Technical Insights - Quick Reference Guide

Inheritance Tax treatment of lifetime gifts

This guide will provide you with the information you require to advise your clients on the Inheritance Tax (IHT) treatment of gifts made during their lifetime. With IHT allowances frozen until 2030, lifetime planning is now even more important than ever.

Some gifts are immediately exempt

When a UK domicile makes a gift, during lifetime, there are a number of exemptions that might apply to the gift. Where an exemption applies, in full, the gift will be immediately outside of the donor's estate. Exemptions include:

- Gifts to a spouse or civil partner
- Gifts up to £3,000 (can be £6,000 if no gift was made in the previous tax year)
- Small gift exemption up to £250
- Normal expenditure out of income
- Gifts for weddings or civil partnership

For more information on any of these exemptions please refer to our article 'UK IHT gifts – exemptions and reliefs' here:

https://www.quilter.com/help-and-support/technical-insights/technical-insights-articles/uk-iht-gifts--exemptions-and-reliefs/

Where a gift is not covered by an exemption, it will either be treated as a Potentially Exempt Transfer or a Chargeable Lifetime Transfer

A Potentially Exempt Transfer (PET) is a gift which is exempt after 7 years. There is no immediate charge to tax irrespective of the size, but if the donor dies within 7 years it is included within their estate for IHT purposes. In order to qualify as a PET, the value of the gift must become part of the recipient's estate. A common example is a gift to a child to buy their first home. The cash value of the gift immediately increases the estate of the child by the same amount as lost from the parent's estate. Another example is a gift into a bare or absolute trust.

A Chargeable Lifetime Transfer (CLT) is a gift which again is exempt after 7 years however, as the gift does not meet the definition of a PET in that it does not become part of the recipients estate it is immediately assessed for a lifetime IHT charge. IHT during lifetime is charged at 20% and applies where during a 7 year period the cumulative total of CLTs exceed the Nil Rate Band (NRB), currently £325,000 (frozen until 2030). A common example of a CLT is a gift to trustees of a discretionary trust. Here, as no one beneficiary is entitled to a particular share of the trust fund, the gift does not form part of any beneficiary's estate.

For more information on lifetime IHT charges on CLTs please see our quick reference guide on 'Entry Charge (Chargeable Lifetime Transfers)' here:

https://www.quilter.com/siteassets/documents/platform/support/quick_ref_guide_entry_charge.pdf

Where the donor of a PET or CLT dies within 7 years, any gifts are assessed for IHT in chronological order

If a gift 'fails', such that the donor dies within 7 years, the value of the gift is included within their estate for IHT purposes. Each failed gift is assessed in turn, starting with the oldest against the available NRB (the NRB on death less CLTs within the 7 years prior to each respective gift). Any PET which fails becomes a CLT for this purpose, for example:

6 years prior	PET	£250,000
4 years prior	PET	£200,000
3 Years prior	CLT	£150,000

The earliest PET is assessed first, assuming no previous CLTs prior to this there is no charge to IHT as the gift is under the NRB of £325,000. However, as the PET failed it is now seen as 'chargeable' so for the PET 4 years ago, the available NRB is only £75,000 (£325,000 - £250,000). As this PET of £200,000 exceeds this, there is a charge to IHT (see below). Similarly, the £150,000 CLT is assessed against £0 NRB as the previous 2 PETs have exhausted this, again being liable to IHT.

Where the gift exceeds the NRB taper relief can help to reduce the rate of tax which applies

IHT only applies to gifts in excess of the available NRB. The rate applicable is 40% however, there is a relief that reduces this rate the greater the amount of time passes from making the gift. This is known as taper relief. Taper relief is available once 3 years have passed since the gift. The relief reduces the rate of tax applicable:

Years between gift and death	Rate of tax on the gift (instead of 40%)
3 to 4 years	32%
4 to 5 years	24%
5 to 6 years	16%
6 to 7 years	8%

Using the example above, we have two failed gifts which are liable to IHT i.e. they're above the available NRB

Gift	Amount in excess of NRB	Tax at tapered rate
PET £200,000 (4 years ago)	£125,000	£30,000 (24%)
CLT £150,000 (3 years ago)	£150,000	£48,000 (32%)

Where a CLT has had an immediate charge at 20%, this lifetime IHT can be offset against any liability on death. However, if the lifetime charge exceeds the liability on death it can't be reclaimed.

The person liable to pay the IHT on the gift can be unexpected

Where a gift fails and tax is payable, the initial liability for IHT falls on the following people:

- PETs – the recipient of the gift
- CLTs – the legal personal representatives of the donor

If the tax is not paid within 12 months other parties can become taxable in line with s199 Inheritance Tax Act 1984.

It is the liability on recipients of PETs that can be surprising. Most recipients will not be expecting the tax and therefore have insufficient provisions to cover this. It is worth including this in any discussions with clients looking to make PETs to family and friends.

The order of gifting can really impact the amount of tax payable

When advising clients on making lifetime gifts it is important to consider whether gifts to individuals (PETs) should be made before or after the creation of any flexible discretionary trusts (CLTs). The ordering of these gifts is particularly important when considering the interaction of failed gifts with periodic and exit charges on such flexible trusts.

For more information on order of gifting please refer to our article 'Order of gifting with PET's and CLT's' here:

https://www.quilter.com/help-and-support/technical-insights/technical-insights-articles/order-of-gifting-with-pets-and-clts/

Summary -3 key takeaways:

With IHT allowances frozen until 2030, lifetime planning is now even more important than ever. The 3 key points from this guide are:

Use the allowances available

- Consider what exempt gifts can be made
- Makes gifts up to the Nil Rate Band

Structure the gift correctly

- Consider whether it is right to make an outright gift (PET) or flexible gift (CLT)
- Understand who would be responsible for the tax should it fail

Make them in the right order

- If multiple gifts are being planned, make sure they are made in the most tax efficient order should they fail

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