

September | 2017

The residence nil rate band

Valuable new benefit...
or merely a shuffling
of the cards?



The residence nil rate band

The Conservative Party's 2010 election manifesto clearly set out the intention to raise the nil rate band (NRB) for inheritance tax (IHT) to £1 million, although its efforts were thwarted by the Liberal Democrats while in coalition government with them.

The Prime Minister at that time, David Cameron, then applied a pincer movement to fulfil his party's promise when prior to the 2015 election he revealed plans to introduce an additional 'Residence nil rate band' (RNRB) of £175,000 which would be added to the standard NRB of £375,000 when a main residence is transferred to a direct descendant of the deceased (including stepchildren and adopted children).

The proposals, and subsequent legislation, also made it possible for some trusts for qualifying beneficiaries to be included **but care needs to be taken with trusts written into wills, as not all trusts will qualify, specifically discretionary ones.**

The proposals were included in the 2015 summer Finance Bill and the House of Commons then amended the legislation such that RNRB gifts made to the spouses and civil partners of direct descendants would also be included. The legislation affects second deaths occurring on or after 6th April 2017, regardless of the date on which the first death occurred.



The Finance Act 2016 then added additional legislation to provide that an 'additional' RNRB would be available to the estate where the sale or downsizing of the main residence occurred after 8th April 2015, *provided* that assets of equivalent value to the lost RNRB (plus the value of the lower value main residence) are left to qualifying persons (i.e. those fulfilling the extended definition of direct descendants).

Note also that the property must have been used as a main residence ('qualifying residential interest' or QRI), so buy to let properties do not apply, although a property once lived in by the deceased and then subsequently rented out would.

The RNRB starts at £100,000 in 2017/18 and will rise by £25,000 each year until it reaches £175,000 in 2020/21 (the intention thereafter is for the threshold to increase in line with the change in the Consumer Price Index each year).

Let's consider a simple example first:

John dies in July 2020 (by when the RNRB will have increased to £175,000), leaving an estate valued at £800,000, which includes a property valued at £300,000. 50% of this he leaves to his long-term partner, April, and the other 50% he leaves in equal shares to his three children from his first marriage.

John's estate will benefit from a RNRB of only £150,000 (rather than the maximum available of £175,000) as that is the value which has been left to direct descendants (his children). His estate would also of course benefit from the standard NRB of £325,000.

Transferring the RNRB between spouses/civil partners

If the RNRB is not used on first death then it will be available on second death.

Since the RNRB is transferable between spouses/civil partners, just like the standard NRB, from 6th April 2020 a married couple could share £350,000 worth of RNRB as well as a combined NRB of £650,000 (2 x £325,000). Bingo! There's your promised £1 million IHT threshold.

If the NRB is not used on first death then again, as with the standard NRB, it can be carried forward to the second death and as long as that second death occurs after 6th April 2017 it does not matter how long ago the first death occurred.

In those circumstances, the RNRB available at first death is deemed to have been the starting level of £100,000 and the first to die is deemed to have used no part of it, regardless of what actually happened. As a result, the starting point for calculating the RNRB on second death (see the effect of tapering below) will be to apply an uplift of 100% to the RNRB at the time of second death.

Furthermore, the first to die does not even have to have owned a QRI at the time of their death.

The amount available to be 'carried forward' must be calculated in percentage terms and applied as an uplift to the RNRB on second death.

Let's look at another example:

Henry died prior to 6th April 2017 and left his entire estate to his wife Sally. Sally subsequently dies in November 2018, by which time the RNRB has risen to £125,000. Her estate will therefore benefit from a 100% uplift and therefore a RNRB of £250,000; provided she leaves a QRI of at least that value to direct descendants then her executors will be able to claim the full amount. Sally also qualifies for the increased NRB of £650,000.

Even if Henry had left a QRI to direct descendants on his death rather than to Sally, Sally's estate still qualifies for the full uplift (although Henry would then have used part of his standard NRB and therefore Sally would only receive the unused portion).

Where first death occurs after 6th April 2017, what actually happened at that time will determine the position on second death.

Will I qualify?

So far, so good. But, of course it's not that simple. You could be 'too wealthy' to benefit. The amount of the RNRB is reduced by £1 for every £2 by which the deceased's 'net estate' exceeds the threshold level of £2 million. 'Net estate' means everything left after deducting liabilities such as loans but before deducting any exemptions or reliefs such as business or agricultural property relief.

This means many business owners and farmers will be precluded from benefiting from the RNRB altogether. Amounts left to charity (which would be exempt from IHT) are also disregarded for the purposes of calculating the estate value for the purposes of applying the taper.

Tapering will apply to reduce any 'carried forward' RNRB on first death where the estate of the first to die exceeds £2 million.

In practical terms, this means that from 6th April 2020 married couples with a joint estate exceeding £2.7 million (£2.35 million for a single person) will receive no benefit from the RNRB.

Let's look at further example:

Audrey inherited her late husband's entire estate (valued at £1.5 million when he died in 2016). On her death in January 2022 the value of her estate has risen to £2.5m, of which her main residence represents £1.6 million. Ordinarily, the position would be as follows:

- *Audrey's estate benefits from two standard NRBs of £325,000, i.e. £650,000 and*
- *her estate benefits from two RNRBs of £175,000, i.e. £350,000*

However, as the value of the estate on Audrey's death exceeds the £2 million threshold by £500,000 the RNRB is reduced by £250,000 (£1 for every £2 by which the estate exceeds £2 million). So, even though her husband's estate was below the £2 million threshold and he did not use any of the RNRB, the value of his RNRB is lost, as is all but £100,000 of Audrey's.

The standard NRB is not affected, so the total amount exempt from IHT is £750,000.

What action can I take to maximise the RNRB?

There are a number of steps which could be taken to preserve the benefits of the RNRB, or at least limit its reduction.

- Give away surplus income to avoid increasing the value of the estate;
- Make lifetime gifts (potentially exempt transfers or chargeable lifetime transfers within the NRB) of assets other than QRIs;
- For married couples/civil partners, leave a share in the QRI to children on first death to ensure that both available RNRBs are used and leave other assets up to the value of the standard NRB to a discretionary trust on first death to reduce the amount passing to the surviving spouse/partner;
- Review your will: if property which would qualify as a QRI is currently left to a discretionary trust it will not benefit from the RNRB (this could potentially mean losing the benefit of both RNRBs if the surviving spouse inherits absolutely on first death and if on second death the estate passes to a discretionary trust). This can currently be rectified by the trustees making an absolute appointment within two years of death using a deed of variation but it is never a good idea to rely on existing legislation still being in force when needed in the future;

- If some or all of your home is already in a trust, then you should seek advice as soon as possible as action may need to be taken during your lifetime in order to secure the RNRB;
- Inclusion of an age contingency with a gift means that the gift is not absolute and therefore (if the age is over 25) a gift of a QRI cannot benefit from the RNRB. Consider either restructuring the gift or provide a right to income from the date of death, even if the capital is withheld until a later date;
- If a death has already occurred, it would be advisable to take advice as soon as possible, as there is a two-year window from date of death which could provide an opportunity to take action that might enable the estate to benefit from the RNRB;
- Finally, whilst deathbed planning is never the ideal option, it is worth bearing in mind that for RNRB purposes the value of an estate is the value on date of death regardless of any prior gifts, even if those gifts are made only a short time - even a few weeks - before death. This provides the opportunity for gifting assets which benefit from business or agricultural property relief and as a result qualify for the full RNRB. Once the full exemption is in place, this could save £70,000 in IHT.

As with all matters such as this, you should seek professional advice before taking any action.

Conclusion

This article only touches on the subject - additional detailed guidance can be found on HMRC's website:

<https://www.gov.uk/guidance/inheritance-tax-residence-nil-rate-band> and as with any legislation the rules are complex, but significant opportunities exist in the right circumstances to legitimately reduce the tax payable on a deceased's estate.

The government has stated that it estimates this new legislation will result in only just over 6% of total deaths resulting in an IHT liability, compared to some 10% without these changes. However, land registry figures document that almost 10,000 properties were sold for in excess of £1 million in 2013-14 – an amount which represents an increase of 270% in the number of property sales above £1 million over the period 2003 to 2013.

Property remains the main reason why many people have an IHT liability and this looks unlikely to change in the future. The need for planning will therefore also continue.

Warm regards
Carolyn



For further information please get in touch
with your usual Bloomsbury Wealth
contact, telephone 0207 965 4480 and ask
for a member of the wealth team or
alternatively
e-mail truewealth@bloomsburywealth.co.uk

Disclaimer

This document is intended for informational purposes only and no action should be taken or refrained from being taken as a consequence of it without consulting a suitably qualified and regulated person. It does not constitute financial advice under the terms of the Financial Services and Markets Act 2000. It is not an offer to sell, or a solicitation of an offer to buy, the instruments described in this document. Past performance is not a reliable indicator of future results. Tax treatment depends on the investor's individual circumstances and may be subject to change. Interested parties are advised to contact the entity with which they deal, or the entity that provided this document to them, if they desire further information. The information in this document has been obtained or derived from sources believed by Bloomsbury Wealth to be reliable but Bloomsbury Wealth does not represent that this information is accurate or complete. Any opinions or estimates contained in this document represent the judgement of Bloomsbury Wealth at this time and are subject to change without notice.

© 2017 Bloomsbury Wealth