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FINANCIAL PLANNING

Chartered Financial Planners

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GUIDE TO

PASSING ASSETS EFFICIENTLY TO THE NEXT GENERATION

WHAT WILL YOUR LEGACY LOOK LIKE?

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What will your legacy look like?

The coronavirus (COVID-19) pandemic has lead many people to reflect on their own mortality. No one wants to think about their hard-earned wealth going to waste after they die. Sorting out your finances early will help the people left behind when you die.

Protecting your estate is ultimately about securing more of your wealth for your loved ones and planning for what will happen after your death to make the lives of your loved ones much easier. It's not nice to think about, but it means that your loved ones can carry out your wishes and be protected from Inheritance Tax (IHT).

Lifetime accumulating wealth

If you don't make the right financial arrangements, your family could potentially have to foot a hefty IHT bill in the event of your premature death. Passing assets efficiently to the next generation remains a primary objective for many who have spent a lifetime accumulating their wealth. Providing funds for family members or a charitable interest is also an important way to see the benefit of your wealth during your lifetime, as well as leaving a legacy.

IHT is the amount of tax owed on a person's estate once they have become deceased. The government assesses what a person's estate is worth once they die, which includes any assets including property minus any debts.

Nil-rate band

The rate of tax on death is 40%, and 20% on lifetime transfers where chargeable. For 2021/22 the first £325,000 chargeable to IHT is at 0% and this is known as the 'nil-rate band'. The nil-rate band has been frozen at £325,000 since 2009 and this will now continue up to 5 April 2026.

An additional nil-rate band is introduced for deaths on or after 6 April 2017 where an interest in a qualifying residence passes to direct descendants. The amount of relief has been phased in over four years and is set at £175,000 for 2021/22.

For many married couples and registered civil partnerships the relief is effectively doubled, as each individual has a main nil-rate band and each will also potentially benefit from the residence nil-rate band.

Potentially complex calculations

The residence nil-rate band can only be used in respect of one residential property which does not have to be the main family home but must at some point have been a residence of the deceased. Restrictions apply where estates (before reliefs) are in excess of £2 million.

Where a person died before 6 April 2017, their estate will not qualify for the relief. A surviving spouse may be entitled to an increase in the residence nil-rate band if the spouse who died earlier has not used, or was not entitled to use, their full residence nil-rate band. The calculations involved are potentially complex but the increase will often result in a doubling of the residence nil-rate band for the surviving spouse.

Inheritance Tax is payable on everything you have of value when you die, including:

- Any property or land (even if they are overseas)
- Businesses you own
- Savings and investments, including pensions, shares, cash in the bank
- Trusts
- Jewellery
- Works of art
- Proceeds from life assurance policies not written in an appropriate trust
- Vehicles
- Any other properties or land – even if they are overseas

Lifetime giving – it's good to give

There are ways to reduce the amount of IHT you pay. HM Revenue & Customs (HMRC) permits you to make a number of small gifts each year without creating an IHT liability. Each person has their own allowance, so the amount can be doubled if each spouse or registered civil partner uses their allowance.

You can also make larger gifts, but these are known as 'Potentially Exempt Transfers' (PETs) and you could have to pay IHT on their value if you die within seven years of making them. Any other gifts made during your lifetime that do not qualify as a PET will immediately be chargeable to Inheritance Tax. These are called 'Chargeable Lifetime Transfers' (CLTs) and an example is a gift into a discretionary trust.

The taxation rules of CLTs are complicated, and you should obtain professional financial advice if you are considering a CLT. Also, if you make a gift to someone but keep an interest in it, it becomes known as a 'Gift With Reservation' and will remain in your estate for IHT purposes when you die.

HMRC permits you give the following as exempt transfers:

- Up to £3,000 each year as either one or a number of gifts. If you don't use it all up one year, you can carry the remainder over to the next tax year. A tax year runs from 6 April one year to 5 April in the next year
- Gifts of up to £250 to any number of other people – but not those who received all or part of the £3,000
- Any amount from income that is given on a regular basis, provided it doesn't reduce your standard of living. These are known as gifts made as 'normal expenditure out of income'
- If your child is getting married, you can gift them £5,000; if a grandchild or more distant descendent is getting married, you can gift them £2,500; and to a friend or anyone else you know, you can gift £1,000
- Donations to charity, political parties, universities and certain other bodies recognised by HMRC
- Maintenance payments to spouses (and ex-spouses), elderly or infirm dependant relatives, and children under 18 or in full-time education
- There are certain other gifts that can qualify for relief from IHT. These can include gifts of a small business, sole trader enterprise or partnership and shares in companies listed on the smaller, riskier stock exchange, the Alternative Investment Market (AIM)
- Farmers can also gain up to 100% relief from IHT when making gifts of certain agricultural land or farm buildings. But the rules in both these situations are complex and you'd be best to seek expert advice before gifting anything away
- Members of the armed forces killed in action or whose death is hastened by injuries sustained on active duty are also exempt from IHT

Life insurance policy

If you don't want to give away your assets while you're still alive, another option is to take out life cover, which can pay out an amount equal to your estimated IHT liability on death. Taking out a life insurance policy written under an appropriate trust could be used towards paying any IHT liability.

Under normal circumstances, the payout from a life insurance policy will form part of your legal estate, and it may therefore be subject to IHT. By writing a life insurance policy in an appropriate trust, the proceeds from the policy can be paid directly to the beneficiaries rather than to your legal estate and will therefore not be taken into account when IHT is calculated. It also means payment to your beneficiaries may be quicker, as the money will not go through probate. ■

PEACE OF MIND AFTER YOU'RE GONE

Making sure that you've made plans for after you're gone will give you peace of mind. It's not pleasant to think about, but it means that your loved ones can carry out your wishes and be protected from IHT.

To discuss how we could help you to pass assets efficiently to the next generation, please contact us for more information.

NO 'ONE SIZE FITS ALL' SOLUTION OR PRODUCT

Appropriate succession planning involves a range of planning options. There is no 'one size fits all' solution or product.

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

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