

## Inheritance Tax Planning

Under section 21 of the Inheritance Tax Act 1984 a gift is exempt if, or to the extent that, it is shown:

- that it was made as part of normal expenditure; and
- that (taking one year with another) it was made out of income; and
- that after allowing for all gifts forming part of normal expenditure, there is sufficient income left to maintain the donor's usual standard of living.

### What is 'normal expenditure?'

The case of *Bennett v IRC* (1995), where the normal expenditure exemption was successfully claimed, sheds some light on this problem.

Mrs Bennett was the life tenant of a will trust, the gross annual income from which was, until 1987, £300 each year. Mrs Bennett was a lady of modest needs and this low level of income was acceptable to her. Subsequently the income of the trust increased dramatically when the family company shares were sold and the proceeds reinvested.

Mrs Bennett told the trustees she wished her sons to have the surplus income above what was needed to maintain her in her settled ways. In 1989 each of her 3 sons received distributions of £9,300 and in the following year £60,000. These payments did not exhaust the surplus income and the trustees intended to make further payments.

Mrs Bennett then died unexpectedly. She had been active and healthy when she gave authority to the trustees to pay the surplus income to her sons. The Court held that normal expenditure is expenditure which, at the time it took place, accorded with the settled pattern of expenditure of the donor. A settled pattern could be established in 1 of 2 ways:

- With the benefit of hindsight, looking at expenditure over a period of time and establishing a pattern, e.g. a payment each year of 10% of all income to family members or payment of a fixed sum each year.
- By assuming a commitment, or adopting a firm resolution, regarding future expenditure and therefore complying with it. The commitment may be legal, religious or moral. There is no fixed minimum period and the expenditure need not be for a fixed amount nor need the individual recipient be the same.

All that is necessary is that a pattern be established by proof of a prior commitment or by reference to a sequence of payments. There is no need for the expenditure to be reasonable. What counts is whether it is 'normal' for the particular donor concerned.

# Guide To...

## Gifts Out Of Income

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### What is 'income?'

'Income' is not defined but will normally be given the ordinary meaning. This may not always be the same as for Income Tax purposes but net income after tax is a good starting point. The exemption cannot in any circumstances apply to gifts out of capital.

In practice, the exemption will normally relate to gifts of cash but gifts such as jewellery or shares may qualify if bought out of income specifically for the purpose of the gift.

### What about 'maintaining the usual standard of living?'

Again, the legislation does not define or explain this. Each case will be different. A rich person who lives frugally can gift substantial amounts, as was shown on the Bennett case. But the gift must not force the donor to resort to capital to meet ordinary living expenses.

### Is there any rule of thumb as to how much can be claimed under this exemption?

No. Each case is judged by its merits. The Capital Taxes Office of HM Revenue & Customs does look carefully at the standard of living of the donor and will usually ask for copy bank statements as a minimum. Because of this, it is not always possible to say that, at the time it is made, a particular gift is or is not exempt as 'normal'. Good records are important, especially if personal representatives are to be able to claim the exemption on death.

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