ROTHESAY BENNETT

FINANCIAL PLANNING

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GUIDE TO

ESTATE PRESERVATION

What will your legacy look like?

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GUIDE TO

ESTATE PRESERVATION

What will your legacy look like?

WELCOME

Welcome to a *Guide to Estate Preservation*. This is an important part of wealth management, no matter how much wealth you have built up. It's the process of making a plan for how your assets will be distributed upon your death or incapacitation.

This subject doesn't only affect the very wealthy. Inheritance Tax, in particular, is becoming more of an issue for many of us due to rising house prices and complex family situations. Making provision for your loved ones is an essential part of managing your estate and assets.

When you have spent an entire lifetime building up your personal wealth, you'll want the comfort of knowing that upon your death your estate will pass into the hands of your chosen beneficiaries and not into the hands of the government.

If you do not plan properly, a significant portion of your wealth could be paid over to the government in Inheritance Tax. With professional financial advice and the correct estate preservation planning, we can help ensure that your loved ones are provided for after you die. Without a proper plan, your family could be left with nothing but debts and expenses.

Estate preservation planning gives you peace of mind knowing that your affairs are in order and that your loved ones will be taken care of after you are gone, especially important for those who have a significant amount of assets.

Unfortunately, some people leave this planning until it's too late. So the sooner you start, the more provisions you can put in place during the course of your lifetime. Planning can also help you to ensure that your assets go to the people that you want them to go to. If you do not have a plan in place, your assets may be distributed according to the laws of intestacy.

This could mean that your assets do not go to the people that you want them to go to. However, if you have the right plan in place, you can specify who you want your assets to go to. Have you considered what will happen to your estate when you're gone?

Wealth transfer has become an important issue for many families today. The fact is, many of us should be preparing for the eventual transfer of our assets, regardless of any tax or legal consequences. The process of estate preservation becomes more important as you age, though, because there is an increased risk of something happening to you as you get older.

Having said that, estate preservation is actually important at all ages of life. As soon as you start to begin to build your wealth, you need to make sure you have structured ownership correctly to reduce risk of loss. You also need to ensure you have the right insurance coverage and an incapacity plan in place in case something unexpected happens to you. ●

TIME TO DISCUSS HOW TO PLAN TO PROTECT AND PASS ON YOUR PERSONAL WEALTH?

The best way to reduce a potential Inheritance Tax bill for your loved ones is to start planning now. The sooner you put things in place, the easier it will be to put the right things in place for your family when you are gone. Everything we do starts with a full understanding of what matters to you. To find out more or arrange an appointment, please contact us – we look forward to hearing from you.

TRUSTS ARE A HIGHLY COMPLEX AREA OF FINANCIAL PLANNING.

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PROFESSIONAL FINANCIAL ADVICE SHOULD BE OBTAINED BEFORE TAKING ANY ACTION.

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PLANNING AND PRESERVING YOUR FAMILY'S WEALTH

Achieving the right balance of control, access, flexibility and tax advantages

> **YOU MAY WANT TO KEEP AN ELEMENT OF CONTROL WHEN PASSING ON YOUR ASSETS. YOU MAY WANT YOUR MONEY TO BE USED FOR A PARTICULAR REASON, SUCH AS PAYING FOR SCHOOL OR UNIVERSITY FEES OR FOR A FIRST PROPERTY DEPOSIT.**

Inheritance Tax is a tax on an estate (the property, money and possessions) of someone who's died. Intergenerational planning helps you put financial measures in place to benefit your children later in life, and even your future grandchildren, but it's important to start planning early.

You may want to keep an element of control when passing on your assets. You may want your money to be used for a particular reason, such as paying for school or university fees or for a first property deposit. Or you may just want to make sure your money stays within the family.

WHEN YOU PASS AWAY

Without appropriate provision, Inheritance Tax could become payable on your taxable estate that you leave behind when you pass away. It's important to remember your taxable estate is made up of all the assets that you owned, the share of any assets that are jointly owned, and the share of any assets that pass automatically by survivorship. Careful planning can reduce or even eliminate the Inheritance Tax payable.

WHO WOULD YOU LIKE TO HAVE YOUR ESTATE?

There are three parties you can allow to have access to your estate: your beneficiaries, a charity or the government. The choice is yours.

BENEFICIARIES

You have the ability to name your beneficiaries and financially help them replace lost income or wealth.

CHARITY

Have a cause that's near and dear to your heart? You can leave a charitable gift to your favourite non-profit organisation.

GOVERNMENT

If you do not have a plan in place, you potentially risk a large portion of your estate going to the government.

SOME KEY ESTATE PLANNING QUESTIONS TO CONSIDER

- How much can I afford to give away?
- What is the best timing and order for my gifts?
- Should I take out insurance?
- Is it worth setting up a trust?
- Could I afford long-term care?
- Do I need to downsize?
- Is my Will structured tax-efficiently?
- Are Inheritance Tax efficient investments right for me?

WEALTH TRANSFER – WHAT YOU NEED TO KNOW

Inheritance Tax is not payable on the first part of the value of your estate – the 'nil-rate band'. The current 2022/23 nil-rate band is £325,000. If the total value of your estate does not exceed the nil-rate band, no Inheritance Tax is payable. Outstanding debts and funeral expenses can be deducted from the value of your estate.

INTEREST IN THE FAMILY HOME

An additional 'residence nil-rate band' (RNRB) allowance was introduced in 2017 and is available if you leave your interest in the family home to direct descendants (such as children, step-children and/or grandchildren). This can apply to any individual property that has been your main residence at some time and can be available even if that home had been sold after 7 July 2015.

For the 2022/23 tax year, the maximum RNRB additional allowance is £175,000, potentially increasing your total Inheritance Tax allowance to £500,000 (£1,000,000 for a married couple).

There are legitimate ways to plan to reduce the amount of Inheritance Tax you may have to pay. We can advise you on the ways that you may mitigate any exposure, including these:

MAKE A WILL

Dying intestate, or dying without a Will, means that you may not be making the most of the Inheritance Tax exemption that exists if you wish your estate to pass to your spouse or registered civil partner. For example, if you don't make a Will, then relatives other than your spouse or

registered civil partner may be entitled to a share of your estate, and this might trigger an Inheritance Tax liability.

MAKE LIFETIME GIFTS

Non-exempt gifts made more than seven years before the donor dies are free of Inheritance Tax. Exempt gifts are immediately out of the donor's estate. So, it might be appropriate to pass on some of your wealth while you are still alive. This will reduce the value of your estate when it is assessed for Inheritance Tax purposes, and there is no limit on the sums you can pass on.

You can gift as much as you wish to other individuals or bare trusts with no immediate Inheritance Tax issue. This type of gift is known as a 'Potentially Exempt Transfer' (PET). If you live for seven years after making such a gift, then it will be exempt from Inheritance Tax, but should you be unfortunate enough to die within seven years, then it will still be counted as part of your estate.

However, if the PET is above your nil-rate band, the longer you survive after making the gift (subject to surviving over three years), the lower the Inheritance Tax charge on the recipient of the gift:

- If you survive between three to four years from the date of the gift, the Inheritance Tax charge on the gift is reduced by 20%.
- If you survive between four to five years from the date of the gift, the Inheritance Tax charge on the gift is reduced by 40%.
- If you survive between five to six years from the date of the gift, the Inheritance Tax charge on the gift is reduced by 60%.
- If you survive between six to seven years from the date of the gift, the Inheritance Tax charge on the gift is reduced by 80%.

You need to be careful if you are giving away your home to your children with conditions attached to it, or if you give it away but continue to benefit from it. This is known as a 'Gift with Reservation of Benefit' and isn't effective for Inheritance Tax purposes.

LEAVE A PROPORTION TO CHARITY

Being generous to your favourite charity can reduce your tax bill. As well as the gift itself being exempt from Inheritance Tax, if you leave at least 10% of your net estate to a charity or number of charities, then your Inheritance Tax liability on the taxable portion of the estate is reduced to 36% rather than 40%.

SET UP A TRUST

As part of your Inheritance Tax planning, you may want to consider putting assets in trust – either during your lifetime or under the terms of your Will. Putting assets in trust – rather than making a direct gift to a beneficiary – can be a more flexible way of achieving your objectives.

Family trusts can be useful as a way of reducing Inheritance Tax, making provision for your children and spouse, and potentially protecting family businesses. Trusts enable the donor to control who benefits (the beneficiaries) and under what circumstances, sometimes long after the donor's death.

Compare this with making a direct gift (for example, to a child), which offers no control to the donor once given. When you set up a trust, it is a legal arrangement and you will need to appoint 'trustees' who are responsible for holding and managing the assets. Trustees have a responsibility to manage the trust on behalf of and in the best interest of the beneficiaries, in accordance with the trust terms. The terms will be set out in a legal document called 'the trust deed'. ●

STRATEGIES AND SOLUTIONS

Provision in place to preserve and protect your assets

Failing to protect family wealth from Inheritance Tax could cost families thousands of pounds. However, there are various strategies and solutions to legally avoid paying this tax.

While some of us may want to spend it while we can, there will be others who want to pass on some of the wealth they've worked hard for. For these people, managing any Inheritance Tax liability is paramount, as is making sure the money they leave ends up with the right people at the right time.

PRESERVE AND PROTECT ASSETS

Whether you have earned your wealth, inherited it or made shrewd investments, you will want to ensure that as little of it as possible legally ends up in the hands of the taxman and that it can be enjoyed by you, your family and your intended beneficiaries.

If you pass away and don't have provision in place to preserve and protect your assets, then your family may end up spending a substantial amount of time and money battling over your wealth.

FUNDAMENTAL PART OF PLANNING

This process of dividing up your assets could become complicated. Estate planning gives you control over what happens to your assets when you pass away. It is a fundamental part of financial planning, no matter how much wealth you have accumulated.

Not only does an estate plan help to ensure that those who are important to you will be taken care of when you're no longer around, but it can also help ensure that assets are transferred in an orderly manner, and that Inheritance Tax liabilities are minimised.

DEVELOPING A CLEAR PLAN

The process involves developing a clear plan that details how you would like all of your wealth and property to be distributed after your death. It involves putting documentation in place to ensure that your assets are transferred in line with your wishes.

Your estate consists of everything you own. This includes savings, investments, pensions, property, life insurance (not written in an appropriate trust) and personal possessions. Debts and liabilities are subtracted from the total value of all assets.

WHAT TO CONSIDER WHEN DEVELOPING AN EFFECTIVE PLAN FOR THE FUTURE

WRITE A WILL

One of the most important components of an estate plan is a Will. First and foremost, a Will puts you in control. You choose who will benefit from your estate and what they are entitled to. You also decide who will administer your affairs after your death.

If you don't make a Will, the intestacy rules will decide who benefits from your estate – and that can produce undesirable results. The law also sets a hierarchy of who is able to handle your financial affairs after death, and that can lead to problems if the person is not suitable because of age, health, geographical location or for any other reason.

MAKE A LASTING POWER OF ATTORNEY

A Lasting Power of Attorney (LPA) can be made for Property and Financial Affairs, as well as Health and Welfare. These documents can be put in place at any time, and it is important to consider setting them up, no matter what age you are.

An LPA sets out your wishes as to who should assist you in relation to your property and financial affairs and your health and welfare. You can control who deals with these and set out any limitations and guidance.

PLAN FOR INHERITANCE TAX

Once the Will and the LPA are sorted, the next step is to think about Inheritance Tax planning. Whenever someone dies, the value of their estate may become liable for Inheritance Tax. If you are domiciled in the UK, your estate includes everything you own, including your home and certain trusts in which you may have an interest.

Inheritance Tax is potentially charged at a rate of 40% on the value of everything you own above the 'nil-rate band' (NRB) threshold. The nil-rate band is the value of your estate that is not chargeable to UK Inheritance Tax.

GIFT ASSETS WHILE YOU'RE ALIVE

The amount is set by the government and is currently £325,000, which is frozen until 2026. In addition, since 6 April 2017, if you leave your home to direct lineal descendants, the value of your estate before tax is paid will increase with the addition of the 'residence nil-rate band' (RNRB). For the 2022/23 tax year, the RNRB is £175,000.

One thing that's important to remember when developing an estate preservation plan is that the process isn't just about passing on your assets when you die. It's also about analysing your finances now and

potentially making the most of your assets while you are still alive. By gifting assets to younger generations while you're still around, you could enjoy seeing the assets put to good use, while simultaneously reducing your Inheritance Tax bill.

MAKE USE OF GIFT ALLOWANCES

A gift from one individual to another constitutes a Potentially Exempt Transfer (PET) for Inheritance Tax. If you survive for seven years from the date of the gift, no Inheritance Tax arises on the PET.

Each tax year, you can give away £3,000 worth of gifts (your 'annual exemption') tax-free. You can also give away wedding or registered civil partnership gifts up to £1,000 per person (£2,500 for a grandchild and £5,000 for a child). In addition, you can give your children regular sums of money from your income.

You can also give as many gifts of up to £250 to as many individuals as you want, although not to anyone who has already received a gift of your whole £3,000 annual exemption. None of these gifts are subject to Inheritance Tax.

INVEST INTO IHT-EXEMPT ASSETS

For experienced suitable investors, another way to potentially minimise Inheritance Tax liabilities is to invest in Inheritance Tax exempt assets. These schemes are higher risk and are therefore not suitable for all investors, and any investment decisions should always be made with the benefit of professional financial advice.

One example of this is the Enterprise Investment Scheme (EIS). The vast majority of EIS-qualifying investments attract 100% Inheritance Tax relief via Business Relief (BR) because the qualifying trades for EIS purposes are very similar to those which qualify for BR. Qualification for BR is subject to the minimum holding period of two years (from the later of the share issue date and trade commencement).

LIFE INSURANCE WITHIN A TRUST

Writing life insurance in an appropriate trust is one of the best ways to protect your family's future in the event of your death. Your life insurance policy is a significant asset – and by putting life insurance in trust, you can manage the way your beneficiaries receive their inheritance.

The proceeds from the policy can be paid directly to your beneficiaries rather than to your legal estate and will therefore not be taken into account when Inheritance Tax is calculated.

KEEP WEALTH WITHIN A PENSION

A defined contribution pension is normally free of Inheritance Tax, unlike many other investments. It is not part of your taxable estate. Keeping your pension wealth within your pension fund and passing it down to future generations can be very tax-efficient estate planning.

If you die before 75, your pension will be passed on tax-free. However, if you die after 75, your beneficiaries will pay tax on the proceeds at their highest income tax rate. Your pension will not be covered by your Will, so you will need to ensure that your pension provider knows who your nominated beneficiaries are.

PRESERVED WEALTH FOR FUTURE GENERATIONS

We all have one thing in common: we can't take our assets with us when we die. If you want to ensure that your wealth is preserved for future generations and passed on efficiently, an estate plan is crucial. ●

PASSING WEALTH TO THE NEXT GENERATION

Making a real difference to the financial position of the recipients

With careful planning it is possible to significantly reduce the need for your estate to pay Inheritance Tax. We spend a lifetime generating wealth and assets but not many of us ensure that it will be passed to the next generation – our children, grandchildren, nieces, nephews, and so on. Estate preservation planning is the transferring of wealth from one family generation to the next.

It's becoming increasingly important for more people to consider succession planning and intergenerational wealth transfer as part of their estate preservation planning. Increasingly as the baby boomer generation reaches retirement age, we're on the brink of a vast shift in assets, unlike any that we have seen before.

FAMILY GENERATION

The transferring of wealth from one family generation can be a huge issue for all family members concerned. If done well and executed properly, it will make a real difference to the financial position of the recipients. If misjudged or poorly handled, it could cause enormous issues, conflicts and resentments that are never forgotten nor forgiven.

One aspect that hasn't been widely considered is the impact on other family members, and in particular children, as their parents think about selling their business or retiring from their career, perhaps selling their family home, and starting life in retirement.

PREPARING CHILDREN

It is important that children are prepared to deal with this process, not least so they are aware of the financial implications and how they may be affected. For instance, children may be expecting to receive a certain amount of money from their parents – particularly those who are selling a business – and end up disappointed. Conversely, they may not be expecting to receive anything, and are therefore not equipped to deal with a windfall.

For those approaching, or in, retirement, it's important to have frank and open conversations with children about expectations and also whether children have the knowledge and understanding to manage financial matters.

FINANCIAL SITUATION

This is not an easy exercise, as you may not want to discuss your financial affairs with your children. You may find your children's eyes are opened when they see what their parents have been able to achieve financially. They may even want to know how they can do that themselves and change their own habits.

Everyone works hard to provide for their family, and perhaps even leave them a legacy. However, parents approaching retirement shouldn't feel that their family is solely reliant on them, or that they need to be responsible for their children's financial situation.

OPEN CONVERSATIONS

A good approach is to help your children establish their own strong financial footing and be ready for intergenerational wealth transfer. For instance, introducing them to your professional advisers can provide comfort that there is someone they can go to for advice.

Having open conversations with your children and expressing wishes and goals will also ensure that your family are all

“IT’S BECOMING INCREASINGLY IMPORTANT FOR MORE PEOPLE TO CONSIDER SUCCESSION PLANNING AND INTERGENERATIONAL WEALTH TRANSFER AS PART OF THEIR ESTATE PRESERVATION PLANNING.”

on the same page, which can help reduce potential conflict later when managing intergenerational wealth transfer.

These are some questions you should answer as part of your intergenerational wealth transfer plans:

- When did wealth enter my life and how do I think this timing influences my values and family relationships?
- What impact does affluence have on my life and the lives of my next generation?
- What was the key to my success in creating wealth and how might telling this story to my future generation be helpful?
- What is my biggest concern in raising my children or grandchildren with affluence?
- What conversations (if any) did I have with my parents about money and wealth growing up?
- How did my parents prepare me to receive wealth?
- What lessons did I learn from my parents about money and finance that I would like to pass on to my heirs?
- What family values would I like to pass down to the next generation and how do I plan on communicating this family legacy?
- What concerns do I have about my adult children when it comes to inheriting and managing the family wealth?
- How can I help prepare my beneficiaries to receive wealth and carry on our family legacy?

ADVANCED PREPARATIONS

Despite the vast amount of wealth likely to be passed down between generations, those in line for inheritance could end up being over-reliant on their expected windfall. The key will be to ensure younger generations are able to get involved and understand how to handle the wealth they will be inheriting, as well as being able to make good decisions about the wealth that they generate themselves.

You need to consider who will receive what and whether you want to pass your wealth during your lifetime or on death. These decisions then need to be balanced by the tax implications of any proposed planning. This is especially important at what can be a highly stressful time. By making advanced preparations, the burden of filing complicated Inheritance Tax returns can be reduced. ●

INHERITANCE TAX RESIDENCE NIL-RATE BAND

Owning a residence which you leave to direct descendants

The introduction of the 'residence nil-rate band' (RNRB) has made it easier for some individuals to pass on the family home. The rise in property prices throughout the UK means that even those with modest assets may exceed the £325,000 'nil-rate band' (NRB) for Inheritance Tax.

On 6 April 2017, the RNRB band came into effect. It provides an additional nil-rate band where an individual dies after 6 April 2017, owning a residence which they leave to direct descendants.

During the 2022/23 tax year, the maximum RNRB available is currently £175,000. Just like the standard NRB, any unused RNRB on the first death of a married couple or registered civil partners has the potential to be transferable even if the first death occurred before 6 April 2017. However, the RNRB does come with conditions and so may not be available or available in full to everyone.

TAXABLE ESTATE

The RNRB is set against the taxable value of the deceased's estate – not just the value of the property. Unlike the existing NRB, it doesn't apply to transfers made during an individual's lifetime. For married couples and registered civil partners, any unused RNRB can be claimed by the surviving spouse's or registered civil partner's personal representatives to provide a reduction against their taxable estate.

Where an estate is valued at more than £2 million, the RNRB will be progressively reduced by £1 for every £2 that the value of the estate exceeds the threshold. Special provisions apply where an individual has downsized to a lower value property or no longer owns a home when they die.

LIFETIME GIFTS

In determining whether the £2 million threshold is breached, it is necessary to ignore reliefs and exemptions. This means that business relief and agricultural relief are ignored when determining the value of the estate for the RNRB even though they are taken into account to calculate the liability to Inheritance Tax.

As the £2 million is based on the value of the assets owned at the time of death, it does not include any lifetime gifts made by the deceased, even if they were made within seven years of death and are included in the Inheritance Tax calculation. The amount of RNRB available to be set against an estate will be the lower of the value of the home, or share, that's inherited by direct descendants and the maximum RNRB available when the individual died.

DECEASED SPOUSE

Where the value of the property is lower than the maximum RNRB, the unused allowance can't be offset against other assets in the estate but can be transferred to a deceased spouse or registered civil partner's estate when they die, having left a residence to their direct descendants.

A surviving spouse or registered civil partner's personal representatives may claim any unused RNRB available from the estate of the first spouse or registered civil partner to die.

RESIDENTIAL INTEREST

This is subject to the second death occurring on or after 6 April 2017 and the survivor passing a residence they own to their direct descendants. This can be any home they've lived in – there's no requirement for them to have owned or inherited it from their late spouse or registered civil partner.

In order to pass on a qualifying residential interest and use the Inheritance Tax RNRB, the property needs to be 'closely inherited'. This means that the property must be passed to direct descendants.

SPECIAL GUARDIAN

For these purposes, direct descendants are lineal descendants of the deceased – children, grandchildren and any remoter descendants together with their spouses or registered civil partners, including their widow, widower or surviving registered civil partner. Also included are a step, adopted or fostered child of the deceased, or a child to which the deceased was

appointed as a guardian or a special guardian when the child was under 18.

Direct descendant doesn't include nephews, nieces, siblings and other relatives. If an individual, a married couple or registered civil partners do not have any direct descendants that qualify, they will be unable to use the RNRB.

DEEMED RESIDENCE

The facility to claim unused RNRB applies regardless of when the first death occurred – if this was before it was introduced, then 100% of a deemed RNRB of £175,000 can be claimed, unless the value of the first spouse or registered civil partner's estate exceeded £2 million, and tapering of the RNRB applies.

The unused RNRB is represented as a percentage of the maximum RNRB that was available on first death – meaning the amount available against the survivor's estate will benefit from subsequent increases in the RNRB.

DEED OF VARIATION

The transferable amount is capped at 100% – claims for unused RNRB from more than one spouse or registered civil partner are possible but in total can't be more than 100% of the maximum available amount.

Under the RNRB provisions, direct descendants inherit a home that's left to them which becomes part of their estate. This could be under the provisions of the deceased's Will, under the rules of intestacy or by some other legal means as a result of the person's death – for example, under a deed of variation.

MAIN RESIDENCE

The RNRB applies to a property that's included in the deceased's estate and one in which they have lived. It needn't be their main residence, and no minimum occupation period applies. If an individual has owned more than one home, their personal representatives can elect which one should qualify for RNRB.

The open market value of the property will be used less any liabilities secured against it, such as a mortgage. Where only a share of the home is left to direct descendants, the value and RNRB is apportioned.

COMPLEX AREA

A home may already be held in trust when an individual dies or it may be transferred into Trust upon their death. Whether the RNRB will be available in these circumstances will depend on the type of Trust, as this will determine whether the home is included in the deceased's estate, and also whether direct descendants are treated as inheriting the property.

This is a complex area, and HM Revenue & Customs provides only general guidance, with a recommendation that a solicitor or trust specialist should be consulted to discuss whether the RNRB applies.

DOWNSIZING ADDITION

Estates that don't qualify for the full amount of RNRB may be entitled to an additional amount of RNRB – a downsizing addition if the following conditions apply: the deceased disposed of a former home and either downsized to a less valuable home or ceased to own a home on or after 8 July 2015; the former home would have qualified for the RNRB if it had been held until death; and at least some of the estate is inherited by direct descendants.

The downsizing addition will generally represent the amount of 'lost' RNRB that could have applied if the individual had died when they owned the more valuable property. However, it won't apply where the value of the replacement home they own when they die is worth more than the maximum available RNRB. It's also limited by the value of other assets left to direct descendants.

PLANNING TECHNIQUES

Different planning techniques are available to address a potential Inheritance Tax liability, and these can be incorporated into the financial arrangements of any individual whose estate is likely to exceed the threshold. ●

> **INHERITANCE TAX EXEMPTIONS CAN BE ACHIEVED BY MEANS OF MAKING CERTAIN EXEMPT TRANSFERS, WHICH APPLY IN A NUMBER OF CASES INCLUDING WEDDING GIFTS, LIFE ASSURANCE PREMIUMS, GIFTS TO YOUR FAMILY AND CHARITABLE GIVING.**

LIFETIME TRANSFERS

Remember the seven-year rule

An outright gift falls into one of two categories, depending on the type of gift and to whom it's made. These categories are Potentially Exempt Transfers (PETs) and Chargeable Lifetime Transfers (CLTs).

Inheritance Tax exemptions can be achieved by means of making certain exempt transfers, which apply in a number of cases including wedding gifts, life assurance premiums, gifts to your family and charitable giving.

If appropriate, you can transfer some of your assets while you're alive – these are known as 'lifetime transfers'. Whilst we are all free to do this whenever we want, it is important to be aware of the potential implications of such gifts with regard to Inheritance Tax. The two main types are Potentially Exempt Transfers and Chargeable Lifetime Transfers.

EXEMPT TRANSFERS

Potentially Exempt Transfers are lifetime gifts made directly to other individuals, which includes gifts to Bare Trusts. A similar lifetime gift made to most other types of trust is a Chargeable Lifetime Transfer. These rules apply to non-exempt transfers: gifts to a spouse are exempt, so are not subject to Inheritance Tax.

Where a Potentially Exempt Transfer fails to satisfy the conditions to remain exempt – because the person who made the gift died within seven years – its value will form part of their estate. Survival for at least seven years, on the other hand, ensures full exemption from Inheritance Tax. Chargeable Lifetime Transfers are not conditionally exempt from Inheritance Tax. If it is covered by the 'nil-rate band' (NRB) and the transferor survives at least seven years, it will not attract a tax liability, but it could still impact on other chargeable transfers.

SEVEN YEARS

Chargeable Lifetime Transfers that exceed the available NRB when they are made result in a lifetime Inheritance Tax liability. Failure to survive for seven years results in the value of the Chargeable Lifetime Transfers being included in the estate. If the Chargeable Lifetime Transfers are subject to further Inheritance Tax on death, a credit is given for any lifetime Inheritance Tax paid.

Following a gift to an individual or a Bare Trust (a basic trust in which the beneficiary has the absolute right to the capital and assets within the trust, as well as the income generated from these assets), there are two potential outcomes: survival for seven years or more, and death before then. The former results in the potentially exempt transfer becoming fully exempt and no longer figuring in the Inheritance Tax assessment. In the other case, the amount transferred less any Inheritance Tax exemptions is 'notionally' returned to the estate.

TAX CONSEQUENCES

Anyone utilising potentially exempt transfers for tax migration purposes, therefore, should consider the consequences of failing to survive for seven years. Such an assessment will involve balancing the likelihood of surviving for seven years against the tax consequences of death within that period.

Failure to survive for the required seven-year period results in the full value of the potentially exempt transfers being notionally included within the estate; survival beyond then means nothing is included. It is taper relief which reduces the Inheritance Tax liability (not the value transferred) on the failed potentially exempt transfers after the full value has been returned to the estate.

EARLIER TRANSFERS

The value of the potentially exempt transfers is never tapered. The recipient of the failed potentially exempt transfers is liable for the Inheritance Tax due on the gift itself and benefits from any taper relief. The Inheritance Tax due on the potentially exempt transfers is deducted from the total Inheritance Tax bill, and the estate is liable for the balance.

Lifetime transfers are dealt with in chronological order upon death; earlier transfers are dealt with in priority to later ones, all of which are considered before the death estate. If a lifetime transfer is subject to Inheritance Tax because the NRB is not sufficient to cover it, the next step is to determine whether taper relief can reduce the tax bill for the recipient of the potentially exempt transfers.

SLIDING SCALE

The amount of Inheritance Tax payable is not static over the seven years prior to death. Rather, it is reduced according to a sliding scale dependant on the passage of time from the giving of the gift to the individual's death.

No relief is available if death is within three years of the lifetime transfer. For survival for between three and seven years, taper relief at the following rates is available.

TAPER RELIEF

The rate of Inheritance Tax gradually reduces over the seven-year period – this is called 'taper relief'. It works like this:

How long ago was the gift made?	How much is the tax reduced?
0-3 years	No reduction
3-4 years	20%
4-5 years	40%
5-6 years	60%
6-7 years	80%
7 years +	No tax to pay

It's important to remember that taper relief only applies to the amount of tax the recipient pays on the value of the gift above the NRB. The rest of your estate will be charged with the full rate of Inheritance Tax – usually 40%.

DONOR PAYS

The tax treatment of Chargeable Lifetime Transfers has some similarities to Potentially Exempt Transfers but with a number of differences. When a Chargeable Lifetime Transfer is made, it is assessed against the donor's NRB. If there is an excess above the NRB, it is taxed at 20% if the recipient pays the tax or 25% if the donor pays the tax.

The same seven-year rule that applies to Potentially Exempt Transfers then applies. Failure to survive to the end of this period results in Inheritance Tax becoming due on the Chargeable Lifetime Transfers, payable by the recipient. The tax rate is the usual 40% on amounts in excess of the NRB, but taper relief can reduce the tax bill, and credit is given for any lifetime tax paid.

GIFT OF CAPITAL

The seven-year rules that apply to Potentially Exempt Transfers and Chargeable Lifetime Transfers could increase the Inheritance Tax bill for those who fail to survive for long enough after making a gift of capital.

If Inheritance Tax is due in respect of a failed Potentially Exempt Transfer, it is payable by the recipient. If Inheritance Tax is due in respect of a Chargeable Lifetime Transfer on death, it is payable by the trustees. Any remaining Inheritance Tax is payable by the estate.

APPROPRIATE TRUST

The Inheritance Tax difference can be calculated and covered by a level or decreasing term assurance policy written in an appropriate Trust for the benefit of whoever will be affected by the Inheritance Tax liability and in order to keep the proceeds out of the settlor's Inheritance Tax estate. Which is more suitable and the level of cover required will depend on the circumstances. If the Potentially Exempt Transfers or Chargeable Lifetime Transfers are within the NRB, taper relief will not apply.

However, this does not mean that no cover is required. Death within seven years will result in the full value of the transfer being included in the estate, with the knock-on effect that other estate assets up to the value of the Potentially Exempt Transfers or Chargeable Lifetime Transfers could suffer tax that they would have avoided had the donor survived for seven years.

ESTATE LEGATEES

A seven-year level term policy could be the most appropriate type of policy in this situation. Any additional Inheritance Tax is payable by the estate, so a Trust for the benefit of the estate legatees will normally be required.

Where the Potentially Exempt Transfers or Chargeable Lifetime Transfers exceed the NRB, the tapered Inheritance Tax liability that will result from death after the Potentially Exempt Transfers or Chargeable Lifetime Transfers are made can be estimated.

'GIFT INTER VIVOS'

A special form of 'gift inter vivos' (a life assurance policy that provides a lump sum to cover the potential Inheritance Tax liability that could arise if the donor of a gift dies within seven years of making the gift) is put in place (written in an appropriate Trust) to cover the gradually declining tax liability that may fall on the recipient of the gift.

Trustees might want to use a life of another policy to cover a potential liability. Taper relief only applies to the tax: the full value of the gift is included within the estate, which in this situation will use up the NRB that becomes available to the rest of the estate after seven years.

WHOLE OF LIFE COVER

Therefore, the estate itself will also be liable to additional Inheritance Tax on death within seven years, and depending on the circumstances, a separate level term policy written in an appropriate trust for the estate legatees might also be required.

Where an Inheritance Tax liability continues after any Potentially Exempt Transfers or Chargeable Lifetime Transfers have dropped out of account, whole of life cover written in an appropriate Trust should also be considered. ●

PRIORITISING THE POWER OF PENSIONS

A very tax-efficient solution for passing on your wealth

Passing wealth through the family, for most, is an important part of their estate preservation planning process. Pension funds are typically free of Inheritance Tax provided the scheme trustees/administrator has discretion over the payment of death benefits

PASSING ON YOUR WEALTH

As well as supporting you through retirement, pensions can be a very tax-efficient way of passing on your wealth. You can even pass on your pension to help give a family member or dependent more money to retire with.

Money left in your pensions can be passed on to your dependents or family tax-efficiently, depending on the type of pension it is, you nominating who you wish to receive the money (your beneficiaries) — your Will won't do this for you; and your age when you die — before or after the age of 75.

PASSED ON IN CERTAIN CIRCUMSTANCES

Defined contribution or money purchase pension savings can be passed on in certain circumstances. These include savings you have made through a workplace defined contribution pension scheme and savings in individual plans such as Self-Invested Personal Pensions (SIPPs) or stakeholder pensions, making them very useful when it comes to Inheritance Tax.

If you die before age 75 and haven't accessed your pension, your beneficiaries have two years to claim your entire pot tax-free. If you're older than 75 when you die, your defined contribution pension won't be subject to Inheritance Tax; however, your beneficiaries will have to pay Income Tax at their usual rate.

TAX-FREE CASH ALLOWANCE

You need to remember any money you take out of your pension becomes part of your estate. This means it could be subject to Inheritance Tax. This includes any of your tax-free cash allowance which you might not have spent.

Some older-style pensions may be inside your estate. So it's important to check if Inheritance Tax might apply your savings.

HOW CAN YOU PASS YOUR PENSION POT THROUGH THE FAMILY WITHOUT INHERITANCE TAX?

- Consider setting up a defined contribution pension if you haven't already, as this will give your beneficiaries the most flexibility.
- Locate your old workplace pensions and weigh up the pros and cons of transferring them into one scheme. This can make things a lot easier for your beneficiaries to manage and will ensure they have access to all of your pension savings.
- Notify your pension provider of who your beneficiaries are and keep this information up to date.
- While it's not essential in order to pass along your pension, drawing up a Will can help remove any doubt when it comes to dividing your estate and respecting your wishes when you die.

PRIORITISE PENSION PLANS

The exemption of pensions from Inheritance Tax gives rise to several types of planning opportunities. Most obviously, if your non-pension assets (such as the cash in your Individual Savings Accounts) are likely to leave your heirs facing an Inheritance Tax bill, it may be appropriate to prioritise pension plans for your future savings.

You may even be able to move existing savings and investments into your pension plan to take them out of the Inheritance Tax net. ●

MAKING A WILL

Distributing financial wealth or possessions in an orderly fashion

> **IT'S IMPORTANT TO MAKE SURE THAT AFTER YOUR DEATH, YOUR ASSETS AND POSSESSIONS GO TO THE PEOPLE AND ORGANISATIONS YOU CHOOSE, SUCH AS FAMILY MEMBERS AND CHARITIES YOU WANT TO SUPPORT.**

A valid Will is an incredibly important part of estate preservation planning and will ensure that should the worst happen, your assets, whether they be financial wealth or possessions, are distributed in an orderly fashion to the right beneficiaries.

It's important to make sure that after your death, your assets and possessions go to the people and organisations you choose, such as family members and charities you want to support.

SENSITIVE SUBJECTS FOR HOUSEHOLDS

A Will is a very powerful document which will hopefully avoid legal wrangles and confusion over who will benefit from your estate. You can also leave a gift to charities of your choosing.

Wills, and Inheritance Tax planning more broadly, are sensitive subjects for households across the UK and are often thought of as slightly taboo topics. However, the global coronavirus (COVID-19) pandemic has focused minds and given us space to think.

MAKING CHANGES TO EXISTING WILLS

And it seems that it's prompted more people to take action, from making changes to existing Wills to encouraging them to think about writing one for the first time. But worryingly, new research[1] reveals over half of UK adults, 29.6 million people (56%) do not have a Will, including 36% of the over-55s.

The research also shows around one in ten people (8%) have written a Will for the first time since the initial pandemic lockdown in March 2020, and a further 14% have changed or update their existing Will in the last two years.

TYPES OF LASTING POWER OF ATTORNEY

A Lasting Power of Attorney (LPA) is a way of giving someone you trust, your attorney, the legal authority to make decisions on your behalf if you lose the mental capacity to do so in the future, or if you no longer want to make decisions for yourself.

HEALTH AND WELFARE LPAS

A Health and Welfare LPA allows you to appoint an Attorney to make decisions about matters such as:

- Your medical care
- Where you live
- Your daily routine, such as what you eat and what you wear
- Whom you have contact with
- Whether you have life-sustaining treatment – although only if you have given express permission

PROPERTY AND FINANCIAL AFFAIRS LPAS

A Property and Financial Affairs LPA gives your Attorney the power to do things such as:

- Buy and sell your property
- Pay your bills
- Collect your pension or benefits
- Manage your bank accounts

EMOTIONAL AND FINANCIAL PRESSURE

A Will can provide peace of mind that not only will the correct beneficiaries benefit from any estate distribution, but also that it is done as efficiently as possible. But only 13% of UK adults have written a living Will, which is used to provide advanced decisions on refusing medical treatments if you become terminally ill or lose the ability to make decisions around medical treatment yourself. A further 6% said they had made a living Will, now more commonly called an 'advance decision'.

While no one likes to think about their own mortality, getting your house in order by having the right legal instructions can take away much of the emotional and financial pressure at a very difficult time. Taking the first step is always the most difficult but puts you as the benefactor in the driving seat.

Especially important if you have children

A Will can help reduce the amount of Inheritance Tax that might be payable on the value of the property and money you leave behind. Writing a Will is especially important if you have children or other family who depend on you financially, or if you want to leave something to people outside your immediate family.

If you die without a valid Will, you will be dying intestate and your estate will pass to those entitled under the intestacy rules. Under the intestacy rules, your estate could pass to unintended beneficiaries and leave your loved ones in a very difficult situation at an already emotionally challenging time. ●

Source data:

[1] Source and methodology: a sample of 2,000 UK adults aged 18+, with fieldwork by Opinium between 4–8 March 2022. Results were weighted to nationally representative criteria.

LEAVING YOUR LEGACY BEHIND

Considerations when making a Will

Thinking about death isn't easy. Talking about it is even harder. The reality of our own mortality is a tough subject, but a discussion will ensure your assets are left to the right people.

If you want to be sure your wishes are met after you die, then it's important to have a Will. A Will is the only way to make sure your money and possessions that form your estate go to the people and causes you care about.

Unmarried partners, including same-sex couples who don't have a registered civil partnership, have no right to inherit if there is no Will. One of the main reasons also for drawing up a Will is to mitigate a potential Inheritance Tax liability.

STATUTORY RULES

Where a person dies without making a Will, the distribution of their estate becomes subject to the statutory rules of intestacy (where the person resides also determines how their property is distributed upon their death, which includes any bank accounts, securities, property and other assets they own at the time of death), which can lead to some unexpected and unfortunate consequences.

The beneficiaries of the deceased person that they want to benefit from their estate may be disinherited or left with a substantially smaller proportion of the estate than intended. Making a Will is the only way for an individual to indicate whom they want to benefit from their estate. Failure to take action could compromise the long-term financial security of the family.

IMPLICATIONS OF DYING WITHOUT MAKING A WILL

- Assets people expected to pass entirely to their spouse or registered civil partner may have to be shared with children.
- An unmarried partner doesn't automatically inherit anything and may need to go to court to claim for a share of the deceased's assets.
- A spouse or registered civil partner from whom a person is separated, but not divorced, still has rights to inherit from them.
- Friends, charities and other organisations the person may have wanted to support will not receive anything.
- If the deceased person has no close family, more distant relatives may inherit.
- If the deceased person has no surviving relatives at all, their property and possessions may go to the Crown.

LEGAL RESPONSIBILITY

Without a Will, relatives who inherit under the law will usually be expected to be the executors (someone named in a Will, or appointed by the court, who is given the legal responsibility to take care of a deceased person's remaining financial obligations) of your estate. They might not be the best people to perform this role. Making a Will lets the person decide the people who should take on this task.

Where a Will has been made, it's important to review it regularly to take account of changing circumstances. Unmarried partners have no right to inherit under the intestacy rules, nor do step-children who haven't been legally adopted by their step-parent. Given today's complicated and changing family arrangements, Wills are often the only means of ensuring legacies for children of earlier relationships.

SIMPLIFYING THE DISTRIBUTION OF ESTATES FOR A SURVIVING SPOUSE OR REGISTERED CIVIL PARTNER

Changes to the intestacy rules covering England and Wales, which became effective on 1 October 2014, were aimed at simplifying the distribution of an estate and could mean a surviving spouse or registered civil partner receives a larger inheritance than under the previous rules.

Making a Will is also the cornerstone for Inheritance Tax and estate preservation planning.

Before making a Will, a person needs to consider:

- Who will carry out the instructions in the Will (the executor/s)
- Nominating guardians to look after children if the person dies before they are aged 18

- Making sure people the person cares about are provided for
- What gifts are to be left for family and friends, and deciding how much they should receive
- What provision should be taken to minimise any Inheritance Tax that might be due on the person's death

> **IF YOU WANT TO BE SURE YOUR WISHES ARE MET AFTER YOU DIE, THEN IT'S IMPORTANT TO HAVE A WILL.**

PREPARING A WILL

Before preparing a Will, a person needs to think about what possessions they are likely to have when they die, including properties, money, investments and even animals. Prior to an estate being distributed among beneficiaries, all debts and the funeral expenses must be paid. When a person has a joint bank account, the money passes automatically to the other account holder, and they can't leave it to someone else.

Estate assets may include:

- A home and any other properties owned
- Savings in bank and building society accounts
- Insurance, such as life assurance or an endowment policy
- Pension funds that include a lump sum payment on death
- National Savings, such as Premium Bonds
- Investments, such as stocks and shares, investment trusts, Individual Savings Accounts
- Motor vehicles
- Jewellery, antiques and other personal belongings
- Furniture and household contents

Liabilities may include:

- Mortgage(s)
- Credit card balance(s)
- Bank overdraft(s)
- Loan(s)
- Equity release

JOINTLY OWNED PROPERTY AND POSSESSIONS

Arranging to own property and other assets jointly can be a way of protecting a person's spouse or registered civil partner. For example, if someone has a joint bank account, their partner will continue to have access to the money they need for day-to-day living without having to wait for their affairs to be sorted out.

There are two ways that a person can own something jointly with someone else:

AS TENANTS IN COMMON (CALLED 'COMMON OWNERS' IN SCOTLAND)

Each person has their own distinct share of the asset, which do not have to be equal. They can say in their Will who will inherit their share.

AS JOINT TENANTS (CALLED 'JOINT OWNERS' IN SCOTLAND)

Individuals jointly own the asset so, if they die, the remaining owner(s) automatically inherits their share. A person cannot use their Will to leave their share to someone else.

PARTIAL INTESTACY

This can sometimes happen even when there is a Will, for example, when the Will is not valid, or when it is valid but the beneficiaries die before the testator (the person making the Will). Intestacy can also arise when there is a valid Will but some of the testator's (person who has made a Will or given a legacy) assets were not disposed of by the Will. This is called a 'partial intestacy'.

Intestacy therefore arises in all cases where a deceased person has failed to dispose of some or all of his or her assets by Will, hence the need to review a Will when events change. ●

TRUSTS

'Ring-fencing' assets to protect family wealth for future generations

You may want to consider putting some of your assets into a trust for a loved one. Trusts are a way of managing wealth, money, investments, land or property, for you, your family or anyone else you'd like to benefit.

They are used to protect family wealth for future generations, reducing the inter-generational flow of Inheritance Tax and ensuring bloodline protection for your estate from outside claims.

The way in which assets held within trusts are treated for Inheritance Tax purposes depends on whether the choice of beneficiaries is fixed or discretionary.

There are lots of different types of trust and some will allow you to 'ring-fence' the money or property so that it sits outside of your estate when you die.

The most popular types of trust commonly used for Inheritance Tax planning can usually be written on either an 'absolute' or a 'discretionary' basis and the taxation treatment is very different for each.

A trust is a fiduciary arrangement that allows a third party, or trustee, to hold assets on behalf of a beneficiary or beneficiaries. Once the trust has been created, a person can use it to ring-fence assets.

Trusts terms:

- **Settlor** – the person setting up the trust.
- **Trustees** – the people tasked with looking after the trust and paying out its assets.
- **Beneficiaries** – the people who benefit from the assets held in trust.

Trusts are a complicated area and can be expensive to set up. Some are subject to other tax regimes, so you should get authorised and regulated specialist advice. ●

EXTENDING THE SCOPE OF THE TRUST REGISTER

Deadline for non-taxable trust registrations announced

When you put assets in a trust, they are under the control of an appointed person or persons called 'trustees'. The trustees then manage the trust according to your instructions, even after your death.

New rules were introduced on 6 October 2020, as part of the UK's implementation of the Fifth Money Laundering Directive (5MLD), that extend the scope of the Trust Register to all UK and some non-UK trusts that are currently open, whether or not the trust has to pay any tax, but with some specific exclusions.

PREVENTATIVE WORK IN THE FIELD OF ANTI-MONEY LAUNDERING

From 1 September 2021, the extended Trust Registration Service (TRS) opened for non-taxable trust registrations, with non-taxable trusts having until 1 September 2022 to register. Under the new rules, organisations and persons involved in preventative work in the field of anti-money laundering, counter-terrorist financing and associated offences can request access to details on the register about the people associated with a trust.

The information will only be released on request in certain limited circumstances and anyone with a legitimate interest will be able to view information on the TRS from late 2022. HMRC has stated that 'each request will be reviewed on its own merits, and access given only where there is evidence that it furthers work to counter money laundering or terrorist financing activity.'

There are also safeguarding measures to protect trusts with minors and vulnerable beneficiaries from requests for information from third parties.

TRUSTS THAT NEED TO BE REGISTERED

Trusts that need to be registered are broadly all UK express trusts, unless they are specifically excluded; and non-UK express trusts that acquire land or property in the UK, or have at least one trustee resident in the UK and enter into a 'business relationship' within the UK. If the trust needs a Unique Taxpayer Reference (UTR) for Self Assessment purposes, it must still register to get this, even if it's highlighted in the exclusion list.

TRUSTS THAT DO NOT NEED TO BE REGISTERED

Certain trusts do not need to register unless they are liable to pay UK tax.

These include:

- trusts used to hold money or assets of a UK-registered pension scheme, such as an occupational pension scheme
- trusts used to hold life or retirement policies providing that the policy only pays out on death, terminal or critical illness or permanent disablement, or to meet the healthcare costs of the person assured
- trusts holding insurance policy benefits received after the death of the person assured, providing the benefits are paid out from the trust within two years of the death
- charitable trusts which are registered as a charity in the UK or which are not required to register as a charity
- 'pilot' trusts which were set up before 6 October 2020 and which hold no more than £100 – pilot trusts set up after 6 October 2020 will need to register
- co-ownership trusts set up to hold shares of property or other assets which are jointly owned by two or more people for themselves as 'tenants in common'
- Will trusts which are created by a person's Will and come into effect on their death providing they only hold the estate assets for up to two years after the person's death
- trusts for bereaved children under 18 or adults aged 18 to 25 set up under the Will (or intestacy) of a deceased parent or the Criminal Injuries Compensation Scheme
- 'financial' or 'commercial' trusts created in the course of professional services or business transactions for holding client money or other assets

EXCLUDED FROM REGISTRATION

Other less common types of express trusts

which are set up for particular purposes are also excluded from registration unless they have to be registered because they are liable to pay tax. These are set out in the legislation and will be described in the detailed guidance.

Trusts which are not set up deliberately by a settlor but are imposed by Courts or created by legislation are not 'express trusts' and therefore do not have to register unless they are liable to tax.

Examples of such trusts include a trust:

- set up under the intestacy laws when a person dies without a valid Will and the assets in the estate are held by a trust before passing to relatives
- set up under a Court Order to hold compensation payments
- to hold jointly owned assets, such as a home jointly owned with a spouse, partner or relation as 'joint tenants', or a joint bank account

TAXABLE AND NON-TAXABLE TRUSTS

You should obtain professional advice if you are unsure whether a product or arrangement is a trust or if it should be registered. The trustees or agents will have to give some basic information about the persons involved in the trust (the settlors and beneficiaries). This will apply to both taxable and non-taxable trusts.

Registerable taxable trusts are required to register by 31 January following the end of the tax year in which the trust had a liability to UK taxation, or 5 October after the end of the tax year for a first-time liability to Income Tax or Capital Gains Tax.

FURTHER GUIDANCE AND CONFIRMATION

From 2022 onwards, any beneficial ownership information of a trust registered on TRS must be kept updated. Trustees must notify HMRC of any changes to registered information within 90 days from the date the trustees become aware of the change; further guidance and confirmation of procedures is expected from HMRC in due course. ●

> **WITH A BARE TRUST, THERE ARE NO ONGOING INHERITANCE TAX REPORTING REQUIREMENTS AND NO FURTHER INHERITANCE TAX IMPLICATIONS.**

BARE TRUST

Held for the benefit of a specified beneficiary

Bare Trusts are also known as 'Absolute' or 'Fixed Interest Trusts', and there can be subtle differences. The settlor – the person creating the trust – makes a gift into the trust, which is held for the benefit of a specified beneficiary. If the trust is for more than one beneficiary, each person's share of the trust fund must be specified.

For lump sum investments, after allowing for any available annual exemptions, the balance of the gift is a Potentially Exempt Transfer for Inheritance Tax purposes. As long as the settlor survives for seven years from the date of the gift, it falls outside their estate.

The trust fund falls into the beneficiary's Inheritance Tax estate from the date of the initial gift. With Loan Trusts, there isn't any initial gift – the trust is created with a loan instead. And with Discounted Gift plans, as long as the settlor is fully underwritten at the outset, the value of the initial gift is reduced by the value of the settlor's retained rights.

INCOME EXEMPTION

When family protection policies are set up in Bare Trusts, regular premiums are usually exempt transfers for Inheritance Tax purposes. The normal expenditure out of income exemption often applies, as long as the cost of the premiums can be covered out of the settlor's excess income in the same tax year, without affecting their normal standard of living.

Where this isn't possible, the annual exemption often covers some or all of the premiums. Any premiums that are non-exempt transfers into the trust are Potentially Exempt Transfers. Special valuation rules apply when existing life policies are assigned into family Trusts. The transfer of value for Inheritance Tax purposes is treated as the greater of the open market value and the value of the premiums paid up to the date the policy is transferred into trust.

PARENTAL SETTLEMENT

There's an adjustment to the premiums paid calculation for unit-linked policies if the unit value has fallen since the premium was paid. The open market value is always used for term assurance policies that pay out only on death, even if the value of the premiums paid is greater.

With a Bare Trust, there are no ongoing Inheritance Tax reporting requirements and no further Inheritance Tax implications. With protection policies, this applies whether or not the policy can acquire a surrender value.

Where the Trust holds a lump sum investment, the tax on any income and gains usually falls on the beneficiaries. The most common exception is where a parent has made a gift into trust for their minor child or stepchild, where parental settlement rules apply to the Income Tax treatment.

TRUST ADMINISTRATION

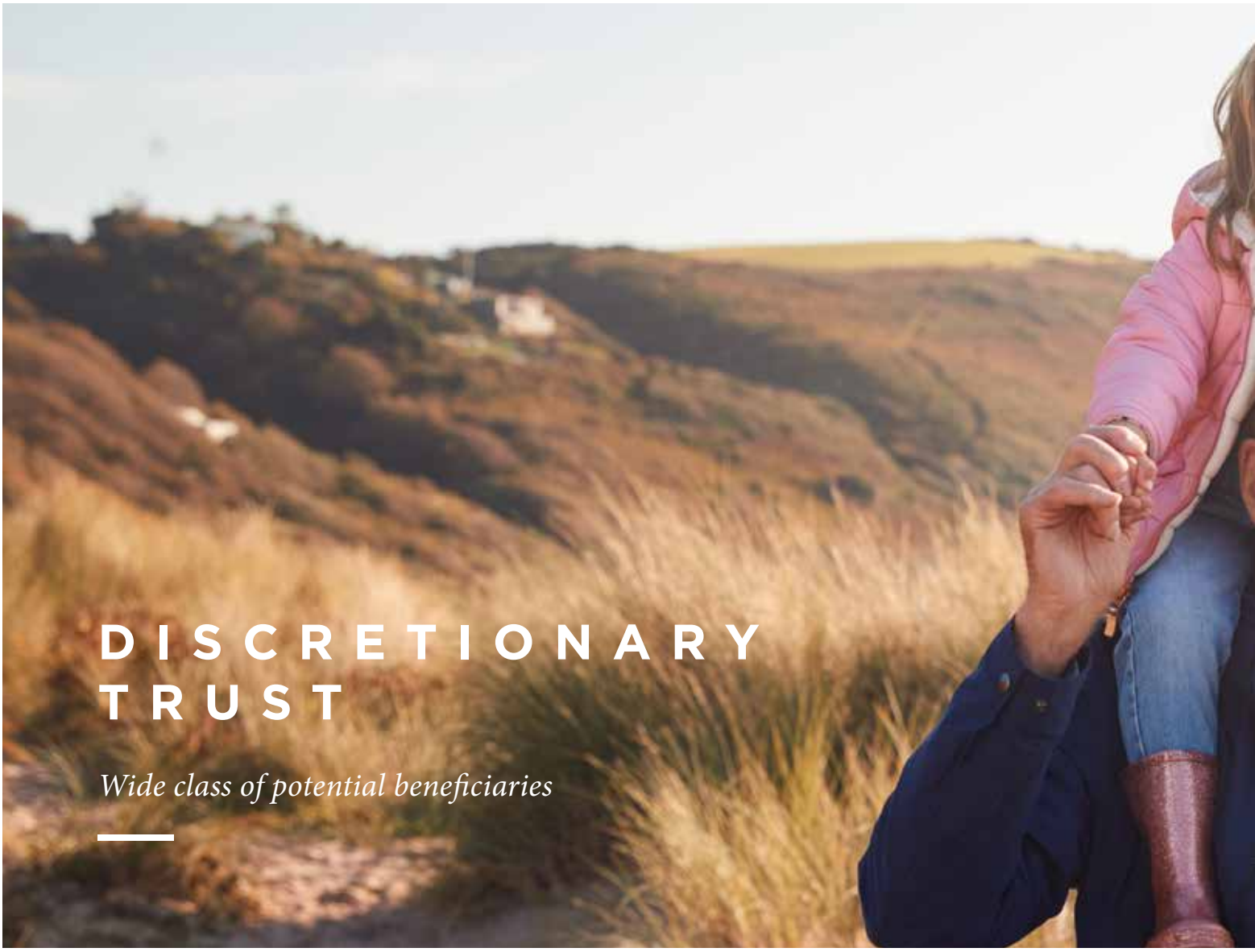
Therefore, the trust administration is relatively straightforward, even for lump sum investments. Where relevant, the trustees simply need to choose appropriate investments and review these regularly.

With a Bare Trust, the trustees look after the trust property for the known beneficiaries, who become absolutely entitled to it at age 18 (age 16 in Scotland). Once a gift is made or a Protection Trust set up, the beneficiaries can't be changed, and money can't be withheld from them beyond the age of entitlement. This aspect may make them inappropriate to many clients who'd prefer to retain a greater degree of control.

TRUST FUND

With a Loan Trust, this means repaying any outstanding loan. With a Discounted Gift Trust, it means securing the settlor's right to receive their fixed payments for the rest of their life. With protection policies in Bare Trusts, any policy proceeds that haven't been carved out for the life assured's benefit under a Split Trust must be paid to the trust beneficiary if they're an adult. Where the beneficiary is a minor, the trustees must use the trust fund for their benefit.

Difficulties can arise if it's discovered that a trust beneficiary has predeceased the life assured. In this case, the proceeds belong to the legatees of the deceased beneficiary's estate, which can leave the trustees with the task of tracing them. The fact that beneficiaries are absolutely entitled to the funds also means the trust offers no protection of the funds from third parties, for example, in the event of a beneficiary's divorce or bankruptcy. ●



DISCRETIONARY TRUST

Wide class of potential beneficiaries

With a Discretionary Trust, the settlor makes a gift into trust, and the trustees hold the trust fund for a wide class of potential beneficiaries. This is known as 'settled' or 'relevant' property. For lump sum investments, the initial gift is a chargeable lifetime transfer for Inheritance Tax purposes.

It's possible to use any available annual exemptions. If the total non-exempt amount gifted is greater than the settlor's available 'nil-rate band' (NRB), there's an immediate Inheritance Tax charge at the 20% lifetime rate – or effectively 25% if the settlor pays the tax.

OTHER PLANNING

The settlor's available NRB is essentially the current NRB less any chargeable lifetime transfers they've made in the previous seven years. So in many cases where no other planning is in place, this will simply be the current NRB, which is £325,000 up to 2022/23. The 'residence nil-rate band' (RNRB) isn't available to trusts or any lifetime gifting.

Again, there's no initial gift when setting up a Loan Trust, and the initial gift is usually discounted when setting up a Discounted Gift plan. Where a cash gift exceeds the available NRB, or an asset is gifted which exceeds 80% of the NRB, the gift must be reported to HM Revenue & Customs (HMRC) on an IHT 100.

FAMILY PROTECTION

When family protection policies are set up in Discretionary Trusts, regular premiums are usually exempt transfers for Inheritance Tax purposes. Any premiums that are non-exempt transfers into the trust will be chargeable lifetime transfers. Special valuation rules for existing policies assigned into trust apply.

As well as the potential for an immediate Inheritance Tax charge on the creation of the trust, there are two other points at which Inheritance Tax charges will apply. These are known as 'periodic charges' and 'exit charges'. Periodic charges apply at every ten-yearly anniversary of the creation of the trust.

INVESTMENT BOND

Exit charges may apply when funds leave the trust. The calculations can be complex but are a maximum of 6% of the value of the trust fund. In many cases, they'll be considerably less than this – in simple terms, the 6% is applied on the value in excess of the trust's available NRB.

However, even where there is little or, in some circumstances, no tax to pay, the trustees still need to submit an IHT 100 to HMRC. Under current legislation, HMRC will do any calculations required on request. For a Gift Trust holding an investment bond, the value of the trust fund will be the open market value of the policy – normally its surrender value.

RETAINED RIGHTS

For a Loan Trust, the value of the trust fund is the bond value less the amount of any outstanding loan still repayable on demand to the settlor. Retained rights can be recalculated as if the settlor was ten years older

For Discounted Gift schemes, the value of the trust fund normally excludes the value of the settlor's retained rights – and in most cases, HMRC are willing to accept pragmatic valuations. For example, where the settlor was fully underwritten

at the outset, and is not terminally ill at a ten-yearly anniversary, any initial discount taking account of the value of the settlor's retained rights can be recalculated as if the settlor was ten years older than at the outset.

> **WITH A DISCRETIONARY TRUST, THE SETTLOR MAKES A GIFT INTO TRUST, AND THE TRUSTEES HOLD THE TRUST FUND FOR A WIDE CLASS OF POTENTIAL BENEFICIARIES.**

OPEN MARKET

If a protection policy with no surrender value is held in a Discretionary Trust, there will usually be no periodic charges at each ten-yearly anniversary. However, a charge could apply if a claim has been paid out and the funds are still in the trust.

In addition, if a life assured is in severe ill health around a ten-yearly anniversary, the policy could have an open market value close to the claim value. If so, this has to be taken into account when calculating any periodic charge.

CHARGEABLE EVENT

Where Discretionary Trusts hold investments, the tax on income and gains can also be complex, particularly where income-producing assets are used. Where appropriate, some of these complications could be avoided by an individual investing in life assurance investment bonds, as these are non-income-producing assets and allow trustees to control the tax points on any chargeable event gains.

Bare Trusts give the trustees discretion over who benefits and when. The trust deed will set out all the potential beneficiaries, and these usually include a wide range of family members, plus any other individuals the settlor has chosen. This gives the trustees a high degree of control over the funds. The settlor is often also a trustee to help ensure their wishes are considered during their lifetime.

TRUST PROVISIONS

In addition, the settlor can provide the trustees with a letter of wishes identifying who they'd like to benefit and when. The letter isn't legally binding but can give the trustees clear guidance, which can be amended if circumstances change. The settlor might also be able to appoint a protector, whose powers depend on the trust provisions, but usually include some degree of veto.

Family disputes are not uncommon, and many feel they'd prefer to pass funds down the generations when the beneficiaries are slightly older than age 18. A Discretionary Trust also provides greater protection from third parties, for example, in the event of a potential beneficiary's divorce or bankruptcy, although in recent years this has come under greater challenge. ●

FLEXIBLE TRUSTS WITH DEFAULT BENEFICIARIES

Default beneficiaries set up in the settlor's lifetime

Flexible Trusts are similar to a fully Discretionary Trust, except that alongside a wide class of potential beneficiaries, there must be at least one named default beneficiary. Flexible Trusts with default beneficiaries set up in the settlor's lifetime from 22 March 2006 onwards are treated in exactly the same way as Discretionary Trusts for Inheritance Tax purposes.

Different Inheritance Tax rules apply to older trusts set up by 21 March 2006 that meet specified criteria and some Will trusts. All post-21 March 2006 lifetime trusts of this type are taxed in the same way as fully Discretionary Trusts for Inheritance Tax and Capital Gains Tax purposes.

DEFAULT BENEFICIARY

For Income Tax purposes, any income is payable to and taxable on the default beneficiary. However, this doesn't apply to even regular withdrawals from investment bonds, which are non-income-producing assets. Bond withdrawals are capital payments, even though chargeable event gains are subject to Income Tax. As with Bare Trusts, the parental settlement rules apply if parents make gifts into trust for their minor children or stepchildren.

SIGNIFICANT DIFFERENCES

When it comes to beneficiaries and control, there are no significant differences between fully Discretionary Trusts and this type of trust. There will be a wide range of potential beneficiaries. In addition, there will be one or more named default beneficiaries.

Naming a default beneficiary is no more binding on the trustees than providing a letter of wishes setting out whom the settlor would like to benefit from the trust fund. The trustees still have discretion over which of the default and potential beneficiaries actually benefits and when. Some older Flexible Trusts limit the trustees' discretionary powers to within two years of the settlor's death, but this is no longer a common feature of this type of trust. ●

“FLEXIBLE TRUSTS ARE SIMILAR TO A FULLY DISCRETIONARY TRUST, EXCEPT THAT ALONGSIDE A WIDE CLASS OF POTENTIAL BENEFICIARIES, THERE MUST BE AT LEAST ONE NAMED DEFAULT BENEFICIARY.”

SPLIT TRUSTS

Family protection policies

These trusts are often used for family protection policies with critical illness or terminal illness benefits in addition to life cover. Split Trusts can be Bare Trusts, Discretionary Trusts or Flexible Trusts with default beneficiaries. When using this type of trust, the settlor/life assured carves out the right to receive any critical illness or terminal illness benefit from the outset, so there aren't any 'gift with reservation' issues.

In the event of a claim, the provider normally pays any policy benefits to the trustees, who must then pay any carved-out entitlements to the life assured and use any other proceeds to benefit the trust beneficiaries.

TRADE-OFF

If terminal illness benefit is carved out, this could result in the payment ending up back in the life assured's Inheritance Tax estate before their death. A carved-out terminal illness benefit is treated as falling into their Inheritance Tax estate once they meet the conditions for payment.

Essentially, these types of trust offer a trade-off between simplicity and the degree of control available to the settlor and their chosen trustees. For most, control is the more significant aspect, especially where any lump sum gifts can stay within a settlor's available Inheritance Tax NRB.

MAXIMUM CONTROL

Keeping gifts within the NRB and using non-income-producing assets such as investment bonds can allow a settlor to create a trust with maximum control, no initial Inheritance Tax charge and limited ongoing administrative or tax burdens.

In other cases, for example, grandparents funding for school fees, the Bare Trust may offer advantages. This is because tax will fall on the grandchildren, and most of the funds may be used up by the age of 18. The considerations are slightly different when considering family protection policies, where the settlor will often be dead when policy proceeds are paid out to beneficiaries.

POLICY PROCEEDS

A Bare Trust ensures the policy proceeds will be payable to one or more individuals, with no uncertainty about whether the trustees will follow the deceased's wishes. However, this can also mean that the only solution to a change in circumstances, such as divorce from the intended beneficiary, is to start again with a new policy.

Settlors are often excluded from benefiting under Discretionary and Flexible Trusts. Where this applies, this type of trust isn't suitable for use with joint life, first death protection policies if the primary purpose is for the proceeds to go to the survivor. ●

LASTING POWER OF ATTORNEY

Allowing someone to make decisions for you, or act on your behalf

A Lasting Power of Attorney (LPA) enables individuals to take control of decisions that affect them, even in the event that they can't make those decisions for themselves. Without an LPA, loved ones could be forced to endure a costly and lengthy process to obtain authority to act for an individual who has lost mental capacity.

An individual can create a LPA covering their property and financial affairs and/or a separate LPA for their health and welfare. It's possible to appoint the same or different attorneys in respect of each LPA, and both versions contain safeguards against possible misuse.

OWN FINANCIAL AFFAIRS

It's not hard to imagine the difficulties that could arise where an individual loses the capacity to manage their own financial affairs and, without access to their bank account, pension and investments, family and friends could face an additional burden at an already stressful time. LPA and their equivalents in Scotland and Northern Ireland should be a consideration in all financial planning discussions and should be a key part of any protection insurance planning exercise. Planning for mental or physical incapacity should sit alongside any planning for ill health or unexpected death.

LOSING MENTAL CAPACITY

Commencing from 1 October 2007, it is no longer possible to establish a new Enduring Power of Attorney (EPA) in England and Wales, but those already in existence remain valid. The attorney would have been given authority to act in respect of the donor's property and financial affairs as soon as the EPA was created.

At the point the attorney believes the donor is losing their mental capacity, they would apply to the Office of the Public Guardian (OPG) to register the EPA to obtain continuing authority to act.

SIMILAR PROVISIONS IN SCOTLAND

Similar provisions to LPAs apply in Scotland. The 'granter' (donor) gives authority to their chosen attorney in respect of their financial and property matters ('Continuing Power of Attorney') and/or personal welfare ('Welfare Power of Attorney').

The latter only takes effect upon the granter's mental incapacity. Applications for powers of attorney must be accompanied by a certificate confirming the granter understands what they are doing, completed by a solicitor or medical practitioner only.

LPAs don't apply to Northern Ireland. Instead, those seeking to make a power of attorney appointment over their financial affairs would complete an EPA. This would be effective as soon as it was completed and would only need to be registered in the event of the donor's loss of mental capacity with the High Court (Office of Care and Protection).

CONCERNING MEDICAL TREATMENT

It's usual for the attorney to be able to make decisions about the donor's financial

affairs as soon as the LPA is registered. Alternatively, the donor can state it will only apply where the donor has lost mental capacity in the opinion of a medical practitioner.

A LPA for health and welfare covers decisions relating to an individual's day-to-day well-being. The attorney may only act once the donor lacks mental capacity to make the decision in question. The types of decisions covered might include where the donor lives and decisions concerning medical treatment.

LIFE-SUSTAINING TREATMENT

The donor also has the option to provide their attorney with the authority to give or refuse consent for life-sustaining treatment. Where no authority is given, treatment will be provided to the donor in their best interests.

Unlike the registration process for an EPA, registration for both types of LPA takes place up front and is not dependent on the donor's mental capacity. An attorney must act in the best interest of the donor, following any instructions and considering the donor's preferences when making decisions.

They must follow the Mental Capacity Act Code of Practice which establishes five key principles:

1. A person must be assumed to have capacity unless it's established he or she lacks capacity.
2. A person isn't to be treated as unable to make a decision unless all practicable steps to help him or her do so have been taken without success.
3. A person isn't to be treated as unable to make a decision merely because he or she makes an unwise decision.
4. An act done, or decision made, under the Act for or on behalf of a person who lacks capacity must be done, or made, in his or her best interests.
5. Before the act is done, or the decision is made, regard must be had to whether the purpose for which it's needed can be as effectively achieved in a way that is less restrictive of the person's rights and freedom of action.

LEGALLY BINDING DUTIES

A donor with mild dementia might be provided with the means to purchase items for daily living, but otherwise their financial matters are undertaken by their attorney. The code of practice applies a number of legally binding duties upon attorneys, including the requirement to keep the donor's money and property separate from their own or anyone else's.

Anyone aged 18 or over who has mental capacity and isn't an undischarged bankrupt may act as an attorney. A trust corporation can be an attorney for a property and financial affairs LPA. In practice, attorneys will be spouses, family members or friends, or otherwise professional contacts such as solicitors.

REPLACEMENT ATTORNEY

Where joint attorneys are being appointed, the donor will state whether they act jointly (the attorneys must make all decisions together), or jointly and severally (the attorneys may make joint decisions or separately), or jointly for some decisions (for example, the sale of the donor's property) and jointly and severally in respect of all other decisions.

An optional but useful feature of the LPA is the ability to appoint a replacement attorney in the event the original attorney is no longer able to act. The donor can leave instructions and preferences, but if they don't their attorney will be free to make any decisions they feel are correct. Instructions relate to things the attorney should or shouldn't do when making decisions – not selling the donor's home unless a doctor states the donor can no longer live independently or a particular dietary requirement would be examples.

'CERTIFICATE PROVIDER'

Preferences relate to the donor's wishes, beliefs and values they would like their attorney to consider when acting on their behalf. Examples might be ethical investing or living within close proximity of a relative.

The following apply to both forms of LPA. A 'certificate provider' must complete a section in the LPA form stating that as far as they are aware, the donor has understood the purpose and scope of the LPA. A certificate provider will be an individual aged 18 or over and either, someone who has known the donor personally well for at least two years; or, someone chosen by the donor on account of their professional skills and expertise – for example, a GP or solicitor.

CONCERNS OR OBJECTIONS

There are restrictions on who may act as a certificate provider – these include attorneys, replacement attorneys, family members and business associates of the donor. A further safeguard is the option for the donor to choose up to five people to be notified when an application for the LPA to be registered is being made.

This allows any concerns or objections to be raised before the LPA is registered, which must be done within five weeks from the date on which notice is given. The requirement to obtain a second certificate provider where the donor doesn't include anyone to be notified has now been removed as part of the Office of the Public Guardian (OPG) review of LPAs.

COURT OF PROTECTION

A person making a LPA can have help completing it, but they must have mental capacity when they fill in the forms. Otherwise, those seeking to make decisions on their behalf will need to apply to the Court of Protection for a deputyship order. This can be expensive and time-consuming and may require the deputy to submit annual reports detailing the decisions they have made.

There are strict limits on the type of gifts attorneys can make on the donor's behalf. Gifts may be made on 'customary occasions', for example, birthdays, marriages and religious holidays, or to any charity to which the donor was accustomed to donating. Gifts falling outside of these criteria would need to be approved by the Court of Protection. An example would be a gift intended to reduce the donor's Inheritance Tax liability. ●

BUSINESS PROPERTY RELIEF

A key solution for significantly reducing a potential future Inheritance Tax bill

If you have business owner status, or have shares of a business, this will be reflected in the value of your estate. Business Property Relief is a valuable Inheritance Tax relief for business owners, whether making a lifetime transfer or on death. Business relief is either 50% or 100% on an estate's business assets. The exact relief amount will depend on the nature of the assets.

This means if you own a business interest at your death and that qualifies for Business Property Relief then the value of this can be exempt from Inheritance Tax. But there are a number of eligibility requirements, although many trading business interests owned by sole traders, partners in a partnership and shareholders in an unquoted company will qualify for this Inheritance Tax exemption.

SPOUSE EXEMPTION

The exemption is not available if your business consists wholly or mainly of dealing in securities, stocks or shares, dealing in land or buildings, or making or holding of investments.

Your Will may leave your business interest to be inherited by your spouse directly on your death. However, it may make sense, from an Inheritance Tax planning perspective, not to do this. This is because anything your spouse inherits would be Inheritance Tax-free anyway due to spouse exemption.

INHERITED TAX-FREE

If you leave a tax-exempt asset (your business interest) to a tax-exempt beneficiary (your spouse), you have wasted the opportunity to leave that asset tax-free to beneficiaries who would otherwise have paid tax (for example, your children).

If the business interest was still owned by your spouse at their death and still qualified for Business Property Relief at that time, this could be inherited tax-free then. If, however, your spouse had sold the business interest or this did not qualify for another reason, the exemption would have been lost.

POTENTIAL DIFFICULTIES

You could leave your business interest directly to your children in your Will. But there are two potential difficulties with this. Firstly, you cannot be certain whether your business interest will qualify for Business Property Relief on your death. Secondly, you don't know whether, notwithstanding the fact that this may not be the most Inheritance Tax-efficient course of action, your spouse may need to inherit some or all of the value of the business.

If you have an estate which exceeds your personal Inheritance Tax free threshold, then Business Property Relief should be considered as an effective estate preservation planning strategy and a key tool for significantly reducing a potential future Inheritance Tax bill. Business owners may also want to consider making a Will leaving their business interests to pass into a Discretionary Trust on their death. ●

PRESERVING WEALTH FOR FUTURE GENERATIONS

Factors likely to have a lasting and positive impact on wealth

Whether you have earned your wealth, inherited it or made shrewd investments, you will want to ensure that as little of it as possible ends up in the hands of HM Revenue & Customs.

With careful planning and professional financial advice, it is possible to take preventative action to either reduce or mitigate a person's beneficiaries' Inheritance Tax bill – or avoid it altogether. These are some of the main areas to consider.

1. MAKE A WILL

A vital element of effective estate preservation is to make a Will. Making a Will ensures an individual's assets are distributed in accordance with their wishes. This is particularly important if the person has a spouse or registered civil partner.

Even though there is no Inheritance Tax payable between both parties, there could be tax payable if one person dies intestate without a Will. Without a Will in place, an estate falls under the laws of intestacy – and this means the estate may not be divided up in the way the deceased person wanted it to be.

2. MAKE ALLOWABLE GIFTS

A person can give cash or gifts worth up to £3,000 in total each tax year, and these will be exempt from Inheritance Tax when they die. They can carry forward any unused part of the £3,000 exemption to the following year, but they must use it or it will be lost.

Parents can give cash or gifts worth up to £5,000 when a child gets married, grandparents up to £2,500, and anyone else up to £1,000. Small gifts of up to £250 a year can also be made to as many people as an individual likes.

3. GIVE AWAY ASSETS

Parents are increasingly providing children with funds to help them buy their own home. This can be done through a gift, and provided the parents survive for seven years after making it, the money automatically moves outside of their estate for Inheritance Tax calculations, irrespective of size.

4. MAKE USE OF TRUSTS

Assets can be put in an appropriate trust, thereby no longer forming part of the estate. There are many types of trust available and they can be set up simply at little or no charge. They usually involve parents (settlors) investing a sum of money into a trust. The trust has to be set up with trustees – a suggested minimum of two – whose role is to ensure that on the death of the settlors, the investment is paid out according to the settlors' wishes. In most cases, this will be to children or grandchildren.

The most widely used trust is a Discretionary Trust, which can be set up in a way that the settlors (parents) still have access to income or parts of the capital. It can seem daunting to put money away in a trust, but they can be unwound in the event of a family crisis and monies returned to the settlors via the beneficiaries.

5. THE INCOME OVER EXPENDITURE RULE

As well as considering putting lump sums into an appropriate trust, people can also make monthly contributions into certain savings or insurance policies and put them into an appropriate trust. The monthly contributions are potentially subject to Inheritance Tax, but if the person can prove that these payments are not compromising their standard of living, they are exempt.

6. PROVIDE FOR THE TAX

If a person is not in a position to take avoiding action, an alternative approach is to make provision for paying Inheritance Tax when it is due. The tax has to be paid within six months of death (interest is added after this time). Because probate must be granted before any money can be released from an estate, the executor may have to borrow money or use their own funds to pay the Inheritance Tax bill.

This is where life assurance policies written in an appropriate trust come into their own. A life assurance policy is taken out on both a husband's and wife's life with the proceeds payable only on second death. The amount of cover should be equal to the expected Inheritance Tax liability. By putting the policy in an appropriate trust, it means it does not form part of the estate.

The proceeds can then be used to pay any Inheritance Tax bill straight away without the need for the executors to borrow. ●

IN CONCLUSION

Whatever your plans, the right advice could help bring them to life

Building wealth clearly has its benefits, but it comes with its challenges too. When we die, we like to imagine that we can pass on our wealth to our loved ones so they can benefit from it. But in order for them to benefit fully from our wealth, it is important to consider the impact of Inheritance Tax.

Estate preservation and the transferring of wealth have become important issues for many families today. We all have different objectives in life and need different strategies to help achieve them.

That's why carefully planning the financial affairs of your estate is essential to ensure that you can pass on the maximum benefit to your beneficiaries, which can have a significant impact on the future of your loved ones.

Careful consideration as to what should go into your plan will also ensure your beneficiaries have sufficient money to maintain their desired lifestyle for the rest of their life and avoid any unwanted Inheritance Tax implications.

We can help you understand the effects of Inheritance Tax on your wealth and offer tax-efficient wrappers for your investments. Our goal is to guide you towards making the right decisions to preserve the wealth in your estate. To find out more, please contact us – we look forward to hearing from you. ●

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ESTATE PRESERVATION AND THE TRANSFERRING OF WEALTH HAVE BECOME IMPORTANT ISSUES FOR MANY FAMILIES TODAY. WE ALL HAVE DIFFERENT OBJECTIVES IN LIFE AND NEED DIFFERENT STRATEGIES TO HELP ACHIEVE THEM.

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IT ALL BEGINS WITH A CONVERSATION – READY TO TALK?

Today's families can be complex. That's why we help our clients plan and structure their financial affairs so that they can pass on wealth from one generation to the next in the most beneficial and tax-efficient way.

To review your current situation or to discuss the options available, please contact us for further information – we look forward to hearing from you.

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