Reporting requirements when making gifts using the normal expenditure out of income exemption

Synopsis: IHT reporting requirements. An IHT report is required where lifetime chargeable transfers exceed the donor's available nil rate band even if gifts are covered by the excess income exemption.

Date posted: 6.7.26

In order to qualify for the normal expenditure out of income exemption, there are three conditions each of which must be satisfied for the exemption to apply...

- the gifts must be part of the donor's "normal expenditure";
- the gifts must be made out of income; and
- taking the gifts into account the donor must be able to maintain their usual standard of living.

This exemption only applies to lifetime gifts, whether the gifts are outright or gifts into trust. Gifts which meet the qualifying conditions are immediately exempt from inheritance tax (IHT), so the donor does not need to survive seven years to obtain the exemption. However, the exemption is only available if it can be shown that the necessary conditions are met.

The exemption must therefore be claimed - it is not given automatically. Form IHT403 requires a deceased person's executors to list all lifetime gifts (both outright gifts and gifts into trust) made within seven years of death and to provide details of the deceased's income and expenditure to claim the normal expenditure out of income exemption.

Lifetime chargeable transfers - lifetime reporting requirements

The donor is required to report lifetime transfers into trust which are immediately chargeable transfers for IHT purposes. Transfers which are wholly covered by an exemption, for example the annual £3,000 IHT exemption, are not chargeable transfers and so do not need to be reported.

However, HMRC takes the view that, where the normal expenditure out of income exemption is in point, a lifetime chargeable transfer remains a chargeable transfer unless and until 'it is shown' to be exempt. This does not mean that it is necessary to deliver an account in all cases where normal expenditure out of income is to be claimed on a lifetime chargeable transfer.

HMRC guidance suggests that where denial of the exemption would not breach the limits for a cash transfer (i.e the available nil rate band), no account will need to be delivered. However, where denial of the exemption would result in a liability to IHT, an account will need to be delivered in order for the availability of the exemption to be agreed.

HMRC includes the following example in its guidance...

‘The transferor makes a number of gifts of £50,000 cash annually to the trustees of a relevant property trust which they consider qualifies for exemption as normal expenditure out of income. No other exemptions are available and no other transfers made. No account will be necessary until the cumulative total of the value transferred by all the transfers of value exceeds the nil rate band - which at current levels would mean not until the seventh transfer is made.’

Comment

This highlights the importance of keeping full records of income and expenditure where the donor wishes to make gifts using this exemption. They can do so by completing form IHT403 in their lifetime to help the executors claim the exemption on death.

020 7183 3931
www.riskassured.co.uk