

INCOME TAX ON PRE-OWNED ASSETS

APRIL 2024

The income tax on pre-owned assets (**pre-owned asset tax or POAT**) is targeted at individuals who have entered into 'contrived arrangements' to avoid Inheritance Tax (IHT) on assets, whilst retaining their potential benefit.

As ever, with a tax targeted at a specific behaviour, the effect may inadvertently be wider than originally intended.

POAT is levied broadly along the lines of existing employee benefit in kind charges, on the market value of the benefit received, although the rules differ according to whether the asset concerned is land, a 'chattel' (tangible moveable property) or intangible property (such as a life assurance policy).

BACKGROUND

HMRC introduced pre-owned asset tax (POAT) as a response to increasingly aggressive Inheritance Tax (IHT) planning schemes. These schemes aimed to 'get round' the existing rules regarding 'gifts with reservation'. This is the problem most normally encountered with IHT planning – how to give away an asset, and thus save the beneficiaries 40% tax, but still continue to gain benefit from it? Inland Revenue legislation dictates that a transfer of legal title to an asset will not be effective for IHT purposes if the person making the gift (the donor) retains a benefit.

However, various schemes were marketed that promised to achieve just such a 'have your cake and eat it' result. HMRC naturally objected to this type of planning, but have lost legal challenges to such arrangements, most notably in the cases of 'Ingram'¹ and 'Eversden'². Consequently the tax legislation has been changed so that new arrangements along the same lines as these are no longer effective. However, there are many other schemes that still claim to be effective.

Instead of moving to change the particular aspect of legislation which each separate scheme uses, HMRC have introduced a new free-standing income tax charge which aims to cover all such aggressive tax planning where the existing legislation is not sufficient.

Notes:

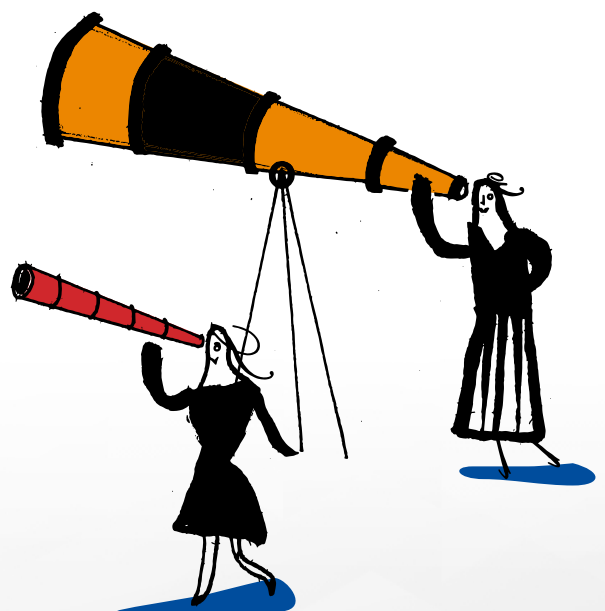
¹ Ingram and another v IRC [1999] STC 37

² IRC v. Eversden [2002] STC 1109

WHO IS AFFECTED?

Those affected are any individuals who have entered into any arrangements to dispose of 'valuable assets' whilst retaining the ability to use them. The Revenue intends the tax charge to cover only those arrangements where the main purpose was to avoid IHT. However, the scope may actually be much larger, as detailed below.

The POAT rules do not apply to individuals who are non-UK resident in a year of assessment. For a UK resident who is non-UK domiciled, the POAT will apply only to assets situated in the UK. The IHT deemed domicile rules also apply when determining domicile for POAT.



HOW DOES THE TAX WORK?

The pre-owned asset tax (POAT) broadly follows the benefit-in-kind charge on employees, and applies, in the main, to UK residents. For those who are not UK domiciled or deemed domiciled, the charge only applies to UK assets. The rules quantify an annual cash value of the assets enjoyed by the individual, which is then treated as their taxable income and taxed accordingly. A de minimus limit of £5,000 per annum applies to the total taxable benefit in a tax year; once the £5,000 has been exceeded, the whole amount is taxable.

For example:

An individual has put their main residence into trust, and continues to live there. The annual rental value is £12,000 per annum. The individual, who is a higher rate (40%) taxpayer, will therefore be subject to an annual income tax charge of £4,800 ($40\% \times £12,000$).

If the individual paid the trustees rent of £5,000 per annum, the income tax charge would be £2,800 ($40\% \times (£12,000 - £5,000)$). This rent will be a taxable receipt on the trust.

If the individual paid the trustees rent of £7,000 per annum, the de minimus limit may cover the balance and so no income tax may be due. Again, the rent will be a taxable receipt on the trust.

Land benefits are related to market rent. For chattels and intangible assets, the benefit will be a percentage of the capital value (the Inland Revenue's 'official' rate). Land and chattels will be valued every 5 years; other assets are valued annually.

EXCLUSIONS

POAT does not apply where:

- The property in question ceased to be owned before 18 March 1986.
- Property formerly owned by a taxpayer is currently owned by their spouse.
- The asset in question was sold by the taxpayer at an arm's length price, paid in cash.
- The taxpayer was formerly the owner of an asset only by virtue of a will or intestacy, which has subsequently been varied by agreement between the beneficiaries within 2 years of death, and a suitable election was made.
- Any enjoyment of the asset is no more than incidental, including cases where an out-and-out gift to a family member comes to benefit the donor following a change in their circumstances.
- The interest retained in the asset is consistent with their ongoing enjoyment of the asset. For example, the proposed charge should not arise where an elderly parent gives 50% of their home to a child who lives with them, and they both share the living expenses in proportion to their share of ownership. Please note that arrangements where, for example, a portion of a property is gifted to a child but that child does not live in the property for that amount of time, the POAT may still apply.

HOW DOES THE TAX WORK?

EXCLUSIONS

- Full consideration is paid for the taxpayer's continued use of the asset, supported by a lease or other written arrangement.
- Intangible assets will only be subject to the tax charge to the extent that the individual derives benefits from them, and that those benefits diminish the benefits potentially available to others. For example, this may apply where a life assurance policy is held in a discretionary trust for a class of beneficiaries including the settlor.
- For tangible assets (land and chattels), the exclusions include:
 - Gifts of money which do not give rise to a benefit for seven years.
 - Gifts covered by the small gifts IHT exemption (up to £250), and gifts covered by the IHT annual exemption (£3,000).

EXEMPTIONS

The main exemptions are:

- The asset in question remains part of the taxpayer's estate for IHT purposes, unless the value of that property has been reduced by an excluded liability (i.e. that which reduces the value of the asset in the estate).
- The asset forms part of the individual's spouse or civil partner's estate
- The asset in question still counts as part of the taxpayer's estate for IHT purposes under the existing 'gift with reservation' rules.
- The asset in question does not directly form part of the taxpayer's estate, but the estate does include property which derives its value from those assets (e.g. all the shares in a company owning a property occupied by the taxpayer).

If you think that you may be affected, we recommend that you take professional advice before acting.



FIND OUT MORE

If you have any questions about our investment methodology, or would like some financial planning or investment advice, the clarity team are here to help.

Please contact your usual clarity adviser, or get in touch using the details below:

Tel: **+44 800 368 7511**

Email: enquiries@clarityglobal.com

Address: **1 Crown Square, Woking, Surrey GU21 6HR**

Web: clarityglobal.com

Twitter: twitter.com/clarityglobal

Instagram: instagram.com/clarity_global

LinkedIn: linkedin.com/company/clarity_7



Important information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested.

© clarity Ltd. clarity Ltd is authorised and regulated by the Financial Conduct Authority (FCA). The FCA does not regulate all types of Pensions, Mortgages or Taxation Advice. clarityLAW is brought to you in association with Taylor Vinters solicitors, a firm regulated by the Solicitors Regulatory Authority.

