

INHERITANCE TAX AND THE FAMILY HOME



The Conservative party's 2015 election manifesto pledged to take the family home out of inheritance tax by increasing the Inheritance Tax ("IHT") for married couples and civil partners to £1 million. The Chancellor announced in the Summer Budget of July 2015 that the enhanced IHT nil rate band ("NRB") would be introduced with effect from 6 April 2017.

Residence Nil Rate Band ("RNRB")

The RNRB is an enhancement to the existing NRB and can be applied to the taxable value of the Estate in the same way that the NRB is applied, except that it may only be used against the value of residential property included in the death estate which passes to direct lineal descendants (including adopted, step and foster children). The value of the allowance will be the lesser of the net value of the interest in the property after liabilities or the maximum amount of the band.

The RNRB is being phased in as follows -

2017-18	: £100,000
2018-19	: £125,000
2019-20	: £150,000
2020-21	: £175,000

The full amount of the relief will not be available until the tax year 2020-21. It will then rise in line with the Consumer Price Index.

The relief is subject to tapering where the estate of the deceased exceeds £2 million. In which case the RNRB is reduced by £1 for every £2 of the excess over £2 million.

It is the value of the estate before deduction of exemptions and reliefs which is viewed for tapering purposes - so business property relief and agricultural property relief are ignored.

However, the cumulative total is not taken into account so the value of the estate could be reduced for tapering purposes by lifetime gifts - including death-bed giving.

As with any newly introduced legislation it is difficult to comment definitively until the practical application has been tested but we do have technical guidance from HMRC.

The legislation is contained in Inheritance Tax Act 1984 ss8D - 8M as inserted by Finance (No 2) Act 2015 s9. The legislation applies where there is a "qualifying

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residential interest" in a person's estate that is "closely inherited" on or after 6 April 2017.

"Inherited" is defined in s8J as a disposition effected by will, the intestacy rules or otherwise. Post-death variations could attract the RNRB (all other requirements being satisfied) because there is reading-back under s142 for all IHT purposes.

The property must be left on death to a lineal descendant. The definition of child is very wide and includes step-children, foster children, and natural children who have been adopted by a third party. Also, spouses and civil partners of lineal descendants. Surviving spouses and civil partners of deceased lineal descendants will qualify provided that they have not remarried.

A residential property interest is defined in the legislation as an interest in a dwelling which has been the person's residence at a time when the person's estate included that, or any other, interest in the dwelling house.

Note that the property does not have to be the person's residence at the time of death. However, a property which was never a residence of the deceased will not qualify - for example a buy-to-let property held as an investment.

It is expected that capital gains tax main residence relief case law will be used to help determine whether the property is a "residence" but the similarities will not continue throughout because the RNRB is not restricted to the main residence - the qualifying residential interest will be limited to one residential property but personal representatives will be able to nominate which residential property if there is more than one in the estate. Also, there is no limitation to one half hectare grounds as permitted curtilage, and there is no apportionment if the property was not occupied as a residence throughout the entire period of ownership.

Brought forward residence nil rate band

For a person who dies on or after 6 April 2017 the brought forward residence allowance can be transferred to a surviving spouse.

The amount of the transferable RNRB is calculated in the same manner as the transferable NRB

that is the unused amount is expressed as a percentage of the full RNRB.

That percentage is applied to the RNRB in place at the time, it is later utilised by the surviving spouse's estate.

Therefore, it could be possible for the survivor's estate to benefit from a total RNRB of £350,000 plus NRB of £650,000 in 2020/21.

To make full use of two RNRB it is necessary for the survivor to have a residential property worth at least £350,000 in 2020/21;

If a person dies without a residential interest, or without one which is closely inherited, the whole RNRB can be transferred to a surviving spouse / civil partner;

In the case of deaths before 6 April 2017, the RNRB will never have been used and so will be available for transfer to a surviving spouse / partner;

Where the death occurs before 6 April 2017 the transferable RNRB is £100,000 (subject to tapering where the estate exceeds £2million).

Downsizing

When the enhanced relief was initially introduced, no provision was made to address the situation where a person has chosen to downsize, or sell their home. The government announced that the RNRB should not be introduced in such a way as to discourage an individual from downsizing or selling their property. Consequently, a consultation document was issued in September 2015, a HMRC technical note was issued in October 2015, and in December 2015 draft legislation was included in the draft Finance Bill 2016.

The provisions apply for deaths on or after 6 April 2017 and for downsizing or disposals on or after 8 July 2015. Essentially, an estate will be eligible for the proportion of the RNRB that is foregone as a result of downsizing or disposing of the property in addition to the RNRB that is available on death, but the calculations are complex and specialist advice is required.

HMRC current guidance states that the additional RNRB will be available where the deceased:

- Downsized to a less valuable residence and that residence, together with assets of an equivalent value to the "lost" RNRB, has been left to direct descendants (i.e. smaller property and cash);
- Sold their only residence, and the sale proceeds, or other assets of an equivalent value, have been left to direct descendants;
- Has otherwise ceased to own their only residence, and other assets of an equivalent value have been left to direct descendants.

The HMRC guidance gives additional conditions which must be satisfied:

- The downsizing or disposal of the property occurs after 8 July 2015;
- Subject to the condition above, there is no time limit on the period in which the downsizing or disposal took place before death;
- There could be any number of downsizing moves between 8 July 2015 and date of death;
- Downsizing would also include disposing of part of a property (including land occupied and used as a garden or grounds) or a share in it;
- Where a property is given away, assets of an equivalent value to the value of the property when the gift was made must be left to direct descendants;
- The value of the property would be the net value after deducting any mortgage or other debts charged on the property;
- The additional RNRB would be tapered away in the same way as the RNRB if the value of the estate at death exceeds £2 million;
- The additional RNRB would be applied together with the available RNRB but the total for the two would be capped so that they would not exceed the limit of the total available RNRB for a particular year.

A claim has to be made for the additional RNRB in a similar way that a claim is made to transfer any unused RNRB to the estate of a surviving spouse / civil partner.

Example

A single person lives in a flat worth £80,000 and has other assets worth £450,000. The total estate is therefore £530,000.

If the person dies in 2017/18 the IHT nil rate band available will be £405,000, being made up of the standard NRB of £325,000 plus RNRB worth a further £80,000. The full £100,000 is not available because the flat is worth less than the RNRB.

As a result, IHT at 40% will be charged on £125,000, giving an IHT liability of £50,000.

However, if the flat had been worth £400,000 and other assets £130,000 the full RNRB would be available and the IHT charge would then be £42,000.



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