FINANCE UPDATES
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CAMPBELL & McCONNACHIE
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INHERITANCE TAX: GIFTING RULES

Understanding the rules and exemptions.

Inheritance tax is one of the most widely criticised taxes in the UK. Many see it as an unfair burden at a time of grief, and it comes with a complex system of rules, reliefs and exemptions.

In reality, only around 4% of estates are liable for the tax, but many more people have to deal with it, as inheritance tax forms are submitted for around half of all deaths.

According to the Office of Tax Simplification (OTS), that paperwork takes up a significant amount of time for executors, with 38% of people who had completed the forms without the help of an adviser saying it took them more than 50 hours.

Plenty of people worry about inheritance tax during their lifetime, too, and the various gifting rules can be a murky area for anyone planning their estate or thinking about giving gifts to their family and friends in later life.

With several exemptions, some of which haven't changed since the 1980s, and different rules depending on the type of gift and who it's for, it's no wonder many people are confused.

Research from HMRC found that 45% of people who had recently made a gift knew about the gifting rules at the time they made it, and only 25% had a 'working knowledge' of the rules.

If you're considering gifts as part of your estate planning strategy, not fully understanding the rules could risk leaving your beneficiaries with a tax bill to pay. Or, on the other hand, it might lead you to give less than you potentially could.

HOW INHERITANCE TAX WORKS

Inheritance tax is applied at a standard rate of 40% when a person's estate exceeds £325,000.

For people leaving their family home to direct descendants, a separate residence nil-rate band can apply on top of the standard nil-rate band. This adds a value of £150,000 in 2019/20, and is set to rise to £175,000 in 2020/21.

Although the tax primarily applies on the estate after death, it can also be due on certain gifts given throughout a person's life.

WHAT COUNTS AS A GIFT?

According to HMRC, a gift can be anything that has a value, such as money, investments, property, or possessions.

It can also be a loss in value when you transfer something – for example, selling your house to a family member for less than it's worth. In that scenario, the difference in value counts as a gift.

Another rule worth noting is that if you give something away but continue to use it, HMRC may categorise it as a 'gift with reservation'.

For example, you can't pass your property on to your child so it doesn't get taxed, but continue to live in the house. The home you passed on would still be considered part of your estate.

WHAT'S EXEMPT?

Not everything that falls into HMRC's definition of a gift will be liable for inheritance tax. There are several different exemptions which allow people to pass on gifts without being taxed.

Annual exemption

You can give up to £3,000 each tax year without it being liable for inheritance tax. If you don't use this full exemption in one year, the remainder can be carried over to the next tax year. It can't be carried over to any of the following years.

Small gifts

You can give as many small gifts of up to £250 per person as you want without inheritance tax being due, as long as you have not used another exemption for the same person.

Wedding or civil ceremony gifts

You can give wedding or civil ceremony gifts to relatives or friends up to the value of £1,000 per person.

This increases to £5,000 if the gift is for a for a child, or £2,500 if it's for a grandchild or great-grandchild.

It's worth noting that the gift must be given before the wedding or civil ceremony for the exemption to apply.

Gifts from income

Gifts from your surplus income may also be exempt from inheritance tax.

This is a complicated area and it's important to keep detailed records of gifts to use this exemption.

Essentially, the gift needs to be part of your 'normal' expenditure, such as a regular or habitual payment.

It needs to be made from your income, and you must be able to maintain your usual standard of living after making it.

For example, giving birthday and Christmas gifts to your children each year may be exempt, but giving a child a one-off payment that leaves you unable to cover your living expenses would not.

Helping with living costs

Gifts to help someone with their living costs, such as an elderly relative or a child under 18, may be exempt.

Gifts to charities and political parties

You can give gifts to charities, and other organisations like museums, universities or community amateur sports clubs, without inheritance tax being due.

Gifts to political parties may also be exempt.

TAPER RELIEF

If inheritance tax is due on a gift given less than three years before death, it will be charged at the standard rate of 40%.

Between three and seven years before a person's death, taper relief applies. This means the rate changes as follows:

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%

THE FUTURE OF INHERITANCE TAX

Following a recent review by the OTS, the inheritance tax system could be due a major overhaul in the next fiscal announcement.

The report made 11 recommendations in three areas: lifetime gifts, the way inheritance tax interacts with capital gains tax, and how it affects businesses and farms.

One of those recommendations was to replace the annual gift exemption and the exemption for gifts to a spouse or civil partner with one overall personal gifts allowance, combined with a new level for the small gifts exemption.

The exemption for normal expenditure out of income would either be reformed or replaced with a higher gift allowance.

The OTS also recommended reducing the seven-year period to five years, and abolishing taper relief so that gifts made within five years of a person's death would be taxed at 40%.

The Government said it would consider the report and "respond in due course".

We can help you to understand the rules on gifts.

IMPORTANT INFORMATION

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change. This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any decisions based on its content. Some tax planning and inheritance tax advice and services are not regulated by the FCA.

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