?

	Yes ?	No ?
1. Gift to discretionary trust where donor is a trustee.		
2. Gift of house to daughter – donor stays once every month		
3. Gift of Porsche to son – son gives donor a lift every day		
4. Gift of freehold to grandson – donor lives in property under a long lease.		

Example 2

Francesca gave £75,000 cash to her daughter Lydia in 2007. In 2008 Lydia used the cash to buy a diamond ring for £125,000. Lydia allows her mother to wear the ring which she does continually. Francesca does not make any payment for the use of the ring, although the annual rental value for such an asset is £100 per month.

HMRC's official rate of interest is 4%.

Calculate the amount chargeable to income tax on Francesca under the Pre Owned Assets rules.

Answer 1

	Yes ?	No ?
1. Gift to discretionary trust where donor is a trustee.		X
2. Gift of house to daughter – donor stays once every month		X
3. Gift of Porsche to son – son gives donor a lift every day	✓	
4. Gift of freehold to grandson – donor lives in property under a long lease.	✓	

Answer 2

There is a charge under the Pre Owned Assets rules as Francesca has provided funds which have been subsequently used in acquiring a chattel which she is now using.

As the asset is a chattel, the charge is calculated using HMRC's interest rate.

	£
£125,000 x 4%	5,000
Apportioned:	
$£5,000 \times \frac{75,000}{125,000}$	£3,000
Below £5,000 threshold, therefore charge =	NIL