DAVIES SOLICITORS

GIVING AWAY YOUR HOME DURING YOUR LIFETIME

Many people consider passing on their home to their children during their lifetime, often intending to continue to live there. Reasons for making such a gift vary but there are consequences which should always be considered.

This leaflet highlights some of the main consequences but cannot cover every case and you should take our advice about your particular circumstances before deciding to proceed. In particular, this leaflet is not designed to be a substitute for detailed tax planning advice.

1 POSSIBLE CLAIM BY SOCIAL SERVICES

It has become well known that if you have more than a small amount of capital you will have to contribute to the cost of any residential or nursing home care you need in your old age. For many people their main capital asset is their home (their 'property') and they wish to give this away, hoping to preserve the family's inheritance from the cost of such care. It is not always possible to achieve this since the law enables some gifts to be ignored by Social Services in assessing your contribution or set aside by the Court.

When assessing what contributions you are liable to pay towards your residential fees, Social Services can treat you as if you still own your property, if it is proved that you have given it away for the purpose of reducing your contributions. To enable them to recover the contributions you are liable for, Social Services can take a mortgage on your property even if it is owned by another person ('the beneficiary') if you gave it to him or her within six months of going into residential care, with the intention of avoiding contributions. In any event, Social Services can take steps to recover the contributions directly from you and if you do not pay the sums due they have the power (although it is

not often exercised) to make you bankrupt; your trustee in bankruptcy could then set aside the gift if it was made less than two (or, in certain cases, five) years before. A Court can also set aside the gift without you being made bankrupt and with no time limit, if it is proved that the gift was for the purpose of putting your property beyond the reach of a creditor such as Social Services.

These measures can apply whatever form your gift takes. If they do not apply and you have given away your property, you may not be able to afford the residential or nursing home which you would prefer.

2 TAX IMPLICATIONS

(a) Inheritance Tax

If you give away your property in your lifetime but live in it at any time afterwards without paying a full market rent you will be considered to have 'retained a benefit' in it. Your property will be treated as being owned by you ('part of your estate') for inheritance tax purposes while the retention of benefit continues, even if the gift was made more than seven years previously. If you cease to retain a benefit, you will be treated as making a gift at that point but for inheritance tax calculation purposes the value of the gift is still treated as part of your estate for seven further years. This means that there may still be inheritance tax to pay on your property when you die even if you have given it away. If the beneficiary dies, the value of your property will also be part of his or her estate even if he or she has had no benefit from the gift.

(b) Capital Gains Tax

If you sell your property, no capital gains tax is payable if you live in it as your principal home throughout your ownership. However, if it is sold

after you have given it to a beneficiary who does not live in it as his or her principal home, he or she may be liable for capital gains tax when disposing of the property even if the sale proceeds are to be used to buy another property for you to live in.

Even if your property is not your principal home throughout your ownership, there will be no capital gains tax on it if you keep it until you die; this 'free uplift' to the date you die may be lost if you give your property away.

(c) **Mortgage Interest Relief**

If the property you give away is subject to a mortgage, mortgage interest relief is likely to be lost.

3 HOW WILL A GIFT AFFCT YOUR RIGHT TO CONTINUE TO LIVE IN YOUR PROPERTY?

(a) If you give away your property without retaining a right to live in it then the beneficiary can sell it and leave you without anywhere to live. You may trust the beneficiary, but he or she may die before you and the property would then belong to the person inheriting his or her estate. It is important that in these circumstances the beneficiary makes a Will to protect you – but remember that the beneficiary can always change his or her Will. You should also consider the possibility of the beneficiary being involved in divorce proceedings or being made bankrupt. In these circumstances the beneficiary's spouse or trustee in bankruptcy may be able to make a claim in respect of the property and leave you without anywhere to live.

(b) When you give away your property you can retain a right to live in it (see 5(b) below).

(c) If after you have given away your property you want to use its sale proceeds to buy another property to live in then you will have to obtain the consent of the beneficiary unless a trust deed has been drawn up to enable the sale proceeds to be used for this purpose.

4 PROBLEMS ARISING ON SUBSEQUENT SALE OR MORTGAGE OF YOUR PROPERTY

(a) If you are made bankrupt within five years of the gift of your property your trustee in bankruptcy may be able to set aside the gift. For this reason, even if the gift is not made with the intention of defrauding your creditors and there is no likelihood of you being made bankrupt, a subsequent buyer or a mortgagee of the property may insist on an indemnity insurance being taken out before completing the purchase or mortgage.

(b) If your property is subject to a mortgage which the beneficiary takes over when the gift is made or which is taken out later it may make it more difficult for the beneficiary to obtain another mortgage on a property he or she wishes to live in.

5 WHAT ARE THE VARIOUS WAYS OF GIVING AWAY YOUR HOME?

(a) If you had complete trust in the beneficiary and were willing to take the risk that he or she would be made bankrupt or involved in divorce proceedings then you could give the property to him or her outright.

The consequences:

(i) the tax implications in paragraph 2 above would apply

(ii) the effect on your right to live at the property would be as in paragraph 3(a) above

(b) If you would like your right of occupation to be protected you could give the property to the beneficiary but retain a right to live there during your lifetime.

The consequences:

(i) you would have the right to live at the property as long as you wished, even if the beneficiary's circumstances changed, but not to move house using the sale proceeds

(ii) the tax implications would be as in 5(c) below, while you lived at the property. The value of the property when you moved out would be treated as part of your estate for inheritance tax purposes for seven years afterwards

(c) If you would like to be totally protected you could give the property to trustees on trust for you for life and then for the beneficiary.

The consequences:

(i) you would have the right to live in the property for as long as you wanted and if it was sold the proceeds could be used to buy an alternative property for you to live in. If the beneficiary's circumstances changed you would be protected.

(ii) the legal documents would be more complicated than for a straightforward gift. The trustees could have some ongoing administrative work and might need to complete an annual tax return relating specifically to the trust.

(iii) **Inheritance Tax** – any property owned by the trustees at your death would be taxed as if you owned it, so there could then be tax to pay.

(iv) **Capital Gains Tax** – the principal residence relief would apply to any property in which you lived as your principal home (even if owned by the trustees). There would be no tax to pay on the property on your death.

(v) **Mortgage Interest Relief** – this would probably be lost.

(d) If you would like more flexibility then it may be worth considering a discretionary trust. The property would be given to trustees and they (not you) would have a right to decide who among a class of beneficiaries, including you, could live at the property and the trustees would also decide how any sale proceeds should be used.

The consequences:

(i) You would have to trust the trustees to protect your interests.

(ii) **Inheritance Tax** – a gift to this type of trust is chargeable when made so there could be a tax bill immediately. The rules for calculating the tax on these trusts are more complex than usual but any tax payable is at a relatively low rate and is due periodically rather than on the death of a beneficiary.

However, if the trusts allow you to occupy the property you would 'retain a benefit' in it; and if the trustees do permit you to occupy the property as your permanent home the Revenue will normally 0treat the trust as not being discretionary. In either case, the value of the property at your death would be taxed in the same way and at the same rate as if it were part of your estate so there may be no tax saving.

(iii) **Capital Gains Tax** – would not be payable on the property on your death, but might be when the trustees disposed of the property on sale or to a beneficiary. Tax would be at the higher rate applicable to these trusts except that the principal residence relief would apply while, with the trustees' permission, you occupied the property as your principal home.

(iv) There would be no adverse effect on you if one of the class of beneficiaries died and unless there had been a distribution in favour of that beneficiary the property would not form part of his or her estate for inheritance tax purposes.

(v) No decision would need to be made immediately as to who would have the benefit of the gift after your death.

(vi) The legal documents would be more complicated than for a straightforward gift and the trustees would be involved in ongoing work, including annual tax returns.

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