

Inheritance Tax and the Residence Nil Rate Band

The Residence Nil Rate Band (RNRB) is an additional allowance for inheritance tax which came in to effect in 2017. It is available to persons with direct descendants who have an estate (including their main residence) which exceeds the inheritance tax threshold (or Nil Rate Band (NRB)) of £325,000.

This article examines how the RNRB works in practice.

Basic Rules

The current basic inheritance tax threshold (NRB) is £325,000. This means that on your death inheritance tax is not payable on this proportion of your estate.

A transfer of an estate to a spouse or civil partner is exempt from IHT and therefore the NRB is not utilised. If certain conditions are met, the NRB is carried over to the spouse or civil partners estate, giving a total NRB of £650,000 on the death of the surviving spouse or partner. This is irrespective of whether or not there are other allowances which may be available such as Agricultural or Business Property Relief.

The additional RNRB applies if a person dies after the 6th April 2017 and their estate is above the basic rate inheritance tax threshold.

In the past, additional threshold amounts were as followed:

- 2017/2018 £100,000
- 2018/2019 £125,000

Currently, the threshold stands at £150,000 for 2019/2020.

In 2020/2021 the threshold will be £175,000.

Calculation of the RNRB

The RNRB can be added to the basic Inheritance Tax threshold of £325,000 if the person and their estate meet the qualifying conditions (see below).

The higher threshold does not mean that the home is exempt from Inheritance Tax but that can be the result in certain cases.

The amount of the additional threshold due for an estate will be the lower of either;

1. The value of the property, or share of the property, that the direct descendants inherit; or
2. The total RNRB available.

The RNRB is applied to the estate first, and then any available NRB is applied.

In most cases, the order in which you apply the additional threshold and basic inheritance tax will make no difference. However, in some cases it will affect the amount of any unused additional or basic threshold available to transfer a spouse or **civil partner's estate**.

Example 1

- John Smith dies in the tax year 2020 /2021.
- He leaves a home worth £300,000 and other assets worth £190,000 to his children. He does not leave anything to his wife.
- The maximum available RNRB in tax year 2020/2021 is £175,000.
- The available RNRB for his estate is £175,000 (the lower of £300,000 and £175,000).

Estate value	£490,000
Less RNRB	-£175,000
Remaining value	£315,000
Less available NRB	-£315,000
Amount that inheritance tax is due on	£0

In this case, the full RNRB has been used up but £10,000 of the NRB of £325,000 is unused and can be transferred to John's wife.

Can the Residence Nil Rate Band be transferred?

What happens if the value of the home is less than the RNRB?

If the home is worth less than the maximum available RNRB, you cannot set the unused amount against the other assets in the estate.

However, the unused amount would be available to transfer to their wife, husband or civil partner's estate when they die and if they leave a home to their direct descendants.

Example 2

- Jane Smith dies in the tax year 2020/2021.
- She leaves a flat worth £100,000 and other assets of £400,000 to her son.
- She leaves the rest of her assets of £500,000 to her husband (NB Spousal transfers are exempt from Inheritance Tax).
- The maximum available RNRB in the tax year 2020/2021 is £175,000.
- The additional threshold for the estate £100,000 (the lower of £100,000 and £175,000)

Estate value	£500,000
Less RNRB	-£100,000
Remaining value	£400,000
Less NRB	-£325,000
Amount that inheritance tax is due on	£75,000

Note the maximum possible RNRB for this estate was £175,000 but the flat left to the son is only worth £100,000 so only £100,000 of the RNRB has been used.

The RNRB that has not been used (£75,000) is available to transfer to the husband's estate to be utilised on his death.

There is no unused NRB to transfer as this was used up.

Gifts and other transfer made during a person's lifetime (lifetime transfers)

Unlike the NRB, the RNRB does not apply to any lifetime transfers; such as transfers into trusts or gifts made within 7 years of death.

Direct descendants

For the purpose of the additional threshold, a direct descendant of someone is:

- A child, grandchild or other lineal descendant; and
- A husband, wife or civil partner of a lineal descendant (including their widow, widower or surviving civil partner)

This also includes:

- A child who is, or was at any time, their step child. A person's stepchild is limited to someone whose parent is, or was the husband, wife or civil partner of that person
- Their adopted child;
- A child who was fostered at any time by them; and
- A child where they have been appointed as a guardian or special guardian when the child is under 18.

The person who inherits the home does not have to be under 18.

Direct descendants do not include nephews, nieces, siblings and other relatives who are not included in the list above.

Example 3

- June Smith dies in tax year 2020/2021.
- Her estate includes a home worth £500,000.
- In her Will she leaves half of the property to her step-son and half to her nephew.

Only her step-son is a direct descendant and therefore the RNRB can only apply to half the value of the property. This means that the RNRB available for the estate is restricted to £175,000. This is the lower of the maximum available threshold for tax year 2020/2021 (£175,000) and the value of the half share of the home (£250,000).

Does the Home Qualify

If the deceased owned more than one property, it is for the personal representative to nominate to which the RNRB will apply, provided they have lived in it at some point. A property which was never a residence of the deceased (such as a buy-to-let) cannot be nominated.

Furthermore, the family home does not need to be owned at the date of death. This assists those who may have either downsized or moved into care. RNRB will still be available provided that the property disposed of was owned by the deceased and would of qualified if the home had been retained. Downsizing on disposal has to have took place after 8th July 2015, but there is no time limit on the period between the disposal and the date of death.

Inheriting the Property

There are rules about how the direct descendants inherit the home. It must be left to them either:

- In the Will of the person that has died;
- Under the rules of intestacy; or
- By some other legal means

Please note that the home does not have to be specifically referred to in the deceased's Will. It can be inherited as part of the residue of the estate, that is to say

what is left of the estate after the payment of debts, taxes and specific legacies has been taken into account.

Where the home is included in the residue and that residue is left to a number of people, HMRC treat each of them as inheriting a proportion of the home.

For the purposes of the RNRB, inheriting the home only counts if the direct descendants become immediately entitled to the home when the person dies. For example, if the Will has a condition whereby the grandchildren have to reach a certain age before they can inherit the home, the property is held in a trust until they reach that age, so the additional threshold will not apply.

If the home is held in a trust for the deceased before their death and it stays in trust **when they die, the home will only qualify for the RNRB if the estate's personal representative sells the home as part of the administration of the estate and passes the net sale proceeds to the direct descendants.**

Limit to the Additional Nil Rate Residence Band Allowance

For an estate worth more than £2 million, the amount of the RNRB will gradually reduce or taper away, even if a home is left to direct descendants.

The RNRB will reduce by £1 for every £2 that the estate is worth more than the £2 million threshold.

Example 4

- Ian Smith dies in the tax year 2018/2019
- He leaves an estate worth £2,100,000 to his children. This includes a home worth £450,000.
- The maximum RNRB available in the tax year 2018/2019 is £125,000.
- The estate is worth more than the taper threshold of £2 million by £100,000.
- The RNRB tapers away by £1 for each £2 that the estate is worth more than the taper threshold. Thus, the additional threshold is reduced by £50,000.

RNRB	£125,000
Less taper	-£50,000
Net RNRB available	£75,000

If Ian's estate was worth £2,250,000 or more, the RNRB of £125,000 would be tapered away completely.

The value of the estate for taper purposes is the total of all the assets in the estate less any debts or liabilities. In these circumstances when you work out how much the estate is worth, you do not take off any exemptions such as spouse exemption or reliefs such as Agricultural or Business Property Relief and ignore assets that are specifically excluded from Inheritance Tax.

Estate Planning Considerations

Care should be taken in advising on how to hold the home and the issues for larger estates. Many couples own their property as joint tenants. On the first death, the home passes to the surviving owner with no IHT because of the spouse exemption. The RNRB is not used on the first death with the surviving spouse inheriting the full unused inheritance however if the combined estate on the second death is greater than £2 million then both RNRB could be lost due to tapering.

By switching property ownership into tenants in common, this allows each spouse to control how the home passes and potentially preserve their entitlements to the RNRB by keeping each parties assets below £2 million.

As can be seen from the above, making sure that the allowances and reliefs are applied fully (and in the correct order) is of utmost importance when dealing with the administration of the estate, otherwise an overpayment of tax may occur.

Butcher & Barlow have a specialist Private Client department who are happy to deal with the administration of any estate, regardless of its value.

Banks and other financial institutions, and some firms of solicitors charge by way of percentage value of the estate. This can in certain circumstances lead to an abnormally high estate administration costs. Butcher & Barlow do not do this.

Butcher & Barlow offer a number of funding alternatives such as a fixed fee for obtaining the Grant of Representation (either Probate or Letters of Administration) and dealing the appropriate HMRC tax return (whether the estate is taxable or not).

If you require Butcher & Barlow to administer the estate i.e. collecting in the assets and preparing estate and distribution accounts and making the final distribution, this can be undertaken on a time / cost basis.

You must remember that even if a Will has been deposited with a bank or financial institution (or any other firm of solicitors), if you are named as the executor of the Will you can request that the Will be released and the estate can be dealt with elsewhere.

Mike Bracegirdle

Partner

01606 334 309

mbracegirdle@butcher-barlow.co.uk