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Adviser factsheet

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The importance in the order of gifting

Introduction

When making gifts to either an individual or to trust, consideration should be given to the order these are made. This helps to make sure available exemptions are utilised for maximum tax efficiency.

The diagram below is a suggested order in which gifts should be made.



The reasons why this is the suggested order is as follows:

1. Wills

A will is a legal document, which outlines how to deal with a person's estate and assets after they've died. It's a fundamental document that gives control as to who can, and importantly, who can't, benefit from and administer the estate.

Without a will, laws of succession and intestacy apply, meaning assets might go to people who the deceased didn't want to benefit, and exclude those they did.

When it comes to estate management, the 'closest' relative deals with this if there's no will. This may be someone the deceased no longer has a relationship with and would exclude co-habiting partners, who'd probably be the person the deceased would want to deal with their affairs.

A will avoids this, as people select who they trust to be their legal personal representatives to deal with their estate as they wish after they've passed.

A will allows for specific bequests to be given and control over who can and can't benefit from the estate. Provisions can be made for co-habiting partners, charities, political parties, and causes the deceased chose, along with family and other friends.

Wills can also be used to establish trusts on the person's death, giving additional control and longevity planning.

A will should be reviewed regularly and kept up to date, especially when life events such as births, deaths, marriages etc. occur. The laws governing England and Wales are currently being reviewed with new draft legislation, removing this rule and making additional changes. See Wills-Report-Volume-II-Draft-Bill-and-Explanatory-Notes-Final.pdf for more information.

2. Loan trust/Gift and loan trust

These can be created on an absolute or discretionary basis and the money is loaned, (usually interest free) rather than gifted to the trustees. If a gift and loan trust is used, the gift (usually of £10) is commonly covered by an exemption. If it's not, it will either be a PET or CLT depending on the type of trust used.

As the money is loaned or loaned with a nominal gift, usually covered by an exemption, there's no transfer of value (unless there's CLT and no nil rate band (NRB) available due to cumulative previous CLTs). Therefore no entry charges should apply, and there should be no reason to use the available nil rate band. For this reason, this type of trust is established before others to leave the NRB available for further planning with discretionary trusts. 10-year principal and exit charges could apply if the trust is discretionary.

When calculating IHT charges, the value of the trust can be reduced by any outstanding loan belonging to the settlor/donor and the NRB may be reduced by CLTs, and failed PETs made seven years before the trust commenced. Another reason this type of trust is considered before CLTs and PETs.

As any outstanding loan on death belongs to the settlor/donor and is included in the estate, provisions should be made in their will as to how this should be dealt with. Growth is outside the estate from day one and belongs to the beneficiaries.

The settlor/donor can recall the loan back at any time but should be mindful of tax consequences, depending on the underlying asset. They can also waive the outstanding loan by making it a gift to trustees/another person. Depending on the type of trust this might be a PET or CLT and there could be tax and reporting consequences if the gift is over the available NRB.

3. Exempt gifts

Gifts for the following are excluded from IHT:

- Spouses and civil partners
- Registered charities and registered clubs
- Political parties
- Housing associations
- The national purpose to the listed organisations in the IHT manual
- The public benefit/heritage/ maintenance fund

Individuals also have the following exemptions they can use:

- £3,000 annual allowance. If the previous years haven't been used, this could be £6,000 or £12,000 combined for spouses and civil partners
- Small gifts of £250 to as many donees as they like, so long as it's not the same people who have benefitted from their annual allowance
- Gifts in consideration of marriage, the limits are:
  - Per parent - £5,000
  - Per grandparent - £2,500
  - Anyone else - £1,000
- Normal expenditure out of income, means gifts made from excess income will be exempt subject to meeting certain conditions, some of which are:
  - that it should be from income (taxable or not) and not capital
  - normal for that person (considering the nature, frequency, and value of the gift)
  - should not negatively impact the person's standard of living
  - show an intention to create a pattern of gifts

4. Chargeable lifetime transfers (CLTs)

These gifts are chargeable to IHT, use the NRB, and remain inside the estate for seven years. These are gifts to trusts subject to the relevant property tax regime, namely discretionary and interest in possession trusts created post 6 March 2006.

Cumulative gifts of more than the available NRB will be subject to an entry charge, but growth will be outside the estate from day one.

Relevant property trusts are subject to a 10-year principal charge and exit charges when the trustees distribute to the beneficiaries. When calculating these charges trustees should ask their tax advisers to complete these calculations for them. These calculations can be complex depending on circumstances at the time, the type of trust used and any actions the trustees may have taken.

Trustees will also need to consider all HMRC reporting requirements including the Trust Registration Service (TRS) if applicable.

5. Potentially exempt transfers (PETs)

These are outright gifts made to individuals, or to certain types of trusts, including absolute trusts or trusts for disabled persons. These gifts don't use up the nil rate band but will remain in the estate for seven years and become chargeable if death occurs within seven years. Failed PETs will use the NRB in the chronological order in which gifts are made. Growth belongs to the beneficiaries and outside the estate from day one.

PETs are completed after the CLTs, as a failed PET can impact the NRB available when doing the principal charge calculation as well as any new gifts to discretionary trusts. This is why they're usually considered after making CLTs.

Summary

The above order in which gifts should be given is a suggested method, which could achieve tax efficiency. When making chargeable or potential chargeable gifts of large value, a full seven years should be left between gifts. This is because if death occurs and a full seven years has not been left, there could be a 14 year shadow depending on the type of gift, causing a tax charge for the beneficiary. Please see our 14- year shadow factsheet for more information of how this works.

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