

## Inheritance Tax Main Residence Nil Rate Band

The Chancellor announced in the Summer Budget of July 2015 that an enhanced IHT nil rate band would be introduced with effect from 6 April 2017 and so fulfil a long-standing Conservative Party pledge to achieve a £1m Inheritance Tax nil rate band.

The increased nil rate band will be available when a residential property passes on death to direct descendants, i.e. to children, grandchildren and more remote issue.

Provided that the value of the residential property exceeds the additional nil rate band then the enhanced nil rate band amount will escape IHT, subject to certain conditions.

The maximum amount of this enhanced nil rate band (NRB) is to be phased in as follows:-

Tax Year	Standard NRB	Enhanced Residence NRB	Total NRB
2017/18	£325,00	£100,000	£425,000
2018/19	£325,00	£125,000	£450,000
2019/20	£325,00	£150,000	£475,000
2020/21	£325,00	£175,000	£500,000

The enhanced nil rate band is then due to increase in line with the Consumer Prices Index (CPI) from 2021/22 onwards.

### Example 1

To see the effect of the new relief, consider the case of a single person who lives in a flat worth £80,000 and has other assets worth £400,000. The total estate is therefore £480,000.

If the person dies in 2017/18 the IHT nil rate band available will be £405,000, being the standard £325,000 plus an enhanced residence NRB worth a further £80,000. The full £100,000 will not be available as the flat is worth less than the enhanced NRB.

As a result IHT at 40% will be charged on £75,000, giving an IHT liability of £30,000. However, if the flat had been worth £400,000 and the other assets £75,000 the full £100,000 residence NRB would be available and the IHT charge would then be £22,000.

Where a married couple leave their assets to each other the existing rules relating to the transferrable nil rate band will also allow the enhanced residence NRB to be transferred.

This can allow the last survivor of the couple to use up to twice the tax-free amounts available to a single individual, meaning that potentially up to £1m can be free of IHT in some circumstances.

## Example 2

A married couple leave all of their assets to each other in their Wills. On the second death the total estate is worth £900,000, including their family home worth £650,000.

The total nil rate band available to the last survivor in 2017/18 will be £850,000, as two enhanced residence NRB's of £100,000 will be given (as the property is worth more than £200,000) plus the two standard nil rate bands totalling £650,000.

The IHT charge is £20,000, i.e. £900,000 - £850,000 = £50,000 charged at 40%.

## Conditions for relief

There are several conditions that must be met in order to qualify for the enhanced NRB, as follows:-

- ❑ The estate must include a residential property or qualify for relief under the "downsizing" rules (see below);
- ❑ The individual, or the second spouse/civil partner, must die after 5 April 2017;
- ❑ The enhanced NRB will be limited to the lower of the figure above and the value of the residential property;
- ❑ Only one residential property will qualify, but personal representatives will be able to nominate which property will qualify if there is more than one in the estate;
- ❑ A property that was never the residence of the deceased, such as a buy-to-let property, will not qualify;
- ❑ The property must be left to a direct descendant, being a child (including a step-child, adopted child or foster child) of the deceased and their lineal descendants (grandchildren, great grandchildren, etc.). In some instances property left to jointly to a descendant and their spouse may qualify, but this will need to be reviewed carefully;
- ❑ Assets and property left in trust will not satisfy the above condition unless the only beneficiaries are direct descendants and the terms of the trust will give them at least a life interest. Some special trusts (for bereaved minors, 18-25 trusts and disabled persons trusts) may also qualify for the relief.

## Clawback

In addition to the above conditions the relief is also restricted where the total net value of the IHT estate, after deduction of liabilities but before deducting any reliefs and exemptions, is more than £2m.

The additional nil rate band is tapered by £1 for every £2 that the net value exceeds £2m.

As this is calculated using the value of the estate before reliefs such as Business Property Relief it will mean that, for example, shareholders of unquoted trading companies may find that they do not qualify for the enhanced residence nil rate band if the shareholding is valuable, even if the shares themselves are not subject to IHT.

The threshold means that for 2017/18 no additional relief will be available for an unmarried individual's estate that exceeds £2.2m, rising to £2.35m in 2020/21.

For the second death in qualifying married couples and civil partnerships the upper limits will be £2.4m in 2017/18, rising to £2.7m in 2020/21 (i.e. the £700,000 over £2m will reduce the NRB by £350,000, cancelling out the 2 x £175,000 residence NRB's).

The taper threshold of £2m is scheduled to rise in line with the CPI from 2021/22 onwards.

## Downsizing

There was a concern that the relief would discourage people living in valuable houses from downsizing to less expensive accommodation or from moving into care, for fear that it would prevent them from benefitting from the enhanced nil rate band.

To prevent this problem an extension to the relief is available where a qualifying residence is sold before death.

There are several conditions that must be met in order to qualify for the enhanced NRB in this situation, as follows:-

- ❑ The death occurs after 5 April 2017;
- ❑ A property is sold in the period after 7 July 2015, but before death;
- ❑ The property must have been eligible for the enhanced nil rate band had it been retained;
- ❑ A less valuable property or other assets of an equivalent value are included in the deceased's estate and these are then inherited by the direct descendants;

The relief will cover both downsizing to a less valuable property and an outright sale without acquiring a new property, provided the above conditions are met.

Downsizing can cover a part disposal of property and there can be more than one downsizing move between 8 July 2015 and the date of death.

Where a property has been given away, assets of an equivalent value to the property at the date of the gift must be left to direct descendants.

The enhanced nil rate band will be subject to taper in the same way as an estate that does not downsize, with the nil rate band being tapered where the estate is valued over £2m.

The calculation of partial relief where downsizing has taken place is based upon the proportion of the enhanced NRB that would have been available at that time. That fraction of the enhanced nil rate band is available to the estate using the value of the enhanced residence NRB at the date of death, provided the other conditions are satisfied.

For example, if an unmarried individual sells their property in 2017/18 and at that time the value of the property was worth £85,000, i.e. 85% of the £100,000 enhanced NRB, their estate will benefit from 85% of the enhanced nil rate band in the year of death provided that sufficient assets are passed to direct descendants.

The above summary is based on legislation and guidance published as at 1 June 2016. The summary is intended to provide a general guide and individual advice should be sought about your specific circumstances.