

## Reducing Inheritance Tax through 'Gifting out of Income'

Gift giving is one way that a person could reduce the value of their estate during their lifetime and thereby decrease or eliminate the inheritance tax (IHT) that would have to be paid after they pass away. Below, we outline the 'seven-year rule' and the key principles of giving gifts 'out of income'.

The thresholds above which IHT must be paid vary according to the marital status of the person who owns the estate (married couples have a combined allowance) and whether the future recipient of the estate is a direct relative ('residence nil-rate band'). Taxpayers also have certain allowances each tax year that are not added to the value of their estate and thus not subject to IHT:

- Up to £3,000 worth of gifts
- Monetary gift on the occasion of a wedding / civil partnership (maximum value depends on the relationship of the giver to the recipient)
- Small gifts allowance of £250 per person (so long as another of the allowances has not been used on the same person)

IHT is not usually paid on gifts unless the owner uses up the tax-free allowance during the seven years before their death – the so-called 'seven-year rule'. If the tax-free threshold is exceeded, the recipients of gifts given by the owner during those seven years would have to pay IHT on the amount above the threshold. The amount of IHT incurred depends on the value of the gift, the relationship between the donor and recipient, and at what point the gift was given during that seven-year period (tapered tax relief is available if the gift was given three years or more before the donor passed away).

Some gifts are not subject to IHT, including donations to charities or political parties and gifts given between spouses or civil partners who reside permanently in the UK.

A little-known exemption to the seven-year rule is so-called 'gifting out of income'. As the name suggests, gifts must be made from your income (pension income is included for this purpose) and not from capital assets. The gifts should follow, or establish, a pattern of regularity and must be given outright, without the donor retaining any benefit from them. Additionally, after giving the gifts, you must be able to maintain your usual standard of living without resorting to the use of capital.

Comprehensive, accurate record keeping is crucial in order to demonstrate eligibility to HMRC. Useful information to record for each gift includes its type, value, when it was given, and to whom. Such records will also assist the executors in the administration of your estate in the future.

If you would like financial planning and recommendations tailored to your individual needs, please contact your Cantab adviser ([advice@cantabam.com](mailto:advice@cantabam.com)).

The content of this document does not constitute personal recommendation or advice. The figures quoted were correct at the time of writing. It is important to check the current HMRC thresholds, allowances, and regulations.



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