# TECHNICAL ADVICE

## *FROM ANDREA PIERCE*

In this article I am going to stick with the theme of gifting and address gifts which are made out of income. If a lifetime gift is made from surplus income it will be exempt from Inheritance Tax.

In order for this exemption to apply, there are certain qualifying conditions that have to be met. The first one is key, in that the gift must be made from income; it cannot be made from capital. To demonstrate that it is made from income it will be necessary to show that the gifting is from net income received (once tax has been made).

HMRC views ‘income’ as being current income, or in other words, income received in the particular tax year. Although it is accepted that some carrying over of income from year to year is allowable, any gifts from income which has been accumulated over several years will not be exempt from Inheritance Tax. The reason being that the income will generally have converted to capital.

What does ‘surplus income’ mean? Once making the gift, the donor must be left with enough income to maintain usual standard of living which is relevant to the donor at the time of making the gift. If the donor has to resort to using capital to contribute towards living expenses, then any gifts out of income will not qualify for the relief.

What do ‘living expenses’ mean? This will all costs associated with maintaining the donor’s standard of living. It is subjective and applicable to the donor only. It is just not the usual household expenses that would be payable to maintain the donor’s standard of living but it will include lifestyle expenses such as holidays etc. I have provided below a screenshot of the Inheritance Tax form (IHT403) which must be submitted to HMRC to obtain this exemption. HMRC must be provided with the level of income received, the outgoings made to maintain the donor’s standard of living which will demonstrate the surplus income and the gifts made from the income.

The gift must form part of the normal expenditure of the donor. It must therefore be demonstrated that there is a regular pattern of gifting which will demonstrate that the expenditure is ‘normal’. A gift which is a one-off will not qualify. An example of regular pattern is paying the school fees for grandchildren. HMRC will look for a ‘settled pattern’ of giving and if only a few had been paid, HMRC will want it confirmed that there was a commitment to continue with the payments in the future.

It is advisable that if your client is making gifts out of their surplus income, that they maintain a record of the income and outgoings to establish that the gifts are made from surplus income. Ideally the donor should use the same format as shown on the IHT403 below to make it easier for their personal representatives to apply for this exemption upon death. Whilst a bit more challenging, if the personal representatives are aware that the deceased made regular gifting out of income, using the bank statements they can complete the IHT403 to apply for this exemption. It will have to demonstrated that there was surplus income before the gifting is made.