GIFTS WITH DEVALUATION

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The purpose of this article is to consider a simple way to avoid the impact of the gift with reservation provisions in s.102 FA 1986.

Suppose that father (F) has made a gift of his freehold house to his son (S) but has carried on living in the house rent-free. The gift is plainly caught by s.102.

If F moves out of the house or starts to pay a commercial rent he will be treated (by s.102(4)) as making "a disposition of the property by a disposition which is a potentially exempt transfer". Inheritance tax may be payable on F's death within 7 years thereafter because the potentially exempt transfer will be deemed to have been a chargeable transfer.

If instead F continues to live in the house without paying a commercial rent until his death, then (by s.102(3)) "to the extent that the property would not, apart from this section, form part of [F's] estate immediately before his death, that property shall be treated for the purposes of the 1984 Act as property to which he was beneficially entitled immediately before his death". Again, tax may be payable on F's death.

Both s.102(3) and s.102(4) refer to "the property". In the case of F's gift, this means the freehold interest in the house (see for example paragraphs 6(1)(a) and (b) of Schedule 20 which say "in the case of property which is an interest in land") rather than the house itself. The s.102(4) deemed disposition by F is of the freehold, and the s.102(3) deemed beneficial entitlement of F is likewise to the freehold.

Thus the freehold interest must be valued at the time of the disposition or at F's death. This is so whether the freehold is worth more or less than at the date of F's gift. One reason why it might be worth less is because S has deliberately devalued it.

For example, S might grant a 99 year lease of the house to himself and trustees (of a trust under which S has the life interest or is a discretionary object) holding as

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tenants in common 90:10 respectively, the term of the lease commencing in, say, 3 months' time. The value of the freehold is now nominal. F moves out of the house or starts to pay S a market rent, in each case before the commencement of the term of the lease. There is now a s.102(4) deemed disposition by F, but because at the time the freehold is of nominal value the value transferred by the disposition is also nominal.

Alternatively S might grant a 99 year lease to himself and trustees as before, the term commencing 3 months after F's death, so that F carries on living in the house rent-free until his death. Section 102(3) applies on F's death to deem him to be beneficially entitled to the freehold, but the transfer of value attributable to the freehold is again nominal.

Is there anything in Schedule 20 which prevents such easy tax avoidance? Paragraph 2(1) provides that if, before the date when s.102(3) or (4) applies, the donee ceases to have the possession and enjoyment of the property, s.102 shall apply as if the property, if any, received by the donee in substitution had been comprised in the gift instead. But this paragraph could not be relied on by the CTO to treat the 99 year lease as comprised in the gift instead of, or in addition to, the freehold. First, because the donee, S, does not cease to have the possession and enjoyment of the freehold before that date. Secondly, because S does not receive the 99 year lease "in substitution for" the freehold. Nothing else in Schedule 20 could apply to treat the 99 year lease as the "property subject to a reservation" instead of, or in addition to, the freehold.

On the contrary, paragraph 2(6) of Schedule 20 shows that this technique of devaluing the property comprised in a gift is in principle effective. Paragraph 2(6) provides that where shares or debentures of a company are comprised in a gift, and the donee is, as holder of the shares or debentures, issued with shares in or debentures of the same or another company, then the new shares or debentures are treated for s.102 purposes as having been comprised in the gift in addition to the original ones. Thus, a bonus issue of shares which devalues the original shares is ineffective, but no other form of devaluation is aimed at by Schedule 20. Contrast the sophisticated anti-devaluation provisions in ss.131-140 of the 1984 Act.

It might be argued that a freehold subject to a future 99 year lease is different "property" from a freehold with vacant possession. But such an argument would get the CTO nowhere. Indeed, if it were right, s.102 could even more easily be avoided. Just before F's death, S could grant F a short lease, thereby rendering it impossible to say that immediately before F's death "there is any property subject to a reservation" so that s.102(3) would not apply at all!

Or it might be argued that the freehold must be valued as if the 99 year lease did not exist, on the ground that it did not exist at the date of the gift and what must be valued is " the property" in the same state as it was in at the date of the gift.

However, in my view this argument is no better. The is nothing at all in s.102 or Schedule 20 to require "the property" to be valued on some hypothetical or counterfactual basis.

The correct answer is that "the property" is the freehold, with all the advantages (planning permission, right to high rent) or disadvantages which exist at the time of the s.102(3) or (4) charge.