STEP Briefing Note: IHT – Gift with reservation and spouse exemption

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We take a leading role in explaining our members’ views and expertise to governments, tax authorities, regulators and the public. We work with governments and regulatory authorities to examine the likely impact of any proposed changes, providing technical advice and support and responding to consultations.

Purpose of note

STEP, together with other professional bodies, has been discussing with HMRC the availability of the inheritance tax spouse exemption in relation to assets held in a trust which are treated as beneficially owned by the settlor as a result of the reservation of benefit rules. HMRC have indicated their agreement to the analysis set out in this note and propose to amend the IHT manual (IHTM14303) to reflect this.

IHT: Gift with reservation and spouse exemption

1. Property subject to a reservation at the donor’s death is treated by the Finance Act 1986 (FA 1986) s102(3) as: ‘property to which he was beneficially entitled immediately before his death’.

2. Section 4 of the Inheritance Tax Act 1984 (IHTA 1984) requires tax on death to be charged as if the deceased had made a transfer of value and: ‘the value transferred had been equal to the value of his estate immediately before his death’.

3. Section 5(1) of the IHTA 1984 provides that a person’s estate is: ‘the aggregate of all property to which he is beneficially entitled’.

4. A chargeable transfer is a transfer of value that is not an exempt transfer.
5. Section 18(1) of the IHTA 1984 provides that a transfer of value is an exempt transfer: ‘to the extent that the value transferred is attributable to property which becomes comprised in the estate of the transferor’s spouse’.

6. It follows that spousal relief applies to settled property subject to a reservation if, on the death of the settlor, the settlor’s spouse becomes beneficially entitled to the property under either:

   • The original terms of the settlement; or
   • A subsequent appointment made thereunder and prior to the settlor’s death.

7. The same would apply where the spouse’s entitlement on the death of the settlor is to a qualifying interest in possession, i.e. to an interest in possession to which IHTA 1984 s49 applies.

8. It is not considered that spousal relief applies where settled property ceases to be subject to a reservation inter vivos. This is because FA 1986 s102(4) operates by deeming there to be a potentially exempt transfer (PET) rather than by deeming the donor to be beneficially entitled to the gifted property.

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