

lifetime planning - the basics

potentially exempt transfers (PET)

The concept of a PET was introduced in the 1986 Finance Act. It enables an individual to make specified gifts of unlimited value that will escape tax completely if he survives the gift for a period of seven years. Broadly speaking, since Finance Act 2006 the gift must be to another individual as most gifts to trusts are now lifetime chargeable transfers (see below).

Where the donor dies within three years of the gift, Inheritance Tax at the full death rate is charged. Where an individual has made gifts exceeding the nil rate band (currently £312,000) taper relief may apply as follows:-

Years between transfer and death	Percentage of full tax rate
More than 3 but not more than 4	80%
More than 4 but not more than 5	60%
More than 5 but not more than 6	40%
More than 6 but not more than 7	20%

In order to be effective for Inheritance Tax purposes the donor must retain no benefit from the assets gifted. For example, if you give your house to your children you must not continue to occupy it.

the annual exemption

A person may give up to £3,000 away each year completely free of Inheritance Tax. Unlike the PET, this exemption applies regardless of the nature of the recipient of the gift. Nor is there any requirement for survival by the donor. If this exemption is wholly or partly unused in any year, it or the balance may be carried forward to the next year but if not used in that year will be lost.

the “normal expenditure out of income” exemption

This exemption applies to a gift if, or to the extent that, it is shown that:-

1. The gift is made as part of the normal expenditure of the donor.
2. Taking one year with another, the gift is made out of his income; and
3. After allowing for all other gifts or dispositions forming part of his normal expenditure, the gift leaves the donor with sufficient income to maintain his usual standard of living.

This exemption is often used where a donor funds premiums of an insurance policy on his life for the benefit of others.



small gifts

Gifts of up to and exceeding £250 made to any one person in any one year are free of Inheritance Tax. This exemption cannot be used in conjunction with another exemption e.g. the annual exemption, and will be lost if the total annual gifts to any one person exceed £250. The gifts must be outright and cannot be made to trustees.

gifts in consideration of marriage

Parents may each give outright gifts in consideration of marriage of up to £5,000 to the parties to the marriage completely free of Inheritance Tax. Grandparents and great grandparents may similarly make outright gifts of up to £2,500. Other persons may make such gifts of up to £1,000.

To ensure that the gifts are made "in consideration of the marriage" it is important that they are made either before or at the date of the marriage. The gifts should also be accompanied by a suitable letter evidencing the fact that the gift is conditional on the marriage taking place.

gifts to trusts

It is often desired to make a gift to a trust to keep an element of control over the property gifted or to provide protection for the beneficiaries. Since Finance Act 2006 most gifts to trust are lifetime chargeable transfers and subject to Inheritance Tax. However, if the total of such gifts made in the last seven years is less than the nil rate band (currently £312,000) no Inheritance Tax is payable on making the gift and, if the donor survives the gift by seven years, it falls out of account. Therefore, gifts to trust still play a major role in estate planning.

get in touch

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