



# Matrix Capital

## Financial Planning

### Exempt Gifts: A practical guide

There are seven types of gifts that may be made by an individual where inheritance tax (IHT) is not charged – they are called ‘exempt’ gifts.

This guide will help you understand how each of them work and some of the rules surrounding their use. However, please bear in mind that this information does not replace professional advice, this is merely to provide information and guidance.

It is recommended that professional advice is taken from someone who is suitably qualified, such as a Trust and Estate Practitioner (TEP) who is registered with the Society of Trust and Estate Practitioners (STEP) and a professionally qualified Chartered or Certified Financial Planner. This is because there are several factors that need to be considered before making the decision to gift, including your own needs both now and in the future, the level of control and flexibility that you require, and other gifts made or intended.

The information in this guide is based upon the law applicable to England and Wales.

#### Annual exemption

This currently stands at £3,000 per tax year per individual donor; and you may also use the previous year’s unused annual exemption. The tax year runs from 6th April to 5th April.

So, as long as you have fully utilised the current year’s exemption, you may carry forward any unused exemption from the previous tax year.

Remember that the exemption applies per donor (i.e., the person making the gift) and not per donee or recipient. Therefore, if you have used none of this or the previous year’s annual exemptions, you could gift a total of £6,000 this year divided amongst donees (e.g., £6,000 to one person or £6,000 divided between recipients).

If you intend making a ‘chargeable lifetime transfer’ (CLT) and a potentially exempt transfer (PET) in the same year, it is usually better to make the CLT before the PET. In the event of the death of the person making the gift (the settlor) it may be advantageous for any available Nil Rate Band to be offset against the CLT rather than the PET. A typical example of a CLT is a gift made to a discretionary trust.

Lastly, please bear in mind that case law in England and Wales (the rules in Scotland are different) has established that a gift by way of a cheque is only effective once the cheque has cleared.<sup>1</sup>

1 Curnock -v- ICR [2003] UKSC SPC00365

## Small gifts

This currently stands at £250 per donee per tax year.

The first thing to emphasise here is that the allowance is per **donee** (i.e., recipient) and not per **donor**, as with the annual exemption described above. Also, there is no limit as to the number of individual donees that can benefit.

So, by way of an example, Paul gifts £250 to each of his 350 family members. All cheques cleared through his bank and then Paul died. The full £87,500 is covered by the small gift exemption and none of the gifts are subject to a supplementary inheritance tax charge.

A word of warning though is that a small gift exemption cannot be used in conjunction with the annual exemption. To illustrate this, if a gift of say £3,250 is gifted to one donee, only the first £3,000 would be covered by the annual exemption and the remaining £250 would not be covered by the small gift exemption. Unless it is covered by another exemption, it will be a PET and potentially taxable upon the death of the donor.

## Gifts in consideration of marriage or civil partnership

These range from £5,000 down to £1,000, depending upon the relationship between the donor and the donee:

- **£5,000** – for a gift from a parent to either party to the marriage or civil partnership.
- **£2,500** – for a gift from a grandparent or more remote ancestor to either party to the marriage or civil partnership.
- **£1,000** – for a gift from any other person to either party to the marriage or civil partnership.

The gift must be made (i.e., cheque or funds cleared) on or before the date of the marriage or civil partnership and, if the marriage or civil partnership does not take place, then the relief is denied.

Unlike the small gift allowance, this exemption can be used in conjunction with the annual exemption.

## Registered legal partner exemption

Any amounts transferred between registered legal partners (be they married persons or persons who are parties to a civil partnership) are exempt gifts.

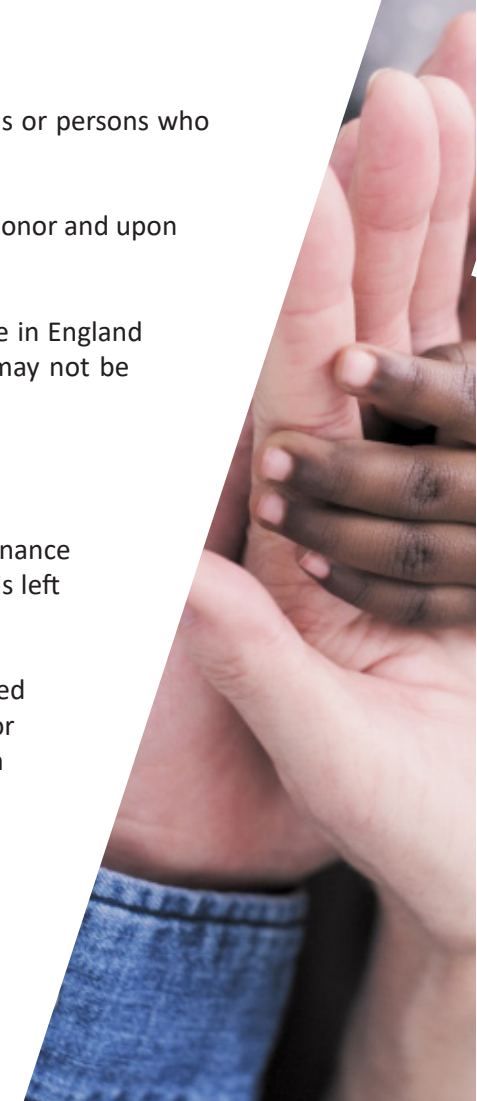
Unlike the exemptions above, this exemption applies both during the lifetime of the donor and upon death, under a will or the rules of intestacy.

The individuals must be either married or in a civil partnership under laws applicable in England and Wales. So, an overseas marriage that is not recognised in England and Wales may not be sufficient to successfully claim this exemption.

## Charities

Gifts to qualifying charities offer full exemption on lifetime and upon death. Also, the Finance Bill 2012 introduced a reduced IHT rate of 36% where at least 10% of the net estate is left to a registered charity.

By way of an additional comment, 'Gift Aid' may be claimed on lifetime gifts to a registered UK Charity. So, quite apart from the potential IHT position, if the donor is a higher or additional rate taxpayer, he or she may be able to also claim an income tax refund on gifts. However, it is crucial for the donor to take professional advice before making significant charitable donations or gifts to charities during their lifetime.





## Gifts from surplus income

This is also referred to as a gift out of 'normal expenditure.'

Legislation<sup>2</sup> allows immediate exemption for regular gifts of value if, taking one year with another, it can be shown the transfers were:

1. made from income and,
2. after the gift, the transferor had sufficient net income to maintain their usual standard of living, and
3. the transfers were normal transfers, which typically means cash gifts.

The normal expenditure should be part of a settled pattern of expenditure, which means that it is regular or intended to be regular. There is no fixed minimum period and there can be variations in the pattern. Also, each transfer does not have to be the same amount.

When relying upon this relief, it is recommended that documentary evidence and good records are retained to confirm that the donor has or had sufficient surplus income. This will be helpful when completing HMRC forms.

## Payments to help with another person's living costs

This is also referred to as 'maintenance of the family' exemption, such as maintaining an elderly relative or a child under eighteen.

This exemption works in a similar way to the gift from normal expenditure. However, the maintenance disregard (i.e., exemption) is not restricted to income, so payments of capital may also be disregarded. The disregard does not apply on death, only during the lifetime of the donor.

Also, it has been established through case law<sup>3</sup> that substantial gifts of capital may be disregarded, depending upon the circumstances.

## Summary

Every aspect of exempt gifting cannot be covered in this guide. However, it hopefully provides you with sufficient information to at least understand the exempt gift options, which may form the basis of a more meaningful discussion with us about how you make gifts, how much, when and to whom.

It is prudent to consider the issue of gifting in the round by taking a holistic approach to your financial and estate planning. Holistic financial planning recognises the interplay between a person's aspirations, which may to some degree conflict. For example, making gifts may in the long run jeopardise the donor's ability to meet any long-term care costs. So, understanding the overall impact of the proposed gifts before making any firm decisions, particularly with regard to larger gifts, is recommended.

We offer a confidential exploratory discussion, without obligation and at our expense. So, if you have further questions, please contact us for an initial discussion.

<sup>2</sup> S.21 Inheritance Tax Act 1984

<sup>3</sup> HMRC -v- R McKelvey [2008] UK SPC 694



(STEP and SOLLA logos are attributed to Robin Melley only)

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