

# Technical Insights - Quick Reference Guide

## *Inheritance Tax treatment of lifetime gifts*

This guide will provide you with the information you require to advise your clients on the Inheritance Tax (IHT) treatment of gifts made during their lifetime. For help calculating tax on existing or proposed gifts, see our [lifetime gifts tool](#).

### *Some gifts are immediately exempt*

When a long-term UK resident makes a lifetime gift, several exemptions may apply. Where an exemption applies in full, the gift is immediately outside the donor's estate. These exemptions include:

- Gifts to a spouse or civil partner
- Gifts of up to £3,000 each tax year (or £6,000 if no gift was made in the previous tax year)
- Small-gift exemption of up to £250 per recipient
- Normal expenditure out of income
- Gifts for weddings or civil partnerships

### *Where a gift is not covered by an exemption, it will either be treated as a Potentially Exempt Transfer or a Chargeable Lifetime Transfer*

A Potentially Exempt Transfer (PET) is a lifetime gift that becomes fully exempt from Inheritance Tax (IHT) once the donor survives for 7 years. There is no immediate IHT charge, regardless of the size of the gift. If the donor dies within seven years, the value of the gift is brought back into their estate for IHT purposes.

For a gift to qualify as a PET, its value must pass outright and become part of the recipient's own estate.

Common examples include:

- A cash gift to an adult child, such as helping them buy their first home. The money leaves the donor's estate and immediately increases the recipient's estate by the same amount.
- A gift into a bare (absolute) trust, where the beneficiary is absolutely entitled to the trust assets

A Chargeable Lifetime Transfer (CLT) is a lifetime gift that does not qualify as a Potentially Exempt Transfer because the value does not pass outright into the recipient's estate. As a result, the gift is immediately assessed for Inheritance Tax (IHT) when it is made.

Although a CLT becomes exempt if the donor survives 7 years, it is still subject to a lifetime IHT charge at 20% at the point of the gift. This charge only applies where, in the preceding 7-year period, the donor's cumulative CLTs exceed the Nil Rate Band (NRB) – currently £325,000.

A typical example of a CLT is a gift into a discretionary trust. Because no beneficiary has an absolute entitlement to the trust fund, the value of the gift does not form part of any beneficiary's estate, so it cannot qualify as a PET.

For more information on lifetime IHT charges on CLTs please see our quick reference guide on '[Entry Charge \(Chargeable Lifetime Transfers\)](#)'.

### *Where the donor of a PET or CLT dies within 7 years, any gifts are assessed for IHT in chronological order*

If a gift "fails" — meaning the donor dies within 7 years — the value of that gift is brought back into the estate for IHT. Each failed gift is then assessed in order, starting with the oldest, against the available Nil Rate Band (NRB). The available NRB is the NRB at death minus any CLTs made in the 7 years before each respective gift.

Any PET that fails is treated as a CLT for this calculation.

## Example

6 years prior — PET £250,000

4 years prior — PET £200,000

3 years prior — CLT £150,000

PET 6 years prior – £250,000

No earlier CLTs, so the full £325,000 NRB is available.

The gift is under the NRB, so no IHT is due.

However, because it failed, it is now treated as chargeable and reduces the remaining NRB.

PET 4 years prior – £200,000

Remaining NRB is £75,000 (£325,000 – £250,000).

The gift of £200,000 exceeds this, so part of the gift is chargeable to IHT.

CLT 3 years prior – £150,000

The two earlier failed PETs have fully used the NRB, leaving £0 available.

The full £150,000 is therefore chargeable to IHT.

### *Where the gift exceeds the NRB taper relief can help to reduce the rate of tax which applies*

IHT only applies to the portion of a failed gift that exceeds the available NRB. The standard rate is 40%, but this rate can be reduced depending on how much time has passed between making the gift and the donor's death.

This reduction is known as taper relief. Taper relief applies once 3 years have passed from the date of the gift. It reduces the rate of tax, not the value of the gift.

The taper relief bands are:

Years between gift and death	Rate of tax on the gift (instead of 40%)
3 to 4 years	32%
4 to 5 years	24%
5 to 6 years	16%
6 to 7 years	8%

## Example continued

Continuing from the earlier example. Two of the failed gifts exceed the available NRB and are liable to IHT.

Gift	Amount in excess of NRB	Tax at tapered rate
PET £200,000 (4 years prior)	£125,000	£30,000 (24%)
CLT £150,000 (3 years prior)	£150,000	£48,000 (32%)

Where a CLT has had an immediate charge at 20%, this lifetime IHT can be offset against any liability on death. However, if the lifetime charge exceeds the liability on death it can't be reclaimed.

### *The person liable to pay the IHT on the gift*

Where a gift fails and tax is payable, the initial liability for IHT falls on the following people:

- PETs – the recipient of the gift
- CLTs – the trust

If the tax is not paid within 12 months other parties can become taxable in line with s199 Inheritance Tax Act 1984.

Most recipients will not be expecting the tax and therefore have insufficient provisions to cover this. It is worth including this in any discussions with clients looking to make PETs to family and friends.

### *The order of gifting can really impact the amount of tax payable*

When advising clients on lifetime gifts, it's important to consider the order in which gifts are made. In particular, think about whether gifts to individuals (PETs) should be made before or after creating any flexible discretionary trusts (CLTs).

The sequence matters because failed PETs interact with the nil-rate band, which in turn affects the calculation of periodic and exit charges on flexible discretionary trusts.

For more information on order of gifting please refer to our article '[Order of making gifts](#)'.

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