This is a short briefing note for clients on the main inheritance tax exclusions, exemptions and reliefs; intended as an overview.

This note provides an overview of the main UK inheritance tax (IHT) exemptions, for those who are unfamiliar with them.

This is an introduction and is not intended as a substitute for professional advice: IHT is a complex area and many aspects are outside the scope of this note.

Broadly, IHT is charged at 40% (36% where you give substantial gifts to charity - 10% of your estate) on your estate on death and at 20% in respect of certain chargeable lifetime gifts (such as gifts to trusts and companies), to the extent that the lifetime gift or death estate exceeds your available nil rate band (currently £325,000).

Nil Rate Band

The First £325,000 of everyone's estate pays no tax, because it is assessed as a nil rate band. It doesn't matter to whom the estate is given. It is possible to make gifts during your lifetime using this nil rate band so as not pay tax. If you do, you have to survive 7 years before you get your nil rate back in full. This is dealt with in more detail below.

Residential Nil Rate Band

If you give your residence to direct descendants that gift does not pay inheritance tax provided that your estate is worth less than £2,000,000. We have a further detailed guide on this and if it's relevant please ask for it.

An IHT liability can be reduced (sometimes to nil) by the availability of certain exclusions, exemptions and reliefs contained in the IHT legislation.

An "exclusion" relates to certain assets which are specifically excluded from IHT. An "exemption" exempts gifts (of any assets) made to certain persons, provided the conditions are met. A "relief" either wholly or partially reduces the amount of IHT payable in respect of certain assets, provided the conditions for the relief are met.

Excluded property

Certain types of property are excluded from IHT:

- Decorations awarded for bravery (not purchased).
- An interest in an "excluded property" trust. Broadly, this is a trust created by a non-UK domiciled settlor, which holds only non-UK assets.
- A future interest in a trust (called a "reversionary interest") provided that:
    - it was not purchased, and neither the settlor nor their spouse or civil partner is, or has been, a beneficiary of the trust.

There are other categories of excluded property, however they only apply if you are not domiciled in the UK. If you have lived in the UK all of your life, you are likely to be domiciled in the UK. If you have not lived in the UK all your life, see the section on *Domicile*, below.

Exemptions available for both lifetime gifts and on death

Gifts to certain persons are exempt and do not use up the nil rate band. The exemptions are as follows:

Gifts to a spouse or civil partner

Any gift made between spouses (including same sex spouses) or civil partners during lifetime or on death is free of IHT (but see the section on *Domicile*, below, if you are not domiciled in the UK).

Gifts to charities

Outright gifts made to charities in the UK, EU, Norway and Iceland, or to charitable trusts from which only those charities may benefit, are exempt from IHT. To qualify, the charity (or charities) must be established in one of those jurisdictions and must be for recognised charitable purposes.

Gifts to political parties

Gifts to political parties are exempt, provided that the party is of sufficient stature. The requirements (as at the last general election) are that either:

- At least two members of the party were elected to the House of Commons.
- At least one member of the party was so elected and at least 150,000 votes were given to candidates who were members of that party.

Gifts of land to housing associations

Gifts of land to housing associations or to registered social landlords are exempt from IHT.

Gifts for national purposes

Gifts for national purposes are exempt from IHT. The IHT legislation contains a list of bodies and institutions that are covered by this exemption. For example:

- Gifts to the National Gallery or British Museum, or another national institution which exists wholly or mainly for the purpose of preserving a collection of scientific, historic or artistic interest for the public benefit.
- Any museum or art gallery in the UK which exists wholly or mainly for the purpose stated above.
- Any library, the main function of which is to serve the needs of teaching and research at a university in the UK.

Gifts to heritage maintenance funds

Heritage maintenance funds are trusts that maintain historic buildings, or land of scenic, scientific or historic interest. A gift to a heritage maintenance fund is exempt from IHT. Since this is a gift of a historic building we won't go into any details here. You're really dealing with a gift to somebody like the National trust of a stately home. Not something we usually come across. Should it affect you, please let us know and we will provide more details.

Transfers to employee trusts

A transfer of shares to an employee benefit trust is exempt provided that:

- The shares are held:
  - on trust for the benefit of all or most of the employees or office holders of the company; or
  - under an approved profitsharing scheme or share incentive plan.
- On (or within one year of) the transfer, the trustees hold more than half of the ordinary shares in the company and have voting control on all questions affecting the company as a whole.
- The trust cannot be used to benefit any shareholder who is entitled to 5% or more of any class of shares in the company or to 5% or more of its assets on winding up.

Exemptions available for lifetime gifts only

If none of the above exemptions apply, there are additional exemptions available for lifetime gifts. The exemptions are applied in the order in which they are discussed below, with "normal expenditure out of income" applied first and "annual" exemption" applied last.

Normal expenditure out of income

Lifetime gifts are exempt if they form part of your normal expenditure out of (after tax) income, provided that you are left with sufficient income to maintain your usual standard of living (and do not need to dip into capital).

A regular pattern of giving is required, for example meeting annual school fees for a grandchild, or paying the premiums on a life policy for another's benefit.

The first in a series of gifts can qualify, provided further gifts are intended (and provided there is sufficient evidence, should you die before the second gift in the intended series).

Small gifts

Any number of gifts of up to £250 (to any one individual) during a tax year are exempt. The exemption is only available if the gifts to that individual for the tax year do not exceed £250 in total. For example, if you were to give your niece £200 and your granddaughter £300 during the tax year 2008/2009, only the gift to your niece would be exempt.

It is not possible to carry forward any unused portion to the next tax year.

Wedding or civil partnership gifts

Lifetime gifts on the occasion of a marriage or civil partnership are exempt up to certain limits. The amount of the limit depends on your relationship to the couple. The limits are as follows:

- Each parent can give £5,000.
- Each grandparent or great-grandparent can give £2,500.
- Either of the couple can give to each other £2,500.
- Any other person can give £1,000.

The gifts can be outright, or in trust (provided that only the couple, their issue and certain other close family members can benefit).

The gift must take place before the ceremony and must be conditional upon the ceremony taking place. The exemption is not available if the ceremony does not take place.

Annual exemption

Lifetime gifts (which do not fall into any other exemption) are exempt up to £3,000 a year. If the annual exemption is (wholly or partly) unused for a particular tax year, the unused portion may be carried forward for one tax year only.

Potentially exempt transfers

If there are no other exemptions available, an outright gift to an individual (called a "potentially exempt transfer") might eventually fall out of charge. They are so called, because if you (the donor) survive for seven years from the date of the gift, the gift becomes fully exempt.

If you fail to survive for seven years, then the gift becomes chargeable and will use up all or part of your nil rate band. However, the longer you survive after making the gift (subject to surviving at least three years), the lower the IHT charge:

- If you survive between three to four years from the date of the gift, the IHT charge on the gift is reduced by 20%.
- If you survive between four to five years from the date of the gift, the IHT charge on the gift is reduced by 40%.
- If you survive between five to six years from the date of the gift, the IHT charge on the gift is reduced by 60%.
- If you survive between six to seven years from the date of the gift, the IHT charge on the gift is reduced by 80%.

Note that it is the IHT charge that is reduced, not the value of the gift (which reduces the nil rate band by the full amount).

Reduction in rate of tax

A lower rate of IHT applies to testators who die on or after 6 April 2012 and who leave 10% or more of their net estate to charity. The lower rate of IHT is 36%, instead of 40%. Working out whether an estate qualifies for the reduction is complicated and involves sorting out the estate assets into different categories. The available nil rate band and any gifts passing to a spouse on death are excluded from the calculation. Sometimes a gift like this to charities can save the ordinary beneficiaries money.

Reliefs

If the gift (whether made during lifetime or on death) is of a special type of asset, relief may apply to reduce the amount of IHT payable, sometimes to nil.

The main types of relief are discussed below.

Business property relief

Where the conditions are met, 100% relief is available for unquoted share-holdings and interests in a business (whether owned as a sole trade or in partnership) located anywhere in the world. 50% relief is available for shares in a quoted company (where you had control of the company) and also for assets, such as land and buildings, used by your partnership or company.

Generally, you must have owned the shares or the business for at least two years prior to the gift (whether made during lifetime or on death). Certain types of activities and investments are excluded from relief: relief is not available if the business or company's activities consist mainly in dealing in securities, stocks or shares, land or buildings, or making or holding investments.

Agricultural property relief

Where land in the European Economic Area (including the UK) has been occupied for the purposes of agriculture, the land and any ancillary buildings may benefit from relief at 100% or 50%, depending on who farms the land and how long the land has been owned.

Relief is given on the agricultural value of the land, which is taken to be the value of the property if it were subject to a permanent restriction prohibiting non-agricultural use. This may be lower than the full market value of the property (for example, where there is planning permission to build houses on the land).

However, business property relief may also be available, for example if you own the land and farm it as a business yourself. This can be useful where the full market value of the land exceeds the agricultural value (agricultural property relief is given first).

National heritage property: conditional exemption

Where property and assets are important to the UK's national heritage, IHT can be deferred (whether on a lifetime gift or on death) provided the recipient of the asset promises to allow public access and to preserve the property. This relief covers pre-eminent works of art, stately homes and land of public interest therefore not of general interest

Domicile

If you are not domiciled in the UK, your exposure to IHT may be reduced unless you elect to be treated as UK domiciled for inheritance tax.