

AF1 IHT 2022/2023

Part 5: The 14 year rule

The milestones for this part are to understand:

- Why we need to check what gifts have been made in the last 14 years.
- How gifts made more than seven years before death can interact with gifts made in the seven years before death.

We've already learnt that any PET or CLT made more than seven years before death will be effectively exempt or to be more precise, they will not reduce the estate's NRB. So why do many fact find forms ask if the client has made any gifts in the last **14 years**? To understand why we need to recap the cumulation rules for CLT's.

Helen made a CLT of £300,000 in May 2013. She made a further one for £225,000 in May 2019.

No lifetime tax would be payable on the 2013 gift but under the 7 year cumulation rule only £25,000 of the NRB would be available for the 2019 gift so tax of £40,000 (£225,000 less £25,000 @ 20%) would have been payable.

Now let's consider what happens if Helen dies in May 2021.

- There is just one CLT of £225,000 made in the seven years before her death
- Therefore, her estate's NRB is reduced to £100,000
- But do the trustees of the 2019 gift have any further liability?

At first glance it seems they don't as the amount is below the NRB at date of death. On the other hand, a lifetime tax charge was made on the 2019 CLT so why should it escape a further tax charge on death? The NRB available to the 2019 gift was reduced by the 2012 gift and the same reduction will apply to the death calculation.

We can compare the tax due on both the lifetime gift and on death as follows:

Tax on lifetime gifts		Tax on donor's death	
NRB 2013	£325,000	£325,000	
2013 CLT	<u>£300,000</u>	<u>£300,000</u>	
Remaining NRB	£25,000	£25,000	
2019 CLT	£225,000	£225,000	
Remaining NRB	<u>£25,000</u>	<u>£25,000</u>	
Chargeable	£200,000	£200,000	
Amount due			
£200,000 @ 20%	£40,000	£200,000 @ 40% = £80,000	
		Less Tax Paid	<u>£40,000</u>
		Amount due	£40,000

Taper relief could be used if the second CLT was made more than three years before death

Let's summarise the rules:

- Only CLT made in the seven years before death reduce NRB available to the estate
- Those made more than 7 years before death do not reduce the estate's NRB
- However, when a CLT was made in the 7 years before death the executors must look back a further seven years to see if another CLT was made in the period seven to fourteen years prior to death. For example, if **death occurred on July 1 2022** then CLTs made before July 1 2015 must be taken into account as follows

Date of CLT	Look back to
July 1 2021	July 1 2014
July 1 2020	July 1 2013
July 1 2019	July 1 2012
July 1 2018	July 1 2011
July 1 2017	July 1 2010
July 1 2016	July 1 2009
July 1 2015	July 1 2008

- If a CLT is found the NRB is available to the second CLT is reduced by the earlier CLT.
- If the first CLT has used up all the NRB, tax is charged on the second gift with no NRB

Bill made a CLT of £500,000 in 2016 and a second one for £200,000 in 2018. He died in 2021

On Bill's death there is no NRB available to the 2018 CLT so £200,000 would be chargeable at 40%. The trustees would be liable for this.

Interaction of PETs and CLTs

Consider this situation.

Brenda dies on August 1 2022 with an estate of £500,000 which she leaves to her children. She made a PET on September 1 2019 for £250,000 (after annual exemptions) and a CLT on July 2014 for £150,000 (after annual exemptions)

At first glance it appears that there is no tax liability on either gift as the CLT was made over 7 years before death and the PET is below the current NRB. This is not the case!

The rule is that if a PET was made in the 7 years prior to death it becomes a failed PET and treated as a CLT. We must look back a further 7 years from the date of the failed PET to see whether a CLT was made in the period seven to fourteen years prior to death.

If there are, as in Brenda's case, the value of the CLT reduces the NRB available to the failed PET.

NRB	£325,000
CLT 2014	<u>£150,000</u>
NRB available	£175,000
Failed PET	£250,000
Less reduced NRB	<u>£175,000</u>
Amount chargeable	£75,000

The recipient must pay £30,000 (£75,000 x 40%). Taper relief can be used to reduce this but there will never be a deduction for tax paid since being a PET no tax would have been payable when the gift was made.

If the previous CLT was greater than the NRB all the failed PET becomes chargeable.

Linus received a gift of £100,000 from his grandfather two years before his grandfather died. Six years before Linus received the gift, his grandfather had made a CLT of £500,000. The CLT would have wiped out the NRB available to the failed PET so Linus will be liable for £100,000 @ 40% = £40,000.

The estate's NRB is unaffected by the CLT. Only the failed PET reduces the estate's NRB so assuming it was the standard £325,000 this would be £225,000.

The full list of combinations and their impact can be summarised as follows:

Gift made in 7 years before death (Gift 1)	Gifts within 7 years of gift 1 that fall out of the 7 year period prior to death (Gift 2)	Impact
PET	PET	PET 1 reduces estate's NRB PET 2 ignored
CLT	CLT	CLT 1 reduces estate's NRB. CLT 2 reduces the NRB available to CLT 1 and excess over NRB is charged at 40%
PET	CLT	PET (gift 1) becomes a failed PET & reduces estate's NRB. CLT (gift 2) reduces the NRB available to the failed PET and excess over NRB is charged at 40%
CLT	PET	CLT (gift 1) reduces estate's NRB. PET i(gift 2 ignored

That concludes this part so you should now understand:

- Why we need to check what gifts have been made in the last 14 years.
- How gifts made more than seven years before death can interact with gifts made in the seven years before death.

Sources and further reading

<https://www.thegazette.co.uk/all-notices/content/100654>

<https://www.pruadviser.co.uk/knowledge-literature/knowledge-library/gifting-and-inheritance-tax/#section-5>