

Estate Planning Options



A concern for many of our clients is the level of Inheritance Tax which their loved ones may be required to pay upon their death.

Inheritance Tax is a levy of 40% of the value of the estate, in excess of any available Nil Rate Bands. The Nil Rate Bands available in the 2018/19 tax year are as follows:

- £325,000 Nil Rate Band per person
- £125,000 Main Residence Nil Rate Band per person, tapered by £1 per £2 that person's estate exceeds £2,000,000. This is increasing to £150,000 on 6 April 2019, and £175,000 on 6 April 2020. This is only available to use on your main residence (or proceeds from this) when this is left to your direct descendants.

Any assets passed to your spouse or civil partner are exempt from Inheritance Tax, and should they pre-decease you any unused Nil Rate Bands from them may be inherited. However, once your estate passes to any other loved ones, Inheritance Tax can apply.

There are a wide range of methods available to lower the impact of Inheritance Tax on your estate, ranging from the very simple to the significantly more complex.

Detailed below are a summary of these methods, the context in which they may be used and the considerations which will come in to play.

Gifting

There are a number of allowances and exemptions which apply to gifts for Inheritance Tax planning purposes. For all of these options it is important that you ensure you have the capital spare to make them and that you keep a record of these gifts to assist your Executors in managing your estate.

Small Gifts Exemption

Each tax year gifts of up to £250 may be given to as many people as you want, as long as no other exemptions below are used for that recipient.

Annual Gift Exemption

Each tax year you may gift up to £3,000, across any number of people. Any unutilised allowance from the previous tax year may be used in the current tax year, for a maximum gift of £6,000.

Wedding Gifts Exemption

Each tax year you may gift up to £1,000, to as many people as you want as a wedding or civil ceremony gift. The gift can be made to both parties, for a total of £2,000 to the happy couple.

If the person is your grandchild this increases to £2,500 and if they are your child it is £5,000.

Normal Gifts Out of Income

A regular payment to someone, whether it is on an annual, monthly, or even weekly basis, can be made without any Inheritance Tax implications, on the condition that they are from your income and that in making the payment your standard of living is maintained. The amount does not need to remain static, and could vary with the expenses being covered or income generated from an investment.

Popular examples include paying school fees for someone, making payments to an insurance policy, or simply making regular payments to your loved ones.

If you intend to use this allowance, you must ensure that these payments are made specifically out of income rather than capital and that your regular outgoings continue to be met. A record of your estimated income and outgoings each year will help your Executors to justify these regular payments to HMRC.

Gifts to Charities and Political Parties

There is no limit to how much and how often you may give in your lifetime to a charity without incurring Inheritance Tax, as long as they are a UK registered charity and subject to the jurisdiction of a UK court or the court of another EU member state.

Furthermore where 10% or more of an estate is left to charity, not only is the charitable bequest tax free, but the remainder of the estate will be subject to an Inheritance Tax liability of 36% instead of 40%.

It is very important if doing this to ensure that the charity you choose is registered, and under the correct jurisdiction, or the exemption will not apply.

There is also no limit to how much and how often you may give to a political party, on the condition that they have at least one Member of Parliament.

Potentially Exempt Transfers

When a gift or transfer of assets is made during your lifetime to an individual or 'specified trust' and is outside of the exemptions above it is known as a Potentially Exempt Transfer (PET).

A PET is assumed to be exempt from Inheritance Tax and it will only become chargeable (and therefore included with the rest of the estate) if the transferor dies within seven years of making the transfer. Once the seven years are complete it becomes an exempt transfer, with no liability to Inheritance Tax.

As a general rule, a 'specified trust' is where the beneficiary (or beneficiaries) has an absolute interest to the trust assets, such as a bare trust. It is very important to determine whether it is 'specified', as otherwise it will be a Chargeable Lifetime Transfer – described below.

When passing on larger amounts to your loved ones it is very important to seek advice, to ensure that this is the best method to achieve your objectives. If a particularly large PET is made it may be worth considering a fixed term insurance policy to cover the potential Inheritance Tax liability should you die within seven years. As with any gift, you must ensure you have the capital to spare and, as this is potentially chargeable to your estate, it is essential that you keep a record.

If the transferor dies between three and seven years of a gift, 'taper relief' may apply. This may reduce the Inheritance Tax due on the gift on a sliding scale (between 20% and 80%), depending on the length of time elapsed since the gift was made.

Chargeable Lifetime Transfers

When a gift or transfer of assets is made during your lifetime into a trust that does not fall under the PET exception it is known as a Chargeable Lifetime Transfer (CLT).

A CLT may potentially have an immediate Inheritance Tax liability, but it will depend upon the cumulative value of all previous CLTs made over the last seven years. If the total cumulative value is in excess of the Nil Rate Band, there will be an immediate Inheritance Tax charge of 20% on this excess.

If the transferor dies within seven years there may be an additional charge. The total amount due is calculated by adding every CLT in the seven years prior to the trust being settled and every failed PET within seven years of the death, and including this with the rest of the estate. This means that the Executors would require records of up to 14 years back from date of death to determine the Inheritance Tax due.

Despite the relative complexity, and the potential initial charge if you exceed the Nil Rate Band, CLTs can be extremely useful to flexibly pass on wealth to your loved ones, while retaining an element of control over how the funds are used. Obtaining advice is essential to ensure your objectives are met, and that the correct tax rules apply.

As with PETs, Taper Relief can also occur for CLTs, but it does not apply to any tax which is immediately chargeable, only for the calculation upon death.

Pension Contributions

Many pensions are deemed to be outside of the member's estate for Inheritance Tax purposes. If you are under age 75 you are able to make contributions to a pension of between £3,600 to £40,000 each tax year, depending on your earnings and income levels. In contributing to a qualifying pension scheme you would not only be reducing your estate for Inheritance Tax purposes, but gaining Income Tax relief at the same time of up to 45%, depending on your taxable income.

Calculating the allowances available to you can be complicated, and advice is crucial to ensure you do not exceed them or there may be tax penalties. Checking that your existing pensions are exempt from your estate is also important and something we are able to help you determine.

Business Property Relief

Business Property Relief (BPR) reduces the value of certain assets for Inheritance Tax assessment purposes. Depending on the type of asset it can attract either 50% or 100% Inheritance Tax relief.

You may get 50% Business Relief on the following:

- Shares controlling more than 50% of voting rights in a listed company; or
- Land, building, or machinery owned by you or held on trust for you, which is used in a business where you are partner in or you control.

You may get 100% Business Relief on the following:

- A business or interest in a business; or
- Shares in an unlisted company.

The relief will only apply if you have owned the business or asset for at least two years prior to death. You should seek advice from your accountant on your own business assets.

The benefits of Business Property Relief (BPR) assets are that they remain within your ownership and may potentially increase in value if invested properly. There are many products and investments available which we may advise you on, which include:

- Alternative Investment Market (AIM) investments
- Enterprise Investment Schemes (EISs)

Also subject to BPR are Seed Enterprise Investment Schemes (SEISs), and Unlisted shares.

These investments cover a vast spectrum of different sectors, from healthcare, to energy, to technology, and each have their own potential drawbacks and benefits. Similarly to pension contributions, there are also other tax incentives available for some of these investments, such as Income Tax relief and favourable treatment for Capital Gains Tax.

Products which qualify for BPR are often very volatile, and are much higher risk than many other asset classes. The potential risk, combined with the wide variety of products on the market, make it essential to seek advice. As part of our recommendations we will ensure that you have the capital to spare, the capacity to take this level of risk and that this is the most suitable option for your objectives.

Whole of Life Insurance

An alternative method to reducing the effect of Inheritance Tax on your estate is to set up a Whole of Life policy designed to pay into a trust upon your death, with the proceeds being used to meet the Inheritance Tax liability. This could be used in conjunction with any of the methods above to attack the problem from both sides; reducing the taxable estate and providing payment for the remainder.

There are many variations on what the terms of the policy may be, such as covering multiple lives or cover increasing with inflation, but what is essential that it is set up on trust, to ensure it is treated separately from your estate.

An assessment of the likely Inheritance Tax liability due to your estate is crucial to determine the correct level of cover. Premiums will vary greatly depending on the terms you choose, and by referring to your situation and objectives we can help you determine the best course of action. This also means that ongoing reviews of your situation are important to confirm the policy remains appropriate.

Conclusions

We are able to advise you on any of these areas as part of our holistic Wealth Management offering, as the suitable method for your circumstances may be a combination of these options.

If Inheritance Tax is a particular concern of yours, please do not hesitate to contact us, so we can determine the right course of action for you.

The information provided does not constitute financial advice. You should seek financial advice to determine whether the material in this document is suitable for you.

For more information please contact your Wealth Manager, or alternatively call us on 01223 720 208.