

News Release: 7th December 2011

Tis the season to be

Jolly, as the old saying goes. It is also better to give than to receive. Combine both together and the afterglow of Christmas may carry you through the dark cold days of January at least until the next pay cheque arrives – hopefully!

However there are limits placed on the “jolly generosity” of us all by no less than Her Majesty’s Revenue and Customs. To be fair to HMRC it is not their fault – they are simply implementing the will of their political masters. Believe it or not Governments of all political parties have been rather ungenerous over the years about the amounts that can be gifted free of all Inheritance Tax (IHT) concerns. They have not increased them since at least 1984. It is probably about time that they did but in the meantime the following gifts can be made free from IHT –

- Small gifts of up to £250 per person per year. This is designed to cover birthday and Christmas gifts, but is now not enough to cover most “I” appeal electronic gadgets.
- Gifts exceeding £250 but totaling less than £3000 in any year. This is the annual exemption that applies to the total amount that can be gifted each year beyond the small gift exemption. There is a common misunderstanding that this applies per person. It does not. It is the maximum of all gifts that can be made by an individual in any one tax year. If any part of this annual exemption is unused in one year it can be carried forward to the next year. If it is not then used it is lost. The maximum that can be gifted free of IHT in any two year period is £6000 per person, so husband’s and wife’s can gift £12,000 between them in one year and from then on £6000 each year. If one spouse cannot afford to make the maximum tax free gift there is nothing to prevent the other spouse transferring funds to allow the maximum gift to be made.
- Annual gifts of excess income – the Normal expenditure out of income exemption - can be made completely free of IHT. If a person’s annual income is, say, £60,000, but they are only spending £40,000, they can gift the balance free of IHT. An example of this situation could be when someone is in a care home; the annual fee (£40K) is known and the person’s income (£60K) leaves an excess. HMRC have just tightened up the rules concerning this exemption but provided there has been a history of such gifts or an intention to continue making them, these gifts will be IHT free. Careful records must be kept in order to justify a claim and you will have to show that when

these gifts were made you did not reduce your standard of living or have to sell some investments to maintain your standard of living. It is safer to take specialist advice about using this allowance as record keeping is vital to save costs later.

- Gifts to qualifying charities of any amount are IHT free. Do not forget to use gift aid if you can because the charity can recover the income tax you have paid on any income earned equivalent to the value of the gift.
- Gifts to spouses and civil partners are IHT free.
- Gifts of £5000 (from each parent), £2500 (from each grandparent) and £1000 (from everyone else) are tax free if they are given "in consideration of marriage". To qualify the gifts must be made before the marriage. It is possible for a newly married couple (or civil partners) to receive £40,000 from their respective parents and grandparents (assuming all 12 are still alive) which could be a useful deposit for a new property assuming a mortgage can be obtained – and that completely free of IHT concerns.

Not everyone is happy making gifts of money which could possibly be misspent. In our current debt laden society it may be time to teach the youngsters the art of saving. With the new Junior ISA having been introduced from 1st November there is nothing to prevent parents and grandparents contributing money to a Junior ISA account. The money is locked away until the child is 18 and with a careful choice of fund manager and an eye on the fee structure and performance of the investments hopefully a significant nest egg will be available for them when they become an adult. Such investments can also be an extremely useful aid in teaching a child about the world of finance and money management.

These are the basic exemptions available "tax free" to all taxpayers. Beyond these there is nothing to prevent gifts being made which are well in excess of these allowances. Gifts to individuals (but not trusts) of any amount in excess of the tax free allowances are initially ignored for IHT – technically they are called "Potentially Exempt Transfers" or PETs. If you survive for 7 years after making a gift it is completely forgotten about. If not the total value of gifts made in the seven years before death is included in your estate to calculate the IHT payable. If the total value of such gifts is less than the tax free part your estate (called the "nil rate band" - currently £325,000) no IHT is paid on the gifts. The gifts effectively reduce the nil rate band that can be used against your estate or reduce the nil rate band that can be transferred to a surviving spouse or civil partner.

If the total value of gifts in the seven years before death is greater than the nil rate band the recipients of the gifts may have to pay IHT. The IHT payable will however be reduced by what is called "Taper Relief" if the gifts were made more than 3 years before death.

If the thought of making outright gifts is not appealing then consider using Trusts. However, a word of caution. Since the shambles of the 2006 Budget when Mr Brown removed the

extremely useful "Accumulation and Maintenance Trust" it is not possible to gift more than £325,000 (the current IHT nil rate band) to a Trust to protect assets for a child until they develop some common sense and financial acumen. If a gift in excess of £325,000 is made to a Trust IHT at lifetime rates (20%) has to be paid on the excess. However there is nothing in the IHT legislation to prevent parents transferring their nil rate band (currently £325,000) into a Trust for their children and grandchildren. There is however a catch in the Income Tax Acts which deems income released from such Trusts to be that of the parent who created the Trust if the child is less than 18. These trusts are therefore best set up by grandparents or by a parent whose children are over 18 if it is felt that a degree of control and protection is necessary. However, even if children are under 18 it may still be possible to organise the investments of a Trust so that it produces no income. If there is no income, no Income tax has to be paid. Again professional advice is best sought on this. If income is received by a Discretionary Trust it is currently charged to Income tax at 50%.

The one tax I have not mentioned so far is Capital Gains Tax. This is the tax which often prevents gifts of assets other than cash. A gift is treated as if the assets gifted had been sold. If the asset has increased in value CGT may be payable. If it has decreased in value and is being transferred to a child, that loss can only be offset against future gains made on gifts to the same child of whatever age. Again it pays to take advice before making gifts of assets other than cash. You could find yourself with an unexpected and unwanted CGT liability.