

Gifting out of Income – the overlooked way to reduce Inheritance Tax

For many people, giving financial support to family members is an important part of their financial planning.

Whether it is helping children with pension contributions or providing ongoing assistance, gifting can play an important role in Inheritance Tax (IHT) planning.

The normal expenditure out of income exemption under Section 21 of the Inheritance Tax Act 1984 allows for gifts to be made free of IHT, if specific conditions are met.

The exemption can be significant as there is no upper cap to the gifts out of income that can be made and the normal '7-year rule' does not apply, so the gifts are immediately outside of your estate.

What are the requirements?

The exemption only applies to gifts made from surplus net income (after tax), not from capital or savings. The donor *must* be able to cover their normal living costs (which can include things like household expenses, personal living costs, holidays, entertainment etc.) from their income, as well as the gift. They cannot give away all their income and then use capital to make up any shortfalls, and they must be able to maintain their usual standard of living.

Importantly, the gift needs to form a regular pattern (this doesn't need to be weekly or monthly but would ideally be a series of at least 3 payments with evidence that the gifts are intended to be ongoing).

Why is record-keeping important?

Any gifts made in the 7 years before death will usually need to be reported to HMRC, this will be on forms IHT400 and supporting form IHT403.

The IHT403 form asks for information about gifts, allowances and exemptions so it is important to keep clear records of any gifts made under the normal expenditure out of income rules, as well as records of net income and normal expenditure.

How can we help?

IHT planning can help to safeguard your family's financial future and utilising allowances and exemptions can help minimise your IHT liability, letting you leave more to your loved ones.

Our Tax team can support you with advice on gifting out of income, so that you can provide for your family's future.

Contact your team at Galloways today!

Just call us on 0800 012 9190 or email us

Disclaimer: The information provided is for general guidance only, does not constitute professional advice, and is not a substitute for consulting a qualified accountant or other professional for specific circumstances.