

IHT normal expenditure out of income exemption

Gifts within this exemption are immediately exempt from IHT, so there is no need for the donor to survive for 7 years for the exemption to apply.

A gift qualifies as normal expenditure out of income if:

1. It is made as part of the donor's normal expenditure; and
2. It is made out of income, taking one year with another; and
3. After allowing for all gifts forming part of their normal expenditure, the donor is left with sufficient income to maintain their usual standard of living.

The donor must establish a pattern of making regular gifts that conform with an overall commitment or intention so to do.

The gifts must be from income not capital. Net income after tax is the benchmark here, although it is possible to include non-taxable as well as taxable income in the calculation.

Gifts can be of different amounts and to different recipients each year.

This exemption is particularly useful for donors whose income exceeds their spending needs and who can afford to do without this excess income.

An example of how this exemption can work is the case of Mrs B, who, having lived modestly for many years, suddenly became entitled to significantly more income than previously from a family trust. Mrs B did not need or want this extra income and arranged for the trustees to distribute the trust income in excess of her needs.

During the next year or so, the trustees duly distributed around £207,000 of the trust income to Mrs B's family. Mrs B then died. The Inland Revenue argued that the gifts were failed potentially exempt transfers (PETs) and therefore liable to IHT. The court held that, even though the gifts had been made over such a short timespan, they conformed with a settled pattern of expenditure adopted by Mrs B and were therefore normal expenditure out of Mrs B's income for IHT purposes. The IHT saving amounted to £82,800.

This factsheet is for information purposes only. Before embarking on any inheritance tax planning, you should take professional advice tailored to your particular circumstances.

Please contact Paul Tobias or Shaun Parry-Jones for further information.