DART CAPITAL

A Guide to Gifting

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CISI Paraplaner of the Year 2017

Kirsty joined Dart Capital in February 2016 as a Paraplanner. Having graduated with a Law degree, Kirsty began her career in financial services working closely with advisers in a paraplanning role and more recently specialising in pensions.

As a Senior Paraplanner, Kirsty is responsible for assisting the Investment Managers with the more specific financial planning needs of Dart's clients. Kirsty was awarded the Paraplanner of the Year 2017 title by the Chartered Institute of Securities and Investments, recognising both her technical knowledge and ability to apply this to individual client needs

Kirsty holds the Diploma in Regulated Financial Planning and is working towards becoming accredited as a Chartered Financial Planner.

With growing concerns about potential inheritance tax liability on death, we are increasingly encouraging conversations with our clients regarding the importance of and the ability to gift assets in their lifetime.

Gifts permitted by HMRC

It is first important to establish how and when gifts can be made, in particular the types of gifts which HMRC permit without risking an inheritance tax liability. The key allowances are outlined below:

1. **Annual gift allowance of £3,000**

   This figure is the total amount, per person, which can be gifted to children, grandchildren or anyone else for that matter, without paying inheritance tax.

   If the allowance for the previous tax year has not been utilised, this can be carried forward to the next year. Therefore, if no gifts were made in 2017/18, a total of £6,000 can be gifted in the 2018/19 tax year by each person. If you are part of a couple, the combined gift in theory can be £12,000.

2. **Small gift exemption of £250**

   Small cash gifts of £250 can be paid to multiple people without incurring a tax liability on death. However, it must not be forgotten that you are unable to gift both £250 and the above £3,000 allowance to the same person.

3. **Special occasions of £various**

   Parents can give up to £5,000 to each of their children as a wedding or civil partnership gift, tax free. Similarly, £2,500 can be gifted to grandchildren on the same basis with a lesser £1,000 being permissible to anyone else.

4. **Regular gifts from income with no limit**

   This final form of gifting is slightly more complex and ultimately relies on the individual's financial arrangements. In brief, legislation allows for gifts of any size to be deemed exempt should they satisfy the following criteria:

   - The gifts are made out of normal expenditure,
   - Have been made out of income,
   - After allowing for such gifts, the individual is left with enough income to maintain his/her normal standard of living; and
   - The payments are deemed to be habitual or regular

   Whilst there is no limit on the amount which can be gifted, the key point here is that the gifts must come from income rather than being drawn from capital. This is to say that gifts cannot be drawn from ISAs or investment bonds for example; they must instead be met by employment income or pension income.

   These gifts cannot affect your lifestyle or leave you resorting to capital to meet your normal living expenses. In addition, HMRC will look more favourably on such gifts should they be made on a regular basis such as monthly, annually or perhaps at regular term dates should the gifts relate to education costs.

   It is important to note that such regular gift arrangements will not be confirmed as exempt from inheritance tax until HMRC have confirmed that they qualify – which will only be established when the estate is being reviewed post-death.

   Such gifts are deemed outside of the estate for inheritance tax purposes immediately and do not fall in the seven year rule (potentially exempt gift) discussed later.

Potentially exempt gifts

Many individuals will be aware that there remains the option to make a significant lump sum gift in the hope of surviving seven years, at which point the gift will no longer fall within your estate on death and would therefore not be subject to inheritance tax.

If you do not survive the full seven years post-gifting, the money that had been gifted will use part of your nil-rate band (currently £325,000). This figure is available to offset against your total estate and the gifts may therefore result in the beneficiary being liable for an inheritance tax bill.

Therefore, deathbed gifting rarely provides a true benefit to the recipient and Dart Capital takes the view that gifts should be made whilst you remain in good health and have a reasonable expectation that you will survive the seven years required.

Trust arrangements

A trust can often provide a number of advantages when gifting funds to children or more often grandchildren. One key attraction of such an arrangement is the ability to retain an element of control as to how and when the funds are paid to the beneficiaries.

A discretionary trust in particular offers a higher level of control being retained by the parent or grandparent as a trustee, however can often be more complex and less tax efficient than a simple bare trust arrangement; whereby the child is able to demand payment of the trust assets on their eighteenth birthday. Whilst in Dart Capital's experience the children and grandchildren of our clients have historically had more sense than to waste away their gifted assets, we remain acutely aware that this is a key concern when gifts are made on an outright basis.

If you are considering establishing a trust, it is important to take note of the increasing reporting requirements on such arrangements and may wish to discuss the suitability of the arrangement with your family solicitor.

Keep a record

Where gifts are made in any given tax year, it is important to keep a record evidencing the gift and the basis on which it has been made – this is especially significant if the hope is for these gifts to be deemed to be met from normal expenditure. A simple letter on an annual basis confirming a gift has been made as part of normal expenditure, has been made out of income and has not affected your standard of living would provide strong evidence to provide HMRC on your death as to why the gifts should be treated as exempt.

The value of the gift

Whilst there are tax efficient ways to gift capital to children or grandchildren, the fundamental question to ask yourself is, how much can I afford to gift? Our priority will always remain ensuring that each of our clients are able to live long and comfortable lives, with as little compromise on their quality of life as possible. Therefore, whilst we appreciate and respect the aspiration to efficiently pass funds to the next generation; gifting should only be undertaken following a detailed exploration of all the options available.

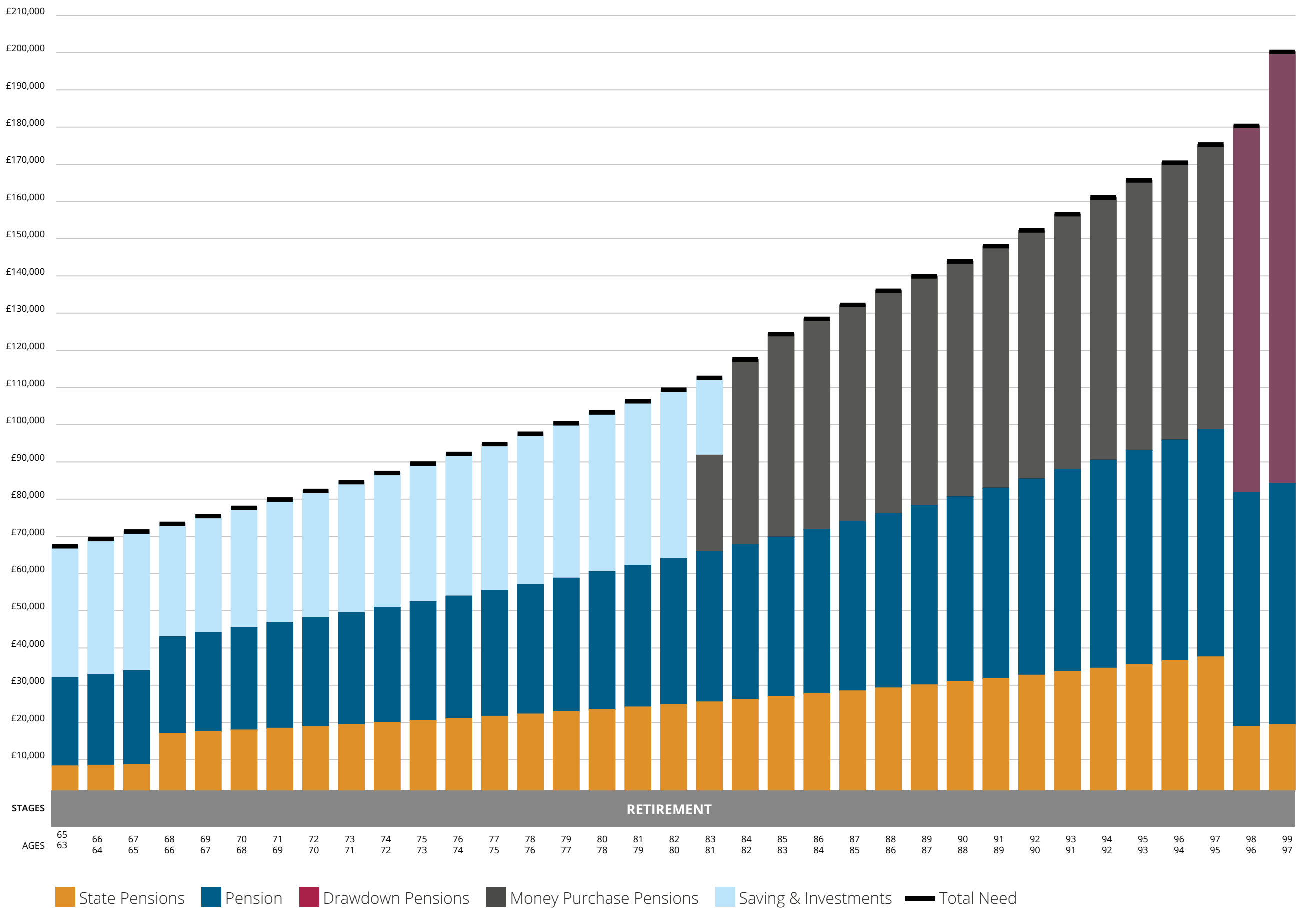
It is therefore important to forecast the likely estate on death and work back from here. Using financial planning software within Dart Capital, we are able to provide the best and worst case scenarios for the financial health of each client – ultimately agreeing that people are often likely to fall somewhere in between the two. Should there be an obvious possibility of excess capital being left on death, then gifting earlier rather than later can often prove the most efficient way to provide a legacy.

In our experience, such gifts are often made to fund property purchases for children given the increasing challenge this generation face when trying to get onto the property ladder. The financial forecasts over the next few pages demonstrate the impact gifts can have on the long term sustainability of a typical client who wishes to provide two lump sums to help their children purchase a property. We have illustrated a desired gift of £125,000 to each of their two children over the next 4 years.

The planning software enables Dart Capital and the client to agree a realistic figure which can be gifted without jeopardising their own financial security. The plans themselves are cash flow forecasts which represent the income requirements for the clients throughout their lifetimes and the ability of their invested assets and guaranteed income, such as final salary pensions or state pensions, to meet their daily living costs.

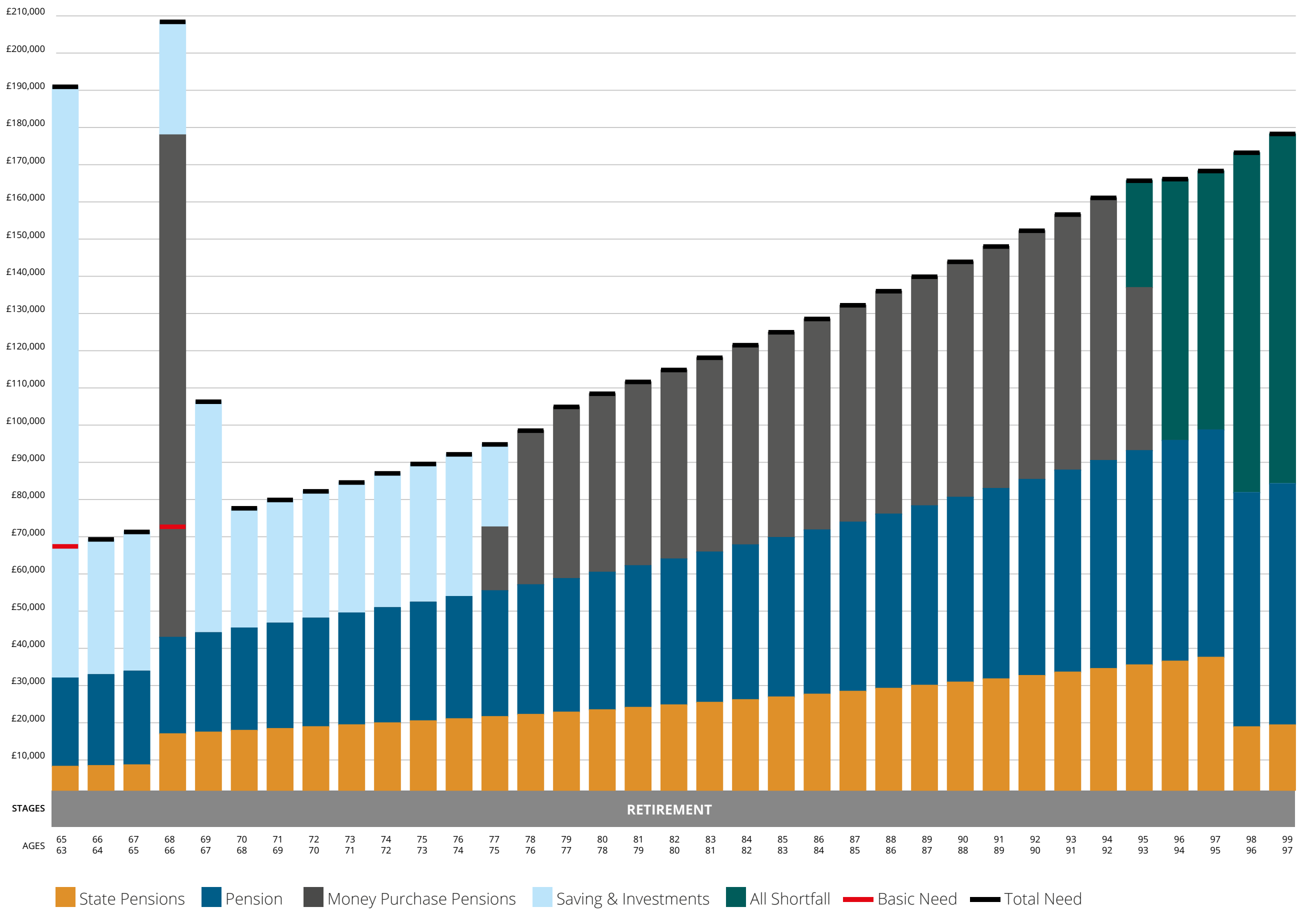
Plan One:

The below cash flow simulates the current financial security of the clients, without any gifts being made in their lifetime. As can be seen, these model clients are able to meet their income requirements throughout their lifetime, with no shortfall at the end of their lives that would be stipulated by red at the end of the plan. We are therefore able to agree that some level of gift can be made.



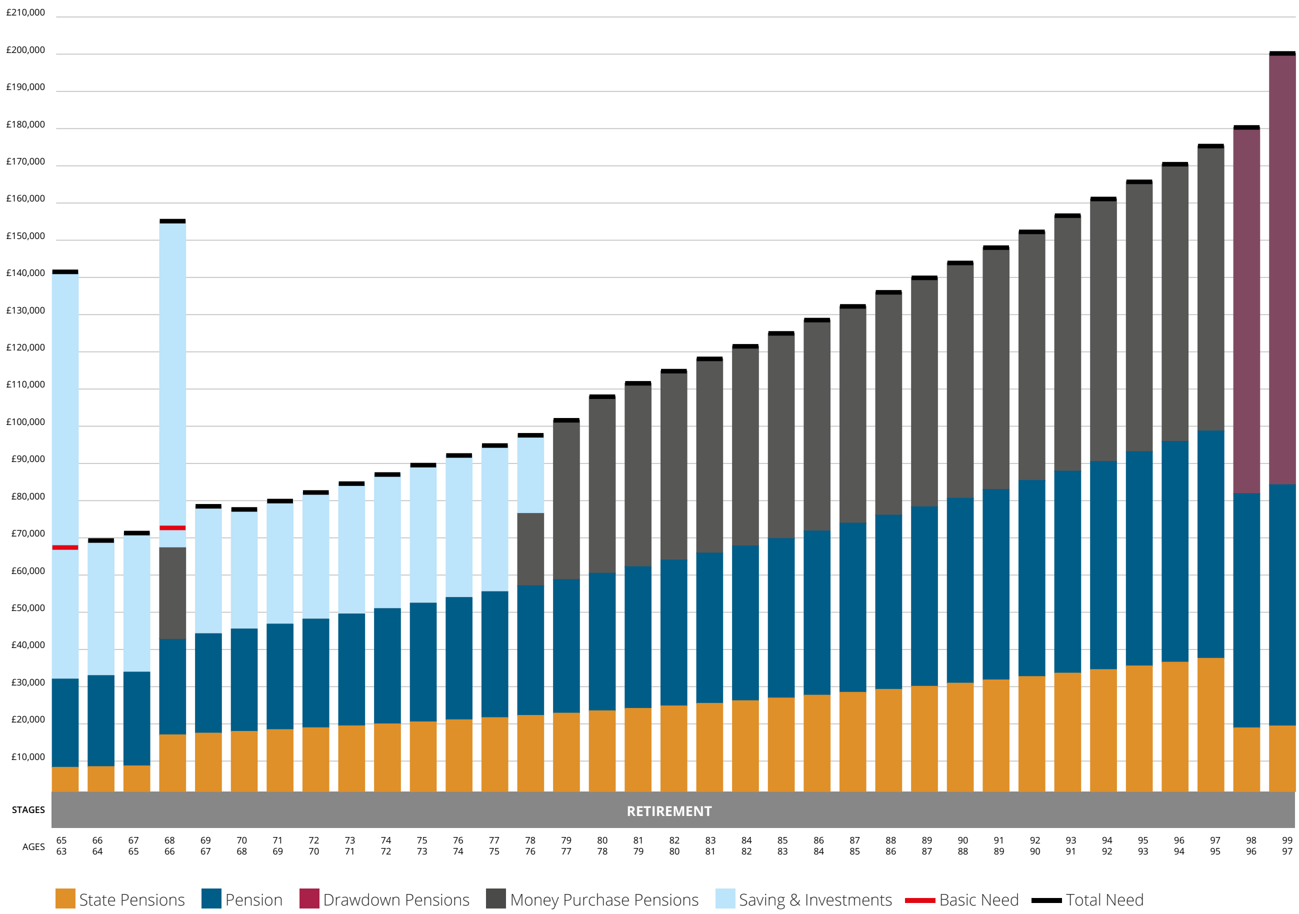
Plan Two:

This next plan demonstrates the wishes of the clients gifting a total of £250,000 to their two children. These two gifts are highlighted below by the 'spikes' within the early years of the plan. As can be seen, it is projected that the clients will have a shortfall in their income over expenditure within the plan. Reviewing these figures, Dart Capital would not advise such significant gifts are made because of this shortfall and a compromise must instead be met.



Plan Three:

Having agreed that the desired level of gift is not sustainable, a forecast presuming a smaller gift is made to each child is reviewed. The below forecast presumes gifts of £75,000 to each of the children are made, rather than the higher £125,000 demonstrated on the previous page. As can be seen from the below, there is no longer a shortfall within the plans therefore highlighting that these gifts are likely to be more sustainable.



Presuming both of the clients survive seven years, the gifts would be exempt from inheritance tax and the objective of helping their children purchase properties have been achieved. If a discussion had not been had as to the level of gift, the individuals may have left themselves with a shortfall in their requirements at the end of their lifetimes.

Gifting to children or grandchildren remains a very personal topic which is dependant not only on your financial ability to gift but also the family dynamics with regards to entrusting a younger generation with large sums of capital of which you may be unable to retain control. Your Investment Manager will be happy to discuss the suitability of gifts and help you to establish not only the most efficient way for gifts to be made but also the level at which they will not jeopardise your own financial security.

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