

Inheritance Tax: What Can You Give Away?

Inheritance Tax ('IHT') is charged at one rate (after the tax free sum, known as the 'Nil Rate Band') on the cumulative total of your lifetime gifts and the value of any property passing on your death. The death rates from 6 April 2009 are:

£0 - £325,000 - 0%

£325,000 + - 40%

It has already been announced that the Nil Rate Band will increase to £350,000 on 6th April 2010. Spouses and civil partners may be able use the Transferable Nil Rate Band against the survivor's estate. Please see our separate briefing in the Transferable Nil Rate Band for more details.

Potentially Exempt Transfers ('PETs')

Certain lifetime gifts are called PETs. These will initially be free from IHT regardless of the amount or the value involved. Provided the donor survives the PET by more than seven years then the value of the assets gifted may escape the ultimate IHT liability of the estate. If the donor fails to survive for the requisite period, the value of the PET will be liable to IHT.

Taper relief (reducing the amount of tax) where the donor survives for more than three years after the gift may apply, but only where the total PETs and previous gifts exceed the Nil Rate Band at the date of death. The death of the donor within three years of making the gift will render the full amount of IHT payable on the failed gift.

The principal types of gift which qualify as PETs will be:

- (a) Outright gifts between individuals
- (b) Gifts to a bare trust for the benefit of someone else, such as a child

It is also vital, for a gift to qualify as a PET, that it does not breach the reservation of benefit rule. This means that the donor must on no account be able to benefit from the asset gifted at any time in the future. If there is a reservation of benefit then the gift will be ineffective as a PET for IHT purposes, and IHT will be paid on the value of the gift on death.

Exempt Gifts

The following are the most important types of gift which are exempt from IHT.

1. Gifts between spouses, and between civil partners, are entirely free of IHT. For IHT purposes, a husband and wife, and civil partners are treated as entirely separate individuals.
2. Gifts to charities are free from IHT. There is no restriction on the amount that can be given.
3. Each individual can make gifts each year of £3,000 (the annual exemption). This exemption can be carried forward for one year only. In any tax year therefore, a

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husband and wife could each give away £6,000, if neither has used the exemption in the previous year.

4. There is a small gifts exemption of £250 per annum, which can be given to any number of individuals, but not to the same recipient as the annual exemption.

5. Regular payments out of income: a gift of income will qualify if it complies with certain conditions:

(a) the payment is part of the normal expenditure of the donor on a regular basis.

(b) that taking one year with another the payment is made out of the donor's income.

(c) that after allowing for all normal expenditure, the donor is left with sufficient income to maintain his or her usual standard of living. This exemption is very useful where a potential donor has excess income to give away.

6. Gifts on marriage: each parent can give a child £5,000 on the occasion of the child's marriage and a grand parent can give a grandchild £2,500 on marriage.

Gifts into Trusts

Since the Finance Act 2006, all gifts to a trust (apart from a bare trust) will be treated for tax purposes as a taxable gift into a Discretionary Trust, and subject to 'the relevant property regime'. Please ask a solicitor in the Private Client team for additional advice on such a gift.

Gifts of Exempt Property

Gifts of certain types of assets, whether direct to another individual or into a trust are not taxable. Agricultural property, non investment business assets, and Heritage Property can all be given away without a tax liability, subject to qualifying conditions. Please ask for further advice on this, if appropriate.

As will be seen from this overview, the current IHT regime does provide the tax payer with many options, and you may choose those that best suit you and your family.

Lifetime gifts (whether made to mitigate IHT or not) should also take into account the effects of the charge to income tax on benefits received by the former owner of property or other assets (including cash). The tax took effect from 6th April 2005 and will affect gifts of cash, personal possessions and property made after 18th March 1986.

The tax is known as the Pre Owned Assets Tax. Please ask one of the solicitors in our Private Client team for further advice, if you think that a past or future gift may be affected by this tax.

GELDARDS July 2009

This is a summary of the subject for general guidance only. Professional advice should be sought to take into account the application of the law to your family and the extent of your assets.
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