

The gift of giving

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In the unfortunate event of one's passing, there's a possibility that HM Revenue & Customs (HMRC) may levy an Inheritance Tax (IHT) bill on the deceased's estate. The estate's total value determines the sum due after deducting any debts and applying all possible thresholds. Two thresholds that come into play are the nil rate band (NRB) and the residence nil rate band (RNRB).

The NRB currently stands at £325,000, while the RNRB is set at £175,000 in the tax year 2023/24. It should be noted that the RNRB is applicable only if the deceased's home, or an amount equivalent to it if downsizing provisions apply, is left to a direct descendant. Any amount exceeding these thresholds is subject to the standard rate of 40% IHT. However, if at least 10% of the estate is left to charity, this rate drops to 36%.

Transferring of assets to the next generation

With IHT becoming an increasing worry for some people, the goal often becomes the efficient transfer of assets to the next generation, which may include gifting as a strategy to minimise IHT. While you're still alive in the UK, an annual 'gift allowance' of £3,000 is at your disposal. This is referred to as your 'annual exemption'. Essentially, this allows you to distribute assets or cash up to the total value of £3,000 within a tax year without contributing to your estate's overall value for IHT purposes.

Gifts that do not count towards the annual exemption

Any portion of the annual exemption not utilised within the tax year can be extended into the following tax year. However, it's important to note that it can only be used in the subsequent tax year and cannot be carried over further. Certain gifts do not count towards this annual exemption; therefore, no IHT is due on them.

Gifts that exceed the £3,000 allowance within any tax year may be subject to IHT. But what else can you give that would be tax-free? Gifts valued at less than £250 are exempt from this rule. You can bestow as many gifts of up to £250 to as many individuals as you like. However, this doesn't apply to anyone

who has already received a gift that utilises your entire £3,000 annual exemption. None of these gifts will be subject to IHT.

Wedding gifts and their value

Wedding gifts also have their own set of rules. If the gift is to be effective for IHT purposes, it must be given before the wedding, not after. Furthermore, the wedding must indeed take place. Here are the specifics: if the gift is given to a child and is worth £5,000 or less; given to a grandchild or great-grandchild and is worth £2,500 or less; or given to another relative or friend and is worth £1,000 or less.

Gifts to aid with living expenses

Gifts intended to assist with the living costs of an ex-spouse, an elderly dependent or a child under 18 or in full-time education might also be exempt from IHT.

Gifts from surplus income

Additionally, if your income is sufficient to maintain your usual standard of living, you can make gifts from your surplus income. This could include regularly contributing to your child's savings account or covering a life insurance premium for your spouse or registered civil partner.

Pet gifting and the 7-year rule

When gifts exceeding the annual allowances are made outright to an individual or an Absolute/Bare Trust, these are termed 'Potentially Exempt Transfers' or PETs. Often, PETs are made to assist a child in buying a property. To ensure that the gift is not included in your estate for IHT purposes, you must survive for seven years after making the gift. If the PET exceeds the NRB (£325,000), there's a gradual tapering on the excess in the event of the gift failing; the longer you survive post-gifting, the greater the tapering.

If you settle money into a discretionary trust, such gifts are known as 'Chargeable Lifetime Transfers' or CLTs. Grandparents who want to pass money down to their grandchildren commonly make these, particularly when their children already possess a

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large estate.

Determining the order in which gifts are liable for IHT

Complications may arise if an individual has made both PETs and CLTs before their passing. This is due to the fact that the order of these gifts can result in a calculation of 14 years' worth of gifts when determining the IHT position.

Additionally, their order is crucial when determining which gifts are liable for IHT. According to HMRC rules, gifts are assessed starting from the oldest and progressing towards the date of death. Furthermore, any CLTs made within seven years preceding any 'failed PETs' must also be considered.

Navigating the planning and timing landscape of IHT

Planning and timing are key when navigating the complex landscape of IHT. If a person makes a PET but unfortunately passes away within six years and 11 months, the PET is considered unsuccessful. From this 'failed PET' date, HMRC will look back an additional seven years and incorporate any CLTs into their calculations. Therefore, if you're considering transferring money into a trust or gifting it outright, it's highly recommended you discuss this with us first.

It's also important to meticulously keep track of any gifts you've made. This record will prove invaluable to the executors of your estate should you pass away. It's worth noting that gifts made from regular income, where expenditure is categorised as normal expenditure, are not classified as gifts by HMRC.

Insuring against a potential IHT bill

You've made some gifts and hope to survive for seven years. While this is an option, you can also insure against the IHT payable on your estate should you pass away within seven years of making your gift, and the liability for the tax would then fall on the recipient of the gift. This can be achieved by taking out a 'gift inter vivos' insurance policy or a 'whole of life' policy.

With a 'gift inter vivos' insurance policy, this life insurance can cover the IHT due on a gift if the donor passes away within seven years, with the sum assured gradually decreasing in line with the tapering of IHT due on the gift. Consideration should also be given to the overall value of your estate. While a 'gift inter vivos' plan may cover the IHT due on a gift over seven years, simple life assurance cover should also be considered as a further IHT mitigation strategy.

Writing policies in an appropriate trust

To cover the potential IHT that your estate may be liable for upon your death, you could secure a 'whole of life' policy that provides lifelong coverage. Whichever option is chosen, it's recommended that these policies are written in an appropriate trust, ensuring that any benefits paid out if you pass away and a claim is made on the policy are not included in the value of your estate for IHT purposes.

The areas of gifting, protection and trust in financial planning are intricate and multifaceted. They involve understanding numerous elements such as tax implications, legal regulations and individual family dynamics. Given the complexity of these areas, it's critical to obtain professional advice to help you navigate the intricacies of these financial planning areas, ensuring that your decisions align with your overall financial goals and family needs. Doing so will allow you to develop the most effective strategy tailored specifically for you and your family.

Feeling daunted at the prospect of managing an inheritance tax liability?

Various strategies exist to minimise the amount of IHT that your family may be burdened with upon your passing. These methods require careful planning, but their implementation could result in substantial financial benefits for your loved ones. We're here to help guide you through this process and offer our expertise. Please contact us for more information or to discuss your situation.