Inheritance Tax Gifting Allowances

The Inheritance Tax Gifting Allowance is a set amount of money that you can give away each year without this being added to the value of your estate for Inheritance Tax purposes. The current annual exemption is a maximum of £5,000.

IHT receipts reached £5.3 billion in the months from April to December 2022, £700 million higher than the same period a year prior, and this figure look set to climb further.

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Introduction

The Autumn 2022 budget confirmed both the Nil Rate Band (NRB) and Residence Nil Rate Band (RNRB) will be frozen at a combined total of up to £500,000 per person until 2028. Ignoring the introduction of the RNRB (currently up to £175,000) in 2017, to which not everyone is entitled, the total wealth a person can shelter from Inheritance Tax (IHT) is set to be static for at least 19 years.

This is often referred to as stealth tax: since 2009, house prices have cumulatively risen 89.0%, global markets 253.6%, and general prices (RPI) 70.6%, yet the amount of estate that can be sheltered from tax is unchanged, meaning more and more people are steadily dragged into paying a tax they might otherwise have avoided had the payment threshold risen in line with everything else.

The current rate of IHT is 40% of all assets exceeding the available nil rate bands, with a reduction to 36% available to those who leave at least 10% of the baseline amount to charity (the baseline amount is broadly the value of the estate less the available NRB (excluding RNRB), and any reliefs or exemptions other than the value of the charitable legacy itself).

Fortunately, NRBs are not the only means of passing on wealth without paying tax; there are various gifting exemptions available and, whilst not all are available or appropriate for everyone, it is worth reviewing the options periodically to ensure you are making use of those that are available.

Please note, this document focuses on the various available gifting allowances and is not a comprehensive list of all IHT exemptions, nor does it go into detail on the NRB or RNRB.

Exemptions Available for Gifts

1. Any gifts to spouses or civil partner are automatically exempt as long as they are UK domiciled.

2. Gifts to charities and political parties are also automatically exempt, as are gifts for 'national benefit' (e.g. gifts to museums, universities and libraries).

3. Every person has an annual gifting exemption, meaning the first £3,000 of gifts made in a tax year are exempt from IHT; you can also carry forward any gifting exemption unused from the tax year prior. This means a couple that have made no gifts previously could give up to £12,000 to a child, e.g. for a house deposit, without any IHT consequence.

4. In addition to the above, you can make outright gifts of up to £250 to as many people as you like in any one tax year, but you cannot use this allowance more than once for the same person, nor can it be used for the same receipt that benefitted from your £3,000 annual gifting exemption.

5. There are also special gifting allowances that can be made in consideration of a wedding or civil partnership ceremony. These limits vary according to your relationship to the recipient, and are summarised in the following table:

Recipient	Maximum exemption (per person)
Child	£5,000
Grandchild or Great-Grandchild	£2,500
Other	£1,000

These gifts must be made in consideration of a specific wedding/ceremony, rather than 'for when you get married' in general, and ideally you should evidence in writing your intention for the gift to claim this allowance and keep it somewhere safe (e.g. with your Will). These allowances can be used in conjunction with the annual gifting exemption.

6. There is an IHT exemption for payments made for the education or maintenance of children aged under 18 or undergoing full-time education, and maintenance payments to dependant relatives can also be exempt from IHT.

7. A slightly more complex exemption exists for 'normal expenditure out of excess income'. This exemption is limitless but, to qualify, gifts must meet the following criteria:

    a. they must form part of the normal expenditure of the gift giver, meaning there is a clear pattern, or clear evidence of an intention to create a regular pattern, of gift giving;

    b. they must be paid from excess income; and

    c. the person giving the regular gifts must be left with sufficient income afterwards to maintain their usual standard of living.

8. Last but not least, you have Potentially Exempt Transfers (PETs). This is another limitless exemption which means a person can gift as much as they like to any individual with no immediate tax to pay, but these gifts only avoid IHT if the giver survives at least 7 years; if the giver does not survive 7 years, the PET is said to have failed and its value for tax is that at the date the gift was made unless the value has since fallen.

   Failed PETs are added back into the estate, whereby they use up the available NRB in chronological order. If the value of all failed PETs is less than the available NRB, no tax falls on the gifts but there will be less NRB available to shelter the rest of the estate from tax.

   If the value of all failed PETs exceeds the gift giver's available NRB, the recipient(s) of the gifts are responsible for the tax due. There is a 'taper relief' available which can reduce this liability for PETs that fail between 3 and 7 years from the date of the gift.

   Please note, a 'gift with reservation' caveat also exists on PETs, meaning you must not continue to benefit from a gift for a PET to be effective; this prevents you from, for example, gifting a valuable painting to a child on paper, but keeping it hung in your own home 'for safekeeping'. In this instance, the 7-year clock would only begin once you no longer retain the benefit of that painting.

Gifts to Trusts

Settlements to trust can also make use of some of the allowances outlined above, but this will depend on the terms of that trust. Gifts to some types of trust may attract an immediate 20% IHT charge, and/or further IHT charges throughout the lifetime of the trust.

You will also find gifts to trusts interact with other gifts in complex ways which can span up to 14 years, meaning prior gifts/settlements can result in IHT becoming payable on later gifts/settlements where none was initially anticipated. These complexities are beyond the scope of this document, and we recommend you contact us when considering settlements into trust.

Conclusion

There are plenty of options available to those who are financially secure and have spare wealth they can give away. However, there are a number of constraints around each allowance, meaning it often takes many years to produce a substantial reduction in a potential IHT liability. This underpins the importance of having a good financial plan and starting this exercise early if reducing IHT is a priority.

Contact Lexington to discuss your own plans around IHT and how you could manage your own liability.

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