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PASSING ON THE FAMILY HOME: THE NEW RULES ON INHERITANCE TAX



Set to come into effect from April 2017, the new 'residence nil-rate band' means the majority of people may soon be able to pass on a 'family home' tax-free on death. Here we consider the new rules in more detail.

THE CURRENT RULES

Inheritance tax (IHT) is currently charged at 40% on the proportion of an individual's 'estate' exceeding the IHT nil-rate band, which is set at £325,000 for 2016/17. Married couples and registered civil partners can pass any unused nil-rate band on death to one another.

An estate includes both the value of chargeable assets held at death plus the value of any chargeable lifetime gifts made within seven years of death (though there may be a discount on the 40% tax rate for certain lifetime gifts). The chargeable value of assets and gifts is the value after deducting any liabilities, reliefs and exemptions that apply.

WHAT'S CHANGING?

Under changes announced by the Government, an additional nil-rate band will be introduced for each individual to enable a 'family home' to be passed wholly or partially tax-free on death to direct descendants such as children or grandchildren. A step-child, adopted child or fostered child is also regarded as a direct descendant.

The new 'residence nil-rate band' (RNRB) is set to come into effect from 6 April 2017 and is in addition to an individual's own nil-rate band. The RNRB will initially be set at £100,000 in 2017/18, before rising in increments to reach £175,000 in 2020/21. This means that up to

£1 million of a married couple's estate could eventually be taken outside the scope of IHT if the full nil-rate bands (£325,000 + £175,000 x 2) are available to each spouse.



The following table sets out the position over the coming years.

Tax year	Nil-rate band	RNRB	Total for an individual	Total for married couples and civil partners
2016/17	£325,000	Nil	£325,000	£650,000
2017/18	£325,000	£100,000	£425,000	£850,000
2018/19	£325,000	£125,000	£450,000	£900,000
2019/20	£325,000	£150,000	£475,000	£950,000
2020/21	£325,000	£175,000	£500,000	£1,000,000

From 2021/22 onwards the RNRB will increase in line with the Consumer Price Index (CPI).

It is worth noting that the RNRB can only be used in respect of one residential property. The property does not have to be the main family home, although it must at some point have been a residence of the deceased, so buy-to-lets, for example, will not be eligible for the relief. Where the deceased has two homes, the individual's personal representatives can nominate which property to elect for the RNRB.

UNUSED ALLOWANCES

On the first death, it is often the case that the bulk of the deceased spouse's (or civil partner's) assets pass to the survivor. The percentage of the nil-rate band not used on the first death is then added to the nil-rate band for the second death. Similarly, any unused RNRB can be transferred between spouses and civil partners when the second person dies.

For example, if on the death of the first spouse 50% of either the main nil-rate band or the RNRB was unused, then the estate of the second

spouse would have 150% (their own plus 50% from their spouse) at the rates existing at the second spouse's death. It is possible, where a remarriage occurs, to inherit unused portions of a RNRB from more than one previous spouse, but a person cannot claim more than their own plus 100% in total of the RNRB of other spouses.

Case Study

David dies in July 2017. His share in the family home is valued at £90,000, which he leaves to his daughter. The rest of his estate passes to his spouse Elaine. Elaine dies in 2020/21 with an estate worth £750,000, including her share in the family home, worth £130,000. Her estate is inherited by her children. No lifetime gifts were made by either spouse.

On David's death £100,000 of the RNRB is available, of which £90,000 is used (90%), leaving 10% available to carry forward to Elaine. Subsequently, on Elaine's death the RNRB is now worth £175,000. Elaine's estate will be able to claim a RNRB of £192,500 (100% + 10% x £175,000), representing her own RNRB and 10% from David. As her share in the property is worth less than this, the claim is restricted to £130,000.

Where the first spouse's death occurs at any time before 6 April 2017, a default amount of £100,000 is deemed to be available for carry forward to a person who was their spouse at that time. This will then be uplifted for use by the second spouse on their death as demonstrated above.

WHAT ABOUT TRANSFERS?

The RNRB may not apply where transfers are made during one's lifetime to individuals or trusts. However, an exception may apply where the value of the property is still included in the deceased's estate due to it being 'a gift with reservation'. This is where the home has been legally gifted but the donor still benefits from the property, such as living in the property rent-free.

Transfers into a trust on death cannot benefit unless a direct descendant has a specific type of interest in the trust, known as an immediate post-death interest or disabled person's interest.

RESTRICTIONS FOR HIGH VALUE ESTATES

There will be a tapered withdrawal of the RNRB for estates with a net value (after deducting any liabilities but before reliefs and exemptions) of more than £2 million. This will be at a withdrawal rate of £1 for every £2 over this threshold. This effectively means that for 2017/18, the first year of operation, a person with an estate in excess of £2.2 million will not benefit from the RNRB. By 2020/21 the limit will be £2.35 million. For spouses it applies on each death estate calculation. This reduction only applies where the estate at death exceeds the limit and it does not include lifetime transfers within seven years of death.

'DOWNSIZING' RELIEF

It is proposed that the RNRB will be available when a person downsizes or ceases to own a home on or after 8 July 2015 where assets of an equivalent value, up to the value of the RNRB, are passed on death to direct descendants. This might apply in cases where, for example, an individual has had to sell their home to move into a residential care facility.

CLAIMING THE RNRB

To benefit from the RNRB, the deceased's representatives must submit a claim within two years from the end of the month in which the death

occurs or, if later, three months from the date on which the personal representatives first act. Extended time limits may apply to others. It is possible to withdraw a claim within one month of whichever of the above time limits applies.

TIPS FOR MINIMISING AN IHT BILL

While the introduction of the RNRB will be welcome news for many, taking steps to minimise the IHT burden should still form an important part of your tax planning strategy. Consider the following steps to help mitigate a potential IHT bill.

IHT exempt transfers between spouses

Transfers of assets between spouses and civil partners are generally exempt from IHT, regardless of whether they are made during a person's lifetime or on their death. Other exempt transfers include:

- small gifts (not exceeding £250 per tax year, per person) to any number of individuals
- annual transfers not exceeding £3,000 (any unused amount may be carried forward to enhance the following year's exemption)
- certain gifts in consideration of marriage or civil partnership
- normal expenditure out of income
- gifts to charities.

Lifetime gifts

A programme of lifetime gifts can also significantly reduce the IHT liability on your estate. Providing you survive the gift by seven years and no longer continue to benefit from the gift yourself, it will not be liable to IHT. Gifts also have the advantage of allowing you to witness your family members benefitting during your lifetime. A discount can also apply where lifetime gifts were made between three and seven years before death – please ask us for more information on the rules.

Trusts

Trusts allow you to transfer assets out of your estate for IHT purposes, without giving the recipient complete control over the asset and/or the income it generates. There may be an IHT charge, but this would be at 20%, and then only if the transfer is over £325,000 (2016/17).

Life assurance policies

Unless designed to cover IHT liabilities, life assurance policies should be assigned during your lifetime so that the proceeds do not form part of your estate on death. The most common assignees are spouses, family members, and trusts.

Your Will

Your Will is an essential planning tool. Not only does it ensure the wealth you have accumulated during your lifetime is passed to your chosen beneficiaries, but it can also be structured to save tax. It might also be worth reviewing an existing Will in light of the new rules outlined in this factsheet.

Charitable giving

Generally, all gifts to charity are exempt from IHT. A reduced rate of 36% can apply to death estates, where 10% or more of the net estate is left to charity.

We can help you plan to minimise the inheritance tax due on your estate – please contact us for further advice.

