

Pre-owned asset tax

Joint property trap

More and more couples are buying property together before marriage. But the pre-owned asset tax means they could now face an annual tax charge. What's the problem and is there any way around it?

The problem

Another tax. Pre-owned asset tax (POAT) has applied since April 6 2005 and is an income tax designed to deter Inheritance Tax (IHT) avoidance. However, the tax rules have not only countered aggressive IHT planning, (e.g. the double trust scheme), but also affected thousands of unmarried couples who never intended to avoid IHT. *So, what are the rules and why do they particularly affect unmarried couples?*

Rental value. Since March 17 1986 where someone has given a property to someone else (or the cash to buy it) and they subsequently live in that property, they will be liable to a POAT annual income tax charge. This charge is based on the value of the home on the rental market, typically 8% of its total worth. Only if the hypothetical rental from the house is less than £5,000 a year, or they equally share the running costs, will it be exempt from the POAT charge. So, if one partner pays a substantially higher deposit than the other on a property that is owned in equal shares, then they could, under the new rules, be liable to a hefty income tax charge as one partner's larger share of the deposit would be treated as a gift to the other.

Example. Mr Smith and Miss Jones decided in 1993 that they want to live together. Mr Smith provides the funds to buy their £100,000 house which they jointly own. So, he has effectively given her £50,000 to buy a share in the property. The house is now worth £400,000. They married in 2000. If Mr Smith pays all the running costs he is still liable for an income tax charge based on the rental value of the house. If this were 8% of the value, the annual tax bill would be £6,400 (£200,000 (share given to Mrs) x 8% x 40%).

Married couples. Gifts between married couples are exempt from the tax. But if the gift of a house deposit was made before the couple were married, the one that paid the larger share of the deposit could be treated as an individual enjoying a pre-owned asset. *So, what should you do if you're in this situation?*

The solution

Tax return entry? As the arrangement is technically caught by the POAT rules, you have to make a decision what to report on your personal tax return.

Future purchase. Most couples buy a house together as joint tenants. This means that they don't have particular shares in the property; they own the whole thing together. However, a house can be owned as tenants-in-common instead, with each owner having a defined share in it. As tenants-in-common, the property is owned in proportion to the funds they've put in, so there's no element of gift.

Tip. Where unmarried couples are contributing unequally to a deposit to buy a house (or running costs), they should ask their solicitor to set them up as tenants-in-common so that any POAT implications can be avoided. When the couple get married, the proportion of ownership can be changed to 50:50, as gifts between married couples (or from a civil partnership) are exempt from POAT (and Capital Gains Tax). However there might be Stamp Duty implications.

If an unmarried couple have funded the deposit to buy their house unequally, they could face an annual income tax charge. This can be avoided by owning the property in the same proportions as the funds they've put in.