September 2019

TIPS FOR MINIMISING INHERITANCE TAX – LIFETIME GIFTS

Some statistics have recently been issued by H M Revenue and Customs (HMRC) which indicate that, in the 2018/19 financial year, the average Inheritance Tax (IHT) bill was £200,000 and, with the current main rate of IHT having remained at 40% for some time now, IHT is a tax which can generate significant sums for HMRC. So, what can you easily do to minimise your IHT bill? Giving away money by way of gift can be relatively straightforward and I have highlighted below some helpful tips, but these are by no means an exhaustive list and, as always, each individual's circumstances will be different and specific advice tailored to your needs is essential.

It is important to remember that the current Nil Rate Band is £325,000. This is the amount up to which an Estate has no IHT to pay. Furthermore, the Residence Nil Rate Band (RNRB) enables individuals to benefit from a further Nil Rate Band which can generally only be applied to a property which has been an individual's residence and which is left to a direct descendant on death. The RNRB is gradually increasing but currently set at £150,000 and, similar to the main Nil Rate Band, any unused RNRB on death can be transferred to a surviving spouse or civil partner. The detailed rules regarding the RNRB are complex and not covered within this article.

Exemptions for Lifetime Gifts

A large part of IHT planning is making use of the exemptions which are available to us all. One of the simplest examples of this is gifts made more than seven years before one's death. These are generally speaking exempt, provided that you have not enjoyed any benefit from money or property which you gave away after the date of the gift, e.g. one cannot just give a property away and continue to enjoy living in it rent free. Professional advice should be sought if the gift is not outright or you continue to enjoy some benefit.

The following gifts are also exempt:

- Small gifts of up to £250 to each of as many individuals as the donor wishes to benefit;
- Annual gifts of up to £3,000 per tax year. This exemption is applied to larger gifts not covered by the £250 exemption above. It can also be carried forward for one tax year only if it is not used in the year in question;
- Gifts that are a wedding or civil partnership gift worth up to £5,000 to a child, £2,500 to a grandchild or great grandchild and £1,000 to anyone else;
- Gifts to charities in the UK or EEA, museums, universities, political parties, housing associations, national heritage bodies or community amateur sports clubs.

Gifts From Surplus Net Income

Perhaps one of the most overlooked IHT exemptions is one entitled "normal expenditure out of income". For gifts to qualify for this exemption, which means that even if the donor dies within seven years they are still not subject to IHT, there are three main criteria which have to be met:

- The gifts must have been made as part of the normal expenditure of the donor and generally speaking there has to be some regularity to the gifts being made;
- Taking one year with another, the gifts must be made out of income (not capital); and
- After allowing for all gifts etc. forming part of the normal expenditure, the donor must be left with sufficient income net of income tax to maintain his or her normal standard of living.

You must also maintain careful records of your gifts and expenditure in order for your executors to be in a position to prove that you were able to maintain the same standard of living after making the gifts. If your Income Tax Returns and tax calculations are retained they should go a long way to providing details of your taxable income and if you also summarise your annual expenditure and your non-taxable income from time to time this would no doubt be appreciated by those dealing with your affairs after your death.

By way of example, let's assume Mr A has an income net of income tax of £50,000 per annum and having reviewed his regular expenditure on holidays, utilities etc. and his other general expenditure (let's assume he is fortunate enough to have paid off his mortgage) there is a surplus of net income of £12,000 in most years. He has two children and he decides to set up a standing order to each of them of £300 per month. He would also like to set up a standing order to accounts in the names of his two grandchildren of £200 per month. Provided that his circumstances remain roughly the same, after 5 years of making those payments he will have contributed £60,000 to his children and grandchildren, considerably helping their financial circumstances and potentially reducing his IHT liability by £24,000.

Although lifetime gifts are a useful means of reducing future IHT bills, I will end this article by reminding you to ensure that you do keep enough for your own needs in the future, whatever those may be. As life expectancy increases, providing for future care becomes an important factor and until crystal balls become more reliable, none of us can be certain what lies ahead.

The above is for general guidance only and no action should be taken without obtaining specific advice.