

## **Estate Planning**

### **IHT: LIFETIME GIFTS**

#### **What counts as a gift?**

A gift can be:

- anything that has a value, such as money, property, possessions
- a loss in value when something's transferred, for example if you sell your house to your child for less than it's worth, the difference in value counts as a gift

Generally, there are three types of gifts for IHT purposes:

#### **Gifts**

There's also no Inheritance Tax to pay on gifts between spouses or civil partners. You can give them as much as you like during your lifetime, as long as they live in the UK permanently.

Other gifts may count towards the value of your estate for IHT purposes, after your death.

##### **1. Exempt transfer (ET)**

An ET is a gift that qualifies for a specific exemption from IHT, such as gifts to lawful spouses, civil partners or charities.

#### **Exempted gifts**

1. You can give away £3,000 worth of gifts each tax year (6 April to 5 April) without them being added to the value of your estate. This is known as your 'annual exemption'.

You can carry any unused annual exemption forward to the next year - but only for one year.

2. You can give as many gifts of up to £250 per person as you want during the tax year as long as you have not used another exemption on the same person.

### **Each tax year, you can also give away:**

- wedding or civil ceremony gifts of up to £1,000 per person (£2,500 for a grandchild or great-grandchild, £5,000 for a child). You can use more than one of these exemptions on the same person - for example, you could give your grandchild gifts for her birthday and wedding in the same tax year.
- payments to help with another person's living costs, such as an elderly relative or a child under 18
- gifts to charities and political parties
- NOTE if you have income in excess to your reasonable needs, you can make regular, committed giving from your excess income, great care needs to be taken to keep records which your executors will need to produce after your death in order to claim this relief. Refer to IHT Schedule 403. This is an often-overlooked relief.

## **2. The 7-year rule, Potentially exempt transfer (PET)**

Broadly, a PET is a gift of property to an individual (other than to an exempt beneficiary). Provided the donor (you) survives seven years from the date of the gift, and retains no benefit in the gifted asset, the value of the gift will fall out of your estate for IHT purposes on death.

### **Example**

Bob gives each of his children Joe and Mary £20,000 for deposits for their first homes. The gifts are made in the same tax year. He did not make any gifts in the preceding tax year.

PET

Exempt = £3,000 c/f one tax year + £3,000 present tax year = £6,000

PET = £40,000 (total gift) - £6,000 (exempt) = £34,000

Therefore, Bob must survive the gift by 7 years otherwise it is brought back into the estate for IHT purposes.

The gift must be a true gift, in other words if you give your house to your children during your lifetime, you must either vacate the house or pay market rent to your children. If you set up a lifetime trust, you can't be a beneficiary of the trust.

There are financial products which may be available through an experienced Independent Financial Advisor (IFA) which are trusts in respect of which you can be a limited beneficiary. Care needs to be taken to ensure that the product is suitable for your needs. I cannot give financial advice of this nature but I can recommend an IFA for you.

If you die within seven years, the value of the gift (now a 'failed PET') will be aggregated with your estate, and IHT may be chargeable if the total of the failed PET and the your assets at the time of their death exceed the IHT nil-rate band (NRB), which is currently £325,000. However, in certain circumstances, taper relief may apply to reduce the IHT payable where you survived for at least three years following the PET.

Gifts made 3 to 7 years before your death are taxed on a sliding scale known as 'taper relief'.

### **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%

### **Advanced Information, use of lifetime trusts**

#### **Lifetime gifts: estate planning and the 14 year IHT rule**

#### **Chargeable lifetime transfer (CLT)**

The third type of gift is a CLT. An example of a CLT is the transfer of assets to a trust (other than a gift made to a specific type of trust, such as a transfer to a disabled trust, which may still constitute a PET).

If the combined value of the 'current' CLT and any CLTs made within the previous seven years of the current CLT exceeds the NRB, then this will create

an immediate IHT liability at the lifetime rate of 20% on the excess value above the NRB. There will be no further IHT to pay, unless the person making the CLT dies within seven years. Even if further IHT is payable as a result of death within seven years, taper relief may also apply to reduce the liability.

### **The 14-year rule**

So far, so straightforward. However, matters become a little more complicated if the deceased made the **first gift (a CLT, not a PET)** more than seven years before their death, followed by a second gift (a PET) made within seven years of the first gift. Here, the earlier CLT may also be caught by the IHT regime, inviting the possibility of IHT being paid on gifts made up to 14 years pre-death. As an example:

- year one: Charles made a CLT to a trust of £50,000
- year six: Charles made a PET of £300,000 to his daughter
- year 10: Charles dies

At first glance, you may assume that the CLT, having occurred more than seven years pre-death, can be ignored, and no IHT will arise on the now failed PET, as it is fully covered by the NRB.

However, this is not the case, as to calculate the available nil-rate band available to offset against the PET, it is necessary to consider events that occurred in the seven years preceding the PET.

So, in the above example, though there is no IHT on the CLT, it nevertheless reduces the NRB to £275,000. When calculating the IHT position of the failed PET, the position is as follows:

- value of PET: £300,000
- less NRB: (£275,000)
- IHT @ 40% of £25,000: £10,000

To summarise, a CLT made within 14 years of death may not itself create an IHT liability on death. However, it could nevertheless reduce the NRB available to offset against a subsequent PET where death occurs within seven years of that PET and 14 years of the initial CLT.

In this sense, for those considering making a PET and a CLT at or around the same time, it is advisable for the donor to make the PET before the CLT.

However, when making a PET, the donor should also be wary of any CLTs made in the previous seven years and may want to consider postponing the PET until the expiry of the seven-year period from the initial CLT.