When is a £1m nil rate band, not a £1m nil rate band?

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- Author: Andy Woollen

The new £1m main residence nil rate band sounds pretty straightforward but, as Zurich's Andy Woollen explains, there is more to it than meets the eye...

For many years now the **number of estates** paying inheritance tax (IHT) has been steadily rising, culminating in the highest-ever annual and monthly IHT receipts of £3.8bn in 2014/15 and £427m in June 2015.

And with the number of estates forecast to pay IHT set to increase to one in ten by 2020/21, the government has been promising to do something for a while (more than five years in fact).

As widely anticipated in the media, **George Osborne** announced in his Summer Budget speech that he would fulfil his longstanding promise to remove the family home out of IHT for all but the wealthiest.

Specifically he said: "You can pass up to £1m on to your children **free of IHT**. No more IHT on family homes."

Of course, he was talking about the new transferable ‘main residence nil rate band' (MR-NRB).

This statement has in turn been widely reported and you could forgive the public for believing that they now have a £1m nil rate band, or that their house is now exempt from IHT. If only it was that simple.

Devilish details

Basically, the MR-NRB will apply to individuals who pass their residential property to their children/grandchildren when they die. Let's look at this in a bit more detail.

The main point to note is that the new allowance won't be available in full for another five years (until after the next election), as it is being phased-in over four years starting from April 2017 as follows:

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

A lot can happen in five years to both governments and clients, so what happens if the client dies before they can fully benefit from the MR-NRB?

In the same way as the personal NRB, any unused MR-NRB will be transferable to a surviving spouse/civil partner. The benefit will apply if the second spouse/civil partner dies on or after 6 April 2017, regardless of when the first of the couple died, so it does include existing widows/ers.

This is how the aspirational £1m nil rate band is achieved. It means that single people will potentially only get half of this amount.

What about unmarried couples?
As the transferability rules do not apply, each individual would have to leave their share of the residential property (if held as tenants-in-common) to their direct descendants in order to benefit.
It is proposed that where part of the MR-NRB might be lost because the deceased had downsized or had ceased to own a residence (maybe to go into care) on or after 8 July 2015, that part [of the MR-NRB] will still be available provided that the deceased left a downsized residence or assets of equivalent value to direct descendants.
This proposal was included due to a concern that the MR-NRB would act as a disincentive for elderly people to downsize from expensive homes during an acute UK housing shortage.
This specific proposal will be the subject of a consultation to be published in September 2015.
However, if the net value of the estate - not just the residential property value - is above £2m after deducting any liabilities (but before reliefs and exemptions), the MR-NRB will be tapered away by £1 for every £2 where the net value exceeds £2m. Effectively a 60% tax trap.
And then, of course, if you have no direct descendants or don't leave your residential property to them, then it doesn't apply anyway. A direct descendant will be a child (including a step, adopted or fostered child) of the deceased and their lineal descendants (i.e. grandchildren).
It's also worth noting that the value of the MR-NRB for an estate will be the lower of:

- the net value of the interest in the residential property (after deducting any liabilities such as a mortgage) or
- the maximum amount of the MR-NRB.

The qualifying residential interest will be limited to one residential property, but personal representatives will be able to nominate which residential property should qualify if there is more than one in the estate.
But a property that was never a residence of the deceased, such as a buy-to-let property, will not qualify.
So this could mean that properties bought on a shared ownership basis or held as tenants-in-common could reduce the value that would qualify against the MR-NRB.

Who will be the winners and losers of the MR-NRB?

Who	**How much MR-NRB from 2020/21**	**Overall NRB from 2020/21**
Married couples; Civil partners	Up to £350k, as transferable	Up to £1m, as transferable
Widow/ers and surviving civil partners	As above	As above
Unmarried couples	Up to £175k each,but not transferable	Up to £500k each, but not transferable
Singletons, spinsters and bachelors	Up to £175k only	Up to £500k only
Divorcees	As above	As above
Net estates above £2m	Tapered down to nil	Up to £325k each, or £650k if transferable
No direct descendants	Nil	As above
Not left to direct descendants	Nil	As above

This is borne out by the Treasury's own estimates of the number of estates they forecast to pay IHT in 2020/21: 63,000 dropping to only 37,000 as a result of these changes.

Opportunity

Apart from having certainty of the detail around MR-NRB, on which to base discussions with your clients, IHT planning still offers benefits for clients, including those who will benefit fully from the MR-NRB, but have large estates.

Furthermore, there is an immediate opportunity for those clients that are exposed to a decreasing IHT liability during the phasing-in period.

Case study

Spencer is a widower aged 75 with a house worth £350,000 and other assets of £650,000.

With his and his spouse's 100% transferable personal NRB (totalling £650,000) his estate would be liable to IHT of £140,000.

If he dies after 2020/21 and leaves his house to his children, then the full transferable MR-NRB of £350,000 will apply to his house, reducing his IHT liability to zero (all other things being equal).

However, if he does no IHT planning and dies before 2020/21, what would the exposed IHT liability be?

The table shows his reducing IHT liability, as the MR-NRB phases-in:

Tax year	MR-NRB per couple	IHT saving	Reducing IHT liability
2015/16	-	-	£140k
2016/17	-	-	£140k
2017/18	£200k	£80k	£60k
2018/19	£250k	£100k	£40k
2019/20	£300k	£120k	£20k
2020/21	£350k	£140k	-

This is where protection products can play a part.

Most affordable would be a series of term assurances to cover the reducing IHT liability in a gift inter vivos-esque way.

Then there is straightforward level term assurance or, for added flexibility, don't forget about convertible term assurance.

And finally, in expectation of an increasing IHT liability, maybe use a guaranteed whole of life plan with indexation.

Either way, the introduction of the MR-NRB is not simple and gives you a reason to discuss IHT planning with your clients. It also presents many opportunities to use protection or asset-backed solutions (such as investment bonds) in trust, to mitigate IHT.

Andy Woollen, national accounts, Zurich