

# Gift Inter Vivos

## The inheritance tax implications of making gifts

Making gifts to family and friends is an effective way to reduce a future inheritance tax (IHT) bill. But, unless it's an exempt gift, anything someone gives away is either regarded as a potentially exempt transfer or a chargeable lifetime transfer and will take seven years to leave their estate for IHT purposes.

If the person making the gift dies before the end of the seven years, the value of the gift will fall back into their estate and will need to be accounted for in the IHT calculation.

Taper relief is available on some gifts. This reduces the IHT payable on those gifts from 40% in years one to three, to 8% in year 7 (see box).

Not all gifts qualify for taper relief. When assessing an estate's IHT liability, gifts are the first to count towards the nil rate band. Therefore, it's only possible to benefit from taper relief where the value of gifts in the seven-year period exceed the nil rate band, which is £325,000 in the 2021/22 tax year.

There's a further particularly nasty sting in the tail. Where a gift does carry an IHT liability, the taxman will expect the recipient of the gift to pay it.

Taper relief		
Years between gift and death	Taper relief applied to tax due	Effective tax rate
Less than 3	0%	40%
3-4	20%	32%
4-5	40%	24%
5-6	60%	16%
6-7	80%	8%
7+	100%	0%



## Planning opportunities

As nobody wants to make a gift that carries the risk of an IHT bill a few years down the line, life assurance can be taken out to cover this future liability if it does arise.

Specific Gift Inter Vivos policies are available that provide a decreasing level of cover over a seven-year term to match the IHT liability. But, as the market for these policies is small, rates aren't particularly competitive.

Instead, the IHT planning benefits can be replicated by taking out a series of five level term assurance policies. To match the decreasing IHT liability, the five policies would run for three, four, five, six and seven years respectively, with each covering a fifth of the potential bill.

As well as the potential for more competitive rates, using a series of policies has additional benefits. As the shorter-term policies expire, the total premium reduces. It's also really flexible, making it easy to cover any further gifts that are made.

## Example case study

Seventy-three-year-old Martin is a widower and wants to help his five grandchildren on to the property ladder, giving each of them £100,000. Although his health is good, he'd like them to get full benefit from these gifts so he decides to cover any IHT liability that would arise if he dies prematurely.

Assuming he hasn't made any other gifts in the last seven years, the £500,000 he's given to his grandchildren is £175,000 over his nil rate band. This would trigger a £70,000 IHT liability if he dies in the first three years, with this falling to £14,000 by year seven.

His adviser recommends taking out five level term assurance policies to cover this liability, each for £14,000, and running for three, four, five, six and seven years respectively. The policies are written in trust to ensure the proceeds are available to pay the IHT liability if Martin dies before the end of the seven years.

If Martin and his wife had taken out a Joint Life Second Event (JLSE) term policy with us for £200,000 to cover his existing IHT liability (£500,000 x 40%) and then made gifts, he could still take out five level term assurance policies each for £14,000 for three, four, five, six and seven years respectively with no underwriting. This would reduce his JLSE sum assured down to £130,000. If Martin decides to make further gifts in the future, he could use this option again and if his IHT liability were to increase, he could use our Milestone Benefit to increase cover by up to £200,000 with no underwriting.

## Joint Life Second Event Gift Inter Vivos option

If a customer takes out a JLSE term policy with us to cover their existing IHT liability and then decides to make gifts, the Gift Inter Vivos option will allow them to 'exchange' some of their JLSE cover for a series of five level term assurance policies without the need for underwriting. The JLSE cover will reduce by the total sum assured of the five policies, as the overall IHT liability in the customer's estate will have reduced as a result of the gift.

## Example case study

Mark and Emma live in Bath, Somerset, and they're both sixty years old. They have a daughter (Sonia, 30) and a son (David, 33) who both have small children. Mark and Emma's house is currently valued at £800,000 and they have other assets totalling £200,000. Mark's dad recently passed away and left them £1,000,000 in property and investments. They haven't used any of their nil-rate bands (NRBs) previously, so they have £1,000,000 in NRBs and residence NRBs. This means that the remaining £1,000,000 of their estate is subject to 40% inheritance tax, creating a potential IHT bill of £400,000. Their financial adviser recommends that they take out a JLSE term policy up to age 89, with a sum assured of £400,000. This is likely a more cost-effective solution, as a Zurich JLSE term policy is on average approximately 50% cheaper than a Zurich Whole of Life policy.