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The new pre-owned assets regime

The Pre-Owned Assets regime, part of The Finance Act 2004, became effective on 6 April 2005. This legislation creates an annual income tax charge where a taxpayer continues to enjoy a benefit from land, chattels or settled intangible property, which he or she previously owned.

It is designed to close loopholes in the Inheritance Tax (IHT) Gift with Reservation rules (GWR). Therefore, if a disposal is already caught by the GWR, it is not also caught by the new pre-owned assets charge.

Where the charge applies the tax can be high. For example with property, the charge is based on the open market rental value, which can be substantial. As this is not a tax on real income, it will have to be paid from other sources. The legislation covers disposals made since 17 March 1986, and will therefore now penalise many for previously successful tax planning which was then designed purely for IHT purposes. The new rules are more extensive than the IHT rules, as they catch not only gifts of land and chattels and so forth, but also cases where funds were provided for another to purchase the asset at a later point.

Exemption from the new regime for non-domiciled taxpayers exists where the land or chattel etc is located outside the UK. However, because the new legislation is designed to complement the IHT rules, the IHT definition of domicile is used, which includes the concept of deemed domicile. Therefore, anyone who has been resident in the UK for 17 out of the last 20 tax years will not be treated as non-domiciled for the purpose of the pre-owned assets rules. The long term non-domiciled resident becomes deemed domiciled for IHT purposes on the first day of the 17th tax year of residence. This means a disposal not caught in the current tax year may become caught in a later year when the person becomes deemed domiciled in the UK. This must be reviewed annually.

Other exemptions are available, and also the ability to elect for the IHT GWR rules to apply instead. Electing for GWR treatment will avoid the annual income tax charge, but will then immediately bring the asset back into the donor's estate for IHT purposes. Great care needs to be taken in considering whether or not an election is appropriate.

The above is only intended as a summary of the new rules. Previous gifts or sales at undervalue should be reviewed if any benefit continues to be enjoyed. Disposals made prior to arrival in the UK may also be affected, as the charge is based on benefit (and domicile status if relevant) in a particular tax year rather than the status being fixed at the date of the gift.

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