Trusts and settlements: gifts with reservation of benefits

Inheritance tax and trusts | Personal tax

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New residence-based rules mean foreign property can now fall back into charge, fundamentally reshaping the treatment of gifts with reservation of benefit.

Key Points

What is the issue?

The long-term residence status of a donor will now determine whether foreign property given away with a reservation of benefit is brought back into charge, even if the gift would previously have been treated as excluded property.

What does it mean to me?

The rules change from April 2025, with only limited transitional protection for settlements created before 30 October 2024, and leaving several anomalies

unresolved.

What can I take away?

The new rules significantly narrow the circumstances in which foreign property escapes the inheritance tax net, and reliance on ‘excluded property’ treatment is no longer straightforward. Early review is essential to avoid inadvertent tax charges under the post-April 2025 regime.

This article concludes our series on the inheritance tax reforms introduced by Finance Act 2025, turning to one of the areas most significantly affected by the shift to a residence-based regime: gifts with reservation of benefit.

Our previous articles have outlined the core architecture of the new system, explaining how long-term residence replaces domicile as the key connecting factor, how the ten-year residence test and transitional ‘tail’ determine exposure to inheritance tax for individuals arriving in or leaving the UK, and how these new rules operate for spouses and trusts. We also briefing consider the 2025 Budget.

This article builds on that by turning to the interaction between the long-term residence test and the gift with reservation rules in Finance Act 1986 s 102 – one of the areas most significantly altered by the move from domicile to residence. The long-term residence status of a donor will now determine whether foreign property given away with a reservation of benefit is brought back into charge on death, even if the gift would previously have been treated as excluded property. The rules change from April 2025, with only limited transitional protection for settlements created before 30 October 2024 and leaving several anomalies unresolved. Together, the three articles trace the arc of the 2025 reforms, offering practitioners a complete guide to the new inheritance tax landscape and the challenges it will pose in the years ahead.

Inheritance tax and gifts with reservation of benefit

Finance Act 1986 s 102 is the key statutory provision that underpins the ‘gift with reservation of benefit’ rules for inheritance tax. It is supplemented by ss 102A–102C, which give more detailed rules on what counts as ‘retaining a benefit’, exemptions and various exceptions.

What is a gift with reservation of benefit?

A gift with reservation of benefit arises where an individual gives away an asset but continues to enjoy, or is able to enjoy, some benefit from it. The classic example is a person who gives their house to their children but continues to live in it rent-free. Others include gifting valuable items but continuing to use them regularly, or transferring shares in a family business but retaining control over dividends or voting rights. Although legal and beneficial ownership has passed, the donor has 'reserved a benefit' in the gifted property.

For inheritance tax purposes, a gift with reservation is not treated as an effective lifetime transfer. Instead, the gifted property is treated as though the donor still owned it at death, and the full value of the asset is brought back into the donor's estate for inheritance tax. It can also still be taxed on the donee's death.

The position before 6 April 2025

HMRC accepted that no charge arose under the gift with reservation rules where the gifted property meets the definition of excluded property at the donor's death, or at the point when the reservation of benefit came to an end. For non-UK assets gifted to a settlement, the test for excluded property was, from July 2020 onwards, based on the settlor's domicile at the time the assets were added to the trust.

This meant that assets added to a trust when an individual was non-domiciled were not brought into scope of the gift with reservation provisions, regardless of the donor's domicile at death or at the time the reservation of benefit ceased.

The position from 6 April 2025

If a donor is long-term resident at the time of their death (or when the reservation of benefit ceases), non-UK property they have given away while retaining a benefit will be chargeable under the gift with reservation rules. This will be the case even if the gift was made when the donor was not a long-term resident.

Therefore, if a donor creates a settlement, say in November 2024, from which they can benefit (even if the property was settled when they were not long-term resident), the property comprised in the settlement which is, or represents, the gifted property will be chargeable under the gift with reservation rules if they are long-term resident at their death (or when the reservation ceases within seven years

of death).

However, where non-UK assets became comprised in a settlement before 30 October 2024, at a time when the settlor was foreign domiciled and that settled property was then excluded property, those assets will not be subject to the gift with reservation rules even if the settlor has since become long-term resident.

While the settled property will fall within the relevant property regime if the settlor is a long-term resident, it will not be subject to a charge on the settlor's death even if they can benefit, or if their reservation ceases during their lifetime, provided that:

- the settled property does not become UK-situated at the date of death or earlier cessation of the reservation of benefit, though it can change in nature;
- the settled property is not UK-situated, or comprised of Schedule A1 property or otherwise non-excluded property as at 30 October 2024; and
- the settlor was not a formerly domiciled resident as at October 2024, meaning an individual born in the UK with a UK domicile of origin who acquired a foreign domicile of choice when settling the assets but who has been UK resident for more than a year.

(Schedule A1 property is a category of non-excluded property for UK inheritance tax purposes, introduced to stop certain trusts from avoiding inheritance tax by holding UK residential property through offshore structures.)

Any additions to existing settlements, or any new settlements made on or after 30 October 2024, will be subject to the gift with reservation rules and will be taxed on the settlor's death if they are then a long-term UK resident. See Finance Act 1986 Sch 13 para 13 inserting new s 7A into Finance Act 1986 s 102.

Other points

There remain anomalies in the Finance Act 2025, even though some issues were corrected at Report Stage. There are still some complex provisions concerning circumstances where a will trust settled by a settlor who was not a long-term resident left a qualifying interest in possession to a spouse who is a long-term resident. See ss 80-81B as amended.

However, the repeal of ss 82 and 82A, which dealt with resettlements, is greatly welcomed. The test for excluded property status for trusts under the relevant property regime will in future be ambulatory and will vary simply by reference to the settlor's long-term residence status; therefore, there is no need for complex anti-avoidance provisions applying to resettlements. The act of resettlement should make no difference to the inheritance tax position.

Trustees will now have to track the long-term residence status of all settlors. How the foreign executors of an individual who has emigrated – and who may have retained no UK property or connections – will be made aware of their UK inheritance tax obligations if the individual dies within ten years remains unclear.

Given their personal liability, relatives of the individual who act as executors may be particularly exposed, as they are unlikely to be aware of any continuing UK inheritance tax liability if the estate is foreign and the individual left the UK some years earlier but remains a long-term resident. The inheritance tax liability can effectively endure for 20 years if no inheritance tax form has been submitted, even if there was no deliberate attempt to defraud.

As noted earlier, there was some relief on 30 October 2024 when the Technical Note and legislation made it clear that existing excluded property trusts will not be subject to a 40% inheritance tax charge on the death of the settlor, even where the settlor is a long-term resident and able to benefit from the trust, provided that the foreign situs status of the settled property is preserved and the settlor was not a formerly domiciled resident immediately before 30 October.

By contrast, a long-term resident will be subject to inheritance tax on their free estate at death, subject to the usual reliefs such as the spouse exemption. The transitional relief allowing a shorter inheritance tax tail for foreign domiciliaries who left the UK by April 2025 was also welcomed.

However, the price of securing inheritance tax protection on death in respect of pre-October 2024 settled property is the continuation of 6% charges and the imposition of an exit charge if the settlor leaves the UK in the future and ceases to be a long-term resident. Some trustees may therefore prefer to wind up the trust sooner rather than later to minimise future exit charges. This will be easier if there is a non-resident beneficiary who can receive the funds tax free or where the temporary repatriation facility can be used.

If the deemed domiciled settlor has become non-UK resident by 6 April 2025, they may prefer the trustees to wind up the trust early in 2025-26 to minimise the inheritance tax exit charge. The downside is that the settled property will fall within the settlor's estate for inheritance tax purposes for three years until April 2028, as they are still a long-term resident. Therefore, if the settlor dies during that period there is a risk of a 40% inheritance tax charge.

Cap on relevant property charges for transitional trusts

The decision on whether to wind up an excluded property trust, particularly where the non-dom has left, has become a little more complex with the announcements in the November 2025 Budget that relevant property charges before the first 10 year anniversary will be subject to an overall cap of £125,000 per quarter up to a maximum of £5 million. So a trust worth more than about £85 million will know that its liability is now capped at up to £5 million every 10 years. This at least helps very large trusts to plan for the cost of retaining the trust. The cap is only available to those trusts that qualify for the transitional relief against a reservation of benefit.

The relief is backdated to April 2025. Those who have been considering winding up large trusts early to minimise the exit charge and to take advantage of the temporary repatriation facility, while accepting the inheritance tax disadvantage of having the property in their free estate, may now have second thoughts.

Example 1

Suzanne, born in France, set up a trust in April 2010 when she was foreign domiciled albeit UK resident. As at October 2024, she has become UK domiciled (and certainly deemed domiciled) but no changes or additions have been made to the trust since 2010, which as at October 2024 contains a portfolio of foreign situated shares and (since 2020) a BVI company holding UK residential let property. Suzanne remains in the UK in 2025/26 and beyond.

As at April 2025, the trust ceased to be excluded property and therefore became subject to the relevant property regime. The next ten year anniversary charge is in 2030. As the foreign portfolio was excluded property in October 2024, there is no inheritance tax due on Suzanne's death provided that at her death the portfolio contains no UK assets. However, the BVI company was not excluded property

immediately before 30 October 2024 as it was subject to Schedule A1 and is therefore chargeable to inheritance tax at 40% on her death. Even if the trustees sell the residential property, it does not become excluded property again unless and until Suzanne ceases to be a long-term resident by leaving for more than 10 years.

However, Suzanne does have the comfort of knowing that in 2030 the 10 year charge on the foreign portfolio (not the UK property) will be a maximum of £2.5 million – which is useful if her trust is very valuable. It is, though, no use if her trust is less than about £83 million, in which case she will pay the 6% on the actual value.

Example 2

The facts are as above, except that Suzanne ceased to be UK resident from 2025/26. In April 2028, she ceased to be a long-term resident after three years under the transitional provisions referred to earlier in Finance Act 2025. The trust will be subject to an exit charge then but the amount will be capped at a maximum of £1.5 million (12 quarters x £125,000).

Example 3

Assume Suzanne has never been UK resident and set up a trust in October 2024 which held only non-UK assets. This trust also qualifies for the transitional protection against reservation of benefit and the cap under the relevant property regime. In April 2026, she becomes UK resident and a long-term resident from April 2036. Provided that she does not resettle the assets, her trust should still benefit from the two transitional protections.

Funding inheritance tax charges

Where the assets of the trust are comprised in a foreign holding company, the overall tax rate required to fund inheritance tax charges may ultimately be somewhat higher than 6%. If the trust has to pay inheritance tax but lacks liquidity at trust level, the charge can only be funded in one of the following ways:

- If the trustees have funded the holding company by way of loan, they can request repayment of that loan without incurring further tax consequences. The repaid funds can be used to pay the inheritance tax.

- If there is no loan from the trustees to the company, the company could lend funds up to the trust. This risks a deemed disposal under Sch 4B and may therefore trigger a capital gains tax charge on the settlor or expose the transaction to a possible attack under the transactions in securities rules.
- The company could pay a dividend up to the trust. Even if the settlor is not the life tenant, if they – or their spouse or civil partner – are UK resident and able to benefit, the settlor will pay 39.35% on the dividend (with a right of reimbursement). The net dividend can then be used to pay the inheritance tax.
- The trust could undertake a capital buy-back of the shares. Although this may be treated as capital in the hands of the trust, it could give rise to a gain which is taxable on the settlor if they are UK resident under s 86, provided that any of the settlor, their issue, or their spouses are able to benefit.

In conclusion

Settlors, trustees, executors and advisers must now reassess historic and future gifts of foreign property, as exposure to inheritance tax may arise unexpectedly many years after an individual has left the UK. The new rules significantly narrow the circumstances in which foreign property escapes the inheritance tax net, and reliance on ‘excluded property’ treatment is no longer straightforward. Early review, clear documentation and proactive advice are essential to avoid inadvertent tax charges under the post-April 2025 regime.