

GIFTING ASSETS DURING LIFE

People often consider giving away something they own, often their house, during their life thinking it will help avoid Inheritance Tax (IHT) or Long Term Health Care fees.

If you are thinking about this there are a number of things to think about. This note is only intended as a guide and should not be taken to be a comprehensive and exhaustive statement.

This note uses giving your home to your son and daughter as an example.

GENERAL CONSIDERATIONS

- 1 If you give your home to your children and then fall out with one or both of them they may force you out of your own home.
- 2 Whilst you live in your home as your 'Principal Private Residence' any increase in the value of your home is yours to keep if and when you sell. You won't have to pay Capital Gain Tax (CGT) on any gain. If you give your home to your children and they don't live with you then when your home is eventually sold your children will have to pay CGT at up to 40% on any gain made since you gifted it to them.
- 3 If you give your home to your children and then one of them gets divorced their soon to be ex-spouse may claim part of your home as part of the divorce settlement.

INHERITANCE TAX CONSIDERATIONS

- 4 If you give your home to your children and continue to live in it rent free the HM Revenue and Customs (HMRC) call this a 'Gift with Reservation of Benefits' and they will still count your home as yours when assessing your estate for IHT after you die. In other words it doesn't work. It will work if after the gift you pay your children a market rent for continuing to live in your home. Your children will have to treat the rent received as income and pay tax on it. After your death your children may have to demonstrate that the rent was at 'market' levels, that it was actually paid and that your children didn't covertly give it back to you as cash or something else.
- 5 If you give your home to your children and continue to live in it paying a less than market rent HMRC may levy a Pre-Owned Asset Tax on you. Any benefit to you from an asset you once owned, that you don't pay a market rate to continue enjoying, is taxed as income.
- 6 Note that an individual can give away free of eventual IHT liability the following: -
 - 6.1 gifts made to individuals more than seven years before your death.
 - 6.2 gifts not exceeding £3,000 in any tax year. (A tax year runs from 6 April in one year to 5 April the following year.) This applies to one gift or a number of gifts and may be used with other exemptions (except the small gifts exemption). If the total value of gifts in one year is less than £3,000 any surplus can be carried forward to the next tax year but no further.
 - 6.3 wedding gifts of up to: -
 - £5,000 for each of your children (including adopted children and step-children) or the person that your child is marrying
 - £2,500 to each grandchild, great grandchild or the person your grandchild or great grandchild is marrying
 - £1,000 to anybody else(To qualify, a wedding gift must be made on or shortly before the marriage, to one or both parties, and exemption only becomes fully effective when the marriage takes place.)
- 7 gifts to UK based charities, registered housing associations and qualifying Parliamentary political parties
- 8 gifts to national museums, universities, The National Trust and certain other bodies
- 9 gifts in any tax year up to a total of £250 to as many people as you wish, but such gifts are only exempt if the total given to any one person in any tax year is not more than £250 (You cannot use this with any other exemption for the same person.)
- 10 gifts out of your income after tax. To qualify, you must show that the gifts are a part of your normal 'usual expenditure', and leave you with sufficient income to maintain your usual standard of living. There is a vague requirement that the gifts should be or be intended to be regular in nature.

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DISCOUNTED GIFT TRUST

- 11 The DGT allows you to gift cash assets to a Trust, which is held for the ultimate benefit of your nominated beneficiaries.
- 12 When set up under a bare trust it is a potentially exempt transfer (PET) and takes 7 years to fall outside of your estate for IHT purposes. A condition of the DGT is that you take a fixed regular withdrawal for life from the Trust. You spend this withdrawal as 'income', so it does not increase the value of your estate. On setting up the arrangement, an actuarial forecast, (based on age, sex and health) is made as to how much you are going to withdraw over your lifetime. This amount is known as the donor's fund. In essence you are carving out this amount for your own benefit and it is therefore deducted from the amount you have gifted to the Trust. Consequently the PET is discounted.
- 13 For example, a male aged 70 in good health, gifting £100k and taking 5% withdrawals each year, equates to a donor's fund of £45k. It follows then for IHT purposes he has only made a gift of £55k, which takes 7 years to fall out of the estate.
- 14 The really attractive part of the arrangement is what happens to the donor's fund. While one might think it still belongs to the estate, this is in fact not the case. As the assets are in the Trust, the only access he has to the 'donor's fund' is in the form of a regular fixed withdrawal over his lifetime (5% pa) which ceases immediately on his death. It follows then, on death there is no value in the estate in respect of the residual donor's fund since it remains in the Trust, and not in his estate and hence no IHT on it. Previous withdrawals have of course been spent. The net result is that on establishing the Trust at the beginning, the donor's fund is immediately outside of the estate for IHT purposes. Once 7 years has passed, IHT is avoided on the 'deemed' gifted element, but the donor still receives withdrawals for life, regardless of how long he actually lives
- 15 While the above example illustrates the concept, with larger sums involved the DGT offers significant incentives and is a compelling proposition in the right circumstances.
- 16 For example, say £1m was gifted to the Trust in the above case, the figures would be a withdrawal of £50k p.a. for life, for the donor to spend as income (tax free in many cases) £450k removed from the estate immediately, saving £180k instantly A £550k PET, which would become fully exempt from IHT after 7 years, with savings after 3 years.
- 17 For a younger donor, the discount is even larger. For example, a 60yr old female in good health removes £670k from her estate on gifting £1m, with a 5% withdrawal.
- 18 The DGT is unprecedented in that it achieves an immediate reduction in the estate and fully exempts an asset from IHT after 7 years, yet it allows access to the asset in the form of a life long 'income' – an invaluable benefit.
- 19 HMRC recognise the DGT and outline the scheme on their website:-
<http://www.hmrc.gov.uk/manuals/ihtmanual/ihtm20424.htm>
- 20 Given the complex nature of this vehicle, and the financial consequences that can arise, one must seek suitably experienced professional advice before embarking on a DGT, or any aspect of estate planning.

LONG TERM HEALTH CARE FEES CONSIDERATIONS

- 21 Current rules say that if you need residential health care then you must pay for it yourself unless your total wealth is less than ~£20,000. If you live without a spouse/civil partner then your house will be included in counting up your wealth. If you are worth less than ~£20,000 your Local Authority will pay for you. If you give away assets deliberately to avoid paying health care fees and the Local Authority find out about it then they will still count those assets as yours and refuse to pay.
- 22 There is no time limit to the Local Authorities ability to look back at what you did. The longer the time between giving something away and needing health care the less the likelihood that the Local Authority will either notice or claim you did it to avoid health care fees. Also, if at the time of your gift you didn't suffer or expect to suffer from a condition that would lead you to expect to need Long Term Health Care this helps.

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