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https://www.taxation.co.uk/articles/gifts-with-reservation-of-benefit

TAXATION

Benefit or bother

Charles Ovenden and Melissa Solly review the inheritance tax gifts with reservation of benefit rules and consider whether the coronavirus outbreak might result in their unexpected application.

Lifetime gifts are an effective way for individuals to reduce the value of their estates and their consequent exposure to inheritance tax. When examining the application of inheritance tax to such gifts, the basic position is that a lifetime gift made by one individual to another will represent a potentially exempt transfer (PET) and generally attract no immediate charge. If the donor survives for seven years from the date of the PET, its value will then fall outside the donor's death estate for inheritance tax purposes. However, if the donor dies within that seven-year period, the PET will 'fail' and become chargeable at the applicable rate (currently 40%), subject to the availability of any relevant exemptions and/or reliefs as well as a tapering of the rate if the gift was made more than three years before death.

Given the tax treatment described above, it is common for older generations to consider making lifetime gifts of significant family assets (which would otherwise attract a large inheritance tax liability on death) to younger family members, with the aim of avoiding a charge on those assets altogether. Generally, this is a straightforward and effective piece of estate planning when done correctly and in good time.

Reserving a benefit

Issues may arise if an individual disposes of an asset, but continues to benefit from that asset after the date of disposal. By way of example, a parent who has gifted their home to an adult child may subsequently look to move back in and cohabit with their child for the support afforded. Similarly, an individual may gift a valuable chattel (say a piece of artwork or furniture) to a younger member of the family, but continue to house the chattel, perhaps for the additional security available at their property or for sentimental or space-saving reasons.

Key points

- **The regime for potentially exempt transfers can limit a possible inheritance tax liability.**
- **The reservation of a benefit in the gifted asset can result in a tax charge.**
- **A gifted asset may fall within the rules if the donor benefits at a later date.**
- **The rules do not affect the actual devolution of the property.**
- **Mitigating the application of the inheritance tax gifts with reservation of benefit rules.**
- **Cohabiting with family members as a result of Covid-19 may result in the rules applying.**

Unfortunately, due to the operation of the 'gift with reservation of benefit' (GWROB) anti-avoidance rules, if, in the above examples, the donor were to die while they continued to occupy the property or house the chattel in question, they will have failed to remove the value of the asset from their death estate for inheritance tax purposes.

The GWROB rules were introduced by FA 1986, Pt V, specifically to address the issue of individuals avoiding an inheritance tax charge by gifting assets to remove them from their death estate but continuing to use or benefit from those assets during their lifetime. In short, the rules provide that a donor who disposes of an asset must be genuinely or virtually excluded from all benefits of owning the asset in question and the donee must assume bona fide possession and enjoyment of it. The rules apply to gifts of all assets and include transfers made into trusts as well as to individuals.

If the donor does retain possession of or continues to derive a benefit from a gifted asset as at the date of their death (or at any time within the seven years before death) the GWROB rules operate such that the value of the asset will still be deemed to be included in the donor's death estate. Therefore, despite the fact that the donor may have technically disposed of an asset many years earlier, their death estate will still attract an inheritance tax liability at 40% of its value (subject to any applicable exemptions or reliefs). There is no limitation period in relation to the rules and therefore a gifted asset that is not initially within the scope of the rules may become so, even many years later, if the donor subsequently obtains a benefit.

If the donor continues to benefit from a gift but ceases to reserve that benefit at some point in the future, the donor will be deemed to make a PET at that point and will therefore be required to survive for seven years from the date of the cessation of the benefit to remove the value of the gift in full from their death estate.

It should be noted that the inclusion of the value of the asset within the donor's estate for inheritance tax purposes is a fiction created by the GWROB rules for anti-avoidance purposes. In reality, the rules do not affect the actual devolution of the property and the asset itself moves from the donor's estate to the donee's on the date of the initial gift. For capital gains tax purposes, the date of disposal of the asset will therefore remain the date of the gift (irrespective of any benefit reserved by the donor) and the donee will not benefit from any capital gains tax uplift on the death of the donor.

However, for inheritance tax purposes, this fiction created by the legislation can result in multiple charges on the same asset.

If, for example, the donor were to die while reserving a benefit in the asset and the donee were to die with the asset still within their estate, both death estates would include the value of the asset for inheritance tax purposes.

Similarly, if, on the death of the donor, the property subject to the reservation also became a 'failed PET', there may be a double charge to inheritance tax (once on the PET that has now become chargeable and once by virtue of the full value of the asset still being included in the donor's death estate). However, this double tax charge may be relieved to an extent by double taxation provisions.

If the donor were to reserve a benefit in settled property, the value of the asset would remain in the donor's death estate for inheritance tax purposes but the asset itself will be held within the trust and subject to the usual charges that apply to trust property – for example, ten yearly and exit charges under the relevant property regime.

Planning options

There are several ways to mitigate the application of the GWROB rules, the principal ones are:

- payment of a market rent;
- the gift of an undivided share in land;
- a change in donor's circumstances;
- use of the residence nil rate band; and

using the business or agricultural property reliefs.

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Market rent

If a donor provides full consideration in money or money's worth for their continued use of a gifted asset, they will not fall within the scope of the GWROB rules. The relevant period for assessment of whether the donor has provided full consideration is the seven years before their death or the cessation of the reservation of the benefit, rather than the seven years immediately following the date of the gift.

This exception allows a donor to pay an open-market rent for, say, their occupation of gifted land or the use of a gifted chattel. If seeking to rely on this exception, it is important to be well prepared to respond to enquiries by HMRC. Any leases should be negotiated at arm's length, on full commercial terms and with full market-rate consideration paid for the whole of the relevant period (with regular rent reviews). In effect, the rental agreement should be an enforceable legal obligation rather than a casual arrangement.

It is also worth pointing out that the recipient of the rent will be required to declare the income and ensure that income tax is paid on the calculated net profit at their applicable rate of tax.

Gift of an undivided share in land

If the donor gifts a share of an interest in land and both the donor and the donee occupy and enjoy the land together, so long as the donor does not receive any benefit (other than a negligible one) that is provided by, or at the expense of, the donee for some reason connected with the gift, the donor's occupation will fall outside of the scope of the GWROB rules. The donee's occupation of the property must be genuine and, if the donee were to give up occupation at some point in the future, the GWROB rules would still be in point. This would then raise the possibility of the full value of the gift falling back into the donor's estate for inheritance tax purposes.

By way of example, a parent donor may look to gift a 50% share of a property to their child and both parent and child then live in the property together (or receive the rent from the property equally) without the donor being deemed to reserve a benefit. However, were the child to make up for the 50% gifted share in the property by paying for all household outgoings, the donor would be deemed to receive a benefit connected with the gift of the share in the property and the occupation would fall outside of the exception.

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Change in donor's circumstances

A further exception to the GWROB rules applies in the event that a donor occupies land and:

- the donor and donee are relatives or spouses/civil partners;
- the occupation is due to an unforeseen change in circumstances; and
- the occupation represents a reasonable provision by the donee for the care and maintenance of the donor, who has become unable to maintain themselves through old age, infirmity or otherwise.

In relation to this exception, it may be difficult to determine what exactly constitutes a 'reasonable provision' for HMRC's purposes. Further, in the case of a donor who moves back into a gifted property due to an acute medical emergency, on

Planning point

A gift with a reservation of benefit could result in double inheritance tax charges as well as a potential capital gains tax charge on the same gift.

regaining their health they would no longer fall within this exception and their occupation may fall foul of the GWROB rules if they continued to occupy the relevant property without paying a market rent.

Residence nil rate band

If the reservation of benefit exists at death and the donor dies on or after 6 April 2017, the residence nil rate band (RNRB) may be claimed if the GWROB property has been gifted to lineal descendants and constitutes a ‘qualifying residential interest’.

Business property and agricultural property relief

Property subject to the GWROB rules can still qualify for business property relief or agricultural property relief.

Summary

Inheritance tax is a notoriously complex area of tax and the GWROB rules are no exception. Further, steps taken in the pursuit of inheritance tax planning may result in other taxes falling due.

For example, a disposal of assets will be a chargeable event for capital gains tax purposes and this will need to be paid without any money necessarily being transferred between parties (a ‘dry’ tax charge). The tax position must therefore be looked at ‘in the round’ when considering the effective shifting of value from one generation to the next.

However, with careful planning and close attention paid to the specifics of each situation, it is often possible to structure affairs such that wealth may be passed down the generations in a tax-efficient manner.

Finally, it is conceivable that difficulties caused by the Covid-19 pandemic may have resulted in some individuals cohabiting with family members in properties that they had previously gifted to those family members. Given that there have been no specific changes made to the GWROB rules by the government in response to the coronavirus, this raises the possibility of individuals falling within the scope of the rules unwittingly. Although it might be argued that these come within the ‘change in donor’s circumstances’ exception, as explained above there are inherent uncertainties in relying on this exception and it is difficult to know what HMRC’s position will be. ●

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