These notes are intended to do no more than refresh the memories of those attending of the salient points made. Whilst every care has been taken in preparing the notes to ensure their accuracy, they cannot be exhaustive and are no substitute for detailed examination of the relevant statues, cases and other materials when advising clients on particular matters. No responsibility can be accepted by the speaker for any loss occasioned to any person acting or refraining from action in reliance on anything contained in these notes. No part of the notes may be reproduced in any form without the prior permission of the speaker.
The Residential Nil Rate Band

Introduction and background

The provisions of Finance (No.2) Act 2015 provide the detail to enshrine the longstanding pledge of the Conservative Government to increase the inheritance tax nil rate band to £1 million. Unfortunately for practitioners rather than a simple increase to the existing nil rate band a brand new band has been introduced. The new nil rate band seems to have acquired a number of different names. For the purpose of this note it will be referred to as the residence nil rate band (‘RNRB’). Practitioners will need to consider the existence of 3 nil rate bands when advising clients as follows:-

- The general nil rate band (NRB)
- The transferable nil rate band (TNRB)
- The residence nil rate band (RNRB)

HMRC guidance

HMRC published guidance on the RNRB on 8 November 2016 which can be found at https://www.gov.uk/guidance/inheritance-tax-residence-nil-rate-band. This is supplemented by a number of case studies which can be found at https://www.gov.uk/government/case-studies/inheritance-tax-residence-nil-rate-band-case-studies. The guidance, although aimed at the general public, is useful to practitioners, particularly the case studies.

HMRC’s Trust and Estates December 2016 newsletter indicated that they are aiming to publish more detailed technical guidance on the RNRB and TRNRB in the IHT manual in the New Year. The updated IHT 400 suite of forms to accommodate the RNRB is not yet available.

The general concept

The RNRB is intended to provide an additional relief against inheritance tax for deaths on or after 6 April 2017 when a residence is bequeathed on death to a lineal descendant or descendants.
Amount of relief

The amount of relief available is referred to as the Residential Enhancement. There are set amounts which prescribe the available RNRB in the applicable tax year as follows:—¹

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Residential enhancement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 2017-18</td>
<td>£100,000 (deemed residential enhancement where RNRB of pre-deceased spouse carried forward)</td>
</tr>
<tr>
<td>2017-18</td>
<td>£100,000</td>
</tr>
<tr>
<td>2018-19</td>
<td>£125,000</td>
</tr>
<tr>
<td>2019-20</td>
<td>£150,000</td>
</tr>
<tr>
<td>2020-21</td>
<td>£175,000</td>
</tr>
<tr>
<td>After 2020-21</td>
<td>Adjusted in line with the consumer prices index (CPI) (unless the Treasury sets a different amount before 6 April in the tax year concerned)</td>
</tr>
</tbody>
</table>

As per the table the amount of £100,000 is set as the carry forward amount for deaths pre 6 April 2017. In relation to deaths pre 6 April 2017 it is simply not possible to have used the RNRB so it will be available to carry forwards. It does not matter how long ago the individual died, what was in their estate in terms of assets and who they bequeathed their estate to either under a will or via the intestacy rules. The only caveat is that the taper provisions need to be applied.

Other practical points in relation to the carry forward allowance:-

- As per the existing transferable NRB the transferable RNRB must be specifically claimed.
- The allowance can relate to more than one predeceased spouse. However as per the transferable nil rate band rules it is not possible to carry forward more than one additional 100% RNRB.
- If the first to die held assets comprised within their estate worth more than £2 million the amount which can be transferred will be tapered (see below).
- The emphasis is very much on married couples/civil partners. Unmarried couples with children must either leave their own share of the house to the children on their death (which can create problems of its own such as security

¹ Table taken from Practical Law January 2016 http://uk.practicallaw.com/0-620-2129#a109644
and capital gains tax issues if the children are not living in the property) or lose their respective RNRB - i.e. the first to die’s RNRB will not be available to carry forward.

**Taper allowance**

A taper is applied to reduce the available RNRB for estates which are valued in excess of the taper threshold. The threshold is currently set at £2 million for the tax years 2017/2018 to 2020/2021 and the taper threshold will increase in line with the Consumer Prices Index unless overridden at a later date.

The provisions work by providing that when the value of an estate exceeds the taper threshold the residential allowance is withdrawn by £1 for every £2 that the value of the estate exceeds the threshold.

The taper rules are also applicable to the amount of the RNRB that can be transferred from spouses who died before 6 April 2017 where the surviving spouse dies after that date.

**Tapered RNRB example**

Mrs Jones dies in June 2020 with an estate worth £2,200,000. All her estate is left to her husband, Mr Jones. Mr Jones dies in September 2020 with an estate worth £1,500,000. Since the value of Mrs Jones’ estate was over £2m, the RNRB is reduced to calculate the carry forward percentage. The excess value is £200,000 and applying 50% taper gives a tapered amount of £100,000. The RNRB that would otherwise be available (£175,000) is reduced by £100,000 giving £75,000. This is expressed as a percentage 75,000/175,000 =42.8%. Mr Jones’ executors will have his full RNRB and an additional 42.8% of the RNRB for Mrs Jones. The total RNRB available is £175,000 plus £74,900 (£175,000 @ 42.8%), totalling £249,900.

Practitioners should also note that the taper threshold is the value of the estate meaning that the value is taken prior to the deduction of exemptions and reliefs.

Practitioners will need to consider with their clients whether in certain circumstances it would be beneficial for the first spouse to use up both their NRB and their RNRB by passing those assets directly to lineal descendants rather than to the surviving spouse. This could avoid increasing the surviving spouse’s estate over the taper threshold.

Practitioners should also appreciate that it is only the value of the estate which is relevant. The cumulative total is irrelevant. In certain circumstances it may be beneficial for an individual to consider making large lifetime gifts on their deathbed to
reduce the estate below the level of the taper threshold. While lifetime gifts will reduce the estate for the purposes of the RNRB exempt gifts on death will not!

**Qualifying residential interest**

There are further criteria which practitioners need to appreciate. To qualify for the RNRB claim the estate must include a qualifying residential interest (QRI) which is closely inherited. A QRI is considered to be a residential property interest that is:

- In a person's estate immediately before death; or
- Nominated by the personal representatives as the QRI in circumstances where an estate contains more than one dwelling house.
- The RNRB is limited to one property. If the deceased had two residential properties, one worth more than the RNRB and one worth less, the PRs are likely to choose the higher value property. Note even if both properties are worth less than the RNRB, the claim is still limited to one so some of the RNRB will be wasted. E.g. if RNRB is £175,000 and deceased owns two properties each worth £87,500, only £87,500 RNRB will be available and £87,500 will be wasted.

It would therefore appear that a buy to let property never used for residential purposes does not qualify. However a buy to let which the deceased occupies towards the end of their life would qualify. Watch out for clients who have taken the decision to rent rather than own property and invest their wealth in other assets. Practitioners should also note that whether the property is to be accepted as a residence will in all likelihood be determined on the basis of the available CGT main residence relief case law. In addition to the election provided above you will note:

- There is no garden/grounds limitation.
- No strict requirement to be occupied through the entire ownership.
- Flexibility for individuals in job related accommodation who have purchased a property they intended to occupy at some point.

Watch this space for further guidance.

**Closely inherited**

There is a strict requirement that one or more lineal descendants must inherit the QRI. The technical definition used is closely inherited. In some regards the definition is generally understood to be extremely wide including children, grandchildren, stepchildren of the deceased, adopted children of the deceased, foster children of the deceased and children of whom the deceased was a guardian or special guardian. Lineal descendants of the above are also included as are the
spouse or civil partner of a lineal descendant at the time of the deceased’s death. The surviving spouse or civil partner of a lineal descendant who died no later than the deceased would also be included if the survivor had not remarried or formed another civil partnership before the deceased’s death. However collateral descendants are not included meaning gifts between siblings or down a generation to nieces and nephews will not attract the relief.

**What does the word ‘inherited’ mean?**

HMRC’s guidance makes it clear that to be eligible for the RNRB the home or a share of it must be left to direct descendants so that it becomes part of the beneficiaries’ estate as a result of the person’s death.

Property will be inherited as follows:

1. **Where property is owned outright by the deceased and is gifted on death via a will, on intestacy or via the rules of survivorship.**

2. **Where the property is owned by the deceased and it is gifted into a qualifying trust and:**
   - The lineal descendant is the immediate post death interest beneficiary of the trust; or
   - The lineal descendant holds the disabled person’s interest; or
   - The lineal descendant is a child of the deceased and the trust falls under the category of a bereaved minor trust or an 18-25 trust.

The property will not be treated as closely inherited if transferred on death to any other form of trust. This would be so even if the trust was a discretionary trust with a narrow class of beneficiaries limited to the lineal descendants. However there is nothing in the legislation which would prevent an appointment during the relevant two year period to a lineal descendant as indicated above.

However, gifts on death to a bare trust for a lineal descendant should benefit from the RNRB. This is on the basis that bare trusts are not settlements for IHT purposes (s.43 IHTA 1984) and therefore such a gift to a bare trust should be classed as a disposition to the beneficiary.

HMRC’s guidance confirms that the home does not have to be specifically mentioned in the deceased’s will it can be inherited as part of the residue of the estate. If the residue passes to a number of different people, HMRC treat each as inheriting a proportion of the home.
If only part of the home is left to direct descendants, there are differing views as to whether a post death appropriation would help in these circumstances. There is no published HMRC view on this and practitioners should proceed cautiously.

**What if the deceased has an interest in possession on death rather than an outright interest?**

The RNRB will be available where the deceased held a qualifying interest in possession if on the death of the deceased either:

- An absolute interest passes to the lineal descendants; or
- a successive qualifying interest in possession is created on death (in reality it is only likely to cover a disabled person’s interest because a successive interest cannot be an immediate post death interest).

**Lifetime gift subject to reservation**

It would also appear that a QRI will be treated as closely inherited if a lifetime gift is made to lineal descendants and a reservation of benefit in favour of the deceased over the QRI subsists. In this scenario the QRI is treated as part of the deceased’s estate for IHT purposes.

**Example**

Mr and Mrs Green have three adult children. They owned a property but gifted it to their daughter some time ago. They continue to live in the house, co-occupying with their daughter who pays all the utility bills and keeps an eye on her parents. Mr Green dies in May 2017 leaving his entire estate to his wife. His estate is valued at £700,000 for IHT purposes. This includes the benefit he reserved over his half share of the property valued at £200,000.

Mrs Green dies in June 2020 and leaves her entire estate to her three children. Mrs Green’s estate is valued at £1 million including the benefit she reserved over her half share of the property she gifted to her daughter which is valued at £300,000. The full value of the estate is chargeable.

Mr Green is entitled to an RNRB because his half of the house is closely inherited because of the gift to his daughter over which he retained a benefit. The RNRB is equal to the residential enhancement in the tax year 2017-18 (£100,000). Nothing can be carried forward because the value of benefit that Mr Green reserved (£200,000) exceeds the residential enhancement. The value of his chargeable estate is, therefore, £200,000.
Mrs Green is entitled to an RNRB because her QRI is represented by the interest in the family home that she gave to her daughter so that it is regarded as closely inherited. She is able to use the residential enhancement for the tax year 2020-21 of £175,000 but cannot use a brought-forward allowance from her husband.

**Checklist for claiming RNRB**

1. Is the QRI closely inherited?
2. Establish value of QRI.
3. Establish value of deceased’s chargeable estate (watch taper provisions)
4. Check the value of the residential enhancement as at date of death.
5. Check value of any carry forward allowance from predeceased spouse.

**Other practical points to watch**

- It is only the chargeable value of the QRI which is taken into account.
- The RNRB is not set against the gift of the residential property, it reduces the IHT on the estate as a whole.
- Watch the impact of the availability of agricultural and/or business relief.
- Watch the impact of lifetime gifts.

**Downsizing provisions**

The Finance Bill 2016 which contained the downsizing provisions received Royal Assent and become the Finance Act 2016 on 15 September 2016.

Following concerns raised after the Finance Bill 2015, the government announced that “where part or all of the RNRB might be lost because the deceased had downsized to a less valuable residence or had ceased to own a residence the lost RNRB will still be available - provided that the qualifying conditions were met. The RNRB would apply where the residence is sold (or is no longer owned) on or after 8 July 2015. This proposal will ensure there is no disincentive to downsize or sell a home from the date the RNRB was announced at the Summer Budget.”

In summary the deceased's estate will benefit from the downsizing provisions where the maximum RNRB cannot be claimed because either:-

- A former residence was sold on or after 8 July 2015 and a less valuable property was purchased; or
- A former residence was sold on or after 8 July 2015 and no residence was owned by the deceased at the date of death

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2 Example taken from Practical Law January 2016 [http://uk.practicallaw.com/3-617-8745](http://uk.practicallaw.com/3-617-8745)

3 HMRC Technical Note dated 18 September 2015
The downsizing addition can only be claimed where at least some of the remainder of the chargeable assets (apart from any QRI) is inherited by one or more lineal descendants.

You will note that although the RNRB applies to deaths on or after 6 April 2017 (and the first death can occur at any time), the downsizing provisions can only apply to proceeds of sale of properties on or after 8 July 2015.

The additional RNRB that relates to the downsizing transaction can be combined with the main RNRB however the total value cannot exceed the RNRB that would have been available on death if the downsizing had not occurred. This is to ensure that those who downsize are not put in a better position than those who do not. The intention is very much to neutralize the impact of downsizing. The additional downsizing RNRB remains subject to the taper threshold.

**Calculating the lost RNRB**

There are 5 steps to work out the amount of RNRB that’s been lost as set out in HMRC’s guidance as follows:

**Step 1.** Work out the RNRB that would have been available when the disposal of the former home took place. This figure is made up of the maximum RNRB due at the date of disposal (or £100,000 if the disposal occurred before 6 April 2017) and any transferred RNRB which is available at the date of death.

**Step 2.** Divide the value of the former home at the date of disposal by the figure in step 1 and multiply the result by 100 to get a percentage. If the value of the former home is greater than the figure in step 1 the percentage will be limited to 100%. If the value of the home disposed of is less than the figure in step 1, the percentage will be between 0% and 100%.

**Step 3.** If there is a home in the estate on death, divide the value of the home on death by the RNRB that would be available at the date of death (including any transferred RNRB). Multiply the result by 100 to get a percentage (again this percentage can’t exceed 100%). If there’s no home in the estate at death this percentage will be 0%.

**Step 4.** Deduct the percentage in step 3 from the percentage in step 2.

**Step 5.** Multiply the RNRB that would be available at the date of death by the figure from step 4. This gives the amount of the lost RNRB.

HMRC’s case studies contain a number of useful examples and set out below are a few of the case studies relating to downsizing.
No residential interest at death

**Case study 11** shows how the lost RNRB is calculated where the deceased’s has no home in her estate at death.

Mrs K, a widow, sold a home worth £195,000 in June 2018. The maximum RNRB when the home was sold in the tax year 2018 to 2019 is £125,000.

She dies in August 2020 with no home in her estate.

The maximum RNRB when Mrs K dies in tax year 2020 to 2021 is £175,000.

Mrs K’s estate is also entitled to transferred RNRB of £175,000.

To calculate the lost RNRB:

**Step 1.** The maximum RNRB when the home was sold was £125,000. Mrs K’s estate is also entitled to transferred RNRB of £175,000 when she dies. So the total RNRB that could have been available when the home was sold is £300,000 (£125,000 + £175,000).

**Step 2.** The home was worth £195,000 when it was sold. You divide this by the value at step 1 (£300,000) to give a percentage of 65%.

**Step 3.** There’s no home in the estate at the date of death, so the percentage is 0%.

**Step 4.** Taking 0% from 65% gives a percentage of 65%.

**Step 5.** When Mrs K dies, the maximum RNRB is £175,000. Her estate is also entitled to transferred RNRB of £175,000, so the maximum RNRB for Mrs K’s estate is £350,000. The ‘lost’ RNRB is £227,500 (65% of £350,000).

Although the lost RNRB is £227,500, the amount of the downsizing addition actually available to Mrs K’s estate depends on the value of any other assets that are left to Mrs K’s direct descendants.

The effect of step 3 is that there will be a different amount of lost RNRB depending on whether the deceased has either:

- downsized to a less valuable home
- disposed of a home. If the percentage in step 3 is the same as, or greater than, the percentage in step 2 there’s no loss of RNRB and there’ll be no downsizing addition.
Downsizing to a less valuable home

Case study 13: how to work out the downsizing addition and RNRB

In May 2018 Mr M downsized from a large house worth £500,000 to a small flat. The maximum RNRB in the tax year 2018 to 2019 is £125,000.

Mr M dies in September 2020. He leaves the flat worth £105,000 to his son, and the rest of his estate worth £200,000 to his 2 daughters.

The maximum RNRB due in tax year 2020 to 2021 is £175,000.

There’s no entitlement to transferred RNRB on Mr M’s death.

Step 1. The maximum RNRB at the date of downsizing was £125,000.

Step 2. The house was worth £500,000 when it was sold. Divide this by the figure at step 1, but limit the percentage to 100%.

Step 3. The flat is worth £105,000 when Mr M dies. Divide this by the maximum RNRB available at death (£175,000). This gives a percentage of 60%.

Step 4. Take away the percentage at step 3 (60%) from the percentage at step 2 (100%) to give a percentage of 40%.

Step 5. Multiply the maximum RNRB at death (£175,000) by the percentage at step 4 (40%) to give a total of lost RNRB of £70,000.

The actual amount of the downsizing addition depends on the value of other assets that are left to Mr M’s children.

As Mr M leaves more than £70,000 of other assets to his daughters, the downsizing addition of £70,000 is added to the RNRB due for the flat of £105,000 left to his son. This gives a total RNRB for the estate of £175,000.

If instead Mr M had left the flat to his son, some assets worth £50,000 to his daughters, and the rest of his estate to his wife, the downsizing addition would be restricted to £50,000. This is because that’s the value of other assets he left to his daughters.

The total RNRB in that case would be £155,000 (£105,000 + £50,000).
Case study 14: how to work out the downsizing addition and RNRB where only a part of the home is left to direct descendants

Mr N downsized in February 2019 from a house worth £400,000 to a bungalow. The maximum RNRB in the tax year 2018 to 2019 is £125,000.

When Mr N’s dies in September 2020, he leaves the bungalow, worth £105,000, in equal shares to his wife and son.

He leaves the other assets in his estate worth £150,000 to his daughter.

The maximum RNRB due in tax year 2020 to 2021 is £175,000.

There’s no entitlement to transferred RNRB on Mr N’s death.

Step 1. The maximum RNRB at the date of downsizing was £125,000.

Step 2. The house was worth £400,000 when it was sold. Divide this by the figure at step 1, but limit the percentage to 100%.

Step 3. When Mr N dies, the bungalow is worth £105,000. Divide this by the maximum RNRB available at death (£175,000). This gives a percentage of 60%.

Step 4. Take away the percentage at step 3 (60%) from the percentage at step 2 (100%). This gives a percentage of 40%.

Step 5. Multiply the maximum RNRB at death (£175,000) by the percentage at step 4 (40%), to give a total of lost RNRB of £70,000.

Mr N only leaves half of the bungalow to his son. So you reduce the RNRB due for that home £52,500 (50% of £105,000).

As Mr N leaves other assets of £150,000 to his daughter, the downsizing addition is £70,000 (the lower of the lost RNRB of £70,000 and £150,000).

You add this to the RNRB due for the bungalow of £52,500, to give a total RNRB of £122,500 (£52,500 + £70,000).

The maximum available RNRB is £175,000, but Mr N’s estate can only use £122,500. So there’s unused RNRB of £52,500 available to be transferred to Mrs N’s estate.
If the assets left to the daughter were worth only £20,000, the downsizing addition would be restricted to £20,000. So the total RNRB for the estate would be £72,500 (£52,500 + £20,000).

There’d be unused RNRB of £102,500 available for transfer.

**General implications of downsizing**

You will need to impress upon your residential conveyancers the importance of keeping proper records so that the downsizing provisions can be properly applied. You should keep full details of properties owned in July 2015 subsequently sold or transferred by gift, completion statements, evidence of ownership (eg office copy entries or conveyances) and details of use as a residence.

It would appear that there are no time limits in relation to the period post the event of the downsizing. For example it would appear that a residential property could be sold and the deceased not pass away for some 15 years. Notwithstanding the significant gap between the sale and death it would appear that the downsizing provisions would be available.

**Downsizing amendments**

Practitioners may have been aware of two quirks in the Finance Bill 2016 as originally published. The first was that the provisions apply only where a “person” disposes of a residential property interest. On a strict interpretation this would not include trustees. For example if a husband leaves a house (solely owned by him) to his wife for life with the remainder to the children absolutely and the trustees sell it let us say because the wife needs permanent residential care then it appeared that the downsizing provisions were of no help and in addition the widow’s estate would have no RNRB.

The draft clauses also provided that if “a person” disposes of two interests in a residence the personal representatives must nominate one interest. In many cases, the survivor may have an IPDI in a half share and own the other share outright. Therefore only 50% of the value would be eligible for relief.

Amendments proposed on 28 June 2016 to clause 82 and schedule 15 of the Finance Bill 2016, and subsequently enacted were as follows:

- Where the deceased had more than one interest in a former residence (eg an outright interest in half the property and a qualifying IIP over the other half), if the two interests are disposed of on the same day, they will both be counted as a qualifying former residence. Where a person disposes of interests in a
former nominated residence on different days, the PRs can only nominate one of those days and the interests disposed of on that day will be the qualifying ones for the purposes of any downsizing addition).

- Where a former residence was given away but the deceased reserved a benefit over it, the amendments provide that the gift will not qualify for the purpose of the downsizing addition until the reservation of benefit ceases.

- A new section 8HA will determine if a former residence in which the deceased had a qualifying IIP is considered as a qualifying former residential interest for the purposes of the downsizing addition.

The purpose of the amendments are to ensure that the provisions work as intended in situations where an individual had more than one interest in a former residence, or the former residence was held in trust. They also clarify how the provisions apply to certain disposals.

These are welcome amendments in respect of trust interests.

**Final points to watch**

This is an extremely complicated piece of legislation and the downsizing provisions add a further layer of complexity!

**Will drafting and planning points**

Let’s take a look at some of the typical will structures that we might draft on behalf of our clients and the implications in respect of the RNRB.

**Qualifying gifts**

A common will structure is for a married couple to leave their estates to each other outright and then onto children equally on the death of the survivor of them.

The first to die’s nil rate band will not be used and will be available for transfer to the survivor. On the second death, the property will pass as residue. Provided one of the following structures is used, the RNRB can be claimed:

- Absolute gift
- Bereaved minor’s trust
- 18 – 25 trust (note: age contingencies over 25 will not qualify)
- IPDI trust
- Disabled person's trust
It is common to include a substitutional gift in favour of grandchildren at a specified age. The substitutional gift for the grandchildren will not qualify for the RNRB as it is not within the class of permitted trust arrangements.

The drafting solution is to remove the age contingency for the grandchildren. Alternatively, the grandchildren’s share could be left on flexible life interest trusts with the necessary amendments to s.31 Trustee Act 1925.

**Discretionary trusts**

For asset protection and succession planning purposes, it is becoming more common for residue to pass onto a discretionary trust on the death of the surviving spouse.

On the second death, the estate will not qualify for the RNRB at the outset, even though the class of beneficiaries who can benefit from the discretionary trust is limited to lineal descendants only.

This will does have the advantage of flexibility and s.144 IHTA 1984 comes to the rescue! (see below).

For existing wills with this structure, no action is needed now. Despite the changes, clients may often still wish to put this will structure in place given the flexibility it offers and depending upon their family situation. You will need to review existing letters of wishes for such wills and when drafting new letters of wishes you will need to take into account the RNRB provisions and to set out any relevant guidance.

**IPDI for spouse**

Again, for asset protection and succession planning purposes, the use of an IPDI trust on the first death for the survivor’s benefits is fairly common will structure. The property is likely to be owned as tenants in common so that the first to die’s share can pass into the IPDI trust.

On the first death, the RNRB will not be used due to the spouse exemption. The survivor will have an IPDI in a share of the property and own a share absolutely. Where a deceased dies with an IPDI in a residence, the RNRB will be available if lineal descendants inherit immediately following the life tenant’s death. The availability of the relief depends upon the terms of the trusts following the life tenant’s death. The RNRB will be available only if the lineal descendants take absolutely. You should note that the RNRB will not be available if the lineal descendants are
given successive life interests (these would not be qualifying IPDIs) or if a discretionary trust arises (even if the class of beneficiaries is limited to lineal descendants). Appropriate care will also be needed in respect of any age contingences.

Alternatively, a slightly modified will structure could be utilised to ensure the availability of the RNRB. This could provide for an IPDI to surviving spouse subject to a limited power of appointment that it is only exercisable over property with a subsisting IPDI (i.e. only exercisable during the life tenant’s lifetime). The reversionary interest would be in favour of the children outright. This retains some flexibility during the life tenant’s life time to revoke the outright gifts before they vest if, for example, family circumstances change but if no such appointment is made it ensures that the RNRB will apply on the life tenant’s death without any further action being needed.

**Drafting to bank the RNRB**

There may be some circumstances in which it is appropriate to expressly bank the RNRB. One way to do this is to simply leave a specific gift of a residence to lineal descendants. The legacy could be an absolute gift to children equally. Alternatively, the legacy could qualify as a bereaved minor’s trust, an 18 to 25 trust or an IPDI. A gift to grandchildren would either need to be an absolute gift or qualify as an IPDI.

There are now available various precedents which bank the RNRB by use of a formula. Essentially, these precedents intend to gift a share in a residence sufficient in size to use the available residence nil rate band. They also pick up cash if the downsizing addition can be claimed. The gift is either an outright gift or a gift onto a qualifying trust. Some precedent works also suggest leaving a residence nil rate band legacy onto a discretionary trust. The legacy would not initially qualify for the residence nil rate band and it would be necessary to make an appropriate appointment within the two year read back period in order to claim the relief.

When would it be appropriate to bank the residence nil rate band in this way? The most obvious answer is the second marriage situation where one or both parties have previously been widowed. In these circumstances, there may be three or four RNRBs available and it may be necessary to bank one or two residence nil rate bands on the first death to ensure all reliefs available are fully utilised.

**Example**

Harry and Henrietta were married. Henrietta died in 2015, leaving her entire estate to Harry absolutely. Henrietta’s unused RNRB is available for transfer to Harry.
Harry subsequently marries Margaret in 2019. If Harry leaves his entire estate to Margaret absolutely, on Margaret’s subsequent death, her estate will make use of her RNRB and Harry’s unused RNRB. Henrietta’s unused RNRB will be wasted.

Alternatively, if Margaret were to die, leaving her entire estate to Harry absolutely, on Harry’s subsequent death, his estate would be able to use his own RNRB and Margaret’s unused RNRB. Again, Henrietta’s unused RNRB would be wasted.

It is sensible for Harry to put in place a will which banks at least one of the RNRBs available to him, should he die before Margaret. This would ensure that Henrietta’s RNRB is used on Harry’s death. On Margaret’s subsequent death, her estate would use her own and Harry’s RNRB.

It would also be sensible for Margaret’s will to bank her RNRB, should she die before Harry. On Harry’s subsequent death, he would then take advantage of his own RNRB and Henrietta’s unused RNRB.

It may also be appropriate to bank the RNRB on the first death of unmarried partners.

**Bunching**

In light of the taper threshold, it may be necessary for married couples to consider using a traditional nil rate band discretionary trust on the first death, in order to keep the value of the survivor’s estate down on the second death.

**Example**

Mr and Mrs Morgan have four daughters. Their home is worth £900,000. Their combined estates are worth £2.3m. If Mr Morgan leaves everything to Mrs Morgan on the first death, then clearly no IHT will be payable on the first death as the spouse exemption for IHT will apply. On Mrs Morgan’s death in 2020/21, her estate is worth £2.3m. Mrs Morgan has her ordinary nil rate band available plus a transferable nil rate band. In addition she has two RNRBs of £175,000. However, her estate exceeds the taper threshold by £300,000 so the RNRB available to her estate is reduced to £150,000.

If Mr Morgan had included a NRB discretionary trust in his will which received £325,000, Mrs Morgan’s estate would then have been worth £1,975,000 and her estate would not exceed the taper threshold.
Consider going back to the good old days whereby an equal distribution of assets between spouses was important for the purposes of nil rate band planning (This would have helped in the above example).
Using the RNRB

In some circumstances, it is appropriate to make good use of the spouse exemption but with a view to passing assets on to the next generation as soon as possible. In these circumstances, it is common for a spouse to be given an IPDI in residue and for the trustees to be given overriding powers of appointment. Assets can be channelled through the spouse exempt IPDI onto other beneficiaries. Provided the spouse outlives the transfer by seven years, the funds will pass on to the next generation free of inheritance tax.

The same principles can apply to the use of the RNRB. A qualifying beneficiary could be given a IPDI in a property or a share of property using the RNRB formula, subject to overriding powers of appointment. A property or share of a property could be channelled through the exempt trust and onto other beneficiaries. This may be of particular use for unmarried couples where the spouse exemption is not available on the first death.

General points

Things begin to become more complicated where non-lineal descendants are also beneficiaries of the will. For example, the testator leaves a substantial pecuniary legacy to his sister and residue to his children. Presumably, the residuary gift will satisfy the requirement for the RNRB even though the children have not been left the house specifically. But what if, the executors appropriate the house in satisfaction of the legacy or sell it and use the proceeds to pay the pecuniary legacy? There does seem to be differing views as to whether or not such actions would result in the loss of the RNRB.

What if an estate is left 50% to the testator’s sister and 50% to the testator’s daughter? HMRC’s guidance clearly indicates that, in these circumstances, the sister and daughter are to be treated as inheriting a 50% share of each individual asset in the estate. The daughter will therefore be treated as inheriting a 50% share of the testator’s property. The value of the half share will determine whether or not the RNRB is fully used or partially wasted.

Variations

If the will does not automatically make use of the RNRB, it may be possible for the beneficiaries to put in place a deed of variation under s.142 IHTA 1984 which redistributes the estate in such a way as to bank the RNRB. Often the easiest route would be to incorporate a substituted will which is based on the planning set out above.
Only beneficiaries of full age and capacity can vary their entitlements.

**Appointments**

A variation may not be possible if there are minor beneficiaries or the estate passes onto discretionary trusts. The trustees in these circumstances need to consider using other powers.

If the property (either as a specific gift or as part of residue) passes to children at an age over 25 or grandchildren at a specified age, the trustees could consider using their power of advancement under s.32 Trustee Act 1925. Provided this is exercised within 2 years of the date of death, it will be read back under s.144 IHTA 1984 and the gift will then qualify for the RNRB.

If the estate passes onto a discretionary trust, the trustees should consider making an appropriate appointment within 2 years of the date of death. This will be read back for inheritance tax purposes under s.144 IHTA 1984 so that the gift is treated as a qualifying gift. The appointment could be an absolute appointment of the property to a qualifying beneficiary or an appointment of the property onto a qualifying trust. For example, the children could be given a revocable IPDI in the property. If the property has been sold during the deceased’s lifetime and the downsizing addition is being claimed, the appointment can be of cash or a sufficient share of residue.

There may be good reasons for not making an appointment of the entire property to children or other qualifying beneficiaries. It may also be appropriate in some circumstances for the appointment to simply bank the RNRB, leaving other assets in the estate unaffected. The trustees could consider appointing a RNRB legacy using a formula as discussed above.

If the appointment is made before the inheritance tax account has been completed, the inheritance tax account can be completed on the basis of the appointment which may prevent the need to pay inheritance tax and make a subsequent claim for the overpaid tax. If an appointment has to be made quickly, the use of the RNRB formula may provide a solution.

When dealing with an estate which provides for a life interest for a spouse followed by a discretionary trust, the trustees will need to consider the position during the life tenant’s lifetime and where appropriate exercise their power of appointment to ensure that a sufficient interest in the property passes outright to lineal decedents on the life tenant’s death. You will need to be careful in drafting the appointment to ensure that you do not disturb the existing life tenant’s IPDI. The risk that both
spouses could die in quick succession before the appointment has been exercised will also need to be taken into account.

Finally practitioners will need to appreciate that:-

- The ordinary NRB can be allocated during lifetime and on death.
- The TNRB can in effect be claimed on the death of the second spouse and against any failed gifts which come into play on second death.
- The RNRB can only be allocated against tax on death.

Lucy Obrey – March 2017