

TECHNICAL  
PAPER

FOR INVESTMENT PROFESSIONALS

# NAVIGATING THE RESIDENCE NIL RATE BAND

This technical paper is designed to assist you in planning for your clients by providing a high level, informative summary of the relevant provisions and rules. It should not be read as advice. Professional tax advice should be sought that can take account of your clients individual circumstances.



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# Helping your clients with the Residence Nil Rate Band

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The Residence Nil Rate Band (RNRB) was introduced almost a decade ago and can save £140,000 of inheritance tax per married couple.

Unlike the Nil Rate Band, the rules governing the RNRB can be complex, and it is not unusual for client scenarios to risk missing out on the allowance.

This will become more likely once unspent pension pots form part of estates from April 2027, making this an area where providing guidance to clients could be very valuable.

# What is the Residence Nil Rate Band?

There are two nil rate band allowances, with inheritance tax being chargeable on estates that exceed these bands.

## Nil Rate Band

£325,000 allowance available to everyone and can be set against all asset types on death. It is also applied to lifetime gifts or transfers into trust that are made within the seven years before death.

## Residence Nil Rate Band

£175,000 allowance established in 2017 specifically to help families pass their home down through the generations. Due to its purpose, the allowance broadly applies only where someone leaves their home, on their death, to a direct descendant. And it is available only to more modest estates - a taper reduces the amount of the RNRB by £1 for every £2 that the net value of the estate is more than £2 million.

These bands are frozen until April 2031, when the Government has made provision for them to increase in line with the Consumer Price Index.



Any Nil Rate Band or RNRB that is unused following the death of an individual can be transferred to their surviving spouse or civil partner. This means that qualifying estates are able to pass on up to £1 million per married couple, before inheritance tax becomes chargeable.

As detailed on GOV.UK – Work out and apply the residence nil rate band for Inheritance Tax, last updated 5 September 2019

# Qualifying property

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To benefit, an estate must contain a “Qualifying Residential Interest”. This means the deceased needs to have owned a residential property that was their home at some point.

But it does not have to be their main residence at the time of their death. A property that was once the deceased’s home, but was later let to tenants, would qualify, however a rental property that had never been their home would not. If the individual no longer owns a property when they die, the downsizing rules will be relevant. These can be complex and are not covered in this paper.

# “Closely inherited”

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In general, the property must be inherited by a child of the deceased, or by a remoter lineal descendant, for example grandchild or great grandchild. The definition includes adopted, fostered or stepchildren, and their spouses.

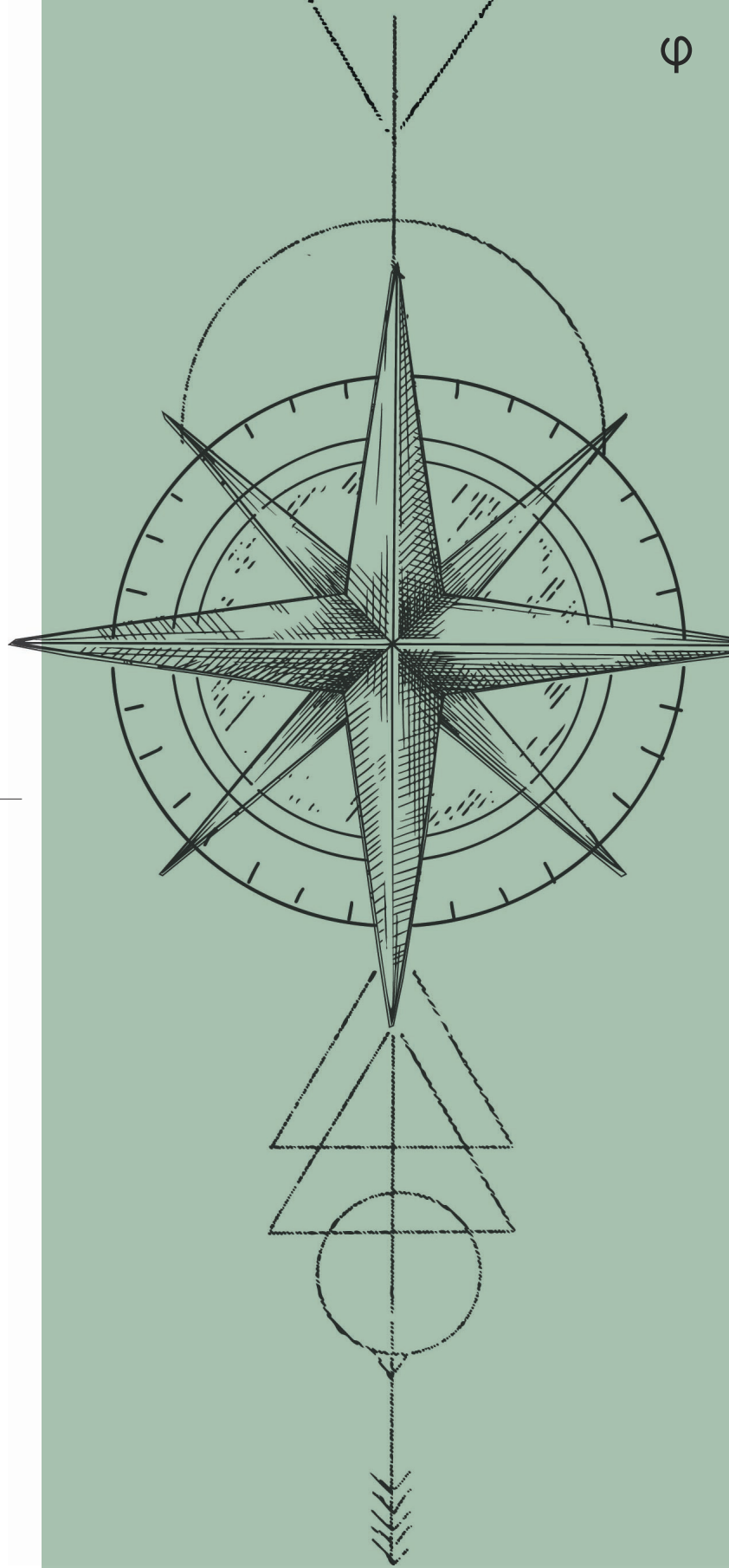
It intentionally does not extend to other categories of beneficiary if the deceased does not have direct descendants.

# Maximum value

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The RNRB exists to allow a property to be passed on death. Therefore the value of the RNRB cannot exceed the value of the property itself.

While properties worth less than £175,000 are uncommon, this rule is more relevant when a second spouse dies with the benefit of a transferred RNRB allowance. The property must be worth at least £350,000 in order for the maximum allowance to be available in this scenario. The exception is where the downsizing rules apply.



# Considerations for clients

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## Spouses

If the first spouse to die leaves their share in the family home to their surviving partner, they will not have used any of their RNRB allowance. In this scenario, the second spouse's estate can claim a double RNRB, even if the first spouse did not have an interest in any property at all.

While it does not matter if the first spouse dies without an interest in a home, the second spouse must have one (or the downsizing provisions must be relevant), else no RNRB will be available.



## First spouse died before the RNRB was enacted

If the first spouse died before 6 April 2017, they are deemed not to have used any of their RNRB, regardless of who inherited their assets to or whether they owned a property. The maximum RNRB available for the estate of a spouse whose partner died before April 2017 will be doubled.

Between 6 April 2017 and 6 April 2020, the value of the RNRB ranged from £100,000 to £175,000. If the first spouse died during this period, the transferrable allowance is based on the percentage of the RNRB utilised on the first death.

In most cases, either:

- No allowance will be available to transfer (because it was fully utilised by a gift of a home to children or grandchildren on the first death).
- None was used, enabling the RNRB on the death of the second spouse to be doubled.

For all spousal RNRB transfer scenarios, the value of the RNRB transferred will be limited, potentially to nil, where the estate of that spouse exceeded the £2 million taper threshold (see below).



### Estates worth more than £2 million

The maximum RNRB allowance is reduced by £1 for every £2 by which an estate exceeds £2 million. This means that for someone otherwise entitled to an RNRB of £175,000, the allowance will be lost completely if their estate exceeds £2.35 million at the time of death.

For someone who has inherited a full unused RNRB from their spouse, the RNRB is lost if their estate exceeds £2.7 million. This is called the RNRB Taper Threshold.



### Married couples and the taper threshold

Many married couples own the majority of their assets and wealth jointly. This means a combined wealth of £4 million may not risk breaching the £2 million taper threshold when the first spouse dies. However, after the first death, the surviving spouse often inherits most or all of the joint assets. At that point, their estate would be too large to benefit from the RNRB without some planning.

The taper restriction is tested on both deaths separately:

- If the estate of the first spouse was valued at more than £2 million, the percentage of transferrable RNRB available to carry forward will be reduced, potentially to nil.
- If the estate on the second death is large enough, both the RNRB of the surviving spouse plus any brought-forward transferrable RNRB can be lost altogether. This could even be the case if the estate on the first death was below the £2 million taper threshold and the RNRB went unused.



### Pensions

For deaths after 6 April 2027, unspent pension pots will form part of the estate for inheritance tax purposes.

As a result, they will be included when assessing whether the estate is too valuable to benefit from the RNRB.

The inclusion of unspent pensions is likely to push many more clients into a world where the RNRB might not be available to their estate. This includes common scenarios where little, or no inheritance tax is payable on the death of the first spouse because they leave all their wealth to their surviving partner. However, the value of the estate is too large for the spouse to inherit their unused RNRB.



### Lifetime gifts

Unlike the Nil Rate Band, the RNRB is an allowance that applies only when a home is left on death. If a lifetime gift of a home is made, the RNRB cannot apply to that transfer.

# Residence Nil Rate Band and Trusts

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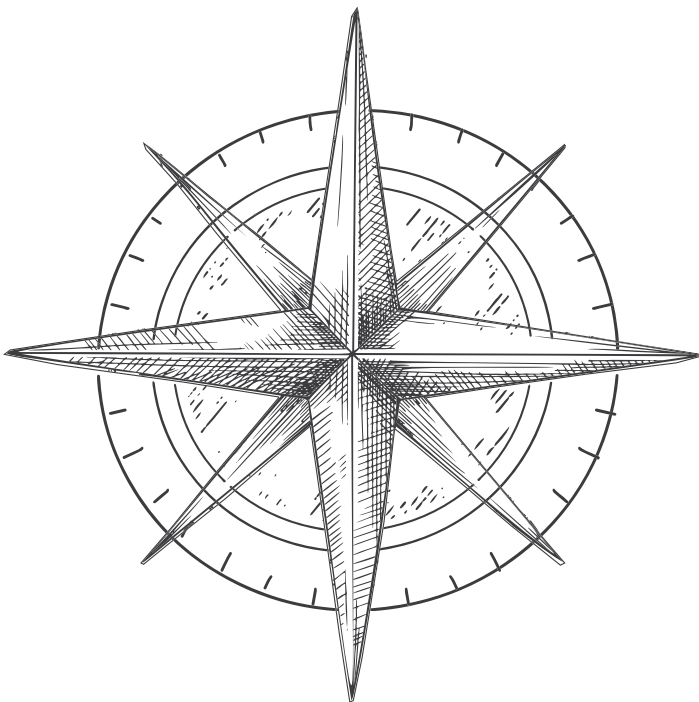
## Discretionary trusts

If an otherwise qualifying home is left to discretionary trust when someone dies, their estate will not benefit from the RNRB because the home has not been inherited by “direct descendants”. This applies even where the beneficiaries of the trust would qualify as direct descendants if they had inherited the home directly.

## Life interest trusts

It is quite common for the wills of married couples to create a life interest in the family home for the surviving spouse on the death of the first, with the property to pass to named beneficiaries on the second death. This creates an immediate post-death interest (IPDI) trust, and the home is treated as having been left to the surviving spouse absolutely for inheritance tax purposes. No inheritance tax should be payable on the first death because the transfer is treated as a transfer between spouses, and for the same reason no RNRB would be used.

If the IPDI trust instructs the home to be left to direct descendants of the second spouse when they die, both spouses' RNRBs should be available on that transfer (subject to the value of either spouse's estate not exceeding the taper threshold).



# Planning for the Residence Nil Rate Band

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## For estates >£2 million

The test for whether an estate is too large to benefit from the RNRB happens at death. Unlike the well-known “seven-year rule” for inheritance tax, there is no waiting period for lifetime gifts to reduce the estate value for RNRB taper threshold purposes. Clients with estates in excess of £2 million who make lifetime gifts or settlements into trust of cash or assets other than their home will benefit immediately from a reduction in the value of their estate for taper threshold purposes. If the gift brings their estate below the threshold, the full RNRB would be available.

For those with very large estates, the maximum inheritance tax saving of £140,000 per couple may not make up for the inconvenience of giving up wealth during their lifetime, or it may not be possible to reduce the estate below £2 million due to valuable properties or significant cash requirements.

## RNRB and the Business Relief Allowance

Everyone now has a £2.5 million “Business Relief Allowance” which provides 100% inheritance tax relief on investments that qualify for Business Relief (BR) or Agricultural Relief.

Qualifying holdings benefit from inheritance tax relief after two years, enabling investors to start to mitigate inheritance tax while retaining access to their wealth. This contrasts with making lifetime gifts, where assets need to be given away at least seven years prior to death in order to be inheritance tax-free.

Qualifying investments remain in the investor’s estate and therefore, count towards the £2 million taper threshold if held at the time the investor dies. However, making such investments can provide a way for estate planning to start early, allowing investors to retain access to and control of their wealth while also reducing the expected tax bill should they die. At a later date, if access to significant wealth is no longer important, BR-qualifying investments can be gifted away.

If this reduces the estate’s value to below the £2 million threshold, the estate should qualify for the RNRB – leading to a potential incremental inheritance tax saving of up to £140,000 per couple.



The recipient needs to keep holding the BR-qualifying investment for seven years or until the death of the donor, whichever is sooner. If not, BR will be lost and inheritance tax will be payable in respect of the gift or settlement if the donor dies within seven years. Investors thinking of undertaking such lifetime planning should consider the impact of lifetime taxes such as capital gains tax and income tax.

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# Get in touch

We're here to help

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Our expert national Business Development team is here to help, and would be happy to discuss our Service and offers in more detail with you either by phone or by visiting your offices.

Please contact us on **020 7408 4070** or email us at **[businessdevelopment@pumainvestments.co.uk](mailto:businessdevelopment@pumainvestments.co.uk)**

For further information, please visit **[www.pumainvestments.co.uk](http://www.pumainvestments.co.uk)**

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