# INHERITANCE TAX CONFERENCE 2010:

# THE FAMILY HOME AND CHATTELS

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# INDEX


| SECTION NO. | SECTION |
|---|---|
| I | Why Plan with the Family Home? |
| II | Gifts with Reservation and the Family Home |
| III | The Income Tax Charge on Pre-Owned Assets and the Family Home |
| IV | Some Inheritance Tax Strategies for the Family Home Considered |
| V | FA 2010 Changes |
| VI | Capital Gains Tax: Main Residence Relief and Spouses |
| VII | Capital Gains Tax: Main Residence Relief and Divorce |
| VIII | Residence and Ordinary Residence |
| IX | Altering the Situs of Chattels |
| X | National Heritage Property |



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# SECTION I

## WHY PLAN WITH THE FAMILY HOME?

### NOT A SUITABLE ASSET FOR TAX PLANNING?

1.1.1 Every writer and lecturer on tax planning for the family home starts by saying that it is far better not to use the family home as a tax planning vehicle. Doing so raises particular problems for tax planning because, by its nature, the taxpayer wishes to continue to use his home and so the gifts with reservations provisions and the Pre-Owned Assets Charge are in point. Tax planning will often involve passing interests and assets to other parties, such as trusts, children or spouses, and it is particularly uncomfortable not to have unfettered ownership of the dwelling in which one lives.

### MANY PEOPLE'S LARGEST ASSET

1.2.1 So why do people want to undertake tax planning in relation to the family home? For the very simple reason that for most people, even quite prosperous people, the family home is their most valuable single asset and will often represent the greater part of their assets by value. Quite simply, many people have no choice but to plan with the family home unless they are going to accept passing a large percentage of their total wealth to the profligate state.


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## CAPITAL APPRECIATION

1.3.1 There is another reason. Over most of my lifetime, property as an investment has outperformed almost all alternative investments. It is true property prices have dipped in the recession, but even at their lowest point most people who have owned their own homes for any period of time have still made substantial unrealised gains. If the surveys of the large estate agencies are to be believed, house prices are once again increasing substantially. So not only has the family home been the most significant asset of many people it has only also been the most significant cause of increases in their wealth.


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# SECTION II

## GIFTS WITH RESERVATION AND THE FAMILY HOME

2.1.1 Under FA 1986 s.102, where an individual makes a gift of property and either:-

(a) possession and enjoyment of the property is not bona fide assumed by the donee within 7 years of the donor's death; or

(b) at any time within the 7-year period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor or of any benefit to the donor by contract or otherwise,

the property is subject to a reservation, with the consequence that the property (or its traceable proceeds) will be brought into charge to tax when the donor dies as if he were still beneficially entitled to it at that time.

2.1.2 There are a number of exemptions to the application of this provision set out in s.102(5) but they are of limited relevance to an individual wishing to benefit any one other than his spouse.

2.1.3 If the property ceases to be subject to a reservation, the donor is treated as making a potentially exempt transfer at the time of the cessation (FA 1986 s.102(4)).

2.1.4 FA 1986 Sch 20, and in particular para 6, provides two further exemptions of importance in the case of gifts of interests in land.


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## THE FULL CONSIDERATION EXEMPTION

2.2.1 First, the donor may retain or assume actual occupation of land or actual possession of a chattel in return for full consideration in money or money's worth. This is a valuable concession which will be considered later.

## UNFORESEEN CHANGES IN THE DONEE'S CIRCUMSTANCES

2.3.1 Secondly, an exemption may apply where the donor has made a gift of a property to a relative, or to a relative of his spouse or civil partner, in circumstances which did not give rise to a reservation of benefit, but subsequently comes to re-occupy it as a result of an unforeseen and unplanned change in the circumstances of the donor. Provided that, at the time concerned, the donor has become unable to maintain himself through old age, infirmity or any other reason and his occupation represents reasonable provision by the donee for his care and maintenance, his re-occupation will be disregarded in determining whether the property is subject to a reservation.

2.3.2 **Example**

A father, on retiring to the country, gave a house to his son. He subsequently became infirm through ill-health, which resulted in him no longer being able to look after himself. If he had moved back into the house and lived with his son, provided his reoccupation represented reasonable provision by the son for the care of his father no gift with reservation would have arisen. Following the introduction of the Income Tax charge on pre-owned assets in FA 2004 Sch 15,


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which applies from 6th April 2005, such an arrangement will now be caught even though the donor's re-occupation of the house in London was unforeseen and notwithstanding that it represented reasonable provision by the son for the care of his father. If the father does nothing, he will be assessed to Income Tax on an amount equal to the market rent of the property.

2.3.3 The gifts with reservation provisions make it very difficult for a person to remove property from his taxable estate whilst continuing to occupy it whether his occupation is long-term under some form of tenancy or other binding arrangement entered into by the donee or merely intermittent under a gratuitous licence from the donee. Clearly, the use of the word ‘virtually’ in FA 1986 s.102(1)(b) is designed to prevent merely occasional visits by a donor to the donee from tainting the original gift (see Revenue Inheritance Tax Manual, para 14334).


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# SECTION III

## THE INCOME TAX CHARGE ON PRE-OWNED ASSETS AND THE FAMILY HOME

3.1.1 FA 2004 Sch 15 introduced a new charge to Income Tax on pre-owned assets which took effect from 6th April 2005.

## THE SCOPE OF THE CHARGE

3.2.1 Broadly, the Income Tax charge will arise in a situation where an individual (the chargeable person) occupies any land (referred to as the 'relevant land'), whether alone or together with other persons, and either the 'disposal condition' or the 'contribution condition' is met in respect of the relevant land.

3.2.2 The 'disposal condition' is met in circumstances in which, at any time after 17th March 1986, the chargeable person:-

- owned an interest in the relevant land (or in other property the proceeds of which were directly or indirectly applied by another person towards the acquisition of an interest in the relevant land), and
- disposed of all, or part of, his interest in the relevant land or the other property, otherwise than by an excluded transaction.


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3.2.3 The 'contribution condition' is met in circumstances in which, at any time after 17th March 1986, the chargeable person has (directly or indirectly) provided, otherwise than by an excluded transaction, any of the consideration given by another person for the acquisition of:-

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

3.2.4 In the example given in para 2.3.2 above, if the father, having made a gift to his son which was not subject to a reservation of benefit, had moved back into the house to live with his son otherwise than for reasons of ill health, he would have fulfilled the disposal condition in relation to that house.

3.2.5 In the same example, if, instead of giving the house directly to his son, the donor had sold the house and given the proceeds of sale to his son then the situation would have been slightly different. If the son had subsequently used the proceeds from the house to purchase a new property, on the father moving in with his son the contribution condition would have been met in relation to the new property but an Income Tax charge would have arisen on the father only if he had moved in with his son within seven years of the date of the gift. Provided that the earliest date on which the father occupied the house was more than seven years after the gift, the disposal would be an excluded transaction for the purposes of the charge.


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## INTERACTION WITH RESERVATION OF BENEFIT PROVISIONS

3.3.1 This Income Tax charge will not arise in circumstances in which a reservation of benefit has arisen. If it were not for this provision, arrangements might create an annual Income Tax charge on the family home as well as an Inheritance Tax charge on the value of the property following the death of the donor. In order to prevent this double charge, the pre-owned assets provisions provide an exemption for property which is subject to a reservation (FA 2004 Sch 15 para 11(5)(a)). There will be situations in which a gift may have been made in the past under which no reservation of benefit has arisen, but which may now (or at some point in the future) be caught by the Income Tax charge on pre-owned assets.

## CONSIDERING OLD ARRANGEMENTS

3.4.1 Advisers need to consider the pre-owned assets provisions in relation, not just to new tax planning strategies which their clients may wish to undertake, but also in relation to tax planning which their clients have undertaken in the past and which has been in place for many years. In the above example, if we suppose that the father made the gift to his son in 1988, and moved in with his son in the year 2000 without suffering any adverse tax consequences, there is a danger that the father would not realise that he would now be liable to Income Tax. Undoubtedly there will be many people who are now subject to an Income Tax liability in relation to gifts they have made in the past without any tax avoidance motivation who are not aware of that fact.


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3.4.2 The Income Tax charge is based on the appropriate rental value of the relevant land less any payments which, in pursuance of any legal obligation, are made by the chargeable person to the owner of the relevant land in respect of the occupation of the land by the chargeable person. It is important to note that it is only payments under a legal obligation which are deductible from the rental value. This means that any payments made informally will not count. A chargeable person may mitigate his liability to the Income Tax charge by paying a full market rent for the period of occupation under a legal obligation. By so doing, the amount on which the Income Tax charge is assessed would be reduced to zero.

3.4.3 **Example**

Using the facts in our example at para 3.2.4 and assuming:-

(a) the father was 44 at the time of the gift in 1988;

(b) he was 61 on 6th April 2005;

(c) he lives with his son until his death at 75;

(d) the house is worth £1,000,000 at his death;

(e) the annual rental value of the house is £80,000;

(f) his nil rate band is used against property actually, rather than deemed to be, in his estate;

(g) the father pays tax on his income at a marginal rate of forty percent.

At current rates, the gift of the house to his son will save him £400,000 in Inheritance Tax. The father would bear an annual Income Tax charge under the pre


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owned assets legislation of £32,000 (£80,000@40%) so he will have paid £448,000 (£32,000 x 14) in Income Tax in order to save £400,000 of Inheritance Tax.

If, instead of being 61, the father had been 81 years of age on 6 April 2005 and had lived to 86, then the Income Tax he would have paid over the period to his death would have been £160,000 (£32,000 × 5) and so he would have made a net saving of £240,000 (£400,000 - £160,000).

3.4.4 If the father could afford to pay a full market rent to his son then, provided there is a formal tenancy agreement between them, the father would have no Income Tax liability in respect of his occupation of the property, although of course, the son would be charged to Income Tax on the rent. This may be an effective way of passing further value out of the father's estate by reducing it by the amount of the rent paid.

3.4.5 If the chargeable person can neither afford to pay the Income Tax nor a full market rent, then he may consider making an election under FA 2004 Sch 15 para 21. A chargeable person may make an election which will have the result that the pre-owned assets provisions will not apply to him but, in return, for as long as the chargeable person continues to occupy the relevant land, he will be treated as having a reservation of benefit in that property. Any such election must be made in the prescribed manner determined by regulations by 31st January in the year of assessment that immediately follows the initial year of assessment. The 'initial year' is any year of assessment in which, but for the election, a person would be chargeable by reference to his enjoyment of the


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relevant property, provided that he has not been chargeable under the relevant provision in respect of that property (or any other property for which it has been substituted) in any previous year of assessment. This means that for people who find themselves subject to the pre-owned assets charge for the first time in 2009/10, the relevant filing date is 31st January 2011. Where an election is made, the result will be that the relevant land will be deemed to be subject to a reservation of benefit (irrespective of whether or not a reservation of benefit would otherwise arise) and the value of the asset will be brought back within the donor's estate for Inheritance Tax purposes. However, for Capital Gains Tax purposes and Income Tax purposes, the relevant land will be treated as belonging to the donee. Once made, an election cannot be withdrawn and the deemed reservation of benefit will continue for so long as the chargeable person continues to enjoy the land.

3.4.6 Clients who now find themselves caught by an Income Tax charge which they cannot or do not wish to pay, may wish to take steps to 'undo' the tax planning undertaken. In many circumstances, however this will simply not be possible or, where it is possible, it is likely to be costly.

3.4.7 Another possibility for those clients wishing to avoid the charge is to move out of the property. Finally, the client may attempt to go back to square one.

3.4.8 **Example**

In the circumstances outlines in para 3.4.3 above, the son may consider transferring the land back to the father. In addition to the transaction costs, the son will have


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made a potentially exempt transfer for the purposes of Inheritance Tax and, should he die within seven years of making the transfer, the value of the property would form part of his estate for Inheritance Tax purposes. The son could take out a policy of life assurance to cover this risk.


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# SECTION IV

## SOME INHERITANCE TAX STRATEGIES FOR THE FAMILY HOME CONSIDERED

### CO-OWNERSHIP

4.1.1 This involves the donor making a gift of an undivided share in land so that, after the gift, the donor and the donee share ownership and occupation of the property. A common application of this is where a parent who solely owns his own property transfers an interest in the property to a child or close relative who either takes up occupation or continues occupying the property. FA 1986 s.102B(2) provides that all gifts by an individual of an undivided share in land are gifts with reservation, subject to two exceptions.

4.1.2 One of these exceptions is found in FA 1986 s.102B(4) which provides that there is no gift with reservation of benefit where the donor and donee occupy the land and the donor does not receive any benefit other than a negligible one which is provided by or at the expense of the donee for some reason connected with the gift. Where there is some collateral arrangement (i.e. an agreement that the donee should pay more than a proportionate share of the running costs), this will amount to a benefit to the donor 'by contract or otherwise'.

4.1.3 Where the donor and donee occupy the land within the exception in FA 1986 s.102B(4), there is no reservation of benefit and the pre-owned assets provisions


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must be considered. Under FA 2004 Sch 15 para 11(3)(a), there will be a complete exemption from the charge.

4.1.4 Beneficial interests may be conferred by the original owner entering into a declaration of trust specifying in what proportions the beneficial interests are to be shared; and in the case of a sole owner (e.g. a surviving spouse) one or more other members of the family, or a professional adviser, should be appointed as co-trustee of the legal title to ensure there are at least two (Law of Property Act 1925 s.27(2)) but not more than four trustees of land (Trustee Act 1925 s.34(1)). A gift of the beneficial interest will constitute a 'potentially exempt transfer' for Inheritance Tax purposes.

**Unequal percentages**

4.1.5 The question often arises as to what percentage should be given away. Although it is possible to give away 99% because the remaining 1% will still entitle the donor to occupy the property, it may not be advisable to do so as the Revenue is understood to regard such an unequal percentage as aggressive tax planning. There would appear to be no authority in law for their view.

**Donor must bear his share of costs**

4.1.6 The donor must bear at least his proportionate share of the maintenance and running costs of the property. A distinction should be drawn between capital expenditure and running costs. Capital expenditure should be borne in proportion to ownership whereas running costs should be borne in proportion to occupation. Where a donor and donee have equal shares, the donor should bear


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at least fifty percent of his costs so that the donor does not receive a benefit from the donee arising out of the gift.

**Donees ceasing occupation**

4.1.7 A problem will arise if and when any one or more of the donees decides to move out of the property. If the donor continues to occupy the entire property the gifts to the donees who move out will become gifts with reservation. Where the gifts become subject to a reservation in this way, the donor's occupation of the property will be completely exempt for the purposes of the pre-owned assets provisions.

**Interaction with the Pre-owned Assets Charges**

4.1.8 FA 2004 Sch 15 para 11(5)(c) provides that if property 'would fall to be treated as property which is subject to a reservation … but for FA 1986 s.102B(4) the pre-owned assets charge will not apply. So the pre-owned asset charge will not apply to co-ownership arrangements exempted from the Inheritance Tax reservation of benefit rules by s.102B(4).

## USE OF THE 'FULL CONSIDERATION' EXEMPTION

4.2.1 FA 1986 s.102B(3) provides that in the event that one of the joint owners does not occupy the property, there will not be a gift with reservation if the donor pays full consideration for his occupation.


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**Form of Interest**

4.2.2 An individual might give away his home entirely and enter into an arrangement with the donee which allows him to continue living there. The arrangement might take the form of either a lease or a licence depending on the circumstances. What is important is that the occupation is for full consideration in money or money's worth (IHTA 1984 Sch 20 para 6(1)(a)). The Revenue accepts that if the terms are the result of a bargain negotiated at arm's length with the parties being independently advised and follow the normal commercial criteria in force at the time they are negotiated, the condition of IHTA 1984 Sch 20 para 6(1)(a) will be satisfied (Revenue Inheritance Tax Manual, para 14341). The provisions of FA 1986 s.102A contain similar provisions to para 6(1)(a) allowing a donor to occupy property for full consideration (FA 1986 s.102A(3)).

4.2.3 The terms of the agreement and the amount of any rent or licence fee are an important commercial consideration. 'Full consideration' implies, in the case of a tenancy, an open market rent. As full consideration is required throughout the period, the rent paid must be periodically reviewed. The Revenue do, however, recognise that there is no single value at which consideration can be fixed as 'full' (Revenue Interpretation RI55).

**Interaction with the Pre-owned Assets Charge**

4.2.4 For the purposes of the Income Tax charge on pre-owned assets, the payment of full consideration (i.e. the full market rent) is likely to reduce the chargeable amount to nil under FA 2004 Sch 15 para 4(1), provided that the payments are


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made in pursuance of a legal obligation. It would therefore be advisable to draw up a tenancy agreement so as to ensure that the amounts paid will be deductible.

**Granting a Lease**

4.2.5 An alternative to charging an open market rent would be to grant a lease, for example a long lease with a term of at least 21 years at a peppercorn rent but at a market premium. As the lease would normally be for less than 50 years, a part of the premium would attract an Income Tax charge at a rate of up to 50% depending on the donee’s marginal rate of Income Tax.

4.2.6 The clear disadvantages of this type of arrangement from the donor's point of view are, first, the payment (out of net income or capital) of the rent or any premium and, secondly, that the lease itself may be a valuable asset in the donor's estate. Whether this is an acceptable price to pay for the ability to divest his estate of a capital asset free of Inheritance Tax will depend on individual circumstances.

4.2.7 There is a further disadvantage under the pre-owned assets provisions for an arrangement involving the payment of a premium. The gift of the freehold interest would meet the disposal condition in FA 2004 Sch 15 para 3(2) for so long as the donor continued to occupy under the terms of the lease and the donor would, accordingly, be subject to Income Tax on the rental value of the property, notwithstanding the payment of the premium. This is because, for each year of assessment in which the pre-owned assets provisions applied in respect of a property, the only payments which are permitted deductions against the


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charge to Income Tax are those made pursuant to a legal obligation in that year of assessment (FA 2004 Sch 15 para 4(1)). Accordingly, in the year the premium is paid, it can be deducted from the appropriate rental value for that period but, in the following periods, no deduction will be permitted.

## **'SHEARING'**

4.3.1 Apart from the addition of the words '… or virtually to the entire exclusion' in FA 1986, s 102(1)(b), the gifts with reservation provisions are in identical terms to those which applied under the estate duty regime. Both the Revenue and commentators accept that the case law on the estate duty provisions and the principles that these cases establish are still relevant although comments by Lightman J in the case of *Melville v CIR* [2006] STC 627 (Ch D) throw doubt on the extent to which a court will have regard to estate duty principles in relation to Inheritance Tax.[1]

### ***Munro v Comr* of Stamp Duties**

4.3.2 The case of *Munro v Comr of Stamp Duties of New South Wales* [1934] AC 61 (PC) established the principle that there was no reservation of benefit where the donor retained a benefit referable to a prior right rather than to the property which is the subject of the gift.

### **The Freehold Reversion Strategy**

4.3.3 Thus, a strategy was developed under which an individual owning the freehold of his home would grant a lease to a nominee for himself, thereby creating a

[1] Although the Court of Appeal confirmed the High Court's decision in that case ([2001] EWCA Civ 1247 (SpC)) it did not specifically consider this issue


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leasehold interest and a freehold reversion. He then gave away the reversion and continued to occupy the property by virtue of his leasehold interest without, it was hoped, falling foul of the gifts with reservation provisions. The scheme was considered by the House of Lords in *Ingram v CIR* [1999] STC 37 (HL). The following discussion sets out the theory of the scheme in detail and then discusses the *Ingram* decision and the insertion of FA 1986, ss.102A–102C which followed that decision.

4.3.4 The scheme involved a two-stage operation. First, the prospective donor granted a lease for a term equal to his life expectancy plus a margin of 5 or 10 years, as appropriate, to a nominee without reserving any rent. As the donor had to create the lease first, he had absolute control over the terms of the lease and there was no necessity to use open market terms. However, to avoid a Revenue claim that the lessor's covenants created a reserved benefit the covenants were not onerous, because when the reversion was given away, the donee took the benefit of those covenants. Secondly, the donor gave the freehold reversion to the donee by way of a potentially exempt transfer. If the lease still had some time to run at the donor's death, its remaining value would be subject to Inheritance Tax. If the lease expired before the donor died, then the donor would have to either move out of the property or pay a rack rent to avoid being in receipt of a 'reserved benefit'. If the donor did not own the freehold, it was possible to achieve the same result with a leasehold interest by creating a sub-lease, if the head lease permitted that. Many modern leases do not.

4.3.5 The House of Lords found this scheme effective in *Ingram*.


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**FA 1986 ss.102A – 102C**

4.3.6 Having lost in the House of Lords, the Revenue announced that it would block the scheme by amending the relevant legislation. In due course, the Finance Act 1999 inserted ss.102A–102C into FA 1986.

4.3.7 Section 102A applies when an individual disposes of an interest in any land by way of gift after 8th March 1999. If the donor or his spouse enjoy a significant right or interest, or is a party to a significant arrangement in relation to the land, the interest disposed of will be property subject to a reservation. A right, interest or arrangement is 'significant' for these purposes if it entitles or enables a donor to occupy all or part of the land (or enjoy some other right), otherwise than for full consideration in money or money's worth. The right, etc is not significant if it:-

(a) cannot prevent another person or persons enjoying the land virtually or entirely to the exclusion of the donor;

(b) does not enable the donor to occupy the land immediately after the disposal but would have done so were it not for the disposal; or

(c) was granted or acquired more than seven years before the gift.

4.3.8 Similar provisions also apply to gifts of undivided shares in land under s.102B.

4.3.9 The *Ingram* scheme clearly falls within these provisions. As is unfortunately becoming common where anti-avoidance provisions are sponsored by the


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Revenue, so too will many other arrangements which are not the provisions' ostensible target. For example, the provisions apply in relation to some family farming partnerships.

4.3.10 For the purpose of these provisions, no account is taken of occupation in circumstances where it would be ignored under FA 1986 Sch 20 para 6(1)(b). This is, broadly, where the donor falls on hard times and the donee makes provision for the donor out of the gift.

4.3.11 Under the pre-owned assets provisions, any *Ingram* scheme already in existence will be subject to an Income Tax charge where the donor continues to occupy the property. The gift of the freehold interest will satisfy the disposal condition and an Income Tax charge will arise on the donor.

**The Deferred Lease Scheme**

4.3.12 There was always, however, an alternative method of achieving the same economic effect whilst avoiding the difficulties of the lease carve out which, in many circumstances, will not be caught by ss.102A–102C.

4.3.13 Instead of making a gift of the freehold subject to an immediate lease in the donor's favour, the donor could make a gift of a long lease the rights of which are deferred for a period (a "Deferred Lease Scheme"). For example, one might grant a 999 year lease which is not to commence for 20 years. A lease may defer the right of possession which it confers for up to 21 years after its execution (Law of Property Act 1925 s.149(3)). As the deferred lease is of small value, the


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value of the potentially exempt transfer is only small. However, the longer the individual survives, the lower the value of the freehold as the period to the beginning of the lease shortens. In effect, the value of the property is transferred to the deferred lease which is outside the estate for Inheritance Tax purposes. The freehold on the death of the donor will therefore have a much reduced value.

4.3.14 The Revenue has always indicated that in its view the associated operations provisions apply to this scheme. That seemed entirely misconceived as, unless one regards death itself as an operation, the scheme consists of only one operation; the grant of the lease. The deferred lease version of the shearing scheme circumvents s 102A if the freehold concerned was originally acquired by the donor more than 7 years before the transfer.

4.3.15 HMRC claimed that the grant of the deferred lease would be a 'significant arrangement' within FA 1986 s.102A(2) even if the grantor acquired the freehold of the land more than 7 years before the grant. Now it was clearly true that the grant of the deferred lease is an 'arrangement' to which the donor is a party. The question is whether it is a significant arrangement. The provisions of s.102A(4) are dense but clearly prevent such a grant from being a 'significant arrangement'. HMRC had acknowledged that reversionary interest lease schemes made before 9th March 1999 were effective but had indicated its view that the strategy was ineffective in relation to reversionary leases executed on or after 9th March 1999. That view was at odds with the clear wording of the legislation.


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4.3.16 On 29th January 2007, HMRC published a statement to say that they now considered 'that where the freehold interest was acquired more than 7 years before the gift, the continued occupation by the donor would not be a significant right, and contrary to our previously held view, a gift with reservation of benefit claim will not arise'. The paragraph went on to say, however, that the donor's continued occupation of the land would give rise to a pre-owned assets charge.

4.3.17 This scheme has a number of disadvantages; namely the base cost of the property concerned for Capital Gains Tax purposes will be very low because, at the time of acquisition, the deferred lease is not very valuable. In addition, the holder of the deferred lease will not receive the principal private residence exemption (see above) and there will be only a small uplift on death. Under the pre-owned assets provisions as the disposal of the deferred lease will satisfy the disposal condition an Income Tax charge will arise on the donor.

## SALE AT FULL VALUE

4.4.1 It may be possible for parents to sell their home for its full value to their children, thus ensuring that any future capital appreciation accrues to the children. The money may be raised by way of a qualifying loan to reduce the purchase price, with the parents paying full rent against which the children's interest liability could be set. This should avoid the gift with reservation of benefit problems because there would be no disposal by way of gift. If the terms of the sale are such as might be expected to be made at arm's length between persons not connected with each other, the disposal will be an excluded


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transaction for the purposes of the pre-owned assets provisions and no Income Tax charge will arise (FA 2004 Sch 15 para 10(1)(a)). Obviously however, there are practical issues such as the parents' security of tenure and there will be stamp duty land tax on the sale by the parents to the children. In addition, the principal private residence exemption is unlikely to be available on the ultimate sale by the children.

**TRUST OF DEBT STRATEGY**

4.5.1 Another strategy for reducing Inheritance Tax on the family home which was much used before the introduction of the pre-owned assets charge is the trust of debt strategy. Under this strategy, the owner of the home settled a small sum on trusts (the 'residence trust') of which he was the life tenant. He then sold his home to the trustees of the residence trust for an amount which was to be payable upon his death and which was to bear interest which was to be rolled up. He now had a debt due to him which he settled on trusts (the 'debt trust') for those he wished to benefit. He had reserved a benefit in the property which he transferred to the trustees but as he was treated by IHTA 1984 s.49(1) as the beneficial owner of that property, the fact that the property was subject to a reservation did not lead to an increased Inheritance Tax charge (FA 1986 s.102(3)).

4.5.2 The donor had not reserved a benefit in the debt. Although the debt was not repayable until after his death, the property settled was the contractual debt itself including all of its terms. The net effect was that the donor had taken the current


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value of the debt (which was normally roughly equal to the market value of the property) out of his estate for Inheritance Tax purposes.

4.5.3 There was no Capital Gains Tax charge on the donor on the assumption that the house had been his principal private residence throughout the time that he owned it. There was, however, a stamp duty land tax charge on the sale of the home to the residence trust.

**Pre-owned Assets Rules**

4.5.4 It is strongly arguable that the trust of debt strategy does not give rise to an Income Tax charge on the donor under the pre-owned assets rules. It is also strongly arguable that, if a charge does arise, an election to treat the property concerned as property subject to a reservation may be made under FA 2004 Sch 15 para 21 without thereby increasing the taxable total of the donor's estate.

4.5.5 The pre-owned assets rules were clearly intended to catch the trust of debt strategy but they appear to have missed their target.

**Relevant Property Settlements**

4.5.6 If the strategy were now implemented the residence trust would be a relevant property settlement subject to decennial and exit charges. That could become significant if the value of the property were to become very much greater than the value of the liability to pay the debt for its purchase price. In schemes implemented before 22nd March 2006, however, the interest in possession in the residence trust will be an existing IIP and therefore not a relevant property


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settlement. If the gift of the debt is made on trusts other than on bare trusts the gift will be an immediately chargeable transfer.

**Sale to a Spouse**

4.5.7 Another version of the strategy which provides further protection against the pre-owned assets charge is to make a sale of the property to one spouse rather than to a trust. In that way FA 2004 Sch 15 para 10(1)(b) and 2(a) would have the effect that the disposal of the property would be an excluded transaction.

## 'EVERSDEN SCHEMES'

**The Case**

4.6.1 The case of *CIR v Eversden (executors of Greenstock Dec'd)* [2003] STC 822 (CA) was also widely seen as permitting a tax planning strategy. In that case a settlor settled her home ('Beechwood') as to 5% for herself absolutely and as to 95% on trusts giving her husband a life interest subject to a wide power of appointment in favour of a class of beneficiaries which included the settlor. The settlor and her husband occupied Beechwood together until the husband's death. Thereafter, the trustees sold Beechwood and brought another house ('Maitland') again as to 5% for the settlor absolutely and as to 95% subject to what was now a discretionary trust. The settlor continued to occupy Beechwood and then, after its purchase, Maitland until her death. The question for decision was whether the 95% interest held on discretionary trusts was property subject to a reservation in relation to the settlor.

4.6.2 The court held that, by virtue of the settlor's occupation of the house, the trust fund was not enjoyed to the entire, or virtually to the entire, exclusion of benefit to the settlor. The settled property was not property subject to a reservation, however, because the settlement of the property was an exempt inter-spouse transfer under IHTA 1984 s.18, FA 1986 s.102(5) disapplies the gifts with reservation provisions where the gift is exempt under various provisions which include s.18.

**The Scheme**

4.6.3 The decision led to the marketing of tax planning strategies branded as '*Eversden* Schemes'. HMRC's riposte was to amend FA 1986 s.102 to provide that the fact that a transfer receives the spouse exemption will not prevent it from being a gift with reservation where the following conditions apply:-

(a) property is settled creating an interest in possession for the donor's spouse;

(b) at some time after the disposal but before the donor's death the spouse's interest in possession comes to an end;

(c) on that occasion the spouse does not become absolutely entitled to, or to a further interest in possession in, the settled property.

4.6.4 Many *Eversden* Schemes which are already in place will now be subject to an Income Tax charge on the donor under the pre-owned assets provisions. Although the initial gift into trust for the donor's spouse is an excluded transaction under FA 2004 Sch 15 para 10(1)(c), where the spouse is entitled to


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an interest in possession, if that interest has come to an end otherwise than on the death of the spouse, the original disposal into trust ceases to be an excluded transaction (FA 2004 Sch 15 para 10(3)).

## LONG-TERM PLANNING

4.7.1 It seems that the most effective form of planning, for both the reservation of benefit and the pre-owned asset provisions, is to make gifts of cash. Provided that the cash is applied to purchase a property which the donor does not occupy until at least 7 years after the gift, there will be no Income Tax charge.

4.7.2 **Example**

In April 2000, a father gave £250,000 cash to his son. The son used the cash to purchase a house in London. In 2010, the father moved in with his son in the London house and paid no rent. There was no charge to Income Tax.

If the donor wishes to make a gift of cash to enable another person to buy a property, careful consideration should be given to structuring the gift.

**Example**

A father gives his daughter £10,000 towards the purchase of a flat worth £170,000. The remainder of the purchase price was met by way of a mortgage. The daughter spends £10,000 on furnishing the flat.

If the father moves into the flat within 7 years of making the gift, a charge to Income Tax will arise.


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If, however, the gift were applied in a different way, the result would be different.

**Example**

The daughter purchases the flat using her savings and raising the balance of the purchase price by way of mortgage. Following the purchase, the father gives his daughter £10,000 to spend on furnishing the flat. After 6 years, the father moves into the property. No Income Tax charge will arise.

In the second example, the gift of cash is not used as any part of the consideration for the purchase of an interest in land. Provided there was no prior arrangement in place that the gift would be made the gift could not be an indirect contribution towards the consideration for the acquisition of an interest in land.


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# SECTION V

## FA 2010 CHANGES

## FA 2010 SECTION 52

5.1.1 FA 2010 s.52 is designed to counteract the following strategy.

5.1.2 A settlor ("Mr A") would settle property on trusts under which, after a period of either discretionary trusts or interest in possession trusts for others, he had an interest in possession ("IIP") for a long fixed period. The retained future IIP was therefore initially a 'reversionary interest'[2] and accordingly it formed part of his estate.[3] Because the succeeding interest in possession was for a very long period of time there was a very small diminution in the settlor's estate and therefore a very small transfer of value.

5.1.3 When the initial trusts came to an end the falling into possession of the succeeding IIP did not result in a transfer of value because there was no disposition by the settlor at that stage. The interest in possession did not form part of Mr A's estate.[4] Once the interest in possession had arisen, therefore, Mr A could assign it on trust for other beneficiaries without that being an occasion of charge. Thus the settlor had been able to create a relevant property settlement without there being an initial charge.

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2 IHTA 1984 s.47

3 IHTA 1984 s.48(1)(b)

4 IHTA 1984 s.5(1) and (1A)


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5.1.4 The scheme wasn't perfect because the property was now in a relevant property settlement with decennial and exit charges. If the property were advanced from that settlement more than three months after its creation the exit charge would have been calculated under IHTA 1984 s.68. The measure of the hypothetical transfer of value, under s.68 includes "the value immediately after the settlement commences, of the property then comprised in it". So if the property were taken out of the relevant property settlement more than three months after the settlement commenced there would be a small Inheritance Tax charge (assuming that the property in the settlement was sufficient to exceed the nil-rate band).

5.1.5 Nonetheless, in its obsessive determination to squeeze every piece of tax avoidance out of the system at whatever cost in added complexity the Government decided to enact FA 2010 s.52 which inserts a new s.81A into the IHTA 1984. That section makes two provisions in relation to reversionary interests in relevant property which are owned by persons who either acquired their interests for a consideration in money or money's worth or are owned by the settlor, the settlor's wife or the settlor's civil partner. The first instance is that the falling in of the reversion in circumstances in which the person entitled to it becomes entitled to an interest in possession is treated as a disposition by that person of the reversionary interest. The second is that a transfer of value of such a reversionary interest is not a potentially exempt transfer. The result, in respect of the scheme, is that when the settlor's interest in possession arises he will make a transfer value equal to the value of the reversion and that transfer will be immediately chargeable.


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## FA 2010 SECTION 53

5.2.1 This provision was introduced to nullify another strategy. Under that strategy Mr A would make a settlement which conferred an interest in possession on B for which Mr B would pay full value. Because Mr B paid full value it was argued that this was a commercial transaction to which IHTA 1984 s.10 applied. Therefore neither Mr A nor Mr B would make a transfer of value. The settled property would then fall outside the estate of Mr B because of IHTA 1984 s.5(1) and (1A) which provides that an interest in possession (other than a disabled person's interest), to which a person becomes entitled after 21st March 2006 does not form part of the estate of the person entitled to it).

5.2.2 The trouble with this strategy was that it was very doubtful whether s.10 would have applied to these transactions. Section 10 applies where it is shown that a disposition was not intended, and was not made in a transaction intended to confer any gratuitous benefit of any person and either:-

(a) it was made in a transaction at arm's length between persons not connected with each other; or

(b) that it was such that might be expected to be made in a transaction at arm's length between persons not connected with each other.

A transaction for this purpose includes a series of transactions and any associated operations.


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It is difficult to see how these transactions satisfied the condition that they were not intended to confer any gratuitous benefit on any person when their whole point is to obtain an Inheritance Tax advantage. They would, in any event, normally involve a transaction with a connected person and so they would have to satisfy the condition that they were such as might be expected to be made in a transaction at arm's length between persons not connected with each other and that condition surely could not have been satisfied. As so often with recent legislation, therefore, if this strategy represented a tax planning opportunity it was a very minor one but the Government has introduced yet more legislation to counteract it.

5.2.3 It does so by providing that what we might call the pre-22nd March 2006 IIP regime is to apply to settled property subject to an interest in possession to which a person domiciled in the UK becomes beneficially entitled on or after 9th December 2009 by virtue of a disposition falling within IHTA 1984 s.10.


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# SECTION VI

## CAPITAL GAINS TAX: MAIN RESIDENCE RELIEF AND SPOUSES

### DUAL ELECTIONS

6.1.1 For the purposes of main residence relief under TCGA 1992 s.222 spouses can only have one main residence. Elections to designate which of two properties are main residences must be made by both spouses jointly.[5] There is no similar restriction on couples living together who are not married.

### OWNERSHIP PERIODS

6.2.1 Where a spouse makes a disposal to his spouse of his interest in a dwelling house which is their only or main residence, including where it passes to the other spouse as legatee, the other's period of ownership begins with the beginning of the period of ownership of the one making the disposal. If the dwelling house was not the only or main residence of both throughout the period of ownership of the one making the disposal, account is to be taken of any part of that period during which it was his only or main residence as if it were the main residence of the other. This can have rather unusual results.

5 These provisions apply to civil partners as they do to spouses


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6.2.2 **Example**

Mr A purchased a house ("House A") in 1995, before he was married, and lived in it until 2000. In 2000 he married and bought another house ("House B") without selling his original one. His wife moved into House A for a few weeks whilst House B was redecorated and they then lived in House B. In 2002 he died leaving House A to his wife. She sold the property in 2004. She had only lived in the property for a few weeks and yet she was treated as if she had owned it since 1995 and actually lived in it from 1995 to 2000. Because she had lived in the property it was treated as having been her main residence for the last three years of her ownership. Thus 8/9ths of her gain is exempt.

6.2.3 The previous example shows these provisions working to the advantage of the transferee. The following is an example of where the provisions work to the spouse's disadvantage.

6.2.4 **Example**

Mr A buys a property in 1995 which he lets. In 2000 he marries and they move into the property. Shortly afterwards he gives a half share in the house to his wife. Four years later they sell the house. The wife has lived in the property for the entire period during which she has had an interest in it. She is treated, however, as having owned her interest in the property since 1995 and, therefore, only 4/9ths of her gain is relieved.


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# SECTION VII

## CAPITAL GAINS TAX: MAIN RESIDENCE RELIEF AND DIVORCE

### PROPERTY ADJUSTMENT ORDERS

7.1.1 On granting a decree of divorce, nullity or separation under MCA 1973 s.24 the court can order one party to the marriage to transfer property to the other party or to a child. A property adjustment order is final, only one such order can be made and it is not possible to vary these orders (save as referred to above, the court has power to make a further property adjustment order on a variation of a periodical payments order).

### FORMS OF ORDERS

7.2.1 The most common options open to the courts in respect of the family home are set out below.

**Outright Transfer**

7.2.2 It is unusual for a court to order an outright transfer of the family home if it is the only family asset.

**Mesher Orders**

7.2.3 A court can order that the parties retain shares in the former home, but defer the sale of the house until the earlier of any number of negotiated terminating events, such as the youngest child reaching 18 or the wife co-habiting for more


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than 6 months, remarrying or dying. This is called a *Mesher* order. These orders became unpopular because they were seen as leaving the occupying spouse in a valnerable position but they have been coming back into fashion following *White v White* (see below).

7.2.4 The Finance Act 2006 has had a negative impact on the popularity of *Mesher* and *Martin* orders (see below). Such orders make on or after 22nd March 2006 will normally create relevant property settlements. Although they may not constitute chargeable transfers (being within IHTA 1984 ss.10 or 11) such settlements may be subject to decennial and exit charges.

**Martin Orders**

7.2.5 A *Martin* order is often considered by the court to be fairer than a *Mesher* order. The conditions are generally the same with the important distinction that there is no requirement to move once the youngest child attains 18. The order takes the form of a settlement.

**Charge Back**

7.2.6 A variation on *Mesher* and *Martin* orders involves the outright transfer of the house to the occupying spouse, but the house is charged with a payment in favour of the other spouse, the charge not to be realised until a specified event. This charge-back can be on the basis of:-

- a charge of a fixed percentage of the market value on sale;


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- a charge of a percentage of the net market value at the time of the order plus interest accrued at an appropriate rate; or
- a charge of a percentage of the net market value at the time of the order, index-linked to a property-based index.

7.2.7 There are potential drawbacks to the first two of these bases. The first basis provides no incentive for the occupying spouse to improve the property and, in fact, the occupying spouse could allow the property to deteriorate (unless safeguards are added to the order). The second basis is arbitrary and takes no account of fluctuations in the property market. The third basis appears the fairest.

**Order For Sale**

7.2.8 This is most commonly encountered where the former matrimonial home is large or more luxurious than is justified by the needs of the occupying spouse or the non-occupying spouse has greater need of the capital represented by the house. The court can make this order only once it has made one of the following orders: a secured periodical payments order, a lump sum order or a property adjustment order. An order for sale cannot take effect until decree absolute. The order may contain consequential and supplementary provisions directing, for example who is to have conduct of the sale and how the price is to be fixed.


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## TAX IMPLICATIONS OF TRANSFERS BETWEEN SPOUSES

7.3.1 While a husband and wife are living together, and before the decree absolute, transfers between them are deemed to be made for a consideration which gives rise to neither a gain, nor a loss (TCGA 1992 s.58). The donee spouse takes over the donor's base value. In effect, the transferee spouse steps into the shoes of the transferor spouse in relation to the asset for Capital Gains Tax purposes. The no gain, no loss rule cannot be disapplied. Any actual consideration for the transfer is ignored. This treatment applies for the years up to and including the tax year of separation but does not apply in subsequent years. While the spouses are separated but not divorced, they will be connected persons for Capital Gains Tax. This means that transfers between them will be deemed to be at full market value. Once the couple divorce, they will normally cease to be connected and transfers will be for actual consideration, if any.

7.3.2 The matrimonial home will be exempt from Capital Gains Tax provided it was the only or main residence of the transferring spouse throughout the period of ownership. The last three years of ownership always count as a period of residence, even if a new qualifying residence has been acquired (TCGA 1992 s.223(1)). In certain circumstances (for example, where job-related accommodation is provided) other periods of absence are also ignored. In some cases, the house may be transferred after a period considerably in excess of three years after the transferring spouse leaves it, in which case a time-apportioned part of the gain will be assessable. Even then, the gain may be covered by the annual exemption which for 2010/11 is £10,100. If a house is jointly owned,


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both spouses must have resided in it throughout the period of ownership for the exemption to apply.

7.3.3 TCGA 1992 s.225B provides that the home may be regarded as continuing to be the only or main residence of the transferring spouse from the date that spouse ceased to occupy the house until the date of transfer. However, certain conditions need to be satisfied:-

- the house must be transferred to the former spouse as part of the agreement made in contemplation of, or in connection with the dissolution or annulment of the marriage or civil partnership or a judicial separation;
- it must have remained the only or main residence of the former spouse; and
- the transferring spouse must not have elected in the meantime for some other house to be treated as his or her only or main residence.

7.3.4 It may, in fact, be more advantageous not to claim this relief. If the transferring spouse has another property eligible for relief it may be better to make the transfer of the former home to the other spouse within three years of leaving the former matrimonial home. Otherwise, a proportion of the relief on the new house may be lost.


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7.3.5 The transferring spouse may retain an interest in the matrimonial home being transferred. This may arise from a mutual agreement or an order of the court (see above). If the transferring spouse is to receive a specified sum (not exceeding his or her current entitlement), but postponed until the earliest of certain events, no Capital Gains Tax liability arises when the sum is paid because of the principal private residence exemption which was due when the interest in the home was transferred to the remaining spouse. This would apply, for example, where the former matrimonial home is transferred to the remaining spouse in return for a cash sum paid from the proceeds of its eventual sale. However, if the non-occupying spouse holds a charge for a percentage of the equity on a future sale, a Capital Gains Tax liability could arise when paid. Arguably, the deferred charge is a new chargeable asset for Capital Gains Tax purposes (following the decision in *Marren v Ingles* [1980] STC 500, [1980] 3 All ER 95 (HL)) and the realisation of the charge will constitute a disposal. However, there is a contrary argument that such a secured charge is in reality a debt and, as such, no Capital Gains Tax charge arises on its realisation. The issues are by no means clear cut and each case will turn on its own circumstances.

**Mesher Order**

7.3.6 With regard to a *Mesher* order, it is understood that the Revenue considers that such an order creates a settlement for Capital Gains Tax purposes (Capital Gains Manual para CG65365). At the date of the order the spouses are treated as disposing of the property to trustees at market value. Any gain will be exempt provided that no more than three years have passed since the non-occupying


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spouse left the family home permanently. When the *Mesher* order lapses there will be a deemed disposal and reacquisition under TCGA 1992 s.71 on termination of the settlement. However, an exemption may be available as the beneficiary will have occupied the property throughout the period of ownership by the trustees (TCGA 1992 s.225).

7.3.7 For Inheritance Tax purposes the transfer of the matrimonial home between separated, but not divorced, spouses falls within the spouse exemption. After the decree absolute has been made, transfers will be potentially exempt transfers unless it can be shown, as is generally the case, that either the exemption for transfers which are not gratuitous (IHTA 1984 s.10) or the exemption covering dispositions for family maintenance (IHTA 1984 s.11) applies.

7.3.8 It would be prudent to ensure that all property transfers are effected prior to the decree absolute to take advantage of the spouse exemption.

7.3.9 As noted above, a *Mesher* order may be regarded as a settlement for Capital Gains Tax purposes. It is likely that the Revenue will so regard a *Mesher* order for Inheritance Tax purposes. This could have Inheritance Tax consequences for the trustees.

## TRANSFER OF THE NIL-RATE BAND

7.4.1 Under Finance Act 2008 surviving spouses or civil partners are entitled to claim an increase to their available nil rate band for Inheritance Tax (£325,000 for


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2010/2011) provided they were married or in a civil partnership at the time of the first death. The amount of additional allowance will depend upon the proportion of available nil rate band unused by the first spouse or civil partner on their death. If 100% of the nil rate band of the first to die is available, the nil rate band available to the survivor is effectively doubled. It is not possible to exceed this level of allowance, even in the case of a widow or widower remarrying. For separated couples there remains the potential to double the available nil rate allowance for the survivor. Divorce will extinguish the ability for any unused nil rate band to be transferred to the survivor.

## OVERSEAS ASPECTS

7.5.1 In a tax year subsequent to the year of separation, a spouse who is not resident and not ordinarily resident in the UK who transfers property to his or her former spouse will generally not be liable to Capital Gains Tax.

7.5.2 Where the Inheritance Tax spouse exemption is in point, it is necessary to bear in mind that a transfer to a non-UK domiciled spouse by a UK-domiciled individual is only exempt up to a limit of £55,000.

7.5.3 In some cases, one or both spouses may be beneficiaries of an offshore trust. It should be remembered that, depending on their personal circumstances, Income Tax or Capital Gains Tax may be payable in respect of any payments to them from the trust as part of the divorce agreement.


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# SECTION VIII

## RESIDENCE AND ORDINARY RESIDENCE

8.1.1 This area has become very controversial recently and a number of cases have vividly illustrated the unsatisfactory state of the case law principles. Those cases demonstrate the importance, in determining whether a person has become non-resident or not, of whether he has retained a residence in the United Kingdom and whether his family continue to live in the United Kingdom.[6] The retention of a home in the UK was given considerable weight in *Gaines-Cooper*, *Karim* and *Hankinson*. Together these cases emphasise the importance for those who wish to establish that they have become non-resident after a period of residence in the UK of showing that they do not retain accommodation here.

[6] *Grace v Commissioners for Her Majesty's Revenue and Customs Commissioners* [2009] EWCA Civ 1082; *Gaines-Cooper v HMRC* [2007] STC 1665; *Genovese v Revenue and Customs Commissioners* [2009] STC (CD) 073; *Karim v Revenue and Customs Commissioners* [2009] TC306 UK F-tT 368 (TC) and *Hankinson v Revenue and Customs Commissioners* [1972] TC 319


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# SECTION IX

## ALTERING THE SITUS OF CHATTELS

9.1.1 Death-bed planning is planning in the short period before death when it has become apparent that someone is terminally ill. For the non-domiciliary, altering the situs of chattels is one of the few examples of simple and straightforward death-bed planning. Many non-domiciliaries will keep valuable chattels in the UK, in particular, works of art, antique furniture and luxury cars. The simple expedient of packing these items up and taking them outside the United Kingdom can save significant amounts of Inheritance Tax. Of course, the well advised domiciliary will already have taken steps to exclude these assets from UK Inheritance Tax perhaps by means of loan arrangements. It is surprising, however, how often non-domiciliaries fail to take advice or fail to implement the advice which they are given.


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# SECTION X

## NATIONAL HERITAGE PROPERTY

### INTRODUCTION

10.1.1 Encouraging the preservation of our national heritage through the giving of tax privileges is not a new idea. The Finance Act 1896 first gave the Treasury discretion to waive estate duty in respect of settled chattels considered to be of national, scientific or historical interest, such as paintings, books and other works of art.

10.1.2 The current reliefs, encompassing Inheritance Tax, Capital Gains Tax, Income Tax, stamp duty and stamp duty land tax aim to help in the preservation of our national heritage property. Some of these reliefs are reliefs for continued private ownership of heritage property including land and buildings of outstanding interest as well as land essential for the protection of the character and amenities of an outstanding building and objects historically associated with such a building. For example the reliefs for maintenance funds provide funds for the upkeep of heritage property kept in private ownership. There are also specific reliefs which give special privileges to gifts or sales of heritage property to certain national bodies.

10.1.3 The legislation continues to refer to the 'Treasury' but FA 1985 s.95 provided that the functions of the Treasury in respect of these provisions were to be


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transferred to the Commissioners of Inland Revenue and their functions have, of course, in turn been transferred to HMRC.

## INHERITANCE TAX

10.2.1 The reliefs available can broadly be split into those which enable the property to be placed in some form of public ownership and those which do not. The two sets of reliefs interact.

### Gifts for national purposes

10.2.2 Transfers of property to various national and local bodies are exempt from Inheritance Tax (IHTA 1984 s.25). The bodies to which such gifts may be made are listed in IHTA 1984 Sch 3 and include the National Gallery, the British Museum and other national museums, the National Trust, any museum or art gallery maintained by a local authority or university, any university library, and any local authority or government department. A list of the qualifying bodies can be found in the Revenue Inheritance Tax Manual, para 11224.

### Conditional exemption for heritage property

10.2.3 The provisions allowing heritage property to be retained in private ownership are found in IHTA 1984 ss.30–35A which provide that a transfer of value of heritage property is exempt from Inheritance Tax provided certain conditions are met (the 'conditional exemption').


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10.2.4 Prior to 31st July 1998, conditional exemption was generally available for chattels where property had been designated under IHTA 1984 s.31 as being of national, scientific, historic or artistic interest, i.e. of museum quality. In addition, undertakings had to be given that certain agreed steps would be taken to maintain and preserve the property, to provide reasonable access to the public and to keep movable property in the UK (unless the Treasury or, later, the Revenue, agreed to a temporary absence for a specified purpose, for example, an exhibition).

10.2.5 For claims made after 30th July 1998, objects (other than those historically associated with a qualifying building) qualify only if they are pre-eminent for their national, scientific, historic or artistic interest. For undertakings given after that date, the facility allowing owners to opt for public access by prior appointment only is not available.

**When does it apply?**

10.2.6 Conditional exemption applies to transfers of value occurring as a result of death and to certain chargeable lifetime transfers. For lifetime transfers, either the transferor must have acquired the property by a transfer on death which was itself a conditionally exempt transfer or the transferor (or spouse or civil partner) must have been beneficially entitled to the property for the 6 years immediately preceding the transfer (IHTA 1984 s.30(3)). Property held on trust may also qualify for conditional exemption in certain circumstances which are discussed separately below.


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10.2.7 Transfers of value which are already exempt from Inheritance Tax because they are either gifts to charities or inter-spouse or civil partner transfers cannot also be conditionally exempt transfers (IHTA 1984 s.30(4)).

10.2.8 Similarly, potentially exempt transfers cannot also be conditionally exempt transfers unless the transfer subsequently becomes chargeable due to the transferor dying within 7 years. Conditional exemption can only be claimed after the transferor's death if the property has not been disposed of in the interim unless the disposal is to a body within IHTA 1984 Sch 3 or is in satisfaction of tax under IHTA 1984 s.230 and, in either case, the property has been or could be designated as heritage property under IHTA 1984 s.31 (IHTA 1984 s.26A).

10.2.9 Conditional exemption may also be claimed if the property has been disposed of by the donee provided the disposal was by way of gift and the new owner, is prepared to give the necessary undertakings.

10.2.10 Where relief is given, the transfer is a conditionally exempt transfer (IHTA 1984 s.30(2)). Provided the undertakings are observed the Inheritance Tax liability can be postponed.

**Chargeable events**

10.2.11 The deferred charge will become payable if a ‘chargeable event’ occurs (IHTA 1984 s.32). There are three occasions on which such an event can arise, namely:-


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(a) the death of the beneficial owner of the property (with certain exceptions);

(b) the disposal, whether by sale or gift, of the property (with certain exceptions); and

(c) the failure of the relevant person to observe, in any material respect, an undertaking given to the Treasury or Commissioners for HM Revenue and Customs.

10.2.12 The exceptions to (a) and (b) above are, broadly, if the transfer of value on death or disposal by gift is itself a conditionally exempt transfer, the sale or disposal is to a body within IHTA 1984 Sch 3 or is in satisfaction of a tax liability under IHTA 1984 s.230 or the requisite undertaking under IHTA 1984 s.31 is given by such persons as the Revenue considers appropriate in the particular circumstances. It is no longer acceptable for such replacement undertakings to simply correspond with the old undertakings.

**Calculating tax**

10.2.13 The Inheritance Tax charge is calculated according to the rules contained in IHTA 1984 s.33 which depend upon what triggers the charge and the market value of the relevant property at the time of the chargeable event. The value of the property will be taxed by reference to the transferor's rates of Inheritance Tax. Where an individual is still alive, his cumulative total of chargeable transfers is adjusted upwards by the amount of the value of the property on which tax is paid (IHTA 1984 s.34). Where this person is dead his estate will be similarly increased and this can affect the rate of tax applicable on the event of a


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second and subsequent chargeable event. The legislation provides that where property has been sold (with no intention to confer a gratuitous benefit on anyone), the value is taken to be the proceeds of sale (IHTA 1984 s.33(3)). Where the chargeable event is not a sale, the computation is more complex because two transfers could occur, on the gift and on the triggering of the deferred charge. Where the gift is a chargeable event (not including PETs), the tax payable on the gift is credited against the triggered deferred charge. Where the gift is a chargeable transfer but not a chargeable event and so no charge arises the credit will be available to be offset against future chargeable events affecting that property.

10.2.14 There are special rules which apply in respect of the interaction between the transferable nil rate band and the tax payable on a chargeable event under s.32 (see IHTA 1984 s.8C).

10.2.15 The rate of tax depends upon the relevant transferor.

10.2.16 It is the responsibility of the owner of heritage property to notify HMRC Inheritance Tax of the ending of the conditional exemption. This should be done on Form IHT100 within 6 months from the end of the month in which the event occurs.

10.2.17 The rules applicable to maintenance funds are dealt with separately below.


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**Meaning of 'disposal'**

10.2.18 There has been much debate about what constitutes a 'disposal' for the purposes of IHTA 1984 s.32. At one time there was concern that mortgaging the property as security for a loan would be treated as a disposal. HMRC's view is that mortgaging a property to raise finance to restore it is not a disposal. (See the summary of the correspondence between the Revenue and the Historic Houses Association published in Historic House Magazine, Spring 1990 and Summer 1991). HMRC also consider that a grant of a lease is not a disposal of the superior interest for this purpose.

**Interaction with agricultural property relief and business property relief**

10.2.19 In the case of landed estates qualifying as heritage property, much of the land will also qualify for agricultural property relief at either 50% or 100%. It is not impossible that a dwelling house may be both a farmhouse and qualify as heritage property. In addition, there may be situations where property qualifies not only as heritage property but also for business property relief.

10.2.20 A chargeable event occurs if conditional exemption is forfeited on one of the three occasions mentioned above. A charge under IHTA 1984 s.32 will arise as explained above and also under the associated property provisions of IHTA 1984 s.32A. Under ss.32 and 33, tax is charged on 'an amount equal to the value of the property at the time of the chargeable event' (IHTA 1984 s.32(1)). There is no transfer of value (deemed or otherwise) and therefore any agricultural property relief or business property relief is not available. It is usually better,


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therefore, to make a chargeable transfer subject to business or agricultural property relief rather than to claim conditional exemption.

**Making a claim for conditional exemption**

10.2.21 Conditional exemption from Inheritance Tax relies upon the property being 'designated' by the Commissioners for HM Revenue and Customs and 'appropriate undertakings' being given by the relevant person. Furthermore, if Capital Gains Tax relief is to apply under TCGA 1992 s.258(2) the appropriate undertakings must have been given and if relief is to apply under TCGA 1992 s.258(3) (see below), the property must have been, or must be capable of being, designated for Inheritance Tax purposes and the appropriate undertakings must be given.

**Designation**

10.2.22 There is no definition of 'heritage property' in the legislation. However, IHTA 1984 s.31 states that the Treasury may designate:-

(a) a relevant object which is pre-eminent for its national, scientific, historic or artistic interest or a collection or group of relevant objects which, taken as a whole, is pre-eminent for its national, scientific or artistic interest. A relevant object is defined as a picture, print, book, manuscript, work of art or scientific object. The test of pre-eminence, which replaced the old test of 'museum quality', requires a higher standard to be reached;

(b) land of outstanding scenic, historic or scientific interest;


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(c) buildings of outstanding historic or architectural interest;

(d) land essential for the protection of the character and amenities of a building falling within (c) above; and

(e) objects historically associated with a building falling within (c) above.

10.2.23 In the past, IR 67 'Capital Taxation and the National Heritage' provided useful guidance as to what the Revenue considered to be appropriate property. IR67 has been withdrawn and the booklet is out of print. A draft of new Revenue guidance has been the subject of consultation with stakeholders. It is unclear whether this revision will be published in due course.

10.2.24 When determining if an object or collection is pre-eminent, regard should be had to any significant association of the object or collection with a particular place.

10.2.25 The Commissioners for HM Revenue and Customs are, of course, unable to determine themselves what objects, buildings and land should be designated as national heritage property. HMRC Inheritance Tax (which is responsible for designating property) takes expert advice before deciding whether to designate a property.

10.2.26 As regards land and buildings, HMRC Inheritance Tax mainly receives advice from bodies such as Natural England, English Heritage, the Forestry Commission, Cadw Welsh Historic Monuments and other more specialist advisers such as the Royal Botanic Gardens (for rare trees), etc.


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10.2.27 If a grant has been given under the Historic Buildings and Ancient Monuments Act 1953 for a particular building that is a *prima facie* indication that it will be accepted as outstanding. Land essential for the protection of the character and amenities of an outstanding building is also eligible for exemption. The factors to be taken into account here include ‘the need to protect the views from an outstanding building (e.g. to landscaped parkland); and the views of and approaches to it; and the need to prevent undesirable development close to it’. The trees and underwood on the land may qualify for the exemption if they contribute to the qualifying interest. There is no requirement that the land has to adjoin an outstanding building. Buildings on essential amenity land qualify for exemption in their own right if they are of outstanding historical architectural interest. When they are not eligible for exemption in their own right, the exemption granted to such essential amenity land will nonetheless extend to buildings on it providing that they make some positive contribution and are essential for the protection of the character and amenities of the outstanding buildings.

10.2.28 For ’objects’ within categories (a) and (e), advice is received from the Council for Museums, Libraries and Archives. An object is considered to be ‘pre-eminent’ if it falls within one of the following:-

- Does the object have an especially close association with our history and national life?
- Is the object of especial artistic or art-historical interest?


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- Is the object of special importance for the study of some particular form of art, learning or history?
- Does the object have an especially close association with a particular historic setting?

Foreign objects as well as British works may fall within the definition.

**Undertakings**

10.2.29 During the process of designation, the relevant expert body negotiate with the owner detailed undertakings in a heritage management plan. The undertakings may include matters such as the maintenance and preservation of the assets, the management of any land, the conservation plans for buildings and their contents and the proposed public access and how it is to be provided and publicised. The Revenue has stated that there will be no agreement as to whether conditional exemption is due until such time as an agreed plan is in place (Inheritance Tax & Trusts Newsletter December 2007).

**Monitoring undertakings and the provision of public access**

10.2.30 Not surprisingly, these are two of the main areas of controversy regarding heritage property.

10.2.31 Because of the concerns that heritage property was not readily available for public viewing as was originally intended and that many owners were not fulfilling their undertaking to provide public access, the Finance Act 1998 provisions were introduced. It was claimed that they were designed to give the


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public improved access to tax exempt assets while maintaining the protection of heritage property. The facility for owners to opt for public access by prior appointment only was withdrawn.

**Variations on undertakings**

10.2.32Both existing and future undertakings may be varied by the Revenue including undertakings given after 6th April 1976 and before 31st July 1998. At any time the Revenue may propose a variation of the original undertaking to the owner for agreement. A Judge sitting in the Tax Tribunal may direct that the proposed undertaking is to have effect from a specified date, which is not to be less than sixty days after his direction, if he is satisfied that:-

"(a) the Board have made a proposal for the variation of such an undertaking to the person bound by the undertaking,

(b) that person has failed to agree to the proposed variation within six months after the date on which the proposal was made, and

(c) it is just and reasonable, in all the circumstances, to require the proposed variation to be made."

10.2.33 In the case of *Re Applications to vary the undertakings of A and B* [2005] STC (SCD) 103 the Revenue's application was dismissed on the basis that the accumulated burdens placed on the owners as a result of the proposals at issue in the case would so outweigh the benefits to the public that it would not be just and reasonable to direct that they took effect. It was considered that the increased risks of theft and damage to the owners' possessions would go beyond


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what Parliament had in mind when empowering the inclusion of extended access requirements and publication requirements.

10.2.34 The Revenue is not able to seek adjustments to terms attaching to estate duty exemptions.

**Compliance**

10.2.35 The legislation imposes a tax charge if the undertakings are not observed in a material respect (IHTA 1984 s.32(2)). The meaning of the phrase 'in a material respect' is unclear.

10.2.36 Under the monitoring procedures it is understood that owners of outstanding land or buildings will generally be required to make annual reports to the Revenue about the maintenance of the assets and the provision of public access. The Revenue did state in IR67, which has now been withdrawn, that exempt land and buildings will be inspected usually every 5 years or when it considers appropriate.

**Public access**

10.2.37 'Public access' means that all owners of exempt assets will have to provide a measure of 'open' access to national heritage assets in accordance with the terms of an undertaking agreed with the Revenue. 'Public access' must be reasonable and this will depend upon the nature and type of asset as well as the preservation and maintenance needs of that asset. For example, what is reasonable access to a large building may not be reasonable in the case of a smaller building or a


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delicate object. In some cases it may be appropriate to mix 'open' access with 'appointment' access if it is required for the preservation of the object. In certain circumstances it may be appropriate to suspend or exclude public access.

10.2.38 In the case of exempt buildings and their amenity land, the minimum period of 'open' access is 28 and 156 days each year. The Revenue states that:-

> "as a general guide, access to the interior of a smaller building at least one day a week during the Spring and Summer months plus the Spring and Summer bank holidays, or their equivalent in Scotland and Northern Ireland would normally be sought (i.e. as a working rule, 28 days per annum, although this might be slightly lower in Scotland, Wales and Northern Ireland). This would be subject to review in the case of buildings of specialised interest or buildings whose structure, contents or decoration would suffer from the normal levels of access. For larger buildings liable to attract, and capable of handling, larger number of visitors, greater access would usually be required. Depending on the circumstances, this might range from 60 to 156 days. Access to amenity land will depend on the nature of the land, its use and all the circumstances."

10.2.39 In the case of land, the access will, in general, be all year round during daylight hours and on defined routes but with agreed closure periods for sporting activities, land management, nature conservation, etc. In most circumstances it will be open to the individual to charge a fee to view the exempt building but


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this must be reasonable from the point of view of the public at large. The Revenue considers that such charges should be ‘along the lines of those made by locally comparable sources, e.g. the National Trust’ (HMRC IHT & Trusts Newsletter-December 2007).

10.2.40 For chattels exempt in their own right, ‘open access’ may be provided by displaying the objects at:-

(a) the residence of the individual or at the place the object is kept (and unless the building itself is tax exempt, access may be limited to the area of the building where the chattels are displayed);

(b) a museum or gallery to which the public have access;

(c) any other building open to the public, e.g. a local Record Office;

(d) the appropriate European Heritage Open Days event free of charge (i.e. Heritage Open Days (England), Doors Open Days (Scotland), London Open House, and European Open Days (Wales and Northern Ireland); and

(e) local, regional or touring exhibitions.

10.2.41 Objects may be loaned for display in public collections for special exhibitions and this period counts as ‘open’. An owner must give an undertaking that an object will be kept permanently in the United Kingdom and will not leave the country temporarily except for an approved purpose and period, e.g. a temporary public exhibition abroad. An application must be sent to HMRC


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Inheritance Tax before applying for an export licence (in the case of objects more than 50 years old). Loans to public collections may be covered by the Government Indemnity Scheme to relieve the borrower of the need to take out commercial insurance.

10.2.41 Access should be given for a suitable period and time each year, and without the need for a prior appointment. The Revenue states that it would not expect this annual period to be less than a month or so (or, where it suited an owner and an institutional borrower, a corresponding triennial arrangement). It is considered that only in very exceptional circumstances would gaps of 3 or more years be reasonable.

10.2.42 Historically-associated objects will normally be displayed in the building with which they have an historical association.

10.2.43 Publicising access and undertakings is a requirement of conditional exemption for heritage assets. The Revenue will expect the individual to make any undertaking available to any member of the public who asks to view it. The undertaking in relation to the building or exempt chattel may be displayed at the premises and the Revenue may also enter the details on their website. The information required for the website is:-

- a description of each object and the country in which it can normally be seen;


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- the county (though not the full address) in which it can normally be seen;
- viewing details including the dates the public can see it and, if applicable, the museum, gallery or other venue for its display;
- a contact point for information, for by appointment access and for loans for special exhibitions.

10.2.44 Owners of buildings open to the public will have their own publicity. The publicity for the attraction, together with the Revenue's web-site publicity, will be sufficient. For items displayed in houses not normally open to the public, further publicity will be necessary - in the local press or at a local tourist information centre and in a national publication or guide.

10.2.45 It is important that these details are renewed and updated annually to avoid an inadvertent loss of the exemption. In the annex to the Inheritance Tax Manual at paras 15 and 16 are the Revenue's views of what it considers is acceptable or not.

10.2.46 The annex to the Inheritance Tax Manual provides a useful summary of what is acceptable and common problems encountered.

**Making a claim**

10.2.47 A written claim for relief from Inheritance Tax under IHTA 1984 s.30 must be made to HMRC Inheritance Tax within two years after the date of death or date of transfer. The Revenue has the discretion to extend this period and has


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indicated that an oversight or mistake on an individual's part or his adviser's part, or the making of a post-death variation will not normally by itself be an acceptable reason to allow a late claim. Before 16th March 1998 there was no such time limit. In the case of both lifetime chargeable transfers and transfers on death (including potentially exempt transfers which became chargeable as a result of death), a claim cannot be made until after the event. With lifetime chargeable transfers this was, perhaps, not such a problem but where the relevant transfer was as a result of death the procedural delays can cause significant problems for the executors as regards administration of the deceased's estate.

10.2.48 Unfortunately, there is no formal advance clearance procedure. However, Natural England will usually give an informal indication of the likelihood of land qualifying for relief on the basis of it being of outstanding scenic interest. Where a claim is likely to be made, perhaps because of the poor health of the current owner, it is worthwhile seeking in advance informal advice from Natural England. This will, at least, allow alternative planning steps to be considered if the property is unlikely to meet the required standards.

10.2.49 One situation where a claim for designation will be considered in advance is the intended lifetime creation of a maintenance fund in support of an outstanding building, outstanding or amenity land and historically associated chattels (IHTA 1984 Sch 4 para 1(2)).


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10.2.50 Another situation where a claim will be considered in advance is in connection with the decennial charge arising under IHTA 1984 s.64. It is essential to ensure that a claim is accepted and the property designated under IHTA 1984 ss.31 and 79 as heritage property *before* the charge actually arises. It is not sufficient merely to have made the claim before the date on which the charge arises. HMRC have no discretion to backdate a designation to cover an earlier decennial charge even though the conditions would have been met had a claim been received. Hence, the claim for relief should be submitted in good time, considering that it can take as long as 2 years to process a claim.

## CAPITAL GAINS TAX

10.3.1 The heritage property provisions tend to be regarded largely as an Inheritance Tax relief. However, there are equally generous Capital Gains Tax reliefs which interact with the Inheritance Tax reliefs. This is most obvious in that the Capital Gains Tax legislation only gives relief in respect of property falling within the relevant Inheritance Tax provisions (TCGA 1992 s.258).

### Transfers to certain heritage bodies

10.3.2 Disposals to certain national bodies within IHTA 1984 Sch 3 (IHTA 1984 s.25) qualify for Capital Gains Tax relief under TCGA 1992 s.258. Relief is given by exempting the gain in full. As indicated above, neither of these Inheritance Tax provisions are strictly in respect of heritage property only.


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**Disposals of conditionally exempt property**

10.3.3 Section 258 also gives Capital Gains Tax relief for the gift of any asset which either has been or could be designated heritage property under IHTA 1984 s.31. This relief includes gifts to a settlement and disposals by trustees of property vesting absolutely. If no Inheritance Tax designation has actually taken place (for example, because the relevant asset was the subject of a potentially exempt transfer and the gift has not therefore created an immediate Inheritance Tax liability) then the equivalent undertakings required under IHTA 1984 s.31 must be given in order to claim the Capital Gains Tax relief.

10.3.4 As regards heritage property falling within IHTA 1984 s.31, Capital Gains Tax relief is given by deeming the relevant disposal to be a no-gain, no-loss disposal. Any relief given is subsequently be clawed back by deeming there to have been a disposal at market value upon one of three occasions:-

(a) Where the property is sold and an Inheritance Tax charge arises under IHTA 1984, s 32.

(b) Where an undertaking has not been observed in a material respect.

(c) Where there is a disposal other than by way of sale and no new undertaking is given. This could apply, for example, where the new owner of the property subsequently dies and no new undertaking is given by the transferee. In this instance, the owner of the asset is treated as having immediately reacquired it at market value.


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10.3.5 These broadly correspond to the occasions on which a chargeable event occurs for Inheritance Tax.

10.3.6 Therefore, where there is a clawback and the property has increased significantly in value, there will be a gain arising of not only the clawed back gain but also the gain accruing since the no gain, no loss disposal.

10.3.7 Where a Capital Gains Tax charge arises due to the clawback of relief and Inheritance Tax is also chargeable, the Capital Gains Tax payable is allowed as a deduction in determining the value of the asset for Inheritance Tax purposes (TCGA 1992 s.258(8)).

## MAINTENANCE FUNDS

10.4.1 The beneficial tax treatment afforded by the heritage property provisions outlined above may not be sufficient on their own to enable a private individual or family to retain and maintain a substantial heritage property. By their very nature, many heritage properties are not income-producing or are unlikely to create sufficient income to be self-maintaining. Generally, other means of support are required.

10.4.2 Legislation designed to alleviate the problems facing the owners of heritage properties exists to exempt funds set aside to maintain the properties from capital taxes. Maintenance funds are now a useful tool in the preservation of heritage properties. They are not, however, always the best solution.


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**Statutory conditions**

10.4.3 A qualifying maintenance fund is one which falls within IHTA 1984 Sch 4 Pt I. Such funds are tax favoured as they attract Inheritance Tax reliefs, and to some extent, Capital Gains Tax and Income Tax reliefs.

10.4.4 To qualify for relief, a fund should be for the benefit of land and/or buildings (and/or historically associated objects) which qualify, or could qualify, for conditional exemption and the fund must be held on the terms of a trust. In the first 6 years the trust fund must not be capable of being applied for a use other than for the maintenance, repair and preservation of, or making provision for public access to, heritage property, except that income not so applied and not accumulated can be paid to a qualifying charity or to a body included in IHTA 1984 Sch 3 (IHTA 1984 Sch 4 para 3). The property comprising the trust fund must be of an appropriate character and amount 'having regard to other sources of upkeep available to the owner'. In practice, this means it must produce sufficient income to maintain the relevant heritage property. The trustees of the settlement must be approved by the Revenue. The trustees or a majority of them should be UK resident and must include either a trust corporation, a solicitor or an accountant or a member of such other professional body (IHTA 1984 Sch 4 para 2).

10.4.5 Although the provisions are stringent, there is some scope for flexibility. In particular, funds can be withdrawn from the settlement after the initial 6-year period (subject to an Inheritance Tax charge) if it becomes apparent that they are required for other purposes or are excess to requirements. It is also possible to


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add further funds at a later date, for example, on the death of the settlor if this is found to be necessary.

**Inheritance Tax**

10.4.6 Were it not for specific relieving provisions the maintenance fund which is a discretionary trust would be a relevant property settlement so that there would be an Inheritance Tax charge on transferring funds into the trust and a decennial charge and an exit charge in the event of trust capital being used to maintain or otherwise benefit the heritage property itself. There are, however, specific reliefs which exempt such transfers of value from Inheritance Tax (IHTA 1984 s.27 and Sch 4).

10.4.7 A maintenance fund can be established not only for national heritage property which has already been subject to a claim for conditional exemption, but also prior to a claim for conditional exemption. The Revenue can designate the relevant heritage property (i.e. confirm they believe it to be of sufficient national importance to qualify) and accept undertakings given by the current owner as if it had been the subject of a chargeable transfer. This allows the maintenance fund to be formed prior to, say, the death of the owner. This course of action is a means of testing whether heritage property is of an acceptable standard to be designated prior to claiming conditional exemption.

10.4.8 Additional property can be added to an existing maintenance fund, free of Inheritance Tax, by an individual. Under IHTA 1984 Sch 4 para 16, property held by a discretionary trust can be appointed to a maintenance fund without an


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exit charge arising under IHTA 1984 s.65. The property may pass either straight to the maintenance fund or via a beneficiary of the discretionary trust provided the beneficiary transfers the property to the maintenance fund within 30 days. The trustees of the maintenance fund must not have acquired an interest in the discretionary trust for money or money's worth or, where the property passes via an individual, that individual must not have acquired the property for money or money's worth.

10.4.9 On the death of a life tenant, property already in an interest in possession settlement can be transferred to a maintenance fund free of Inheritance Tax (IHTA 1984 s.57A). Where a person became entitled to an interest in possession after 21st March 2006, relief will not be available unless the interest was immediately before the person's death in one of the special privileged trusts:-

- an immediate post-death interest;
- a disabled person's trust;
- a transitional serial interest.

10.4.10 The transfer must be made within 2 years after the death of the life tenant or within 3 years if a court order is required to change the terms of the settlement.

10.4.11 A claim for Inheritance Tax relief must be made within 2 years after the date of the transfer concerned or within such longer period as the Revenue may allow.


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10.4.12 If property leaves a maintenance trust for a purpose other than to repair, preserve or maintain the property and is not given to a qualifying charity or to a body falling within IHTA 1984 Sch 3, an exit charge arises (IHTA 1984 Sch 4 Pt II). Although property can be reclaimed from the maintenance fund after 6 years, there is a penalty for doing so. One notable exception to this charge is where the property is transferred to another qualifying maintenance fund (IHTA 1984 Sch 4 para 9) which again gives some flexibility to the arrangement.

**Income Tax**

10.4.13 The income of a heritage maintenance settlement is taxed under the normal Income Tax provisions applicable to settlements, subject to the provisions contained in ITA 2007 ss.507–517. Where the settlor has retained an interest in the trust fund, even an indirect interest by virtue of his owning the heritage property which the trust is established to benefit, the income arising is treated as that of the settler (ITTOIA 2005 ss.624–629). ITA 2007 s.508, however, enables the trustees to elect that the trust income, which would otherwise be taxable as the settlor's income, be taxable as if it were the trustees own income. The election must be made on or before the first anniversary of the self-assessment filing date for the tax year to which it relates. If the election is made, the trust's income will be taxable at 50%. If the settlor does not pay higher rate tax it will be better for the trust income to be taxed as if it were the settlor's. Should the settlor be a Lloyd's underwriter, the possibility that losses may become available may make it preferable for the income to be taxed on the settlor.


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10.4.14 Where property of the maintenance fund (either capital or income in nature) is applied for a non-qualifying use, or the fund ceases to qualify and the Revenue's direction is withdrawn, any income which has arisen since the establishment of the settlement and which has not been applied in the upkeep of the heritage property is, with certain exceptions, subject to an additional tax charge under ITA 2007 ss.512–513. This additional tax charge is at a rate equivalent to the difference between the higher rate of Income Tax and the trust rate. Because the higher rate of Income Tax and the trust rate are the same the additional charge will be 0%.

10.4.15 Care needs to be taken to avoid a situation where an election is made to treat the income as the trustees' own Income Taxable at 50%, while the settlor is not paying tax at all.

**Capital Gains Tax**

10.4.16 Specific hold-over relief for transfers into maintenance funds is provided by TCGA 1992 s.260(2)(b)(iii). The relief is available on the establishment of the maintenance fund, on the addition of further funds at a later date and on transferring funds from an existing maintenance fund to a new maintenance fund.

10.4.17 The provisions in TCGA 1992 ss.169B and 169C, which prevent hold-over relief being available on transfers into a settlor-interested trust and which provide for clawback of the tax in certain circumstances, do not apply to a disposal to the trustees of a settlement which is a maintenance fund for historic


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buildings (TCGA 1992 s.169D(1)) where an Income Tax election under ITA 2007 s.508 has been made. Gains made by the trustees will be subject to Capital Gains in the usual way.

**SETTLED HERITAGE PROPERTY**

10.5.1 Historically, owners of heritage property have used trusts to ensure continuity of ownership and management and also to protect the property from improvident heirs.

10.5.2 Broadly speaking, property can be subject to the settled heritage property provisions in three circumstances:-

(a) Where the property is the subject of a chargeable transfer into trust.

(b) Where an individual dies with a life interest in settled heritage property.

(c) Where property is held on discretionary trusts and is therefore subject to the relevant property regime.

10.5.3 These three situations are dealt with in turn below, followed by a brief review of problem areas encountered in practice.


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**Transfers of property into trust**

10.5.4 Since 22nd March 2006, the lifetime transfer of property to either an interest in possession (or to a trust which would previously have been an accumulation and maintenance trust within IHTA 1984 s.71) is not a potentially exempt transfer but a lifetime chargeable transfer unless a relieving provision makes it exempt. Therefore the conditional exemption will be of importance not only in relation to transfers to discretionary trusts but also to transfers to interest in possession trusts. A claim is made in the normal way and, if conditional exemption is granted, the trustees will have to give the required undertakings.

10.5.5 Therefore, a lifetime transfer of heritage property to a trust other than a privileged trust, where conditional exemption is relied upon to mitigate the potential Inheritance Tax liability, can be an expensive strategy if conditional exemption is not, subsequently, granted.

**Termination of life interest on death**

10.5.6 The termination of a life interest on death may be a chargeable transfer by the holder of the interest if the interest either existed before 22nd March 2006 or was a privileged interest. If that is not the case, it may be an occasion of charge on property ceasing to be relevant property under IHTA 1984 s.65 because, for example, an individual becomes absolutely entitled to the trust property. In either circumstance, the charge may be avoided if the property is designated as heritage property in relation to that occasion.


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**Property held on trust**

10.5.7 A trust can be exempt from Inheritance Tax in respect of heritage property for the purposes of the decennial charge (IHTA 1984 s.79) and also when heritage property leaves the trust subject to certain ownership conditions (IHTA 1984 s.78).

10.5.8 Generally, the trust is exempt from the decennial charge if either the trust property has previously been the subject of a conditionally exempt transfer (and has therefore already been designated) or there has been an exempt disposal for Capital Gains Tax purposes (also requiring designation). Alternatively, the trust property may be specifically designated as heritage property prior to the decennial charge to avoid tax on that event. As explained above, this is the only occasion on which the statute provides for advance designation of a property, and the property *must* actually be designated before the decennial.

**Gifts with reservation**

10.5.9 Where heritage property is settled on trust and the original owner is included as one of the initial beneficiaries, the gifts with reservation provisions need to be considered regardless of whether the settlor actually receives any benefit. FA 1986 s.102(5) provides an exemption from the provisions for exempt transfers of property to maintenance funds but not for transfers of the heritage property itself. Presumably this is because the heritage property is conditionally exempt and should continue to be exempt provided the undertakings are not broken and, therefore, the gift with reservation provisions should not cause any difficulty.


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**Pre-owned assets**

10.5.10 A charge to Income Tax will arise on donors who continue to enjoy a benefit from property of which they have previously disposed. Where the arrangements put in place reserve a benefit to the original owner, there will be an exemption from the pre-owned assets charge. If, however, the original owner is excluded from the class of beneficiaries under the trust but later derives some benefit from the property, an Income Tax charge will arise. There is an exemption from the charge for transfers of property to maintenance funds for historic buildings although there is no exemption for transfers of the heritage property itself.

## STRATEGY

10.6.1 When considering the strategy for a particular set of circumstances, there are two main questions to be answered:-

(a) Does the family wish to, and indeed is it able to, retain and finance the upkeep of the heritage property in future years?

If the answer is 'yes', then it is necessary to consider whether, and how best, to utilise the various heritage property reliefs. In some circumstances where one qualifies for conditional exemption it may be beneficial not to claim it.

(b) Is a lifetime gift appropriate or should conditional exemption be claimed on death?


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A gift on trusts under which neither an existing IIP nor a privileged interest subsists would be a chargeable lifetime transfer and conditional exemption may therefore be claimed. Other gifts will generally be potentially exempt transfers and may, therefore, escape the impact of Inheritance Tax altogether or, if the donor dies within 7 years, conditional exemption may be claimed on death. Furthermore, a lifetime transfer is deemed to be a no gain, no loss disposal for Capital Gains Tax purposes where the property is either designated or could be designated as heritage property.

10.6.2 One potentially significant disadvantage of a lifetime gift is the loss of the tax-free Capital Gains Tax uplift on death. This may be relatively unimportant where the property is to be retained by the family and can continue to be designated as heritage property or where the property is unlikely to appreciate significantly prior to the death of the transferor. If the property is sold, however, or conditional exemption is lost for other reasons, the cost of losing the Capital Gains Tax uplift on death may be substantial.

10.6.3 A lifetime gift on flexible trusts may be considered as it enables the choice of eventual heir to be left open and the transferor can oversee such matters as the provision of public access to the newly designated heritage property. However, there are problems as explained above with this strategy.


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10.6.4 Waiting until the death of the current owner of potential heritage property before claiming conditional exemption may have its advantages. This enables the Capital Gains Tax uplift on death to be utilised. However, it also means that the deceased's executors and family will have to make an application for conditional exemption.

10.6.5 Should ‘supporting property’ (i.e. property to provide funds for the upkeep of the heritage property itself) be placed in a maintenance fund or not?

10.6.6 Maintenance funds do have advantages and they are flexible vehicles. In particular, a lifetime gift of property to a maintenance fund has the advantage that it requires the relevant heritage property to be designated even where no chargeable transfer of the actual heritage property has been made. The establishment of a maintenance fund can therefore be used to test whether the relevant property is of sufficiently high standard to be designated as heritage property. However, the use of property held in a maintenance fund is severely restricted for the first 6 years. This restriction will need to be weighed against the tax advantages of using a maintenance fund.

10.6.7 An alternative to a maintenance fund is to advance supporting property direct to the transferor’s heir. Such a gift, during lifetime, would be a potentially exempt transfer and no Inheritance Tax would be payable if the transferor survives for 7 years. This is risky, however, as, if it fails, it is not then possible to obtain relief retrospectively by transferring the property to a maintenance fund and asking for the now chargeable potentially exempt transfer to be ignored. It is understood


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that the Revenue is aware that this can cause a problem but does not consider the existing rules to be unfair. The Income Tax and Capital Gains Tax advantages of maintenance funds are not huge and the motivation for using a maintenance fund will be almost purely Inheritance Tax driven.

10.6.8 The final decision as to whether to use a maintenance fund may well be determined on practical grounds, such as whether the family is comfortable with the supporting property being almost entirely alienated from their control for 6 years. The attractiveness of a maintenance fund from an Inheritance Tax perspective should not, however, be overlooked.


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