

# AF1 IHT 2020/2021

## Part 3: Residential Nil Rate Band

The milestones for this part are to understand:

- What is RNRB and what are the conditions for claiming it.
- How to apply RNRB in a calculation.
- How unused RNRB can be transferred.
- How RNRB can be tapered.
- How RNRB is affected if the property is passed into trust.
- The conditions for getting the Downsizing Addition.

### Outline

The RNRB is an additional Nil Rate Band of £175,000 that can be claimed if the following conditions are met:

- Death occurs on or after 6 April 2017.
- The deceased's home, or a share of a home, is transferred either through a will or intestacy
- The home is left to direct descendants or their spouses.
  
- It does **not** apply to lifetime transfers.
- RNRB will be gradually withdrawn if the total estate is more than £2 million.
- Unused RNRB can be transferred between spouse's/civil partners

In HMRC language, to get RNRB there must be a **Qualifying Residential Interest (QRI)** that is **closely inherited**.

## Qualifying Residential Interest

A QRI is an interest in residential property that has at some time during the deceased's period of ownership was occupied by him or her as a residence.

Roger only owned one house on his death which was his main residence. He has a QRI in that property.

Hilary lived in her house for most of his life before moving in with her daughter as her health had deteriorated. She then rented out the property which she still owned on her death. She has QRI in the property

Bill owned a buy to let property that was never his home. He does not have a QRI.

It is possible for the deceased to have QRI in more than one property. If in the above example Hilary had purchased a retirement property where she lived, and rented out her old house, she would have QRI in both properties. In that case her executors can nominate which one will be treated as the QRI.

## Closely Inherited

To get RNRB, the QRI must be left to a "lineal descendent" or a spouse of one. These are:

- Children, grandchildren and great grandchildren of the deceased. It includes adopted, and step children. Foster children together with any child for whom the deceased acted as legal guardian when the child was under 18 even if these relationships had ended when death occurred.
- The spouse's/civil partners of the above descendants.
- Widows/widowers and surviving civil partners of the descendants as long as they had not remarried at the time of the deceased's death

It cannot be claimed if the deceased had no children or step children. If the deceased had children but chose to bequeath the house to a cousin, or nephew this would not get RNRB.

It can't be claimed if the property is passed to an unmarried partner but the wording of the Act is unclear on the status of an unmarried couple's children.

Jack and Jill are unmarried. Jill has two children from a previous relationship. Jack has no children. The issue is whether legally Jack is their stepfather.

Jack dies first and Jill inherits the property under joint tenancy. On her death she leaves the property to her children, they are direct descendants and can get RNRB.

If Jill dies first and, on his death, Jack passes the house to her children it is uncertain whether RNRB could be claimed.

If they were Jack and Jill's children RNRB could always be claimed.

A transfer to a spouse/civil partner is of course an exempt transfer

The amount of RNRB is also restricted to the value of the property that is passed to the beneficiary. The value is market value less any mortgage.

When Julie died her house was valued at £450,000 with a mortgage of £350,000. The RNRB would be £100,000

What the beneficiary or beneficiaries do with the house is irrelevant and RNRB can still be claimed. Similarly, if the executors sell the property and distribute the proceeds to the beneficiaries RNRB can still be claimed.

### Applying RNRB in a calculation

These examples illustrate how RNRB is dealt with in a calculation where there is no transferable RNRB. The basic principle is the RNRB is applied first and the standard NRB can be offset against any excess. In these examples, the deceased's house and other assets are shown separately but it is acceptable to just show the total estate. However, the RNRB and NRB must be shown separately.

Angela is divorced and has a property with a value of £500,000 and other assets worth £300,000. In her will this is all bequeathed to her daughter.

House	£500,000
Less RNRB	<u>£175,000</u>
	£325,000
Other assets	<u>£300,000</u>
	£625,000
Less NRB	<u>£325,000</u>
Taxable	£300,000

If the value or share of the property is less than £175,000 the RNRB is limited to the value of the property.

Dennis owns his house on a tenants in common basis with his wife. On his death, the house was valued at £200,000. He left his share (£100,000) to his daughter.

The RNRB would be £100,000. The unused £75,000 cannot be used to increase his "standard" NRB of £325,000 so if he leaves other assets of £400,000 to his daughter, £75,000 is chargeable.

If there is a previous PET/CLT this is deducted from the NRB and not the RNRB.

Stuart died in September 2021. Two years earlier he made a PET of £100,000 to his son. His will left his house valued at £300,000 plus other assets of £200,000

House		£300,000	
Less RNRB		<u>£175,000</u>	
		£125,000	
Other assets		<u>£200,000</u>	
		£325,000	
NRB	£325,000		
Less PET	<u>£100,000</u>		
	£225,000	<u>£225,000</u>	
Taxable Amount			£100,000

If the PET had exhausted the NRB the full amount of RNRB is still available

Camilla died in May 2021. Two years earlier she made a PET of £500,000 to her son. Her will left the house valued at £325,000 plus other assets of £200,000 to her son.

House		£325,000	
Less RNRB		<u>£175,000</u>	
		£150,000	
Other assets		<u>£200,000</u>	
		£350,000	
NRB	£325,000		
Less PET	<u>£500,000</u>		
	(£175,000)		<u>£0</u>
Taxable Amount			£350,000

## Transferable RNRB

Transfers between spouses/civil partners remain exempt so the RNRB cannot be used if the property is left to the surviving spouse.

Tim and Sarah own their house on a joint tenancy basis. On Tim's death, this passes automatically to Sarah and his will bequeaths all his personal property to her. Tim's estate has not used his standard NRB nor his RNRB

In these circumstances, any unused RNRB can be transferred to the surviving spouse but as it was only introduced in April 2017 there are different rules depending on whether the first death occurred before or after April 6 2017.

### First death occurred before April 6 2017

Even if someone died before April 2017 the surviving spouse's estate can normally claim 100% of the unused RNRB. This could be reduced through tapering if the estate of the first to die was over £2m. This will be looked at later.

Debbie died in 2009. All her property including the marital home was passed to her husband Peter. He died in May 2021 and left everything to his two children in equal shares. The property had a value of £800,000 and other assets of £400,000.

His executors can claim 100% of Debbie's unused NRB and Peter's RNRB.

House	£800,000
Less RNRB	<u>£350,000</u> (2 x £175,000)
	£450,000
Other assets	<u>£400,000</u>
	£850,000
Less NRB (x 2)	<u>£650,000</u>
Taxable amount	£200,000

A further quirk is that there is no requirement for the first to die to have a QRI at the time of their death for RNRB to be transferred to the survivor.

Charles who lived in rented accommodation married Camilla who had her own house. Despite the property being solely owned by Camilla, if Charles dies first, on her death her executor's can claim Charles' unused RNRB

### First death occurred after 6 April 2017

In many cases the second death can claim 100% since the house would usually be owned on a joint tenancy basis and would pass automatically to the survivor. It could not be passed on to anyone else.

If part was used on first death then only the percentage of the unused amount can be transferred.

Henry died in December 2018 and his daughter inherited a £60,000 share of his house. The percentage used was £60,000/£125,000 or 48% so 52% is unused. His wife Susan, died in May 2021.

Susan's executors can claim 52% of £175,000 which is £91,000.

As with the process of calculating a transferable NRB, the unused percentage is applied to the current RNRB

## Tapering of RNRB

RNRB is reduced if the deceased's net estate is more than £2million. The reduction is £1 for every £2 over £2 million which means there is no RNRB if the estate is more than £2,350,000

Alistair died in November 2021 with a net estate of £2,080,000. This is £80,000 above the threshold level so the RNRB is reduced by £40,000 to £135,000

The net estate means the total value of the estate less any liabilities such as loans. Reliefs and exemptions cannot be deducted.

Mike died with an estate of £2.5 million. This included his business valued at £1 million which qualified for Business Property Relief. His IHT liability will be based on £1.5 million but the estate will get no RNRB.

Katrina was divorced and left her home with a value with £1 million to her son. The remainder of her estate of £1.5 million was left to several charities. No RNRB can be claimed.

Tapering must also be taken into account in calculating the amount of RNRB that can be transferred.

Julian died in tax year 2019/20 leaving an estate of £2,150,000.

His home went to his wife, Petra, as it was owned on a joint tenancy and everything else went to his children. His estate couldn't use RNRB as the children did not inherit the house. However, as his estate was £150,000 above the threshold the RNRB is reduced by £75,000. The amount of unused RNRB is therefore 50% (£75,000/£150,000)

Petra died in 2021/22 when the RNRB is £175,000. Her estate is below £2 million so the total amount of RNRB available to her estate will be £175,000 + (£175,000 x 50%) = £262,500

Helen died in May 2019 with an estate of £2.5 million. Everything was left to her husband Paul. Her estate would have no RNRB.

Paul died some years later but had steadily made significant lifetime gifts with the result that his estate at death was £1.8 million. The house with a value of £1 million was left to his children so his executors could claim 100% of the then RNRB but could not claim any of Helen's.

If the situation had been reversed with Helen's estate being below £2m and Paul's above £2.3m, his executors could claim 100% of her unused RNRB.

Tapering must also be taken into account if the first death occurred before April 2017. The deceased's estate is deemed to have a RNRB of £100,000

Sam who died in 2005 owned the house on a joint tenancy basis with his wife Alice. Alice died in November 2019 with an estate of £2,100,000.

When her executors calculated the IHT they assumed that they could use £350,000 (2 x £175,000)

However HMRC pointed out that Sam's estate was £2,100,000 so if RNRB had been available it would have been reduced by £50,000. This means only 50% can be transferred which is applied to the current NRB so Alice's estate can only claim £87,500 of his RNRB.

## RNRB and Trusts

It is common for a trust to be set up by a will. Provided the following conditions are met RNRB can be claimed:

- The trust property includes a residential property in which the deceased had a QRI
- The beneficiary is lineal descendant.
- The trust is **Non-Relevant Property Trust (NRPT)**

The following will trusts are NRPT and can benefit from RNRB.

- Bare/Absolute Trust for a lineal descendant.
- Immediate post death interest (IPDI) for a lineal descendant
- Disabled Person's trust for a lineal descendant
- Bereaved Minor Trust
- 18-25 trust

The latter two can only be set up by a parent on death for the benefit of their children.

A discretionary trust is a Relevant Property Trust and will never qualify for RNRB even if a direct descendant is one of the beneficiaries because they do not have an absolute right to the property.

An IPDI trust is often used with a second marriage.

Jack and Rhoda are married. Each was married before and have children from their first marriages. Rhoda who never owned a house moves into Jack's house.

In his will Jack passes the house into an IPDI trust that gives Rhoda the right to live there for the rest of her life. On her death, the house passes to Jack's children.

The initial transfer into the trust was exempt as a spousal transfer so Jack's NRB and RNRB weren't used. On Rhoda's death, her executors can claim her and Jack's RNRB as Jack's children are Rhoda's stepchildren.

## Downsizing and Disposal

Consider this situation:

- Phil died in January 2015 leaving his house to his wife Dorothy.
- In November 2015, she sold the home for £400,000 and bought a smaller property for £180,000.
- Dorothy died in June 2021 leaving her estate of £1,000,000 to her children which includes the new property which has increased in value to £210,000

Dorothy has been disadvantaged by downsizing since if she had retained her old home her estate could have had a RNRB of £350,000. Because the new property has a value of £210,000 the RNRB is restricted to that amount.

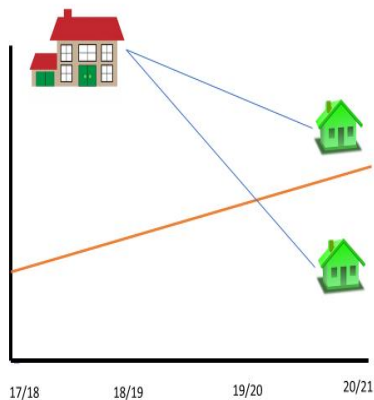
Under certain conditions this "lost RNRB" can be claimed. It enables the deceased's estate to pass assets other than the house to direct descendants using the lost RNRB rather than the estate's standard nil rate band.

To get the downsizing addition the following conditions must be met:

- The deceased disposed of a former home either by moving to a less valuable home or ceased to own a home on or after 8 July 2015.
- The former home would have qualified for the RNRB if it had been held until death.
- If the deceased had no house at death at least some of the estate must be inherited by the deceased's direct descendants.

In practice, it can only be claimed if the value of the downsized house is less than the RNRB at the time of death.





In this diagram, the red line represents the level of the RNRB increasing from £100K/£200K to £175K/£350K between 17/18 and 20/21. In the top example, the value of the downsized house is still above the RNRB so there is no loss. In the lower example, the value is below the RNRB so there is a loss

There are two stages.

- Calculate the “lost” RNRB
- Establish how much can be used

### Calculating the lost RNRB

To do this we need to know

- The value of the original house when sold
- The value of the second property when death occurred
- The RNRB available at each event.

When Alan sold his home in December 2017, the value was £500,000. The value of the new house at death in 21/22 was £140,000. There is no transferable NRB available

The value of each house is divided by their respective RNRB and multiplied by 100 to give a percentage. If either is more than 100% it is capped at 100%. The “lost RNRB” is the difference between the percentage of RNRB on the first sale and the percentage at death. This is applied to the current RNRB.

$£500,000/£100,000 \times 100 = 500\%$  so capped at 100%

$£140,000/£175,000 \times 100 = 80\%$

The difference is 20% which applied to £175,000 gives a “lost” amount of £35,000

The available amount of RNRB at the sale will always be 100% unless the sale price is less than the then RNRB.

Ted sold his flat for £120,000 in 2019/2020 when the RNRB was £150,000. The starting amount would be 80%

Passing Alan’s house to a direct descendant will already be covered by the RNRB since the amount of RNRB is the lesser of the standard amount and the value of the property. The downsizing addition means other assets up to £35,000 can be passed to direct descendants.

How this could be used is shown in the following examples using the example of Alan. (We will assume he has assets of £500,000 in addition to the house with a value of £140,000)

1. Total estate of £640,000 is left to his daughter. RNRB is £175,000 (£140,000 + £35,000)
2. House left to his daughter, all other assets to his nephews and nieces. RNRB is £140,000
3. House left to his sister, £500,000 left to his daughter. RNRB is £35,000
4. House and £20,000 left to his daughter. Remainder of estate to nephews and nieces. RNRB is £160,000.

In calculations, they would be shown like this:

	Case 1	Case 2	Case 3	Case 4
Estate	£640,000	£640,000	£640,000	£640,000
Less RNRB	<u>£175,000</u>	<u>£140,000</u>	<u>£35,000</u>	<u>£160,000</u>
	£465,000	£500,000	£605,000	£480,000
Less NRB	<u>£325,000</u>	<u>£325,000</u>	<u>£325,000</u>	<u>£325,000</u>
Chargeable	£140,000	£175,000	£280,000	£155,000

### Calculation of lost RNRB when the value is more than RNRB

Pam sold her house for £500,000 in 2018/19 and bought a smaller property. She died in 2021/22 when the house was valued at £200,000. The RNRB was £175,000

$£500,000/£125,000 \times 100 = 500\%$  so capped at 100%

$£200,000/£175,000 \times 100 = 114\%$  so capped at 100%.

The difference is 0% so there is no loss and the RNRB is £175,000

### Calculation where there is a transferable RNRB

Following her husband’s death in 2017/18 Joan sold the marital home for £800,000 and moved into a smaller house.

She died in 2021/22 when the RNRB is £175,000. The house was sold for £280,000 and it was left in equal shares to her children.

When she sold the house the RNRB is £100,000. She would have inherited 100% of her late husband’s RNRB.

The “lost RNRB” is:

$\text{£}800,000/\text{£}200,000 = 400\%$  so capped at 100%

$\text{£}280,000/\text{£}350,000$  80%

The loss is 20%

$\text{£}350,000 \times 20\% = \text{£}70,000$

### Calculation when the deceased did not own a house

After the death of her husband, Hilda sold her house in 2017/18 for £500,000 and moved into a care home. She died in 2021/22 when the RNRB is £175,000.

She would have had 100% of the RNRB at the time of the sale and as she had no house when she died she has no RNRB. The loss is therefore 100%.

Her will left all her estate of £800,000 to be split equally between her children and grandchildren. Her estate can use her late husband’s RNRB plus her “lost” RNRB, a total of £350,000.

The estate will be free of IHT since the first £350,000 is covered by the RNRB and the remainder is within the NRB of £650,000

That ends this part so you should now understand:

- What is RNRB and what are the conditions for claiming it.
- How to apply RNRB in a calculation.
- How unused RNRB can be transferred.
- How RNRB can be tapered.
- How RNRB is affected if the property is passed into trust.
- The conditions for getting the Downsizing Addition.

### Sources and further reading

<https://www.gov.uk/guidance/inheritance-tax-residence-nil-rate-band>

<https://www.gov.uk/guidance/how-downsizing-selling-or-gifting-a-home-affects-the-additional-inheritance-tax-threshold>

<https://www.canadalife.co.uk/adviser/ican-academy/briefing-notes/estate-planning-trusts/the-residence-nil-rate-band>

<https://www.pruadviser.co.uk/knowledge-literature/knowledge-library/residence-nil-rate-band-rnr-b-facts/>