

# The residence nil rate band

## Briefing Note

**In addition to the inheritance tax (IHT) standard nil rate band (NRB) (currently £325,000) a residence nil rate band (RNRB) was introduced from 6 April 2017. This is available when residential property is left to direct descendants.**

Initially, the RNRB was set at £100,000 but increased by £25,000 each year until it reached £175,000 in April 2020. Just like the standard nil rate band, any unused RNRB on the first death of a married couple or civil partners has the potential to be transferable even if the first death occurred before 6 April 2017.

However, the RNRB does come with conditions attached and so may not be available – or available in full – to everyone.

Let us look at some of the factors that will affect the availability and use of the RNRB:



### Qualifying residential interest

- The RNRB can be used only by those who held a 'qualifying residential interest' at some time during their lifetime. Simply, they need to own or have part ownership of a property that was their residence at some point during the period of ownership.
- The RNRB cannot be offset against other properties owned by the deceased; for example, buy-to-let or investment properties. However, if the deceased has two qualifying residential interests, then the personal representatives can nominate which property will utilise the RNRB. It cannot be divided across two properties.
- Any individuals who do not own their home will be unable to utilise the RNRB as they will not have a qualifying residential interest (although the RNRB may still be available in some cases – for example where the deceased 'downsized' or sold a property to move into residential care on or after 8 July 2015).

- It will also affect those that have released equity from their property as it is the net value of the home that will be used, so the value of any outstanding loan against the property will have to be deducted from the value to arrive at the net value to be used.



### Descendants

- In order to pass on a qualifying residential interest and use the RNRB, the property needs to be 'closely inherited'. This means that the property must be passed to direct descendants.
- Direct descendants include children, grandchildren and any remoter descendants together with their spouses or civil partners, including their widow(er) or surviving civil partner who has not remarried or entered into a new civil partnership. It also includes a step, adopted or fostered child or a child to which the deceased was appointed as a guardian or a special guardian when the child was under 18.
- Direct descendant doesn't include nephews, nieces, siblings and other relatives who aren't included in the list above.
- If an individual, a married couple or civil partners do not have any direct descendants that qualify, they will be unable to use the RNRB.
- If a qualifying residential interest is placed into a discretionary will trust, it will not qualify for the RNRB, even if the beneficiaries are limited to direct descendants. However, if the trustees appoint the qualifying residential interest to direct descendants, within two years, the RNRB could potentially be claimed.
- Alternatively, if a qualifying residential interest is placed into a bare trust or interest in possession will trust (amongst others), it will qualify for the RNRB provided the beneficiaries are direct descendants.

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### Transferring unused allowance

- Like the standard nil rate band, any unused RNRB can be transferred between spouses and civil partners to be used when the surviving partner dies, regardless of when the first death occurred and whether or not the first deceased held a qualifying residential interest (that is, property ownership is not required by the first deceased). The only check that is required is whether the first deceased's estate was over £2 million. The transferable RNRB must be claimed by the personal representatives within two years from the end of the month in which the second death occurs.
- Where the first death occurs before 6 April 2017, 100% of the RNRB will be available to be transferred when the surviving spouse or civil partner subsequently dies, unless the estate was 'large' (see below). This is the case regardless of whether or not the first to die owned a qualifying residential interest.



### Large estates

- Where an estate is valued at more than £2 million, the RNRB will be progressively reduced by £1 for every £2 that the value of the estate exceeds the threshold.
- In determining whether the £2 million threshold is breached, it is necessary to ignore reliefs and exemptions. This means that business relief and agricultural relief are ignored when determining the value of the estate for the RNRB even though they are taken into account to calculate the liability to IHT.
- As the £2 million is based on the value of the assets owned at the time of death, it does not include any lifetime gifts made by the deceased, even if they were made within seven years of death and are included in the IHT calculation.
- Estates of £2.35 million or greater will not benefit from an RNRB.
- If the deceased has brought forward an unused RNRB from a spouse or civil partner then this can also be factored in, so some individuals may not see the RNRB fully disappear until the estate is worth in excess of £2.7 million. The loss of £350,000 in RNRB, means an extra £140,000 of IHT may be payable.

As you can see, not everyone will benefit from the full or even any RNRB.



### Downsizing

People can downsize and still benefit from the RNRB.

The provisions apply to situations where someone has:

- downsized to a less valuable residence and the new property, together with other assets of an equivalent value to the 'lost' RNRB, has been left to direct descendants
- sold their only residence, and the sale proceeds (or other assets of equivalent value) have been left to direct descendants
- otherwise ceased to own their residence and other assets of equivalent value have been left to direct descendants.

The qualifying conditions for the RNRB after downsizing are:

- The individual died on or after 6 April 2017
- The property must have been owned by the individual and it would have qualified for the RNRB had the individual retained it
- A lower value property, or other assets if the property has been disposed of, are in the deceased's estate
- A lower value property, and other assets of equivalent value, are inherited by the individual's direct descendants on that person's death

In addition, the following conditions also apply:

- The downsizing or the disposal of the property occurs on or after 8 July 2015
- As for the RNRB, the value of the property is the net value after deducting any mortgage or other debts charged on the property
- The downsizing RNRB would be tapered away in the same way as the RNRB for estates above £2 million
- The downsizing RNRB would be applied together with the available RNRB, but the total for the two would still be capped so that they would not exceed the total available RNRB for a particular year
- A claim would have to be made for the downsizing RNRB in a similar way that a claim is made to transfer any unused RNRB

If the deceased disposed of more than one home between 8 July 2015 and their date of death, the personal representatives can choose which disposal is taken into account to calculate the downsizing addition.

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.

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### RNRB example

Now we have given an overview of the RNRB, let us consider some examples.

#### Scenario 1

Eric dies in May 2017 leaving a wife, Joan, and their adult son, Arthur. The family home was valued at £400,000 at that time and other assets, such as investments and cash, totalled £1,000,000. Everything was held jointly between Eric and Joan.

- The spousal exemption applies meaning that ownership of the family home and other assets passes to Joan without any IHT being due and Eric's nil rate band and RNRB are unused.
- Subsequently, in July 2021, Joan dies and leaves her estate to Arthur. At that time the house has increased in value to £600,000 and the other assets are now worth £800,000, giving a total estate of £1.4 million.
- Joan's personal representatives have her standard nil rate band of £325,000 and as she owns a qualifying residential interest on death, the RNRB is also available to use against her estate. As Eric left everything to Joan, her personal representatives can claim his unused RNRB in addition to his unused standard nil rate band.
- Joan's estate can therefore benefit from a total of £1 million in nil rate bands; two standard nil rate bands of £325,000 and two RNRBs of £175,000 (note that had the value of the house been less than £350,000 at the time of Joan's death, the total amount of RNRB available to Joan would have been limited to the value of the house).
- After allowing for the available nil rate bands, the residual value of the estate is £400,000 and IHT of 40% means a tax liability of £160,000 on the amount being inherited by Arthur.

But what if someone had utilised some of their RNRB when they died?

#### Scenario 2

- George died on 23 August 2017 with an estate worth £500,000.
- George owned the family home as tenants in common with his wife, Marjorie.
- George left his share of the family home to his son, Terry. The value of George's share at the time was £75,000.
- The residue of his estate was bequeathed to Marjorie.
- The transfer of £75,000 utilised 75% of his RNRB of £100,000.
- On Marjorie's subsequent death on 23 May 2021, her personal representatives can claim George's unused standard nil rate band of £325,000 and 25% of the RNRB of £175,000, giving a total of £325,000 + £325,000 + (£175,000 + (25% x £175,000)) = £868,750).

#### Scenario 3

Jeff dies on 24 January 2019 leaving an estate worth £2,100,000.

He leaves his £450,000 home to his wife Jenny and everything else to his children.

The maximum RNRB in the tax year 2018/19 is £125,000. But as Jeff's children don't inherit the home, his estate can't use any RNRB so on Jenny's death his RNRB can be transferred. However, Jeff's estate is worth more than the taper threshold of £2 million by £100,000. Therefore the transferable RNRB available from Jeff's estate is tapered by £1 for each £2 over the taper threshold. So his available RNRB is reduced by £50,000, meaning that his estate would have been entitled to RNRB of £75,000 (£125,000 less £50,000).

The percentage of unused RNRB in Jeff's estate which can be claimed on Jenny's death is therefore 60% (£75,000 ÷ £125,000).

Jenny dies on 23 May 2021, when the maximum RNRB is £175,000. She has an estate worth £1.8 million, including her home worth £500,000. She leaves all of this to her children.

The amount of additional threshold available to transfer to her estate is:

- maximum RNRB in tax year 2021/22 is £175,000
- multiplied by the unused percentage x 60%
- additional threshold to transfer £105,000

So Jenny's estate qualifies for £175,000 RNRB based on her estate, plus a further £105,000 transferable RNRB from Jeff's estate, to give a total RNRB of £280,000.

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### RNRB in summary

- The RNRB is £175,000
- It has been frozen at £175,000 to April 2026
- The property must have, at some point, been occupied by the deceased as a residence
- The RNRB is limited to the net value of the property; that is, after any outstanding mortgage or charge has been deducted
- The RNRB will be available when the 'qualifying interest' is transferred on death to direct descendants
- In general, the transfer must be outright but transfers into some types of trust are acceptable. This excludes discretionary will trusts
- The RNRB is an extra nil rate band which is in addition to the NRB if the qualifying conditions are met. In calculating the IHT due on an estate, the RNRB is not applied directly to the value of the home, it is applied to the value of a person's estate on death before applying the existing NRB. However, unlike the existing NRB, it does not apply to lifetime transfers made within seven years of the death.
- Any RNRB that is not used on first death can be transferred to a surviving spouse or civil partner. This is the case regardless of when the first death occurred and whether the deceased could have used their RNRB or not
- The amount of unused RNRB (expressed as a percentage of the amount available) will be applied to uplift the survivor's RNRB entitlement on second death
- If the first death occurred before 6 April 2017, the only check that is required is the £2 million taper threshold
- Where the value of the deceased's net estate exceeds £2 million, the RNRB will be reduced by £1 for every £2 above that limit

This document is based on Canada Life's understanding of applicable legislation, law and current HM Revenue & Customs practice as at March 2021. The information regarding taxation is based on our understanding of current legislation, which may be altered and depends upon the individual circumstances of the investor. We recommend that investors seek their own professional advice.



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