

Information

The Residence Nil Rate Band

Introduction

On death, a person's estate is liable to Inheritance Tax (IHT) at 40% to the extent, if any, that its value exceeds the current threshold of £325,000. This threshold is referred to below as the IHT-free amount. Assets which pass between spouses are free of IHT and so will not use up any of the IHT-free amount. If after a person's death any of this IHT-free amount is unused (perhaps because the majority of the deceased's estate passed to the surviving spouse), the unused part is transferable to the surviving spouse, whose executors may make use of it on their death. This means that many surviving spouses will have a combined allowance of £650,000 available on their death.

In 2007, the Conservatives proposed to increase the threshold above which IHT is payable to £1million for married couples and civil partners, the rationale being to "reduce the burden of IHT for most families by making it easier to pass on the family home to direct descendants without a tax charge." The government created the Residence Nil-rate Band (RNRB) to meet this aim. This additional allowance is more restrictive and does not follow the same rules as the normal IHT-free amount, described above. Individuals need to carefully plan their affairs to ensure they make the most of the RNRB.

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The RNRB applies only to property that meets certain requirements (see 'The requirements'). The RNRB increases the IHT-free amount for an individual. The RNRB was phased in for deaths after 6 April 2017 and reached its current limit of £175,000 per person for deaths after 6 April

2020. The amount of the RNRB has been frozen until at least April 2026. In a similar way to the IHT-free amount, the RNRB is transferable to a surviving spouse if it is unused.

If the second spouse dies on or after 6 April 2017, they may be able to claim some transferrable RNRB from the spouse who died first, regardless of the date of that spouse's death.

Example: Eric died in March 2011 leaving his estate to his wife Jane. Jane dies in September 2022. Assuming the other requirements are met, Jane's estate will have a transferable RNRB from Eric of £175,000 as well as Jane's RNRB of £175,000.

Where the surviving spouse dies on or after 6 April 2020, it may be possible to claim two full RNRBs totalling £350,000. This, combined with the IHT-free amount, increases the IHT threshold for spouses to the promised £1million.

The requirements

The relief is only available against residential property. The property must have been occupied by the deceased at some point during the time in which they owned it. Crucially, it does not need to have been the main residence at the date of death.

If more than one property falls within the definition above, the deceased's executors may choose which property the RNRB should apply to. The RNRB is capped at the value of the elected property, so it will normally be appropriate to choose the more valuable property.

Head Office
Heathervale House
2-4 Vale Avenue
Tunbridge Wells
Kent TN1 1DJ
T 01892 510000
F 01892 540170

Thames Gateway
Corinthian House
Galleon Boulevard
Crossways Business Park
Dartford
Kent DA2 6QE
T 01322 623700
F 01322 623701

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Example: Terry and Anne are married and live in their marital home valued at £350,000 (House 1). They decide to downsize and move to a smaller house valued at £175,000 (House 2). They keep House 1 and rent it out to tenants. Terry dies in 2021 leaving everything to Anne, who dies in 2022. Anne's executors should elect to attribute the RNRB to House 1, so that the full RNRB of £350,000 is available. In contrast, if they elect House 2, the estate will receive a maximum RNRB of £175,000, assuming no increase in value.

The RNRB is only available if the residential property is inherited by lineal descendants, which includes children, grandchildren, step-children, adopted children and foster children (as well as the spouses of any of them). It does not include other relatives such as siblings and their children.

Some trusts for these beneficiaries will also qualify. However, if the property is left to a discretionary trust, the RNRB will not be available, even if children / grandchildren are amongst the beneficiaries of the trust. The trustees could, however, appoint a share of the property out of the trust to lineal descendants within two years of death and still claim the RNRB. Of course this might defeat the asset protection purpose of having the trust, so the trustees will need to weigh the benefit of potential IHT savings against the risks of property passing to beneficiaries outright.

The RNRB may still be available if a person downsizes or sells their property before their death, provided that part of the estate is inherited by lineal descendants as described above. If a person sells their property and replaces it with one of a lower value there will be an adjustment to the RNRB based on the difference between the

value of the property previously sold and the new property.

It is therefore important to keep records of relevant property transactions.

Losing the RNRB

If the value of the deceased's estate exceeds £2m (the Limit) on their death, some or all of the RNRB will be lost. The amount lost is £1 of the relief for every £2 that the estate is over the Limit.

Example: Anthony and Thomas are civil partners. Anthony dies in 2021 leaving his entire estate to Thomas. Thomas dies in 2022 with a total estate of £2.1million. Normally, £350,000 RNRB would be available but, because Thomas' estate is £100,000 above the Limit, he loses £50,000 of the RNRB.

Once an estate exceeds £2.35m (or £2.7m where it qualifies for a transferable RNRB) it will receive no benefit from the RNRB.

The Limit has also been frozen until at least 6 April 2026.

Where a surviving spouse inherits assets on the first death, this could push the surviving spouse's estate above the Limit. In those circumstances it could be worth considering the use of trusts and outright gifts on the first death to use the allowances and reduce the total value of the survivor's estate.

Death-bed gifts are also not taken into account when assessing the Limit. Tax planning may be undertaken before death to reduce a person's estate below the Limit, so that the full RNRB is available.

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Continued example: Thomas is aware of the RNRB rules and one week before his death makes a gift of £100,000 to his son. This is effective in reducing the size of his estate for RNRB purposes and none of the allowance will be lost, saving £20,000 of IHT.

Another area where individuals need advice is in respect of gifts to take effect under a will if a child dies prematurely.

Example: Mary, a widow, has prepared a will leaving everything to her daughter Claire. The will provides that, if Claire dies before her, the estate will pass to Mary's grandson Andrew provided that he reaches 18. Claire dies before Mary, and on Mary's death her estate passes into trust for Andrew, who is then aged four. Because the residential property has passed into trust and not outright to Andrew, no RNRB will be available.

Conclusion

The implementation of the RNRB was a welcome, if complex, development for taxpayers in the UK. In order to take advantage of the maximum RNRB available careful planning will be required when preparing a new will or reviewing an existing one. Executors and beneficiaries should also examine the rules in detail to ensure they are applying them correctly, undertaking post-death tax planning where possible, and obtaining the maximum RNRB available to the estate.

Disclaimer

This information sheet is written as a general guide. As any course of action must depend on your individual circumstances, it is strongly recommended

to obtain specific professional advice before you proceed. We do not accept any responsibility for action which may be taken as a result of having read this information sheet.

NOTE: The law is stated as at April 2022.

If you require further information, please contact Amy Lane, Nicola Plant or Mark Politz at:

amy.lane@ts-p.co.uk

nicola.plant@ts-p.co.uk

mark.politz@ts-p.co.uk

* All references to the term 'spouse' include a civil partner as defined by Section 1 of the Civil Partnership Act 2004