Planning with owner-occupied property during lifetime

Synopsis: Detailed consideration of IHT planning with owner-occupied property during lifetime.

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This technical paper covers the lifetime planning strategies, some of which are still effective and some of which, while popular in the past, are no longer tax effective.

General consideration of planning with owner occupied property and the impediments to such planning, including the gift with reservation (GWR), pre-owned assets tax (POAT) and anti-avoidance legislation.

Planning with lifetime gifts taking account of the GWR, Eversden and POAT rules

The following are the key tax issues relevant to lifetime gifs of land...

It is necessary to avoid the GWR of benefits provision in section 102 Finance Act 1986. In particular, the donor should not enjoy any benefit from the gift or the value of the property will continue to form part of their taxable estate on their death. In general (and ignoring for the time being the joint occupation let out – please see below), three exceptions exist to this rule...

- Where the donor pays a full market price for their enjoyment (i.e. a rent in the context of the family home). This is covered in more detail below. This arrangement (full rent) would also appear to avoid the POAT rules applying.
- FA 1986 Sch 6(1)(b) provides that occupation of a property is disregarded if...
    i. It results from a change in the donor's circumstances since the time of the gift, provided that it was unforeseen at that time and was not brought about by the donor to enable them to benefit from the rule; and
    ii. It occurs when the donor has become unable to maintain themselves through old age, infirmity or otherwise; and
    iii. It represents reasonable provision by the donee for the donor's care and maintenance; and
    iv. The donee is a relative of the donor or their spouse/civil partner.
- Where there is relatively little benefit to the settlor following the gift.

Back in 1993, HMRC (in Inland Revenue Tax Bulletin of November 1993) provided useful guidance on how this relief would be interpreted. Some examples of what is acceptable are set out below...

a. The donor stays in the house without the donee for no more than two weeks per annum or with the donee for less than one month per annum.

b. The degree of social visits by the donor (excluding overnight stays) are such as might be expected in the absence of the gift.

c. A temporary stay for some short-term purpose, e.g. convalescence by the donor after medical treatment, the donor looking after the donee during the donee's convalescence or during redecoration of the donor's own home.

d. Visits for domestic reasons, e.g. baby-sitting by the donor for the donee's children.

   HMRC did warn, however, that where the benefit to the donor becomes more significant, the gifts with reservation provisions might apply, for example, where...

   i. The donor spends most weekends in the house or for a month or more per annum; or

   ii. A gift of a second or holiday home, which both donor and donee use from time to time.

   There are, as well as the de minimis "let out", a number of other ways whereby an individual might escape the reservation of benefit provisions and make effective transfers for inheritance tax (IHT) purposes. Clearly, ceasing to reside altogether in the property is the most obvious way. The prior sale of the property followed by an unconditional gift of the cash proceeds may also be an attractive alternative. If the cash, after a period of time, is used to buy a property for the occupation of the original donor, it would seem that there would be no GWR because it is not possible to trace a GWR through cash.

   If following such a course of action, great care would need to be exercised and all actions must be unconditional. Such a course of action would, however, to be caught by the income tax charge on pre-owned assets unless the cash gift was made more than seven years before the contribution condition was met (please see above).

2. Capital gains tax (CGT) needs to be considered. No CGT will arise when an interest in the family home is gifted because of the principal private residence

relief, but CGT could arise on a later disposal by the new owner in respect of any capital growth on the property after the gift was made.

3. Stamp duty land tax (SDLT) may apply if the plan involves an element of sale or other valuable consideration.

4. The POAT provisions – largely applying when the GWR provisions are avoided – must be seriously considered as they are of extremely wide potential application.

What follows are the main methods that are considered as ways of making an effective gift of a property or an interest in property. Some work, some no longer work and some work subject to certain conditions.

Full commercial rental

IHT effective - no POAT

There is a statutory provision (in the shape of FA 1986 Sch 20 para 6(1)(a)) that provides there will be no GWR if full consideration is given for the gift. In the context of the private residence, there would, typically, be a gift (say, to children) with a lease back granted by the new owners at a full market rent. This would also prevent there being a deemed settlement under IHTA 1984 S43(3). The payment of full consideration would also enable a gift of property and continued use/ occupation by the donor to avoid the POAT provisions.

The above-mentioned Inland Revenue Tax Bulletin of November 1993 gave guidance on the meaning of “full consideration”. To avoid the GWR provisions, full consideration is required throughout the relevant period (i.e. the seven-year period before death) and there should be periodic rent reviews to reflect market changes. It is accepted that there is no single value at which consideration can be fixed as “full” and that as there are a range of values reflecting normal valuation limits, any amount within that range can be accepted as satisfying the “full consideration” test.

The payment of rent to remain in occupation of the family residence will be unacceptable to most people, because it will mean that a person will need to suffer a loss of net spendable income in attempting to save IHT. Also, future capital growth will be potentially subject to CGT in the hands of the new owner (unless it is also their principal private residence) and the rent will be subject to income tax in the hands of the recipient.

On the other hand, for a client with an IHT problem and a large amount of excess income, payment of a commercial rent for continuing occupation of a gifted property may be an attractive method of planning.

Impact of planning on availability of the Residence Nil Rate Band (RNRB) – legislation is included in Finance Act 2016 which is designed to compensate those who have disposed of their only residence prior to the death for the loss of all or part of the RNRB.

However, to qualify for this ‘additional nil rate band’, both the lower value property (if any) and assets of equivalent value to the ‘lost’ RNRB must be left to lineal

descendants (or their spouses/civil partners) on death. Consequently, the advantages of an IHT effective lifetime gift of a qualifying residence will need to be reassessed having regard to factors such as the value of the qualifying residence, the life expectancy of the donor and the availability of other assets of equivalent value in the estate. If there is any doubt that the donor will live for seven years, the gift may create an additional IHT liability unless there are other assets in the estate, equivalent in value to the lost nil rate band that will be 'closely inherited' on death. For more information on the RNRB and the downsizing provisions, please see The residence nil rate band.

Gift of part of the property with donee remaining in occupation – co-ownership as tenants in common

Can be IHT effective - no POAT

Another possible planning route that can avoid the GWR and the POAT rules, which may be appropriate if adult children are living at home, is for the parent(s) to make a gift of a proportion of the property to the child and for that child to occupy the property with the donor and pay an appropriate proportion of the outgoings on the property.

In 1999, the original 1986 legislation was supplemented as regards this particular aspect by section 102B Finance Act 1986, that requires that the donor should not receive any benefit, other than a negligible one, which is provided by or at the expense of the donee.

It is, therefore, important that one should take great care to ensure that the donee does not contribute too much towards the running costs of the property. The donor will clearly not receive any benefit if they continue to pay all the running costs. It may be arguable, however, that the donor does receive a benefit in a case where, for example, a 75% interest is given away and the donee thereafter pays 75% of the running costs.

The view could be taken that there is equal enjoyment of the property and therefore the donee is providing a benefit to the donor by paying most of the running costs. Under section 102B(4), it is clearly acceptable if the donor pays everything: the problems arise in quantifying how much the donee can safely pay.

Under this route, the problems of joint ownership will need to be considered and, in particular, thought should be given as to what happens if one of the co-owners wants to force a sale. Possibly, an option to acquire the interest at market value by way of first refusal would be preferable to a restriction on sale without the written consent of the others.

In addition, a problem will arise if, and when, one or more of the donees decides to move out of the property (as could be the case with an adult child), as this will bring the gift back into the GWR net unless a full commercial rent in respect of the part of the property not owned by the donor then commences.

An advantage of this form of planning is that, on the donor's death, the value of their share will be discounted by perhaps 10-15% to reflect the joint ownership.

In conclusion, and as a general guide, it is recommended that ownership and the payment of household expenses in these "shared occupation" cases should be on a 50/50 basis to minimise the risk of any HMRC's scrutiny/attack.

Impact of planning on availability of RNRB – RNRB can be offset against an interest in a qualifying residence as well as a residence that is left to lineal descendants in its entirety. Provided, therefore, that the retained share is of sufficient value to utilise the RNRB, there will be no adverse consequences of planning. Where the value of the retained share is significantly below the RNRB (which is £175,000 in 2022/23), then the same considerations as outlined above (please see 'Full commercial rental') will apply.

Lease carve out

No Longer IHT effective - POAT can apply if GWR doesn't

Prior to 9 March 1999, one popular method of making a gift of the private residence but avoiding the GWR provisions was by way of the lease carve-out scheme. Here, the original owner would transfer the property to a nominee who created a lease in the original owner's favour. The lease, which could be for a nominal rent, would be set to run for a period exceeding the original owner's life expectancy.

The freehold reversion would then be gifted to children or a suitable trust. The benefits were that the value of the lease gradually reduced the longer the original owner survived until expiry date and, after seven years, the gift of the freehold would fall outside the taxable estate of the original owner.

In Ingram v CIR (1999 STC 37), the House of Lords held that a carve-out of a clearly defined proprietary right is valid under English law and that no reservation of benefit existed by virtue of a lease carve out scheme in that case.

However, the effect of the Ingram decision has been significantly restricted in relation to gifts after 8 March 1999 by provisions introduced in the Finance Act 1999 and it is necessary to consider how these may apply to the scheme under consideration.

By virtue of Section 102A Finance Act 1986 (inserted by S104 Finance Act 1999), if a gift of an interest in land is made after 8 March 1999, it is treated as giving rise to a reservation of benefit if at any time in the relevant period (the seven years before the donor's death or, if shorter, the period from the date of the gift to the date of the donor's death) the donor or their spouse/civil partner enjoys a significant right or interest in relation to the land or is party to a significant arrangement in relation to the land.

A right, interest or arrangement is significant for this purpose if (and only if) it entitles or enables the donor to occupy all or part of the land, or to enjoy some

right in relation to all or part of the land, otherwise than for full consideration in money or money's worth. A right, interest or arrangement is not significant if either...

- It does not (and cannot) prevent the enjoyment of the land to the entire exclusion (or virtually the entire exclusion) of the donor; or

- It does not entitle or enable the donor to occupy all or part of the land immediately after the disposal, but would do so were it not for the interest disposed of; or

- In the case of a right or interest, that right or interest was granted or acquired more than seven years prior to the date of the gift. [This exclusion seems to indicate that the GWR problem can be avoided if the estate owner can undertake their planning over a 14-year window (although as we have seen, schemes if this type will now be caught by POAT).]

The provisions will not apply where...

- The gift is itself covered by the main exemptions from IHT, including transfers between spouses/civil partners (e.g. where husband as sole freeholder gives wife a share so that they become co-owners as joint tenants or tenants in common);

- The retained right or interest is negligible so that the donor is virtually entirely excluded from any enjoyment of the land – ("virtual exclusion" means that the benefit obtained by the donor is insignificant in relation to the gifted property. HMRC outlines a number of situations where limited benefits could arise to a donor without causing the reservation of benefit rules to come into play here);

- The donor pays full consideration for their occupation of that land (please see FA 1986 Sch 20 para 6 FA 1986, e.g. a market value rent or premium);

- The occupation of the land is effectively forced on the donor by some unforeseen downturn in their financial circumstances (e.g. please see the very restricted scope in Sch 20 para 6(l)(b)) FA 1986); or

- The gift is made more than seven years after the right, interest or arrangement concerned is created or entered into.

It should be noted that for section 102A Finance Act 1986 to apply there must be a disposal of an interest in possession by way of gift.

Example

Lady Elizabeth carves out a lease for herself and her husband for 20 years on 10 March 1999. On 11 March 2006, she gives away the freehold reversion to her children - i.e. as a potentially exempt transfer (PET). Lady Elizabeth dies on 12

March 2013. The gift of the freehold reversion appears to be effective as a PET and without GWR problems. The HM Treasury Explanatory Notes to Finance Bill 1999 state: *"For example a lease created and retained by a donor will not be a reservation in relation to the gift of the freehold reversion made more than seven years after the creation of the lease."*

Clearly any planning strategy using the private residence must, in order to be successful, avoid the potential application of section 102A. This will mean that the arrangement must either...

- Be structured in such a way as to avoid a gift, or

- The donor should carve out a lease which he keeps for their own benefit together with the freehold reversion. After seven years, he can gift the freehold reversion without giving rise to a GWR. Provided he then survives this gift by a further seven years, this lifetime gift will drop out of account for IHT purposes.

The POAT rules will also now need to be borne in mind.

Impact of planning on availability of RNRB – As this type of arrangement will now usually either give rise to a GWR or a POAT charge, it is unlikely to be in point. However, clients who do enter into a variant of the scheme (perhaps accepting the POAT charge) will need to bear in mind that RNRB can only be used where a qualifying residential interest is 'closely inherited' on death of the owner. As this arrangement involves a lifetime gift of the freehold interest in the property (leaving the donor with a lease of negligible value), the benefit of the RNRB will not be available.

Downsizing provisions included in Finance Act 2016 compensate those who have sold or otherwise disposed of a qualifying residential interest after 8 July 2015 (but before their death), with an additional amount equivalent to the amount of RNRB 'lost' by virtue of the disposal, provided that other assets of equivalent value to the lost RNRB are closely inherited instead.

As long as all the other conditions are satisfied, the 'downsizing addition' would appear to be available even where the disposal is not of the entire interest in the property.

Spousal interest trust

No longer IHT effective - POAT can apply if GWR doesn't

In the Court of Appeal decision in CIR -v- Eversden in May 2003 the Court held that, where a settlor created a trust under which their spouse had an immediate interest in possession, then, even if the settlor was a potential beneficiary under the trust, the gift to the trust would not be a GWR.

This was because of the exemption in section 102(5)(a) Finance Act 1986, which states that a gift will not be a GWR *"to the extent that the disposal of property by way of gift is an exempt transfer by virtue of...the spouse exemption"*.

The impact of the IHT legislation was to treat the settlor's spouse as owning the trust capital supporting the interest in possession, so the Court found that the gift was fully covered by the spouse exemption.

This meant that a later appointment of benefits by the trustees away from the spouse in favour of, say, children, even if only a short time thereafter, would mean that the trust property would be outside of the GWR rules even though the settlor could, at a later date, benefit from the trust.

To combat planning involving spousal interest trusts, the Government introduced changes to s 102(5) FA 1983 in Finance Act 2003 which affect trusts created on or after 20 June 2003.

The new provisions (now embodied in sub-sections (5A) and (5B) to section 102 FA 1986) disapply the previous exception from the GWR provisions in section 102(5)(a), Finance Act 1986 for gifts to a spouse/civil partner where gifts are made after 19 June 2003 where...

- The property becomes settled property by virtue of the gift;
- The trusts of the settlement give an interest in possession to the donor's spouse/civil partner, so that the gift is exempt from IHT by reason of the exemption for transfers between spouses/civil partners and the rule which treats an interest in possession as equivalent to outright ownership;
- Between the date of the gift and the donor's death the interest in possession to the spouse/civil partner comes to an end; and
- When that interest in possession comes to an end, the donor's spouse/civil partner does not become beneficially entitled to the settled property, or another interest in possession in it.

In applying section 102 in these circumstances, the original disposal by way of a gift will be treated, where relevant, as having been made immediately after the donor's spouse's/civil partner's interest in possession ends, so that the circumstances before that time will not be considered in determining whether the gifted property is "property subject to a reservation" for IHT purposes.

Trusts set up before 19 June 2003 remain effective for IHT purposes but will be caught by the POAT charge unless the deemed annual benefit is within the de minimis limit or the settlor has been excluded from benefit.

Impact of planning on availability of RNRB – As spousal interest trusts created on or after 19 June 2003 will give rise to a gift with reservation, these schemes are

now more or less redundant and a consideration of the impact on the availability of the RNRB is therefore unnecessary.

Schemes that were created prior to 19 June 2003 (and that remain IHT effective) do not adversely affect the availability of transferable RNRB (TRNRB) where a claim for TRNRB could otherwise be made.

The lifetime (or home) loan plan – double trust scheme

Can be effective to avoid GWR but caught by POAT provisions

This plan, which is also known as the "double trust" scheme, typically worked as follows...

- The owner of a private residence established a life interest trust (Trust 1) under which the owner had the interest in possession. The owner paid £10 to establish the trust.

- The owner sold the private residence to the trustees of Trust 1 at a full market value with a fixed sum paid as a deposit and the balance payable on completion. The unpaid sale price was left outstanding but was payable by the trustees on demand to the owner's personal representative under the terms of a promissory deed (loan note). With some versions of the scheme, no interest was charged under the loan note, with others the interest is rolled-up (please see below). Payment of the outstanding amount could not be enforced by the owner during their lifetime.

- Under the terms of Trust 1, the owner is the life tenant. They are therefore entitled to occupy any dwelling house owned by the trustees.

- The owner then owns the benefit of a loan note. They would give this away to another trust (Trust 2) for the benefit of their family. This trust would normally be a power of appointment interest in possession trust from which the owner was excluded from benefit. The children or grandchildren of the owner would normally be entitled to the interest in possession under the trust.

- The owner occupied the house under the terms of Trust 1.

- On the owner's death, the debt would need to be repaid to the trustees of Trust 2. To achieve this, the trustees of Trust 1 would need to sell the property and use the proceeds of the sale of the property to repay the debt to the trustees of Trust 2.

The tax implications and benefits

The scheme raised a number of tax implications as follows...

- The establishment of the life interest trust (Trust 1) for £10 prior to 22 March 2006 would not give rise to a PET for IHT purposes because the settlor had the interest in possession and therefore was treated as owning the trust capital in which the interest subsists. Therefore, there was no transfer of value.

- The transfer of £10 to Trust 1 would not give rise to any CGT implications.

- The sale of the house to the trust would trigger a disposal for CGT purposes but no tax would arise because of the principal private residence exemption.

- The sale of the house to the trust would only be a disposition for IHT to the extent that the owner's taxable estate was reduced. Such a reduction could arise to the extent that the trustees did not actually pay a fixed sum deposit or if the value of the house exceeds the sale price. However, because the owner was the life tenant (and therefore treated as owning the trust capital) this would not give rise to a transfer of value for IHT purposes.

- The sale/transfer of the property to the trust would be regarded as a conveyance on sale for stamp duty purposes (please see below).

- No income tax should arise as, in most cases, there would bet no interest payments made on the loan note. If interest is paid, there would clearly be an income tax charge on this. As the trustees will not have any cash to pay the interest, it was sometimes the case that interest was rolled up and paid when the house was later sold. Tax would still be payable on interest even if it were paid at a later date.

- The gift by the owner of the benefits of the loan note (prior to 22 March 2006) would represent a PET equal to the benefit of the sum payable. No immediate IHT should arise and the gift would fall out of account for IHT if the owner survived it by seven years.

- The CGT principal private residence relief would continue to apply to the private residence owned by Trust 1 because the owner would occupy the house under the terms of the trust by virtue of being the life tenant (section 225 Taxation of Chargeable Gains Act 1992).

- On the death of the owner, there would be a revaluation of the trust assets (i.e. the house) for CGT purposes with a consequent uplift in the base value of the house to the then current value. This means that no CGT should arise on the subsequent sale of the property quite soon after the owner's death.

- On the owner's death, because they were entitled to the interest in possession under Trust 1, the capital value of the trust fund would be treated as forming part of their taxable estate. At that stage, the capital

value of the trust fund would be the value of the house less the debt (now owing to Trust 2). This meant that the value remaining in the owner's estate would be the value by which the value of the house then exceeded the purchase price plus any growth in value since the sale.

- If the owner survived the gift of the loan note to Trust 2 by seven years, there would be no charge to IHT on that gift. If they died within seven years, the PET would become chargeable with the usual tax consequences.

- The POAT charge will apply to the donor's continued occupation of the house from 6 April 2005. Indeed, when POAT was introduced, it was intended to catch (inter alia) home loan schemes and, in many cases, substantial sums of income tax have been paid. In some cases, taxpayers were advised to opt into reservation of benefit because this prevented a POAT charge applying.

Technical considerations

- As the scheme involved a sale of a property to a trust then, clearly, one had to consider stamp duty, which could involve substantial amounts for the types of property used in these schemes. Until the 1 December 2003, it had been possible to avoid the stamp duty issue by arranging for the transaction to "rest in contract". In other words, the parties exchanged contracts but did not complete the transaction. However, changes introduced by Finance Act 2002 became effective from 1 December 2003 to mean that such transactions resting in contract will not avoid stamp duty.

- Of course, it could be argued that, even though stamp duty is incurred at 4%, this is much better than IHT at 40%. However, not many of these schemes were entered into after 1 December 2003.

- A homeowner using this plan would lose overall direct control of the property and so if they wanted to directly derive the capital value, they could not do so. However, as well as being the life tenant, the owner would be a potential beneficiary as to capital under Trust 1 and so the trustees could exercise their power to benefit them. The outstanding indebtedness under the loan note would first need to be considered.

- As the asset held by Trust 1 would already be treated as forming part of the life tenant's taxable estate by virtue of their interest in possession, there would be no GWR issues because of section 102(3) Finance Act 1986. The owner would have lost all access to the value of the loan note. The trust capital (the house) would be subject to the debt and this could affect the valuation for IHT purposes.

- It is likely that the trustees would wish to enforce repayment of the loan note following the owner's death (as being interest free it is not a good

investment). The house would possibly need to be sold at that time and it may not be known whether the children and the owner would wish this.

- The only value that has been removed from the owner's taxable estate is the value of the loan note. The balance of the house value (less the debt) remains in their estate. The owner had to survive the gift of the loan note by seven years for it to fall out of account for IHT purposes.

HMRC attitude

This plan was complex and involved a number of difficult tax points and there was no certainty that HMRC would accept the tax implications put forward by the promoters of the scheme.

Indeed, for many years HMRC argued that these schemes were caught by the GWR rules on the basis that the donor reserved a benefit on the loan because it is not called in by the second trust – thereby allowing them to continue to enjoy the property (though this view was not generally accepted).

The approach of HMRC is as follows...

a) in the POAT Guidance Notes published in 2005 they distinguished between:

(i) schemes where the loan was payable "on demand" which was considered to confer a significant benefit on the taxpayer in that he continued to live in the property so that *"the debt was not enjoyed to the entire exclusion of any benefit to the vendor(s) by contract or otherwise";* and

(ii) other schemes where the debt was only repayable after death where they stated that "*since the loan cannot be called in by the loan trustees it is generally thought that these schemes will not be caught as gifts with reservation."*

(b) In October 2010, this Guidance was revised with the inclusion of the following sentence...

"HMRC is now of the view that these schemes [those in (ii) above] *are also caught as gifts with reservation. Further guidance, including the consequences for the POA charge, will be issued shortly."*

(c) In October 2011, there was a further update as follows (taken from the IHT Manual)...

"Where the terms of the loan are that the debt is only repayable after the death of the life tenant, the settlor still obtains a benefit that is referable to the gift.

This is because by signing up to a loan which was repayable only after their death, the individual has ensured that their continued occupation of their home cannot be disturbed. So, whilst they no longer own the property, they have prevented the holder of the loan note from upsetting their enjoyment of the property. That is a

benefit to them and one that arose directly from the terms of the loan that was given away.

The benefit arises within the terms of FA86/ Sch20/ Para 6(1)(c), so the loan note should properly be regarded as subject to a reservation of benefit under FA86/ Sch20/ S102(1)(b).

Alternative arguments have been put by taxpayers and the matter is being litigated."

The latest view from HMRC is that they now consider that there are three alternative arguments open to them to argue that the scheme is caught by the GWR provisions…

(a) the loan is disallowed under FA 1986 s103 (the "artificial debt rules");

(b) a reservation of benefit exists in the loan;

(c) per Ramsay there is a GWR in respect of the property.

Of course, even if the double trust scheme were successful in avoiding the GWR provisions, it will be caught by the POAT provisions.

Impact of planning on availability of RNRB – Assuming that the scheme does not give rise to a GWR, the sale of the property to Trust 1 will result in loss of the RNRB unless the donor leaves assets of equivalent value to the value of the property at the time of the gift to direct descendants on their death. There may be scope for the donor to offset RNRB against their trust interest if Trust 1 was created prior to 22 March 2006 and the occupying donor's life interest passes absolutely to lineal descendants on their death. However, little detail is available on this aspect of the legislation at the time of writing and legal advice will be essential.

Of course, many clients who have entered into these schemes will have estates well in excess of the £2m taper threshold and so will be ineligible for RNRB in any event.

Reversionary lease scheme

Caught by the POAT provisions if not a GWR

Under a reversionary lease scheme, the taxpayer grants a long lease to a donee (perhaps their children or a trust) to take effect at a future date, reserving no rights to the lessor.

Generally, the idea is that the lease will not come into effect until after the death of the homeowner, so the deferred period of the lease ties in with the houseowner's life expectancy (although a term of less than 21 years to avoid falling foul of Law of Property Act 1925 S149 (3)).

It is generally thought that section 102A Finance Act 1986 (Gifts with Reservation: Interest in Land – please see above) has no impact on reversionary lease schemes in relation to a person's home so long as the freehold was acquired more than

seven years before the gift of the reversionary lease, or alternatively, as will often be the case, if it was acquired by the donor for full consideration (please see section 102A(3)).

The scheme would then work by means of a lease for a term of 99 years over the property being granted to an intended beneficiary, the start date for the lease being deferred until a suitable date in the future, say, fifteen years. A peppercorn rent is charged and there would be no covenants to benefit the freeholder at the expense of the tenant. The gift of the 99-year lease is a PET.

The scheme is thought to be effective in avoiding the GWR rules on the basis that the donor continues to occupy the land by virtue of their freehold interest (rather than as a consequence of any 'significant right, interest or arrangement' in respect of the land). However, HMRC does not agree and is likely to challenge cases where they consider a GWR to be in point.

The reversionary lease scheme suffered a further blow, so far as it is implemented in relation to leasehold property, by the decision of the Upper Tier Tribunal in Buzzoni v HMRC [2011]. HMRC argued that, because the lease contained terms that could be deemed beneficial to the donor, a GWR arose. However, the Court of Appeal overturned the tribunal decision in 2013, confirming that positive covenants in favour of the donor did not constitute a GWR of benefit to the extent that they *"merely mirrored but did not add to the obligations which the underlease already bore under the licence to underlet".*

The scheme also suffers from the drawback that the reversionary lease will normally have a very low CGT base cost that will ultimately come to be worth all the value in the property. Thus, unless the donees of the reversionary lease are in occupation, there is a significant potential future CGT problem as there will be no substantial revaluation on the owner's death.

The problem is the eventual CGT liability that will be incurred by the holder of the reversionary lease. To deal with this, the client could settle the reversionary lease onto a life interest trust for their adult children. Prior to the settlement, the trustees will have appointed a small part of the initial trust fund onto a life interest trust for the client. Except for this sub-trust, the client is excluded from all benefit under the trust to the extent that they do not reserve any benefit in the gift to the children's life interest trust. They then gift the freehold shorn of the reversionary lease to the sub-trust. The client occupies as life tenant until such time as the lease commences. This should enable the trustees to claim principal private residence relief for the whole property. On the client's death, only the value of the freehold shorn of the lease should remain in their estate.

It is reiterated that although these schemes can avoid the GWR provisions they are now likely to be caught by the POAT provisions resulting in an income tax charge.

Impact of planning on availability of RNRB – As mentioned above, those who downsize to a lower value home prior to death may be eligible for an additional

amount of nil rate band equivalent to the amount of RNRB ‘lost’ by virtue of the downsize.

While it would appear from a direct reading of the legislation that ‘additional nil rate band’ may be available to compensate the donor for the loss of any RNRB occurring as a result of the grant of a reversionary lease; the position is by no means clear. The deceased’s residual freehold interest will of course be a ‘qualifying residential interest’ (and so theoretically eligible to receive the benefit of RNRB if left to direct descendants).

However, given that the value of the freehold interest will diminish over time, the benefit of the RNRB may well be lost for all practical purposes if this scheme is successfully implemented.

Second properties (e.g. holiday homes)

It is generally easier to make lifetime gifts of this type of property without infringing the GWR provisions, even if the donor intends to use the property occasionally. However, it is also necessary to take into account the POAT rules as ‘occupation’ is construed widely for these purposes.

Avoiding these provisions can be achieved using the co-ownership route (please see above) or by the donor paying rent for the time spent there. Both are based on the commerciality underlying the arrangement.

Alternatively, unconditional cash gifts that are invested by donees in second properties that the donors occasionally use can avoid the GWR problem because it is not possible to trace a GWR through cash. However, this route would not be effective to avoid the POAT provisions which **do** contain tracing provisions.

Note that a second property is not a ‘qualifying residence’ for the purposes of the new RNRB rules unless it has been occupied by the owner as a residence at some point during their period of ownership. Consequently, the ‘additional’ nil rate band that will be given where a qualifying residence is sold or otherwise disposed of prior to death, may be unavailable in these circumstances.

Gifting a second property and avoiding CGT

“Discretionary trust and hold over” plan no longer effective

Prior to 10 December 2003, it was possible to avoid a CGT charge on a gift of a second property by making a prior gift of that property into a discretionary settlement. Any capital gains could be held over on transfer into the trust. The next step was for the beneficiary and trustees to elect for the property to be treated as the beneficiary's principal residence for CGT purposes. On a subsequent sale, the principal private residence exemption applied to the whole gain (i.e. including the held-over gain).

However, principal private residence relief is not available for disposals made on or after 10th December 2003 by an individual or the trustees of a settlement, and where the computation of the amount of any gain arising on the later disposal by

the trustees has to take account of hold-over gifts relief obtained under section 260 of the TCGA in respect of an earlier disposal. This was subject to a transitional provision, which restricts the amount of private residence relief available if the earlier disposal concerned was made before 10th December 2003. If there was more than one relevant earlier disposal the transitional provisions applied only if all those earlier disposals were made before that date.

These provisions do not apply in any case where the gain arising on the disposal is not in any way affected by a gifts relief claim under section 260 of the TCGA in respect of an earlier disposal into the trust.

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