

FINANCIAL PLANNING

A GUIDE TO PLANNING

INHERITANCE TAX





Independent Financial Advisers - Financial Life Planners



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The Problem

Inheritance Tax ('IHT') remains the most contentious of taxes – both politically and morally. Where it is payable it often involves substantial sums. It is also beginning to bite harder as more families than ever before are getting caught in the IHT net.

People have very different views of IHT and its fairness and how actively it should be avoided. Most people, in our experience, have little appetite for having a large sum deducted from their estate in favour of the government, especially at a time when government finances are in such a dire straight. Why pay tax to a government which has shown little evidence of spending the money wisely?

However many people are also wary of leaving sizeable sums to beneficiaries, who have not earned the money themselves and who may be vulnerable to receiving large amounts of wealth in the future. This can be dealt with quite easily.

The extent and the amount of IHT payable across the UK is increasing.

The reason why there are more families being 'caught in the net' is largely down to a combination of the freezing of the IHT Nil Rate Band and the recent escalations in property and other asset values.

The IHT Nil Rate Band

The amount of wealth that may be passed down to beneficiaries is £325,000 per individual. For a couple this is doubled to £650,000. These amounts (£325,000 and £650,000) have been static since 2009 and it seems they will remain so for the foreseeable future (the current proposal is to maintain this frozen level until 2021).

Freezing allowances is one of the more pernicious ways for a government to increase the tax take.

If allowances had increased by, say, 2% per year for the past 8 years the approximate allowance would now be about £380,000 or £760,000 (for a couple). This may not look much of a difference but on an estate subject to IHT this has the potential to make the IHT payable as much as £44,000 more today than would otherwise be the case if allowances had increased.

Property and Asset values

The frozen allowance is just one side of the equation, rising wealth is the other side. A frozen allowance coupled with increasing asset prices is a potent combination. An estate worth £650,000 in 2009 could easily be worth £1 million today even at modest rates of asset growth. The UK stock market has risen around 70% between 2009 and 2018, property prices around 35% higher, with London prices in particular having risen much faster and further than this UK average.

Again this has a stealth effect on IHT payable. To see how this effect works, take a simplistic example of a couple that have a property valued at £600,000 in 2009 with other assets totalling £200,000. Their potential IHT liability at that time was £60,000.

Assume their property is now (2018) worth £850,000 and their other assets £350,000 – a total of £1.2 million. Their current potential IHT liability Post April 6th 2016 (even allowing for the new Residence Nil Rate Band – see below) is now £140,000 an increase of £80,000. Their wealth has increased by 50%, their IHT liability has more than doubled.

FROZEN ALLOWANCES
AND INCREASING ASSET
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The Residence Nil Rate Band

A new extended band was introduced on 6th April 2017 to make the position more palatable for some people and some estates. Known as the Residence Nil Rate Band, this is an additional £125,000 (for tax year 2018/2019) which is only allowable against residential property.

This means home owners in many cases will get an extended allowance taking the combined Nil Rate Band up to £450,000 in 2018/2019.

There are several things to note about this new Residence Nil Rate Band, including:

- This can be only used where residential properties (e.g. buy-to-let properties are excluded) are left to direct descendants (e.g. children)
- The allowance will become £175,000 by 2020/21 (£100,000 in 2017/18, £125,000 in 2018/19, £150,000 in 2019/20, £175,000 in 2020/21)
- The allowance is progressively withdrawn once a joint estate, with the inclusion of their main residence, is worth £2,000,000 or more. The withdrawal is at the rate of £1 for every £2 over the £2,000,000 limit.

It is very important to understand for a simple 'looking' extension to the rules, there are many complexities which make it far from simple.

However on balance the introduction of this new allowance will help in many cases alleviate some of the additional IHT liability that has been building across the UK in recent years.

Overall the IHT 'Problem' is Extending

Even allowing for the benefit of the new Residence Nil Rate Band, the two effects of a frozen allowance and increasing asset values, described above, combine to bring more and more people into the position where IHT is either a reality for the first time or is becoming more of a problem, because their liability is escalating and disproportionately.

The disproportionate effect is important. Take the following numbers as an example of how the tax bites ever harder on the scale of wealth:

Estate Value (£)	Tax Payable (£)	Tax as a % of Wealth (%)
900,000	0	0
1,000,000	40,000	4.0
1,350,000	180,000	13.33
2,000,000	440,000	22.0
3,000,000	940,000	31.33

The above assumes that the estate is for a couple who both have the maximum available allowances. Including the Residence Nil Rate Band allowances.

The IHT, both in pounds payable and percentage, continues to increase as the estate value increases.

For many individuals or families the 'problem' is exasperated by a feeling of being powerless to do anything about it. The impression is that to deal with the IHT there have to be some major sacrifices made in the lifetime of the individual whose estate will be taxed later down the line (if no action is taken). This is further complicated by the obvious point that most people don't know when they will die.

There is good anecdotal evidence to suggest (and this is backed up by our experience in this area) that if people knew when they were going to die they could plan their finances down to a tee (or a precise day) mixing their lifetime requirement (to have everything they need in their lifetime, i.e. in terms of income/expenditure) against their IHT reduction; but this doesn't happen because of this unknown (which in every other respect is a good thing).



In Summary

- IHT is a tax which is catching more and more people, families and estates
- The IHT amount hits ever harder as asset values increase above the thresholds
- It is a tax which most people want to avoid paying
- However in many cases people are wary of what they leave, to whom and when, and want control of this
- There is a feeling that this is too difficult a problem to solve in a lifetime
- And that the problem requires too much "lifetime" sacrifice

Gifting

Although it is often perceived that IHT planning involves the sacrifice of lifetime benefit (i.e. you have to give everything away to reduce your future estate value and estate IHT liability) this is exactly that: a perception.

Essentially for the majority of people there are a handful of approaches that can be taken towards a future IHT liability:

1. Ignore it – allowing the “what will be, will be” approach to win the day. If there is tax to pay later on so be it.
2. Spend enough money so that nothing is left; which may be more difficult said than done! (There are only so many holidays one can take and spending it on fast cars if they are expensive enough may actually increase the estate value!).
3. Wanting to do something but feeling like it is too tough a task or requires too much sacrifice or cost.
4. Wanting to do something and creating a structured plan and approach to tackle the ‘problem’.

There are many ways IHT can be reduced, offset or eradicated altogether and many of these ways do not have to involve a reduction in lifetime benefit.

However having made the statement above, the flip side is that there are many people who can reduce their estate by distributing their assets in their lifetime who can afford to do so.

It is a case of determining what can be done and how much any particular approach will cost (where the cost may be measured in other ways over and beyond a monetary cost).

The solutions available are likely therefore to represent different opportunities or attractions to different people, depending on their circumstances.

We present below a series of possible methods of tackling the IHT liability. In every case we present a top level explanation, which is not meant to act as anything other than an indication of what may be achievable – nothing here is intended to represent a detailed analysis, which can only come from an individual consultation and advice.

It is likely in any IHT planning situation that a combination of the individual solutions will be used to create an overall solution, therefore many of these areas can be combined together to achieve an effective plan of action to take care of the IHT liability.

IHT DOES NOT
HAVE TO INVOLVE
A REDUCTION IN
LIFETIME BENEFIT

The '7 Year Rule'

Naturally the most effective solution is to ensure that your estate value on death is equal to or less than the value of your Nil Rate Band, the allowance you have where no IHT is payable (£325,000 for an individual/£650,000 for a couple or £450,000/£900,000 if you can use the Residence Nil Rate Band).

In this respect distributing wealth prior to death is highly effective. If you have an estate value which is £200,000 more than the IHT allowance then gifting £200,000 is going to bring your estate below the IHT allowance and save your beneficiaries £80,000 in tax. If you can do this without affecting your lifetime position then this is a clear and easy step to take.

However this does have some drawbacks:

- Most notably that gifts are not always outside of your estate from day one. Yes some gifts are immediately effective (for example you can gift as much money as you like from your yearly income, providing it does not reduce your standard of living) but most larger gifts are not.
- You will also need to live 7 years for gifts to clear out of your estate; even then the type and the extent of the gift(s) you make are important because some gifts are known as Potentially Exempt Transfers (PETs) and some Chargeable Lifetime Transfers (CLTs).
- These can sometimes have tax charges in your lifetime – if they are above a certain size. Although it may seem simple to just gift your money away, it is not; you need to do so very carefully and with a clear structure if you are to achieve an IHT saving.
- In addition many people don't want to gift their money (assets/wealth) away because they do not know exactly how long they will live or how much money they may need in their lifetime; especially where there is a major concern around care costs.
- Most people will not need care in their lifetimes, but enough will to make it a serious threat and the costs of care are now so high, with an emphasis on individual payment of these costs (and there is no insurance available) that this threat often causes people to hoard their assets against this eventuality.
- Finally gifting obviously comes with some threat or concern over the beneficiary's position – "if I give Johnny £100,000 and he is bankrupted or divorced, might my wealth end up outside of my family or bloodline?" The answer is, yes it might. Gifting can therefore be an attractive IHT reducer but it may end up robbing Peter (the taxman) to pay Paul (an ex-spouse of a daughter for example).

Trusts

It is odd that many have a perception of trusts as complicated, costly and cumbersome; only for the rich. None of these are accurate descriptions of trusts.

There are many different types of trust with multiple ways of being used, so any short summary has to simply highlight the main points:

- Trusts are an excellent way to make gifts; rather than gifting money direct to beneficiaries assets can be gifted into trust, maintaining an element of control, flexibility and direction for the person(s) making the gift.
- They allow for money to be ring fenced from future taxes (including and most prevalently IHT) and possibly from being taken into account for future care fees assessments.
- They can be used to ensure that assets are kept within the family and/or the bloodline, protecting against bankruptcy or divorce of a beneficiary.
- They can help ensure assets are distributed quickly after death (see further comments at the end of this document).

Using Exemptions

There are various ways of gifting money without any recourse to a 7 year rule, these include gifts to charities, using the annual allowance of £3,000 (that every individual has to make gifts which are automatically exempt), gifts to children or grandchildren on marriage and, as described above, the rule that you can gift any amount you like 'out of normal income'.

Although these gifts can look peripheral and unlikely to make any significant difference in the big scheme of things, they can quickly add up. For parents who have two children who both marry within a 10 year period, it is possible the combined value of making regular gifts utilising the three exemptions mentioned above could be very close to £100,000, which could save £40,000 in IHT liability.

TRUSTS ALLOW MONEY
TO BE RINGFENCED
FROM FUTURE TAXES...

BPR

Another exemption can be achieved via Business Property Relief (BPR). BPR is available for qualifying investments and assets and includes a reasonable list of suitable holdings, for example shareholdings in smaller companies listed on the AIM stock market, shares in a privately owned business and holdings in agricultural. The relief is generally either 50% of the value of the holding or asset or 100% depending which category it falls into.

BPR locks in after the asset has been owned for 2 years and then the relief is absolute.

Where the relief is 100% this means that the whole value is taken out of the estate after that period. For example, an investment into BPR qualifying AIM shares will take the full value of that investment out of the estate after just 2 years. £100,000 placed in such investments reduce the IHT liability by £40,000 after 2 years.

Many people who have an IHT liability hold money in ISAs and in a lot of cases the value of these ISAs will be £100,000 +, the issue with ISAs is they have no IHT

exemption. The whole ISA value will be entered into the calculation for IHT purposes. The comparison here with a BPR qualifying investment portfolio is largely about risk because the tax advantages of such a portfolio are often comparable to ISA holdings and they offer IHT exemption. So it is only the fact they are perceived to be higher risk that most IHT affected investors would hold money in ISAs.

Unlike gifting assets away, the BPR schemes will typically keep the value available to the investor in their lifetime.

In reality the BPR portfolio can be constructed in such a way that the risk is not increased too much, if at all. We would encourage anyone looking for IHT planning ideas to take a serious look at the BPR possibilities.

This can be especially valuable to anyone looking to achieve a quick reduction in IHT, because of age or ill health or where all other avenues have been exhausted.

AND CAN KEEP
ASSETS WITHIN
THE FAMILY

Life Assurance Solutions

Amongst all possible options, the life assurance solution is the one that often receives the least attention, because it is often assumed that it is expensive or prohibitive.

Ironically this is not the case at all. For a couple in their 60s or even 70s, for example, the cost of a joint life second death policy is remarkably low (in relative terms).

The way this solution works is that the potential IHT liability is assessed (for example £200,000) and a policy put in place with a life assurance amount equal to the IHT liability. In this example the sum assured would be £200,000. It is written on a joint life second death basis with the life assurance amount under a trust. Normally this will be set up on a 'whole of life' basis meaning it will run until the death of the second person.

Then the £200,000 will be paid out (when the second person dies), under the trust, to the trustees. The trustees will then use this money to settle the IHT.

The premiums paid come out of the normal expenditure rule or via the £3,000 per year annual exemption each individual has, so the premiums are outside of the IHT loop.

This is a neat, tidy way of insuring the IHT exposure and may act as a simple way of keeping the full value of an estate within the family, suiting many people's circumstances.

One of the more subtle aspects of this arrangement – and this applies to all trust arrangements – is that their mechanisms keeps assets outside of the estate, not only for IHT purposes but also for the purposes of probate. This means that the assets within the trust (or paid into the trust on death) can be distributed with immediate effect, there is no need to wait for probate. This can be very beneficial to the family and those responsible for the affairs of the family. It can also help beneficiaries.

LIFE ASSURANCE
MECHANISMS KEEP
ASSETS OUTSIDE OF
THE ESTATE, FOR BOTH
IHT AND PROBATE

Summary

Inheritance Tax is most commonly payable by beneficiaries after death; although it is not strictly a death tax anymore (IHT can be payable in a lifetime in some circumstances) this is when it will apply for the majority of people. Death is inevitable, therefore for anyone who has assets above the IHT threshold – IHT is inevitable, unless action is taken. We hope the solutions presented show that with sensible approaches and action, IHT can be reduced or avoided without too much difficulty.

There are many possible ways of dealing with this liability, and avoiding it. Just about any circumstance or requirement can be met. What is important is that you seek advice on your options.

History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.



ALAN MORAN
Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

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The information contained in this guide is based on legislation as of the date of preparation and this may be subject to change.

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