



Private Client Briefing

## The devilish detail on inheritance tax



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When Chancellor George Osborne announced significant changes to inheritance tax (IHT) in last summer's Budget speech, the move had been much anticipated. But rather than simply raising the tax-free threshold for everyone, he announced a new allowance specifically for those who own their home and want to leave it to their children.

For these homeowners, a transferable residence nil rate band allowance (RNRB) will be introduced from April 2017. However, as is often the case with such announcements, the devil is in the detail and following last summer's announcement, the Treasury have tried to address a number of objections to the Chancellor's original proposals.

As a result, the Government came back with amendments to the Finance Bill to clarify the treatment of family homes left in trust, to extend the scope of the RNRB to include gifts to the spouses and civil partners of descendants, and to extend the RNRB to include situations where someone has had to downsize or to sell their home completely, perhaps because they had to move to a residential home.

The treatment of even simple trusts under the RNRB rules is complex and anyone who owns their home, has a family and is concerned about inheritance tax, should check how the new rules impact upon their will, if they have one.

And, as this is going to be a gradual change, those with estates in excess of the current £325,000 per person threshold should still be working with their advisors to see how best to manage and mitigate values in the transitional period.

For anyone with high value estates, the new RNRB will be tapered, so estates worth more than £2.35m will not benefit. That means estate planning as usual, with the agenda of lifetime gifts and other tax mitigation worth considering.

There may be further clarification of the legislation before the Finance Bill becomes law, but looking in more detail, what do the new IHT rules mean for you?

*An overview of the RNRB :*

Under the new rules, when a person leaves a residential property to direct descendants there will be an additional nil-rate band for inheritance tax purposes. It is attributable only to residential property, or the proceeds of property after down-sizing (of which, more later) and it will be introduced from April 2017,

increasing each year through to 2020. The property must have been a residence of the tax payer at the time of their death and only one property will qualify for the allowance so, if they had more than one residence in the UK, their executors will have to elect which one is to receive the RNRB.

Direct descendants include natural and adopted children, grandchildren and remoter descendants. It also includes step children and foster children, and the spouse or civil partner of a living or dead direct descendant, as long as any surviving spouse or civil partner has not remarried. For the purposes of the RNRB, adopted children are treated as being the children of both the adoptive and the natural parents. Direct descendants do not include brothers and sisters or nieces and nephews.

<i>Tax year</i>	<i>Residential Nil Rate Band</i>
2017-18	£100,000
2018-19	£125,000
2019-20	£150,000
2020-21	£175,000 and then subject to indexation

The current nil-rate band of £325,000 per person will continue to be available for the same qualifying range of assets as at present, and without restriction on who inherits the assets.

So, from 2017, a married couple or civil partners who satisfy the criteria on the 'property passing to descendants' rule will have a potential combined allowance of £850,000 rising to £1 million by 2020; up from the current level of £650,000, with a resulting saving of inheritance tax of £140,000 at the maximum level. A single person satisfying those criteria will have a £500,000 allowance by 2020, up from £325,000, giving a potential tax saving of up to £70,000.

The new residence nil rate band, like the current nil-rate band, will be transferable to a surviving spouse or civil partner, if unused on the death of the first to die, as long as the first to die owned the property or a share in it.

High value estates will not qualify for the additional relief, which will be tapered away for estates valued at over £2m, at a rate of £1 for every £2 over the £2m threshold. It means that the RNRB will be completely lost on an estate worth more than £2.2m in 2017/18, rising to £2.35m from 2020/21.

The transferable allowance can be claimed even where a spouse dies before April 2017 and in this case, the property does not have to have been held in joint names.

Inheritance tax will continue to be charged at a rate of 40% on the value of an estate above any tax-free threshold.

#### *Downsizing:*

People will be allowed to sell a larger house and retain the relief from inheritance tax, to encourage downsizing and free up larger properties by older owners. There can be any number of downsizing moves between 8 July 2015 and the date of death, and downsizing can also include disposing of part of a property, including land occupied and used as a garden or grounds or a share in it.

The amount of RNRB available after downsizing is calculated so the person should not lose out on the RNRB by the move. They receive at least the same proportion of RNRB on death, as they would if they had died at the time of downsizing.

But it will apply only to reduce tax payable by an estate on death; it will not apply to reduce the tax payable on lifetime transfers that are chargeable as a result of death. So if a property or the sale proceeds are given away within seven years of death, whether it is to a direct descendant or not, the RNRB will not be available to offset against that gift, although it may be available to set against the estate itself. Again, this is rather complicated and requires specialist advice.

### *Property left in trust*

Following the Budget announcement, a number of queries were raised on the handling of property that was held in trust. There are many practical reasons why a person might want to leave their estate, or part of it, in a trust, and tax saving is probably the least common reason for doing so. A person who is in a second marriage and who wishes to provide for their second wife or husband whilst ensuring that children from the first marriage benefit might leave their estate on trust for the use of their wife or husband during their lifetime and then to pass to the children. Another example is where very young children inherit when a parent dies prematurely, as the estate would be held on trust for them until they are old enough to manage their inheritance. Similarly, if a child is incapacitated or disabled in some way, it may be best to leave assets in trust and appoint someone to look after their money.

The RNRB will be available where beneficiaries of a trust are direct descendants and the trusts provide an absolute right to benefit, or where a disabled person is the main beneficiary.

However, in the case of any so-called discretionary trust, where payments of income or capital are made at the discretion of the trustees or are conditional on certain circumstances, for example reaching a certain age, RNRB is not available. The position is complex and for anyone with any form of trust in their will, it's worth reviewing the situation now to see if you're still going to be best served by your current arrangement.

*Some examples of how and when the new Residential Nil Rate Band will work in practice:*

#### **Single, married or civil partners, with no children:**

No RNRB is available on the family home, as it will not pass to direct descendants. Anything over £325,000 per person will be taxed.

#### **All assets held in cash, investments or other non-property, none relating to sale of previous family home:**

No RNRB is available as nothing relates to a family home. At death, only the existing £325,000 per person transferable nil rate band will apply, with anything over that being subject to IHT.

#### **All assets held in cash, investments or other non-property, some relating to sale of previous family home:**

If the downsize took place after 8<sup>th</sup> July 2015, RNRB will be available at the same percentage as the sale value of the family home, or the maximum current RNRB, whichever is the lower, if this element is left to direct descendants. In addition, any unused part of the £325,000 per person transferable nil rate band will be available to offset against the property value.

#### **Transferring the RNRB to other assets:**

If a property is worth less than the full RNRB, any unused RNRB allowance cannot be transferred to offset against other assets.

**Not living in a property owned at death:**

Not living in a property may affect the RNRB. If job-related accommodation is provided and a property is the only one owned at death and it has been lived in as home at some point, or it was planned to do so in future, the allowance will be available, similar to the way only or main residence relief can be claimed for capital gains tax purposes in such circumstances.

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