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Briefing document

IHT – Normal expenditure of income

Introduction
The contents of this note are aimed at providing a brief overview of the Inheritance Tax (IHT) exemption available to individuals who make regular gifts out of income. Where the exemption applies, the value of the funds given away are immediately outside the donor's estate for IHT purposes. Contrast this with the position that generally applies when individuals make gifts, which is that up to 40% IHT may be chargeable if the donor dies within seven years of making a gift (assuming no other reliefs or exemptions are available).

The normal expenditure out of income exemption may also be available on gifts to trusts. Broadly, if no reliefs or exemptions are available, gifts to trusts may be subject to up to 20% IHT when the gift is made, with up to a further 20% IHT being payable if the donor does not survive for seven years from the making of the gift.

Various conditions are set out below, which must be met in order for the exemption to be available.

This briefing note is most relevant to UK domiciled or deemed domiciled individuals whose worldwide estate is within the scope of IHT, though may also be relevant to non-UK domiciled individuals in certain cases. It is assumed that any gifts will be outright gifts of cash and the donor will not be able to benefit from the funds given away after the date of the gift.

The exemption
In order for the exemption to be available it is necessary to show that:

a) The gift is made as part of a normal pattern of expenditure;

b) The gift is made out of income, taking one year with another; and

c) The donor retains sufficient income to maintain his or her normal standard of living after allowing for all other gifts forming part of his or her normal expenditure.

'Normal' here means 'usual'. As a result, it will be important to demonstrate that the gift giving forms a regular pattern of expenditure. There is no minimum period or number of times gifts must be made in order for the exemption to be available. It is however recommended that the intention to make regular gifts out of income is documented from the outset of the arrangements and that appropriate records are maintained.

The income available to be given away is based on the amount of income received, net of taxes, less expenditure. There is no set way to determine how the amount of the gifts should be calculated, provided the other conditions set out above are met. This means that the amount given away could be a set amount, a proportion of income received each year or based on some other formula to take account of other expenditure.

The statutory rules accept that incomes may fluctuate from year to year. However, it is important to ensure that the gifts do usually fall within income. Should this not be the case, the gifts may be only partly exempted, or the exemption may be completely unavailable.

As noted, in order for the exemption to be available, the making of gifts out of income should not reduce the donor's normal living standards. The exemption will not be available if the donor is required to spend capital in order to maintain his or her living standards.

Gift recipients

Gifts may be made either to individuals or to trusts and HMRC does not consider that the identity of a recipient matters. This means that the exemption may be available if the expenditure falls within a set category of people. For example, gifts totalling £10,000 could be made to relatives each year, but the gift made to any particular individual within this group could vary from year to year.

Record keeping

Suitable records should be maintained to evidence the availability of the exemption, in the event that HMRC challenge whether or not the exemption is due. The HMRC guidance says that HMRC will consider the following factors with regards to gifts:

- Frequency
- Amount given
- The nature of the gifts
- The identity of the donees
- The reason for the gifts
- Records of income received and spending patterns should also be maintained.

Find out more...

This note reflects the law in force as at 8 April 2020 Please be aware that it does not cover all aspects of this subject. To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Patricia Mock (pmock@deloitte.co.uk).

For further information visit our website at www.deloitte.co.uk.