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IHT rules on giving gifts – the facts and figures

Her Majesty's Revenue & Customs (HMRC) have rules regarding gifts made by someone before they passed away.

These rules cover the value of the gifts, when they were gifted, who to gift is to and what relationship they had with the deceased.

This all means that Inheritance Tax may need to be paid from the deceased's estate on some of the gifts they have given.

In this information sheet we will try to outline the rules. Professional advice from a solicitor or a tax advisor should be sought if there is any doubt as to what should be declared to HMRC.

What is deemed to be a gift

Gifts include the following:

- Money
- Personal and household goods such as furniture, jewellery, artwork, or antiques
- A dwelling (house, bungalow, mobile home) land or buildings
- shares and stocks that are listed on the London Stock Exchange
- unlisted shares that the deceased has held for less than two years before the date of death

Gifts also include monetary value that was lost when something is sold for less than it is worth. For example, if the deceased sold their home to one or more of their children at a price that was below market value on the date the sale completed the difference in value counts as a gift.

Anything left in a will is not counted as a gift but is part of the estate. An estate is a combination of all the deceased's property, possessions and money left when they died. The total value of their estate will be used to calculate and Inheritance Tax that will need to be paid.

Exclusions from paying Inheritance Tax

Certain gifts are exempt from Inheritance Tax.

Gifts to registered charities and also to political parties are not subject to Inheritance Tax

Gifts between civil partners or spouses are not liable for Inheritance Tax either, so there is no limit on gifts, or their value during the deceased's lifetime, however there are to requirements that have to be met:

- the civil partner or spouse has to live in the UK permanently, and
- they were legally married to, or in a civil partnership with the deceased on the date of the deceased's death

Making use of personal allowances to make tax free gifts whilst alive

Each tax year (6 April to 5 April the following year) everyone is allowed to give away money or possessions without incurring Inheritance Tax liability. The tax free value depends on which allowances have been used.

Annual Inheritance Tax exemption

A person can give away gifts (money and/or possessions) up to a value of £3,000 each tax year without them being added to their estate's value. This is referred to as their "annual exemption".

The £3,000 gifts or money can be to just one person or split between several people, there are no restrictions on this.

Any unused annual exemption can be carried forward to the next tax year, but not into subsequent years.

Example

- during the 2019 to 2020 tax year, Peter gave his son Mike £2,000. If he dies within seven years of making the gift it would have used up £2,500 of his annual exemption for 2019 to 2020.

- during the next tax year (2020 to 2021), Peter gave his daughter Phoebe £3,500 (which exceeds the annual allowance of £3,000). If Peter dies within seven years of making this gift the total falls within the annual £3,000 exemption because £500 from the previous tax year is carried forward.

- so, even if Peter did die within seven years of making the gifts, there would be no Inheritance Tax to pay.

Small gift allowance

Everyone is also allowed to make as many gifts of up to £250 per person as they choose to in each tax year providing any other allowances have not been used when gifting to the same person.

Christmas and/or birthday gifts from regular income are exempt from Inheritance Tax. For example, the funds for the gifts have to be shown to have come from regular income such as wages, bank interest, pension, share dividends etc.

Civil partnership or wedding gifts

In each tax year, everyone is allowed to make tax free gifts to someone who is starting a civil partnership or getting married, the limits are:

- £5,000 to a child
- £2,500 to a grandchild or a great-grandchild
- £1,000 to any other person

If different gifts are made to the same person, allowances can be combined except for the small gift allowance. For example, a parent may give their child up to their full annual exemption of £3,000 and also a wedding gift of £5,000, totalling £8,000 with no Inheritance Tax liability.

Regular payments

Regular payments can be made to help with another person's living costs and there is no limit to how much can be contributed tax free so long as:

- the doner is able to afford the payments providing they can meet their own usual living costs, and
- the payments are made from regular monthly income

Termed "normal expenditure out of income", these payments can include:

- paying rent for a child
- giving financial support to an elderly relative
- paying into a savings account for a child under 18

Again, there are opportunities to double up on allowances, so it is allowed to combine a wedding gift of £5,000, and the annual exemption of £3,000 with a monthly payment (perhaps £100, totalling £1,200 a year) to a child which combine to make £9,200 in the same tax year.

The seven year rule

There is no tax liability on any gifts of the doner lives for seven years after giving them, this is called the seven year rule, but excludes any gifts that are part of a trust, If a person dies within seven years of making a gift, and there is Inheritance Tax to be paid the percentage of tax due tapers (decreases) from a maximum of 40% if the gifts were within 3 years of death on he following scale:

Years between gift and death	Rate of tax on the gift's value
3 to 4 years	32%
4 to 5 years	24%
5 to 6 years	16%
6 to 7 years	8%
7 or more	0%

Giving gifts and still benefitting from them

A "gift with reservation" is a gift that can still be benefitted from, and it will count towards the value of the estate. These types of gifts can include

- giving one's home to a relative but still living in it
- giving away a caravan and still taking free holidays in it
- giving away a painting or work of art but still displaying it in the home

Record keeping

An Executor will need to be able to work out what gifts a deceased person made in the seven years prior to their death, so it is very useful if records have been kept.

It is often very difficult to establish exactly what possessions may have been gifted without detailed knowledge of what the deceased owned. At Provals we offer a "Living Probate Inventory" that catalogues an individual's possessions, with photographs and descriptions that becomes a permanent record that can be updated on a regular basis as needed. Please ask us for details.

As a minimum, it is useful for the following records to be maintained:

- what was given, and to whom
- the "open market value" of each gift. This is not the retail price unless the item was brand new.
- on what date the gift was made

How Inheritance Tax on gifts is paid – and who pays it

The state usually pays any Inheritance Tax on gifts unless the deceased has given away more than £325,000 worth of gifts in the seven years prior to their death. Unfortunately, once that figure has been reached anyone receiving a gift during the seven years period will have to pay Inheritance Tax on their gift.

Example

Joan died on 1 July 2018. She was not married or in a civil partnership when she died.

She gave 3 gifts in the 9 years before her death:

- £50,000 to her brother 8 years before her death
- £100,000 to her friend 4 years before her death
- £325,000 to her sister 3 years and 7 months before her death

There's no Inheritance Tax to pay on the £50,000 gift to her brother as she gave it more than 7 years before she died.

Unfortunately her friend must pay Inheritance Tax on her £100,000 gift at a rate of 24%, as it's above the tax-free threshold and was given 4 years before Sally died. (See the table above) The Inheritance Tax due is £24,000.

There's also no Inheritance Tax to pay on the £325,000 she gave her sister, as this is within the Inheritance Tax threshold.

Sally's remaining estate was valued at £420,000, so the estate would pay Inheritance Tax of 40% on £420,000 (£168,000) if it didn't meet any of the conditions explained above, such as being donated to charity.

Conclusion:

We hope that this article helps you to deal with Inheritance Tax in general, and particularly as it relates to gifts. Although it seems like a complex and time consuming process we are able to assist at most stages including providing general guidance, pointing you towards additional sources of information, and primarily preparing a detailed probate valuation of the deceased's possessions. Provals are proud to have been selected to prepare probate valuations directly for members of HMRC's Probate Department and we always operate in compliance with their reporting requirements.

Provals have almost 60 years' experience of preparing probate valuations so will be able to help, advise and value in the vast majority of situations, so please contact us if you have any questions or would like a quotation for a probate valuation.