Leaving a legacy

This guide provides a broad outline of Inheritance Tax (IHT) and the various aspects involved in estate planning.

JUST WEALTH

The importance of estate planning

Successful estate planning helps you to better control the amount of tax you are liable to pay on the wealth you accumulate.

If you would like to learn more, or receive advice tailored to your personal circumstances, then please get in touch.

The importance of estate planning

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

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

To start with, it's important to think about what you'd like to happen to your wealth when you die. For example:

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

By answering these questions, you'll greatly help us to structure your estate planning. Your responses may also prompt you to consider whether making lifetime gifts could be a sensible option.

HM Revenue & Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes, which cannot be foreseen.
Please contact an accountant or tax specialist for specific tax advice.

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 2021/2022 tax year.

The current nil-rate band for IHT is £325,000.

JUST WEALTH

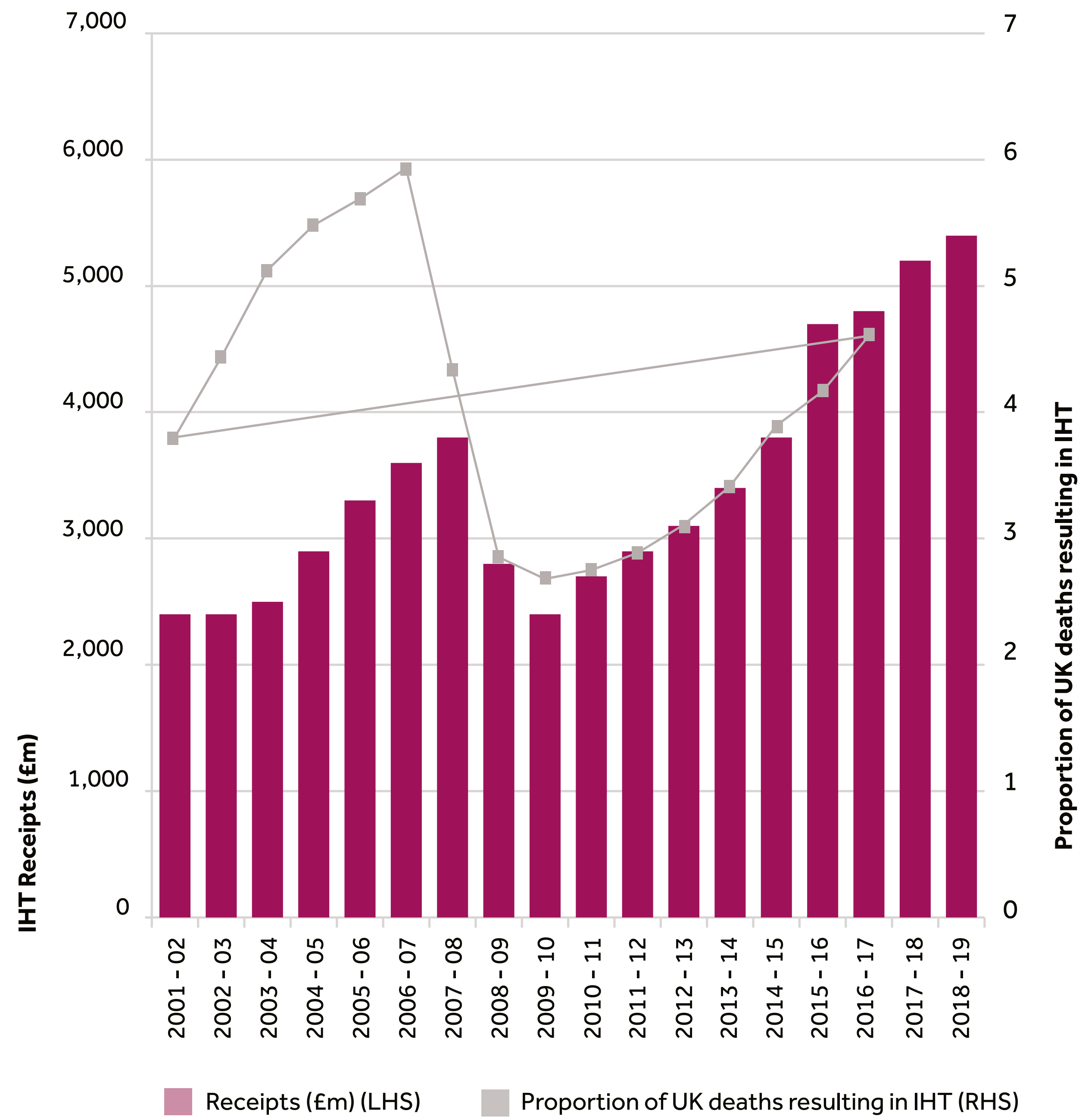

JUST
WEALTH

An introduction to Inheritance Tax (IHT)

While most estates are too small to be subject to IHT, those valued above the current starting point of £325,000 face an average bill of £179,000.

IHT is a complex system with its roots in the 1970s, when it was introduced as the successor to Estate Duty.

However, rising house prices and a freeze on the IHT threshold have sharply increased the government's tax take in recent years, as this chart shows.



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

JUST WEALTH

An introduction to Inheritance Tax (IHT)

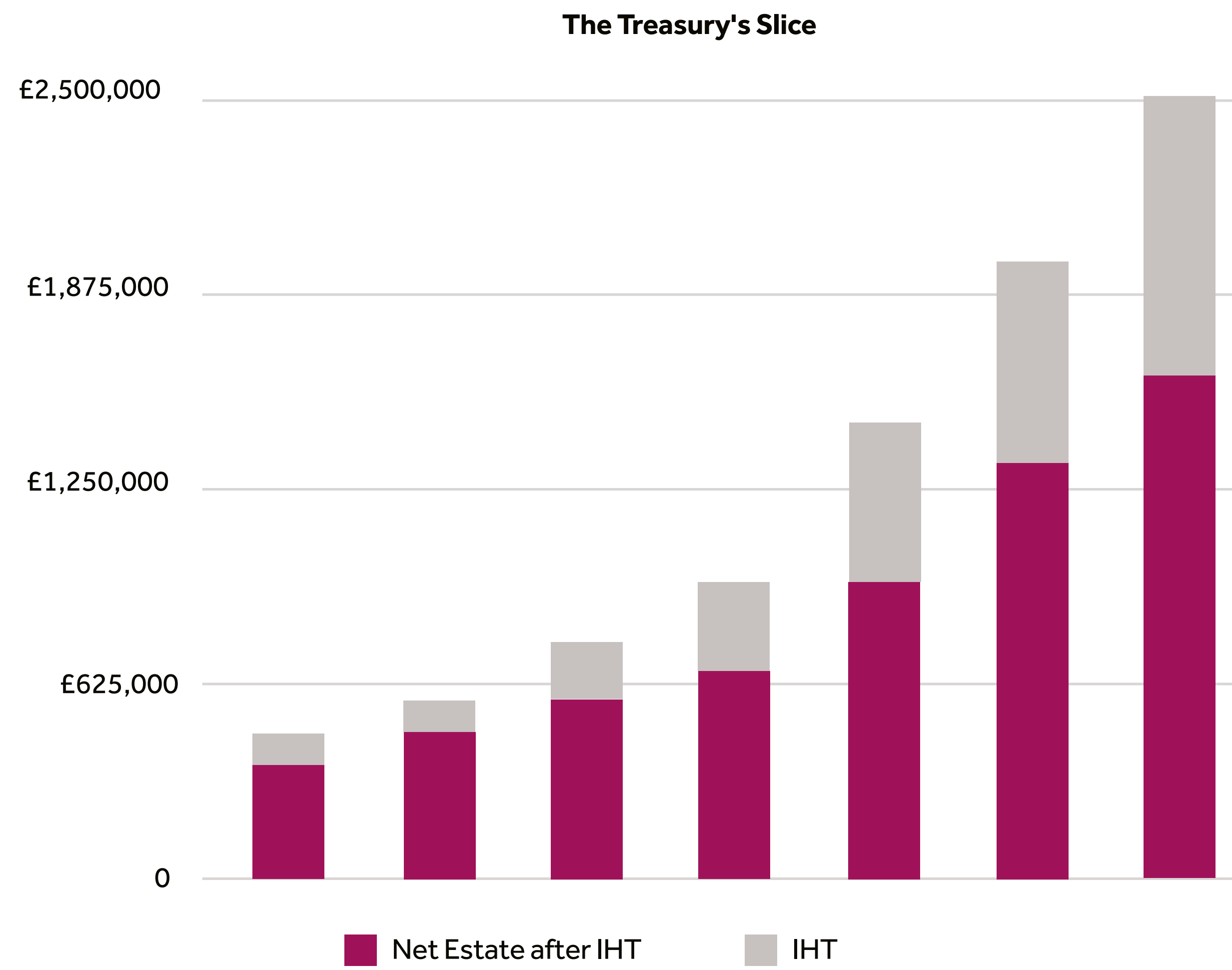
How much can I expect to pay?

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, which is currently £325,000 for the 2021/2022 tax year.

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

There are often other reliefs and exemptions that may help to reduce your IHT liability (we'll cover these shortly); however, if none of these apply, your estate will be divided between IHT payable to HM Treasury and your beneficiaries, as demonstrated by this graph. This shows clearly the increasing impact of IHT at 40% as the value of the estate rises.

Opposite: Graph based on the nil-rate band of £325,000 (2021/2022 tax year)



IHT exemptions and reliefs

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

Spouse or civil partner exemption

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

Transferable nil-rate band

If a spouse/civil partner does not use their entire nil-rate band when they die (e.g. because their entire estate passes to their widow(er)), then the unused portion is added onto their estate when the second partner dies. According to 2021/2022 tax year rates, this means that if each spouse's Will leaves everything to the surviving partner, then the threshold before tax becomes payable will increase to the equivalent of two nil-rate bands (i.e. a maximum of £650,000).

Residence Nil Rate Band (RNRB)

Couples with direct descendants and who have an estate (which includes their main residence) exceeding the IHT threshold may be eligible for this relief. Effectively, it introduces an additional threshold on top of the current £325,000 nil-rate band, making it easier to pass on the family home without incurring IHT. The RNRB for 2021/2022 is £175,000.

Annual exemption

In addition to being able to gift as much as you like to your spouse or civil partner, you're also permitted to make IHT-free gifts of up to £3,000 each tax year. Even better, you can carry this exemption forward (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 amount carried forward) 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 these gifts will all be exempt from IHT. However, this exemption does not apply to anyone to whom you have gifted money in the current tax year using 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 (e.g. regular pension contributions for family members), these will also be 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 from IHT up to a certain threshold, which depends on your relationship to the parties. A maximum of £5,000 can be gifted by parents to their child, £2,500 by grandparents to their grandchild, and £1,000 to anyone else.

Charitable gifts

Any amount of money you gift to a UK-registered charity (either during your lifetime or as a bequest) is 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%.

Agricultural property relief

If you own all, or part of, a trading business or farm, you may be entitled to other valuable reliefs. The rules are complex[1], but in broad terms:

— Agricultural Relief is due at 100% if the landowner farmed it themselves, if 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 most other cases.

Taper relief

In the unusual circumstance that you make lifetime gifts that attract tax, either during your lifetime or within the seven years preceding your death, the recipient(s) may benefit from taper relief. This relief reduces the amount of tax payable when you die, if the gift was made more than three years before your death.

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 their death and comes from agricultural property that forms part of the company's assets.
- There are also rules relating to the sale of related property within three years of the owner's death.

These reliefs will often allow family enterprises to be passed on completely free of IHT if the appropriate conditions are met. If you think they may be relevant, then, advice is absolutely vital to ensure you receive the relief you're entitled to.

[1] *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 would be eligible to receive a drawdown pension on the plan holder's death.

Since April 2015, however, you can now nominate another person (or people) to receive a drawdown pension called nominee flexi-access drawdown. What's more, when the nominee dies, a successor or successors can then take a drawdown pension called successor flexi-access drawdown.

There is a problem, however. Unfortunately, many existing pension plans do not offer nominee or successor flexi-access drawdown, which means that the pension fund value is paid out to the nominees as a cash lump sum when the pension policyholder dies and is then treated as part of their estate. This creates two avoidable issues:

- The money is not in a tax-advantaged environment, meaning that tax might have to be paid on income or growth (or both) should the nominee/successor wish to invest the money.
- When the nominee dies, the cash sum passed on to their beneficiaries could be subject to IHT.

The benefits of nominee and successor flexi-access drawdown

- You can pass wealth down through generations of your family in a pension wrapper and it won't be subject to IHT. This is otherwise known as the 'family pension tree'.
- This means that the monies will be retained in a tax-advantaged environment until needed by the nominee or successor. Otherwise, they can be passed down to the next generation when the nominee or successor dies and they won't be subject to IHT.
- They provide the nominee or successor with a flexible income as and when they need it. What's more, if the pension policy holder dies before they reach the age of 75, the income payments will also be 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 when you die, but also because it covers a number of other important aspects.

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

Who should your executors be?

You need to decide who will be responsible for carrying out (i.e. 'executing') the terms of your Will. Ideally, you should appoint two or more executors. Think carefully before appointing your surviving spouse or partner as an executor, as coping with estate administration while grieving can be a heavy burden to bear.

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

Usually, Wills are drafted to give maximum flexibility to executors, as well as to 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).

What are your funeral wishes?

Your Will can determine whether you'd like to be buried or cremated and (if the latter) specify where you'd like your ashes to be scattered.

If your children are minors, who should be their guardian?

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

Who gets what, when and how?

The distribution part of your Will sets out what will happen to your estate, and potentially has significant IHT consequences. You will need to ask yourself:

- Are there specific items you would like to gift to particular beneficiaries?
- How should gifts to minors be dealt with? This will normally involve some form of trust, at least until the child reaches 18 (16 in Scotland).
- Would you prefer your surviving spouse or partner to receive a lump sum to be managed as they see fit, or would you prefer to set up a trust to provide them with an income, with capital passing to children or grandchildren after their death? This may be particularly relevant if you have children from a previous marriage.
- Would you like the balance of your estate (after any specific bequests and transfers to your surviving spouse or partner) to pass outright to your chosen beneficiaries? Don't just consider minors when it comes to trusts – a trust can also protect spendthrift adult children from wasting their inheritance.

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

The decisions you make in your Will are legally binding when they take effect. A poorly drafted Will could therefore create problems for your executors and beneficiaries.

Review your Will regularly

You should review your Will on a regular basis, as you would 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 get married, your Will is usually revoked; on the other hand, if you get divorced, your Will remains valid but your ex-spouse/ partner will be treated as pre-deceasing you.

In theory, Wills can be rewritten by your adult beneficiaries after your death via a deed of variation; however, relying on this route to correct errors is not recommended. Unsurprisingly, some beneficiaries may be unwilling to reduce their entitlements,even if it could mean tax savings for others.

Ensuring your Will is up to date is very important.

We can arrange to have one prepared for you if you wish.

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

Will writing is not regulated by the Financial Conduct Authority.

JUST WEALTH

The consequences when you don't leave a Will

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

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, takes a markedly different approach.

To make matters worse, the rules also change periodically.

For example, major revisions were brought in towards the end of 2014 for England and Wales.

Your estate distributed according to intestacy rules is unlikely to correspond with what you would put in your Will and could contribute towards an unnecessarily high IHT bill. As in the case of Wills, a deed of variation could offer an escape route; however, any changes involving minors would need the consent of the Courts, which may not be forthcoming.

Case Study: The perils of intestacy

Colin was born in Scotland and moved to England after leaving university in 1954, remaining there until he died in October 2014.

Colin's estate was worth £600,000 when he died, including £200,000 which represented 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 (who was already a millionaire) would receive nothing. However, that is not the way intestacy rules worked.

The property did indeed pass outright to Jane because she jointly owned it with Colin. And, as Colin had acquired an English domicile, the balance of the estate after the property passed to his wife and all debts and any applicable IHT was paid was subject to laws of intestacy in England.

This means that his wife would inherit his personal property and belongings and the first £270,000 of the estate, but only half of the remaining estate, with the other half passing to any living beneficiaries. Therefore:

- Jane received the first £270,000, plus half the remaining estate. — William received the other half of the estate.
- When Jane dies, William will then receive whatever value remains in Jane's life interest trust.

Lasting powers of attorney

A Will deals with how you would like your estate to be distributed on your death. But what if you lose the ability to handle your affairs while you're still alive, as a result of either mental or physical illness?

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

There are two types of LPA:

Health and welfare

This covers issues such as moving into care and the refusal of life-prolonging treatment.

Property and financial affairs

This deals with your personal finances, from the 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 eventually be the beneficiaries and/or executors of your estate. As with Wills, there is a legal default if you don't make an LPA but, like intestacy, it should not be your first choice.

There may be other options available if you live in Scotland.
Lasting powers of attorney are not part of The Openwork Partnership's offering and are offered in our own right. The Openwork Partnership accept no responsibility for this aspect of our business.

Successful estate planning

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

In theory, it's simple: to avoid unnecessary IHT liabilities, you need to make sure you have made enough outright gifts, and sufficiently long ago, to mean that (with a valid Will) your estate (including gifts added back from the past seven years) is less than the available nil-rate band when you die (currently £325,000).

In reality, life does not happen that way, because:

- You don't know when you're going to die.
- You'll want to make provisions for your spouse or partner.
- You may be wary of making too many lifetime gifts, as you may need the capital 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.

This is why estate planning is about trying to find compromises between theory and reality, which is made all the more difficult by a range of anti-avoidance provisions.

It will frequently involve a holistic approach; for example, how you arrange your retirement plans will usually have a knock-on effect on your eventual IHT liability. The most important estate planning tools include:

- A carefully drafted, up-to-date Will.

Lifetime gifts:

These are favourably treated under IHT rules, particularly outright gifts. In most cases, they won't attract any tax when they are made, and will be completely tax-free if you survive for the next seven years. However, a lifetime gift means just that: anti-avoidance rules prevent you from retaining any significant interest in what you claim to be a gift. For example, you cannot put your holiday home in your children's name and continue to treat it as your own.

Trusts:

These allow you to control the gifts you make by way of a third party (i.e. the trustees) who will act as an intermediary between yourself and your beneficiaries. You can choose the trustees and can even be one yourself, if you wish. Your trustees' actions are governed by the terms of the trust set up to receive the gift. These terms can be as rigid or flexible as you want.

Exemptions:

These are generally small, but regularly making use of them can help whittle down your taxable estate over time. The normal expenditure gifts exemption is a good example of this; giving away investment income that you would otherwise allow to accumulate is a straightforward and painless way of trimming down your estate.

Reliefs:

Business and agricultural reliefs are generous for both businesses and 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). Whenever you make an investment to secure business property relief, it is essential to carefully consider the risk you are exposing yourself to.

Tailored investment products:

Over the years, investment structures have been developed that go some way towards allowing you to make a gift and retain the income from it (something IHT anti-avoidance rules are designed to prevent). It may be possible to use existing investments in such structures, thereby avoiding the tax and other consequences of their sale and reinvestment.

Pension arrangements:

These do so much more than simply providing you with retirement income. For example, the lump sum death benefits that feature as part of most pension arrangements are usually IHT-free. During your retirement, a solid pension income will make it 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 following the last day of the month of death; therefore, an appropriate life policy can help to pay that bill. Otherwise, your executors may need to take out a loan, as they cannot realise the assets in your estate until they have been granted probate – which in turn cannot take place until the IHT bill is settled.

Advice that suits you

We hope this guide has helped to demonstrate the different financial products that you may need as you go through the various stages of your life.

For personalised financial advice to suit your circumstances, please get in touch.

JUST WEALTH