



THE RESIDENCE NIL-RATE BAND

The Conservative party's pledge to increase the inheritance tax nil-rate band (the threshold below which inheritance tax is not payable) to £1,000,000 goes back to 2007, during their time in opposition. When they came to sole power in May 2015, they found themselves under pressure to make good on their promise. With this in mind, the government announced the introduction of the new "residence nil-rate band" (RNRB) that summer, the provisions of which came into effect for deaths on or after 6 April 2017.

Unfortunately, far from simply increasing the nil-rate band threshold as had been hoped for, the measures are complex to understand and apply, and only go some way towards fulfilling the government's original pledge. However, there are opportunities to maximise the available RNRB both by undertaking lifetime planning and when drafting a will.

THE ORIGINAL NIL-RATE BAND

On a person's death, inheritance tax is payable at a rate of 40% on the chargeable value of the estate above the nil-rate band (taking into account the value of any chargeable lifetime transfers). The nil-rate band is currently £325,000, and is to be frozen at this level until 5 April 2028.

Any unused nil-rate band of the first spouse to die may be transferred and set against the estate of the surviving spouse on their eventual death (the "transferable nil-rate band"). On this basis, the nil-rate band available on the second death may be as much as £650,000.

CONDITIONS FOR OBTAINING THE RELIEF UNDER THE RNRB

The RNRB applies in respect of deaths on or after 6 April 2017 where the deceased leaves all or part of their interest in a property which has, at some point, been their residence (or, if certain conditions are met, assets representing that interest) to one or more direct descendants.

For the purposes of the relief, a direct descendant is a child of the deceased (including a stepchild, adopted child or foster child), together with that child's own lineal descendants (again including stepchildren, adopted children and foster children). It also includes the spouses and civil partners of those persons, as well as their widows, widowers and surviving civil partners (provided that they have not re-married before the deceased's death).

The direct descendants must inherit upon the deceased's death. This can be under the terms of the deceased's will, by the operation of the intestacy rules or by survivorship (for example, where property is owned as joint tenants).

The transfer to the direct descendants must either be outright, or to certain specified types of trust of which the direct descendants are beneficiaries. These include life interest trusts arising immediately upon the death of the deceased person, as well as trusts for disabled beneficiaries and specified trusts for a child of the deceased.

Where transfers are made otherwise, it may be possible to vary the terms of the disposition within two years of death, so that the result is "read back" to the date of death, to allow the relief to apply. Most commonly, this will be done through deeds of variation or appointments from discretionary will trusts.

CALCULATING THE RELIEF

The value of the RNRB will, broadly, be the lower of:

- a) the net value of the proportion of the deceased's interest in the residential property (before deduction of exemptions and reliefs) which is inherited in accordance with the requirements of the legislation; and
- b) the individual's "residential enhancement" for the tax year of death (plus any amount brought forward from a predeceased spouse and as adjusted by the tapering provisions – see below for more detail). The residential enhancement started at £100,000 per person for the 2017/18 tax year, and has risen by £25,000 each year, reaching £175,000 in the 2020/21 tax year. It has been frozen at that level until at least 5 April 2028.

The amount of the person's estate over and above any RNRB and standard nil-rate band to which they may be entitled will be charged at the normal rates that apply for inheritance tax.

TAPERING PROVISIONS

There is a tapered withdrawal of the RNRB relief for estates with a net value of more than £2m. This is at a withdrawal rate of £1 for every £2 by which the estate's value is over this threshold. So for example, if a person were to die in the 2023/24 tax year, when the residential enhancement is £175,000, by the time that the net value of the deceased's estate exceeds £2,350,000 (in the case of an unmarried person, or on the death of the first to die of a married couple or £2,700,000 on the death of a surviving spouse who has been able to bring forward 100% of the predeceased spouse's allowance) the relief will no longer apply. The taper threshold has been frozen at £2m until at least 5 April 2028.

It is worth noting that the value of the net estate does not include the value of any failed potentially exempt transfers (i.e. gifts made in the seven years before death). "Late" gifts might therefore be considered in cases where this can fully secure the relief by avoiding tapering.

TRANSFER OF THE RELIEF BETWEEN SPOUSES/CIVIL PARTNERS

In the case of a married couple or civil partners, any RNRB that is not used on the first death can be transferred to the surviving spouse or civil partner, in much the same way as the existing nil-rate band. The amount unused, expressed as a percentage of the residential enhancement at the date of the first death, will be applied to uplift the survivor's RNRB entitlement as a percentage of the residential enhancement applicable at the date of the second death.

Where the first spouse or civil partner died before 6 April 2017, the residential enhancement at the time of the first death is deemed to be £100,000. Because the RNRB did not take effect until 6 April 2017, the first spouse, whose death took place before this date, cannot have used any RNRB. Therefore, the uplift on the second death, occurring on or after 6 April 2017, will always be 100% (unless tapering applies).

MULTIPLE PROPERTIES

The RNRB will only be available in respect of one residential property. Where the deceased owned more than one property, the personal representatives will be able to nominate which property should qualify for the relief.

However, a property which has never been a residence of the deceased (for example, a buy-to-let property) will not qualify.

DOWNSIZING

The RNRB will also apply to individuals who downsize by moving to a less valuable property, or who cease to own a property altogether. Broadly, where the deceased downsized or ceased to own a residence on or after 8 July 2015, the RNRB will be calculated by reference to the residence that has been disposed of, provided that the replacement property (or, where there is no replacement property, assets of an equivalent value) passes on the death of the deceased to a direct descendant.

POINTS IN PRACTICE

The potential to benefit from the RNRB provides a good reason to review existing inheritance tax planning. In particular, thought should be given as to whether assets should be disposed of during lifetime (and if so, to whom) and the types of provisions that should be included in wills. In particular, the fairly common will planning which involved leaving property to a surviving spouse for life, with the remainder passing to children on trust following the second death, will not be tax efficient from a RNRB perspective – clients with these provisions in their wills may wish to take further advice.

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