TAX PLANNING:
THE RULES OF GIFTING

Careful planning to pass more on to your loved ones.

THE RULES OF GIFTING EXPLAINED

Many people are not aware of the long list of rules, exemptions and allowances when it comes to gifting assets to your loved ones, which actually takes a lot of careful planning to do so tax-efficiently.

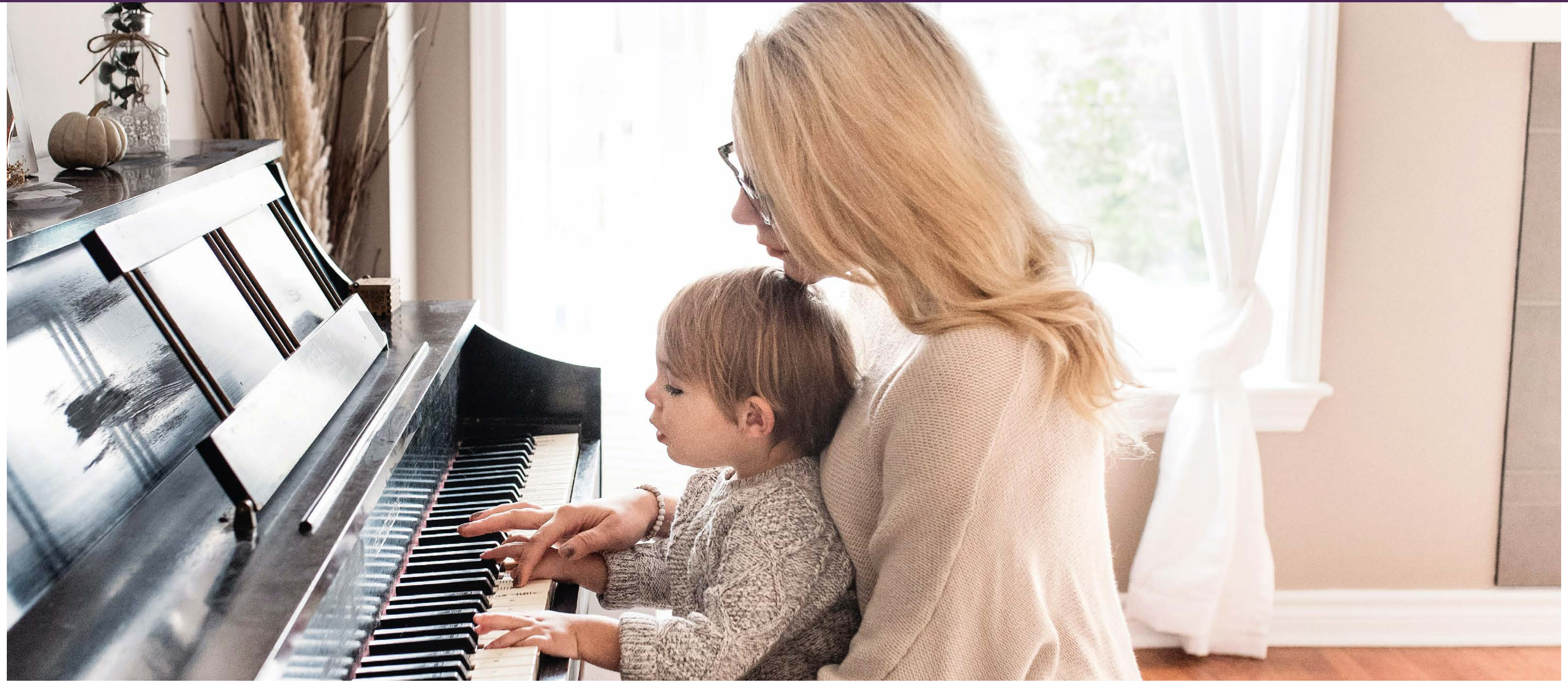
Tax planning is a complex subject, and can be even more challenging when families, emotions and the loss of a loved one are involved. Although this is not something that many of us wish to dwell on, planning towards an eventual passing of assets can ensure that your loved ones benefit as you wish when you pass away.

A key area of Inheritance Tax (IHT) planning is making the most effective use of gift allowances. Understanding these thresholds and exemptions can allow you to pass on more of your wealth whilst avoiding further IHT liabilities in the future.

The gift allowance – currently £3,000 - has not increased since 1981 when this amount was enough for a 10% deposit on the average London property. Whilst the gift allowance may no longer constitute a significant amount, it should still be an important area of consideration when minimising potential IHT liabilities.

INHERITANCE TAX PLANNING

Understanding what you have and who you wish to leave it to is an important initial step in Inheritance Tax planning. From this point, we can look at ways to further reduce your estate to avoid a hefty IHT liability upon death.



Gifting can reduce your IHT liability by decreasing the size of your estate. On an emotional level, gifts also let you experience the pleasure of giving and bringing joy to your loved ones at the same time.

However, with tax, it is never simple. There are rules around gifts that need to be considered. For example, in some instances it takes a full seven years for a gift to become tax-free. It is worth thinking about giving earlier rather than later, as giving when you are younger can increase the chances of surviving seven years after the gift was given.

This chart shows how IHT on gifts decreases over time. If the person making the gift passes away before seven years have passed, IHT is due. After seven years, there is no IHT due.

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%

Please note: The tapering of the Inheritance Tax on gifts is applicable for any gifts over the Nil Rate Band. For how this applies to you, speak to your independent financial adviser.

GIFTS AND EXEMPTIONS

Another key area in tax planning, is making effective use of gift allowances. Understanding these thresholds and exemptions can allow you to pass on more of your wealth whilst avoiding further IHT liabilities in the future.

UK Domiciled Spouses & Registered Civil Partners

Gifts between spouses and civil partners are exempt from IHT both during their lifetime and on death. If the death estate of the first to die is passed in full to the survivor, this essentially means that the IHT liability is deferred until the second death.

Annual Gift Exemption

One of the most basic ways to avoid IHT is to ensure you make use of the £3,000 gift allowance. £3,000 in assets or cash (or a combination of both) can be gifted annually, either as a single gift or as several gifts adding up to that amount, without incurring IHT. If no gifts are made in one year, or less than the £3,000 amount is gifted, the unused balance can be carried forward to the next tax year.

Small Gift Exemption

Gifts of up to £250 can be made to as many individuals as you like tax-free, with the caveat that this does not include an individual in receipt of a gift made under the annual gift exemption relief rules.

Normal Expenditure from Income

Regular gifts from after-tax income will be immediately exempt from IHT, providing you are left with enough income after gifting to maintain your normal lifestyle. There is no limit to the size of gifts that can be made under this exemption, subject to these conditions being met. Keeping records will assist your executors.

Payments to Help with Living Costs

There is no IHT on gifts to help with supporting other people's living costs, providing the payments are to a former spouse, a relative who is dependent because of age, illness or disability or a child in full time education.

Wedding and Civil Partnership Gifts

Gifts to someone getting married or registering a civil partnership are exempt, but to qualify must be given on or shortly before the date of the ceremony. The maximum amount is dependent on the strength of the relationship; for parents up to £5,000, for grandparents up to £2,500 and for others up to £1,000.

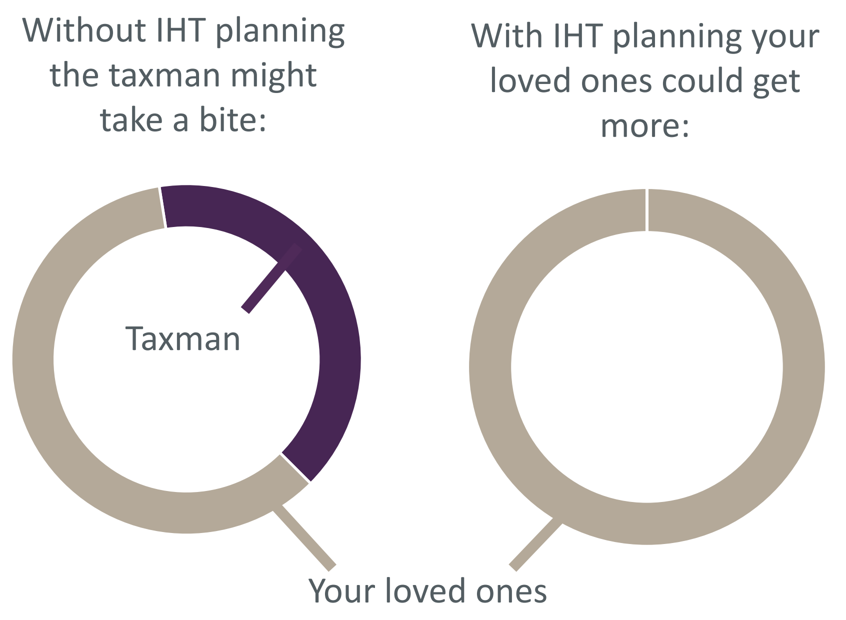
GIFTS AND EXEMPTIONS CONTINUED...

We understand that each client is an individual, and we take time to build relationships to learn more about their circumstances in order to offer the best financial advice, especially with more complex situations.

Other Exemptions

Gifts to UK registered charities during your lifetime, or in your will, are exempt from IHT. Gifts to some national institutions such as museums, universities, community amateur sports clubs and the National Trust are included within this exemption, along with gifts to political parties (as long as they have at least two members elected to the House of Commons, or one member elected to the House of Commons and received at least 150,000 votes in the most recent general election).

Who do you want to leave your estate to?



USING GIFTS AND TRUSTS
TO REDUCE IHT

IHT planning is a complex subject and there are a variety of strategies that could be implemented. Whilst we cannot cover all of these in depth, we can look at two key approaches: gifts and trusts.

Gift-Giving Checklist

To establish whether or not IHT is due, you will need to show what gifts have been given. For example a bank statement can provide evidence that a gift of money was given. So when giving gifts, make a record and keep the list with other important papers.

Take note of:
- who each gift was given to
- what gift they were given
- the date the gift was given
- the value of the gift

Trusts

Trusts are another tool frequently used to reduce or eliminate Inheritance Tax. However, there are many different types of trusts, therefore, this is a complex subject that is best explored with an Independent Financial Adviser.

In general, you may choose to use a trust when you wish to leave property, investments or money for loved ones but keep some control over how the money is spent. A trust can ensure that the money you leave is used for a certain purpose, for example, school fees or to buy a house.

CASE STUDY: REDUCING A £3M ESTATE FOR IHT PURPOSES

Many people are not aware of the long list of allowances and rules when it comes to gifting assets, which actually takes a lot of careful planning to do so tax-efficiently.

Clients Mr and Mrs Jones (aged 68 and 64 respectively) were looking for ways to further reduce their estate to avoid a hefty Inheritance Tax (IHT) liability upon death, whilst still leaving adequate income for their retirement.

After building a comfortable lifestyle with an income derived from rental properties, pensions, and investment pots, as well as having sold a business 7 years prior, the couple's estate – with an overall value of approximately £3m - would be passed on to their 4 children, and ultimately 6 grandchildren. If they were to pass away with their estate in its current state, this would result in a tax bill of circa £940k (40% of the excess of their combined £650k allowance).

In order to avoid such a large tax bill and allow more to be passed on to their chosen beneficiaries as they wish, their Integrity365 Independent Financial Adviser was able to help them put a range of plans in place to reduce this amount.

Reducing the Estate

The family home – worth £1m – would be jointly left to their children in their will upon the second spouse's death. After planning, this would allow the residence nil rate band (NRB) to be used again (an additional, joint £350k allowance), as further planning reduced the estate to below £2m, therefore increasing their Inheritance Tax allowance to £1m.

As mentioned, Mr and Mrs Jones also owned a rental property, which they decided to sell and gift the proceeds into Junior ISAs to their six grandchildren, using the annual allowance over future tax years to further reduce their estate.

They could also help their family now by paying for their grandchildrens' school fees by gifting £10k per annum, which was covered by the out-of-income exemption.

The couple also gifted £400k from their joint savings into Trust Funds, for their four children which, after 7 years (as per the 7-year-rule) would be considered a 'potentially exempt transfer' if they were both still alive at that point and fall out of their Inheritance Tax calculations.

Please note: client names have been changed for the purposes of this publication.

CASE STUDY CONTINUED...

There are huge savings to be made with careful IHT planning that is tailored to your individual family circumstances, and it is never too early to start planning for.

Income at Retirement

Cash savings were used to invest into a Discounted Gift Trust (£600k) in Mrs Jones' name due to her better state of health (after underwriting this gave a 50% immediate discount, which effectively reduced their estate value by £300k on day one, then tapered £300k over the next 7 years). This provided an income of £24k per annum for the remainder of Mrs Jones' lifetime (tax efficient on the first 5% for 20 years).

Two of their current £100k ISA portfolios were also transferred to AIM investment funds – which are exempt from IHT after 2 years but still accessible if required later in retirement. The value of these will be subject to market fluctuations relative to an AIM portfolio.

Further investments were made with NS&I Premium Bonds of £50k each, where interest is paid as monthly tax free 'prizes'. The couple also had an investment portfolio of ISAs, Unit Trust/OEICS and Offshore bonds which totalled £400,000 of available funds within their estate. We also set aside an emergency fund in cash of £50,000 as well as £75,000 within their deposit account for expenditure, leaving plenty for a comfortable lifestyle both now and at retirement.

IHT Liability

After survival for 7 years the various Trusts and gifts fully benefit from the planning completed, as their estate was valued at circa £1,625,000 instead of the initial £3m.

Estate value	£1,625,000
Minus IHT allowance of £325k each	£975,000
Minus residence NRB of £175k each	£625,000
Tax at 40%	£250,000
WOL cover	£250,000
Estimated IHT bill	**£0**

However, planning did not stop there. By putting a Whole of Life Policy in place and in trust to pay-out to their children, this would offer £250k upon the death of the second spouse, they could provide further tax savings and allow more of their estate to be passed on still, as seen in the table across.

There are clearly huge savings to be made with careful IHT planning, and so many different exemptions and allowances that can be implemented in order to do so, depending on your individual circumstances.

Please note: client names have been changed for the purposes of this publication.

SEEK ADVICE FROM AN INDEPENDENT FINANCIAL ADVISER

Using gifts effectively and carefully to reduce a potential IHT burden can be a complex process and professional advice should be sought. Please do not hesitate to get in touch for further support.

This guide contains some of many considerations to be taken into account when it comes to tax planning and gifting rules. However, the strategy that is best for you is one that is tailored to your specific circumstances and information in this guide should not be taken as advice.

Please do not hesitate to get in touch with an Integrity365 adviser to discuss your own financial planning needs and we can help you make the most of your wealth and plan for what you leave behind.

Get in touch:

enquiries@integrity365.co.uk

integrity365.co.uk

Bristol: 0117 450 1300

High Wycombe: 01494 509 666

London Office Tel: 020 7417 0417