

CHAPTER 2

CHARGEABLE TRANSFERS

2.1 Types of chargeable transfer

Inheritance tax is charged on the value transferred by a chargeable transfer. In this chapter, we shall look at the types of transfer of value that exist for IHT purposes. We will start by looking at **chargeable transfers**.

[IHTA 1984, s.1](#)

The most common type of chargeable lifetime transfer, is a **gift to a discretionary trust**. If an individual transfers assets into a discretionary trust, there will be an immediate lifetime inheritance tax charge.

[IHTA 1984, s.2](#)

With effect from **22 March 2006**, gifts to most other trusts are also chargeable lifetime transfers. We will look at how to calculate tax on chargeable lifetime transfers in the next chapter.

Certain transfers of value are **completely exempt** from inheritance tax.

If a transfer of value is neither a chargeable transfer nor an exempt transfer, then it will fall under the definition of a "**potentially exempt transfer**" or "PET". A potentially exempt transfer is treated as **exempt whilst the donor is alive** and will **only become chargeable** to inheritance tax if the **donor dies within 7 years** of making a gift. We will look at PETs in more detail later.

Therefore the only time an individual will pay inheritance tax whilst he is alive, is if he makes a chargeable lifetime transfer - eg a gift to a trust, or pre 22 March 2006, a gift to a discretionary trust

2.2 Exempt transfers

(i) Gifts to spouse/civil partner

The transfer of any asset by an individual to his or her spouse or civil partner either during lifetime or on death, is completely exempt from IHT.

[IHTA 1984, s 18](#)

The only exception to this is if the donor spouse or civil partner is UK domiciled and the **recipient spouse or civil partner is not domiciled** in the UK. In this instance, **only the first £55,000** of the transfer is **exempt** from IHT.

[IHTA 1984, s. 18\(2\)](#)

This rule was introduced to prevent a UK domiciled person giving assets to his non-domiciled spouse/civil partner, which would then be outside the scope of inheritance tax if they were transferred abroad.

(ii) **Gifts to UK charities**

[IHTA 1984,
s. 23](#)

Gifts to UK charities or UK charitable trusts are completely exempt from IHT, without any monetary limit. Gifts to other bodies, such as **political parties, housing associations, or national heritage bodies** such as museums etc, are also completely exempt. All these exemptions apply to transfers both during the lifetime and on the death of the donor.

Gifts to non-UK charities are chargeable transfers.

(iii) **Small gifts**

[IHTA 1984,
s. 20](#)

Lifetime gifts of **up to £250** to any donee in a tax year are completely exempt from tax. This is an **"all or nothing"** exemption. For example, if an individual makes a birthday gift of £300 to his grandchild, the whole of the £300 is treated as a transfer of value, and not just the excess above £250.

There is no limit to the number of donees. Therefore if a grandparent has 100 grandchildren, he could give each of them a gift of up to £250 without making a transfer of value for IHT purposes.

(iv) **Gifts on marriage**

[IHTA 1984,
s. 22](#)

Lifetime gifts on marriage/civil partnership are also exempt from tax, up to certain limits. These limits **depend on the relationship** between the donor and the donee. A **mother or father** could give up to **£5,000** to a son or daughter as a wedding gift, and the whole amount would be exempt from tax.

A gift of **up to £2,500 from a grandparent to a grandchild** is also exempt. The same limit applies for remoter ancestors such as great-grandparents etc.

This limit also applies to gifts from the bride to the groom or vice versa. Finally, wedding gifts of **up to £1,000** can be made by **any person** free of inheritance tax.

These exemptions **apply per marriage/civil partnership**. Therefore if a father gives £5,000 to his daughter as a wedding gift, he could not give a further £1,000 to his son-in-law and claim exemptions for both gifts. These are not "all or nothing" exemptions, so only excess transfers above these limits will be treated as transfers of value for inheritance tax purposes.

(v) **Normal expenditure out of income**

[IHTA 1984,
s. 21](#)

A lifetime gift is exempt if the donor can satisfy HMRC that it constitutes "normal expenditure out of income". "Normal" in this case means **habitual** or typical - i.e. a gift that happens year after year. The gift will be treated as having been made out of the donor's income if the donor is **left with sufficient income to maintain his normal standard of living**.

This exemption would apply to life assurance premiums or personal pension premiums paid by an individual in respect of another person, or to regular small gifts of cash as Christmas or birthday presents.

(vi) **Annual exemption**

[IHTA 1984,
s. 19](#)

The annual exemption reduces the IHT value of lifetime transfers only. The annual exemption is **£3,000 per tax year**, so any individual can give away up to £3,000 of value each year, without this giving rise to an inheritance tax charge.

The annual exemption is set against gifts in **chronological order** in the tax year - i.e. against earlier gifts before later gifts.

Any unused annual exemptions may be carried forward for one tax year only. Where the annual exemption is carried forward, the **current year** exemption must be **used before** that of the **previous year**.

For example, if an individual makes a lifetime gift for the first time in 2010/11, he will first use his £3,000 annual exemption for 2010/11, and then may use the annual exemption brought forward from 2009/10. Any unused annual exemptions before 2009/10 will be wasted.

The annual exemption can be used in addition to the marriage exemption. For example, if a father makes a cash gift to his daughter on her marriage, the gift will qualify for the £5,000 wedding exemption and (potentially) two lots of annual exemption.

Illustration 1

A father gives his daughter £10,000 in December 2010 as a wedding present. First the donor will use the marriage exemption of £5,000. Next he can use any annual exemptions. The annual exemption of £3,000 is available for 2010/11. If this is the first ever gift, he has an unused exemption to bring forward from 2009/10. The donor can use £2,000 of this exemption, bringing his transfer of value for inheritance tax purposes down to zero.

	£
Gift	10,000
Less: marriage exemption	(5,000)
Less: annual exemption	
2010/11	(3,000)
2009/10 b/f	<u>(2,000)</u>
Transfer of value	<u>Nil</u>
No AE to c/fwd to 2011/12	

The £1,000 of unused exemption from 2009/10 could be used against later transfers in the tax year 2010/11, but it could not be carried forward to 2011/12, as the carry forward is for one tax year only.

2.3 Potentially exempt transfers (PETs)

[IHTA 1984, s. 3A](#)

A potentially exempt transfer is treated as **exempt whilst the donor is alive**. Therefore a PET will not give rise to a lifetime inheritance tax charge.

A potentially exempt transfer is **fully exempt if the donor survives 7 years from the date of the gift**. A PET will become a chargeable transfer if the donor dies within 7 years of making a gift. On the death of the donor within 7 years, an inheritance tax charge will be levied and any **tax will be payable by the recipient** of the gift - i.e. by the **donee**.

All gifts between individuals are potentially exempt transfers.

Before 22 March 2006, a gift by an individual to a **trust** other than a fully discretionary trust was also a potentially exempt transfer. Therefore gifts before 22 March 2006 to "**interest in possession**" trusts were PETs for IHT purposes. There was also a special type of discretionary trust for children called an "accumulation and maintenance" (A&M) trust which could have been set up before 22 March 2006. Lifetime transfer to an A&M trust were PETs. Therefore on creating these types of trust there was no IHT charge, unless the donor dies within 7 years of making the gift.

From 22 March 2006, **all gifts to trusts** (except gifts to charitable trusts or trusts for the disabled) are **chargeable transfers**. Therefore from 22 March 2006, the only example of a PET is an outright gift from one individual to another.

The value of a potentially exempt transfer for inheritance tax purposes is the value of the gift less any available exemptions.

Illustration 2

Robert made the following lifetime gifts:

May 2009	£10,000 to Oxfam
June 2009	£100,000 to his wife
July 2009	£2,000 to his son
August 2010	£10,000 to his daughter as a wedding gift
September 2011	£5,000 to his nephew
December 2011	£100 to each of his 6 grandchildren

We will illustrate how the various exemptions reduce the value of the lifetime gifts, and show the total PETs made by Robert.

Starting with the gift of £10,000 to charity in May 2009, all gifts to UK charities are exempt without limit.

Assuming Robert's wife is domiciled in the UK, this gift to his spouse is also completely exempt from tax. If his wife was non-UK domiciled, only the first £55,000 would be exempt.

The gift of £2,000 to his son is Robert's first non-exempt gift in 2009/10. The gift will qualify for the annual exemption which will reduce the transfer of value down to zero. Robert therefore has an unused exemption of £1,000 to carry forward to 2010/2011.

	£
Gift to son (July 2009)	2,000
Less: AE 2009/10	<u>(2,000)</u>
Transfer of value (PET)	<u>Nil</u>

£1,000 of unused AE to c/fwd to 2010/11.

In August 2010 Robert gave his daughter £10,000 as a wedding present. Against this we can set a marriage exemption of £5,000.

As this is the first transfer in 2010/2011, it will qualify for the £3,000 annual exemption. Robert also has £1,000 of unused exemption to bring forward from 2009/10. No other exemptions are available, so Robert has made a potentially exempt transfer of £1,000.

	£
Gift to daughter (August 2010)	10,000
Less: marriage exemption	<u>(5,000)</u>
	5,000
Less: AE 2010/11	<u>(3,000)</u>
Less: AE 2009/10 b/fwd	<u>(1,000)</u>
PET	<u>£1,000</u>

This PET will only become chargeable to inheritance tax if Robert dies within 7 years - i.e. before August 2017. If Robert is still alive in August 2017, this £1,000 becomes exempt from inheritance tax.

In September 2011 Robert gave £5,000 to his nephew. This is the first gift in 2011/2012, so will qualify for the £3,000 annual exemption. All the annual exemptions from the previous year have been used, so there is nothing to bring forward.

	£
Gift to nephew (September 2011)	5,000
Less: AE 2011/12	<u>(3,000)</u>
PET	<u>£2,000</u>

Robert therefore has a PET of £2,000 which will become chargeable only if Robert dies before September 2018.

In December 2011, Robert gave £100 to each of his six grandchildren. This gift of £600 will be completely exempt, as any individual can give up to £250 per tax year to any donee, and the gift will qualify for the small gifts exemption.

In summary, Robert has made two PETs, one in August 2010 of £1,000 and the other in September 2011 of £2,000. If Robert dies within 7 years there will be an inheritance tax charge and any IHT will be paid by the donees.

2.4 Chargeable lifetime transfers

If a transfer is not exempt or potentially exempt, it must be chargeable to inheritance tax. The most common chargeable lifetime transfers are **gifts to discretionary trusts** or gifts to **other trusts on or after 22 March 2006**.

The value of a chargeable lifetime transfer can be reduced by any available annual exemptions. It will not be possible to use either the marriage exemption or the small gifts exemption to reduce the value of a chargeable lifetime transfer.

Technically a **gift to a company** is also a chargeable lifetime transfer. In practice this is very rare, because when an individual transfers money to a company, he or she will usually get either shares or loan stock in return. If an individual buys shares or loan stock in a company, there is no loss to donor as a result of the transfer, so there are no IHT consequences.

However, if an individual transfers assets to a company and receives nothing in return - i.e. there is a genuine gift - this will be a chargeable lifetime transfer. In the next session we shall look at how we calculate inheritance tax on chargeable lifetime transfers.

2.5 “Excluded property”

[IHTA 1984, s. 6](#)

Transfers of excluded property are outside the scope of inheritance tax.

There is **no general concept of an exempt asset** for inheritance tax purposes. Assets such as cars and ISAs are exempt from CGT, however they are chargeable assets for IHT purposes. Therefore if a grandparent gives his grandson a brand new car as a birthday present, he has made a potentially exempt transfer equal to the value of the car less any available exemptions.

Non-UK assets owned by individuals not domiciled in the UK are excluded property. Therefore if an American national is living in the UK such that he is resident but not domiciled, any assets which are situated outside the UK - be they in the United States or anywhere else - are excluded property. Any transfers of those assets will not give rise to an inheritance tax charge.

Certain other assets will also be regarded as excluded property. We will not go into these in this session, but the laws can be found in Sections 6, 48, and 157 of IHTA 1984.

Example 1

Tara made the following lifetime gifts:

June 2009	£1,000 to son
June 2010	£4,000 to daughter
June 2011	£7,500 to best friend as a wedding gift

Calculate the total potentially exempt transfers made by Tara.

Example 2

Which of the following are potentially exempt transfers for IHT?

	Yes	No
(a) Gift to spouse	✓	X
(b) Gift to grandson		
(c) Gift to accumulation and maintenance trust in 2005		
(d) Gift to a discretionary trust		
(e) Gift to an interest in possession trust in 2010		
(f) Gift to a charitable trust		

Answer 1

		£
June 2009	Gift to son	1,000
	Less: AE 2009/10	<u>(1,000)</u>
		<u>Nil</u>
		£
June 2010	Gift to daughter	4,000
	Less: AE 2010/11	(3,000)
	Less: AE 2009/10 b/f	<u>(1,000)</u>
		<u>Nil</u>
The remaining £1,000 AE for 2009/10 is wasted.		
		£
June 2011	Wedding gift to friend	7,500
	Less: marriage exemption	(1,000)
	Less: AE 2011/12	<u>(3,000)</u>
	PET	<u>£3,500</u>

Answer 2*Potentially exempt transfer?*

	Yes	No	
a) Gift to spouse		X	(Exempt)
b) Gift to grandson	✓		
c) Gift to A&M trust in 2005	✓		
d) Gift to discretionary trust		X	(CLT)
e) Gift to interest in possession trust in 2010		X	(CLT)
f) Gift to charitable trust		X	(Exempt)

Note:

The tax treatment of gifts to interest in possession trusts or A&M trusts has changed w.e.f. 22 March 2006. It is not possible to set-up an A&M trust from 22 March 2006.