

# Estate Planning with Gifts

In theory, reducing Inheritance Tax (IHT) is simple, former Labour Chancellor Roy Jenkins even labelled it a voluntary tax. Give away your assets and survive 7 years from the date of the gift and there's no IHT to pay. If only it were that simple. Numerous challenges present themselves when thinking about a gifting strategy. How long will I live? What if I end up needing the asset I give away? What would happen in a beneficiary divorces after receiving a gift? Estate planning is difficult because these types of questions cannot be answered definitively – the future is unknown. The good news is that many of these challenges can be addressed to some extent if the correct type of gift is made. In this article, we cover some of the basic aspects of gifting.

Whenever you give something away, your estate reduces in value, hence why gifting can be an effective form of estate planning. However, gifts must be true gifts with no conditions attached and will generally be classified in one of three ways.

**Exempt Transfers** – these are gifts which are immediately out of the estate. They will either be covered by exemptions such as the annual gifting allowance (£3,000) or the gifting of surplus income, or they will be a gift to an exempt organisation, e.g. a charity.

**Potentially Exempt Transfers (PET)** – These are all non-exempt gifts that go directly to another individual (or trusts with fixed beneficiaries). If you die within 7 years of making a PET, the value of the 'failed PET' becomes chargeable to IHT. The gift recipient is the person liable for any IHT due.

Individuals can make PETs of any size and as often as they want without triggering an immediate charge to IHT.

**Chargeable Lifetime Transfers (CLT)** - These are gifts made to a 'relevant property trust' (usually a discretionary trust). In IHT terms, 'property' is not just physical bricks and mortar but rather assets in general. If you die within 7 years of making a CLT, the value of the CLT also becomes chargeable to IHT and the liability to any IHT due falls on the trustees.

Unlike a PET where the value of gifts is unlimited, a CLT will trigger an immediate assessment and charge to IHT where the value of the CLT, or cumulative CLTs made in the preceding seven years, exceeds the nil rate band in the tax year the latest CLT is made. The rate of the charge is 20% and based on the excess over the nil rate band, not the entire amount. Due to the immediate 20% IHT charge, it is rare for gifts exceeding the nil rate band to be made in a 7 year period to a relevant property trust.

## Becomes Chargeable....

With both PETs and CLTs, death within 7 years of making a gift means the gift becomes chargeable, something we will define to provide clarity on who pays any tax due. When a person dies, any gifts made in the previous 7 years are assessed against their available nil rate band in the order they were made and before remaining estate assets.

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## PET Example

David makes a cash gift to his oldest child of £190,000. Six months later, he makes another cash gift of £190,000 to his youngest child. Two years later David dies with a remaining estate of £1m and the nil rate band is £325,000. He had made no other gifts but did gift the £3,000 annual exempt amount each year. What is the IHT position?

The oldest gift is assessed first and uses £190,000 of the nil rate band, so no IHT is payable by his oldest child. This assessment means only £135,000 of nil rate band is still available.

The second gift therefore exceeds the available nil rate band by £55,000 and IHT at 40% (£22,000) would be owed by his youngest child.

This may not have been the outcome David intended when making the gifts as the net inheritance is not the same for both children due to one of them being liable to IHT on the gift they received. If this scenario applies to you, we suggest taking legal advice as it may be possible to word a will in such a way so as to ensure any IHT due on previous gifts can be met from the estate if desired.

The two gifts fully utilised the available nil rate band so the entire remaining estate will be chargeable to IHT at 40% (subject to any other allowances such as the residence nil rate band being applicable).

## Taper Relief

***Taper relief is only a benefit when the value or cumulative value of gifts exceed the nil rate band.***

Taper Relief can mean there is a reduction in the amount of IHT due once the donor survives more than 3 years from the date of the gift. Once 3 years have passed, the rate of tax due on a gift reduces by 8 percentage points per year.

Years between gift and death	Rate of tax due on gift
0 – 1	40%
1 – 2	40%
2 – 3	40%
3 – 4	32%
4 – 5	24%
5 – 6	16%
6 – 7	8%
7 or more	0%

**N.B.** Some people incorrectly believe that it is the value of the gift that reduces each year and thus that any gift benefits from Taper Relief after 3 years but this is not the case. Many websites which mention taper relief do not make this clear, even the government's own website (here)

## Audit Trail is Key

Many investors are often surprised that it takes on average 6-9 months to receive probate for an estate. Useful information on administering an estate or planning financial affairs can be found in form IHT 400 – the Inheritance Tax account, found here. The form is 'only' 16 pages long but the explanatory notes are 92 pages! On reviewing this form, you will note that many supplementary forms may also be needed, e.g. gifts require form IHT 403.

If you understand the type of information that is needed to complete the various HMRC forms, you are better placed to make sure this information is held with a will and other papers. Solicitors reviewing estate documents such as bank statements may come across large, unexplained withdrawals within the 7 years prior to death (large here generally being anything above £3,000 in a tax year). They then have to carry out enquiries to find out where these monies went. These enquiries can be very time consuming (and costly) and go part of the way to explaining why obtaining probate takes longer than most expect.

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Thus, if you make any type of gift, document it, noting the date, amount, the account it was paid from, to whom it was made and any other information you feel is relevant. One final word of caution. Make sure that all of the audit trail information is accessible to your executors. We've seen examples where people die with the information held on password protected hard drives where only the deceased knew the password!

## Gifts with Reservation of Benefit

As the name implies, this would be a gift where the donor reserves some kind of ability to benefit further down the line. An example could be a holiday home that is gifted to family members. If the donor continued to use the holiday home, they would be deemed to have reserved a benefit and HMRC would place the value of the home in the donor's estate. However, if the donor paid a commercial rate to rent the property for the period of their stay, the gift would be seen as valid (and subject to the normal 7 year rule).

## Which Type of Gift to Make?

The answer to this clearly varies from person to person and is driven by what they want the gift to achieve. The good news is that options exist for the majority of everyday objectives investors have. If you want access to a future income stream from a gifted capital amount, that is possible. If you want to make a gift to a child or grandchild but are worried what will happen if they were to split up with a legal partner, a discretionary trust would be an option to consider as the trustees own the asset, not the beneficiary and can use their discretion on deciding who should benefit. As long as the trust is administered properly, any divorcing child has no automatic right to trust assets, so their partner has no right to any share of assets in the trust.

As there are so many gifting options available, each with their own little nuances, seeking advice is recommended. In the IHT field, trying to go it alone risks making a gift that does not achieve your intended outcome. Requirements on how to correctly record and administer gifts are becoming more onerous as legislation seeks to counteract tax evasion. The new requirement for the vast majority of trusts to register via the Trust Registration Service (TRS) by September 2022 (details found [here](#)) is a good example of the increasing administration requirements.

## Final Words

There are numerous gifting options and it's likely that one, or some combination will provide investors who want to undertake estate planning with suitable solutions. However, remember the old warning, "if something appears too good to be true, it probably is".

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For the majority of estates, simple gifting strategies that have been utilised for many years and which HMRC are aware of will likely suffice. As a general rule, the more convoluted (and costly) an estate planning scheme is, the more likely it will not achieve the desired outcome!

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