

THE 14 YEAR IHT TRAP

Most people are aware of the fact that if you make a gift in the UK and then live for more than 7 years then that gift will fall out of your estate. What is less well known is that if you make more than one gift and you **die within 7 years of the last gift** then Inheritance Tax (IHT) may well be due on some or all of your gifts.

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1. WHAT IS A POTENTIALLY EXEMPT TRANSFER (PET)

A PET is a gift usually made outright to an individual (including a bare/absolute trust) and would not involve any immediate lifetime inheritance tax being payable.

If the donor dies within 7 years of making a PET then the PET fails and becomes a Gross Chargeable Transfer (GCT).

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2. WHAT IS A CHARGEABLE LIFETIME TRANSFER (CLT)

A CLT is usually made through the creation of a discretionary trust. Whereas PETs are not liable to tax unless you die within a 7 year period, CLT's are subject to IHT at a rate of half of the death rate (i.e. 20%) **unless they fall within the individual's Nil Rate Band.**

The available Nil Rate Band for these purposes is the current Nil Rate Band, reduced by other chargeable lifetime transfers made by the settlor in the seven years prior to creating the trust. **Note PETs are ignored for these purposes.**

3. WHAT IS YOUR NIL RATE BAND? (NRB)

The NRB or Nil Rate Band (NRB) is your inheritance tax free allowance. In 2021/22 this is £325,000 per individual. If you make a CLT during your lifetime you are allowed to set the first £325,000 of your gifts against your NRB. Once your CLT has fallen out of account (i.e. 7+ years) then you can gift a further amount via CLT up to the NRB applicable at that time.

It is possible for one spouse in a married relationship to leave their allowance to the survivor thus allowing the widow(er) to have a NRB of £650,000. This extra allowance only occurs when the second spouse dies however and **cannot be used for lifetime gifting purposes.**

4. WHAT IS TAPER RELIEF?

When a gift becomes taxable on death it may be possible to obtain a credit towards the tax based around the period of time between the date of the gift and the date of death.

If the gift is found to exceed your NRB and is subject to tax, then the tax can be reduced as follows:

Years From Gift To Death	0 to 3	3 to 4	4 to 5	5 to 6	6 to 7	7 +
Reduction In IHT	0%	20%	40%	60%	80%	100%
Effective rate of IHT	40%	32%	24%	16%	8%	0%

5. WORKED EXAMPLE

Bill over a period of 5 years makes the following gifts:

Gift No	Date	Sum	To	Type
(1)	18/07/2007	£100,000	Disc Trust	CLT
(2)	01/10/2010	£150,000	Son	PET
(3)	15/04/2012	£150,000	Daughter	PET

5.1 During His Lifetime

It is important to realise that the treatment of a gift changes on death.

The NRB in 2007/8 tax year was £300,000 so the Chargeable Transfer (CLT) gift (1) did not have to pay any immediate tax as it fell within the NRB.

The subsequent absolute PET gifts (2) and (3) were not subject to any tax as long as Bill did not die within 7 years.

5.2 Tax On These Gifts After Death

Bill dies on the 10th June 2016 leaving an estate worth £400,000 when the NRB was £325,000. Bill was not married so had no transferable NRB to use up.

As his gifts (2) and (3) were within 7 years of his death they become a Gross Chargeable Transfer (GCT), which means they are effectively returned to the estate. The Nil Rate Band (NRB) available for the gift is the current NRB less any gifts made in the 7 years prior to the GCT.

The gifts are taxed on an earliest basis.

5.2.1 Tax on Gift (1)

Gift (1) is over 7 years before Bill's death so is not taxed.

5.2.2 Gift (2)

NRB	£325,000
Gift (1) (made <7 years before Gift 2)	(£100,000)
NRB left	£225,000
Remaining NRB	£225,000
Gift (2)	(£150,000)
NRB left	£75,000
Tax Due	-

5.2.3 Gift (3)

NRB	£325,000
Gift (1) Gift (1) (made <7 years before Gift 3)	(£100,000)
NRB left	£225,000
Remaining NRB	£225,000
Gift (2) Gift (1) (made <7 years before Gift 3)	(£150,000)
NRB left	£75,000
Tax Due	-
Gift (3)	(£150,000)
NRB left	(£75,000)
Tax Due @ 40%	(£30,000)

Note, had Bill been married and had NRB allowances from his deceased spouse these would have been taken into account at this stage.

So the tax on the daughter's gift (3) which was made between 4 and 5 years prior to Bill's death brings into account the gift to trust and the net result is then a taxable value of £75,000. Now we can look to see if we get any taper relief on the tax.

Taxable Gift	£75,000
Tax at 40%	(£30,000)
Taper Relief On Gift (4-5 Years)@ 40%	£12,000
Net Tax Due	(£18,000)
Making The Effective IHT Rate	24.00%

Unless otherwise specified, the tax is usually paid by the recipient of the gift.

5.3 Tax On the Rest Of The Estate

For the purpose of the rest of the estate the tax due is:

Value Of Estate On Death	£400,000
Nil Rate Band	(£325,000)
Gift To Son (2) <7 Years Before Death	£150,000
Gift To Daughter (3) <7 Years Before Death	£150,000
Remaining NRB	(£25,000)
Taxable Estate	£375,000
Tax At 40%	(£150,000)

5.4 Summary

The 7 year rule (as with so many tax concessions) is not as generous as at first it seems, but nonetheless the gifts did save tax:

Bill Gave Away	£400,000
Bill's Estate Was Worth	£400,000
So Total Gifts	£800,000
Tax on Gifts	(£18,000)
Tax on estate	(£150,000)
Total Tax	(£168,000)
% Of Estate	21.00%

Had Bill not given away anything the tax would have been:

Bills Estate	£800,000
Less NRB	(£325,000)
Taxable Estate	£475,000
Tax At 40%	(£190,000)
% Of Estate	23.75%

So his generosity has saved his children £22,000 in tax.

6. OTHER IHT NOTES

We advise clients to use qualified Society of Trusts and Estate Practitioners (STEP) lawyers and/or their tax advisers when considering their inheritance tax position. We are happy to recommend suitably qualified individuals if clients need a recommendation.

We have a number of other notes relating to IHT issues, they can be found on our website under [Library](#) .

Please note that whilst every effort is made to ensure that the information contained within this explanation is correct, these notes are by necessity brief and of a generalised nature. Clients should seek specific personalised advice prior to undertaking any arrangement. These notes are named [05.2021 The 14 Year IHT Trap](#) and was last updated in May 2021. Whilst we have done our best to ensure facts are current to this date laws and options are changing constantly so always check before action.

E.&.O.E.