



Private Client Law Bulletin

INHERITANCE TAX TRAPS

Most practitioners will be aware that any lifetime gift, that does not involve a reservation of benefit, falls out of account for inheritance tax purposes once the donor has survived 7 years from the date of the gift.

This is routine advice that is given to clients and is seen as an incentive to persuade clients to gift early where their circumstances permit.

Gifts made more than 7 years prior to death do not suffer inheritance tax though these gifts can increase the liability on gifts made within 7 years of death.

If for example Mrs X set up a discretionary trust on 1 January 1996 using her nil rate band and died on 1 January 2005 with an estate of £1 million the tax on her estate would be calculated without reference to the gift made in 1996.

If Mrs X made an additional lifetime gift of half a million pounds to her son on 1 January 2002 and then died on 1 January 2005, the gift on 1 January 2002 would be a failed PET. The tax on that failed PET is calculated by reference to chargeable transfers made within the previous 7 years. This catches the gift made on 1 January 1996. That gift would be deemed to have used the entire nil rate band then available and would accordingly leave the entire gift in charge to tax subject to taper relief on the tax payable. This in turn uses up the nil rate band which would otherwise have been available on death. Had the gift have been delayed by more than 12 months the nil rate band would have been renewed in its entirety and aggregation of 1996 gift would no longer have been an issue.

Accordingly practitioners should take care in advising clients over lifetime gifts, to assess the consequences of making those gifts by reference to earlier patterns of gifting. This may save tax liabilities and will also ensure that you have a complete file of gifting history which will assist in avoiding penalties on any omissions in future.

If you would like an informal chat or require any specific advice in connection with the material contained in this bulletin, or on any other Private Client issues, please contact the Liverpool office on 0151 600 3451 or the Manchester office on 0161 836 8800.

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