COLUMBIA THREADNEEDLE INVESTMENTS

Recording lifetime gifts – why bother?

Key takeaways:

- Understand the benefits of recording lifetime gifts
- Understand the responsibilities of the deceased's personal representatives
- Know the penalties for inaccurate record keeping

Category:
Estate and Trust Planning

Estate planning can involve many different strategies, some more sophisticated and complicated than others. Perhaps the simplest strategy, for those willing to entertain it, is simply to give assets away. Although this is the easiest way to pass on your wealth, even straightforward gifts should be adequately documented and recorded, to avoid potential problems for your beneficiaries.

Background

When gifts are made, there are inheritance tax (IHT) issues to consider. But the person making the gift might be unaware of these, unless they have the benefit of professional advice. In January 2019, HMRC published a report by The National Centre for Social Research (NatCen) in collaboration with The Institute for Fiscal Studies (IFS) called **"Lifetime gifting: reliefs, exemptions and behaviours"**.

The report says:

"Fewer than half (45%) of gifters reported being aware of IHT rules or exemptions when they gave their largest gift. Of this group 18% reported that the rules influenced that gift, equivalent to 8% of all gifters.

Knowledge of IHT rules amongst gifters was low, and not associated with gifting behaviour. There was no significant association between the number or value of gifts and the level of knowledge of IHT rules, as measured by responses to a series of true or false statements and a self-assessment of confidence about their knowledge. Only 25% of gifters could be classified as having a 'working knowledge' of IHT rules on these measures."

“Why do I need to record gifts, and who would know if I didn’t?”

Let’s consider why it’s important to document your gifts, and why failure to adequately record your intentions can cause problems.

Resulting trusts and the presumption of advancement

Where there is a voluntary transfer of personal property into the name of another person, there is a general presumption that the transferee (the person receiving the property) will hold the property on a resulting trust for the transferor (the person transferring the property).

In other words, unless it is clear that the transfer of property was a gift, it may well be argued that the person receiving the property is simply holding that property on trust for the person that gave it to them.

This may seem unlikely to occur in the “real world”, but consider the responsibility of the deceased’s personal representatives to make reasonable efforts to identify any debts to the estate and pursue repayment. If the personal representatives discovered that the deceased had transferred a sum of money to a relative to help with a house purchase, they’d have to decide if that was a gift or a loan. If the personal representatives regard it as a loan, they should pursue repayment.

An interesting exception to the presumption of a resulting trust occurs where the transferor is deemed to have an obligation to provide for or support the recipient, such as a gift from a husband to a wife or a gift from a father to a child. In this situation, there is a presumption that the donor has “advanced” the property and that they have given it away. Interestingly, this does not apply in respect of gifts from wives to husbands or mothers to children!

Although the presumption of advancement was to be repealed by The Equalities Act 2010 (s199), at the time of writing, this section of the Act is not yet enacted, so the presumption (and the gender inequality) may still apply.

Both the presumption of a resulting trust and the presumption of advancement would be subject to evidence to the contrary. That’s why it’s useful and important to document the nature of the transactions to provide evidence of your real intentions.

Lifetime gifts and IHT

Outright gifts to individuals, in excess of the donor’s IHT gift allowances, are referred to as Potentially Exempt Transfers (PETs). Although the asset has left the donor’s estate, it remains “on account” for IHT purposes for seven years. This means that, on the death of the donor within seven years of making the gift, the failed PET will have first call upon the deceased’s Nil Rate Band (NRB) before the estate. It may attract an IHT charge if it actually exceeds the available NRB.

When dealing with the administration of the deceased’s estate, the personal representatives must make reasonable enquiries about gifts made by the deceased in the seven years prior to death. Failure to account for lifetime gifts could result in the personal representatives applying a larger amount of NRB than is actually available to the estate. This could lead to a lower amount of IHT being paid than was due, leading to fines and penalties.

But it is not just good practice to document your lifetime gifts in order to protect your personal representatives and make the administration of your estate easier. You should also consider the possible impact upon those you have made the gifts to.

The responsibility of the person receiving the gift

Many people will not realise that they have a responsibility to declare gifts received from the deceased in the seven years prior to their death. The case of Hutchings v HMRC (2015) illustrates the importance of this. Despite the executors requesting details from the deceased’s family of any lifetime gifts, one of the children failed to disclose a substantial gift of c£443,000 in the form of funds transferred to a Swiss bank account. The executors duly submitted the IHT return without knowledge of this gift.

Apparently, the HMRC received an anonymous tip-off and investigated. Of course, not only should the failed PET have attracted an IHT charge, it also rendered the executors’ account of the estate inaccurate. The executors would have inappropriately applied the NRB to the estate when the NRB had actually been used up by the gift to the son. The son was found to be not only liable for the tax due on the failed PET, but also subject to a c£87,000 penalty because of tax underpaid in respect of the rest of the estate due to his non-disclosure.

“Why do I need to record gifts, and who would know if I didn’t?” (continued)

Tax and penalties – be aware!

While under-declaration of tax may be due to the personal representatives failing to perform their duties diligently; the above-mentioned case of Hutchings v HMRC demonstrates that it could also be attributable to the person who received the gift failing to tell the personal representative about it.

Personal representatives who submit an inaccurate IHT return prepared on the basis of information given by family members or other third parties must show that they took all reasonable steps to ascertain that the information was correct or they may face a penalty.

However, it is also important to note that there is an obligation on the recipient of the gift to report it under Schedule 24 Para 1A Finance Act 2007. The approach taken by HMRC is that failure to tell the personal representative of any such gifts and failure to report the gift will be considered primarily as deliberate behaviour. The minimum penalty in these circumstances is 50% of the tax undeclared and could be up to 100% of the undeclared tax.

Record keeping – consider IHT403

A clear record of gifts made should make the personal representatives’ job easier, avoid deliberate or inadvertent failure to disclose gifts and avoid unnecessary penalties. Although intended for use by your personal representatives when dealing with the administration of your estate, you could consider maintaining a record of your lifetime gifts using the IHT schedule IHT403. This schedule can be particularly useful for maintaining a record of income and expenditure should you wish to claim that gifts have been made out of surplus income and so qualify for the ‘normal expenditure out of income exemption’.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/917890/IHT403-05-20.pdf

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