

Regular Income Gifting

A smart strategy for
UK estate planning

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Why gift surplus income to your family?

Utilising an income fund with steady targeted dividend payments may help in estate planning

Many retirees and high-net-worth individuals find they have more income than they need for their own living expenses. Instead of letting that surplus accumulate (and ultimately inflate their taxable estate), a savvy strategy may be to gift that excess income regularly to family. This approach can immediately reduce the size of their estate for inheritance tax (IHT) purposes while helping their loved ones now, rather than waiting until they're gone.

In the UK, estates above £325,000 can incur a sizeable 40% IHT charge, so gradually shrinking your estate by gifting surplus income can significantly cut the future tax bill for your beneficiaries. It may be a win-win: the client supports their family's needs (such as helping with a house deposit or school fees) and makes their estate more tax-efficient at the same time.

What's special about gifting surplus income? Under HMRC's rules, 'normal expenditure out of income' is an often-overlooked exemption that, if done correctly, means these gifts are immediately outside of the client's estate for IHT – no seven-year wait, no using up their annual gift allowance. In other words, gifts that qualify under this rule are entirely IHT-free from day one. This is incredibly powerful for estate planning: it prevents an IHT problem from arising or getting worse. Compared to one-off large gifts (which generally take seven years to fully escape IHT), regular gifts from surplus income offer a more certain and HMRC-approved solution.

At a glance

- HMRC's rules on gifting through regular income and how to ensure that clients' gifts meet the 'normal expenditure out of income' rule
- Find out how to implement a regular gifting plan
- Guidance on choosing a suitable income fund
- Case study: making gifting through income work in practice

What are HMRC's rules on gifting through regular income?

Three conditions must be met to ensure that gifts are not treated as a chargeable or potentially exempt transfer

A gift is immediately outside a person's UK IHT estate if it (1) forms part of the donor's normal spending pattern, (2) is funded wholly out of the donor's net income, and (3) leaves the donor with enough income to maintain their usual standard of living – the three statutory conditions set out in the Inheritance Tax Act 1984 s.21 and expanded in HMRC's Inheritance Tax Manual. The donor (or, after death, the executors) must be able to prove each condition has been met and will claim the relief on schedule IHT403 when submitting form IHT400. If any condition fails, the gift is treated as a chargeable or potentially exempt transfer and may be taxed.

Legislative foundation

Reference	What it says	Link
IHTA 1984 s.21	A transfer is exempt if made 'as part of the donor's normal expenditure, out of income, and without reducing the donor's standard of living.'	Legislation.gov.uk
IHTM14231	Restates the three limbs and notes the exemption applies only if all are satisfied.	GOV.UK

The three statutory conditions

Reference	What it says	Link
IHTM14241 Normal (habitual) expenditure	HMRC defines 'normal' as 'standard, regular, typical, habitual or usual – for that donor.' Factors include frequency, amounts, donees and reasons for giving. A single gift can qualify if it is clearly intended to start a pattern.	GOV.UK
IHTM14250 Gift made out of income	Income covers employment earnings, pensions, rents, interest and dividends; it is the net amount after income tax. Capital withdrawals (for example, selling investments or taking 5% bond withdrawals) do not count. HMRC normally treats income that has been retained for more than two years as capital unless there is evidence it was set aside for gifting.	GOV.UK
IHTM14255 Donor left with enough to live on	After all such gifts, the donor must still meet their usual living costs from income; if they later use capital to fund everyday spending, HMRC will disallow or restrict the exemption.	GOV.UK

Burden of Proof

HMRC states that 'a transfer remains chargeable unless and until it is shown to be exempt. The onus is therefore on the donor's executors to demonstrate the three conditions.

How the ‘normal expenditure out of income’ rule works

Based on HMRC’s rules, HMRC allows these gifts to be IHT-free only if strict conditions are met. In simple terms, your clients' gifts must:

- Come from their income, not their core capital. This means using sources like pension income, interest, dividends or rental income after tax, rather than dipping into their savings or selling investments. (For example, with drawing 5% from an investment bond is considered a return of capital, not true income, so that wouldn’t qualify under this rule.)
- Be part of a regular pattern. The gifts should be habitual – for instance, a standing order every month or an annual transfer every Christmas. A one-off gift is unlikely to qualify unless they clearly intended it to start a series of future gifts. Consistency is key to demonstrate it’s ‘normal’ for them.
- Not compromise their own standard of living. They must have enough income left after making the gifts to maintain their usual lifestyle. If they give away so much that they then have to dip into savings to pay their bills, HMRC will not allow the exemption.

These three rules ensure that only genuine surplus income is gifted – essentially, money they truly don’t need for themselves. As long as the above conditions are met, such gifts are exempt, and it won’t matter whether they survive seven years or not. It’s important for clients to keep good records of their gifts and income (using HMRC’s form IHT403 to log the gifts each year, for example) so that their executors can show the pattern and source of the payments when the time comes. But done right, this strategy is fully compliant with HMRC rules, enabling them to sidestep IHT legally and transparently.

Regulatory note

The Financial Conduct Authority (FCA) guidelines encourage advisers to take clients’ tax planning needs into account and to recommend suitable, lawful strategies. Regular income gifting fits squarely within allowable HMRC exemptions, meaning it’s not a contrived tax dodge but a legitimate planning technique. Advisers still need to ensure any investments used are appropriate to the client’s risk profile and that the client isn’t financially strained by the gifting plan (in line with the FCA Consumer Duty to act to deliver good customer outcomes). In short, this strategy, when properly advised, meets both tax regulations and financial planning best practices, giving advisers confidence to recommend it.

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Implementing a regular gifting plan: a guide

Adopting this strategy involves a few clear steps. Below is a roadmap you could follow with a client:

- 1 Assess the client's income and expenditure**

Start by calculating all sources of net income – e.g. pensions, dividends, interest, rental income. Then determine the client's normal living expenses. The difference is the surplus income available to gift. For example, if Mr. Jones has £5,000 monthly after-tax income (from pension and investments) and spends £3,500 on living costs, he has about £1,500 a month surplus that could potentially be gifted. It's crucial to exclude any withdrawals from capital (like drawing from savings or non-income investments) in this calculation.
- 2 Determine a sustainable gift amount**

Based on the surplus income figure, decide on an amount that can be gifted regularly without ever needing to tap into capital. In the above example, the adviser might suggest Mr. Jones gifts £1,000 per month to family, leaving a £500 buffer in case of income fluctuations – ensuring Mr. Jones always maintains his lifestyle comfortably. The gifts could also be made quarterly or annually if that fits better, but the key is that an ongoing commitment is intended.
- 3 Choose the right investment or fund**

Often, clients may not have a stable 'excess income' from their pension or salary alone. This is where repositioning some assets into an income-producing investment can help. The client can invest a portion of their savings (such as that in an ISA) into a diversified income fund or portfolio that is designed to pay a relatively steady stream of income. The goal is to generate roughly the amount of cash flow they wish to gift each month. For example, an adviser might recommend moving £300,000 into a multi-asset income fund targeting about a 4% annual yield paid monthly. This could produce around £1,000 per month in distributions, which can then be gifted. By structuring it this way, the investment fund's payouts become the 'surplus income' for gifting purposes. (Notably, interest or dividends from such a fund count as income in HMRC's eyes, whereas simply selling assets would not.)
- 4 Set up regular transfers to beneficiaries**

Once the income stream is in place, automate the gifting. For instance, set up a standing order to send the fund's monthly income (or whatever amount you've chosen) directly to your children or grandchildren. This creates a clear pattern – e.g. 'Grandma gifts £1,000 on the first of every month' – which strongly evidences the intention of regular expenditure. Regular transfers also ensure you don't forget gifts, which helps maintain the all-important consistency.
- 5 Document and monitor**

Keep a record of the gifts made and the fact that they are from income, not eroding your capital. An easy way is to maintain a simple spreadsheet or diary of the payments and retain bank statements showing the income coming in and gifts going out. As an extra precaution, many advisers suggest writing a letter to the recipient (or to your solicitor) stating that these payments are part of a planned series of gifts out of surplus income. This can be useful evidence for HMRC down the line. Also, review the plan annually – if the client's income or expenses change, adjust the gift amount so that it remains truly surplus and sustainable.

Following these steps ensures the gifting strategy is both effective and compliant. The result is a stream of wealth transfer to your family that is immediately outside your estate (no waiting period) and does not conflict with any HMRC or FCA rules.

Choosing a suitable income fund: consistency is key

An important consideration is which investment, or fund, will generate the income for these gifts. Not all income-producing funds are created equal. In this context, consistency and reliability of payouts are often more desirable than chasing the highest possible yield, for the following reasons:

Avoid unpredictable payments

- Many standard income funds (for example, equity income funds or dividend-paying stock portfolios) have uneven or uncertain payouts. One month you might get a high distribution, the next month much lower, depending on dividends or interest received. Such variability can complicate a regular gifting plan – if the fund's income drops, would you reduce the gift that month or dip into capital to keep the gift amount steady? A sudden shortfall could jeopardise the 'normal expenditure' pattern. It's generally easier to work with investments that aim for steady, predictable income flows. Some specialised funds even offer fixed-rate monthly distributions – for instance, a fund might target a 4% yearly payout, divided into equal monthly payments. This kind of approach provides a smooth cash flow that aligns perfectly with a regular gifting schedule. By contrast, a typical fund that only pays whatever it earns (variable dividends) could make it harder to establish a 'habitual' gift amount. (HMRC does acknowledge that gifts can vary if tied to a variable source like dividends, but from a practical standpoint, a stable amount is simpler to manage and explain.)

Don't blindly chase the highest yield

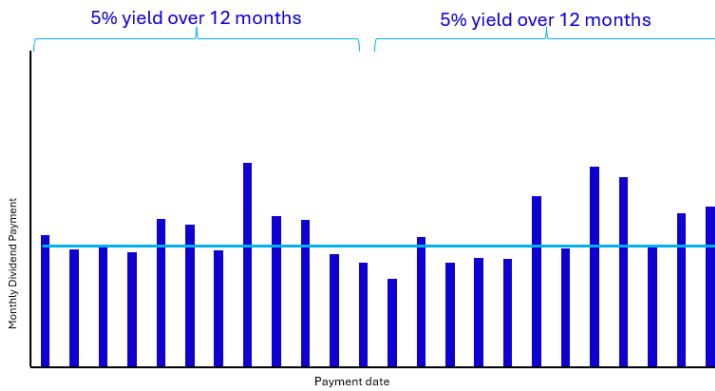
- It may be tempting to pick the fund advertising a 7% or 8% yield to maximise the income. However, extremely high-yield investments often carry higher risk or may be unsustainable. A very high yield could imply the fund is taking on lots of risk (e.g. junk bonds, risky equities) or even paying out capital to prop up the income. The last thing you want is the fund's value to plummet or for the 'generous' income stream to be cut after a market downturn. As the old saying goes, 'high yield can be fool's gold'. A yield that looks too good to be true might indicate an underlying problem that jeopardises future payouts. For example, a company with a particularly high dividend yield might be in financial distress and could slash its dividend, which would reduce your fund's income. In short, extreme yield comes with trade-offs – potentially eroding capital or unreliable dividends. It's usually better to aim for a moderate, sustainable yield from a well-diversified fund than to stretch for maximum yield and endanger the plan.

Protecting (and possibly growing) capital

- The ideal fund for this strategy will not only provide stable income but also strive to preserve your capital (or even grow it modestly) over the long term. Remember, the goal is not to deplete the client's wealth entirely – just to prevent it from needlessly ballooning inside the estate. A balanced, multi-asset income fund that holds a mix of dividend-paying stocks, bonds, and perhaps property can achieve a reasonable yield while spreading risk. This diversification helps smooth out the returns, so the income remains steadier, and the capital value is less volatile. Many such funds target around a 3–5% annual yield, which is often enough to fund generous gifts without significantly eating into principal. For instance, one UK multi-asset fund specifically aims for roughly a 4% yield and relatively steady monthly dividend payments. With a fund like that, a client could feel confident that the monthly gift of (say) £1,000 is backed by a sustainable portfolio, not by rapidly depleting their savings.

Comparing two funds: more than just yield

To visualise the difference, consider the following comparison of two hypothetical funds' monthly payouts over a year.



Returns

Notes

Vary by month

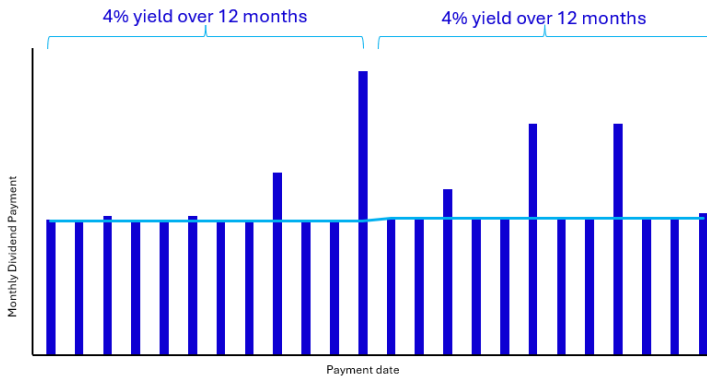
Unpredictable income flows makes it hard to provide consistent gift payments without touching capital

6% 12-month yield

High income

-0.65% capital return

Capital erosion over time



Returns

Notes

Consistent minimum payment

The greater predictability of income allows greater planning for regular gifting of income

4% 12-month yield

Not high, but sustainable

11.2% capital return

Showing capital growth allows for future higher income while showing capital has not eroded at the expense of gifting income

Consistency and quality matter more than sheer yield when selecting an investment for funding regular gifts. Investors should look for funds with a track record of regular distributions, competent management, and an asset mix aligned to the client's risk tolerance. All of this ensures the income-gifting strategy is likely to remain viable for many years, without unpleasant surprises.

Case study: making gifting through income work in practice



Client Profile

Peter and Judy Smith, aged seventy and sixty-eight, are a retired couple in good financial shape. They have a comfortable pension income that covers their needs, plus substantial savings and investments – including a £250,000 stocks & shares ISA portfolio and other assets, which puts their estate well above the IHT threshold. Their only child and three grandchildren are doing okay financially; however, they could certainly use some help as their oldest grandchild will be starting university shortly. Peter and Judy also want to start reducing their estate now rather than leaving an excessive IHT bill.

Problem

The Smiths' ISA portfolio generates roughly 5% growth each year. They don't actually need this money, as their DB schemes and state pension more than cover their living costs. Every year, their growing pot just adds to their estate value (which will eventually face 40% tax). They realise this excess could be put to better use by helping to pay for their grandchildren's university fees (currently capped at £9,250 per year), if only there were a tax-efficient way to do it.

Solution

After consulting with their financial adviser, the Smiths decide to implement a 'surplus income gifting' plan. They rearrange a portion of their investments into a diversified monthly income fund that aims for around a 4% annual yield. For example, using their ISA pot, they invest the full £250,000 into this fund, which is projected to produce the amount required to pay for the university fees. Crucially, the fund is designed to pay consistent monthly distributions from a mix of global equities and bonds – aligning with the Smiths' goal of making regular gifts, while staying aligned to their overall level of risk. They also plan to make use of the £3,000 gifting allowance.

They then set up a standing order to gift £800 per month to their child, helping cover fees as each grandchild goes to university.

Because this money is coming directly from the fund's income distributions (and not, from selling off chunks of the ISA), it counts as gifting out of their income. They document that this £800 per month is well within their surplus income. They also write a letter for their records stating their intention to make these gifts every month indefinitely as part of their normal spending routine.

Case study cont'd: making gifting through income work in practice

Outcome

Over the first year, Peter and Judy gift a total of £12,600 to their child and grandchildren (£9,600 in income gifting to their child and £3,000 gifting allowance to the grandchildren). This immediately reduces the value of their taxable estate by £12,600 (the capital growth they would have received had it not been earned from income) – and importantly, none of these gifts will ever be subject to IHT (no seven-year rule to worry about). The estate has effectively been ‘compressed’ by using what would have been idle surplus income for their family’s benefit.

The Smiths are pleased to see their gifts helping with university fees for their eldest grandchild. They plan to continue this for as long as they live and even increase the gift if their income surplus grows. Meanwhile, the diversified fund they chose is doing its job – the capital value fluctuates a bit with markets but remains around £250k and is expected to hold its real value over time while spinning off the targeted income. The Smiths keep a clear record of each monthly transfer and will ensure their executors claim the exemption on those gifts when settling the estate.



	Income gifting	Left to grow
Final Value	£241,677	£458,246
Total Gifted	£192,916	£45,000
IHT (40%)	£96,671	£183,298

Assumptions used: investments had 5% continuous growth, 4% was taken in the income and distributed monthly. £3,000 was taken annually from each

This case illustrates how a high-net-worth retired couple can successfully use regular income gifting. It particularly suits clients like Peter and Judy who have significant assets (ISAs, investments) generating income they don't need, are concerned about IHT, and would like to see their family benefit now rather than leaving everything in their will.

Other ideal candidates might be widows or widowers with large survivor pensions, or anyone with substantial dividend income exceeding their spending. By adopting this strategy, they take control of their legacy, enjoying the process and minimising the tax man's cut.

Gifting with purpose

Regularly gifting surplus income is a powerful yet straightforward strategy – it starts with the ‘why’ (reducing IHT and helping family) and follows through with the ‘how’ (establishing a steady income and a routine of gifting). For the right clients, it can be an immensely rewarding plan. It demonstrates proactive estate planning, turning IHT into an opportunity to support the next generation in real time.

By understanding the HMRC rules and selecting the right tools (such as suitable income funds), UK financial advisers can confidently implement this strategy for clients who have more income than they need. The result is an educational and impactful solution that clients can easily grasp – one that doesn’t rely on complex trusts or risky schemes, but simply good planning and consistent execution. In a world of uncertain markets and changing tax laws, helping clients gift with purpose and make a positive impact now is positive for all involved.

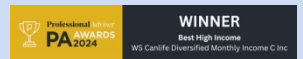
The WS Canlife Diversified Monthly Income Fund

Targeting steady income with monthly dividends

- Aims to deliver a yield of 4% or more annually
- Aims for a steady monthly income payment
- Potential for quarterly and annual enhanced income
- Potential for real growth in dividends and capital

Directly invested multi-asset allocation

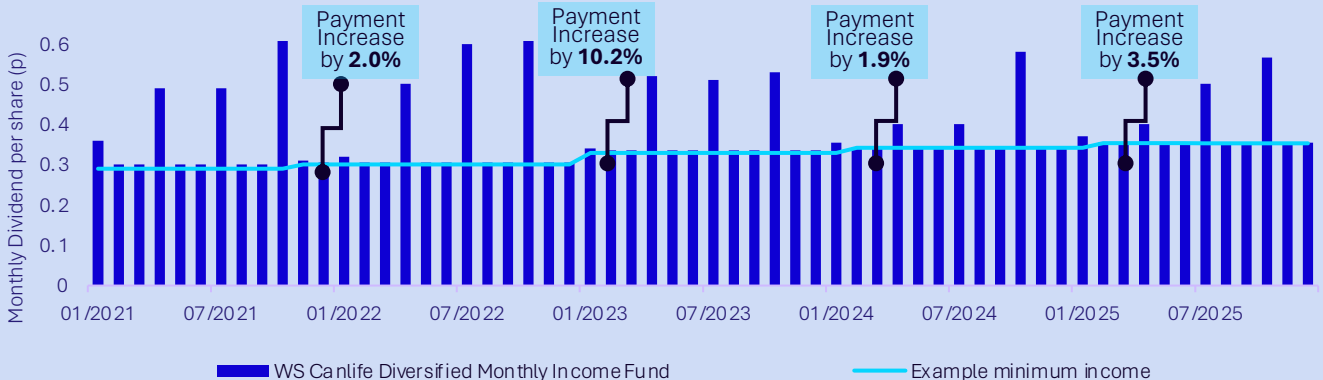
- Directly invested
- Focus on businesses with strong revenue generation
- Multi-asset and multi-region exposure
- Risk management implemented through top-down asset allocation and bottom-up security analysis



Total Return Since Inception:		Quartile Ranking		
Fund	Benchmark	1 yr	3 yrs	5 yrs
47.0%	29.0%	2nd	2nd	1st

Launch date	28/06/2019
Fund manager	Craig Rippe & Jordan Sriharan
Fund size	£94.1m (as at 31.12.2025)
Number of holdings	135
Legal structure	OEIC
Dealing frequency	Daily (midday)
Dividend frequency	Monthly
Base currency	GBP
Benchmark	IA Mixed Investment20-60% Shares
ISIN	GB00BK5BDK84 Acc GB00BK5BDD18 Inc
OCF	0.67% (C Acc & C Inc)

Historical Monthly Dividend Payments



Past performance is not a guide to future performance. Income from investments may fluctuate. Currency fluctuations can also affect performance. Performance: Morningstar, bid to bid, with income re-invested for C share class. All data expressed as at 31/12/2025. Fund returns based on accumulation units.

Important information

An investment should not be contemplated until the risks of investment and tax implications have been considered fully.

Past performance is not a guide to future performance. The value of investments may fall as well as rise and investors may not get back the amount invested. Income from investments may fluctuate. Currency fluctuations can also affect performance.



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