

Leaving a legacy

A guide to successful estate planning

This guide provides a broad outline of inheritance tax and estate planning.

If you want to learn more and receive advice tailored to your personal circumstances, please get in touch.

PR Financial

T 01179 516999

pr.financial@openwork.uk.com

pr-financial.co.uk



The importance of estate planning

*Successful estate planning helps you control the amount
of tax you pay on the wealth you create.*



The importance of estate planning

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes, which cannot be foreseen.

Please ask us for information as to where to obtain further tax advice.

You've worked hard to build up your current wealth. You may have taken risks, devoted long hours to creating a business or made sacrifices to establish your investment portfolio. At the same time you've probably paid significant tax in the form of:

- Income tax
- Corporation tax
- Capital Gains Tax
- Stamp Duty Land Tax
- National Insurance

And then, of course, there's Inheritance Tax (IHT).

The importance of estate planning

As a general rule, if you live in the UK and consider it to be your permanent home, then you are regarded as having UK domicile and your entire estate, wherever it is situated, will be subject to UK IHT. This guide only considers the UK domicile situation.

This guide is based on the IHT figures for the 2017/18 tax year. The current nil-rate band for IHT is £325,000 and will remain at £325,000 from 2018/19 until 2020/21.

While IHT may be a concern for you and your heirs, there is more to estate planning than simply trying to reduce the Chancellor's slice of your legacy.

As a starting point, it's important to think about what you would want to happen to your wealth on your death. For example:

- What should any surviving spouse or partner inherit?
- Who are your (other) chosen beneficiaries?
- Are there specific items you want to leave to particular people?
- What framework - if any - is needed for your bequests? For example, you might be happy to leave capital outright to a 40 year-old architect daughter, but the same may not be true of a 19 year-old student son.

Answers to these questions will help us to structure your estate planning. They may also prompt you to consider whether making lifetime gifts is a sensible option.

An introduction to Inheritance Tax (IHT)

While most estates are too small to be subject to IHT, those that are above the current starting point of £325,000 face an average bill of just over £170,000.



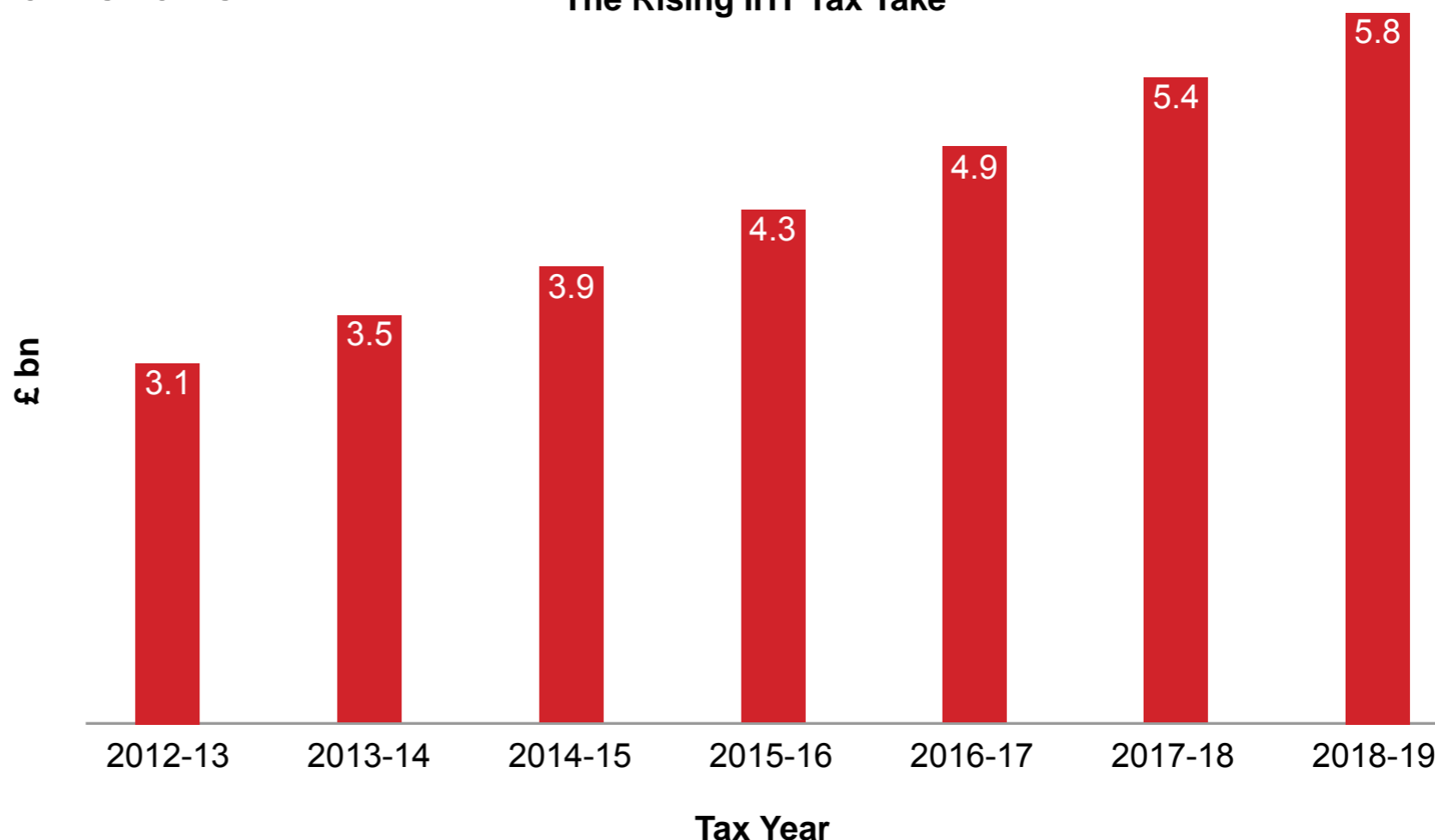
An introduction to Inheritance Tax

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes, which cannot be foreseen.

IHT is a complex tax which has its roots in the 1970s as a successor to Estate Duty.

While most estates are too small to be subject to the tax, those that are above the starting point face an average bill of just over £170,000¹. However, in recent years, rising house prices and a freeze on the IHT threshold until April 2018 have sharply increased the current and prospective tax take, as the chart below shows:

The Rising IHT Tax Take



Source: HMRC, OBR Budget 2014

¹ <https://www.gov.uk/guidance/agricultural-relief-on-inheritance-tax>

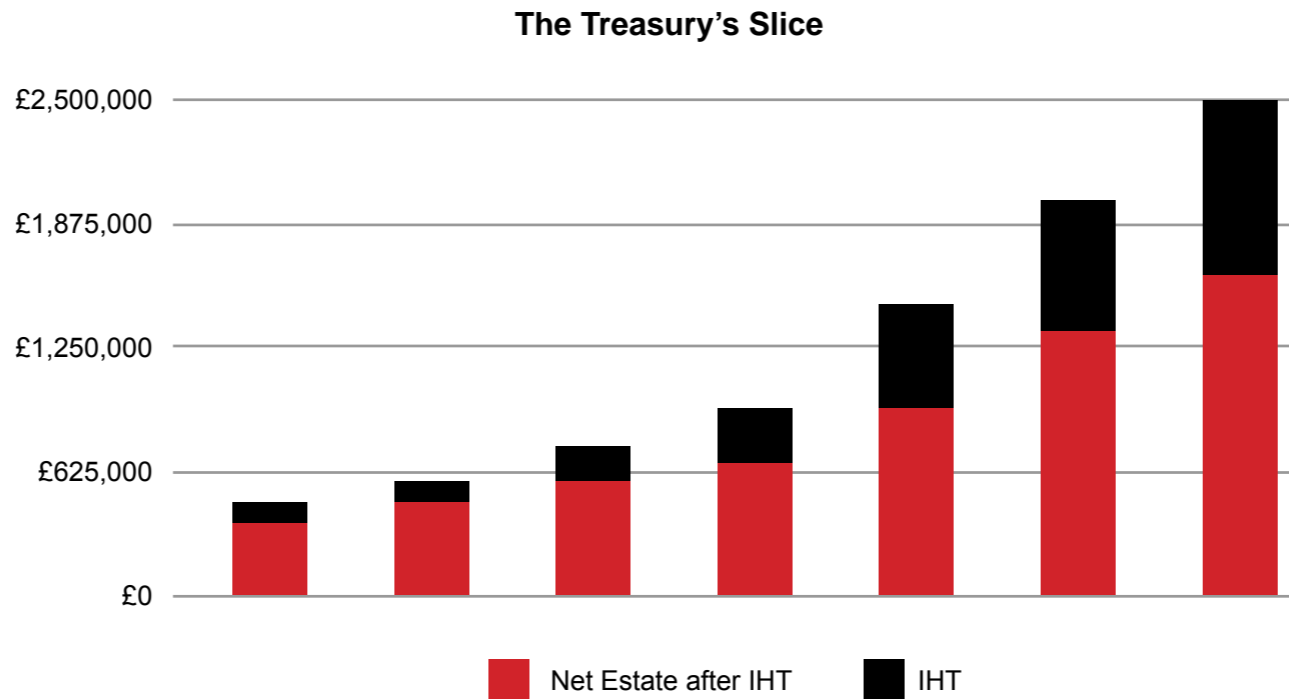
An introduction to Inheritance Tax

How much can I expect to pay?

At its simplest, IHT is a 40% tax generated upon death that applies to the amount by which your estate exceeds the nil-rate band.

Your estate will include any gifts you made in the seven years preceding death (unless the gifts are covered by exemptions).

There are often other reliefs and exemptions to take into account (we'll cover these shortly) but, if none of these apply, your estate is divided between HM Treasury and your beneficiaries as the graph below demonstrates. The government takes an increasing slice as the size of the estate rises.



Graph based on the current nil-rate band of £325,000

IHT exemptions and reliefs

There are a range of exemptions and reliefs that can reduce your IHT liability.



IHT exemptions and reliefs

- **Spouse or civil partner exemption**

Any amount you leave to your spouse / civil partner in your Will is exempt from IHT. The same applies for lifetime gifts to spouse/civil partners as long as they live in the UK permanently. There are no exemptions for unmarried couples or 'common-law' spouses.

- **Transferable nil rate band**

If your spouse / civil partner does not use their entire nil rate band on death (eg. because everything passes to the widow(er)), the unused portion is available to your estate on second death. At current rates, this means that if each spouse's Will leaves everything to the survivor on first death, the threshold before tax becomes payable will be equivalent to two nil rate bands (ie. a maximum of £650,000).

- **Resident's Nil Rate Band (RNRB)**

This RNRB effectively introduces an additional amount (in respect of the main residence) to the current £325,000 Nil Rate Band. RNRB is an additional £100,000 in 2017/18 gradually increasing each year to an additional £175,000 by 2020/21.

IHT exemptions and reliefs

- **Annual exemption**

In addition to being able to gift as much as you like to spouses and civil partners, you can gift up to £3,000 free of any IHT each tax year. You can also carry forward this exemption for one tax year only, but only after you have used the current year's exemption. It is possible to use this exemption (including any carried forward element) as part of a larger gift.

- **Small gifts exemption**

You can make small gifts of up to £250 to as many people as you like and they will all be exempt from tax. However, the exemption does not apply to gifts to anyone who, in the same tax year, has received a gift covered by your £3,000 annual exemption.

- **Normal expenditure gifts exemption**

If you make regular gifts out of your income that do not reduce your standard of living, these are exempt from IHT. This can be useful if you have surplus income, whatever the source.

- **Wedding/civil partnership gifts**

Gifts made to someone who is getting married or registering a civil partnership are exempt within limits based on your relationship to the parties. A maximum of £5,000 applies if you are a parent gifting to your child. £2,500 if you are gifting to a grandchild, and £1,000 to anyone else.

IHT exemptions and reliefs

- **Charitable gifts**

Any amounts you give to a UK registered charity (during your lifetime, or as a bequest) are exempt from IHT. In addition, if you leave 10% or more of your taxable estate to charity, the IHT rate levied on your estate will typically be cut to 36%

- **Taper relief**

If, unusually, you make lifetime gifts that attract tax, either in lifetime or during the seven years that precede your death, the recipient(s) may benefit from taper relief. This relief reduces the amount of tax payable at death on a gift that was made more than three years before death.

IHT exemptions and reliefs

- **Agricultural property relief**

If you own all or part of a trading business or farm, you may be entitled to valuable reliefs. The rules are complex, but in broad terms:

- Agricultural Relief is due at 100% if the person who owned the land farmed it themselves, or the land was used by someone else on a short-term grazing licence, or if it was let on a tenancy that began on or after 1 September 1995. Relief is due at a lower rate of 50% in any other case.

- **Agricultural shares and securities**

Some company shares and securities are eligible for Agricultural Relief if their value:

- Gave the deceased control of the company at the time of death comes from agricultural property that forms part of the company's assets
- There are also rules relating to sale of related property within 3 years of death

These reliefs will often allow family enterprises to pass free of IHT if the appropriate conditions are met. Advice is therefore vital if you think they may be relevant.

¹ <https://www.gov.uk/guidance/agricultural-relief-on-inheritance-tax>

Pension death benefits

Before the changes to pension rules in April 2015, only a dependant of the pension plan holder could receive a drawdown pension on the plan holder's death.



Pension death benefits

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Before the changes to pension rules in April 2015, only a dependant of the pension plan holder could receive a drawdown pension on the plan holder's death.

Since April 2015 however, a nominee(s) can also now receive a draw down pension called Nominee Flexi-Access Drawdown. What's more, on the nominee's death, a successor(s) can take a drawdown pension called Successor Flexi-Access Drawdown.

The problem is, that many existing pension plans are not able to offer Nominee and Successor Flexi-Access Drawdown, which means that on the pension policy holder's death, the pension fund value is paid out to the nominees as a cash lump sum and treated as part of their estate. This creates two avoidable issues:

- The money is not in a tax-advantaged environment which means if the nominee or successor wants to invest the money, tax might have to be paid on income or growth or both.
- On the nominee's death, the amount could be subject to Inheritance Tax (IHT) when passed onto their beneficiaries.

Pension death benefits

The benefits of Nominee and Successor Flexi-Access Drawdown

- You can pass wealth down through family generations in a pension wrapper and they won't be subject to IHT. Otherwise known as the 'family pension tree'.
- The monies will be retained in a tax-advantaged environment until they are needed by the nominee or successor. Or they can be passed down to the next generation on the nominee or successor's death and they won't be subject to IHT
- They provide a flexible income to the nominee or successor as and when they need it. What's more, if the pension policy holder dies before they reached age 75, the income payments are made tax free.

Why your Will matters

A Will is a key part of estate planning - not just because it sets out what you want to happen to your wealth after your death, but also because it covers a number of other important aspects.



Why your Will matters

Ensuring your Will is up to date is very important. We can arrange to have that prepared for you if you wish.

Please note, Will writing is not part of the Openwork Limited offering and is offered in our own right. Openwork Limited accepts no responsibility for this aspect of our business.

There are a number of important considerations to take into account when drawing up a Will. These can be summarised as follows:

Who should be your executors?

You need to decide who will be responsible for carrying out ('executing') the terms of your Will. Ideally you should appoint two or more executors. Think carefully before appointing a surviving spouse/partner as an executor, as bereavement and estate administration can be a difficult combination to cope with.

What powers do you wish to give your executors and trustees?

Usually, Wills are drafted to give maximum flexibility to executors and the trustees of any trusts it creates. However, you can impose constraints if you wish, for example, requiring trustees to consider a surviving spouse's wishes.

If you have children who are minors, who should be their guardian?

This can be a difficult question to resolve, but it needs to be addressed and agreed with your chosen nominees. Guardianship could be a long-term commitment and is not a responsibility to be taken lightly.

What are your funeral wishes?

Your Will can determine whether you are buried or cremated and, if the latter, state where you want your ashes to be scattered.

Why your Will matters **Who gets what, when and how?**

The distribution part of the Will sets out what happens to your estate and potentially has important IHT consequences. You will need to ask yourself:

- Are there specific gifts of items you want to make?
- How should gifts to children who are minors be dealt with? Normally this will involve some form of trust, at least until the child reaches 18 (16 in Scotland).
- Do you want a surviving spouse / partner to receive capital for them to manage as they see fit, or would you prefer to use a trust to provide them with an income, with capital passing after their death to children or grandchildren? This can be particularly relevant if you have children from a previous marriage.
- Do you want the balance of your estate, after any specific bequests and transfers to a surviving spouse / partner, to pass outright to your chosen beneficiaries? Don't simply consider minors when it comes to trusts - a trust can also protect spendthrift adult children from wasting their inheritance.

Why your Will matters

Anything you own jointly - most commonly your home - will usually pass automatically to the surviving joint owner(s) outside of your Will (although it remains in your IHT estate). The exception to this is if ownership takes the form of 'tenants in common', in which case your Will can determine what happens to your share.

The decisions you make in your Will have legal force when they take effect. A poorly drafted Will could create problems for your executors and beneficiaries.

Review your Will regularly

Your Will should be reviewed regularly, like any other aspect of financial planning. Your wishes and / or circumstances may change, or there may be tax revisions which need to be taken into account. If you marry, your Will is usually revoked whereas, if you divorce, your Will remains valid, but your ex-spouse / partner will be treated as pre-deceasing you.

In theory, Wills can be re-written by the adult beneficiaries after your death, via a deed of variation, but relying on this route to correct errors is not recommended. Unsurprisingly, beneficiaries may not be willing to reduce their entitlements, even if it could mean tax-savings for others.

The consequences of no Will

If you die without a Will, the rules of intestacy determine how your estate will be distributed.



The consequences of no Will

The rules of intestacy vary depending on where you live in the UK. England and Wales share the same rules, and Northern Ireland's are very similar. Scotland, however, has a markedly different approach.

To compound matters, the rules change from time to time, for example, major revisions for England and Wales were brought in towards the end of 2014.

Intestacy rules are unlikely to match what you would put in your Will and could create an unnecessary IHT bill. As with Wills, a deed of variation could offer an escape, but if there are minors involved any changes would need the consent of the Courts, which may not be forthcoming.

The consequences of no Will

CASE STUDY: The perils of intestacy

Colin was born in Scotland, but moved to England after leaving university in 1954, remaining there until his death in October 2014.

On his death, Colin's estate was worth £600,000, including £200,000 representing his half-share of the jointly-owned family home. Colin hadn't made a Will, thinking that everything would pass to his wife, Jane, and that their 55 year-old son William, already a millionaire, would receive nothing. However, that is not the way the law worked.

The property passed outright to Jane because of its joint ownership. As Colin had acquired an English domicile, the balance of the estate after the property passes to his wife and all debts and any applicable IHT is paid, was subject to laws of intestacy in England.

This would mean a married partner/civil partner would inherit personal property and belongings, the first £250,000 of the estate, and only half of the remaining estate, with the other half of the estate passing to any living beneficiaries.

- Jane would receive the first £250,000 plus half the remaining estate.
- The son William would receive the other half of the estate.
- On Jane's death William will receive whatever value remains in Jane's life interest trust.

Lasting power of attorney

A Will deals with matters at the end of your life. But what if you are unable to handle your affairs before then, as a result of mental or physical illness?



Lasting power of attorney

Lasting power of attorney are not part of the Openwork Limited offering and are offered in our own right. Openwork Limited accept no responsibility for this aspect of our business.

If you are concerned about a future physical or mental illness affecting your ability to manage your personal affairs, you could set up a lasting power of attorney (LPA). Under an LPA you can appoint one or more people to act on your behalf if you become unable to do so.

There are two types of LPA:

- **Health and welfare**

This covers issues such as whether you need to move into care and the refusal of life-prolonging treatment.

- **Property and financial affairs**

This deals with your personal finances, from payment of regular bills and tax affairs to the sale of your home.

LPAs can be thought of as pre-Wills, because they are likely to involve the same people (in the guise of attorneys) who will be beneficiaries and / or executors of your estate. As with Wills, there is a legal default if no LPA exists but, like intestacy, it is not a first-choice option.

There may be other options available if you are in Scotland.

Successful estate planning

Estate planning is about trying to find compromises between the simple theory and the awkward reality.



Successful estate planning

In theory it is simple: to avoid any IHT you need to make sure you have made sufficient outright gifts, long enough ago, to mean that on death (with a valid Will) your estate (including gifts added back from the past seven years) is less than the available nil rate band (currently £325,000).

In reality, life does not happen that way:

- You don't know when you are going to die
- You'll want to make provision for your spouse / partner
- You may be wary of making lifetime gifts of capital that you may need in later life - perhaps to cover care costs
- You may not think it wise to make lifetime gifts while the recipients are still relatively young
- You may not be able to afford to make sufficient lifetime gifts

Estate planning is about trying to find compromises between the simple theory and the awkward reality, made the more difficult by a range of anti-avoidance provisions. It will frequently involve a holistic approach. For example, your retirement planning will usually have consequences on your eventual IHT liability.

Successful estate planning

The tools of estate planning include:

- **A carefully drafted, up-to-date Will.**
- **Lifetime gifts:** favourably treated under the IHT rules, particularly outright gifts. In most instances they will attract no tax when they are made and none if you survive for the following seven years. However, a lifetime gift means just that: anti-avoidance rules prevent you from retaining any significant interest in what you claim to gift. For example, you cannot put your holiday home in your children's name and continue to treat it as your own.
- **Trusts:** these provide a way of controlling gifts by involving a third party, the trustees, between you and your beneficiaries. You can choose the trustees and can be one yourself, if you wish. The trustees' actions are governed by the terms of the trust that you create to receive the gift. These can be as rigid or as flexible as you want.

Successful estate planning

- **Use of exemptions:** these are generally small, but their regular use can help whittle down your taxable estate. The normal expenditure gifts exemption is a good example: giving away investment income that you would otherwise allow to accumulate is a straightforward and painless way to trim your estate.
- **Use of reliefs:** the business and agricultural reliefs are generous for business or landowners. Even if you do not currently fall into either ownership category, you may still be able to benefit from these reliefs by making and holding appropriate investments. It may even be possible to secure business relief through an Individual Savings Account (ISA). In all cases where investment is made to secure business property relief it is essential to carefully consider risk.
- **Tailored investment products:** over the years, investment structures have been developed which go some way towards allowing you to make a gift and retain the income from it, something the IHT anti-avoidance rules are designed to prevent. It may be possible to use existing investments in such structures, avoiding the tax and other consequences of sale and reinvestment.

Successful estate planning

- **Pension arrangements:** these are about much more than just providing your retirement income. For example, the lump sum death benefits under most pension arrangements are free of IHT (so are best not directed to your spouse / civil partner who would not suffer tax anyway). In retirement, a solid pension income will mean it is that much easier to make lifetime gifts or take advantage of the normal expenditure gifts exemption.
- **Life assurance:** if planning cannot eliminate all of the potential IHT liability on your estate (and usually it won't) then life assurance can be a valuable backstop. IHT is due six months after the end of the month of death and an appropriate life policy can help to pay that bill. Otherwise your executors may need to borrow, as they cannot realise the assets in your estate until they have been granted probate - something that cannot happen until the IHT bill is settled.

PR Financial

664 Muller Road
Eastville
Bristol
BS5 6XB

T 01179 516999

pr.financial@openwork.uk.com
pr-financial.co.uk

*Appointed Representative
of Openwork*

Next steps

We hope this guide has given you a broad insight into IHT and estate planning.

There are many complexities and pitfalls which we haven't been able to cover in this guide. If you'd like more information, or would like help developing your own estate plan, please get in touch.