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What is the 14-year shadow?

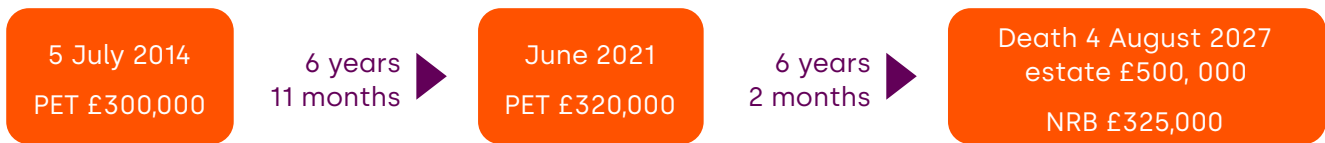
Introduction

Gifts made more than seven years before death are outside the estate for inheritance tax (IHT) purposes. However, when making multiple gifts consideration needs to be made to the type of gift made and the order, the time between them and the values, or a 14-year shadow may apply which can impact the tax due.

Previous chargeable lifetime transfers (CLTs) can affect the amount of tax payable on failed potentially exempt transfers (PETs) or CLTs when a full seven years has not been left between gifts being made. CLTs in the seven years prior to the subsequent gift (failed PET or CLT) will reduce the available nil rate band (NRB) for the gift, which is within seven years of death, and therefore increasing the tax due.

The case study below shows how this might apply.

Mrs Anne Example made the following gifts:



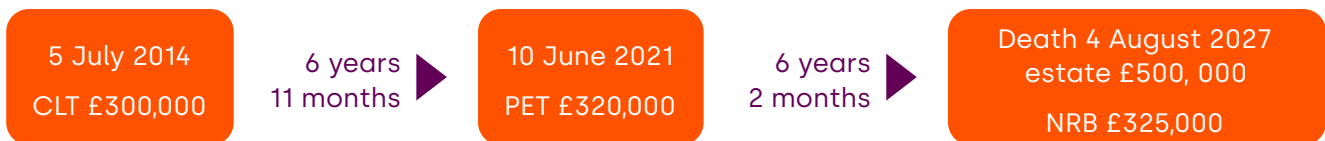
Mrs Anne Example IHT calculation:

- The £300,000 PET made in 2014 can be forgotten and is exempt from the calculation as made more than seven years before death.
- The £320,000 PET made in 2021 has now become chargeable as death has occurred with seven years of making it. This value is first into the calculation as per the order of gifting.

• Calculation:

- $£320,000 \times 0\% = £0$ This is because it is covered by the NRB.
- There is £5,000 of the NRB remaining.
- £5,000 of the £500,000 estate is covered by the NRB so $£5,000 \times 0\% = £0$.
- $£495,000$ remaining estate $\times 40\% = £198,000$ IHT due.

Mr Andrew Sample made the following gifts:



Mr Andrew Sample IHT calculation:

- The £300,000 CLT made in 2014 is exempt from the IHT calculation as made more than seven years before death.
- The £320,000 PET made in 2021 has now become chargeable as death has occurred with seven years of making it.
- When looking at failed PET from 2021, we need to check the seven years previous for any CLTs.
- As there is not a full seven years between the CLT made in 2014 and the now failed PET in 2021, the CLT is first into the IHT calculation to assess the tax due on the failed PET.

• PET tax calculation

- £300,000 CLT takes up the first part of the NRB and so $£300,000 \times 0\% = £0$.
- There is £25,000 of the NRB remaining so this can be used to offset against the failed PET, so $£25,000 \times 0\% = £0$.
- The remaining value of the failed PET is £295,000.
- As death occurs between year six and seven after making the gift, taper relief can be applied to reduce the tax payable rather than being charged at the full 40%.
- Therefore $£295,000 \times 40\% \times 20\% = £23,600$ and this is payable by beneficiaries as recipients of the gift.
- The £500,000 estate then sits on top, with the NRB previously used against the gifts so is charged $£500,000 \times 40\% = £200,000$ IHT payable on estate.

Considerations

When making multiple gifts, the order, timing, and values need to be considered, and advice should be sought before making them. Ideally, a full seven years should be left between gifts, but this is not always feasible as the client may have given gifts prior to becoming a client. However, when advising on making new multiple gifts or those who have already made previous gifts in the past seven years, consideration should be given to the following and discussed with the client to ensure they understand any tax implications before proceeding:

- What is the value of the estate liable to IHT?
- What is the potential IHT liability?
- How will the proposed changes bringing unused pension funds into estates for the purposes for IHT affect your clients?
- What is the current state of health of the clients when making the gifts?
- Are they likely to survive seven years? If not seven years, would any chargeable gift benefit from taper relief?
- What is the potential tax liability on the gifts, and should there be a protection policy in place to cover the potential liability?
- What NRB or residence nil rate bands (RNRB) are available to offset against chargeable gifts and/or the estate?
- Are there any transferable NRBs or RNRB available from previously deceased spouses or civil partners?

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