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Lifetime gifts - the nil band for inheritance tax

A look at the nil band for inheritance tax by Amanda Edwards

Betsy and Harriet go to see their solicitor, Mrs Stern, about their uncle Ted's will. Uncle Ted died recently, leaving an estate valued at around GBP1 million to Betsy and Harriet in equal shares. He had been ill for a few years and, knowing that he had a terminal illness, in 2009 made a large gift of GBP325,000 (equal to the amount of the inheritance tax (IHT) free nil rate band) to his third niece, Heidi, as she was in financial difficulties and was about to lose her house.

Uncle Ted had assured Betsy and Harriet that he would leave them everything else in his will and that this should all turn out more or less equally. He had taken advice and had been told (mistakenly) Heidi would bear her share of the IHT on the gift. The aim was that each of the three nieces would receive roughly the same amount. Uncle Ted was happy that even if Heidi got slightly less from his estate, she would have had the benefit of getting her money early.

His will stated that any IHT on lifetime gifts should be paid by the donee, as is the case under the general law.¹ If the donee does not pay the IHT due on the gift within 12 months of the end of the month of the death of the transferor, the executors have a secondary liability² to settle the IHT that has become due on the lifetime gift.

Mrs Stern explains to Betsy and Harriet that as the gift to Heidi is exactly the nil rate band amount (still GBP325,000 in 2011) there is in fact no IHT at all on the gift, so Heidi has no IHT to pay.

The residue of the estate, which Betsy and Harriet receive, is the GBP1 million remaining at the date of Uncle Ted's death, and this is divided equally between them. Because the nil rate band has been fully used by the gift to Heidi, the residuary estate bears IHT at the full rate of 40 per cent. IHT on GBP1 million at 40 per cent is GBP400,000, leaving net residue of GBP600,000 to be divided equally. This leaves Betsy and Harriet with GBP300,000 each, less the costs of administering the estate, compared with the GBP325,000 which Heidi received. Betsy and Harriet are rather upset and ask how this has come about.

Mrs Stern explains that there must have been a misunderstanding as to the IHT effect of the gift to Heidi if Uncle Ted died within seven years. The unintended result is that the whole nil rate band has been used on the gift, solely for Heidi's benefit.

Mrs Stern explains that Betsy and Harriet may have a claim against the solicitor or will writer who gave the advice, as disappointed residuary beneficiaries. They may have lost out as a result of the advisor not warning Uncle Ted that Heidi would pay no IHT at all because she benefited from the nil rate band. Taper relief, which can reduce the IHT payable on a potentially exempt transfer that becomes chargeable, does not apply to the gift to Heidi because the value transferred is within the nil rate band for IHT, for which the rate of tax is 0 per cent.

The merits of any claim will depend on the advisors' retainer and various other factors, which are beyond the scope of this article.

❖ ¹Section 199(2) Inheritance Tax Act 1984

• [2](#)Section 204(8) Inheritance Tax Act 1984

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