WEALTH MANAGEMENT ALERT

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Clients' changing financial priorities in light of Covid-19

The coronavirus lockdown has forced many people to rethink what they want out of life – maybe leave the corporate world to set up that small business they were always dreaming about running or putting their skills to use in a less well-paid but perhaps more useful way. And it has forced many people to confront their own mortality.

Are you finding that clients are asking you how they may be able to pass more of their wealth on now, while they are alive, possibly because the lockdown restrictions have hit the young particularly hard? If so the good news is that the Chancellor has not yet removed the mainstream inheritance tax (IHT) mitigation options.

However, clients wishing to make substantial gifts while they are alive should think carefully about what they are going to give away and to whom. If they want to give away assets that have gone up in value there may be capital gains tax (CGT) to pay on the gift. An independent financial adviser can review their holdings and may be able to identify assets that can be passed on tax-efficiently. The Office of Tax Simplification submitted its review of the CGT regime towards the end of last year, so changes, such as a higher rate of tax, could well be in the pipeline.

Gifts out of regular income

An often-overlooked way of helping family members is by making gifts out of regular income. Clients whose income exceeds their expenditure may not realise that they can give away all or part of any excess free of IHT, and the recipients of such gifts are not liable to pay income tax on them. Again, it is important that clients take independent financial advice before doing this, to ensure that they really can afford to give away excess income. Some might not realise that their expenditure could well increase as they get older.

In some circumstances it might be appropriate for clients to use a trust to pass money down the generations, for instance grandparents who want to pay for their grand-children's education. An individual can put up to £325,000 in to a trust without triggering an immediate IHT liability. Trusts offer flexibility as to how much goes to whom and when. Some clients might be wary of trusts, thinking that they are complicated and expensive. However, thinking of a trust as a fund that can benefit beneficiaries as and when required can help demystify them. Trusts can also be a useful way of reducing a likely IHT liability, especially if the donors live for at least seven years after setting one up.

However, clients should remember that they should only help their children to the extent that they are able – it is not wise to give away – or even lend – more than they can afford, now and in the future.

Write life assurance in trust

Clients with life assurance policies should make sure that their policy is written under an appropriate trust. Doing this ensures that it falls outside the individual's estate when they die, subject to the potentially exempt transfer rules, whereas if it isn't it will form part of their estate for IHT purposes.

Clients may not realise that their pension is probably in a trust – if they are not sure they should check. In most instances death benefits do not form part of the deceased's estate and are normally free of IHT. In the case of occupational pension schemes including executive pension plans and small self-administered schemes (SSAS), and personal pensions including self-invested personal pensions (SIPPs) established under trust, the trustees or scheme administrators have discretion as to whom the death benefits are paid. Clients need to make sure that the administrator of their scheme(s) has the names and details of the people they wish to benefit.

What type of trust?

The most appropriate type of trust will depend on the client's country of residence, whether or not they are married or in a civil partnership and

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whether they will need access to their money and if so in what form – capital or regular payments. If they have inherited assets recently they could use a deed of variation to place the assets directly in to the trust. Couples need to decide whether a single or joint trust works best for their needs. To do this they are likely to need the help of in independent financial adviser experienced in trusts and inheritance tax planning.

Having talked through the above with an independent financial adviser and understood the implications of their various options, it should be clear which of the various trust options that are acceptable to HMRC for IHT planning purposes are suitable for them. Two of the most commonly used are discounted gift trusts and loan trusts.

Discounted gift trusts

Discounted gift trusts involve placing money into a whole-of-life life assurance or capital redemption bond written in trust. The money is usually invested a diverse range of appropriate investment funds. The trust allows the settlor to make regular withdrawals, usually agreed at the outset, during their life or until the bond comes to an end.

The total value of these withdrawals is the ‘discount’. This is estimated when the trust is set up by taking into account factors such as the settlor’s age, state of health and “income” they need. The precise discount is agreed with HM Revenue & Customs when the settlor dies, and this agreed amount is considered to have been removed from the settlor’s estate from the date on which the money was placed in trust.

In addition to taking regular “income”, the settlor can make one-off payments to the named beneficiaries if they so wish, so long as this does not put the income they are taking at risk. When they die the trust can continue for the benefit of the beneficiaries, parts of the bond can be assigned to the beneficiaries who can then cash them in when they need money, or the trust can simply be wound up and the proceeds distributed.

Loan trusts

Loan trust can help people remove any future growth of capital lump sums from their estate, while giving them control over the amount invested. As its name suggests, the settlor makes an interest-free loan to the trust, repayable on demand.

Helping offspring on to the property ladder

Clients in their 50s or older may well ask you about how they can help their children get on to the property ladder. However, before handing over any money there are a number of important things they need to think about.

Firstly, can they afford to do so? They should carry out a thorough audit of their income right through into retirement, taking into account possible long-term care costs and major items of capital expenditure. It is probably not a good idea to compromise their own quality of life in retirement.

They should also take into account the tax considerations. On the one hand making an outright gift could help reduce a future inheritance bill, subject to the seven years rule (and assuming the amount is above the annual tax-free gift allowance).

An equally important consideration is how they make the gift – as a loan or outright gift. If it is a gift, then it might have to be split if the child gets divorced or separates. A loan should mean that if that happens, the money should stay within the family. Many parents opt to make interest-free loans – they don’t need the income.

On the other hand, being lent a deposit could restrict the offspring’s ability to get a mortgage, as mortgage providers take loan repayments into account when calculating affordability.

Whether a loan or a gift, a legal document should be drafted stating the terms and any conditions, including what happens if a loan isn’t fully repaid before the donor dies.

Another option is for the parents to buy a suitable property and rent it to their children (and partner or others on a house-share basis). This might appeal to clients with a reasonable amount of spare cash and who want to increase their income. Clients who are not sitting on a pile of cash might even consider taking out a mortgage, depending on their age and circumstances. The cheapest way of doing this is likely to be by remortgaging their main residence, assuming that they have enough equity in it, rather than borrowing against the property they are buying for their child. They would then have the option of gifting the property to their child at a later date if they so wish. There wouldn’t be any SDLT to pay on the transfer of ownership and if the donor(s) live for a further seven years under the current rules there won’t be any IHT to pay on the gift. However, if there is still a mortgage on the property the parents would have to pay it off – or arrange for the mortgage to be transferred with the property to their child (and possibly their offspring’s partner or spouse if appropriate).

Clients wishing to help their children on to the property ladder should talk to an independent mortgage adviser before acting to ensure they set about this in a way that suits all parties involved. If they or their offspring are considering taking out a mortgage, taking independent mortgage advice can also help them get a suitable mortgage at a competitive rate.

LighthouseCarrwood do not offer independent mortgage advice but will refer queries on to a suitable firm within the network.

For the trust to be effective for IHT planning, the repayments should be spent as income, otherwise they will increase the value of the settlor's estate, thereby negating the reason for making the loan in the first place.

The trustees invest the money lent in a single premium whole-of-life assurance or capital redemption bond from which the settlor can request withdrawals in the form of loan repayments and the settlor has the flexibility to vary the amounts they request be repaid according to their needs. All growth on the trust fund falls outside the settlor's estate. However, as it is a loan, not a gift, any amount not repaid when they die will be part of their estate if they die before the whole loan has been repaid.

Business Property Relief

Clients who want to retain ownership of and full control over their assets, and those who may be running out of time could consider moving their investments to ones that qualify for Business Property Relief (BPR).

Investments that qualify for BPR are not taken into account for IHT purposes when the investor dies, provided they have owned the shares for at least two years. To qualify for BPR, a company must not be listed on a main stock exchange. Typical holdings that qualify for BPR include:

- shares in an unquoted qualifying company, for instance a small or family business
- shares in a qualifying company listed on the Alternative Investment Market (AIM). These shares can be held in an ISA and still qualify for BPR relief.
- an interest in a qualifying trading business, such as a partnership.

The main advantages of BPR relief are that the shares fall outside the estate after just two years and that the individual retains ownership and can take income from or sell them as they wish (although new qualifying purchases are still subject to the two-year rule to qualify for BPR). However, investing in smaller, unquoted companies is considered to be riskier and more volatile than investing in larger, quoted companies. They can also be less liquid, possibly making it harder to sell the shares for a good price at a specific time – or at all. Another thing to bear in mind is that tax rules could change and there is no guarantee that companies that qualify today will continue to qualify for BPR in the future.

IHT planning is complex and it is important to choose a structure that meets the varied needs of all people involved and that is recognised as effective for IHT planning by HMRC. It is also important to make sure that funds placed in trust are invested appropriately, and that any BPR investments are selected carefully, preferably with the help of investment managers specialising in such investments. We would be delighted to work with you to help more of your clients pass on more of their wealth to their loved ones, whether now or when they eventually pass away.

Expert independent IHT planning advice for your clients

We are experienced, independent financial advisers. We specialise in working closely with accountants in order to provide independent financial advice to their clients with complex financial affairs, such as business owners, the self-employed, people whose income is irregular and those who have accrued considerable assets, whether via businesses, investments, property or inherited.

Not taking independent financial advice could prove costly for clients in many ways.

To discuss how we could work together to help your clients make the most of their finances please contact me.

Email Mark Dallas, Managing Director, LighthouseCarrwood Limited at mark.dallas@lighthousefinancialsolutions.co.uk.

The Financial Conduct Authority do not regulate inheritance tax planning.
Business Property Relief (BPR) invest in assets that are high risk and can be difficult to sell such as shares in unlisted companies. The value of the investment and the income from it can fall as well as rise and investors may not get back what they originally invested, even taking into account the tax benefits.
Your home may be repossessed if you do not keep up repayments on your mortgage.
Commercial mortgages, including business buy-to-let, are not regulated by the Financial Conduct Authority.