



**Helping you understand
Inheritance Tax Planning
and gifting from surplus
income**



Introduction

Inheritance Tax (IHT) is a tax on the value of your estate when you pass away. The standard rate is **40% on assets above available allowances**. For many families, thoughtful planning can reduce, or even remove, a future IHT liability.

One of the most effective ways to achieve this is through gifting during your lifetime. By passing wealth to loved ones in a structured way, you can support them today while gradually reducing the value of your estate.

Gifting from Surplus Income

If you have more income than you need to maintain your lifestyle, you may be able to make regular gifts to family or friends. When structured correctly, these gifts are **immediately free of IHT** and do not fall under the usual 7-year rule.

This makes gifting from income one of the most valuable, and often overlooked, estate planning opportunities.

The Three Key Conditions

For gifts to qualify, they must meet three simple requirements:

1. Regular pattern

Gifts should form part of your normal spending, such as monthly, quarterly, or annual payments.

2. Paid from income

The gifts must come from income (salary, pension, interest, or dividends), rather than savings or investments.

3. Maintain your lifestyle

After making the gifts, you must still have enough income to cover your usual living costs without using capital.

If income fluctuates from year to year, HMRC will usually consider the position over several years rather than focusing on one single period.



Practical Examples

Many families use this exemption in simple, meaningful ways, such as:

- Paying school or university fees for grandchildren
- Helping with rent, childcare, or mortgage overpayments
- Making monthly contributions towards hobbies, lessons, or activities
- Supporting wedding savings or other life events

As long as these payments are regular, come from income, and don't affect your financial security, they may qualify for the exemption.

What Doesn't Count as Income

Not all payments are treated as income for IHT purposes. For example:

- Withdrawals from investment bonds (including 5% withdrawals) are considered capital
- With purchased life annuities, only the interest element counts as income
- Income retained for long periods (typically more than two years) may be viewed as capital instead

Understanding this distinction is important when planning gifts.

Record Keeping and Evidence

HMRC may review gifting after death, so clear documentation is essential. It is helpful to keep:

- A record of gift amounts and dates
- Details of your income and expenditure
- A short letter confirming gifts are made from surplus income

You may also find it helpful to complete the **Government Schedule IHT403 form** to keep an accurate record of any lifetime gifts you have made. This can support clear and efficient inheritance tax planning and make the administration of your estate simpler for your executors.

You can access the form here:

<https://www.gov.uk/government/publications/inheritance-tax-gifts-and-other-transfers-of-value-iht403>

Other Useful Gift Allowances

Annual Exemption

You can give away **£3,000 each tax year** free of IHT. If unused, this allowance can be carried forward for one year.

Small Gifts

You may give up to **£250 per person per tax year** (provided this is not combined with the annual exemption for the same recipient).

Wedding Gifts

- Parents: £5,000
- Grandparents: £2,500
- Anyone else: £1,000

These gifts are immediately exempt when made.

Larger Gifts and the 7-Year Rule

Larger gifts are known as **Potentially Exempt Transfers (PETs)**. These become free of IHT if you live for seven years after making them.

If death occurs within 3–7 years, taper relief may reduce the tax payable.



Additional Exemptions and Planning Options

Spousal exemption

Unlimited transfers between UK-domiciled spouses or civil partners are IHT-free.

Charitable gifting

Gifts to registered charities are exempt from IHT. Leaving at least 10% of your estate to charity may reduce the IHT rate on the remaining estate from 40% to 36%.

Trusts and life assurance

Trust planning can help control how assets are distributed, while life insurance can be used to provide funds to cover a potential IHT liability.



Final Thoughts

By combining gifting from surplus income with other available allowances, you can gradually reduce the value of your estate while providing meaningful support to loved ones during your lifetime.

The key to successful planning is to:

- start early
- gift regularly
- maintain your financial security
- keep clear records

With thoughtful planning and good documentation, gifting can provide both tax efficiency and peace of mind for you and your family.



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