

TECHNICAL SALES BRIEFING

IHT "BITESIZE" SERIES - PART THREE GIFTS WITH RESERVATION OF BENEFIT (GWR) AND PRE-OWNED ASSET TAX (POAT)

KEY POINTS

This Technical Sales Briefing:

- › is the third in a series covering many aspects of UK Inheritance Tax (IHT). The full content is available on our uTech site
- › deals with Gifts With Reservation of benefit (GWR) and Pre-Owned Asset Tax (POAT)

GIFTS WITH RESERVATION AND PRE-OWNED ASSET TAX (POAT)

Rules were introduced in the Finance Act 1986 and apply against all gifts made by an individual on or after 18 March 1986 which are subject to a reservation of benefit to the donor. A gift with reservation is defined in legislation under s102 as one by which either:

- › possession and enjoyment of the property is not bona fide assumed by the donee at or before the beginning of the relevant period; or
- › at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise

The relevant period for this purpose is the seven years prior to death.

If a reservation exists at death the property will be considered as property to which the donor was beneficially entitled immediately before death and it will be aggregated with and form part of his taxable estate. The expression 'or virtually to the entire exclusion' is not defined in the legislation but the intention of the phrase is to prevent the gift with reservation rules from applying where the benefit enjoyed by the donor is very small.

The reservation rules only apply to the donor and not to the donor's spouse. HMRC have confirmed, however, that if a benefit is given to the donor's spouse and such benefit is shared by the donor, the original gift becomes a gift with reservation.



The information is based on Utmost's understanding of current law and HM Revenue and Custom's practice as at 1 July 2021. Tax rules may change and depend on individual circumstances. This information does not constitute legal or tax advice and must not be taken as such. The companies in the Utmost Group can take no responsibility for any loss which may occur as a result of relying on any information in this technical briefing.

Specific rules apply to prevent the avoidance of the gift with reservation provisions by the conversion into or substitution of gifted property into other property. These rules provide that where the donee receives a gift of property other than a sum of money and exchanges that property for another asset of comparable value, the substituted property is to be treated as if it had been comprised in the gift.

There is also a provision under which where a gift is made into trust and that gift is a gift with reservation and the donor then makes a loan to the trustees, the property derived directly or indirectly from the loan is treated as part of the property comprised in the donor's gift into settlement.

GIFT WITH RESERVATION IHT CALCULATIONS

If at the death of a donor, it is determined that he has derived a benefit or enjoyment from the gift in the 'relevant period' (the seven years preceding death) then the property which is subject to the gift will form part of his taxable estate on death, even if he made the gift many years earlier. As there was still a gift, but the property gifted remains in the donor's estate, there are provisions to avoid a double charge to IHT arising. Here HMRC will prepare two IHT calculations:

1. HMRC will calculate the tax on the Potentially Exempt Transfer (PET) ignoring the gift with reservation
2. HMRC will ignore the PET and calculate the tax on the estate as if it hadn't happened

HMRC will then use the calculation which gives rise to the greater IHT charge. Often this will be the position ignoring the PET as assets often increase in value over time and annual exemptions and taper relief may be applied to the PET.

EXAMPLE 1 - GIFT WITH RESERVATION

On 1 November 2018 Sally, who is UK resident and domiciled, makes a gift of a painting to her daughter. The value of the painting was £400,000 at the date of the gift. She had made no gifts in the previous seven years and made no further gifts. However, Sally keeps the painting hanging in the study of her house and therefore the gift is not made to the exclusion, or virtually to the entire exclusion, of the donor (Sally). Sally dies on 1 December 2021 with an estate of £10,000,000 (excluding the painting now valued at £700,000) which was all left to her daughter. Sally has never married.

CALCULATION 1 (ASSUME PET MADE WHICH SUBSEQUENTLY FAILS)

Gift		£400,000
Less annual exemption 2018/19 and 2017/18		(£6,000)
PET		£394,000
Nil Rate Band 2021/22	£325,000	
Less previous (gross) chargeable transfers in last 7 years	(£0)	
Nil Rate Band remaining	£325,000	
		(£325,000)
Taxable		£69,000
IHT payable at the death rate of 40%		£27,600
Less taper relief of 20% (just over 3 years since PET made)		(£5,520)
IHT payable by the daughter on the PET is therefore		£22,080
Estate		£10,000,000
Nil Rate Band 2021/22*	£325,000	
Less previous chargeable transfers in last 7 years*	(£394,000)	
Nil Rate Band remaining	£0	
		(£0)
Taxable		£10,000,000
IHT payable by PR's at 40%		£4,000,000

CALCULATION 2 (EXCLUDE PET AND ASSUME PROPERTY WITHIN ESTATE ON DEATH)

Estate		£10,700,000
Nil Rate Band 2021/22*	£325,000	
Less previous chargeable transfers in last 7 years*	(£0)	
Nil Rate Band remaining	£325,000	
		(£325,000)
Taxable		£10,375,000
IHT payable by PR's at 40%		£4,150,000

*We can ignore Residence Nil Rate Band in both examples as the tapering provisions would apply.

Here, the IHT generated by the second calculation is greater and so would be applied. Of course, had Sally actually gifted the painting to her daughter, the first calculation would have applied and the estate would have paid less IHT as evidenced by the first calculation.

ENDING THE RESERVATION

The reservation will end if the donor no longer has enjoyment of the property gifted. If the reservation ends before death then the position is as follows:

- › If the reservation ceased more than seven years before death, there is no death charge on the property in which the reservation subsisted
- › If the reservation ceased less than seven years before death, the gift is taxed as if the donor had made a PET of the property at the time, on the basis of its value when the reservation ceased. However, an annual exemption cannot be applied to this PET

Again, rules exist in order to avoid a potential double charge to tax occurring which could arise where:

- › There is a transfer by way of a gift of property which subsequently becomes a chargeable transfer by virtue of the donor's death within seven years and
- › The property is, due to the rules relating to the release of gifts with reservation, subject to a further transfer which is chargeable as a result of the donor's death

Here two calculations will need to be performed considering the original PET and the PET made due to the release of the reservation. To avoid a double tax charge only the PET which gives rise to the **greatest charge to IHT** will be considered. This will usually be the PET caused by the release of the reservation, as assets often go up in value and this transfer of value cannot utilise the IHT annual exemptions.

EXAMPLE 2 - RELEASING THE RESERVATION

Following on from the above example, assume that instead Sally had taken the painting off her wall a year later in November 2019 and gifted it to her daughter. This would effectively release the gift with reservation as she would no longer enjoy the benefit. Let's assume at this time the painting was worth £500,000. Here the second transfer on the release of the gift with reservation would create a larger charge to IHT when Sally died on 1 December 2021 as:

- a) the painting has increased in value
- b) the annual exemption cannot be used on the release of a gift with reservation
- c) tapering would not apply as Sally did not survive more than 3 years after the release

This is calculated as follows:

PET		£500,000
Nil Rate Band 2021/22*	£325,000	
Less previous chargeable transfers in last 7 years*	(£0)	
Nil Rate Band remaining	£325,000	
		(£325,000)
Taxable		£175,000
IHT payable by the daughter on the PET at the death rate of 40% is therefore		£70,000

N.B no A/E can be used to reduce this subsequent transfer.

It would be the £500,000 PET that would then be used in the calculations on death as the IHT raised of £70,000 is greater than the original IHT on the gift of £22,080.

The gift with reservation of benefit provisions do not apply to gifts that are exempt. The rules relating to gifts with reservation involving land were tightened with effect from 9 March 1999 in response to the House of Lords' ruling in the case of *Ingram v IRC*. These rules extend the existing provisions to prevent the avoidance of IHT on death by way of a lifetime gift aimed at reducing the value of the donor's estate, while leaving the donor to continue to enjoy the gifted asset as he/she did before the gift.

PRE-OWNED ASSET TAX (POAT)

From 2005/06 provisions have applied to impose an income tax charge where an individual has the benefit of free, or low-cost, use of an asset that they previously owned. The intention is to counter schemes which avoid IHT on gifts with reservation. The provisions apply to land, chattels and gifts into settlements (trusts) of intangible assets. The charge for land will be based on the commercial rental value. The charge for chattels is calculated by applying the official rate of interest (2.25% from 6 April 2020) to the value of the asset (reduced by any payments made for its use).

The charge for intangible assets is also calculated by applying the official rate of interest to its value, reduced by any income tax or capital gains tax payable. There will be no charge if the value of the benefit is £5,000 per year or less.

Where a person is caught by the provisions of POAT they can make an election to instead be treated as having made a gift with reservation of benefit. The decision whether

to make such an election will depend on circumstances including the age of the client, with elderly clients perhaps more likely to prefer an annual income tax charge than have the asset treated as being within their death estate.

BUSINESS INTERESTS

Great care should be exercised where a donor wishes to gift a partnership interest or private limited company shares and still wishes to be involved in the business and receive a salary or share of profit. Such benefits may be considered to be reserved benefits. HMRC have however indicated that provided remuneration is considered to be 'reasonable' then they would not seek to challenge under the gift with reservation provisions.

FURTHER UPDATES IN THIS SERIES AND OUR UTECH SITE

The next Technical Sales Briefing in this series will look at Reliefs from Inheritance Tax.

Note the content in this briefing is taken from our comprehensive Inheritance Tax Manual which is available in the Technical Briefings section of our uTech site (www.utmostinternational.com/wealth-solutions/our-wealth-solutions/united-kingdom/utech). uTech has several other technical briefings exploring the more niche and complex areas of UK IHT. These include several guides to the Residence Nil Rate Band and a detailed briefing exploring Domicile, Remittance Basis and Excluded Property.

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