TAPERING OF THE RESIDENCE NIL RATE BAND

THE 60% IHT 'TRAP'

KEY POINTS

- The tapering of the Residence Nil Rate Band (RNRB) can lead to a 60% tax 'trap' whereby the value of estate assets above the £2,000,000 tapering threshold are charged at an effective rate of 60%
- There are various strategies available help mitigate this 'trap' for larger estates. In fact, this is one area where very late Inheritance Tax (IHT) planning can still work to lessen a person's exposure to IHT.

BACKGROUND

Estates that are able to fully utilise the additional RNRB on death together with the standard Nil Rate Band (NRB) can now benefit from a total effective Nil Rate Band of up to £1,000,000.

This will apply where the deceased was married (or was in a registered civil partnership) and their Personal Representatives have made a claim to obtain the full Transferable Nil Rate Band (TNRB), RNRB and Transferable Residence Nil Rate Band (TRNRB). These claims are made using form IHT402 for TNRB and forms IHT435 and IHT436 for RNRB and TRNRB.

This is broken down as follows and aligns with the Conservative Party's original manifesto pledge of a £1,000,000 Nil Rate Band:

RNRB	£175,000
TRNRB	£175,000
NRB	£325,000
TNRB	£325,000
TOTAL	£1,000,000

However, in order to benefit from this maximum enhanced allowance of £1,000,000, the RNRB of £175,000 and TRNRB (uplift of £175,000) must also be available **in full** on second death. This requires that a property valued at £350,000 or more (for which the deceased had a Qualifying Residential Interest) is left to a direct descendant on death.

FURTHER READING

This briefing is focusing on the planning surrounding the tapering provisions of RNRB. Detailed information on the operation of the RNRB can be obtained from our Guide To The Residence Nil Rate Band which is available from our uTech site.

The site also contains a comprehensive document on Inheritance Tax fundamentals.

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TAPERING OF THE ADDITIONAL RNRB FOR LARGER ESTATES

The additional RNRB, which can only apply on death, is available as an addition to the standard NRB. However, unlike the standard NRB, the RNRB is tapered away where the **estate** is valued at more than £2,000,000 at death.

For such estates, the RNRB is reduced by £1 for every £2 that the net estate exceeds this threshold. This means that for some estates, the combined figure of £1,000,000 may not be available.

EXAMPLE

James and Nora are both UK domiciled and have been married for over 50 years. They have always been UK resident and have lived for 30 years in a sizeable property on the outskirts of London. The property is held as a joint tenancy, meaning it will pass to the survivor automatically on death.

Nora died in July 2020 leaving her entire estate to James. James subsequently died in January 2021 leaving his entire estate to his two sons. His estate includes the family home that passed through survivorship and which was previously valued in 2020 at approximately £1,800,000. Other net assets total £200,000 at the date of death taking into account some debts which are able to be offset. As the value of the estate was equal to the tapering threshold, the full RNRB and TRNRB should be available on his death.

His Personal Representatives will be able to claim TNRB and potentially TRNRB using forms IHT402 and IHT436. As the death occurred in January 2021, the available Nil Rate Bands are as follows:

TNRB £325,000 x 2 = £650,000

TRNRB £175,000 x 2 = £350,000

Total Nil Rate Bands available prior to looking at tapering = £1,000,000

However, we then need to consider how the final probate value of the property within the estate could impact the availability of the RNRB. The important point here is the value of assets can increase out of line with any increase in the tapering threshold.

Here the estate includes a property with a 2020 valuation of £1,800,000, so RNRB will be available in full if the value of the property is still the same as the value of the remaining estate is £200,000 giving a total value equal to the RNRB tapering threshold of £2,000,000.

However, let's assume that the value of the property has risen slightly over the last year and the probate value is in fact £1,900,000. We can see the effect of this on the IHT position in the following chart:

THE 60% IHT 'TRAP' DUE TO TAPERING

	NET Estate	NRBs	RNRBs	Total Nil Rate Bands	Estate liable to IHT	IHT 40%
Initial estate valuation	£2,000,000	£650,000	£350,000	£1,000,000	£1,000,000	£400,000
Revised estate valuation	£2,100,000	£650,000	£350,000-£50,000=£300,000	£950,000	£1,150,000	£460,000

Increase in estate value of	£100,000
Reduction in RNRB; £1 for every £2 excess	£50,000
Increase in IHT	£60,000
Effective Tax Rate on increase: (£60,000/£100,000) x100	60%

UWS PR 00272 I 11/22

So, how can the RNRB be maximised and what could have been done by James and Nora to avoid the 60% 'trap'?

There are various options here.

MAKE USE OF THE RNRB ON FIRST DEATH

- For married couples (and registered civil partners) changing the ownership of the property from a joint tenancy to a tenants in common basis. On first death the RNRB could be used if part of the property is to be left to a direct descendant (it should be noted that any RNRB used on first death is not transferable to the surviving spouse)
- Using part or all of the deceased's available nil rate band to gift further assets on the first death to reduce the survivor's potential estate.

MAKE LIFETIME GIFTS TO FAMILY MEMBERS OR BARE TRUSTS TO REDUCE THE VALUE OF THE ESTATE

- Making lifetime gifts to individuals or bare trusts can reduce the net value of the estate. This would be a potentially exempt transfer (PET) and the full value would fall outside of charge after 7 years. Taper relief could also reduce the value of any tax on any gifts that fail after 3 years
- The 60% IHT 'trap' can be avoided if the reduced value of the net estate is £2,000,000 or less. This means even gifts made in the weeks or days prior to death can allow the RNRB to be claimed in full although these will also impact the availability of the standard NRB. However, as this will remove the 60% IHT 'trap', this can still lead to advantages. This is the only situation where in fact a lifetime gift can reduce IHT even if the transferor has a very short life expectancy
- If we look at our revised valuation example and consider the position if James had made a gift of £100,000 (net of any IHT annual exemptions) to his son a week before his death. Here the RNRB would have been preserved and the NRB available for the estate would be reduced to £900,000, i.e. by the £100,000. However, this would still save IHT due to the difference between the effective rate of 60% on the £100,000 when tapering applies and the standard rate of 40% when simply reducing the standard NRB (as seen in the table below).

	NET Estate	NRBs	RNRBs	Total Nil Rate Bands	Estate liable to IHT	IHT 40%
Revised estate valuation	£2,000,000	£550,000	£350,000	£900,000	£1,100,000	£440,000

MAKING A SETTLEMENT TO A DISCRETIONARY TRUST

- Making a settlement into a Discretionary Trust can also reduce the estate for RNRB purposes although such settlements can be immediately chargeable to IHT. Again, James could have settled the £100,000 into a discretionary trust and this would have preserved the RNRB allowing only the standard NRB to be reduced on death
- Gifting outright or making a settlement of any assets that qualify for Business Relief or Agricultural Property Relief. This can allow for larger transfers of value providing the conditions are met and continue to be met on death.

OTHER PLANNING USING LIFE POLICY TRUSTS

- Settling a Loan Trust to enable any growth in value of the trust to be outside the settlor's estate and reduce the effects of tapering
- Investing in a Discounted Gift Trust may also benefit from an immediate discount for IHT purposes PLUS the additional benefit that the whole of the investment is immediately outside of the estate value for the calculation of the RNRB.

SUMMARY

For estates in the range between £2,000,000 and £2,700,000, pre-planning to maximise RNRB can achieve significant savings and avoid the potential impact of the 60% IHT 'trap'.

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UWS PR 00272 | 11/22