A case study on lifetime gifting - interaction between the transferable nil rate band and taper relief

Synopsis: An explanation of how lifetime gifts affect the availability of any transferable nil rate band and the application of taper relief.

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Chargeable lifetime transfers which exceed an individual's available nil rate band are subject to inheritance tax (IHT) at the lifetime rate. The available nil rate band is broadly the standard nil rate band - currently £325,000 reduced by earlier chargeable lifetime transfers made in the previous seven years.

Case study

Maria decides to set up a discretionary trust for £250,000 on 1 May 2019. A couple of months later she decides to set up another discretionary trust for £100,000. Ignoring any available annual exemptions, because the total of these two gifts amount to £350,000, the excess of £25,000 over the standard nil rate band of £325,000 would immediately be subject to IHT at 20% (or grossed-up to 25% if Maria were to pay the tax).

It is important to bear in mind that even in cases where there is 100% nil rate band available for transfer, each individual can only use their own nil rate band for the purposes of chargeable lifetime transfers before any lifetime IHT would become payable.

So, in the case of Maria, let us say she was able to benefit from a total nil rate band of £650,000 made up of her own nil rate band and 100% transferable nil rate band from her late husband, Clive. For the purposes of any lifetime chargeable transfers, she could only settle up to £325,000 into discretionary trusts as shown in the above example before any IHT would become payable.

Following on from the above example, let us say Maria made an additional outright gift to her niece in June 2020 of £200,000. As this gift is a potentially exempt transfer there would be no lifetime IHT payable at the time she makes the gift.

A few years later, on 20 August 2023, Maria sadly dies in a car accident. As this is just over four years from the first gift, all three gifts fail and become chargeable.

At this point, Maria's personal representatives make a claim to use Clive's unused nil rate band.

The total gifts made by Maria amount to £550,000 and would be covered by her own nil rate band and Clive's unused nil rate band leaving £100,000 to be used against Maria's death estate.

If the gift to her niece had been double the amount, so say £400,000, then in this situation, the total gifts which fail would have amounted to £750,000 – and, on the basis that Maria's personal representatives had made a claim to use Clive's unused nil rate band, £650,000 would be covered by the two nil rate bands, leaving £100,000 chargeable. As the last gift was made just over three years before Maria's death, taper relief would apply to reduce the IHT payable on that gift.

Essentially, gifts made three to seven years before death, which are in excess of any available nil rate band, are taxed on a sliding scale, relieved by what is known as 'taper relief' as follows...

Years between gift and death	**Tax paid**
Less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
7 or more	0%

So, in our example of Maria, £100,000 of the failed £400,000 gift to her niece would be taxable at 32% instead of 40%. This means IHT of £32,000 would be payable by the recipient, i.e. her niece.

And, this would also mean that there would be no nil rate band available to apply against the death estate.

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