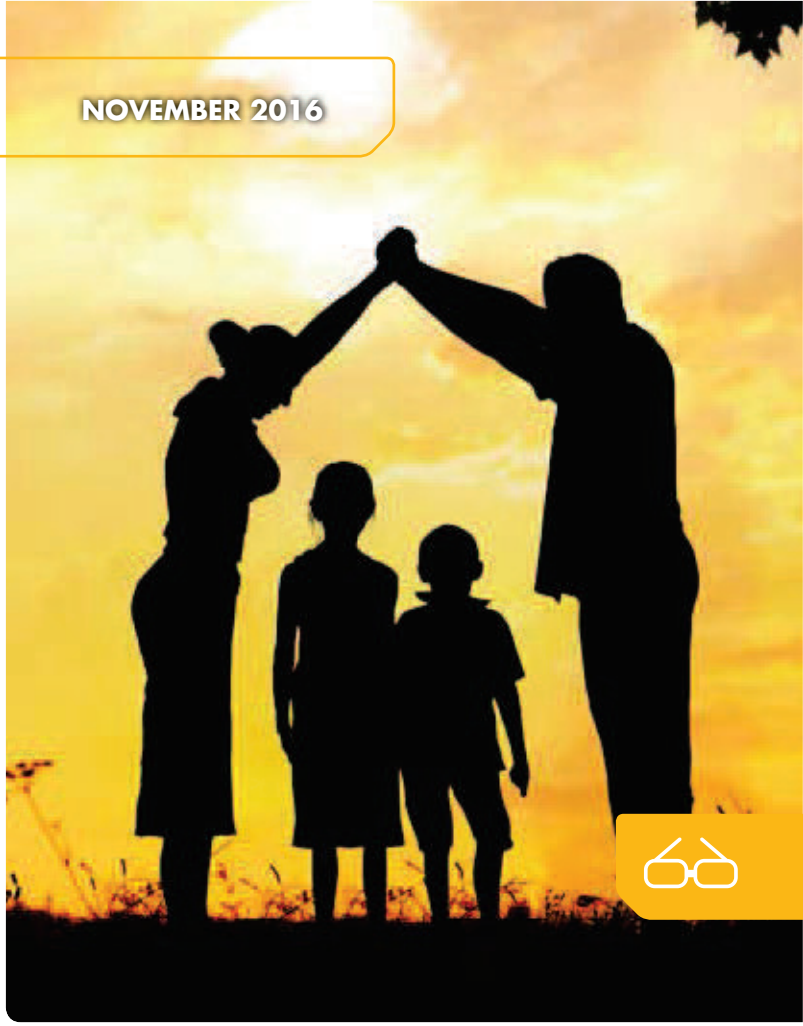

Chandlers CA

Inheritance tax and the residence nil-rate band

A detailed guide to the residence nil-rate band for inheritance tax.

The rise in property prices throughout the UK means that even those with modest assets may find that their estate exceeds the £325,000 nil-rate band for inheritance tax (IHT).

The percentage of properties sold for more than £325,000 has doubled since the current nil-rate band was set in 2009, research by Saga Investment Services has found.

Given that house prices increased by 5.8% in the year to September 2016 and the nil-rate band will remain frozen until the end of 2020/21, an increasing number of homeowners could find that their estate is liable for IHT when they die.

Fortunately there are a number of ways individuals can minimise their IHT liability, such as giving to charity and making use of gift exemptions.

The introduction of the £100,000 residence nil-rate band (RNRB) from 6 April 2017 will be another tool individuals can use as part of their IHT planning.

The RNRB (which is also referred to as the family home allowance) will apply when a family home is passed on to a direct descendant. The RNRB will increase by £25,000 each tax year until it reaches £175,000 in 2020/21. From 2021/22 the RNRB will increase in line with the CPI measure of inflation.

Tax year	RNRB	Individuals: maximum nil-rate band	Married couples and civil partners: maximum nil-rate band
2017/18	£100,000	£425,000	£850,000
2018/19	£125,000	£450,000	£900,000
2019/20	£150,000	£475,000	£950,000
2020/21	£175,000	£500,000	£1,000,000

The RNRB will be applied to property before the existing nil-rate band.

Like the current nil-rate band, people who are married or in a civil partnership will be able to pass on any unused allowance to their spouse or partner.

This means that from April 2020, married couples and people in civil partnerships will potentially have a combined nil-rate band of £1 million.

While the prospect of a nil-rate band of £1 million is certainly headline-grabbing, there are several details and exceptions that may affect your tax planning.

Direct descendants

The RNRB only applies if you pass a property onto direct descendants.

This means:

- children
- step children
- adopted children
- foster children
- any other lineal descendants such as grandchildren.

If you pass the home onto someone else, the RNRB won't apply to your estate.

Inheritance tax and the residence nil-rate band

Eligible property

The allowance is limited to a single property. At the simplest level, if you own one residential property (sometimes referred to as a dwelling house) and you have lived in it, this property will qualify for the allowance.

Where there is more than one residential property in the estate the executor or administer of your estate can nominate which property the allowance should apply to.

Property that you've never lived in, such as buy-to-lets, do not qualify.

Example

Karen is single and has 2 daughters. She dies in September 2017 and leaves all of her estate to her children. This comprises of her home, which is worth £400,000, and assets of £50,000.

The RNRB can be claimed against the first £100,000 of her house, reducing the total value of her estate to £350,000.

Once the general nil-rate band has been deducted, £25,000 of Karen's estate is liable for IHT at 40%, meaning a tax bill of £10,000.

High value estates

The RNRB will be tapered on estates worth more than £2 million.

If the value of the estate (assets minus liabilities but ignoring exemptions and reliefs such as the spouse exemption) is above £2 million, the RNRB will be reduced by £1 for every £2 above the threshold.

Therefore, there will be no RNRB available on estates worth more than £2.2 million in April 2017 (assuming no unused RNRB has been transferred to a surviving spouse or civil partner).

This figure will increase each tax year as the band increases. From April 2020, individuals with estates worth £2.35 million will not have any RNRB available.

Now is the time to review your will if you are likely to be affected by the taper reduction. In particular married couples and those in civil partnerships who currently intend to pass all their assets (and nil-rate bands) onto their partner may find that any tax saving is negated if the estate exceeds £2 million at the time of the second death.

We can advise on strategies to avoid the taper reduction.

Downsizing

The rules permit individuals who downsize or no longer own a home on or after 8 July 2015 to potentially still benefit from the full RNRB. Individuals will be able to pass on cheaper properties and/or assets up to the value of the full RNRB to direct descendants.

There are other conditions to meet in order to be eligible for this.

Talk to our team about additional qualifying conditions.

Unused allowance

Any unused RNRB can't be used against other assets. If your property is worth less than the RNRB, the allowance will be reduced.

However, any unused allowance can be passed to a surviving spouse or civil partner, even if the deceased didn't own a property at the time of their death.

Any unused RNRB is passed on as a percentage rather than a figure. On the second death, the unused RNRB available is calculated according to the current RNRB. For deaths before 6 April 2017, the full RNRB can be transferred to a spouse or civil partner.

Example

Richard dies in May 2017 and leaves his share of his house and the rest of his estate to his wife Jane.

Jane dies in May 2020 when the RNRB is £175,000. Assuming Jane's estate is valued at less than £2 million, the total RNRB available is £350,000.

Trusts

Family homes placed into a trust will be eligible for the RNRB provided that the beneficiary is a direct descendant.
This will include:

- bare trusts
- interest in possession trusts
- bereaved minor trusts
- 18-25 trusts
- disabled persons' trusts.

Planning pointers

Confirm your eligibility
Do you own property and have direct descendants who you'd like to inherit your property?

Review your will
Check that your will is structured to help maximise the benefit of the RNRB.

Estimate the value of your estate
Will you be affected by the taper reduction?

We can work with you to devise an IHT strategy that means your assets go to your loved ones and ensures you pay as little tax as possible.