

RESIDENCE NIL-RATE BAND

James Kessler QC and Mary Ashley

1.1 Introduction

The rules are in the 18 sections, numbered non-numerically, from s.8A to 8M IHTA.

The development of the rules can be traced in HMRC “Inheritance Tax: main residence nil-rate band and the existing nil-rate band”(“**the HMRC paper**”)¹ but this is now of historical interest only.

There is guidance in the IHT manual.

1.2 The two nil rate bands

We now have two nil rate bands with different rules:

- (1) The *general* nil-rate band. This is to remain at £325,000 until end 2020/2021.
- (2) The *residence* nil-rate band.

1.3 Commencement and scope

Section 8D(1) IHTA provides:

Subsections (2) and (3) apply for the purpose of calculating the amount of the charge to tax under section 4 on a person’s death if the person dies on or after 6 April 2017.

This links to s.4(1) IHTA which provides:

On the death of any person tax shall be charged as if, immediately before his death,
[1] he had made a transfer of value and
[2] the value transferred by it had been equal to the value of his estate immediately before his death.

¹ <https://www.gov.uk/government/publications/inheritance-tax-main-residence-nil-rate-band-and-the-existing-nil-rate-band/inheritance-tax-main-residence-nil-rate-band-and-the-existing-nil-rate-band> (8 July 2015)

1.3.1 *Failed PETs*

The relief applies to reduce the tax payable by an estate on death; it does not apply to reduce the tax payable on lifetime transfers that are chargeable as a result of death.

The general nil rate band is different, but the transferable general nil rate band is the same: note planning point.

1.4 **The relief**

Assuming a post 2017 death, we read on. Section 8D(2) IHTA provides:

If the person's residence nil-rate amount is greater than nil, the portion of VT that does not exceed the person's residence nil-rate amount is charged at the rate of 0%.

The words "If the person's residence nil-rate amount is greater than nil," are otiose. The drafter was innumerate.

1.4.1 *Relationship with general nil rate band*

Section 8D(3) IHTA provides:

References in section 7(1) [Rates of IHT] to the value transferred by the chargeable transfer under section 4 on the person's death are to be read as references to the remainder (if any) of VT.

Amended as s.8D(2) directs, s.7(1) reads:

(1) Subject to subsections (2), (4) and (5) below and to section 8D and Schedule 1A the tax charged on the ~~value transferred by a chargeable transfer made by any transferor~~ remainder (if any) of VT shall be charged at the following rate or rates, that is to say—

(a) if the transfer is the first chargeable transfer made by that transferor in the period of seven years ending with the date of the transfer, at the rate or rates applicable to that value under the Table in Schedule 1 to this Act;

- (b) in any other case, at the rate or rates applicable under that Table to such part of the aggregate of—
- (i) that value, and
 - (ii) the values transferred by previous chargeable transfers made by him in that period,
- as is the highest part of that aggregate and is equal to that value. In short, the residence NRB (if available) is used first.

1.5 Definitions

There is the usual cascade of definitions before we reach the final term, residence nil-rate amount (“RNRA”).

1.5.1 Residential enhancement

This is a fixed sum. Section 8D IHTA provides:

- (5) For the purposes of those sections and this section—
- (a) the “residential enhancement” is—
- (i) £100,000 for the tax year 2017-18,
 - (ii) £125,000 for the tax year 2018-19,
 - (iii) £150,000 for the tax year 2019-20, and
 - (iv) £175,000 for the tax year 2020-21 and subsequent tax years, but this is subject to subsections (6) and (7) [indexation]

This is an opaque and inapt term. What is “enhanced” is presumably the nil rate band; but the residential enhancement is only one step in the process. But it is better to use the language of the statute.

For spouses the effective maximum relief is:

| | Residence NRB Band | Potential IHT(40%) | General NRB | T o t a l NRBs |
|----------|-----------------------|--------------------|-------------|-------------------|
| 2017/18: | £200k | £80k | £650k | £850k |
| 2018/19: | £250k | £100k | £650k | £900k |
| 2019/20: | £300k | £120k | £650k | £950k |
| 2020/21: | £350k | £140k | £650k | £1m |

1.5.2 *Taper threshold (“TT”)*

TT stands for **Taper Threshold**.

This is another fixed sum. To start, TT is £2m.

Section 8D(5) IHTA provides:

- (b) the “taper threshold” is £2,000,000 for the tax year 2017-18 and subsequent tax years, but this is subject to subsections (6) and (7) [indexation],
- (c) TT is the taper threshold at the person’s death

1.5.3 *Indexation of residential enhancement and TT*

Figures from 2021 subject to indexation by reference to CPI: Section 8D(6)-(9) IHTA:

- (6) Subsection (7) applies if—
 - (a) the consumer prices index for the month of September in any tax year (“the prior tax year”) is higher than it was for the previous September, and
 - (b) the prior tax year is the tax year 2020–21 or a later tax year.
- (7) Unless Parliament otherwise determines, the amount of each of—
 - (a) the residential enhancement for the tax year following the prior tax year, and
 - (b) the taper threshold for that following tax year,is its amount for the prior tax year increased by the same percentage as the percentage increase in the index and, if the result is not a multiple of £1,000, rounded up to the nearest amount which is such a multiple.
- (8) The Treasury must before 6 April 2021 and each subsequent 6 April make an order specifying the amounts that in accordance with subsections (6) and (7) are the residential enhancement and taper threshold for the tax year beginning on that date; and any such order is to be made by statutory instrument.
- (9) In this section—
 - “consumer prices index” means the all items consumer prices index published by the Statistics Board,
 - “tax year” means a year beginning on 6 April and ending on the following 5 April, and
 - “the tax year 2017–18” means the tax year beginning on 6 April 2017

(and any corresponding expression in which two years are similarly mentioned is to be read in the same way).

1.5.4 *Estate ("E")*

Section 8D(5) IHTA provides:

(d) E is the value of the person's estate immediately before the person's death,

1.5.5 *Value transferred (VT)*

Section 8D(5) IHTA provides:

(e) VT is the value transferred by the chargeable transfer under section 4 on the person's death

VT is *not* the value transferred on death. (If it was, E and VT would mean the same thing.) VT is the part (if any) of the value transferred (if any) which is a *chargeable* transfer. This is terrible drafting.

IHTM46012 Basic Definitions: The value of the estate 'E' and the value transferred on death 'VT':

Example

The deceased's estate includes assets worth £1,200,000 and liabilities of £20,000. There is a legacy to charity of £100,000 which is exempt.

The value of the deceased's estate is the value of the assets (£1,200,000) less the value of the liabilities (£20,000) = £1,180,000. This is 'E'

The value transferred by the chargeable transfer on death is the net value of the estate (£1,180,000) less the exemption for the legacy to charity (£100,000) = £1,080,000. This is 'VT'.

1.5.6 *Default allowance*

In short:

Default allowance is the allowance before taper

Adjusted allowance is the allowance after taper (the adjustment only goes down).

We refer to “**default [pre-taper] allowance**” and “**adjusted [post-taper] allowance**”.

Section 8D(5) IHTA provides:

- (f) the person’s “default [pre-taper] allowance” is the total of—
 - (i) the residential enhancement at the person’s death, and
 - (ii) the person’s brought-forward allowance [transferable allowance from spouse]

1.5.7 *Adjusted allowance*

The HMRC paper provides:

There will be a tapered withdrawal of the additional nil-rate band for estates with a net value of more than £2 million. This will be at a withdrawal rate of £1 for every £2 over this threshold.

Section 8D(5) IHTA provides:

- (g) the person’s “adjusted [post-taper] allowance” is—
 - (i) the person’s default [pre-taper] allowance, less
 - (ii) the amount given by—
$$(E - TT) \div 2$$but is nil if that amount is greater than the person’s default [pre-taper] allowance.

| Default [pre-taper] allowance | Estate | Adjusted [post-taper] allowance |
|--------------------------------------|---------------|--|
| £175,000 | £2m | £175k |
| £175,000 | £2.35m | £0 |
| £350,000 | £2m | £350k |
| £350,000 | £2.7m | £0 |

1.5.8 *Effect of lifetime gift on taper*

Taper depends on value of estate on death.

Gift to non-charity: Will v lifetime gift
gift by will

Lifetime gift

| | | |
|----------------------------|-------------------|-------------------|
| Original Estate | £2,350,000 | £2,350,000 |
| Lifetime gift (failed PET) | £0 | -£350,000 |
| Estate on death | <u>£2,350,000</u> | <u>£2,000,000</u> |

IHT computation

| | <i>gift by will</i> | <i>IHT</i> | <i>Lifetime gift</i> | <i>IHT</i> |
|-------------------------|---------------------|-----------------|----------------------|-----------------|
| General NRB (0% rate) | £325,000 | £0 | £0 | £0 |
| Residence NRB (0% rate) | £0 | £0 | £175,000 | £0 |
| Rest of VT (40% rate) | <u>£2,025,000</u> | £810k | £1,825,000 | £730,000 |
| Tax on failed PET | £0 | | | <u>£10,000</u> |
| Total IHT | | <u>£810,000</u> | | <u>£740,000</u> |

Saving £70k less CGT if any on lifetime gift

1.6 Residence nil-rate amount

Section 8E IHTA defines two terms:

- (1) RNRA
- (2) Amount available for carry forward (“carry-forward amount”)

The latter term is used in calculating the brought-forward allowance. See 1.8 (Brought-forward allowance). The two terms are inter-linked, but we focus at this point on RNRA.

1.6.1 “N”

Section 8E IHTA provides:

- (1) Subsections (2) to (7) apply if—
 - (a) the person’s estate immediately before the person’s death includes a qualifying residential interest, and
 - (b) N% of the interest is closely inherited, where N is a number—
 - (i) greater than 0, and
 - (ii) less than or equal to 100

Obviously N cannot be greater than 100, so para (b)(ii) is not necessary. Nor is para (b)(i).

But perhaps it was thought helpful for the sake of clarity.

The rule that N must be greater than 0 requires a separate set of rules to

cater for the position when N would be 0, ie when

- there is no qualifying residential interest or
- none of the interest is closely inherited.

Does N really stand for “Number”?

1.6.2 “NV/100” (*closely-inherited residence value*)

Section 8E(1) IHTA provides:

in those subsections [s.8E (2) to (7)] “NV/100” means N% of so much (if any) of the value transferred by the transfer of value under section 4 as is attributable to the [qualifying residential] interest.

The drafting is as opaque as the terminology. We refer to NV/100 as **“closely-inherited residence value”**.

Steps are:

Ascertain N% (percent of residential interest that is closely inherited)

Ascertain value transferred (this is the same as E, the value of the estate).

It is not the same as VT (though it would actually make no difference if it were).

Ascertain value of residential interest

Ascertain amount of value transferred attributable to the interest.

Compute N% of that.

Some examples:

T gives entire estate to spouse S:

There is no “N”. (That amounts to saying $N = 0$, but that is not the way it is drafted).

Residence nil-rate amount is transferred to spouse.

T gives entire estate to children;

$N = 100\%$.

NV/100 (closely-inherited residence value) = value of house unless estate has debts.

T gives half estate to children, half to others

N = 50% !

NV/100 (closely-inherited residence value) = 50% of value of house unless estate has debts

NV/100 (closely-inherited residence value) is in short the percentage of the residence that is closely inherited, with adjustments in special cases such as debts or a farmhouse qualifying for APR.

NV/100 is about as opaque a label as one could invent. We refer to it as **“NV/100 (closely-inherited residence value)”**

In the simple, typical, case, NV/100 is the value of the residence.

1.6.3 *Planning*

May need to give house to children; balance to others (could be expressed as an appropriate fraction of the estate).

Deed of variation may be needed.

1.6.4 *Debts*

If property subject to a mortgage, that reduces the value of the property: s.162(2) IHTA. Planning (including deathbed planning) is needed here if there is insufficient net value, ie value of residence less debt is less than the residential enhancement.

Unsecured debt: reduces value of estate: see s.162 IHTA.

Pre-death planning may be needed. Charge on property other than the residence?

What should be done with existing NRB trusts where debt charged on property in estate of surviving spouse?

1.6.5 *Residential nil rate amount: table*

Armed with the definitions, we can turn to the definition of RNRA and brought-forward amount.

Section 8E IHTA sets out four possible computations. In short:

Estate <£2m

| | |
|--|----------------------|
| NV/100 (closely-inherited residence value) < default [pre-taper] allowance | Carry-forward |
| Yes | Yes: ss(2) |
| No | No: ss(3) |

Estate >£2m

| | |
|---|----------------------|
| NV/100 (closely-inherited residence value) < adj'd [post-taper] allowance | Carry-forward |
| Yes | Yes: ss(4) |
| No | No: ss(5) |

1.6.6 Estate less than £2m taper threshold; NV/100 [closely-inherited residence value] less than default [pre-taper] allowance

Section 8E(2) IHTA provides:

Where—

- (a) E is less than or equal to TT, and
- (b) NV/100 [closely-inherited residence value] is less than the person's default [pre-taper] allowance,
 - [i] the person's residence nil-rate amount is equal to NV/100 [closely-inherited residence value] and
 - [ii] an amount, equal to the difference between NV/100 [closely-inherited residence value] and the person's default [pre-taper] allowance, is available for carry-forward.

1.6.7 Estate less than £2m: NV/100 [closely-inherited residence value] less than default [pre-taper] allowance

Section 8E(3) IHTA provides:

Where—

- (a) E is less than or equal to TT, and
- (b) NV/100 [closely-inherited residence value] is greater than or equal to the person's default [pre-taper] allowance,
 - [i] the person's residence nil-rate amount is equal to the person's default allowance
 - [ii] (and no amount is available for carry-forward).

1.6.8 *Estate greater than £2m taper threshold; NV/100 [closely-inherited residence value] less than adjusted [post-taper] allowance*

Where the estate is more than £2m, we move from the default [pre-taper] allowance to the adjusted [post-taper] allowance.

Section 8E(4) IHTA provides:

Where—

- (a) E is greater than TT, and
- (b) NV/100 [closely-inherited residence value] is less than the person's adjusted [post-taper] allowance,
 - [i] the person's residence nil-rate amount is equal to NV/100 [closely-inherited residence value] and
 - [ii] an amount, equal to the difference between NV/100 [closely-inherited residence value] and the person's adjusted [post-taper] allowance, is available for carry-forward.

1.6.9 *Estate greater than £2m taper threshold: cap at adjusted [post-taper] allowance*

Section 8E(5) IHTA provides:

Where—

- (a) E is greater than TT, and
- (b) NV/100 [closely-inherited residence value] is greater than or equal to the person's adjusted [post-taper] allowance,
 - [i] the person's residence nil-rate amount is equal to the person's adjusted [post-taper] allowance
 - [ii] (and no amount is available for carry-forward).

It makes sense once one has mastered the terminology.

1.6.10 *RNRA exceeds VT*

Section 8E(6) IHTA flags up exceptions:

- (6) Subsections (2) to (5) have effect subject to subsection (7) and sections 8FC and 8M(2B) to (2E).

We move on to s.8E(7) IHTA:

(7) Where the person's residence nil-rate amount as calculated under subsections (2) to (5) without applying this subsection is greater than VT—

- (a) the person's residence nil-rate amount is equal to VT,
- (b) where E is less than or equal to TT, an amount, equal to the difference between VT and the person's default [pre-taper] allowance, is available for carry-forward, and
- (c) where E is greater than TT, an amount, equal to the difference between VT and the person's adjusted [post-taper] allowance, is available for carry-forward.

When will RNRA exceed VT? RNRA cannot exceed NV/100, and NV/100 cannot exceed VT.

1.7 No home/home not closely inherited

Section 8F IHTA provides:

(1) Subsections (2) and (3) apply if the person's estate immediately before the person's death—

- (a) does not include a qualifying residential interest, or
- (b) includes a qualifying residential interest but none of the interest is closely inherited.

(2) The person's residence nil-rate amount is nil.

(3) An amount—

- (a) equal to the person's default [pre-taper] allowance, or
- (b) if E is greater than TT, equal to the person's adjusted [post-taper] allowance,
is available for carry-forward.

It would have been simpler in this case to say $N = 0$; so $NV / 100 = 0$. The drafter had difficulty with the number zero.

1.8 Brought-forward allowance

1.8.1 *Terminology: Brought-forward allowance /carry forward amount*

There are two distinct terms:

| Term | Defined s. | Used in definition of: |
|------------------------------------|---|-------------------------------|
| Amount available for carry forward | 8E, 8FC ² or 8F, 8FD ³ | Brought-forward allowance |
| Brought-forward allowance | 8G | Default allowance |

It would be good to have more transparent terminology, but it is hard to think of a helpful paraphrase, so it seems best to stick with the statutory terminology.

1.8.2 “*Related person*”

In short, the “related person” is a former spouse.

Section 8G(2) IHTA provides:

In this section “related person” means a person other than P where—

- (a) the other person dies before P, and
- (b) immediately before the other person dies, P is the other person’s spouse or civil partner.

Very clumsy drafting.

1.8.3 “*Brought-forward allowance*”

The brought-forward allowance would be better called a transferable allowance, but it is easier to follow the statutory terminology.

Section 8G(3) IHTA provides:

P’s brought-forward allowance is calculated as follows—

- (a) identify each amount available for carry-forward from the death of a related person (see sections 8E, 8F and 8FD, and subsections (4) and (5)),
- (b) express each such amount as a percentage of the residential enhancement at the death of the related person concerned,

2 Section 8FC applies where there downsizing relief.

3 Where there is no home/home not closely inherited

- (c) calculate the percentage that is the total of those percentages, and
 - (d) [i] the amount that is that total percentage of the residential enhancement at P's death is P's brought-forward allowance
- ...

This is like the transferable general NRB.

Generally better not to use the RNRA on the first death of a married couple, because it is worth more on the second death. That may change after 2021.

Suppose:

H dies 2017/18

W dies 2020/21

H's RNRA may be worth £100,000

W's brought-forward allowance may be worth £175,000

But a future government may scrap the RNRB scheme, so this is not without risk, particularly if the second death is after 2020/21.

HMRC provide some examples of calculations in IHTM46041. Example 2 provides a detailed calculation:

Example 2:

Paul's wife, Linda, died in June 2017. Linda had an estate worth £2,100,000 including a share of a flat valued at £30,000 which was a QRI, left to her daughter. Her sister was left £100,000, and the remainder of her estate passed to Paul. The RNRB in 2017-18 is £100,000. However, as Linda's estate is valued at more than £2,000,000 the RNRB is tapered (IHTM46023) by £1 for every £2 by which the taper threshold is exceeded. Linda's adjusted allowance (IHTM46025) therefore becomes £50,000:

£100,000 less $(2,100,000 - 2,000,000) \div 2 = £50,000$

On Paul's death in June 2018 a claim is made by his personal representatives to use Linda's unused RNRB. Since she left a QRI valued at £30,000 to her daughter, the value of Linda's unused RNRB will be reduced by this amount:

| | |
|------------------------------------|--|
| Chargeable value of Linda's estate | £130,000 |
| Less RNRB | £30,000 (lower of £30,000 and £50,000) |
| | £100,000 |

| | |
|-------------------------|----------|
| Less NRB | £100,000 |
| Value chargeable to IHT | Nil |

So in this example there is £20,000 unused RNRB, which as a percentage of the residential enhancement at that date is $£20,000 \div £100,000 = 20\%$. On Paul's death the residential enhancement at that time of £125,000 is multiplied by 20% to give a value of £25,000 for the brought-forward allowance.

There is also £225,000 of Linda's unused NRB available to transfer (IHTM43000).

1.8.4 *Remarriage: Only one allowance is transferable*

Section 8G(3)(d) IHTA continues:

- [ii] if that total percentage is greater than 100%, P's brought-forward allowance is the amount of the residential enhancement at P's death,

So one cannot get more than one full brought-forward allowance. The same rule applies to the ordinary transferable NRB. This is like nil rate band trusts: see *Drafting Trusts and Will Trusts* (13th ed, 2017) para 18.8 (Untransferable NRB problems)

1.8.5 *Brought-forward allowance: claim*

Section 8G(3) IHTA continues:

but P's brought-forward allowance is nil if no claim for it is made under section 8L

See 1.12 (Claims for brought-forward allowance and downsizing addition).

1.8.6 *Spouse dies before 2017*

Section 8G(4) IHTA provides:

Where the death of a related person occurs before 6 April 2017—

- (a) an amount equal to £100,000 is treated for the purposes of

- subsection (3) as being the amount available for carry-forward from the related person's death, but this is subject to subsection (5), and
- (b) the residential enhancement at the related person's death is treated for those purposes as being £100,000.

Section 8G(5) IHTA provides for taper:

If the value ("RPE") of the related person's estate immediately before the related person's death is greater than £2,000,000, the amount treated under subsection (4)(a) as available for carry-forward is reduced (but not below nil) by—

$$(\text{RPE} - £2,000,000) \div 2$$

Fixed sum of £2m tends to work favourably if spouse died long ago.

1.9 "Qualifying residential interest"

Section 8H IHTA provides:

- (1) This section applies for the purposes of sections 8E to 8FE.

1.9.1 "Residential property interest"

Section 8H IHTA provides:

- (2) In this section "residential property interest", in relation to a person, means an interest in a dwelling-house 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.

The drafting is based on s.222(1) TCGA (CGT private residence relief).

A property which was never a residence of the deceased, such as a buy-to-let property, is not a residential property interest.

1.9.2 *Estate with one residence only*

Section 8H(3) IHTA provides:

Where a person's estate immediately before the person's death includes residential property interests in just one dwelling-house, the person's interests in that dwelling-house are a qualifying residential interest in relation to the person.

Where the context allows, we abbreviate "qualifying residential interest" to "residence".

1.9.3 *Power to nominate residence*

Section 8H(4) IHTA provides:

Where—

- (a) a person's estate immediately before the person's death includes residential property interests in each of two or more dwelling-houses, and
 - (b) the person's personal representatives nominate one (and only one) of those dwelling-houses,
- the person's interests in the nominated dwelling-house are a qualifying residential interest in relation to the person.

What is the position if an estate includes two residences, and no nomination is made? There is no qualifying residential interest. So a nomination is essential.

Where an individual owns two residences, the power of nomination may affect:

- (1) The amount of the relief (if the value of one residence is above the available RNRB, and the other is below); and
- (2) Who benefits from the RNRB (if the residences pass to different persons under the will).

In particular, suppose:

- (1) An estate IP trust holds one residence; and
- (2) The free estate of the life tenant/testator holds another residence

The PRs of the estate can choose which residence qualifies, not the trustees. The choice will be important if the beneficiaries of the trust are different from the beneficiaries of the estate. It may be appropriate to give the PRs directions in the Will.

1.9.4 “*Dwelling-house*”

Section 8H(5) IHTA provides:

A reference in this section to a dwelling-house—

- (a) includes any land occupied and enjoyed with it as its garden or grounds,...

The drafting is based on main private residence relief. There is no restriction to the permitted area of ½ hectare but taper has a similar effect, for large estates, so that may not often matter.

Section 8H(5) IHTA provides:

A reference in this section to a dwelling-house...

- (b) does not include, in the case of any particular person, any trees or underwood in relation to which an election is made under section 125 [woodlands relief] as it applies in relation to that person’s death.

1.9.5 *Job-related accommodation*

Section 8H IHTA provides:

(6) If at any time when a person’s estate includes an interest in a dwelling-house, the person—

- (a) resides in living accommodation which for the person is job-related,⁴ and

- (b) intends in due course to occupy the dwelling-house as the person’s residence,

this section applies as if the dwelling-house were at that time occupied by the person as a residence.

1.10 “**Inherited**”

4 Defined by reference in s.8H(7) IHTA: “Section 222(8A) to (8D) of the 1992 Act (meaning of “job-related”), but not section 222(9) of that Act, apply for the purposes of subsection (6).”

The RNRB (in short) only applies if the property is closely inherited. *Closely* and *inherited* are defined separately.

Section 8J IHTA provides:

(1) This section explains for the purposes of sections 8E, 8F, 8FA, 8FB and 8M whether a person (“B”) inherits, from a person who has died (“D”), property which forms part of D’s estate immediately before D’s death.

(2) B inherits the property if there is a disposition of it (whether effected by will, under the law relating to intestacy or otherwise) to B.

In following examples:

C is child of testator

X is non-child (and not a descendant)

Suppose:

(1) Gift of estate to C

(2) PR's sell and use proceeds

(a) to make distribution to C

(b) to pay debts or IHT.

Disposition to C by will in both cases?

An administrative power, so yes.

IHTM46033 More Detailed Guidance: Inherited

The actual residence does not have to end up in the hands of the deceased’s direct descendants. An estate could still be eligible for the RNRB if the deceased’s personal representatives sell the residence as part of the administration of the estate and pass the sale proceeds to the direct descendants.

Equally a gift in the deceased’s will directing the personal representatives to sell the deceased’s residence with the sale proceeds being paid to a direct descendant would be treated as the residence being closely inherited.

Once the direct descendants have inherited the residence, there are no restrictions on what they have to do with it. An estate will still qualify for the RNRB even if the direct descendants decide to sell the residence after they have inherited it.

Suppose:

- (1) Legacy to X; residue to C
- (2) (a) PR's assent property to C
(b) PR's appropriate property to X in satisfaction of legacy
(c) PR's sell and use proceeds to pay legacy.

Disposition to C by will in all cases?

IHTM46033 More Detailed Guidance: Inherited

Appropriations

Appropriation of property by the personal representatives (PRs) under the administrative powers given expressly under the will, or by Section 41, Administration of Estates Act 1925, during the administration of an estate is, as it says, an administrative power used by the PRs in the execution of their duties. An appropriation is not a disposition. An appropriation would, therefore, not make the RNRB available if the residential property was not left to qualifying beneficiaries and so was not closely inherited on death.

Example:

The deceased's estate includes a residential property interest. Under his will he leaves half his estate on life interest trusts to his mother, and the other half to his son. As the residential property interest passes into residue, only a half share is closely inherited. Using their administrative powers, the PRs appropriate the residential property interest to the son in satisfaction of his half share of the estate. Although the whole property now passes to the son, it did so by virtue of the PRs administrative powers, not directly under the will. It remains the case that only a half share of the residential property interest is closely inherited.

Suppose:

- (1) Legacy to C; residue to X
- (2) (a) PR's assent property to X
(b) PR's appropriate property to C in satisfaction of legacy
(c) PR's sell and use proceeds to pay legacy.

Disposition to C (otherwise than by will) in case (b)?

HMRC say: An administrative power, so no.

Suppose:

- (1) Legacy to C
- (2) Grant of option to purchase at market value to X.

Is this a disposition to C?

1.10.1 *Property becomes settled by D's will*

Section 8J IHTA provides:

- (3) Subsection (2) does not apply if—
 - (a) the property becomes comprised in a settlement on D's death, or
 - (b) immediately before D's death, the property was settled property in which D was beneficially entitled to an interest in possession.
- (4) Where the property becomes comprised in a settlement on D's death, B inherits the property if—
 - (a) B becomes beneficially entitled on D's death to an interest in possession in the property, and that interest in possession is an immediate post-death interest or a disabled person's interest, or
 - (b) the property becomes, on D's death, settled property—
 - (i) to which section 71A or 71D applies, and
 - (ii) held on trusts for the benefit of B.

Section 91(1) IHTA provides:

Where a person would have been entitled to an interest in possession in the whole or part of the residue of the estate of a deceased person had the administration of that estate been completed, the same consequences shall follow under this Act as if he had become entitled to an interest in possession in the unadministered estate and in the property (if any) representing ascertained residue, or in a corresponding part of it, on the date as from which the whole or part of the income of the residue would have been attributable to his interest had the residue been ascertained immediately after the death of the deceased person.

1.10.2 *Settled property in D's estate*

Section 8J(3) IHTA provides:

- Subsection (2) does not apply if ...
- (b) immediately before D's death, the property was settled property in which D was beneficially entitled to an interest in possession.
 - (5) Where, immediately before D's death, the property was settled

property in which D was beneficially entitled to an interest in possession, B inherits the property if B becomes beneficially entitled to it on D's death.

1.10.3 *GWR property*

Section 8J(6) IHTA provides:

Where the property forms part of D's estate immediately before D's death as a result of the operation of section 102(3) of the Finance Act 1986 (gifts with reservation) in relation to a disposal of the property made by D by way of gift, B inherits the property if B is the person to whom the disposal was made.

If an individual gives a residence to a trust, and reserves a benefit, then there is no relief on the individual's death (even if the property then passes to a close relative absolutely).⁵

1.11 "Closely" inherited

Section 8K(1) IHTA provides:

In relation to the death of a person ("D") something is "closely inherited" for the purposes of sections 8E, 8F, 8FA, 8FB and 8M if it is inherited for those purposes (see section 8J) by-

- (a) a lineal descendant of D,
- (b) a person who, at the time of D's death, is the spouse or civil partner of a lineal descendant of D, or
- (c) a person who—
 - (i) at the time of the death of a lineal descendant of D who died no later than D, was the spouse or civil partner of the lineal descendant, and
 - (ii) has not, in the period beginning with the lineal descendant's death and ending with D's death, become anyone's spouse or civil partner.

⁵ Unless, exceptionally, the trust qualified as an estate interest in possession trust.

We refer to persons within (a) to (c) as “**close family**”.

Property passing to parents, siblings, non-linear descendants of the deceased, is not closely inherited.

Thus the amount of IHT payable depends on whether the relevant assets are inherited by close family or more distant family. This is a new development in UK inheritance taxation, though We understand that gift and inheritance taxes in some civil law jurisdictions follow this approach, and in the UK there is a distant precedent in the long abolished Succession Duty. Section 10 Succession Duty Act 1853 provided:

There shall be levied and paid to Her Majesty in respect of every such Succession as aforesaid, according to the Value thereof, the following Duties; (that is to say,)

Where the Successor shall be the lineal Issue or lineal Ancestor of the Predecessor, a Duty at the Rate of One Pound *per Centum* upon such Value:

Where the Successor shall be a Brother or Sister, or a Descendant of a Brother or Sister of the Predecessor, a Duty at the Rate of Three Pounds *per Centum* upon such Value:

Where the Successor shall be a Brother or Sister of the Father or Mother, or a Descendant of a Brother or Sister of the Father or Mother of the Predecessor, a Duty at the Rate of Five Pounds *per Centum* upon such Value:

Where the Successor shall be a Brother or Sister of the Grandfather or Grandmother, or a Descendant of the Brother or Sister of the Grandfather or Grandmother of the Predecessor, a Duty at the Rate of Six Pounds *per Centum* upon such Value:

Where the Successor shall be in any other Degree of collateral Consanguinity to the Predecessor than is herein-before described, or shall be a Stranger in Blood to him, a Duty at the Rate of Ten Pounds *per Centum* upon such Value.

1.11.1 *Stepchildren, adopted children, foster children, guardians*

Section 8K IHTA provides:

(2) The rules in subsections (3) to (8) apply for the interpretation of subsection (1).

(3) A person who is at any time a step-child of another person is to be treated, at that and all subsequent times, as if the person was that other person’s child.

(4) Any rule of law, so far as it requires an adopted person to be treated as not being the child of a natural parent of the person, is to be disregarded (but this is without prejudice to any rule of law requiring an adopted person to be treated as the child of an adopter of the person).

(5) A person who is at any time fostered by a foster parent is to be treated, at that and all subsequent times, as if the person was the foster parent’s child.

- (6) Where—
- (a) an individual (“G”) is appointed (or is treated by law as having been appointed) under section 5 of the Children Act 1989, or under corresponding law having effect in Scotland or Northern Ireland or any country or territory outside the United Kingdom, as guardian (however styled) of another person, and
 - (b) the appointment takes effect at a time when the other person (“C”) is under the age of 18 years, C is to be treated, at all times after the appointment takes effect, as if C was G’s child.
- (7) Where—
- (a) an individual (“SG”) is appointed as a special guardian (however styled) of another person (“C”) by an order of a court—
 - (i) that is a special guardianship order as defined by section 14A of the Children Act 1989, or
 - (ii) that is a corresponding order under legislation having effect in Scotland or Northern Ireland or any country or territory outside the United Kingdom, and (b) the appointment takes effect at a time when C is under the age of 18 years, C is to be treated, at all times after the appointment takes effect, as if C was SG’s child.
- (8) In particular, where under any of subsections (3) to (7) one person is to be treated at any time as the child of another person, that first person’s lineal descendants (even if born before that time) are accordingly to be treated at that time (and all subsequent times) as lineal descendants of that other person.
- (9) In subsection (4) “adopted person” means—
- (a) an adopted person within the meaning of Chapter 4 of Part 1 of the Adoption and Children Act 2002, or
 - (b) a person who would be an adopted person within the meaning of that Chapter if, in section 66(1)(e) of that Act and section 3038(1)(e) of the Adoption Act 1976, the reference to the law of England and Wales were a reference to the law of any part of the United Kingdom.
- (10) In subsection (5) “foster parent” means—
- (a) someone who is approved as a local authority foster parent in accordance with regulations made by virtue of paragraph 12F of Schedule 2 to the Children Act 1989,
 - (b) a foster parent with whom the person is placed by a voluntary organisation under section 59(1)(a) that Act,
 - (c) someone who looks after the person in circumstances in which the person is a privately fostered child as defined by section 66 of that Act, or
 - (d) someone who, under legislation having effect in Scotland or Northern Ireland or any country or territory outside the United Kingdom, is a foster parent (however styled) corresponding to a foster parent 45 within paragraph (a) or (b).

1.12 Claims for brought-forward allowance and downsizing addition

In short, the PRs of the surviving spouse make the claim within 2 years of the death of the second to die.

Section 8L IHTA provides:

- (1) A claim
 - [1] for brought-forward allowance for a person (see section 8G)⁶ or
 - [2] for a downsizing addition for a person (see sections 8FA to 8FD) may be made—
 - (a) by the person’s personal representatives within the permitted period, or
 - (b) (if no claim is so made) by any other person liable to the tax chargeable on the person’s death within such later period as an officer of Revenue and Customs may in the particular case allow.
- (2) In subsection (1)(a) “the permitted period” means—
 - (a) the period of 2 years from the end of the month in which the person dies or (if it ends later) the period of 3 months beginning with the date on which the personal representatives first act as such, or
 - (b) such longer period as an officer of Revenue and Customs may in the particular case allow.

Need to keep records on the first death.

1.12.1 *Brought-forward allowance claim after series of deaths*

Section 8L IHTA provides:

- (4) Subsection (5) applies if—
 - (a) no claim under this section has been made for brought-forward allowance for a person (“P”),
 - (b) the amount of the charge to tax under section 4 on the death of another person (“A”) would be different if a claim under

⁶ See 1.8.4 (Brought-forward allowance: claim)

⁷ See 1.24 (Downsizing condition F (claim)); see 1.27.5 (Downsizing condition K (claim)).

- subsection (1) had been made for brought-forward allowance for P, and
- (c) the amount of the charge to tax under section 4 on the death of P, and the amount of the charge to tax under section 4 on the death of any person who is neither P nor A, would not have been different if a claim under subsection (1) had been made for brought-forward allowance for P.
- (5) A claim for brought-forward allowance for P may be made—
- (a) by A’s personal representatives within the allowed period, or
 - (b) (if no claim is so made) by any other person liable to the tax chargeable on A’s death within such later period as an officer of Revenue and Customs may in the particular case allow.
- (6) In subsection (5)(a) “the allowed period” means—
- (a) the period of 2 years from the end of the month in which A dies or (if it ends later) the period of 3 months beginning with the date on which the personal representatives first act as such, or
 - (b) such longer period as an officer of Revenue and Customs may in the particular case allow.

This may apply if:

P’s spouse (S1) dies

P marries A

P dies. P has a brought-forward allowance but may not need to claim it at this stage.

A dies. A has the brought-forward allowance from P, but not from S1 which matters if P’s brought-forward allowance is less than 100%

How often will that happen?

1.12.2 *Withdrawing a claim*

Section 8L(3) IHTA provides:

A claim under subsection (1) made within either of the periods mentioned in subsection (2)(a) may be withdrawn no later than one month after the end of the period concerned.

similarly subsection (7):

(7) A claim under subsection (5) made within either of the periods mentioned in subsection (6)(a) may be withdrawn no later than one month after the end of the period concerned.

Why would you want to withdraw a claim?

1.13 Interaction with IHT charity relief

Taper depends on value of estate on death (not on whether chargeable transfer on death is exempt) so gift to charity by will does not reduce taper.

Gift to charity: Will v lifetime gift

| | <i>gift by will</i> | | <i>Lifetime gift</i> |
|----------------------------|---------------------|--------------|----------------------|
| Original Estate | £2,350,000 | | £2,350,000 |
| Lifetime gift | £0 | | -£350,000 |
| Estate on death | <u>£2,350,000</u> | | <u>£2,000,000</u> |
| <i>IHT computation</i> | | | |
| | | <i>IHT</i> | <i>IHT</i> |
| General NRB (0% rate) | £325,000 | £0 | £325,000 |
| Residence NRB (0% rate) | £0 | £0 | £175,000 |
| Exempt on death | £350,000 | £0 | |
| Rest of VT (36%/40% rate) | £1,675,000 | £603k | £1,500,000 |
| Total IHT | | <u>£603k</u> | <u>£600,000</u> |

Saving: £3k + gift aid/QIDR on lifetime gift

1.14 Foreign domiciled testator

The amount of the unused general nil-rate band depends on the amount of the chargeable transfer on the death of the first spouse. If there is no chargeable transfer, the full nil-rate band is unused and is transferable.⁸

The IHT Manual provides:

⁸ S.8A(3)(4) IHTA.

1.15 Some existing will forms

From DTWT 8th ed (2007) (before transferable nil rate bands)

“I give the maximum amount of cash which I can give on the terms of the Nil-Rate Fund without incurring any liability to IHT on my death...”

From DTWT 12th ed (2015):

“I give the maximum amount of cash which I can give on the terms of the Nil-Rate Fund”:

- (1) without incurring any liability to IHT on my death
- (2) without reducing the amount which the Nil Rate Band applicable on the death of my Spouse would (apart from the fit of the Untransferable Nil Rate Sum made in my Will) be increased under s.8A IHTA 1984.”

1.16 Planning

1.16.1 *Valuation of residence*

Planning: ensure that estate of testator, or of surviving spouse, includes:

- (1) residential property of sufficient value or
- (2) has included residential property of sufficient value for downsizing relief.

On first death of a married couple: related property valuation rules will apply: no discount for holding a share in property; see s.161 IHTA.

The HMRC paper provides:

The main behavioural response is the proportion of estates with a residence being left to direct descendants may be expected to increase as people change their wills over time so that their estates can benefit from the main residence nil-rate band to a greater extent.

1.17 Impact

1.17.1 *Effect on IHT yield*

The HMRC Paper provides:

| | |
|-----------|------|
| 2017/2018 | -270 |
| 2018/2019 | -630 |
| 2019/2020 | -790 |
| 2020/2021 | -940 |

These figures have been certified by the Office for Budget Responsibility.

1.17.2 *Economic*

The HMRC paper provides:

This measure could marginally increase demand for housing but it is not expected to have a significant impact on either house prices or rent levels due to the small overall proportion of the housing market affected and the offsetting impact of wider budget measures.

1.17.3 *Equality*

The HMRC paper provides:

The government has no evidence to suggest that the measure will have any significant adverse equalities impacts. Those in same-sex relationships may be less likely to have direct descendants, although children will also include adopted and foster children. HMRC does not hold data on the protected characteristics of all those potentially affected.

The legislation discriminates against the childless (and those who do not want to benefit their children) but these are not protected characteristics under the Equality Act 2010.

1.17.4 *Administrative burden*

The HMRC paper provides:

This measure ... may lead to a small additional burden for personal

representatives to confirm that a residence meets the qualifying criteria. There will be a negligible one-off cost to advisers as they familiarise themselves with the measure and advise on changes that individuals may wish to make to their wills in response to the policy.

1.18 Downsizing relief

Section 8FA IHTA provides:

(1) There is entitlement to a downsizing addition in calculating the person's residence nil-rate amount if each of conditions A to F is met (see subsection (8) for the amount of the addition).

We refer to “**downsizing conditions A to F**”

HMRC have published a paper “Inheritance Tax on main residence nil-rate band and downsizing proposals: technical note”.⁹ This provides:

4. Examples

The following examples illustrate how the additional RNRB would apply and how it would be calculated.

Example 1

A widow sells a home worth £400,000 in August 2020 and moves to a home worth £210,000.

At the time of the sale the available RNRB is £350,000 as, had she died at that time, her executors would be able to make a claim to transfer all the unused RNRB from her late husband.

By downsizing, she has potentially lost the chance to use £140,000 or 40% of the available RNRB which could have applied had the more valuable home not been sold.

When the widow later dies in October 2020, the home is worth £225,000 and is left to her children together with £500,000 of other assets. The estate can use an RNRB of £225,000. However, the widow was eligible for an RNRB of £350,000 had she not downsized. The estate can therefore claim an additional RNRB of 40% of the available RNRB ($40\% \times £350,000$) or £140,000. This would give a total RNRB of £365,000 (£225,000 + £140,000). But this is more than the maximum available RNRB (£350,000) so the additional RNRB is restricted to

⁹ <https://www.gov.uk/government/publications/inheritance-tax-on-main-residence-nil-rate-band-and-downsizing-proposals-technical-note/inheritance-tax-on-main-residence-nil-rate-band-and-downsizing-proposals-technical-note>

£125,000 to ensure that the total amount used does not exceed the maximum available.

In addition, the existing nil-rate band together with any transferable nil-rate band claimed from her late husband's estate can be applied to the remaining assets in the estate.

Example 2

A husband sells a home worth £300,000 in July 2020 and moves to a home worth £140,000. At the time the available RNRB is £175,000. He has potentially lost the chance to use £35,000 or 20% of the available RNRB which could have applied had the more valuable home not been sold.

When he dies in December 2020, the home is worth £175,000 and is left to his son with the remainder of the estate passing to his wife. The estate can use the RNRB of £175,000 to the full and since the RNRB was fully used on death, there is none to transfer to the widow. However, none of the existing nil-rate band has been used, so it can be transferred and will be available on the widow's death along with her own RNRB.

Example 3

A widower gives away his home worth £400,000 to his children in May 2020 and moves into rented 'later living' accommodation.

At the time of the gift the available RNRB is £350,000.

He has potentially lost the chance to use £350,000 or 100% of the available RNRB which could have applied had he not given away his home.

When he dies in February 2021, within 7 years of the gift, his estate is worth £600,000 and is split between his four children. As there is no qualifying residence in his estate, it cannot use RNRB directly. But the estate is eligible for additional RNRB up to the maximum 100% of the available RNRB at his death or £350,000.

The position for the gift of the house is considered first. RNRB only applies to the assets in the estate, so it is not available in respect of the gift of the house. However, the estate can claim the full transferable nil-rate band (TNRB) of £650,000 so there is no tax to pay on the gift of £400,000. The balance of £250,000 TNRB remains available to be set against the estate.

RNRB is applied first against the estate of £600,000, leaving a remainder of £250,000. The balance of TNRB from his late wife's estate is applied to this amount so no tax is payable as a result of the death.

1.19 “Qualifying Former Residential Interest”

It is helpful first to consider the definition of this term.

Section 8H IHTA provides:

(4A) Subsection (4B) or (4C) applies where—

(a) a person disposes of a residential property interest in a dwelling-house on or after 8 July 2015 (and before the person dies),

The cut-off date is 8 July 2015: a disposal before that date does not count.

Section 8H IHTA provides:

(4A) Subsection (4B) or (4C) applies where ...

(b) the person’s personal representatives nominate—

(i) where there is only one such dwelling-house, that dwelling-house, or

(ii) where there are two or more such dwelling-houses, one (and only one) of those dwelling-houses.

In the absence of a nomination there is no QFRI.

1.19.1 *Single disposal*

Section 8H IHTA provides:

(4B) Where—

(a) the person—

(i) disposes of a residential property interest in the nominated dwelling-house at a post-occupation time, or

(ii) disposes of two or more residential property interests in the nominated dwelling-house at the same post-occupation time or at post-occupation times on the same day, and

(b) the person does not otherwise dispose of residential property interests in the nominated dwelling-house at post-occupation times, the interest disposed of is, or the interests disposed of are, a qualifying former residential interest in relation to the person.

1.19.2 *Multiple disposals*

Section 8H IHTA provides:

(4C) Where—

(a) the person disposes of residential property interests in the nominated dwelling-house at post-occupation times on two or more days, and

(b) the person's personal representatives nominate one (and only one) of those days,

the interest or interests disposed of at post-occupation times on the nominated day is or are a qualifying former residential interest in relation to the person.

This will be rare.

1.19.3 *GWR*

GWR is not common, but for completeness, s.8H IHTA provides:

(4D) For the purposes of subsections (4A) to (4C)—

(a) a person is to be treated as not disposing of a residential property interest in a dwelling-house where the person disposes of an interest in the dwelling-house by way of gift and the interest is, in relation to the gift and the donor, property subject to a reservation within the meaning of section 102 of the Finance Act 1986 (gifts with reservation), and

(b) a person is to be treated as disposing of a residential property interest in a dwelling-house if the person is treated as making a potentially exempt transfer of the interest as a result of the operation of section 102(4) of that Act (property ceasing to be subject to a reservation).

1.19.4 “*Post-occupation time*”

Section 8H IHTA provides the definition:

(4F) In subsections (4B) and (4C) “post-occupation time” means a time—

(a) on or after 8 July 2015,

(b) after the nominated dwelling-house first became the person's residence, and

(c) before the person dies.

1.19.5 *Date of disposal*

Section 8H IHTA provides:

(4G) For the purposes of subsections (4A) to (4C), if the disposal is under a contract which is completed by a conveyance, the disposal occurs at the time when the interest is conveyed.

1.20 **Downsizing condition A: spare RNRA**

Section 8FA(2) IHTA provides 2 ways to satisfy downsizing condition A:

1.20.1 *Insufficient RNRA*

Section 8FA IHTA provides

(2) Condition A is that—

(a) the person's residence nil-rate amount is given by

[i] section 8E(2) [estate less than £2m taper threshold; NV/100 (closely-inherited residence value) less than default [pre-taper] allowance]¹⁰ or

[ii] [s.8E](4) [estate more than £2m taper threshold; NV/100 (closely-inherited residence value) less than default [pre-taper] allowance]¹¹ or ...

[1] Section 8E(6) and (7) do not apply,¹² and

[2] any entitlement to a downsizing addition is to be ignored, when deciding whether paragraph (a) of condition A is met.

1.20.2 *Residence not closely-inherited*

A separate rule is supplied (unnecessarily) to deal with the situation where

10 See 1.6.6 (Estate less than £2m taper threshold; NV/100 [closely-inherited residence value] less than default [pre-taper] allowance).

11 See 1.6.8 (Estate greater than £2m taper threshold; NV/100 [closely-inherited residence value] less than adjusted [post-taper] allowance).

12 (6) and (7) operate together: see 1.6.9 (RNRA exceeds VT). But

none of the residence is closely-inherited, ie where $N = 0$.¹³

So s. 8FA IHTA provides the other way of satisfying condition A:

- (2) Condition A is that ...
 - (b) the person's estate immediately before the person's death includes a qualifying residential interest but none of the interest is closely inherited, and—
 - (i) where E is less than or equal to TT [£2m], so much of VT as is attributable to the person's qualifying residential interest is less than the person's default [pre-taper] allowance, or
 - (ii) where E is greater than TT, so much of VT as is attributable to the person's qualifying residential interest is less than the person's adjusted [post-taper] allowance.

1.20.3 Downsizing condition B: other assets in estate

Section 8FA IHTA provides:

- (3) Condition B is that not all of VT is attributable to the person's qualifying residential interest.

1.21 Downsizing condition C: qualifying former residential interest

Section 8FA IHTA provides:

- (4) Condition C is that the person has a qualifying former residential interest (see section 8H(4A)).

1.22 Downsizing condition D: sufficiently value of QFRI

Section 8FA IHTA provides:

- (5) Condition D is that the value of the qualifying former residential interest exceeds so much of VT as is attributable to the person's

¹³ See 1.6.1 ("N").

qualifying residential interest.¹⁴

1.23 Downsizing condition E: closely inherited

Section 8FA IHTA provides:

(6) Condition E is that at least some of the remainder is closely inherited, where “the remainder” means everything included in the person’s estate immediately before the person’s death other than the person’s qualifying residential interest.

1.24 Downsizing condition F (claim)

Section 8FA IHTA provides:

(7) Condition F is that a claim is made for the addition in accordance with section 8L(1) to (3).

See 1.12 (Claims for brought-forward allowance and downsizing addition).

1.25 Amount of downsizing addition

Assuming downsizing conditions A to F are all met, we move on to the amount of relief. Section 8FA IHTA provides:

- (8) Where there is entitlement as a result of this section, the addition—
- (a) is equal to the lost relievable amount (see section 8FE) if that amount is less than so much of VT as is attributable to so much of the remainder as is closely inherited, and
 - (b) otherwise is equal to so much of VT as is attributable to so much of the remainder as is closely inherited.

1.26 “Lost relievable amount”

Section 8FE IHTA provides:

¹⁴ The subsection goes on to flag up the valuation provision discussed below: “Section 8FE(2) explains what is meant by the value of the qualifying former residential interest.”

(1) This section is about how to calculate the person's lost relievable amount for the purposes of sections 8FA(8) and 8FB(7).

1.26.1 *Qualifying former residential interest: valuation date*

Section 8FE IHTA specifies the valuation date:

(2) For the purposes of this section and section 8FA(5), the value of the person's qualifying former residential interest is the value of the interest at the time of completion of the disposal of the interest.

1.26.2 *Former allowance*

We continue with some definitions. Section 8FE IHTA provides:

- (3) In this section, the person's "former allowance" is the total of—
- (a) the residential enhancement at the time of completion of the disposal of the qualifying former residential interest,
 - (b) any brought-forward allowance that the person would have had if the person had died at that time, having regard to the circumstances of the person at that time (see section 8G as applied by subsection (4)), and
 - (c) if the person's allowance on death includes an amount of brought-forward allowance which is greater than the amount of brought-forward allowance given by paragraph (b), the difference between those two amounts.
- (4) For the purposes of calculating any brought-forward allowance that the person ("P") would have had as mentioned in subsection (3)(b)—
- (a) section 8G (brought-forward allowance) applies, but as if references to the residential enhancement at P's death were references to the residential enhancement at the time of completion of the disposal of the qualifying former residential interest, and
 - (b) assume that a claim for brought-forward allowance was made in relation to an amount available for carry-forward from a related person's death if, on P's death, a claim was in fact made in relation to the amount.

Amended as s.8FE(4) directs, s.8G would provide:

- (3) P's brought-forward allowance is calculated as follows—

- (a) identify each amount available for carry-forward from the death of a related person (see sections 8E, 8F and 8FD, and subsections (4) and (5)),
- (b) express each such amount as a percentage of the residential enhancement ~~at the death~~ at the time of completion of the disposal of the qualifying former residential interest of the related person concerned,
- (c) calculate the percentage that is the total of those percentages, and
- (d) the amount that is that total percentage of the residential enhancement ~~at P's death~~ at the time of completion of the disposal of the qualifying former residential interest is P's brought-forward allowance or, if that total percentage is greater than 100%, P's brought-forward allowance is the amount of the residential enhancement ~~at P's death~~ at the time of completion of the disposal of the qualifying former residential interest.

but P's brought-forward allowance is nil if no claim for it is made under section 8L.

- (4) Where the death of a related person occurs before 6 April 2017—
 - (a) an amount equal to £100,000 is treated for the purposes of subsection (3) as being the amount available for carry-forward from the related person's death, but this is subject to subsection (5), and
 - (b) the residential enhancement at the related person's death is treated for those purposes as being £100,000.
- (5) If the value (“RPE”) of the related person's estate immediately before the related person's death is greater than £2,000,000, the amount treated under subsection (4)(a) as available for carry-forward is reduced (but not below nil) by—
 $(\text{RPE} - £2,000,000) \div 2$

1.26.3 *Amount of brought-forward allowance*

Section 8FE IHTA provides:

- (5) For the purposes of subsection (3)(c), where the person's allowance on death is equal to the person's adjusted [post-taper] allowance, the amount of brought-forward allowance included in the person's allowance on death is calculated as follows.

Step 1

Express the person's brought-forward allowance as a percentage of the person's default [pre-taper] allowance.

Step 2

Multiply—

$$(E - TT) \div 2$$

by the percentage given by step 1.

Step 3

Reduce the person's brought-forward allowance by the amount given by step 2.

The result is the amount of brought-forward allowance included in the person's allowance on death.

1.26.4 *Sale before 6 April 2017*

Section 8FE IHTA provides:

- (6) If completion¹⁵ of the disposal of the qualifying former residential interest occurs before 6 April 2017—
- (a) for the purposes of subsection (3)(a), the residential enhancement at the time of completion of the disposal is treated as being £100,000, and
 - (b) for the purposes of subsection (3)(b), the amount of brought forward allowance that the person would have had at that time is treated as being nil.

1.26.5 *“Allowance on death”*

This term is used in computing the amount of brought-forward allowance: see 1.26.3 (Amount of brought-forward allowance).

Section 8FE IHTA provides:

- (7) In this section, the person's “allowance on death” means—
- (a) where E is less than or equal to TT, the person's default [pre-taper] allowance, or
 - (b) where E is greater than TT, the person's adjusted [post-taper] allowance.

¹⁵ Defined s.8FE(6): Section 8FE IHTA provides: “For the purposes of this section, “completion” of the disposal of a residential property interest occurs at the time of the disposal or, if the disposal is under a contract which is completed by a conveyance, at the time when the interest is conveyed.”

1.26.6 *Lost relievable amount*

We can at last compute the lost relievable amount:

(9) Where, as a result of section 8FA, there is entitlement to a downsizing addition in calculating the person's residence nil-rate amount, take the following steps to calculate the person's lost relievable amount.

Step 1

Express the value of the person's qualifying former residential interest as a percentage of the person's former allowance, but take that percentage to be 100% if it would otherwise be higher.

Step 2

Express QRI as a percentage of the person's allowance on death, where QRI is so much of VT as is attributable to the person's qualifying residential interest, but take that percentage to be 100% if it would otherwise be higher.

Step 3

Subtract the percentage given by step 2 from the percentage given by step 1, but take the result to be 0% if it would otherwise be negative. The result is P%.

Step 4

The person's lost relievable amount is equal to P% of the person's allowance on death.

HMRC provide example calculations in IHTM46060. One is reproduced here:

Example: The downsizing addition and RNRB

In May 2018 Maurice downsized from a large house worth £500,000 to a small flat which was valued at £105,000 on his death in September 2020. He left the flat to his son, and the rest of his estate worth £200,000 to his two daughters. Conditions A to F, in section 8FA, are met.

The residential enhancement in 2018-19 is £125,000.

The residential enhancement in 2020-21 is £175,000.

There is no entitlement to any transferred RNRB on Maurice's death.

Step 1 – Maurice's 'former allowance' equals the value of the residential enhancement at the date of disposal, £125,000,

Step 2 - Maurice's QFRI was valued at £500,000. His former allowance is £125,000. Expressed as a percentage $£500,000 \div £125,000$ is 400%, but this is limited to 100%.

Step 3 - The QRI expressed as a percentage of Maurice's allowance on death is $\pounds 105,000 \div \pounds 175,000 \times 100 = 60\%$.

Step 4 - Subtract the percentage at step 3 from the percentage at step 2. Therefore $100\% - 60\% = 40\%$.

Step 5 - Maurice's default allowance is $\pounds 175,000$. This is multiplied by the percentage at step 4, 40%, to give a total lost relievable amount of $\pounds 70,000$. The actual amount of the downsizing addition depends on the value of other assets (the remainder) which are left to his children. As more than $\pounds 70,000$ of the remainder is left to Maurice's daughters, the downsizing addition of $\pounds 70,000$ is added to the RNRB due in respect of the flat of $\pounds 105,000$ left to his son, to give a total RNRB for the estate of $\pounds 175,000$.

If instead Maurice had left the flat to his son, some assets worth $\pounds 50,000$ to his daughters and the rest of his estate to his wife, the downsizing addition would be restricted to $\pounds 50,000$ because that is the value of other assets left to his daughters. The total RNRB in that case would be $\pounds 155,000$ ($\pounds 105,000 + \pounds 50,000$).

1.26.7 *No residential interest at death*

Section 8FE IHTA provides:

(10) Where, as a result of section 8FB,¹⁶ there is entitlement to a downsizing addition in calculating the person's residence nil-rate amount, take the following steps to calculate the person's lost relievable amount.

Step 1

Express the value of the person's qualifying former residential interest as a percentage of the person's former allowance, but take that percentage to be 100% if it would otherwise be higher.

Step 2

Calculate that percentage of the person's allowance on death.

The result is the person's lost relievable amount.

1.27 **No residential interest at death**

Section 8FB IHTA provides:

(1) There is also entitlement to a downsizing addition in calculating the

¹⁶ See 1.27 (No residential interest at death).

person's residence nil-rate amount if each of conditions G to K is met (see subsection (7) for the amount of the addition).

We refer to “**downsizing conditions G to K**”. Comparing A-H and G-K:

(2) Condition A is that—

(a) the person's residence nil-rate amount is given by section 8E(2) or (4), or

(b) the person's estate immediately before the person's death includes a qualifying residential interest but none of the interest is closely inherited, and—

(i) where E is less than or equal to TT, so much of VT as is attributable to the person's qualifying residential interest is less than the person's default allowance, or

(ii) where E is greater than TT, so much of VT as is attributable to the person's qualifying residential interest is less than the person's adjusted allowance.

(3) Condition B is that not all of VT is attributable to the person's qualifying residential interest.

(4) Condition C is that there is a qualifying former residential interest in relation to the person (see sections 8H(4A) to (4F) and 8HA).

(5) Condition D is that the value of the qualifying former residential interest exceeds so much of VT as is attributable to the person's qualifying residential interest.

(6) Condition E is that at least

(2) Condition G is that the person's estate immediately before the person's death (“the estate”) does not include a residential property interest.

(3) Condition H is that VT is greater than nil.

(4) Condition I is that there is a qualifying former residential interest in relation to the person (see sections 8H(4A) to (4F) and 8HA).

some of the remainder is closely inherited, where “the remainder” means everything included in the person's estate immediately before the person's death other than the person's qualifying residential interest.

(5) Condition J is that at least some of the estate is closely inherited.

(7) Condition F is that a claim is made for the addition in accordance with section 8L(1) to (3).

(6) Condition K is that a claim is made for the addition in accordance with section 8L(1) to (3).

1.27.1 *Downsizing condition G*

Section 8FB IHTA provides:

(2) Condition G is that the person's estate immediately before the person's death (“the estate”) does not include a residential property interest.

“Residential property interest” has the same meaning as in section 8H (see section 8H(2)).

1.27.2 *Downsizing condition H*

Section 8FB IHTA provides:

(3) Condition H is that VT is greater than nil.

1.27.3 *Downsizing condition I*

Section 8FB IHTA provides:

(4) Condition I is that the person has a qualifying former residential interest (see section 8H(4A)).

1.27.4 *Downsizing condition J*

Section 8FB IHTA provides:

(5) Condition J is that at least some of the estate is closely inherited.

1.27.5 *Downsizing condition K (claim)*

Section 8FB IHTA provides:

(6) Condition K is that a claim is made for the addition in accordance with section 8L(1) to (3).

1.28 Amount of downsizing relief

Assuming downsizing conditions G to K are all met, we move on to the amount of relief.

Section 8FB IHTA provides:

- (7) Where there is entitlement as a result of this section, the addition—
- (a) is equal to the lost relievable amount (see section 8FE) if that amount is less than so much of VT as is attributable to so much of the estate as is closely inherited, and
 - (b) otherwise is equal to so much of VT as is attributable to so much of the estate as is closely inherited.

1.29 Operation of downsizing relief

1.29.1 *Section 8E case (home closely inherited)*

Section 8FC IHTA provides:

- (1) Subsection (2) applies if—
- (a) as a result of section 8FA, there is entitlement to a downsizing addition in calculating the person's residence nil-rate amount, and
 - (b) the person's residence nil-rate amount is given by section 8E.
- (2) Section 8E has effect as if, in subsections (2) to (5) of that section, each reference to NV/100 [closely-inherited residence value] were a reference to the total of—
- (a) NV/100 [closely-inherited residence value], and
 - (b) the downsizing addition.

1.29.2 *Section 8F case (no home/not closely inherited)*

Section 8FC IHTA provides:

- (1) This section applies if—
 - (a) as a result of section 8FA or 8FB, there is entitlement to a downsizing addition in calculating the person's residence nil-rate amount, and
 - (b) apart from this section, the person's residence nil-rate amount is given by section 8F.
- (2) This section applies instead of section 8F.
- (3) The person's residence nil-rate amount is equal to the downsizing addition.
- (4) Where—
 - (a) E is less than or equal to TT, and the downsizing addition is equal to the person's default [pre-taper] allowance, or
 - (b) E is greater than TT, and the downsizing addition is equal to the person's adjusted [post-taper] allowance,no amount is available for carry-forward.
- (5) Where—
 - (a) E is less than or equal to TT, and
 - (b) the downsizing addition is less than the person's default [pre-taper] allowance,an amount, equal to the difference between the downsizing addition and the person's default [pre-taper] allowance, is available for carry-forward.
- (6) Where—
 - (a) E is greater than TT, and
 - (b) the downsizing addition is less than the person's adjusted [post-taper] allowance,an amount, equal to the difference between the downsizing addition and the person's adjusted [post-taper] allowance, is available for carry-forward.

James Kessler QC

Mary Ashley

21 September 2017

15 Old Square

Lincoln's Inn

London WC2A 3UE

kessler@kessler.co.uk

MaryAshley@15oldsquare.co.uk