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The family home: gift and lease planning

In this guide, we look at how a homeowner can gift their main residence to reduce the value of their estate for inheritance tax purposes, yet still remain in occupation.

At a glance

- A homeowner can give away the family home for inheritance tax purposes but continue living in it.
- If the homeowner survives the gift for at least seven years and continues to pay full market rent, the property will fall outside their estate for inheritance tax purposes.
- Full market rent is usually around two to three per cent of the property's value.
- The house is usually given to a trust, or to adult children.
- There is a potential saving of 40 per cent inheritance tax on the value of the home gifted.

The basic principle is for the family home to be given away (usually into trust or to adult children), but for the original owners to remain living in it under the terms of a lease.

If the homeowner survives the gift for at least seven years and continues to pay full market rent for their ongoing occupation, the value of the property gifted will fall outside their estate for inheritance tax (IHT) purposes.

It is important that a lease is put in place and the rent represents the genuine market rate to get around the gift with reservation of benefit rules. Under these rules, if you give away an asset but continue to derive a benefit from it, on your death it is brought back into your estate and considered subject to IHT.

No capital gains tax (CGT) liability should arise on the gift of the family home as principal private residence relief can be claimed. A CGT liability could arise, however, on any future sale or transfer.

Depending on the terms of the lease and the value of the property, a small stamp duty land tax charge may be payable.

The main benefits

- There is a potential saving of 40 per cent IHT on the value of the home gifted.
- Even if the homeowner does not survive the gift for seven years, any increase in value from the date of the gift to the date of their death would be considered outside their estate for IHT purposes and avoid the 40 per cent charge.
- When using a trust, you can retain control and there may be an opportunity to maximise tax efficiency by passing the rent received to non or lower rate taxpayers.

How much can be transferred?

If the homeowner is not confident that they could afford to rent the whole property, they can instead gift a share of the house (the share being determined by the rent that they could afford).

Leases and rents

Full market rent often falls in the region of two to three per cent of the property's value but would need to be determined by professional valuers.

Rent reviews would be required every three to five years to ensure that the homeowner is not receiving any benefit as a result of paying a level of rent that should have increased.

The recipient must pay income tax on the rent that they receive.

If the property is transferred into trust, the income is subject to the trust rate of tax. Please see our separate briefing note 'Taxation of New Lifetime Trusts'. There may, however, be an opportunity to reclaim some or all of the tax paid by distributing the income to non or lower rate taxpayers (e.g. grandchildren).

Gift into trust or to children?

An advantage of using a trust is that the homeowner can be included as one of the trustees, allowing them to retain a degree of control over the property.

The trust also provides flexibility by giving the trustees a choice of potential beneficiaries (such as grandchildren for tax efficiency). The terms of the lease would set out the homeowner's occupation rights and these would be strengthened if a share of the property was retained.

An outright gift to children may be appropriate in cases where the value of the property is in excess of the IHT allowance (currently a maximum of £325,000), as a gift into trust would trigger an immediate IHT charge of 20 per cent on the value over and above the allowance.

Is there anything else I should know?

Currently, there is some uncertainty about what impact the proposed updated "hallmark" (used by HM Revenue & Customs (HMRC) to identify inheritance tax planning arrangements that must be notified to them) will have on gift and lease planning. If such inheritance tax planning falls within the Disclosure of Tax Avoidance Schemes regime, it will need to be notified to HMRC on being entered into, with possible further consequences if disputed tax is at stake.

In addition, this type of planning should not be undertaken without taking a broader look at the homeowner's other assets and circumstances. In particular, the introduction of an extra residence nil rate band for deaths on or after 6 April 2017 will affect whether this type of planning should be put in place. This residence nil-rate band will be available (subject to certain conditions being satisfied) where the deceased's residence is left to direct descendants, including children, stepchildren, adopted and foster children, and their respective spouses and civil partners, or left in trust for their benefit.

For further advice, please contact a member of the team.