

CHAPTER 3

CHARGEABLE LIFETIME TRANSFERS: CALCULATION OF TAX

3.1 Basic principles

[IHTA 1984, s. 7](#)

If a donor gifts assets into a discretionary trust, this is a chargeable lifetime transfer (CLT) for IHT purposes. Gifts to interest in possession (IIP) trusts on or after 22 March 2006, are also chargeable lifetime transfers.

We will therefore have to calculate the IHT due. This tax will **either be paid by the donor or by the trustees**. In this chapter we will assume that the trustees pay any IHT due.

When calculating inheritance tax, a “**nil band**” is available. This is simply a band within which IHT is “charged” at 0%. For transfers in 2010/11, the nil band is **£325,000**. The IHT nil bands for previous years are given in your tax tables at the front of this manual.

Inheritance tax is only payable if chargeable lifetime transfers exceed the IHT nil band. This is a very generous way of charging tax and is one of the reasons why inheritance tax brings in only a modest amount of revenue for the Government.

We start by calculating the **value transferred**, measured in terms of the loss to donor. We **deduct any available annual exemptions** to leave a chargeable lifetime transfer. By “chargeable lifetime transfer” we mean the gift less any available exemptions.

From the CLT we **deduct the available nil band**. The chargeable transfer in **excess** of the nil band will be charged to inheritance tax. The **trustees will pay inheritance tax at the lifetime rate of 20%**.

Illustration 1

Nigel set up a discretionary trust in December 2010 with cash of £500,000. Nigel's only previous gift had been £1,000 to his son in June 2009. This PET will use some of the annual exemption for the tax year 2009/10.

The value transferred by Nigel in December 2010 is £500,000. We deduct the annual exemption of £3,000 for 2010/11. £2,000 of the annual exemption for the previous year is still available and can be brought forward. After deducting annual exemptions, Nigel has made a chargeable lifetime transfer of £495,000.

| | |
|-----------------------------|----------------|
| | £ |
| Gift to discretionary trust | 500,000 |
| Less: AE 2010/11 | (3,000) |
| Less: AE 2009/10 b/fwd | <u>(2,000)</u> |
| CLT | <u>495,000</u> |

The nil band for 2010/11 is £325,000. IHT will be chargeable on the excess above the nil band. The trustees will pay IHT on the chargeable amount at 20%.

[IHTA 1984,
Sch 1](#)

| | |
|--------------------------------|------------------|
| | £ |
| CLT | 495,000 |
| Less: nil band at date of gift | <u>(325,000)</u> |
| Chargeable to IHT | <u>170,000</u> |
| IHT @ 20% | <u>£34,000</u> |

3.2 "Cumulation"

Unfortunately the calculation of lifetime inheritance tax is not quite this simple, as we need to consider the concept of "**cumulation**".

Inheritance tax is a "cumulative" tax. This means that when calculating inheritance tax, we need to take account of **any other chargeable lifetime transfers** made by the donor **in the previous 7 years**.

For example, if a donor makes a gift to a discretionary trust in March 2011, the tax payable by the trustees in 2010/11 will be affected by any other chargeable lifetime transfers in the previous 7 years. Therefore to work out the IHT due on the March 2011 transfer, we must take account of any other CLTs the donor has made since March 2004. CLTs in this **7 year "cumulation period"** will use up **all or part of the nil band** for 2010/11.

| | |
|---|------------|
| | £ |
| Nil band at date of gift (2010/11) | 325,000 |
| Less: chargeable lifetime transfers in previous 7 years | <u>(X)</u> |
| Nil band remaining | <u>X</u> |

The chargeable transfer in excess of this **remaining** nil band is taxed at 20%.

Therefore if chargeable lifetime transfers between March 2004 and March 2011 had exceeded £325,000, none of the 2010/11 nil band is remaining. The whole of the chargeable lifetime transfer would then be fully taxable at 20%.

Note that it is only chargeable lifetime transfers which use up the nil band. **PETs are not chargeable transfers**, so these can be ignored when looking back 7 years.

Illustration 2

In December 2010, Peter made a gift to a discretionary trust of £200,000. He had previously made a chargeable lifetime transfer (after exemptions) of £155,000 in March 2004.

The gift in December 2010 will qualify for annual exemptions. Peter has an annual exemption for 2010/11 as well as an annual exemption for the previous year to bring forward.

| | |
|---|----------------|
| | £ |
| Gift to discretionary trust (December 2010) | 200,000 |
| Less: AE 2010/11 | (3,000) |
| Less: AE 2009/10 b/fwd | <u>(3,000)</u> |
| Chargeable lifetime transfer | <u>194,000</u> |

The nil band for 2010/11 is £325,000. However, we must look back 7 years to see if Peter has made any other chargeable lifetime transfers in this cumulation period. In the 7 years before December 2010, Peter's chargeable lifetime transfers have totalled £155,000. This uses up part of the nil band, such that the nil band remaining is £170,000.

| | |
|--|------------------|
| | £ |
| Nil band at date of gift | 325,000 |
| Less: chargeable transfers in previous 7 years | <u>(155,000)</u> |
| Nil band remaining | <u>£170,000</u> |

The amount chargeable to inheritance tax is therefore the CLT of £194,000 less the remaining nil band, giving a taxable amount of £24,000. The trustees will pay inheritance tax on this at 20%.

| | |
|--------------------------|------------------|
| | £ |
| CLT | 194,000 |
| Less: nil band remaining | <u>(170,000)</u> |
| Taxable | <u>24,000</u> |
| IHT @ 20% | <u>£4,800</u> |

Procedure for calculating lifetime tax:

- (i) Identify the "value transferred" - i.e. using "loss to donor" principle;
- (ii) Deduct annual exemptions to arrive at the chargeable lifetime transfer;
- (iii) Identify nil band for year of transfer;
- (iv) Deduct other chargeable transfers in the 7 years before the gift to arrive at the nil band remaining;
- (v) The excess lifetime transfer over the nil band remaining is charged at 20%.

3.3 The effect of potentially exempt transfers

We only calculate lifetime inheritance tax on chargeable lifetime transfers. **A PET is not a chargeable transfer so there is no lifetime tax.**

HMRC will regard a PET as being an exempt transfer whilst the donor is alive. Therefore potentially exempt transfers will have no effect on the remaining nil band. Therefore, when calculating lifetime inheritance tax, any PETs can be virtually ignored.

The only reason we consider PETs whilst the donor is alive, is because they will **use up any available annual exemptions**. Annual exemptions are given chronologically against gifts in the year, regardless of whether those gifts are potentially exempt or fully chargeable.

As a tax planning point, donors should try and make sure that chargeable lifetime transfers are made before PETs wherever possible. By making a chargeable transfer before a PET, the donor is ensuring that the annual exemptions will reduce any lifetime inheritance tax.

Illustration 3

In June 2005, Sonia made a chargeable lifetime transfer (after annual exemptions) of £118,000. In June 2010, Sonia gave £10,000 to her son. Against this we will allocate the annual exemptions for 2010/11 and for the previous year. The PET is therefore £4,000.

| | |
|------------------------|----------------|
| | £ |
| Gift (June 2010) | 10,000 |
| Less: AE 2010/11 | (3,000) |
| Less: AE 2009/10 b/fwd | <u>(3,000)</u> |
| PET | <u>4,000</u> |

In July 2010 Sonia gave £210,000 to a discretionary trust. The annual exemptions for 2010/11 and the previous year have been set against the PET, so Sonia has a CLT of £210,000. This will be immediately chargeable to inheritance tax.

As the transfer takes place in 2010/11 we start with an available nil band of £325,000. From this we deduct any other chargeable lifetime transfers made in the 7 years before the gift.

If we go back 7 years from July 2010, the only CLT in this cumulation period is the £118,000 made in June 2005.

| | |
|---|------------------|
| | £ |
| Nil band at date of gift | 325,000 |
| Less: chargeable transfers in the 7 years before July 2010 | <u>(118,000)</u> |
| Nil band remaining | <u>£207,000</u> |
| <i>Tax</i> | |
| Chargeable lifetime transfer | 210,000 |
| Less: nil band remaining | <u>(207,000)</u> |
| Taxable | <u>3,000</u> |
| IHT @ 20% | <u>£600</u> |

We ignore the PET of £4,000 because this PET is not a chargeable transfer. The only effect of the potentially exempt transfer is to use up the annual exemptions for the current year and the preceding year. The PET is ignored when it comes to working out the available nil band.

As a planning point, it would have been more sensible for Sonia to have made the PET after the CLT, so that £6,000 worth of annual exemptions could have been taken into account when calculating the lifetime inheritance tax. This would have reduced the tax to nil.

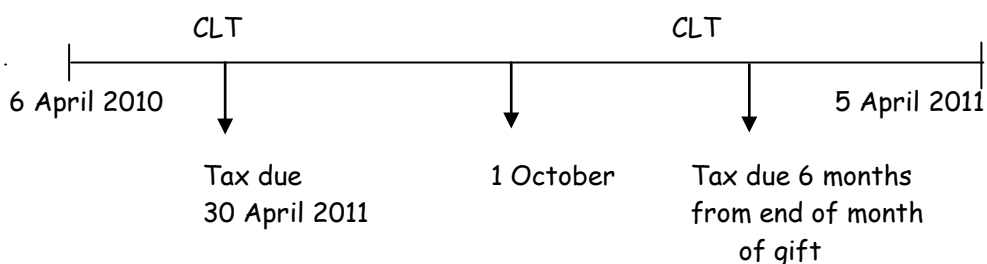
3.4 Due dates

[IHTA 1984,
s. 226](#)

Lifetime IHT is due either;

- (i) 6 months from end of month of gift, or
(ii) 30 April in following tax year } whichever is later

Consider chargeable lifetime transfers made between 6 April 2010 and 5 April 2011. We split this year in half either side of 1 October 2010.



If a chargeable lifetime transfer is made in the **first half of the year**, inheritance tax will always be payable on the following 30 April.

If a chargeable lifetime transfer is made **between 1 October and the end of the tax year**, the tax will always be due **6 months from the end of the month of the gift**.

3.5 IHT returns

[IHTA 1984, s. 216](#)

All chargeable lifetime transfers (subject to some exceptions mentioned in the chapters on administration) must be **reported** by the donor to HMRC. There is no requirement for a potentially exempt transfer to be included on any tax returns. PETs only need to be reported to HMRC if the donor dies within 7 years.

On making a chargeable lifetime transfer, the donor must send in form **IHT 100** to HMRC Inheritance Tax. The HMRC Inheritance Tax is responsible for the administration of inheritance tax in the UK.

The time limit for submission of an IHT return, is **12 months from the end of the month in which the CLT was made**. Therefore if a donor makes a gift to a discretionary trust on 15 June 2010, the IHT 100 must be submitted no later than 30 June 2011.

Example 1

Vernon makes a cash gift of £150,000 to a discretionary trust in May 2010. He had set up the trust in July 2005 with cash of £305,000.

His only other gift had been a birthday gift of £10,000 to his brother in August 2009.

Calculate the IHT payable on the gift in May 2010.

Example 2

Stanley set up a discretionary trust with £500,000 in cash on 17 November 2009.

Show the due dates for payment of tax and the submission of form IHT 100.

Answer 1

(i)

| | |
|---|----------------|
| | £ |
| Gift to discretionary trust (July 2005) | 305,000 |
| Less: AE 2005/06 | (3,000) |
| Less: AE 2004/05 b/fwd | <u>(3,000)</u> |
| CLT | <u>299,000</u> |

(ii)

| | |
|-------------------------------|----------------|
| | £ |
| Gift to brother (August 2009) | 10,000 |
| Less: AE 2009/10 | (3,000) |
| Less: AE 2008/09 b/fwd | <u>(3,000)</u> |
| PET | <u>4,000</u> |

(iii)

| | |
|--|------------|
| | £ |
| Gift to discretionary trust (May 2010) | 150,000 |
| Less: AE 2010/11 | (3,000) |
| Less: AE 2009/10 (used against PET) | <u>Nil</u> |
| CLT | 147,000 |

| | | |
|---|------------------|-----------------------|
| Nil band 2010/11 | 325,000 | |
| Less: chargeable transfers in previous 7 years (i.e. ignoring PET) | <u>(299,000)</u> | |
| Nil band remaining | | <u>(26,000)</u> |
| Taxable | | <u>£121,000</u> |
| IHT @ 20% | | <u>£24,200</u> |

Answer 2

IHT due later of;

- (i) 6 months from end of month of transfer = 31 May 2010
- (ii) 30 April following = 30 April 2010

IHT therefore due 31 May 2010.

IHT 100 due
- 12 months from end of month of transfer = 30 November 2010