BUCKINGHAM GATE

INHERITANCE TAX CASE STUDY GUIDE & FAQS

This communication is for general information only and is not intended to be individual advice. It represents our understanding of law and HM Revenue & Customs practice. You are recommended to seek competent professional advice before taking any action.

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INTRODUCTION

Buckingham Gate Chartered Financial Planners is an award winning, independent financial planning firm based in the heart of central London.

Our mission is to empower our clients and their families to enjoy their wealth and to help them achieve true financial peace of mind. With the most dedicated team in financial planning, we make this possible by creating simplicity out of complexity and acting as the guardian of our clients' financial wellbeing.

When we work with clients on their estate planning, we always try to incorporate both lifetime gifting and so called 'deathtime' estate planning if appropriate. It is only by combining both lifetime and deathtime planning that we can achieve the best outcome for our clients.

This guide walks you through a typical client case study, showing the position before and after the planning has taken place. This guide is designed to provide an illustration only and no actions should be taken or inferred based on its contents. If you are unsure you should seek advice from an Independent Financial Adviser or an estate planning expert.

JACK & JILL CASE STUDY

Jack and Jill are in their late 60s. They are married and have two children, Bill and Ben, both in their 40s, who themselves each have two children (Jack and Jill's grandchildren).

Jack and Jill have built up a sizeable estate of **£2.7 million** and for simplicity this can be broken down as follows:

Main residence £1,200,000

Buy-to-let property £500,000
(Produces £20,000 of income each year)

Cash and investments £1,000,000

It is important to mention that, because **the estate exceeds £2 million**, Jack and Jill will start to lose entitlement to the Residence Nil Rate Band.

(The full workings of the RNRB are beyond the scope of this guide, however it is technical in nature and has many caveats and exceptions).

It is assumed that the couple have a basic will leaving everything to each other and then to the surviving spouse.

As such, their Inheritance Tax (IHT) liability if they passed away without doing any other planning would be as follows:

Taxable Estate equals **Total Estate Value** minus 2 x **Nil Rate Band** £2.7m - (2 x £325,000) = £2.7m - £650,000 = £2,050,000
Taxable Estate = £2,050,000

IHT Bill equals **40%** times **Taxable Estate**
0.4 x £2,050,000 = £820,000
IHT Bill = £820,000

LIFETIME GIFTS

The couple are keen to make some lifetime gifts to their children and the buy-to-let property has been identified for this purpose.

They don't require the rental income that it produces (in fact, they are currently using the income to pay school fees for the grandchildren, after paying 40% tax on it) and they will not need the capital as they have the pot of cash and investments to draw on if required.

PROTECTIVE GIFTING TRUST

They create a protective gifting trust and gift the whole of the buy-to-let property into this trust. They appoint themselves as the trustees, as well as the two children, as they are happy that Bill and Ben are financially literate and responsible.

The beneficiaries of the trust are Bill and Ben and their children (Jack and Jill's grandchildren), who are all of school age.

Once the buy-to-let property is in the trust, the family discuss the options available to them. They decide to retain the buy-to-let property as an investment. They also discuss the income stream that the buy-to-let property generates. As both Bill and Ben's children are attending private school, it is decided that the income should be used to help with school fees.

In order to maximise the tax benefits, the income is directed by the trustees to be paid to the four grandchildren equally. As the grandchildren have no other income, they can use their tax-free personal allowance to receive the rental income tax free. This means that there is more net income available to cover school fees as they are no longer losing 40% of the income to tax, as was the case while it was in Jack's and Jill's names.

Trustees: Jack, Jill, Bill and Ben
Beneficiaries: Bill and Ben and their children
Income: Direct to grandchildren's school fees

> "AS THE GRANDCHILDREN HAVE NO OTHER INCOME, THEY CAN USE THEIR TAX- FREE PERSONAL ALLOWANCE TO RECEIVE THE RENTAL INCOME TAX FREE."

There are also **three other** significant benefits of this type of planning;

1. By removing the £500,000 buy-to-let property, the value of the estate has been reduced back closer to £2m. This is advantageous because it means that they will be able to reclaim part of the residence nil rate band, providing a tax saving of up to £140,000.
2. Furthermore, the gift will fall outside of their estate once they survive for seven years, creating another £200,000 tax saving (40% of £500,000).
3. Finally, the house is also protected from so-called social impacts in the event that one of the beneficiaries gets divorced in the future. If the property had been given to them directly, this asset would have been at risk in this situation.

DEATHTIME PLANNING

Now that we have looked at the lifetime estate planning, we move onto consider Jack and Jill's 'deathtime' planning.

They have similar wishes to most families in that they would like their remaining estate (made up of the £1.2m home and £1m cash and investments) to go equally to their two children when they die. They are, however, concerned that Ben's marriage is looking a little uncertain and they wonder what might happen to their inheritance in the event of a future divorce.

In the first instance, they need to consider provision for the surviving spouse.

LIFE INTEREST TRUST

Jack and Jill would like the surviving spouse (but not any future partners they might have) to be fully provided for.

So, they write a life interest trust into the will that says that, in the event of the first spouse's death, the survivor will receive a life interest in the assets of the deceased.

This means that the surviving spouse will have full use of the family home during their lifetime (including the ability to upsize, downsize or move home in the future if required). In addition, the surviving spouse will be able to receive income from any cash or investments or receive loans of capital sums if required.

If the surviving spouse remarries or has a new relationship, the assets in the life interest trust are protected from 'attack' by this new third party.

Jack and Jill also decide to set up a beneficiary protection trust for Bill and Ben.

BENEFICIARY PROTECTION TRUST

When the surviving spouse dies, the remaining assets are gathered together and split into the beneficiary protection trusts for the two children. At this point the children can choose to receive an income from the assets or take an interest-free loan for the full sum due to them. (From experience, children are more likely to take the loan.)

Alternatively, as is often the case, Bill and Ben may decide that they are already financially comfortable and that they would rather use the funds to help their children. As the grandchildren are potential beneficiaries of the trust (with Bill and Ben as trustees) they can make this decision and advance money to the grandchildren as soon as they deem this appropriate.

In addition, if Ben's relationship does sadly end in divorce, as Jack and Jill suspect, the inheritance is protected for the grandchildren and not lost to the outgoing partner.

When Bill and Ben die, any assets that they have taken out of the trust will be repaid and then the grandchildren can benefit from the same funds, without losing 40% to the tax office again!

WHAT HAVE THE PARTIES IN THIS CASE STUDY ACHIEVED?

- Bill and Ben save £300,000 in inheritance tax because of the tax planning that was carried out.
- The grandchildren now have the full £20,000 of rental income to put towards their school fees (rather than just £12,000 as before when Jack and Jill were paying 40% tax on the income). This is a saving of £8,000 every year.
- If Jill remarries on Jack's death, the assets are protected from the new partner.
- When the funds pass to the children, this is done in a structured way with clear instructions. The right people get the right money at the right time.
- Bill and Ben have the ability to give money to their children sooner if they think this is best.
- If Ben's relationship breaks down, the grandchildren's inheritance is protected from the outgoing partner.
- When the grandchildren receive the money, they are potentially around £800,000 better off as they have not paid a second lot of 40% inheritance tax on the same money.

FAQS

This is a lot to take in, and at this stage, naturally, people often have some questions. We have tried to cover some of the most common ones here.

Q A TRUST SOUNDS SCARY AND COMPLICATED – IS IT?

A Not really. While a trust will inevitably involve some paperwork and administration, it does not need to be, nor should it be, overly complicated. A good estate planning professional should be able to talk you through the process in simple prose and at a level that is understandable to all.

Q TRUSTS ARE EXPENSIVE, AREN'T THEY?

A This of course depends on many things, including who you use to prepare your trusts and the complexity and scope of the work. I would suggest that, as a rule of thumb, the cost of any legal arrangement should be between 1% and 2% of the tax saved. However, never use a provider who calculates charges based on a percentage of your estate – this has no bearing on the work to be done. Always ask for a fixed fee arrangement.

Q ARE THERE ANY ONGOING FEES?

A Not unless you want there to be. Most families are capable of managing and administering a trust themselves, but as with most other areas of life, you can appoint people to help if you wish, and given the importance of trusts, this might be one of those situations where having a professional on board can add real value.

Q IF I MAKE MY CHILDREN TRUSTEES, WILL THEY IMMEDIATELY FIND OUT HOW MUCH MONEY I HAVE?

A Not unless you want them to. They are acting as the trustee of a trust. In the event of a deathtime trust, this will contain almost no assets until the time that you die.

Q ARE TRUSTS LIKELY TO BE CHALLENGED BY HMRC IN THE FUTURE?

A There are two answers to this question. In the case of convoluted arrangements that attempt to circumvent the rules and exploit loopholes, the answer is almost certainly yes. If, however, you are planning on using traditional trust planning, as advocated in this guide, the answer is it is very unlikely. While future governments can change things (the same can be said about any financial planning; just look at pensions rules in the past few years), you can only plan based on what you know at the moment. If you follow the rules, you should have no issues with HMRC later.

Q DO I NEED TO CHANGE MY ASSETS IF I PUT THEM INTO A TRUST?

A Not generally. You can usually transfer properties, shares and other assets into a trust on an in specie basis in their current form.

Q WHAT IF THE RULES CHANGE IN THE FUTURE?

A Then you have to deal with it at the time. There is almost always going to be a reason to delay planning your estate. What if there is a new government? What if legislation changes? What if X happens? If you delay taking action because of this uncertainty, you will never achieve anything.

You have to take action now, based on what the rules are today and taking into account known changes in the future. If things change in the future (which they will), then you adapt the planning to take this into account.

Of course, unlike some other planning, by its very nature estate planning can't be done retrospectively. If you die without having put all of this in place, you can't go back and do it later!

Q WILL I NEED TO DO A TRUST TAX RETURN?

A In some cases you will, but this will depend on the trust's income position and who that income is ultimately given to. If the trust has income that is being retained or distributed on an ad hoc basis to beneficiaries, it may need to do a tax return.

In the event that the trust does need to do a return, my initial guidance to clients is that, if you do your own self-assessment tax return, you can probably do a trust one as well. If you use an accountant for your personal return, then you should probably use an accountant for the trust return as well.

A good accountant will probably charge around £300 per year to prepare the return, which is in my mind good value for not having the hassle and getting it right first time.

FREE INHERITANCE TAX PLANNING SEMINARS

Buckingham Gate Chartered Financial Planners hold regular Inheritance Tax Planning seminars in Central London.
The seminars are **FREE** to attend, but places are limited.

If you would like to reserve places please email us at **events@buckinghamgate.co.uk** or call us on **020 3478 2160**

THE SEMINARS WILL COVER:

- How to update your will to save thousands in inheritance tax.
- Ways to reduce the inheritance tax liability on your estate.
- How to protect your assets for your loved ones.

BOOK YOUR DISCOVERY MEETING

Buckingham Gate Chartered Financial Planners offer a 1-1 discovery meeting with a chartered financial planner. If you would like to see how we can add value to your personal situation, please get in touch by emailing **contact@buckinghamgate.co.uk** or calling **0203 478 2160**.

"BUCKINGHAM GATE PROVIDED EXPERT INFORMATION AND RECOMMENDATIONS ON HOW TO BEST MANAGE MY ESTATE WITH TRUST SETUP, WILL & EFFECTIVE PLANNING FOR IHT. VERY IMPRESSED WITH THEIR KNOWLEDGE AND THE SIMPLE ENGLISH USED TO EXPLAIN HOW TO EFFECTIVELY PUT PLANS IN PLACE TO GIVE ME PEACE OF MIND."

This case study has been taken from the book Efficient Estate Planning, written by estate planning expert Matthew Smith. You can purchase a Kindle edition or paperback copy from Amazon.

Inheritance tax used to be the preserve of only the wealthiest in society, but with rising property and asset prices more ordinary people have been pulled into its grasp.

In Efficient Estate Planning, Matthew Smith will guide you through easy strategies to reduce your inheritance tax bill immediately, thereby maximising the value and impact of your legacy and simplifying the process for your family of dealing with your estate. The book is suitable for inheritance tax beginners and experts alike.

★★★★★

A BRILLIANT BOOK - SHORT AND SIMPLE TO UNDERSTAND. ANYONE CONSIDERING DOING SOMETHING ABOUT THEIR ESTATE PLANNING MUST PURCHASE THIS. AN EXCELLENT OVERVIEW OF THE OFTEN COMPLICATED AREA OF TRUSTS USING CURRENT TAX EXEMPTIONS & ALLOWANCES.

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