

Explanatory Note

Clause 44 and Schedule: Inheritance tax: Increased nil-rate band

Summary

1. This measure ensures that an estate will continue to qualify for an increased residence nil-rate band for inheritance tax when an individual downsizes from a higher value residence to a lower value one or ceases to own a residence and other assets are left on death to direct descendants. The Schedule sets out the conditions for the entitlement to the additional amount (the downsizing addition), the effect of the addition, and how the amount of the residence nil-rate band that has been lost as a result of downsizing or disposal should be calculated. The change will apply for deaths on or after 6 April 2017 and for downsizing moves or disposals on or after 8 July 2015.

Details of the clause and Schedule

Schedule 1: Inheritance tax: Increased nil-rate band

2. Paragraph 1 amends Inheritance Tax Act (IHTA) 1984.
3. Paragraph 2 explains the meaning of "consumer prices index" in section 8D(9) IHTA 1984.
4. Paragraph 3 makes consequential amendments to section 8E IHTA 1984 to take into account the new provisions introduced by the Schedule. It also amends section 8E(7) IHTA 1984 to ensure that this works as intended to give the correct amount of residence nil-rate band and carry-forward amounts to transfer to a spouse or civil partner's estate.
5. Paragraph 4 makes consequential amendments to section 8F IHTA 1984 as a result of new section 8FD.
6. Paragraph 5 inserts new sections 8FA to 8FE into IHTA 1984.

Section 8FA: Downsizing addition: entitlement: low-value death interest in home

7. New section 8FA applies where a person has downsized from a more valuable residence and there is a less valuable residence left in the estate on death. It gives the conditions that have to be met for an estate to be entitled to the increased amount of the residence nil-rate band (downsizing addition) in these circumstances and how that amount is calculated.
8. Subsection (1) provides that the downsizing addition will be taken into account when calculating the amount of the residence nil-rate band if all the conditions in this section are

met. This gives the entitlement to the downsizing addition.

9. Subsection (2) sets out Condition A, which is that either
- a. there is a residence in the estate on death which qualifies for the residence nil-rate band (a qualifying residential interest) but the full amount is not due because the value of the residence, or the proportion inherited by direct descendants (i.e. closely inherited), is below the maximum residence nil-rate band available for that person, or
 - b. there is a residence in the estate on death but none of it is closely inherited and the value of the residence is less than the maximum residence nil-rate band available for that person.

For the purposes of paragraph (a), sections 8E(6) and 8E(7) and the entitlement to the downsizing addition are ignored because Condition A only tests whether there is scope for any downsizing addition but does not give effect to it.

10. Subsection (3) sets out Condition B, which is that the value transferred by the chargeable transfer on death (VT) is more than the value of the residence (the person's qualifying residential interest).
11. Subsection (4) gives Condition C, which is that the person previously had a residence which could have qualified for the residence nil-rate band (the qualifying former residential interest).
12. Subsection (5) gives Condition D, which is that the value of the former residence has to be more than the chargeable value of the residence in the estate at death.
13. Subsection (6) sets out Condition E which is that at least some of the other assets in the estate must be inherited by direct descendants (closely inherited).
14. Subsection (7) gives Condition F which is that a claim has to be made for the downsizing addition.
15. Subsection (8) gives the amount of the downsizing addition. This is equal to the lost residence nil-rate band (the lost relievable amount) as a result of the downsizing move, which is calculated in accordance with section 8FE IHTA 1984. However, the amount is limited to the value of other assets, or proportion of that value, which is closely inherited.
16. Subsection (9) identifies other provisions which explain the effect of this section or which give the meaning of the terms used in this section.

Section 8FB: Downsizing addition: entitlement: no residential interest at death

17. New section 8FB applies where a person no longer owns a residence so that there is no residence in the estate on death. It sets out the qualifying conditions for an estate to be entitled to the downsizing addition in these circumstances and how that amount is calculated.
18. Subsection (1) provides that the downsizing addition will be taken into account when calculating the amount of the residence nil-rate band if all the conditions in this section are met. This gives the entitlement to the downsizing addition.
19. Subsection (2) sets out Condition G which is that there is no residence in a person's estate at the date of death. Residence in this context means a house which the person has lived in at

some stage while they owned it.

20. Subsection (3) gives Condition H, which is that the value transferred by the chargeable transfer on death (VT) has to be greater than nil.
21. Subsection (4) gives Condition I, which is that the person previously had a residence which could have qualified for the residence nil-rate band (the qualifying former residential interest).
22. Subsection (5) gives Condition J, which is that at least some of the other assets in the estate are inherited by direct descendants (closely inherited).
23. Subsection (6) gives Condition K which is that a claim has to be made for the downsizing addition.
24. Subsection (7) gives the amount of the downsizing addition. This is equal to the lost residence nil-rate band (the lost relievable amount) as a result of disposing of the residence, which is calculated in accordance with section 8FE IHTA 1984. The amount is limited to the value of other assets, or proportion of that value, which is closely inherited.
25. Subsection (8) identifies other provisions which explain the effect of this section or which give the meaning of the terms used in this section.

Section 8FC: Downsizing addition: effect: section 8E case

26. New section 8FC gives the effect of the entitlement to the downsizing addition where some or all of the residence in the estate is left to direct descendants.
27. Subsection (1) provides that the effect applies if there is an entitlement to the downsizing addition because a person has downsized and the residence in their estate, or a part of it, is left to direct descendants.
28. Subsection (2) has the effect that the downsizing addition is added to the amount of the residence nil-rate band that would otherwise be due to arrive at the total residence nil-rate band for the estate.

Section 8FD: Downsizing addition: effect: section 8F case

29. New section 8FD gives the effect of the entitlement to the downsizing addition where there is no residence left to direct descendants.
30. Subsection (1) provides that the effect applies if there is an entitlement to the downsizing addition because a person has downsized but none of the residence has been inherited by direct descendants, or has disposed of a residence so that it cannot be inherited by direct descendants.
31. Subsection (2) provides that this section applies instead of section 8F so that the downsizing addition will still apply even if no part of the residence is inherited by direct descendants.
32. Subsection (3) provides that in these cases the residence nil-rate band will be equal to the downsizing addition.
33. Subsection (4) sets out the circumstance where there is no carry-forward amount. This is where the downsizing addition is equal to the residence nil-rate band plus any transferred residence nil-rate band (the default allowance where the value of the estate is below the taper threshold, or adjusted allowance if it is above the taper threshold). In that case, the

downsizing addition is fully used and nothing is available to be transferred to a spouse or civil partner's estate.

34. Subsection (5) determines the carry-forward amount where the value of the estate is equal to or below the taper threshold and the downsizing addition is less than the residence nil-rate band plus any transferred residence nil-rate band (the default allowance). In that case, the difference between the downsizing addition and the default allowance is available for transfer to a spouse or civil partner's estate.
35. Subsection (6) determines the carry-forward amount where the value of the estate is above the taper threshold and the downsizing addition is less than the residence nil-rate band plus any transferred residence nil-rate band (the adjusted allowance). In that case, the difference between the downsizing addition and the adjusted allowance is available for transfer to a spouse or civil partner's estate.

Section 8FE: Calculation of lost relievable amount

36. New section 8FE sets out how the value of the residence nil-rate band which has been lost as a result of downsizing or disposal of a residence (the lost relievable amount) should be calculated.
37. Subsection (1) specifies the purpose of the section, which is to show how to calculate the lost relievable amount
38. Subsection (2) defines the value of a person's former residence which could have qualified for the residence nil-rate band (the former qualifying residential interest). This is the open market value of the residence, or interest in it, at the time when the disposal of it was completed.
39. Subsection (3) gives a person's "former allowance". This is the total of
 - a. the maximum residence nil-rate band available at the time of the disposal,
 - b. any transferred residence nil-rate band (brought-forward allowance) that would have been due if the person had died at the time of the disposal, and
 - c. any difference between the brought-forward allowance which would have been due at the time of disposal and the actual brought-forward allowance at the time of the person's death.
40. Subsection (4) gives further rules for calculating the brought-forward allowance that would have been due had the person died at the time of disposal of the former residence.
41. Subsection (5) gives steps for calculating the brought-forward allowance for the purposes of section 8FE(3)(c) where the estate on death exceeds the taper threshold. It reduces the brought-forward allowance, ensuring that the taper reduction applies proportionally to the residential enhancement and the brought-forward allowance.
42. Subsection (6) explains what the maximum residence nil-rate band (the residential enhancement) and the brought-forward allowance should be if the residence was disposed of before 6 April 2017. The residence nil-rate band is treated as £100,000 and there is no brought-forward allowance.
43. Subsection (7) defines a person's "allowance on death" as their default allowance if the value of the estate is less than or equal to the taper threshold, or their adjusted allowance if the

value of the estate is above the taper threshold.

44. Subsection (8) defines the time of completion of the disposal of the residence, or interest in it.
45. Subsection (9) sets out the steps in the calculation of the lost residence nil-rate band as a result of downsizing to a less valuable residence (the lost relievable amount). Step 1 calculates the percentage of the residence nil-rate band that was 'lost' at the time of the disposal. Step 2 calculates the percentage of the residence nil-rate band at death that is used up by the residence at death. Step 3 calculates the difference between these percentages and Step 4 multiplies the person's allowance on death by this percentage to determine the lost relievable amount.
46. Subsection (10) sets out the steps in the calculation of the lost residence nil-rate band as a result of the disposal of the residence (the lost relievable amount). Step 1 calculates the percentage of the residence nil-rate band that was 'lost' at the time of the disposal. Step 2 multiplies the person's allowance on death by this percentage to determine the lost relievable amount.
47. Paragraph 6 of the Schedule makes a consequential amendment to the provisions dealing with the transfer of the residence nil-rate band (the brought-forward allowance) in section 8G to include a reference to new section 8FD in the calculation of the amount transferred.
48. Paragraph 7 makes various consequential amendments to provisions in section 8H defining the residence qualifying for the residence nil-rate band so that they also include the former residence (the qualifying former residential interest) which has been disposed of before the person's death.
49. Sub-paragraph (4) inserts new subsections (4A) to (4E) in section 8H.
50. Subsection (4A) states that new subsection (4B) or (4C) apply where a person has disposed of their former house(s) on or after 8 July 2015 and the person's personal representatives nominate one such house. This means that personal representatives can nominate only one disposal of a residence, or of an interest in it, to qualify for the downsizing addition.
51. Subsection (4B) provides that where a person disposes of only one nominated residence, or interest in it, that residence or interest will be the qualifying one for the purposes of any downsizing addition.
52. Subsection (4C) provides that where a person disposes of two or more interests in the nominated residence, the person's personal representatives can only nominate one of those interests. That nominated former interest will be qualifying one for the purposes of the downsizing addition.
53. Subsection (4D) ensures that the person must have lived in the house at some point before disposal of it in order for it to be treated as a qualifying former residence. A house which the person has never lived in, such as a property bought solely as an investment or rental property, would not qualify.
54. Subsection (4E) clarifies that if a residence is disposed of under the two-stage exchange of contract followed by completion process, the disposal time for these purposes is the completion date.
55. Paragraphs 8, 9 and 10 make minor amendments to sections 8J, 8K and 8M respectively to

include references to new sections 8FA, 8FB, 8FD and the downsizing addition.

Background note

56. The Summer Budget 2015 announced the introduction of an additional nil-rate band when a residence is passed on death to a direct descendant. This would be £100,000 in 2017 to 2018, £125,000 in 2018 to 2019, £150,000 in 2019 to 2020, and £175,000 in 2020 to 2021. It will then increase in line with CPI for 2021 to 2022 onwards. Any unused nil-rate band will be transferred to a surviving spouse or civil partner. For estates with a net value of more than £2m there will be a tapered withdrawal of the additional nil-rate band at a rate of £1 for every £2 over this threshold.
57. In addition, the announcement also said that the new residence nil-rate band will be available when a person downsizes or ceases to own a home on or after 8 July 2015 and assets of an equivalent value, up to the value of the additional nil-rate band, are passed on death to direct descendants. This clause and Schedule provide for this extension of the residence nil-rate band.
58. If you have any questions about this change, or comments on the legislation, please contact the HM Revenue & Customs Assets and Residence policy team (email: ihtandtrustsconsult.car@hmrc.gsi.gov.uk)