

Nil Rate Band guide

An introduction to the Nil Rate Band

In our inheritance tax guide, we introduced the concepts of the Nil Rate Band (NRB) and the Residence Nil Rate Band (RNRB). The NRB, often referred to as the inheritance tax (IHT) threshold, is the amount up to which an estate has no IHT to pay. Each individual's estate can benefit from the NRB. From 6 April 2017, the newer RNRB became available in addition to the NRB.

Inheritance tax and estate planning can be complicated and the RNRB in particular is often not very well understood. Now could be a good time to speak to a financial planner and review your existing arrangements (if any) to ensure that you are making the most of your allowances.

In this guide, we provide examples of how both the NRB and RNRB can be utilised, outline the eligibility criteria for the RNRB and demonstrate how any unused NRB and RNRB may be transferred/brought forward to a surviving spouse or civil partner to reduce their IHT burden.

Glossary of terms

Estate Planning	The preparation of tasks that serve to manage an individual's asset base in the event of their incapacitation or death.
Domicile	The country that a person treats as their permanent home, or lives in and has a substantial connection with.
HMRC	Her Majesty's Revenue & Customs.
Inheritance tax (IHT)	A tax on the estate (the property, money and possessions) of someone who has passed away.
Lifetime Transfer	A transfer of value (broadly, gifts) made by an individual to another individual or to a specified trust during their lifetime. If the donor survives for seven years from the date of transfer no IHT will be payable.
Nil Rate Band (NRB)	The threshold below which some or all of the value of a gift, a death estate or assets held within a trust is subject to a zero rate of Inheritance Tax.
Potentially Exempt Transfer (PET)	A gift of unlimited value which will become exempt from Inheritance Tax (IHT) if the individual survives for a period of seven years.
Qualifying Former Residential Interest (QFRI)	An interest in a previous residence that could have qualified for the Residence Nil Rate Band.
Qualifying Residential Interest (QRI)	An interest in a property which has been the person's residence at a time when the person's estate included that, or any other, interest in that property.
Residence Nil Rate Band (RNRB)	An extra amount (£175,000 in the current tax year) that can pass on death without any inheritance tax being payable.
Taper Threshold (TT)	The RNRB is tapered for estates in excess of the £2m. The Taper Threshold (TT) thereby reduces by £1 for every £2 over the £2m figure. Therefore, where an estate is valued at £2,350,000 or greater, the RNRB (currently £175,000) will be zero.
Situs	A place where something exists or originates specifically.
Transferable Nil Rate Band	The unused proportion of the NRB which can be transferred to the surviving spouse or civil partner upon death.

What is the Nil Rate Band?

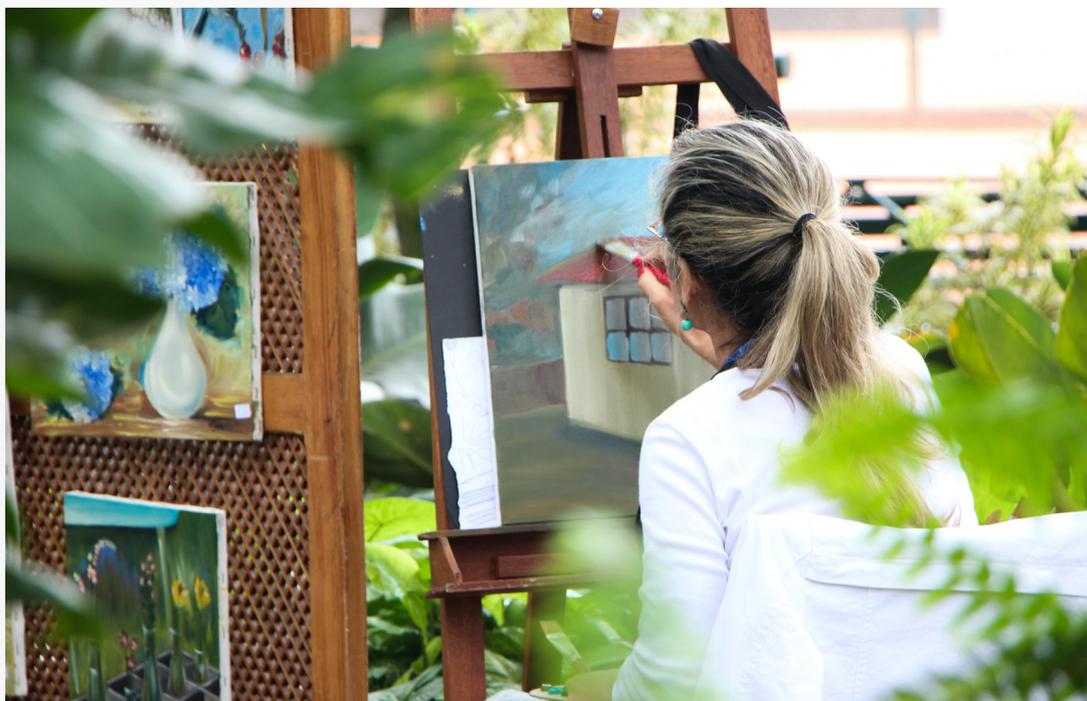
The Nil Rate Band (NRB) is the Inheritance Tax (IHT) threshold charged at 0%. In the current tax year the threshold is £325,000 and IHT is charged at 40% on anything above this amount.

Transfer(s) on or within seven years of death:

Value	Rate
Nil to £325,000	0%
Excess over £325,000	40%

The NRB can be transferred between spouses and civil partners. Therefore, any unused proportion of the NRB upon the first death can be transferred, effectively inherited, by the surviving spouse or civil partner – the ‘Transferable Nil Rate Band’ (TNRB). This proportion, not the monetary amount at the time of first death, can then be applied to the survivor’s estate upon second death. Where the NRB is 100% unused upon the first death, the potential uplift upon the second death is 100% giving a maximum NRB of 200%.

The NRB for a given individual cannot exceed 200%. This is important to remember where a person has ‘inherited’ any unused transferable NRB from a deceased spouse/civil partner and then goes on to remarry/enter into a new civil partnership. If their new spouse/civil partner dies and they inherit their unused NRB, the maximum uplift they can receive is capped at 200%, even if it originates from more than one source.



Domicile

Those who are UK-domiciled are liable to IHT on all worldwide assets, even if not resident in the UK. Non-UK-domiciled individuals who are resident in the UK are liable to IHT on UK assets, i.e. UK situs. Non-UK-domiciled, non-UK-resident individuals are generally only liable to transfers of assets within the UK.

Fig. 1

Situs	UK Domicile	Non-UK-Domicile
UK Assets	Liabile	Liabile
Foreign Assets	Liabile	Not liable

Domicile is an important consideration in the context of IHT and it is advisable to seek professional advice to establish your exact position ahead of creating your Estate Plan.



NRB examples

Example 1

Penny's husband Philip died in 2015. They did not have any children; they had not made any gifts within the last seven years, and everything was left to Penny. Penny died recently and left everything to her nephew Paul, as follows:

Fig. 2

Primary Residence	£650,000
Investments	£320,000
Cash Savings	£30,000
Total Estate Value	£1,000,000
Less: NRB	-£325,000
Less: NRB	-£325,000
Taxable Estate	£350,000
IHT Liability	£140,000

Paul settled the IHT liability, probate was granted, and he inherited Penny's estate. The effective rate of IHT was 14% ($£140,000/£1,000,000 \times 100$).

Example 2

Now let us assume that Philip had made a gift of £162,500 in cash to his sister Pernilla the year before he died. This Lifetime Transfer was a Potentially Exempt Transfer (PET). Philip utilised 50% ($£162,500/£325,000 \times 100$) of his NRB when he made this gift and as a result, his NRB will not be fully replenished to 100% (£325,000) until the gift drops outside the estate after seven years from the date of the gift. Therefore, as the PET failed, Penny inherits the unused proportion of 50% and this is the maximum proportion that can be applied to her estate upon death, as follows:

Fig. 3

Primary Residence	£650,000
Investments	£320,000
Cash Savings	£30,000
Total Estate Value	£1,000,000
Less: NRB	-£325,000
Less: NRB	-£162,500
Taxable Estate	£512,500
IHT Liability	£205,000

The difference in the IHT liability is £65,000 which is 40% of £162,500 – the amount of Philip's used NRB, which was not available to be transferred to Penny and used upon the second death. This increases the effective rate of IHT to 17.63%, including the failed PET.

Inclusion of the gift (failed PET) highlights the 'cumulation principle' that underpins IHT. This can be a complex area of financial planning and it is advisable to seek professional advice to ensure your Estate Plan is secure.

NRB examples continued

Example 3

Finally, let's assume that Philip and Penny were not married and not in a civil partnership. This can be complicated, but we make further assumptions for clarity:

1. Philip and Penny owned everything on a 50:50 basis;
2. Philip left everything to Penny and no gifts were made in the previous seven years.

First, we need to consider Philip's estate, inherited by Penny, as follows:

Fig. 4

Primary Residence	£325,000
Investments	£160,000
Cash Savings	£15,000
Total Estate Value	£500,000
Less: NRB	-£325,000
Taxable Estate	£175,000
IHT Liability	£70,000

Penny is faced with an IHT liability of £70,000. She settles the liability and probate is granted. Her estate is reduced by £70,000 as she encashed some investments to pay the tax bill.

Example 4

Penny then dies six years later in 2021, leaving her entire estate to Paul.

Despite inheriting a significant sum, the estate value has been eroded by the previous IHT liability upon Philip's death paid by Penny and the absence of a transferred NRB from Philip to Penny. Subsequently the effective rate of IHT at death is over 26%.

The NRB, more specifically any unused proportion thereof, can only be transferred to a spouse or civil partner. Therefore, a partnership or relationship of any other description does not meet the criteria.

The NRB has remained unchanged at £325,000 since the start of the 2009/10 tax year and it is foreseen to remain at this level until the start of the 2026/27 tax year.

Fig. 5

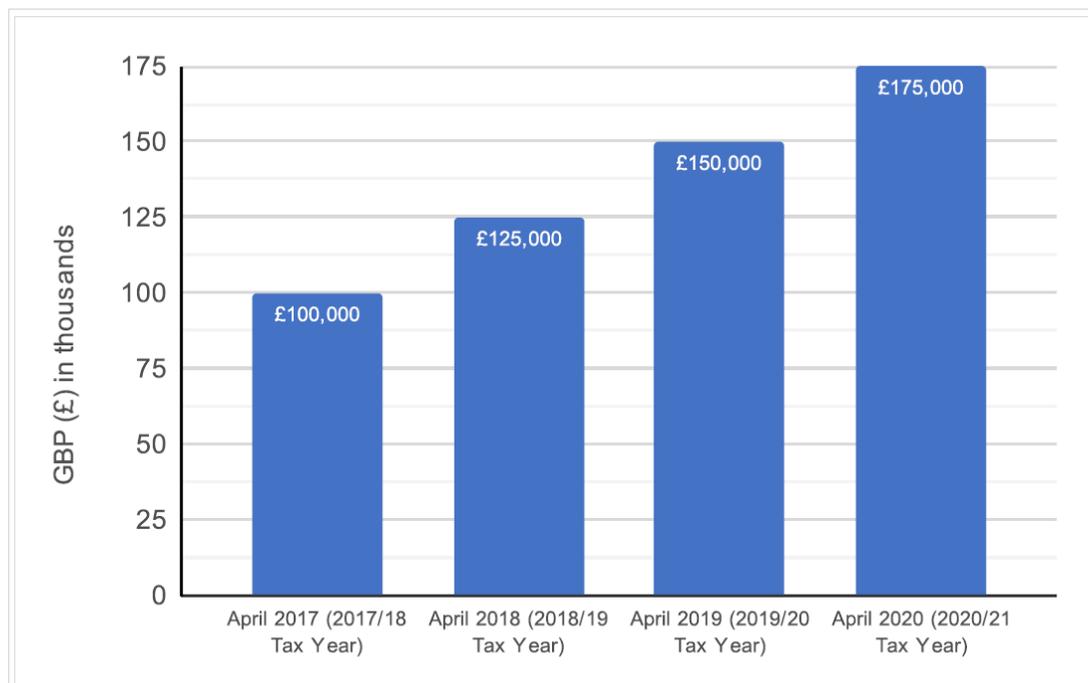
Primary Residence	£650,000
Investments	£250,000
Cash Savings	£30,000
Total Estate Value	£930,000
Less: NRB	-£325,000
Taxable Estate	£605,000
IHT Liability	£242,000

Residence Nil Rate Band (RNRB)

The Residence Nil Rate Band (RNRB) in the current tax year is £175,000 and is in addition to the NRB. The RNRB is not anticipated to change until at least April 2026.

In April 2017 the Residence Nil Rate Band (RNRB) was introduced in order to enable homeowners, that meet the eligibility criteria, to distribute or pass on more of their estate to their beneficiaries. Originally £100,000, the RNRB was phased in and increased by £25,000 each year up to £175,000 in April 2020.

Phased increase of Residence Nil Rate Band (RNRB)



RNRB eligibility criteria

- Available to those who died on or after 06 April 2017, even if the first death occurred before this date;
- There must be a Qualifying Residential Interest (QRI) or a Qualifying Former Residential Interest (QFRI);
- Home must be inherited on death by their Direct Descendants or Direct Lineal Descendants, i.e. 'closely inherited'.

The RNRB is available to be set against chargeable estates of those who died on or after 06 April 2017. However, it can be 'brought forward' to the surviving spouse, where the first death occurred prior to 6 April 2017. The RNRB, unlike the NRB, is not available to be used against Lifetime Gifts, e.g. failed PETs. It is only available upon death.

The RNRB can be used for those who held a QRI at some point during their lifetime. In many cases, this will be the family home, but it could be full or partial ownership of a property that was their residence during the period of ownership. Where an individual has a QRI in two or more properties, the RNRB can be applied to a nominated single property of their choosing, e.g. those who have more than one residence, but it cannot be used against more than one property nor can it be used against buy-to-let or investment properties.

There may be situations where an individual no longer owns a property but may still be able to take advantage of the RNRB, e.g. where downsizing has taken place or where an individual sells their home and moves into residential care, thereby giving consideration to those who had a QFRI. This 'protection' is available where the home is downsized or disposed of after 7 July 2015, provided assets of

an equivalent value are then passed on to direct descendants upon death.

This is a complex area of financial planning, and it is recommended that you seek professional advice.

The RNRB is only available where a home is inherited by a direct descendant(s). This is typically the children, but can include a step-child, adopted child or a foster child of the deceased or their direct lineal descendants. Where an individual does not have any direct descendants that qualify, they will not be able to utilise the RNRB.

In addition, if the home is valued less than the RNRB then the RNRB will be reduced to the value of the home. Therefore, in some instances, the RNRB will be less than the maximum of £175,000 or £350,000 for a couple. It is the net value that will be used - meaning the value after deductions such as any outstanding mortgage debt or where a form of equity release has been undertaken.

The 'Brought Forward' allowance can be claimed within two years ending from the month in which death occurs. If there is any unused RNRB in the estate of the first to pass away, the unused part is available to increase the RNRB available to the survivor upon their passing. As with the NRB, this is the unused proportion and not a monetary amount.

RNRB is available in conjunction with the standard rules and irrespective of:

- when the first death occurred;
- the value of the estate – provided it was under the £2m Taper Threshold (TT);
- whether or not the estate on first death included a home.

Interaction between the NRB and RNRB

When undertaking an IHT calculation, the RNRB is deducted from the estate first and then the NRB second. As the RNRB cannot be applied to Lifetime Transfers made within seven years of death, it does not reduce any IHT payable on Lifetime Transfers that become chargeable upon death, e.g. failed PETs.

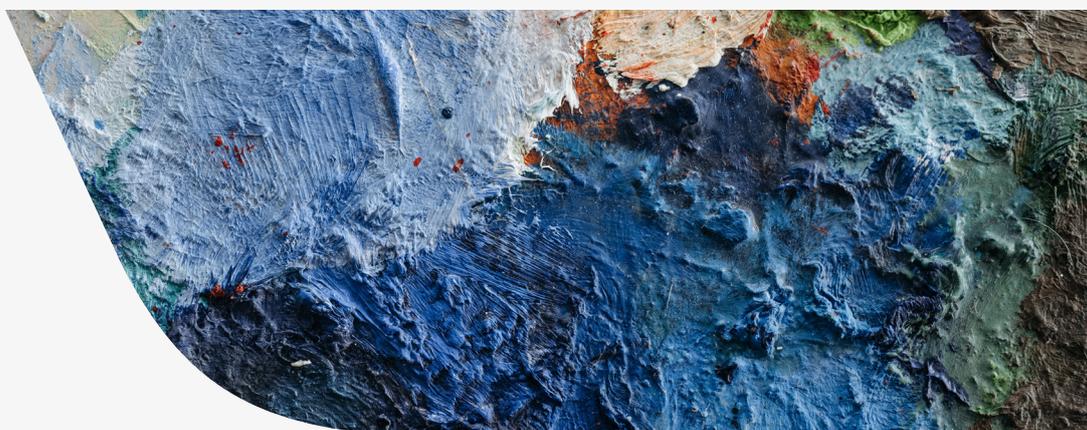
Example:

Colin (72) and Catherine (68) are married with two grown-up children, Catriona and Connor. They meet the eligibility criteria and thus qualify for the RNRB. They are concerned about IHT when they die and have engaged a financial planner to provide an overview of their situation. They have not made any lifetime gifts in the last seven years.

Fig. 7

Primary Residence	£750,000
Investments	£220,000
Cash Savings	£30,000
Total Estate Value	£1,000,000
Less: RNRB	-£175,000
Less: RNRB	-£175,000
Less: NRB	-£325,000
Less: NRB	-£325,000
Taxable Estate	£-
IHT Liability	£-

Given the 'additional' protection the RNRB provides, their potential IHT liability is currently nil, saving their beneficiaries (Catriona and Connor) a tax bill of £140,000.



Large estates and tapering

The RNRB is tapered for large estates in excess of £2m (the 'Taper Threshold'), where for each £2 over the Taper Threshold the RNRB is reduced by £1 to the point where the RNRB is fully extinguished. Therefore, an estate valued at £2.35m will not benefit from the RNRB and an estate valued at £2.7m where an unused RNRB is 'brought forward' will not benefit from the RNRB either.

The £2m is based on the value of the estate upon death and does not include Lifetime Transfers even if they were made within seven years of death and subsequently included in the IHT calculation.

Example:

Keith (68) and Kamila (50) are married. Keith has a son from a previous marriage, Karl (38). They made a substantial gift of £500,000 to Karl eight years ago. Keith is concerned about IHT and its impact on Kamila and, eventually, Karl. He has engaged with a financial planner to prepare an Estate Plan, below is a summary of their position.

NB. The fact that Karl is Kamila's stepson makes no difference to his status as a 'direct descendant' for IHT purposes.

Fig. 8

Primary Residence	£1,000,000
Holiday Home (Norway)	£600,000
Investments	£850,000
Cash Savings	£250,000
Total Estate Value	£2,700,000
Less: NRB	-£325,000
Less: NRB	-£325,000
Taxable Estate	£2,050,000
IHT Liability	£820,000

As their estate is in excess of £2m the RNRB is subject to tapering.

Understandably, Keith is concerned by this information, and he is now keen to explore his options to mitigate their potential IHT liability. Fortunately, the £500,000 Lifetime Transfer made to Karl is not included in the taxable estate as it was made more than seven years ago. Had the gift been made more recently, i.e. within the last seven years, this would have further exacerbated the tax issue.



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