Residence Nil Rate Band: An outline

Inheritance tax and trusts | Tax voice



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Allan Holmes guides us through some key issues regarding the Enhanced Nil Rate Band for residential property

Introduction

The Conservative party 2015 election manifesto stated that it would "take the family home out of tax by increasing the effective Inheritance Tax threshold for married couples and civil partners to £1 million".

The Chancellor duly announced proposals to bring into force the election pledge in the Summer Budget 2015 and the provisions were duly enacted in Finance (No 2) Act 2015. The Government is expecting the legislation to cost approximately £980 million per year when the maximum relief is introduced in 2020/21, that is almost £2.5 billion of residential property value predicted to move outside of the IHT net!

In this article I look at some of the key aspects of the legislation and the direct issues which need to be considered going forward. I then recap IHT planning in relation to UK residential property and the potential impact of the legislation.

Key provisions

The legislation introducing the residence nil rate amount (RNRA) is effectively bolted on to the existing legislation for the nil rate band and the transferrable nil rate band (s8D –s8M IHTA1984). It is beyond the scope of this article to set out a detailed analysis of the legislation (there is not enough space!) but as you will see it is extremely complex with some difficult areas.

The main points to be aware of are as follows

- The relief applies to residential property which is included in an individual's estate on death and which is bequeathed to children and descendants (including step children) and /or their spouses.
- The property must pass into the estate of the descendant or onto a favoured trust for their benefit i.e. to them outright or onto an Immediate Post Death Interest, Bereaved Minor, 18-25 or Disabled Persons trust.
- The residential property must have been occupied by the individual as a residence at some time but does not need to have been their main residence. It is possible to choose which property obtains the relief via an election.
- The legislation will apply to deaths from 6 April 2017.
- The relief is in the form of an "enhancement" of the nil rate band available on death and is used in priority to any other elements of the nil rate band (ordinary nil rate band or transferred nil rate band).
- The maximum relief starts at £100,000 (2017/18) then rises by £25,000 per year until it reaches a maximum of £175,000 for 2020/21.
- Whilst the relief is calculated by reference to the value of the residential property transferred on death, it is applied across all of the chargeable estate.
- Unused relief can be transferred to a surviving spouse or civil partner on a claim.
- For deaths prior to 6 April 2017 the surviving spouse will be able to claim the deceased persons RNRA (as it would have been impossible for them to use it). The deceased does not need to have owned a property.
- The £1 million inheritance tax threshold is reached by 2X NRB of £325,000 plus 2x RNRA of £175,000.
- The relief is withdrawn by £1 for every £2 the estate exceeds £2m – so for an individual it is lost after £2.35 million (£2.7 million for a surviving spouse). The estate is calculated before reliefs such as BPR and APR.
- Additional legislation will ensure that an individual who downsizes in later life is not disadvantaged.

- The legislation contains a number of definitions and formulae which require extremely careful navigation.

Planning around the legislation

Legislation of this complexity will take some time to bed in and even though the relief does not come into force for another year it needs to be considered now, in particular in relation to will drafting and in situations where one spouse may die before 6 April 2017.

I am sure that there will be further aspects of the legislation to focus on but some initial points are as follows:

- It only apples to transfers of qualifying residential property on death to qualifying descendants – so property gifted just before death cannot qualify.
- The restriction of the amount of relief applies by reference to the value of the estate on death; it does not include failed PETs so gifts pre death of other assets may be a good idea.
- Property identification will be important as if the property was never used as a residence by the deceased the relief is not available. It will also be necessary to ensure that there is sufficient evidence to prove that the property was occupied by the deceased as a residence.
- The RNRA is not available on transfers to relevant property trusts.
- The likely value of the estate of the surviving spouse needs to be considered, there is no point passing all of the deceased's assets to the spouse and with it the full RNRA if the spouse is likely to have a combined estate on death greater than £2.7 million.
- Gifts with reservation of benefit WILL qualify for the relief as the value will be included in the estate of the deceased.
- The time limits for claiming the deceased spouse allowance will need to be carefully monitored.
- Will drafting is now much more complicated as it will be necessary to factor in the RNRA and ensure that there is a qualifying property to leave to a descendant.

Effect on existing planning

Estate planning around the family home has always been difficult and there are few effective planning ideas around. A number of individuals have planned via a gift of their residence and the payment of rent but there are income tax and capital gains tax downsides. This is likely to become less popular as a) for many people it will be unnecessary and b) it may result in loss of the RNRA. Others have based their planning on the exemption from the reservation of benefit provisions available for joint occupation but this is often not easy to achieve in the long term, the RNRA will in some circumstances allow scope to default to the reservation of benefit provisions.

Current will planning under which residential property is transferred to a relevant property trust is likely to be less popular, again due to the loss of the RNRA.

For younger individuals, simple term life insurance is a good medium term option.

Gifts of other property pre death are likely to become more popular in order for the estate on death to be below £2 million, even if there is little likelihood that the donor will survive three years. It will be necessary to consider the capital gains tax implications.

As with much modern legislation it is a pity that a tax relief which can be summarised in a few words is enmeshed in such complicated provisions.