

# Property monopoly

In a tax basics article, **John Colville** summarises the main provisions relating to the inheritance tax residence nil rate band.

**T**he Conservative election manifesto of 2015 promised that the government would ‘take the family home out of tax for all but the richest by increasing the effective inheritance tax threshold for married couples and civil partners to £1m, with a new transferable main residence allowance of £175,000 per person.’

After the election, a ‘residence nil rate band’ (RNRB) was introduced to take effect from 6 April 2017 and applies to deaths on or after that date. The RNRB runs alongside, and is in addition to, the general inheritance tax nil rate band. The band has been phased in over a period of four years and by 2020-21 has reached its full value of £175,000. In this article I will ignore any transitional rules. I will also refer to married couples, but the same rules apply to civil partners.

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## General nil rate band

We are all familiar with the general nil rate band whereby, currently, the first £325,000 of an individual’s death estate is chargeable at 0%. The excess is then chargeable at 40%. However, the nil rate band which is available to set against the death estate is reduced by any transfers the individual has made in the previous seven years. So, if lifetime transfers of £100,000 have been made only £225,000 of nil rate band can be set against the death estate. If lifetime transfers exceed £325,000, no nil rate band remains available and the whole of the death estate is chargeable at 40%.

### Key points

- The promise of a £1m inheritance tax threshold for married couples and civil partners.
- The RNRB applies to deaths from 6 April 2017 and was introduced in phases.
- The full band of £175,000 applies for deaths on or after 6 April 2020.
- The qualifying residence must be ‘closely inherited’.
- The relief is tapered if the estate exceeds £2m.



We then have the transferable nil rate band, whereby if the first spouse dies but does not use their nil rate band (perhaps because all of their estate was left to the surviving spouse or comprised exempt assets), the unused proportion can be transferred to the surviving spouse and is available to use when calculating the inheritance tax arising on the death of the second spouse.

Let’s consider William and Mary, a married couple. William dies and, in his will, leaves the whole of his estate to Mary. His estate is exempt and none of his nil rate band is used. In years to come, when Mary dies she will be entitled to two nil rate bands – her own and the unused nil rate band transferred from William. This will give an aggregate nil rate band of £650,000. So, inheritance tax will only be charged on Mary’s estate on the value in excess of £650,000.

If the first spouse uses part of the nil rate band on their death, it is only the unused proportion that can be transferred. Let us suppose that, on his death, William had left £250,000 to his daughter, Anne, with the residue to his wife, Mary. William would have used £250,000 of his nil rate band. The unused proportion could then be transferred to Mary.

Assuming the nil rate band remains at £325,000, then £75,000 would be transferred to Mary who would have an aggregate nil rate band of £400,000.

## Residence nil rate band

The RNRB applies to deaths from 6 April 2017 and has the value of £175,000 for deaths on or after 6 April 2020. It applies only to the calculation of the tax on the death estate and (unlike the nil rate band and transferred nil rate band) cannot be taken into account in determining the tax on a lifetime transfer.

Assuming the necessary conditions are satisfied, an individual will be entitled to an RNRB of £175,000 together with a general nil rate band of £325,000. Consequently, they will pay tax only on the value of the estate above £500,000, assuming they have made no lifetime transfers.

- Two principal conditions need to be satisfied:
- the estate must contain a qualifying residence, being a house which at some time has been the deceased's residence; and
  - the residence must be closely inherited; in other words, it passes to direct descendants such as children or grandchildren.

If the value of the residence is less than the amount of the RNRB, the band is restricted to the value of the residence.

### The brought forward allowance

There is a provision similar to the transferable general nil rate band which applies to the RNRB. The unused proportion of the RNRB on the death of the first spouse is transferred to the second spouse and can be used on their estate. This is known as the brought forward allowance. Situations where the RNRB is unused would include:

- the first spouse did not have a qualifying residence;
- the residence was not left to direct descendants;
- the value of the residence was less than the value of the RNRB; or
- the first spouse died before 6 April 2017.

This last case is interesting in that even if the first spouse died before 2017 – in other words, before the new rules applied – the surviving spouse can still claim the brought forward allowance as long as, of course, they die after 2017.

The simplest and most common situation will be a married couple. Let's consider another couple, George and Caroline. George dies and leaves the whole of his estate, which may include an interest in the family home, to Caroline. As we have seen previously, George's estate is exempt and any unused general nil rate band can be transferred to Caroline. Further, George does not use his RNRB (because the house is left to Caroline rather than a direct descendant). The unused proportion of the RNRB is transferred to Caroline, where it is referred to as the brought forward allowance.

Suppose Caroline dies later and leaves the whole of her estate, including the family home, to her daughter, Amelia. The combined nil rate bands which will be available in calculating the tax on Caroline's estate would be £1,000,000, made up as follows.

	<b>£</b>
Residence nil rate band	175,000
Brought forward allowance	175,000
General nil rate band	325,000
Transferable nil rate band	<u>325,000</u>
	<u>1,000,000</u>

### Tapering the RNRB

As so often with tax, governments may want to benefit the majority of individuals, but not to reward the very well off. This principle applies with the RNRB.

The RNRB is reduced if the value of the deceased's estate exceeds £2m. The value of the estate is measured before any deduction for business or agricultural property relief. The RNRB is reduced by £1 for every £2 by which the estate

exceeds £2m. So, if the estate is valued at £2,100,000, the RNRB is reduced by £50,000 to £125,000. If the estate exceeds £2,350,000 the RNRB would be reduced to nil.

If the individual is entitled to the brought forward allowance as well, the combined allowance is known as the default allowance. Tapering also applies to the default allowance. It would be reduced to nil if the estate exceeds £2,700,000.

We can illustrate this with the example of Oliver and Elizabeth.

### Oliver and Elizabeth

Oliver died in August 2017 leaving an estate as follows:

	£
Main residence	1,500,000
Other assets	<u>400,000</u>
Total estate	<u>1,900,000</u>

Oliver left £250,000 in cash to his son Richard and the residue of the estate to his wife Elizabeth.

Elizabeth died in May 2020 leaving an estate as follows:

	£
Main residence	1,700,000
Other assets	<u>500,000</u>
Total estate	<u>2,200,000</u>

She left her estate to her son Richard and neither Oliver nor Elizabeth had made any lifetime transfers.

“The unused proportion of the RNRB on the death of the first spouse is transferred to the second spouse.”

Oliver did not use his full nil rate band on his death in August 2017 so the unused proportion of the general nil rate band can be transferred to Elizabeth as follows:

	£
Nil rate band 2017-18	325,000
Less: used on death	<u>250,000</u>
Unused nil rate band	<u>75,000</u>

Since the nil rate band is £325,000 on both Oliver and Elizabeth's deaths, Elizabeth's nil rate band is increased by £75,000.

Elizabeth's general inheritance tax nil rate band is £400,000 (£325,000 + £75,000).

Oliver would have been entitled to an RNRB because he died in 2017-18. As the main residence passed to his spouse on his death (and not to a direct descendant), 100% of the RNRB is unused. This can be transferred to Elizabeth. The amount transferred is based on the value of the RNRB at Elizabeth's death.

The RNRB will be available to Elizabeth because she left a qualifying residential property to her son, Richard.

Elizabeth died in 2020-21, so the RNRB available in her estate is therefore:

	£
RNRB 2020-21	175,000
Brought forward allowance: £175,000 × 100%	<u>175,000</u>
Default allowance	<u>350,000</u>

However, because her estate exceeded £2m, this is restricted as follows:

	£
Default allowance (above)	350,000
Less restriction: $\frac{1}{2} \times £(2,200,000 - 2,000,000)$	<u>100,000</u>
RNRB available to Elizabeth	<u>250,000</u>

The inheritance tax payable as a result of Elizabeth's death is therefore as follows:

	£
Total estate	2,200,000
Less: RNRB	250,000
General NRB	<u>400,000</u>
Taxable estate	<u>1,550,000</u>
Inheritance tax @ 40%	<u>620,000</u>

## Conclusion

Has the government kept to its manifesto promise and, in effect, raised the threshold to £1m?

The answer must be a qualified yes. In a simple scenario, if the first spouse dies, leaving all their estate to the second spouse who subsequently dies leaving all their estate to their son or daughter this would appear to be the case, but let's just think about some of the anomalies.

### Planning point

Advisers acting for couples who are unmarried or not in a civil partnership should review their assets and warn them of potential inheritance tax liabilities that could be mitigated by marriage or civil partnership.

The residence must be left to direct descendants. If an individual wishes to leave their house to, for example, a niece or nephew, the RNRB will not be available.

To obtain the full benefit, the estate cannot exceed £2m. Given house prices in London and the south of England, it is quite likely that someone living in a modest terraced house in some parts of London could find the RNRB being tapered away. By contrast, someone with a large country house in the North of England may be well within the limit.

“The inheritance tax system appears to favour married couples and civil partnerships.”

Yet again, the inheritance tax system appears to favour married couples and those in civil partnerships. Consider Stephen and Matilda, an unmarried couple who jointly own the house they live in. Suppose Stephen dies leaving his estate to Matilda. If they were married no inheritance tax would be payable because his estate would be exempt. Here, not only will the estate not be exempt and the excess over the nil rate band charged at 40%, but no RNRB is available because the house is not left to a descendant. In many cases, the house may be the only significant asset and this could cause undue hardship for Matilda. Further, the unused RNRB on Stephen's death cannot be transferred to Matilda because she is not a surviving spouse.

Despite this, the government makes the rules and, like them or not, our job is to apply them as best we can for the benefit of our clients even if we do feel that some have a monopoly of the tax advantages over others. ●

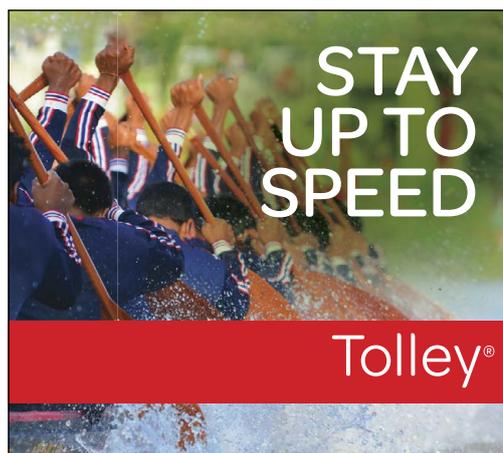
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