



The Inheritance Tax Planning Guide

Penguin 

Plan - Perform - Protect

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The “Problem”

Inheritance Tax (“IHT”) remains the most contentious of taxes – both politically and morally. Where it is payable it often involves substantial sums. It is also beginning to bite in every great instances as more families than ever before are getting caught in the IHT net.

People have very different views of IHT and its fairness and how actively it should be avoided. Most people, in our experience, have little appetite for having a large sum deducted from their estate in favour of the government, especially at a time when government finances are in such a dire straight. Why pay tax to a government which has shown little evidence of spending the money wisely?

However many people are also wary of leaving sizeable sums to beneficiaries, who have not earned the money themselves and who may be vulnerable to receiving large amounts of wealth in the future. This can be dealt with quite easily.

The extent and the amount of IHT payable across the UK is increasing.....

The reason why there are more families being ‘caught in the net’ is largely down to a combination of the freezing of the IHT Nil Rate Band and the recent escalation in property and other asset values.

The IHT Nil Rate Band

The amount of wealth that may be passed down to beneficiaries is £325,000 per individual. For a couple this is doubled to £650,000. These amounts (£325,000 and £650,000) have now be static since 2009 and it seems they will remain so for the foreseeable future (the current proposal is to maintain this frozen level until 2021).

Freezing allowances is one of the more pernicious ways for a government to increase the tax take.

If allowances had increased by, say, 2% per year for the past 8 years the approximate allowance would now be around £380,000 or £760,000 (for a couple). This may not look much of a difference but on an estate subject to IHT this has the potential to make the IHT payable as much as £44,000 more today than would otherwise be the case if allowances had increased.

That is just one side of the equation, a frozen allowance coupled with increasing asset prices is a potent combination. An estate worth £650,000 in 2009 could easily be worth £1 million today even at modest rates of asset growth. The UK stock market has risen around 80% between 2009 and 2017, property prices around 35% higher, with London prices in particular having risen much faster and further than this UK average.

Property and Asset Values

The frozen allowance is just one side of the equation, rising wealth is the other side. A frozen allowance coupled with increasing asset prices is a potent combination. An estate worth £650,000 in 2009 could easily be worth £1 million today even at modest rates of asset growth. The UK stock market has risen around 80% between 2009 and 2017, property prices around 35% higher, with London prices in particular having risen much faster and further than this UK average.

Again this has a stealth effect on IHT payable. To see how this effect works, take a simplistic example of a couple that have a property valued at £600,000 in 2009 with other assets totalling £200,000. Their potential IHT liability at that time was £60,000.

Assume their property is now (2017) worth £850,000 and their other assets £350,000 – a total of £1.2 million. Their current potential IHT liability Post April 6th 2016 (even allowing for the new Residence Nil Rate Band – see below) their IHT liability is now £140,000 an increase of £80,000. Their wealth has increased by 50%, their IHT liability has more than doubled.

The Residence Nil Rate Band

A new extended band was introduced on 6th April 2017 to make the position more palatable for some people and some estates. Known as the Residence Nil Rate Band, this is an additional £100,000 (for tax year 2017/2018) which is only allowance against residential property.

This means home owners in many cases will get an extended allowance taking the combined Nil Rate Band up to £425,000 starting in 2017/2018.

There are several things to note about this new Residence Nil Rate Band, including:

- This can be only used where residential properties (e.g. buy-to-let properties are excluded) are left to direct descendants (e.g. children)
- The allowance will become £175,000 by 2020/21 (£100,000 in 2017/18, £125,000 in 2018/19, £150,000 in 2019/20, £175,000 in 2020/21)
- The allowance is progressively withdrawn once a couple's estate, with the inclusion of their main residence, is worth £2,000,000 or more. The withdrawal is at the rate of £1 for every £2 over the £2,000,000 limit.

It is very important to understand for a simple 'looking' extension to the rules, there are many complexities which make it far from simple.

However on balance the introduction of this new allowance will help in many cases alleviate some of the additional IHT liability that has been building across the UK in recent years.

Overall the IHT 'Problem' is Extending.....

Even allowing for the benefit of the new Residence Nil Rate Band, the two effects of a frozen allowance and increasing asset values, described above, combine to bring more and more people into the position where IHT is either a reality for the first time or is becoming more of a problem, because their liability is escalating and disproportionately.

The disproportionate effect is important. Take the following numbers as an example of how the tax bites ever harder on the scale of wealth:

Estate Value (£)	Tax Payable (£)	Tax as a % of Wealth (%)
850,000	0	0
1,000,000	60000	8
1,350,000	200000	14.8
2,000,000	460000	23
3,000,000	940000	0.3133

The IHT, both in pounds payable and percentage, continues to increase as the estate value increases.

For many individuals or families the 'problem' is exasperated by a feeling of being powerless to do anything about it. The impression is that to deal with the IHT there have to be some major sacrifices made in the lifetime of the individual whose estate will be taxed later down the line (if no action is taken). This is further complicated by the obvious point that most people don't know when they will die.

There is good anecdotal evidence to suggest (and this is backed up by our experience in this area) that if people knew when they were going to die they could plan their finances down to a tee (or a precise day) mixing their lifetime requirement (to have everything they need in their lifetime, i.e. in terms of income/expenditure) against their IHT reduction; but this doesn't happen because of this unknown (which in every other respect is a good thing).

In Summary

- IHT is a tax which is catching more and more people, families and estates
- The IHT amount hits ever harder as asset values increase above the thresholds
- It is a tax which most people want to avoid paying....
- However in many cases people are wary of what they leave, to whom and when and want control of this
- There is a feeling that this is too difficult a problem to solve in a lifetime...
- And that the problem requires too much "lifetime" sacrifice

The Solutions

Although it is often perceived that IHT planning involves the sacrifice of lifetime benefit (i.e. you have to give everything away to reduce your future estate value and estate IHT liability) this is exactly that: a perception.

Essentially for the majority of people there are a handful of approaches that can be taken towards a future IHT liability:

1. Ignore it – allowing the “what will be, will be” approach to win the day. If there is tax to pay later on so be it...
2. Spend enough money so that nothing is left; which may be more difficult said than done! (There are only so many holidays one can take and spending it on fast cars if they are expensive enough may actually increase the estate value!)
3. Wanting to do something but feeling like it is too tough a task or requires too much sacrifice or cost.
4. Wanting to do something and creating a structured plan and approach to tackle the ‘problem’.

There are many ways IHT can be reduced, offset or eradicated altogether and many of these ways do not have to involve a reduction in lifetime benefit.

However having made the statement above, the flip side is that there are many people who can reduce their estate by distributing their assets in their lifetime who can afford to do so.

It is a case of determining what can be done and how much any particular approach will cost (where the cost may be measured in other ways over and beyond a monetary cost).

The solutions available are likely therefore to represent different opportunities or attractions to different people, depending on their circumstances.

We present below a series of possible methods of tackling the IHT liability. In every case we present a top level explanation, which is not meant to act as anything other than an indication of what may be achievable – nothing here is intended to represent a detailed analysis, which can only come from an individual consultation and advice.

It is likely in any IHT planning situation that a combination of the individual solutions will be used to create an overall solution, therefore many of these areas can be combined together to achieve an effective plan of action to take care of the IHT liability.

Gifting

Naturally the most effective solution is to ensure that your estate value on death is equal to or less than the value of your Nil Rate Band, the allowance you have where no IHT is payable (£325,000 for an individual/£650,000 for a couple or £425,000/£850,000 if you can use the Residence Nil Rate Band).

In this respect distributing wealth prior to death is highly effective. If you have an estate value which is £200,000 more than the IHT allowance then gifting £200,000 is going to bring your estate below the IHT allowance and save your beneficiaries £80,000 in tax. If you can do this without affecting your lifetime position then this is a clear and easy step to take.

However this does have some drawbacks:

- Most notably that gifts are not always outside of your estate from day one. Yes some gifts are immediately effective (for example you can gift as much money as you like from your yearly income, providing it does not reduce your standard of living) but most larger gifts are not.
- You will also need to live 7 years for gifts to clear out of your estate; even then the type and the extent of the gift(s) you make are important because some gifts are known as Potentially Exempt Transfers (PETs) and some Chargeable Lifetime Transfers (CLTs).
- These can sometimes have tax charges in your lifetime – if they are above a certain size. Although it may seem simple to just gift your money away, it is not; you need to do so very carefully and with a clear structure if you are to achieve an IHT saving.
- In addition many people don't want to gift their money (assets/wealth) away because they do not know exactly how long they will live or how much money they may need in their lifetime; especially where there is a major concern for hundreds of thousands of people over care costs.
- Most people will not need care in their lifetimes, but enough will to make it a serious threat and the costs of care are now so high, with an emphasis on individual payment of these costs (and there is no insurance available) that this threat often causes people to hoard their assets against this eventuality.
- Finally gifting obviously comes with some threat or concern over the beneficiary's position – “if I give Johnny £100,000 and he is bankrupted or divorced, might my wealth end up outside of my family or bloodline?” The answer is, yes it might. Gifting can therefore be an attractive IHT reducer but it may end up robbing Peter (the taxman) to pay Paul (an ex-spouse of a daughter for example).

The '7 Year Rule'

Gifts you make to individuals will be exempt from Inheritance Tax as long as you live for 7 years after making the gift. Gifts of this sort are called 'Potentially Exempt Transfers' (PETs).

To make sure the gift qualifies as a PET you must ensure you do not retain any interest in it.

If you die within 7 years and the total value of gifts you made is less than the Inheritance Tax threshold, then the value of the gifts is added to your estate and any tax due is paid out of the estate.

However, if you die within 7 years of making a gift and the gift is valued at more than the Inheritance Tax threshold, Inheritance Tax will need to be paid on its value, either by the person receiving the gift or by the estate (the executors).

If you die between 3 and 7 years after making a gift, and the total value of gifts that you made is over the threshold, any Inheritance Tax due on the gift is reduced on a sliding scale. This is known as 'Taper Relief'. The gift itself has to be above the Nil Rate Band to qualify for this.



A good way to structure the gift to get immediate IHT-saving value is to combine the gift with a short term decreasing life assurance policy (written in trust). For example if you gift an asset worth £200,000 to save £80,000 in IHT, it will take 7 years before this £80,000 is outside of your estate. In this case you can put a life policy in place which pays out £80,000 in the first three years and then a smaller sum in years 4-7 (to match the IHT still liable in each year), so that the net effect is the £200,000 is effectively IHT free from day one.

Gifting is very effective but comes with some risks and potential complications, which is why gifting may work in conjunction with the next segment:

Trusts

It is odd that many have a perception of trusts as complicated, costly and cumbersome; only for the rich. None of these are accurate descriptions of trusts.

There are many different types of trust with multiple ways of being used, so any short summary has to simply highlight the main points:

- Trusts are an excellent way to make gifts; rather than gifting money direct to beneficiaries. Money (assets, wealth etc.) can be gifted into trust, maintaining an element of control, flexibility and direction for the person(s) making the gift.
- They allow for money to be ring fenced from future taxes (including and most prevalently IHT) and possibly from being taken into account for future care fees assessments.
- They can be used to ensure that money is kept within the family and/or the bloodline, protecting against bankruptcy or divorce of a beneficiary.
- They can help ensure money is distributed quickly after death (see further comments at the end of this document).

Using Exemptions

There are various ways of gifting money without any recourse to a 7 year rule, these include gifts to charities, using the annual allowance of £3,000 (that every individual has to make gifts which are automatically exempt), gifts to children or grandchildren on marriage and, as described above, the rule that you can gift any amount you like 'out of normal income'.

Although these gifts can look peripheral and unlikely to make any significant difference in the big scheme of things, they can quickly add up. For parents who have two children who both marry within a 10 year period, it is possible the combined value of making regular gifts utilising the three exemptions mentioned above could be very close to £100,000, which could save £40,000 in IHT liability.

BPR

Another exemption can be achieved via Business Property Relief (BPR). BPR is available for qualifying investments and assets and includes a reasonable list of suitable holdings, for example shareholdings in smaller companies listed on the AIM stock market, shares in a privately owned business and holdings in agricultural. The relief is generally either 50% of the value of the holding or asset or 100% depending which category it falls into.

BPR locks in after the asset has been owned for 2 years and then the relief is absolute.

Where the relief is 100% this means that the whole value is taken out of the estate after that period. For example, an investment into BPR qualifying AIM shares will take the full value of that investment out of the estate after just 2 years. £100,000 placed in such investments reduce the IHT liability by £40,000 after 2 years.

Many people who have an IHT liability hold money in ISAs and in a lot of cases the value of these ISAs will be £100,000 +, the issue with ISAs is they have no IHT exemption. The whole ISA value will be entered into the calculation for IHT purposes. The comparison here with a BPR qualifying investment portfolio is largely about risk because the tax advantages of such a portfolio are often comparable to ISA holdings and they offer IHT exemption. So it is only the fact they are perceived to be higher risk that most IHT affected investors would hold money in ISAs.

Unlike gifting assets away, the BPR schemes will typically keep the value available to the investor in their lifetime.

In reality the BPR portfolio can be constructed in such a way that the risk is not increased too much, if at all. We would encourage anyone looking for IHT planning ideas to take a serious look at the BPR possibilities.

This can be especially valuable to anyone looking to achieve a quick reduction in IHT, because of age or ill health or where all other avenues have been exhausted.



Life Assurance Solutions

Amongst all possible options, the life assurance solution is the one that often receives the least attention, because it is often assumed that it is expensive or prohibitive.

Ironically this is not the case at all. For a couple in their 60s or even 70s, for example, the cost of a joint life second death policy is remarkably low (in relative terms).

The way this solution works is that the potential IHT liability is assessed (for example £200,000) and a policy put in place for the same sum as the IHT to equal the life assurance amount. It is written on a joint life second death basis with the life assurance amount under a trust. Normally this will be set up on a 'whole of life' basis meaning it will run until the death of the second person.

Then the £200,000 will be paid out (when the second person dies), under the trust, to the trustees. The trustees will then use this money to settle the IHT.

The premiums paid come out of the normal expenditure rule or via the £3,000 per year annual exemption each individual has, so the premiums are outside of the IHT loop.

This is a neat, tidy way of insuring the IHT exposure and may act as a simple way of keeping the full value of an estate within the family, suiting many people's circumstances.

One of the more subtle aspects of this arrangement – and this applies to all trust arrangements – is that their mechanisms keeps assets outside of the estate, not only for IHT purposes but also for the purposes of probate. This means that the money within the trust (or paid into the trust on death) can be distributed with immediate effect, there is no need to wait for probate. This can be very beneficial to the family and those responsible for the affairs of the family. It can also help beneficiaries.

Summary

Inheritance Tax is most commonly payable by beneficiaries after death; although it is not strictly a death tax anymore (IHT can be payable in a lifetime in some circumstances) this is when it will apply for the majority of people. Death is inevitable, therefore for anyone who has assets above the IHT threshold – IHT is inevitable, unless action is taken. We hope the solutions presented show that with sensible approaches and action, IHT can be reduced or avoided without too much difficulty.

There are many possible ways of dealing with this liability, and avoiding it. Just about any circumstance or requirement can be met. What is important is that you seek advice on your options.

The (Financial) Journey Never Ends...One Life, Live it Well.

Plan

What's Your Number?

Life is precious, living it well does not come from having lots of money, it comes from contentment, family, friendships, giving and giving back, good health and achieving success (which is defined in different terms for different people). Money or wealth is simply the means to the end.

We build a Plan, individual to you, linking your goals, your values and your finances together.

Perform

One Life, Live it Well

Implementing and Maintaining the Plan is vital. This includes taking on the responsibility of looking after your requirements day in, day out.

For someone in business this frees up your time to focus on your business, for those of you with family, it allows you to enjoy time with your family, for those wanting to pursue ambitions and passions, you can be free to spend your time on what you love doing.

Protect

We are the 2nd most important professional you will need

We help you cover all eventualities by protecting you from life's curve balls – keeping you on track to fulfil your goals and dreams, no matter what happens.

Your planning is only complete when you have ensured that the unexpected is catered for.

PLAN PERFORM PROTECT

Mapping out the future to meet your widest life goals is all about taking the right steps *now*, making sure your plan is managed through the years that follow and that all your plans have an inbuilt protection for you, your family and your business. It is about integration and the best support, at all stages, from the best specialists.

We help you achieve all of the above via a mixture of:

- Financial Forecasting (cashflow for your personal life)
- Saving Tax
- Maximising returns on capital
- Managing all your risks for and with you
- Reviewing your plans and goals
- Working alongside your other professionals
- Supporting your Family Unit

About Us

Penguin is an Independent Financial Adviser firm in Cardiff, formed in 2010 by a group of Financial Planners with a shared vision and a love for their jobs. We get to help you plan for a more comfortable and enjoyable future. How could we not find satisfaction in that?

Penguin's founders share a vision of continuous professional development. It is their mission to become the best they can possibly be, to continuously learn and progress so that they can stay on top of the latest industry developments and provide people with the best possible advice.

It is this attitude towards development that has seen Penguin grow from four to fourteen and now has five Financial Advisers who have achieved the highest level of qualifications.

Voted 'Adviser Firm of the Year Wales' at the 2016 Citywire New Model Adviser Awards in London and 'Adviser firm of the year Wales' at the 2016 MoneyAge Awards, Penguin are now reaping the rewards of this development and growth.

Penguin became the very first firm in the U.K. to complete the hat-trick, becoming:

- A CISI Accredited Firm
- A Chartered Firm
- BS8577 Certified

These signify that we "demonstrate the highest professional standards of financial planning service and advice", "our clients are at the heart of our business" and that we "ensure our staff members acquire and retain the necessary knowledge and skills to deliver the highest quality advice".

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