The Summer Budget 2015 announced an additional IHT nil rate band available where an individual leaves their main residence to a direct descendant. As more detailed information has come to hand we now consider the proposals in more detail.

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The basics

In addition to an individual’s nil rate band, currently worth ₤325,000, from 2017/18 a further nil rate band will be introduced where on their death they leave their main residence to a direct descendant.

The Residence Nil Rate Band (RNRB) will be introduced for individuals who die on or after 6 April 2017 and will increase as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017/18</td>
<td>₤100,000</td>
</tr>
<tr>
<td>2018/19</td>
<td>₤125,000</td>
</tr>
<tr>
<td>2019/20</td>
<td>₤150,000</td>
</tr>
<tr>
<td>2020/21</td>
<td>₤175,000</td>
</tr>
<tr>
<td>2021/22 onwards</td>
<td>The value will increase in line with the Consumer Prices Index</td>
</tr>
</tbody>
</table>

The RNRB will be offset against the value of the property before the standard nil rate band.

As with the individual’s main nil rate band, any unused RNRB can be transferred to the surviving spouse or civil partner. This is the case even where the first spouse or civil partner to die, died before 6 April 2017.

EXAMPLE 1

Richard and Virginia are married. On Richard’s death in 1997, he leaves his half share of the matrimonial home, together with the remainder of his estate, to Virginia. Virginia dies in October 2018.

The value of the matrimonial home is ₤300,000. Virginia’s remaining estate is worth ₤650,000 and she has her own nil rate band available and the transferrable nil rate band from Richard.

IHT of ₤20,000 will be due following her death. This is because ₤650,000 of her estate is covered by the nil rate band and ₤250,000 of the value of the home is covered by the RNRB, which includes unused RNRB transferred from Richard leaving ₤50,000 taxed at 40%.

The RNRB will be tapered for estates with a net value, after deducting expenses but before any exemptions and reliefs (including nil rate band, spouse exemption and business/agricultural relief), of more than ₤2 million. For every ₤2 net estate above ₤2 million, ₤1 of RNRB is lost.
EXAMPLE 2

Marjorie, who dies in 2020/21, has an estate with a net value of £3 million, including the matrimonial home worth £350,000. She is a widow and has her husband’s transferable nil rate band, including the RNRB, available in full. However, the combined RNRB of £350,000 is wiped out as her estate exceeded £2.7 million.

If her estate had included shares and other property which qualified for business property relief worth £1 million, RNRB would still have been tapered, as the tapering limit will apply regardless of other business property relief or other inheritance tax reliefs and exemptions.

One quirk in the legislation is that there is no actual requirement for the first to die in a couple to actually own a qualifying residential interest at the time of their death for RNRB to transfer to the survivor.

EXAMPLE 3

Harry married Margaret having no assets or savings. When he died, despite the property they both lived in being owned outright by his wife, she will acquire not only his unused nil rate band but also his RNRB on her death.

Beneficiaries who qualify as direct descendants

The property must be left to direct descendants of the deceased. A direct descendant will include a child, including a step-child, adopted child or foster child, and their lineal descendants. It is also to include spouses or civil partners of lineal descendants and widows, widowers and surviving civil partners of lineal descendants, providing they have not re-married before the death of the donor.

A direct descendant can be treated as having inherited the property even where it has been left to a trust, provided the direct descendant is treated as owning the trust asset (bare trust) or has a qualifying interest in possession (immediate post-death interest in possession trust, or a disabled person’s interest) or an interest which meets the conditions of a bereaved minors or an 18 to 25 trust.

Where the property was subject to the gifts with reservation rules, the RNRB will be available so long as the recipient is the person to whom the original gift, subject to the reservation, was made.

Qualifying property

To qualify, the deceased must have an interest in a property which was their residence at some point in time and which forms part of their estate. So even if the property was let out at the time of death, as long as it had been their residence at some time in the past it will qualify for RNRB.

Where an individual owns more than one residential property on their death, their personal representatives can elect which property qualifies for RNRB. It will only be possible to make the election where the property has been the deceased’s residence at some point. Buy-to-let properties which have never been lived in by the deceased will not qualify for RNRB.
EXAMPLE 4

Elizabeth, a widow, owns three properties. She lived in one “House 1”, with her husband, worth £400,000 before they moved to a smaller property, “House 2”, worth £200,000 a couple of years before her husband, Dan, died. They kept hold of House 1 to generate rental income. They also held a buy-to-let property worth £500,000.

On her death, her executors can choose between House 1 and House 2 as both were at one point in time Elizabeth’s main residence. The executors cannot choose the buy-to-let property as it is not a qualifying property, not having been Elizabeth’s main residence at any point.

EXAMPLE 5

John, a widower, sells his home for £400,000 in May 2020 and buys a smaller property for £200,000. He unfortunately dies six months later. He leaves his house and the remainder of his estate worth £800,000 to his two children. Assuming the nil rate band is still £325,000 and he can also take the benefit of his late wife’s nil rate band leaves £350,000 of his estate liable to IHT. However, John’s executors can also claim the joint maximum RNRB of £350,000 based on the value of his original home so the full £1 million estate would pass free of IHT.

If John owned only one residential property during his lifetime and died in November 2020 leaving his house valued at £200,000 and the remainder of his estate valued at £800,000 to his two children, and all other details remained the same, he would have a taxable estate of £150,000 as he could only utilise £200,000 of the combined RNRB.

The qualifying conditions for this concession are:

- Individual dies on or after 6 April 2017
- The property disposed of would have qualified for the RNRB had the individual retained it
- Less valuable property, or if the property has been disposed of other assets of an equivalent value, is in the deceased’s estate
- Less valuable property and any other assets of an equivalent value, are inherited by the individual’s direct descendants on that person’s death

Downsizing or sale of the main residence

It will be possible to claim the RNRB in full where the deceased had either downsized to a less valuable residence or sold their residence on or after 8 July 2015. The full RNRB will only be available where the deceased left the smaller residence, together with assets of an equivalent value to the ‘lost’ RNRB, to direct descendants or, where the property was sold, the sale proceeds, or other assets of an equivalent value are left to direct descendants. Also, where someone ceased to own their only residence, for example they gifted it away, the assets of an equivalent value left to direct descendants also qualify for RNRB, which appears to be particularly generous.
Conclusion

The RNRB is a welcome addition to the inheritance tax legislation, allowing individuals whose estates do not exceed the upper taper threshold, to transfer the family home to direct descendants in an inheritance tax friendly manner. The Government believes that 94% of estates of couples will pass to the next generation free of IHT as an outcome of these changes. The downside, however, is that it does bring further complication to estate planning and there may yet be further changes before its introduction in April 2017.

Further information

Visit the Technical Hub for further information:

www.jameshay.co.uk/technicalhub