GUIDE TO

ESTATE PRESERVATION

THE IMPORTANCE OF MAKING EARLY PLANS

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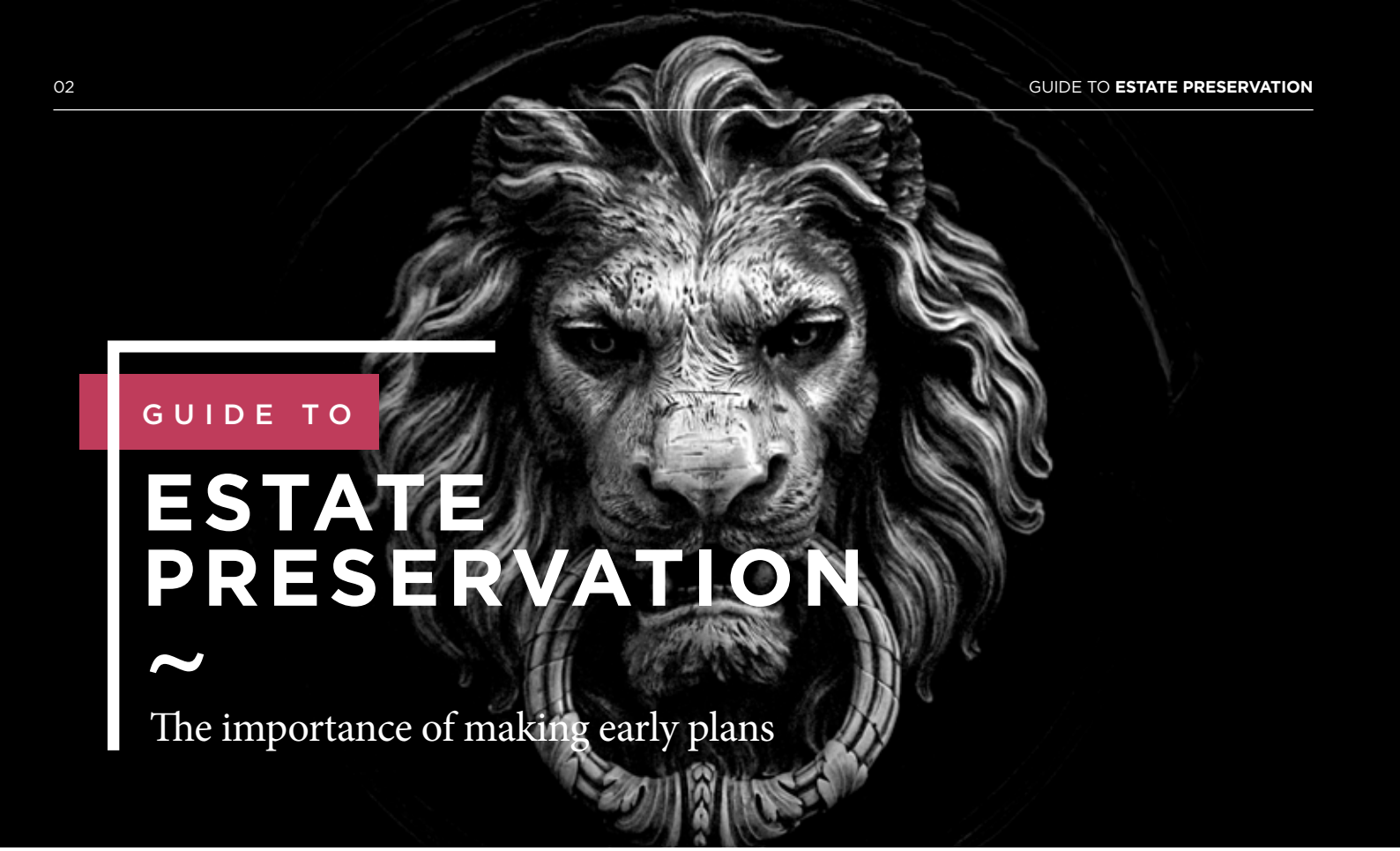

GUIDE TO

ESTATE PRESERVATION

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The importance of making early plans

WELCOME

Welcome to our *Guide to Estate Preservation*. Effective estate planning aims to ensure that the wealth you have accumulated during your lifetime is distributed to the right people, at the right time and as tax-efficiently as possible.

Preserving and enhancing your wealth is one of our core objectives. You're likely to want to pass as much of your wealth to your loved ones as possible. And you'll want to provide for your dependents, especially your spouse and children.

We're here for all of life's milestones to help you prepare for the future. We are able to help you navigate the complexities of estate planning, Inheritance Tax and setting up trusts, for seamless family transitions.

Inheritance Tax is no longer confined to the super-rich. If, like many people in the UK, your assets exceed £325,000, being subjected to a 40% tax bill upon inheritance can exacerbate an already stressful time for your loved ones. But with careful tax planning, we can help you preserve more of your estate legacy, without compromising your financial security. The average bill for an estate paying Inheritance Tax is over £170,000[1].

By helping you with Inheritance Tax mitigation, or working with your solicitor on appropriate Will and Trust structures, we can help you pass on your wealth tax-efficiently. For added reassurance, we can also help with a range of protection solutions, including life assurance to protect your family.

By structuring your estate tax-efficiently, HM Revenue & Custom's (HMRC) claim on your estate could be minimised so your loved ones receive more of your wealth. This may reduce the need for your beneficiaries to sell your assets quickly in order to meet Inheritance Tax bills. It should also reduce the amount of paperwork for them and avoid costly disputes with HMRC.

You may want to consider how you can pass on your hard-earned assets to the next generation and how you minimise the Inheritance Tax bill. We can advise you on how to structure your assets appropriately to pass more of your wealth to your chosen beneficiaries. We will review your current situation and help you determine how you want your estate to be distributed and keep you appraised of the current rules, as levels and bases of taxation are liable to change. ■

Is your wealth appropriately structured?

Whatever you wish for your wealth, we can tailor a plan that reflects your priorities and particular circumstances. To review your current situation or if you have any concerns, please contact us – don't leave it to chance.

Source data:

[1] Prudential 2019

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WEALTH TRANSFER AND THE NEXT GENERATION

How to secure your family's financial future

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. Intergenerational wealth transfer is the passage 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 financial planning strategy. 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.

Wealth transfers

By 2027, it is expected that wealth transfers will nearly double from the current level of £69 billion, to £115 billion[1], coined as 'the Great Wealth Transfer' of the 21st century.

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

Financial implications

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.

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.

Contributory factors

According to the King's Court Trust, £5.5 trillion will move hands in the United Kingdom between now and 2055, with this move set to peak in 2035[2]. Why? Well, there are a number of contributory factors that account for this. The two main reasons are increased net worth and rising mortality rates.

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.

Approaching retirement

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.

Expressing wishes

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 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 own 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?

Between generations

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. It's worth noting that UK Inheritance Tax receipts exceed £3bn from 17,900 estates[3]. ■

Source data:

[1] Kings Court trust, 'Passing on the Pounds – The rise of the UK's inheritance economy'.
[2] Resolution Foundation, Intergenerational Commission. 'The Million dollar be-question'.
[3] Prudential 2019.

INHERITANCE TAX

Minimise taxes, court costs and unnecessary legal fees with effective estate planning

Effective estate preservation planning could save a family a potential Inheritance Tax bill amounting to hundreds of thousands of pounds. Inheritance Tax was introduced in 1986. It replaced Capital Transfer Tax, which had been in force since 1975 as a successor to Estate Duty. Inheritance Tax planning has become more important than ever following the Government's decision to freeze the £325,000 lifetime exemption, with inflation eroding its value every year and subjecting more families to Inheritance Tax.

Reducing the amount of money beneficiaries have to pay

Inheritance Tax is usually payable on death. When a person dies, their assets form their estate. Any part of an estate that is left to a spouse or registered civil partner will be exempt from Inheritance Tax. The exception is if a spouse or registered civil partner is domiciled outside the UK. Unmarried partners, no matter how long-standing, have no automatic rights under the Inheritance Tax rules. However, there are steps people can take to reduce the amount of money their beneficiaries have to pay if Inheritance Tax affects them.

Where a person's estate is left to someone other than a spouse or registered civil partner (i.e. to a non-exempt beneficiary), Inheritance Tax will be payable on the amount that exceeds the £325,000 nil-rate threshold. The threshold is currently frozen at £325,000 until the tax year 2020/21.

Inheritance Tax is payable at 40% on the amount exceeding the threshold

Every individual is entitled to a nil-rate band (that is, every individual is entitled to leave an amount of their estate up to the value of the nil-rate threshold to a non-exempt beneficiary without incurring Inheritance Tax). If a widow or widower of the deceased spouse has not used their entire nil-rate band, the nil-rate band applicable at the time of death can be increased by the percentage of the nil-rate band unused on the death of the deceased spouse, provided the executors make the necessary elections within two years of your death.

To calculate the total amount of Inheritance Tax payable on a person's death, gifts made during their lifetime that are not exempt transfers must also be taken into account. Where the total amount of non-exempt gifts made within seven years of death plus the value of the element of the estate left to non-exempt beneficiaries exceeds the nil-rate threshold, Inheritance Tax is payable at 40% on the amount exceeding the threshold.

Certain gifts made could qualify for taper relief

This percentage reduces to 36% if the estate qualifies for a reduced rate as a result of a charity bequest. In some circumstances, Inheritance Tax can also become payable on the lifetime gifts themselves – although gifts made between three and seven years before death could qualify for taper relief, which reduces the amount of Inheritance Tax payable.

From 6 April 2017, an Inheritance Tax residence nil-rate band was introduced in addition to the standard nil-rate band. It's currently worth up to £150,000 for the 2019/20 tax year and will increase to £175,000 for 2020/21. It starts to be tapered away if an Inheritance Tax estate is worth more than £2 million on death.

Unlike the standard nil-rate band, it's only available for transfers on death. It's normally available if a person leaves a residential property that they've occupied as their home outright to direct descendants.

Property, land or certain types of shares where Inheritance Tax is due

It might also apply if the person sold their home or downsized from 8 July 2015 onwards. If spouses or registered civil partners don't use the residence nil-rate band on the first death – even if this was before 6 April 2017 – there are transferability options on the second death.

Executors or legal personal representatives typically have six months from the end of the month of death to pay any Inheritance Tax due. The estate can't pay out to the beneficiaries until this is done. The exception is any property, land or certain types of shares where the Inheritance Tax can be paid in instalments. Beneficiaries then have up to ten years to pay the tax owing, plus interest. ■

Definitions

Net capital value - The net capital value of the estate is the sum of all assets, including settled assets in which there is a change of the interest in possession on the death, minus the sum of all liabilities including funeral expenses.

Net estate - The net estate is the net capital value plus the value of any lifetime transfers made within the seven-year period.

Net chargeable value - The net chargeable value is the net estate minus the sum of any reliefs set against assets.

Receipts - Cash revenue from Inheritance Tax liabilities received by HM Revenue & Customs. This is distinct from the liability (see below under 'Tax payable') due to the six-month lag between the date of death and the date Inheritance Tax is due.

Reliefs set against assets - The majority of Inheritance Tax reliefs, including Agricultural Property Relief and Business Property Relief, are used to reduce the chargeable value of the estate before any tax due is calculated.

Relief against tax - A small number of Inheritance Tax reliefs, including double taxation relief and quick succession relief, are used to reduce the amount of tax due after it is first calculated.

Tax chargeable - The tax chargeable is the amount of tax calculated by applying the appropriate tax rates to the net chargeable value.

Tax payable - The tax payable is the tax chargeable minus any reliefs against tax. This may also be referred to in the tables as 'tax liability'.

RESIDENCE NIL-RATE BAND

Owning a residence which is left to direct descendants

The Inheritance Tax residence nil-rate band came into effect on 6 April 2017. 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 2019/20 tax year, the maximum residence nil-rate band available is £150,000. This rises to £175,000 in 2020/21, after which it will be indexed in line with the Consumer Prices Index.

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

Special provisions apply where an individual has downsized

Where an estate is valued at more than £2 million, the residence nil-rate band 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.

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 – 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.

Any unused allowance can't be offset against other assets

The amount of residence nil-rate band 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 residence nil-rate band available when the individual died. Where the value of the property is lower than the maximum residence nil-rate band, 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 residence nil-rate band available from the estate of the first spouse or registered civil partner to die. 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.

Survivor's estate will benefit from subsequent increases

The facility to claim unused residence nil-rate band applies regardless of when the first death occurred – if this was before it was introduced, then 100% of a deemed residence nil-rate band of £150,000 can be claimed, unless the value of the first spouse or registered civil partner's estate exceeded £2 million, and tapering of the residence nil-rate band applies.

The unused residence nil-rate band is represented as a percentage of the maximum residence nil-rate band that was available on first death – meaning the amount available against the survivor's estate will benefit from subsequent increases in the residence nil-rate band. The transferable amount is capped at 100% – claims for unused residence nil-rate band 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.

Personal representatives can elect which property should qualify

Under the residence nil-rate band 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.

The residence nil-rate band 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 residence nil-rate band. 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 residence nil-rate band is apportioned.

Depending on the type of Trust will determine whether the home is included

A home may already be held in Trust when an individual dies or it may be transferred into Trust upon their death. Whether the residence nil-rate band 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 residence nil-rate band applies.

Limited by the value of other assets left to direct descendants

Estates that don't qualify for the full amount of residence nil-rate band may be entitled to an additional amount of residence nil-rate band – 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 residence nil-rate band 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' residence nil-rate band 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 residence nil-rate band. It's also limited by the value of other assets left to direct descendants.

Planning techniques are available to address a potential Inheritance Tax liability

The downsizing addition can also apply where an individual hasn't replaced a home they previously disposed of – provided they leave other assets to direct descendants on their death. The deceased's personal representatives must make a claim for the downsizing addition within two years of the end of the month in which the individual died.

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. ■

LIFETIME TRANSFERS

Potential implications of such gifts with regard to Inheritance Tax

If appropriate, you can transfer some of your assets while you're alive – these are known as 'lifetime transfers'. While 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'.

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.

Survival for at least seven years ensures full exemption from 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. A chargeable lifetime transfer is not conditionally exempt from Inheritance Tax. If it is covered by the nil-rate band and the transferor survives at least seven years, it will not attract a tax liability, but it could still impact on other chargeable transfers.

A chargeable lifetime transfer that exceeds the available nil-rate band when it is made results in a lifetime Inheritance Tax liability. Failure to survive for seven years results in the value of the chargeable lifetime transfer being included in the estate. If the chargeable lifetime transfer is subject to further Inheritance Tax on death, a credit is given for any lifetime Inheritance Tax paid.

Transferred amounts less any Inheritance Tax exemptions is 'notionally' returned to the estate

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 a potentially exempt transfer becoming fully exempt, and it no longer figures in the Inheritance Tax assessment. In other cases, the amount transferred less any Inheritance Tax exemptions is 'notionally' returned to the estate.

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.

Determining whether taper relief can reduce the tax bill for the recipient of the potentially exempt transfers

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. 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 nil-rate band 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 dependant on the passage of time from giving the gift to death

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. Survival for between three and seven years and taper relief at the following rates is available.

Tax treatment of chargeable lifetime transfers has some similarities to potentially exempt transfers

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 nil-rate band. If there is an excess above the nil-rate band, 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 nil-rate band, but taper relief can reduce the tax bill, and credit is given for any lifetime tax paid.

Potentially increasing the Inheritance Tax bill for those who fail to survive for long enough

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.

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.

Covering the gradually declining tax liability that may fall on the gift recipient

If the potentially exempt transfers or chargeable lifetime transfers are within the nil-rate band, 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. 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 nil-rate band, the tapered Inheritance Tax liability that will result from death after the potentially exempt transfers or chargeable lifetime transfers are made can be estimated, and 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.

Level term policy written in an appropriate Trust for estate legatees might be required

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 nil-rate band that becomes available to the rest of the estate after seven years.

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. ■

MAKING A WILL

Failure to take action could compromise the long-term financial security of the family

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.

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.

What are the 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

Unmarried partners have no right to inherit under the intestacy rules

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 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 the children are aged 18
- Making sure that people whom 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

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 shares 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.

Dying without a Will is not the only situation in which intestacy can occur

It 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 (the 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 minimise or mitigate Inheritance Tax

Appropriate Trusts can be used for minimising or mitigating Inheritance Tax estate taxes and can offer other benefits as part of an integrated and coordinated approach to managing wealth. 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.

Bare Trust

Simplest form of Trust

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.

Normal expenditure out of 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.

No ongoing Inheritance Tax reporting requirements or further Inheritance Tax implications

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.

Trustees look after the Trust property for the known beneficiaries

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.

Securing the settlor's right to receive their fixed payments

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

Settled or relevant property

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, there's an immediate Inheritance Tax charge at the 20% lifetime rate – or effectively 25% if the settlor pays the tax.

The settlor's available nil-rate band is essentially the current nil-rate band 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 nil-rate band, which is £325,000 up to 2020/21. The residence nil-rate band isn't available to trusts or any lifetime gifting.

Special valuation rules for existing policies assigned into trust

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 nil-rate band, or an asset is gifted which exceeds 80% of the nil-rate band, the gift must be reported to HM Revenue & Customs (HMRC) on an IHT 100. 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.

Value of the trust fund will be the open market value of the policy

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. 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 nil-rate band.

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. 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.

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.

Investing in life assurance investment bonds could avoid complications

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.

Powers depend on the trust provisions, but usually include some degree of veto

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

At least one named default beneficiary

These 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. 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.

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.

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.

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.

Trade-off between simplicity and the degree of control

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 nil-rate band. Keeping gifts within the nil-rate band 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.

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

Taking control of decisions even in the event you can't make them yourself

A lasting power of attorney enables individuals to take control of decisions that affect them, even in the event that they can't make those decisions for themselves. Without them, 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 lasting power of attorney covering their property and financial affairs and/or a separate lasting power of attorney for their health and welfare. It's possible to appoint the same or different attorneys in respect of each lasting power of attorney, and both versions contain safeguards against possible misuse.

Individual loses the capacity to manage their 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. Lasting power of attorney 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.

Commencing from 1 October 2007, it is no longer possible to establish a new enduring power of attorney 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 enduring power of attorney 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 enduring power of attorney to obtain continuing authority to act.

Powers of attorney in Scotland and Northern Ireland

Similar provisions to lasting powers of attorney 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.

Lasting powers of attorney don't apply to Northern Ireland. Instead, those seeking to make a power of appointment over their financial affairs would complete an enduring power of attorney. 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).

Where the donor has lost mental capacity in the opinion of a medical practitioner

It's usual for the attorney to be able to make decisions about the donor's financial affairs as soon as the lasting power of attorney 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 lasting power of attorney 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.

Option to provide authority to give or refuse consent for 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 enduring power of attorney, registration for both types of lasting power of attorney 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:

- A person must be assumed to have capacity unless it's established he or she lacks capacity.
- 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.
- A person isn't to be treated as unable to make a decision merely because he or she makes an unwise decision.
- 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.

- 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.

Trust corporation can be an attorney for a property and financial affairs lasting power of attorney

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.

Relating to things an attorney should or shouldn't do when making decisions

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 lasting power of attorney 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.

Beliefs and values an attorney has to consider when acting on the donor's behalf

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 lasting power of attorney. A 'certificate provider' must complete a section in the lasting power of attorney form stating that as far as they are aware, the donor has understood the purpose and scope of the lasting power of attorney. 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.

Allowing for any concerns or objections to be raised before the lasting power of attorney is registered

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 lasting power of attorney to be registered is being made.

This allows any concerns or objections to be raised before the lasting power of attorney 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 lasting powers of attorney.

Strict limits on the type of gifts attorneys can make on the donor's behalf

A person making a lasting power of attorney 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. ■

WEALTH PRESERVATION

Planning steps to consider when passing wealth in the most tax-efficient way

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 either to reduce or mitigate a person's beneficiaries' Inheritance Tax bill – or to mitigate 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 settlers, 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. ■

TAKING THE NEXT STEP

Whatever stage of life you're at, we can guide you through the opportunities and challenges you may face. If you would like further information or to arrange a meeting, please contact us.

We look forward to hearing from you.

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