

Quick reference guide – Inheritance Tax

The order of gifting and the 14 year rule

This quick reference guide provides information on how the order in which donors make Potentially Exempt Transfers and Chargeable Lifetime Transfers can affect the amount of inheritance tax (IHT) payable on their death.

Types of gift

When an individual makes a gift that is not exempt from IHT, there is a transfer of value that is measured by the loss to the donor's estate immediately after the transfer is completed. A transfer of value could be either a potentially exempt transfer or an immediately chargeable transfer, also known as a chargeable lifetime transfer.

Potentially Exempt Transfers (PET) are gifts made outright by individuals to another individual or certain trusts. Whilst these gifts are not immediately taxable they only become exempt from IHT if the donor survives 7 years from the date of the gift.

Chargeable Lifetime Transfers (CLT) are gifts made by an individual but because they do not immediately pass to another individual or certain types of trust, are immediately assessable for IHT as well as on death within 7 years.

How the order of gifting can affect what IHT is payable on death

If the donor made a CLT followed by a PET, the personal representatives may have to look back 14 years prior to the donor's death to account for any chargeable gifts.

To calculate the tax on a chargeable transfer it is necessary to cumulate this with any chargeable transfers made within the 7 years prior to the gift in question. This means that when a PET fails and becomes a chargeable transfer, any other chargeable transfers made in the preceding 7 years must be taken into account. As a result a CLT made nearly 14 years before the donor died is still within cumulation.

The following example explains how the 14 year rule can arise on the death of the donor.

- Margaret died on 1 January 2019 having made the following gifts:
- On 3 January 2005 Margaret made a CLT establishing a discretionary trust with £200,000
- On 2 January 2012 Margaret made a PET gifting a property valued at £350,000 to her adult grandson



The IHT payable is as follows:

- The PET made by Margaret on 2 January 2012 becomes a chargeable transfer
- The CLT reduces the NRB that can be used against the PET as it was made within 7 years of the PET
- The NRB is assumed to be £325,000 and as death occurred more than 6 years after the PET, the IHT rate becomes 8% after taper relief
- NRB of £325,000 is reduced by the CLT of £200,000 to £125,000
- Failed PET £350,000 less NRB £125,000 = £225,000 x 8% = £18,000
- The IHT of £18,000 is payable by Margaret's grandson as the recipient of the gift
- All of Margaret's NRB has been used up by the cumulated chargeable transfers leaving none remaining to set against her estate

Advising your clients on the tax implications of making different types of gift in a particular order will enable them to make informed decisions on the best way to structure their succession and inheritance tax planning.

The information provided in this article is not intended to offer advice.

It is based on Quilter International's interpretation of the relevant law and is correct at the date shown on the title page. While we believe this interpretation to be correct, we cannot guarantee it. Quilter International cannot accept any responsibility for any action taken or refrained from being taken as a result of the information contained in this article.

www.quilterinternational.com

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Quilter International Isle of Man Limited is registered in the Isle of Man under number 24916C. Registered and Head Office: King Edward Bay House, King Edward Road, Onchan, Isle of Man, IM99 1NU, British Isles. Tel: +44 (0)1624 655 555 Fax: +44 (0)1624 611 715.

Quilter International is registered in the Isle of Man as a business name of Quilter International Isle of Man Limited.

Quilter International Ireland dac is regulated by the Central Bank of Ireland. Registered No 309649. Administration Centre for correspondence: King Edward Bay House, King Edward Road, Onchan, Isle of Man, IM99 1NU, British Isles. Tel: +353(0)1 479 3900 Fax: +353 (0)1475 1020.

Registered and Head Office address: Ashford House, 18-23 Tara Street, Dublin 2, D02 VX67, Ireland.

Quilter International is registered in Ireland as a business name of Quilter International Ireland dac.

25125/INT21-1621/October 2021

