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## Tax on Pre Owned Assets

### A new income tax charge which may affect anyone enjoying a benefit from assets they have given away

Under the Finance Act 2004 a new income tax charge (“the Tax”) has been introduced which will apply wherever a person enjoys a benefit from assets which they either formerly owned, or provided the funds to purchase, but which they no longer own.

The Tax is intended to penalise those who enter or have entered into arrangements which save inheritance tax by giving away assets, but under which the giver continues to use or enjoy the assets. The person who gave/provided the assets is referred to below as “the taxpayer”.

#### The Tax applies where:

- in the case of **land**, the taxpayer occupies the land and either once owned it but gave it, or an interest in it, away; or gave another person the funds to buy it or an interest in it; or owned other property which was sold and the proceeds used by another person, directly or indirectly, to buy the land; or
- in the case of **chattels**, the taxpayer possesses or has use of the chattel and either once owned it but gave it, or an interest in it, away; or gave another person the funds to buy it or an interest in it; or owned other property which was sold and the proceeds used by another person to buy the chattel; or
- **intangible property** (e.g. shares or insurance policies) is held in a settlement and the person who gave that property to the settlement may benefit from it.

The Tax comes into effect from 6 April 2005, but will be imposed in respect of schemes set up before the Tax was announced, subject to the exceptions set out below.

Where the Tax applies it will be charged as if the taxpayer’s income were increased by the deemed value of the benefit received. So if the asset given is a property and the open market rental of it is £20,000 p.a., then the taxpayer will

be treated as though his annual income were increased by £20,000 and he will be taxed at his highest rates. Market rentals may change as time passes and Regulations are to be introduced to govern how the Tax charge will change accordingly (it is thought the Revenue will want to avoid the need for annual valuations). A reduction will be made if only a share of or interest in an asset is given away.

Any payment made by the taxpayer *under a legal obligation and during the taxable period concerned* in respect of the benefit will be taken into account, and will reduce the Tax to nil if at a full market rent. Regulations setting out how this will be calculated in the case of chattels and intangible property are expected early in the New Year.

#### Exemptions

The Tax will not apply where:

- the disposal was made before 18 March 1986
- the property has been given to, or to a trust for, the spouse of the taxpayer, unless the spouse’s interest terminates in his/her lifetime
- the property, or other property deriving its value from it, is included in the estate of the taxpayer for Inheritance tax purposes
- the whole property was sold on commercial terms
- where the taxpayer provided money to another person to buy the land or chattels concerned, the gift of money was made at least seven years before the taxpayer started to occupy the land or had use of the chattels
- the property passed under a Will which was varied for Inheritance tax purposes
- the value of the benefit from the assets given is no more than £5,000 p.a.

- the disposal was a disposition for the maintenance of the family (narrowly defined); or was made to a charity, a political party, a housing association, a historic house maintenance fund, an employee trust, or for national purposes
- the disposal was of a share in land, including a house, to a person who occupies it with the taxpayer
- the taxpayer now lives in the property given away with the owner of it, due to the taxpayer's age or ill health
- the taxpayer is non-resident
- the taxpayer is resident but non-domiciled, and the property concerned is situated outside the UK (but see further below).
- arrangements under which the occupier has given an interest in land he occupies, e.g. the freehold, to his children or to a trust
- "Eversden" schemes where, typically, a property or a share in a property is given by one spouse to a life interest trust for the other; and the second spouse gives up the life interest in favour of the children, in his/her lifetime. The charge takes effect after the gift by the spouse to the children
- insurance based schemes involving bonds or policies held in trust under which the settlor takes some benefit but, typically, may be excluded from benefit under parts of the trust fund
- arrangements, often created by non-domiciliaries, where a UK property is held through an offshore situated company or trust. Such arrangements may escape the Tax if the taxpayer owns the shares in the offshore company directly, or is entitled to income from a trust owning the shares or property. However all such structures should be reviewed before 6 April 2005 to establish the correct position.

The Revenue appear to accept that the disposal of the land or chattels must be by the former owner who now occupies the land or uses the chattel. It seems therefore that land or chattels held in trust and disposed of by the trustees, allowing the beneficiary still to occupy or have use, escape the provisions.

## Election

Taxpayers can choose, on or before 31<sup>st</sup> January following the end of the first year in which the charge applies (i.e. 31<sup>st</sup> January 2007 at the earliest), to avoid the Tax if they accept that the assets given away will be treated as still owned by them for the purposes of Inheritance Tax.

## Types of arrangements which may be affected by the Tax

Despite the above exceptions the new provisions will apply in a wide range of circumstances. These may include:-

- the "double trust" or "home loan" scheme where, although the taxpayer's home is sold to a trust, the price is left outstanding and this debt is given to a second trust for the children
- Shearing schemes, mainly set up before 1999, where a taxpayer gave away the freehold of his home retaining a rent free lease intended to last his lifetime
- reversionary lease schemes, where the taxpayer retains ownership of the property but gives away a lease commencing usually in 21 years' time
- "Chattels Lease" schemes where chattels are given away and leased back to the owner at a rent less than "market rent"

This list is not comprehensive and other types of scheme may be affected. If you benefit from any type of arrangement involving assets which you previously owned or paid for but which were given away then you should seek advice urgently on the implications of the Tax for you.

## Further Information

If you need help and advice on the issues raised in this commentary, please contact Jennet Davies (jadavies@jonesday.com), Lucy Johnson (cljohnson@jonesday.com) or Sarah Challinor (slchallinor@jonesday.com) at Jones Day, 21 Tudor Street, London EC4Y 0DJ telephone 020 7039 5959.

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