Can you buy your parents' house under market value?

What are the tax implications if you buy your parents' house? Zeen Al Atroshi, a Solicitor at Duncan Lewis Solicitors, explains the risks when gifting a property.

What are the tax implications if you buy your parents' house?

If you buy your parents' home for less than the market value, you are essentially receiving the rest of the property as a gift. For example, if the property is worth £300,000 and you purchase it for £250,000, it means £50,000 has been gifted. As a result, there will be various tax implications that should be considered before deciding to proceed with the sale.

If parents own their main residential property without any mortgage then they have the option to gift it to their children in its entirety, even if they still live in it. This option means there will be no stamp duty land tax payable. However, if parents wish to occupy the property it will still be liable for inheritance tax when they pass away unless they pay rent at the market rate. Subsequently, income tax must be declared and paid on that income.

What are the risks of gifting a property?

It should be stressed that there are some risks when gifting a property. These risks include:

- **Inheritance tax**

An individual has an annual exemption of £3,000, each tax year. This means that any gifts during lifetime of up to this amount are immediately free of inheritance tax. You can carry any unused annual exemption forward to the next year (but only for one year).

Any gifts (not into trust) which exceed this amount are known as potentially exempt transfers (PETs) and do not attract an immediate tax charge, but would be subject to inheritance tax on the person's death, if they die within 7 years of making the gift.

Gifts use the nil rate band allowance before any balance is applied to the estate.

Gifts made 3 to 7 years prior to one's death above the nil rate band available are taxed using the following 'taper relief' scale:

Years between gift and death	Tax paid
less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
7 or more	0%

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Therefore, if someone was to pass away within seven years of gifting a property ('transfer by way of gift') then the property in question would be subject to inheritance tax.

- **Gift with reservation of benefit rules**

In addition, if you make a gift but 'reserve a benefit' in the property given, it will still be treated as being part of your estate for IHT purposes upon your death, regardless of how long you survive from the gift.

For example, if a parent gifts their property to their children but continues to live there, the date of death value of the house upon the parent's death will be chargeable to IHT.

If rent is paid at market value, then this will prevent the gift with reservation of benefit rules applying.

- **Pre-owned asset tax (POAT)**

If, for any reason, the gift with reservation of benefit rules do not apply, the 'pre-owned assets tax' (POAT) charge applies where an individual removes an asset from their estate for IHT purposes and continues to enjoy a benefit from it. This is an annual income tax charge imposed on an individual who has given away property and who subsequently benefits from that property (or property derived from it).

It's calculated by reference to the benefit the donor receives from the continuing use of the asset. This was introduced to avoid artificial tax avoidance schemes designed to get around the gift with reservation of benefit rules (such as home loan schemes).

- **Capital Gains Tax (CGT)**

There is no CGT payable when gifting your main place of residence, only on second properties including but not limited to holiday homes or buy-to-let properties. In these circumstances, HMRC will calculate the CGT owed based on the market value of the property as opposed to the price the property sold for.

It's worth bearing in mind that the market value of a property is based on the price which might reasonably be expected to obtain on a sale in the open market.

- **Insolvency**

If the transferor is declared bankrupt within five years ('relevant time period') of gifting the property, then the transaction can possibly be deemed as invalid. This is pursuant to section 239 of the Insolvency Act 1986.

- **Disputes**

When gifting a property all consequences must be considered thoroughly. In the event where a parent(s) remains in occupation of the property which has been gifted to a child, the child may attempt to evict the parents as he/she is now the legal owner of the property. The parent(s) would have little rights and would need to fight to reclaim their home. Accordingly, this factor must be considered thoroughly before any decisions are made when gifting a property whilst remaining in the said property.

Furthermore, if the child is declared bankrupt and/or if they divorce, it would mean the property is at risk and the parent(s) will be in a vulnerable position and at jeopardy of losing their home to satisfy creditors or the financial settlement on divorce.

Finally, after death, if there is a claim against the estate under the Inheritance (Provision for Family and Dependants) Act 1975, and the court deems the gift to have been made with the intention to defeat a claim for reasonable provision then section 10 of the Act allows the asset to be clawed back into the estate.

- **Deprivation of assets**

The term 'deprivation of assets' is used by Local Authorities (LA) when they believe someone has deliberately made a gift or transfer of assets to a third party, usually a relative, to avoid or reduce their liability to pay for care.

If someone has assets below £23,250, which is the current threshold, then the LA has a duty to assist a person with their social care costs, including care home fees. As such, if the LA decides that a person has intentionally 'deprived' themselves of assets, then they shall treat that person as still owning the value of that asset.

Should you buy your parents' house under market value?

To summarise, great care must be taken when gifting assets to ensure all legislation is complied with otherwise there could be grave consequences.

Before proceeding with any property sale, each party should consult an independent solicitor to avoid any conflicts of interest. It's also important each party gets professional advice from a specialist lawyer with experience in property and estate planning.

About the author

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