Tax treatment of pre-owned assets (POAT)

Synopsis: The tax treatment of pre-owned assets (POAT).

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The basics

The pre-owned assets tax (POAT) rules were introduced in Schedule 15 Finance Act 2004 to combat inheritance tax (IHT) avoidance schemes which allowed individuals to make gifts of assets whilst retaining access but avoiding the gift with reservation rules. These statutory provisions are supplemented by Regulations introduced in March 2005 and HMRC guidance published at the same time (please see Appendix).

In short, the rules can apply an annual income tax charge on a donor who enjoys (or can enjoy in the case of intangibles) a free benefit from an asset that they have previously disposed of for less than full consideration and the IHT gift with reservation provisions do not apply.

The rules can apply where the donor has made a disposal of land, chattels and intangibles for less than full consideration or where they have made a contribution to the purchase of land or chattels. The following are some of the basic rules that apply in connection with this legislation...

(i) The POAT income tax charge applies from tax year 2005/06, i.e. from 6 April 2005.

(ii) There will be no tax charge where the property is already subject to the IHT gift with reservation rules and, where it is not, the taxpayer can elect for this treatment so as to avoid a POAT charge.

(iii) The POAT rules will not apply to the extent that all or part of the gifted property is comprised in the donor's taxable estate.

(iv) There will only be a tax charge where the value of the benefit in the tax year (when added to any other such benefits) exceeds £5,000 and where it does exceed this amount, the whole amount of the benefit is subject to income tax not just the excess.

The rules apply to land and chattels in a different way from intangibles except as regards the exemptions which are common to all three types of asset. Here we deal with land and chattels first then intangibles.

Gifts of land and chattels

When the rules apply

An income tax charge can arise when an individual, at any time during a tax year, occupies land or possesses/uses chattels where one of the following two conditions is satisfied...

(i) At any time after 17 March 1986 the individual owned an interest in the land which they now occupy or a chattel they now possess/use and the relevant land or chattels were given away after 17 March 1986. This is known as the **disposal** condition.

The disposal condition is also satisfied if the individual gave away other property they owned, of whatever nature, the proceeds of which were directly or indirectly applied to buy land or chattels they now occupy or use.

(ii) An individual has made a gift of cash after 17 March 1986 (note the relevant date was later confirmed to be 5 April 1998 – please see later) which is eventually applied towards the acquisition of an interest in land or chattels which the donor occupies or uses. This is known as the **contribution** condition.

In considering whether these provisions apply, as ever, it is worthwhile taking account of HMRC's interpretation of these rules, some of which are as follows...

- Land or chattels comprised within a life interest trust are not regarded as "owned" by the life tenant.
- An interest in a partnership owning land is not regarded as an interest in land.
- The term "occupies" does not extend to the mere enjoyment of income from land, but "occupation" can continue despite periods of physical absence.

  HMRC guidance notes give some guidance on the meaning of occupation and confirm that someone is not in occupation if the property is let, but they are in occupation if they use it for storage or have sole possession of the means of access and use the property from time to time. Thus, merely restricting actual use to three months of the year will not be sufficient, if, in fact, the client has the right to use it throughout the year.
- The giving of a guarantee does not fall within the contribution condition.
- Creating a new interest in land or chattels out of an existing interest is treated as a disposal of part of the existing interest.
- HMRC takes the view that IHT avoidance schemes, such as the Ingram lease carve-out scheme, the deferred lease scheme, the double trust IOU scheme and Eversden type schemes, are within the scope of these provisions to the extent that they circumvent the gift with reservation rules (although it is important to note that, in the view of HMRC, some of these schemes are not effective for IHT purposes). We consider the impact of these rules on such schemes in more detail below.
- HMRC in its guidance on the POAT has confirmed that the making of an interest free loan does not fall within the POAT charge.

  If an individual makes a cash gift to another who already owns

land/property and the donee uses the cash gift to, say, build an extension that the donor occupies, the gift with reservation rules will not apply (gift of cash) and the POAT rules will not apply because the donee has not used the cash to **acquire** an interest in land.

Excluded transactions

Paragraph 10 of HMRC guidance sets out the transactions excluded from the POAT rules. The excluded transaction provisions **only** apply to gifts of land and chattels - not gifts of intangibles. Whether an exclusion applies will need to be tested at the appropriate time.

There will be no POAT charge where a donor has made a disposal of land or chattels which he occupies or uses (under the disposal condition) or on a cash gift which is used to purchase land he occupies or chattels he uses (under the contribution condition) if the transaction falls within one of the following exclusions...

(i) The disposal is of the individual's whole interest in property by a transaction made (or such as might be expected to be made) at arm's length with an unconnected person, i.e. the sale of a whole interest on commercial terms (Paragraph 10 of Schedule 15 Finance Act 2004).

It should be noted, however, that following concerns that taxpayers who have entered equity release schemes may be caught by these rules, relief has been given for certain part disposals of land in regulation 5 of the Charge to Income Tax by Reference to Enjoyment of Property Previously Owned Regulations 2005.

Regulation 5 has the following effects...

- a sale of a partial interest in a house will always be exempt if made to a commercial organisation (e.g. an equity release company);
- a sale of partial interest before 7 March 2005 to a connected party will be exempt if made on arm's length terms;
- a sale of a partial interest after 6 March 2005 to a connected party will be exempt if made at arm's length for a non-cash consideration (e.g. in exchange for other land). This will help farmers who enter into land swap arrangements.

(ii) It is a transfer to the individual's spouse/civil partner (or by court order to their former spouse/civil partner).

(iii) It is a gift which results in the property becoming settled property in which the individual's spouse/civil partner has an interest in possession. It should be noted that this protection only exists whilst the spouse/civil partner has an interest in possession. In Eversden type spouse alienation schemes involving a private residence, once the spouse's life interest is revoked the trust will be subject to the POAT rules if the settlor occupies the house that is the trust property.

There has been some debate as to whether the spouse or civil partner must take an interest in possession from the outset in order for the gift of chattels or land to be an excluded transaction under paragraph 10 or whether it is sufficient for the spouse/civil partner to take an interest in possession later and for it to become at that point an excluded transaction. HMRC has taken the firm view that the spouse/civil partner must take an interest in possession from the outset. Hence a gift into trust for the settlor followed by an interest in possession trust for the spouse/civil partner would appear not to be an excluded transaction.

(iv) It is a disposition falling within the IHT family maintenance exemption in section 11 IHT Act 1984.

(v) It is an outright gift to an individual falling within the IHT £3,000 annual exemption or the small gifts exemption.

These are the transactions that are excluded under the **disposal** condition. The exclusions from the **contribution** condition are set out separately, but mirror the transactions in (i) to (v) above. There is also one particularly important extra exclusion from the contribution condition. This applies if an outright cash gift is made at least seven years before the earliest date on which the donor occupied the land or had possession or use of the chattels (as the case may be) purchased by the cash gift.

The reasoning behind this last exclusion is that the gift with reservation provisions in Schedule 20 Finance Act 1986 are not extensive enough to catch cash gifts made outright to individuals unless the associated operations provisions apply, which is unlikely to be the case. Therefore, if a cash gift does indeed escape the gift with reservation provisions and the donor later benefits from assets purchased from the cash gift, a POAT charge could arise.

This exclusion means that provided no donor enjoyment exists for seven years, a cash gift escapes the POAT provisions. Indeed, HMRC has confirmed that any cash gift made before 5 April 1998 is outside of the POAT rules because no tax charge could arise within seven years of the gift (given that the POAT rules did not become effective until 5 April 2005).

Exemptions

Paragraph 11 of Schedule 15 sets out various exemptions from the POAT rules. It should be noted that these exemptions apply to gifts of land, chattels **and** intangibles. The most important are as follows...

(i) There is no POAT charge where the property is part of the donor's estate. This means that there will be no charge if the property has been returned to the donor, for example if the original arrangement has been unscrambled, or if it is held in a trust under which the donor is entitled to an interest in possession.

An important qualification to this rule exists in cases where the value of a person's estate is reduced because of an "excluded liability". Here, the property that is exempt from the POAT charge (known as the "relevant property") is only treated as

comprised in the person's estate to the extent that its value exceeds the amount of the excluded liability. So, there will only be an exemption from the POAT charge to the extent that the value of the property exceeds the excluded liability.

It is this qualification that counteracts the IHT effectiveness of the lifetime double trust private residence schemes.

(ii) A POAT charge will not arise if the gift is subject to the IHT gift with reservation of benefit provisions.

(iii) There will be no POAT charge in cases where the gift is saved from being a gift with reservation because of the gift with reservation exemption from joint occupation in section 102B(4) Finance Act 1986 where both occupants pay a share of the outgoings on the property. Therefore, if a mother gives cash to her son and they buy a house jointly there is no reservation of benefit and there is no POAT charge (paragraph 11 (5)(C)).

(iv) There is no POAT charge if the gifted property would have been subject to the gift with reservation provisions but was excluded by the let outs in paragraph 6 of Schedule 20 Finance Act 1986, e.g. the donor gave full consideration for the enjoyment of their benefit.

The guidance notes provide confirmation that where a gift would be subject to a reservation of benefit but for the fact that the donor is paying full consideration for their use or occupation of the land or chattels, such full consideration brings the gift not only outside the reservation of benefit provisions but also outside pre-owned assets. Paying full consideration under para 11(5)(d) could be different from paying a rent under paragraph 4 of Schedule 15 and in some cases may be preferable for taxpayers.

(v) There will be no POAT charge in cases where there has been a disposition by way of a deed of variation made within two years of a deceased's death (paragraph 16). This means that, if, within two years of one spouse's/civil partner's death, the surviving spouse/civil partner enters a deed of variation to vary the destination of assets they inherited from their spouse/civil partner in favour of another person yet still continues to enjoy the benefits of that property, there will be no POAT charge.

Intangibles

When the rules apply

For the POAT rules to apply to intangibles (which includes life assurance policies), two conditions in paragraph 8 of Schedule 15 need to be satisfied...

(i) There must be a settlement

The first condition that needs to be satisfied is that there must be a **settlement of property**. What does "settlement" mean for these purposes?

Well, a clue may be given by the second limb of the POAT test (please see (ii) below) which relates to whether the settlor would be taxed under sections 622 and

624 to 627 ITTOIA 2005. This is a clear reference to a settlement in the income tax code and for income tax purposes, settlement has a very wide meaning as set out in section 620(1) ITTOIA - “settlement” includes any disposition, trust, covenant, agreement, arrangement or transfer of assets.

However, paragraph 1 of Schedule 15 states that “settlement” for the purpose of Schedule 15 has the meaning given in section 43 IHT Act 1984. This is of fundamental importance because the IHT meaning of settlement in section 43 IHT Act 1984 is more limited than that which applies for income tax. For example, a bare trust is not a settlement for IHT (and therefore for the purposes of the POAT rules) yet a bare trust is a settlement for income tax purposes.

(ii) The settlor must be subject to tax under sections 622 and 624 to 627 ITTOIA 2005 on the income of the settlement

Sections 622 and 624 to 627 ITTOIA 2005 are the anti-avoidance income tax rule that states that where a settlor (or their spouse/civil partner) may enjoy any benefit from a settlement, then any income will be taxed on the settlor. For the purposes of the POAT rules, however, one excludes any reference to the settlor’s spouse/civil partner (again to provide correlation with the IHT gift with reservation rules). The key question is therefore can the settlor benefit under the settlement?

In interpreting these provisions, it is possible for a gift to be made to a single settlement but held on more than one trust. So, for example, in such cases the property could be held by the trustees on a number of sub-trusts. Each of those sub-trusts would then need to be tested separately to see if it constitutes a settlement and, if so, whether the settlor could benefit under the settlement.

For example, it is possible that a person could make a gift of property to trustees under which some of that property was held on bare trust for a beneficiary (not a settlement) and the rest on discretionary trusts (a settlement).

For the purposes of the POAT rules one would then only have to test the discretionary trust to see if the settlor could enjoy a benefit under this part of the trust fund.

Exemptions

The exemptions which apply to land and chattels apply equally to intangibles. However, there are no excluded transactions as there are for land and chattels.

Other issues of general application

Non-domiciliaries

The POAT charge only applies to persons resident in the UK. Persons who are UK resident but are neither UK domiciled nor deemed domiciled under the 15 out of 20-year rule are only taxed if the property in question is situated in the UK.

In the case of a person who created a trust investing in non-UK situs property before becoming UK domiciled or deemed domiciled, the POAT charge will not

usually apply because the trust fund will usually be excluded property within section 48(3)(a) IHT Act 1984.

From 6 April 2025, the concept of domicile will cease to exist for tax, including IHT purposes, and a new system of taxation based on residence status will apply. The test for whether excluded property (whether held outright or within a trust structure) is within scope for UK IHT will depend on whether the taxpayer/settlor is a long-term UK resident at the material time.

The right of election

Paragraphs 21 and 22 give a right of election in respect of chattels and land, and intangibles. This election enables a person to opt to treat the property as forming part of their estate as a gift with reservation for IHT purposes rather than being subject to the POAT rules.

This relief is limited and does not appear to deal fairly with people who have undertaken tax planning in the past because they are not put in the same position as if the planning had never been carried out. For example:

Because the election only has the effect of treating the property as being in the deceased's estate for IHT purposes, the property will not be uplifted to market value for capital gains tax (CGT) purposes at the date of the person's death.

The donee may separately face CGT charges on disposal of the property even though for IHT purposes it is treated as being in the estate of the donor.

If the donor wishes to cover the potential IHT liability with insurance, they will probably find it more expensive (than when the transaction was first undertaken) due to them being older.

There is also no provision for the donor to be required to notify the donee about the election, even though the donee may be made liable for the IHT due on the donor's death because the gift was a potentially exempt transfer. The election has to be made on form IHT 500 and guidance on completion of the election form is contained in notes IHT 501.

An election must be made by 31 January following the end of the initial year (being the first year for which the POAT rules may apply to the individual in respect of a particular transaction) and it cannot be revoked after that date. It should be noted that the deceased's personal representative cannot revoke an election. So, for cases where the POAT rules could apply to a gift in 2024/25, the election must be made by 31 January 2026.

Chargeable amount

Land

A formula is set out for calculating the chargeable amount based on the rental value. The rental value of land is the annual value in the first year when the charge applies. The meaning of annual value will typically follow that of an assured

shorthold tenancy and there is no change in this figure for five years. Only amounts paid under a legal obligation by the individual to the owner for occupation/possession or use can be deducted. The valuation of land is done on 6 April 2005, or on the first day the individual becomes subject to a tax charge (if later). This is known as the valuation date and it remains unchanged for five years.

Example 1 – Bob

In 2000, Bob made a gift of cash to his daughter Marcia. Marcia used all that cash to buy a property and Bob first occupied the property on 1 May 2005. He will have to pay pre-owned assets income tax in respect of his occupation (being in breach of the contribution condition) and the property will be valued on 1 May.

This is particularly favourable in relation to reversionary leases and Ingram schemes where the valuation of the land given away, and therefore the income tax charge, is likely to increase. If property falls in value, taxpayers have no option but to use the 6 April 2005 value but at least know now what their charge for the next five years will be. Many may decide to pay the income tax rather than unravel schemes or consider more aggressive tax planning.

Chattels and intangibles

In order to establish a POAT charge on a gift of chattels or on intangibles held in a settlor-interested trust, it is necessary to apply a deemed rate of return to the value of the asset in question. The deemed rate of return is the official rate of interest on 6 April 2005 or the first day of the taxable period (i.e. when the gift is made). Currently the official rate of interest is 2.25%. This means that if the value of settled property is, say, £200,000, the settlor will be treated as having taxable income of £4,500 (i.e. 2.25% of £200,000). Any changes in rate later in the tax year are ignored.

Intangibles have to be valued annually on 6 April. The valuation of chattels is done on 6 April 2005, or on the first day the individual becomes subject to a tax charge (if later). This is known as the valuation date and it remains unchanged for five years.

This issue has caused some considerable concern. If the settlor is merely a potential beneficiary under the trust who might benefit if the trustees appoint benefits to them, why should the settlor be taxed on the basis that the whole trust fund belongs to them? There is no guarantee that the settlor will benefit and whether they will or not is outside of their control.

In these circumstances, HMRC takes the view that this is “psychic income”. Its view is that because the settlor **could** benefit from all of the trust fund they should be taxed as if they actually enjoyed it. This approach is on a similar basis to that used by the IHT gift with reservation rules which state that if a settlor is a potential beneficiary under a trust the whole of the trust property is treated as forming part of their estate.

Example 2 – Mark

Mark, a higher rate taxpayer, did an Eversden scheme involving a bond. He is caught under paragraph 8. The bond is worth £450,000 as at 6 April 2024. He is treated as receiving a benefit of £10,125 (2.25% of £450,000) on which he pays tax at 40%. What is relevant is the rate in force on the valuation date which will normally be 6 April.

De minimis

If the total of all annual values for one individual does not exceed £5,000 the POAT charge will not apply, (paragraph 13), However, there is a catch here. Suppose the appropriate rental value of a property given away, but still occupied by the donor, is £7,000 per annum and rent of £4,000 is paid under a legal obligation, reducing the chargeable amount to £3,000. The de minimis rule does not apply as it is the appropriate rental value which must not exceed the de minimis amount of £5,000.

HMRC acknowledges that certain de minimis occupation exists which will not be in breach of either the reservation of benefit rules or POAT.

For example, if the donor stays in a house for not more than two weeks each year on their own, or for less than one month each year with the donee, that would fall within de minimis use. However, a second home or holiday home which the donor and donee both use on an occasional basis would be outside the de minimis exemption.

Appendix

HMRC guidance notes

The guidance notes cover the following areas…

- When the POAT charge can apply on gifts of land, chattels and intangibles (investments, life assurance, etc.);
- Disposals that are excluded transactions and not subject to the POAT - this only applies to land and chattels;
- Disposals that are exempt from the POAT. This applies to gifts of land, chattels and intangibles;
- How the taxable amount is calculated;
- Avoidance of a double charge to income tax;
- The effect of electing for gift with reservation treatment;
- How non-UK residents and/or non-UK domiciled individuals are taxed;
- Sales at undervalue;
- Disposals for full or part consideration;
- Double charges relief for IHT;

- How the POAT rules apply to various IHT schemes using land;
- How the POAT rules apply to certain life policies in trust.

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