

GIFTS AND INHERITANCE TAX

Some of the inheritance tax rules relating to lifetime gifts are complex and open to interpretation, particularly in relation to creating trusts. However, the main rules for simple gifts are as follows :-

- Every individual donor has an annual exemption of £3,000 for each financial year, and one year's unused exemption can be carried forward. This is to say that someone who wishes to start making gifts for the first time can give £6,000 now, a further £3,000 after the next 5th April, and continue in future tax years. Certain additional sums are exempt if given to close relatives as wedding gifts.
- Additional "small gifts" of up to £250 each to any number of donees in any one tax year are also exempt, provided that the donees are not involved in the main annual exemption already. For example, if a donor gives £3,000 to his son he cannot claim exemption for an extra £250 gift to him as well, although he can claim for gifts of £250 each to his daughter-in-law and his grandchildren.
- There is a further exemption for "gifts out of normal expenditure". The qualification is that such gifts must be made from income rather than capital, must still leave the donor with enough income for his usual standard of living, and must be part of a regular pattern. For example, a donor may make gifts of £5,000 to each of his two children out of his income. If he writes a covering letter stating that the gifts are made from surplus income which he does not need and that he intends to make further gifts at regular intervals, then the Inland Revenue should accept that they are exempt. The question of a "regular pattern" refers to the timing of the gifts rather than the amounts, and even if the next ones are only £50 each there is still continuity.
- Any other gift outside the above exemptions is counted back into an estate if it is made within 7 years before death. In theory the tax payable on death can be reduced on a sliding scale if the gift was more than 3 years before, but in practice this only operates if the gift itself was above the level of the overall inheritance tax exemption. The overall exemption is £325,000 for the current financial year.
- No gift is eligible for any exemption unless it is an outright one. For example, there is no tax advantage in someone making a lifetime gift of their house to their children if they continue to live there without paying the children a full rent.