HARTSFIELD
FINANCIAL SERVICES LIMITED

Personal Tax

You and yours - estate planning

Keeping more of what you make

KEY GUIDE

Estate planning – too important to put on hold

Estate planning is usually not a subject that attracts immediate attention. It requires you to consider what will happen when your life is over, hardly something most of us rush to contemplate. Consequently, estate planning often becomes, and all too often remains, a do-it-tomorrow task. Then it could suddenly become all important... or it might be too late. After all, accidents do happen.

Think about what arranging your estate planning *now* achieves:

- ***You decide* on the choice of beneficiaries** If you do not set out in a will whom you wish to benefit from your estate, then the State will do it for you. The results are not always what you would expect and can create unnecessary tax liabilities.
- ***You decide* what goes to whom** You might want to leave a particular item to a particular person. Without estate planning, those wishes may not become reality.
- ***You decide* the structure** Leave it to the State to distribute your wealth and normally anyone aged 18 or over will receive their inheritance outright. In some families, that will not be an issue, but in others placing some constraints on how an inheritance is handled could be essential.

With estate planning in place, you will have addressed these important issues rather than left them on permanent hold. However, like all other aspects of financial planning, your estate planning will need regular review.

Action point

Assess your assets and how you would like to dispose them. Answer the questions and discuss them with your partner and, if appropriate, your family.

The importance of wills

Failure to prepare a will means your estate will fall under the rules of intestacy. This default can produce some surprising – and unwelcome – results, as explained below.

Your will needs to be kept up to date. Something that was prepared a decade ago may still be largely relevant, but across such a long period of time your situation and your family's circumstances will probably have changed. Tax legislation has certainly done so. Remember too that marriage will normally result in the automatic revocation of an existing will. Divorce does not have the same effect, but it does treat the former spouse as having died before the will takes effect.

A typical will can be divided into three main elements:

1. Appointments and funeral wishes The duty of executing the terms of your will falls to the people you appoint as executors in the will. It is best to appoint at least two executors: your spouse/partner alone – if they survive you – may struggle to cope with bereavement and estate administration. The choice of executors and guardians is not one to be taken lightly, as both roles involve considerable responsibility.

The first section of the will often also deals with funeral arrangements, such as whether you want to be cremated and perhaps where your ashes should be scattered.

2. Distribution This central part of the will sets out the 'who, what, when and how' of your bequests. This will include specific legacies of cash and/or particular assets to named individuals or charities.

Repayment of debts, the costs of your funeral, outstanding taxes and any other liabilities will usually be met from the part of your estate that is not covered by the legacy provisions. What is left (the 'residue') will ordinarily form the bulk of your estate. This can be divided up however you wish or simply passed outright to a single beneficiary. Dealing with the residue will usually be where the questions of 'how' and 'when' are addressed:

- If some of your beneficiaries are minor children, a trust will be necessary and it is best to seek advice about this. For example, few parents are happy to see an 18 year old receive a substantial windfall with no strings or restrictions attached.
- You may want a surviving spouse or partner to receive the income from your estate, but on their death you would want any capital to pass to your children from a previous marriage. Again, a trust can achieve this.
- In some instances it may be best to leave the decision on the distribution of the residue to trusted members of the family or friends, acting as trustees. You can give them guidance and in your will include a list of potential beneficiaries. However, as your trustees have the final decision, they will be able to take account of the circumstances upon your death.

3. Executor/trustee powers This final section of your will is the part that sets out in legal terms the powers of your executors and, if any trusts are created by your will, the powers given to the trustees. Usually the will is drafted to maximise their flexibility of operation.

Action point

Take some time to review your existing will, alongside your spouse or partner. Does it still reflect your current circumstances and wishes?

A will can be as simple as a few lines or it can be complex and cover many pages. DIY wills are possible and many people use a simple will form or internet will writing services. Whoever prepares your will, it remains a legal document, a point which has regularly created problems in the interpretation of DIY wills. For your own and your family's peace of mind, in nearly all cases it is best to have your will prepared by a solicitor or professional will writer. The error in a poorly drafted will may only emerge after it is too late for you to make any changes.

A word about probate

Before your executors can carry out the terms of your will, they need to obtain probate. This usually involves a considerable amount of paperwork, most notably inheritance tax (IHT) returns *and* payment of any inheritance tax and probate fees due. If your estate does not have enough cash to cover these levies, your executors may need to borrow to meet the bill. The government halted legislation in April 2017 for in England and Wales which would substantially increase probate fees, with the maximum for estates valued at over £2,000,000 rising from £215 to £20,000. This may or may not return after the general election in June.

The Financial Conduct Authority (FCA) does not regulate will writing or taxation and trust advice.

And if you don't make a will…

Whether or not you have a will, anything you own jointly with someone else will pass to the other joint owner(s) on your death. The exception to this arises where your ownership takes the form of a tenancy in common (which would be unusual for married couples and civil partners). If you die without having a valid will, then the laws of intestacy apply. These differ depending on the part of the UK in which you are

domiciled – which may not necessarily be the same as the country where you are living when you die. Intestacy rules often do not produce the distribution of your estate that you might expect. For example, the surviving spouse/civil partner will not necessarily receive everything, as the example below shows.

Example – The unwelcome intestacy surprise

Henry and Ann had been married for 27 years when Henry died in a fishing accident on a Scottish loch in December 2016. He had made no will, but both he and Ann assumed everything would be left to her, as a childless widow. The family home did indeed pass to Ann, because it was owned jointly (as joint tenants), but Henry's £850,000 personal estate was dealt with under intestacy. Although he died in Scotland, the then current English intestacy laws applied as his home and roots were in Kent rather than Kirkcudbrightshire:

- Ann received £250,000 outright and Henry's personal chattels.
- She was also entitled half of the remaining estate (i.e. £300,000).
- The other £300,000 passed immediately to Patrick, the 35 year-old 'permanent student' son from Henry's first brief marriage in the early 1980s.

Unscrambling the unfortunate effects of intestacy may be possible by the use of a legal document called a deed of variation, but it requires the agreement of some parties to give up all or part of their benefits. They may be legally unable to do so because they are minors or they may be adults who are unwilling to do so – like Patrick in the example. There may be similar difficulties with attempts to rectify wills after a death; family ties may not count for much when money is involved.

Action point

Establishing LPAs can be very beneficial for your family in managing your affairs should the need arise.

Lasting powers of attorney

Whenever you make (or amend) your will, you should also consider putting in place a lasting power of attorney (LPA). There are two types of LPA, both of which let you appoint one or more people (your attorneys) to make decisions on your behalf if infirmity prevents you from doing so.

- **Health and welfare LPA** This covers decisions about areas such as:
  - Your daily routine (e.g. eating, washing, dressing).
  - The provision of medical care.
  - If you should move into residential or nursing care.
  - Whether life-sustaining treatment should be refused.
- **Property and financial affairs LPA** This LPA covers your finances, handling areas such as:
  - Paying your bills.
  - Collecting your benefits.
  - Sorting out your tax affairs.
  - Selling your home.

Property and finance LPAs replaced the old enduring power of attorney (EPA) system in October 2007. EPAs established before the changeover are still valid, regardless of whether they have been registered.

Although not strictly part of estate planning, arranging LPAs can be of great value to your beneficiaries, as they allow your affairs to be handled efficiently later on in life. As with intestacy, there is a state fall-back (through the Public Guardian), but the whole process can be slow, expensive and impersonal.

The impact of inheritance tax

Do not ignore the impact of IHT on your estate. Very broadly speaking, IHT is levied on your estate at death and on certain gifts made during your lifetime.

The tax rate at death is normally 40%. However, everyone has a nil rate band (frozen at £325,000 until at least April 2021), and it is available on death to the extent that this has not been set against the total value of lifetime gifts in the preceding seven years. The table below shows the effective rate of tax on an estate of a single person, assuming no reliefs and exemptions are available, but they qualify for a full nil rate band at death.

Action point

Inheritance tax is generally charged at 40% on death and 20% on certain lifetime gifts.

- If you make an outright lifetime gift, regardless of its size, you pay no IHT initially, but the value of the gift is brought back into your estate if you die within the following seven years.
- Other lifetime gifts that you do not make outright – notably gifts into most types of trust – will normally attract lifetime IHT. This is at a lifetime rate of 20% to the extent that they exceed your available nil rate band and any exemptions.
- There may also be further tax, up to another 20%, if you die within the following five years.

The IHT burden

Total estate £	IHT tax payable £	Effective rate on estate %
400,000	30,000	7.5
500,000	70,000	14.0
600,000	110,000	18.3
750,000	170,000	22.7
1,000,000	270,000	27.0
1,500,000	470,000	31.3
2,500,000	870,000	34.8

The IHT tax regime

This brief description is an extreme simplification of the IHT regime. The rules include:

Transfers

Transfers between spouses and civil partners These are exempt from IHT, provided the recipient is domiciled in the UK. Non-domiciled aspects are beyond the scope of this guide, but if you are affected you should know the rules have recently changed.

The transferable nil rate band To the extent that one spouse or civil partner does not use their full nil rate band at death, it is transferable to the survivor's estate. The precise rules are complex, but the effective result is that a couple currently has a combined nil rate band of up to £650,000 (£325,000 x 2). The transferability means that there is no need to ensure that the first of a couple to die uses their nil rate band, as was the case before transferability was introduced in 2007.

Main residence nil rate band (new from 2017/18) An additional nil rate band, initially of £100,000 has been introduced to set against the value of your home provided it is bequeathed to a direct descendant. The band will be increased by £25,000 a year until 2020/21, when it reaches £175,000. Like the existing nil rate band, any unused portion will be transferable between spouses and civil partners, but unlike the existing band it will be subject to a 50% taper if your estate is worth more than £2m. Special rules will deal with downsizing or selling up completely (e.g. on moving into a care home).

Example – The main residence nil rate band in practice

Jack and Jill each had an estate of £1.2m when Jack died in June 2020. His will left everything to Jill, who died eight months later. So Jill inherited 100% of Jack's nil rate band and, as his estate was under £2m, 100% of his main residence nil rate band (of £175,000).

However, on Jill's death her estate was worth £2.4m, which brought the tapering rule into play. Instead of having a total main residence allowance of £350,000 (2 x £175,000), the allowance available to her estate was therefore reduced by £200,000 (£400,000/2) to just £150,000.

If Jack had used his £325,000 nil rate band on first death to make gifts to beneficiaries other than Jill, there would still have been no IHT on his death, but Jill's estate would have been correspondingly smaller on second death. As a result, the available main residence allowance would have been £312,500 (£350,000 – £75,000/2).

Action point

Consider what gifts you could make over the next few years to use your exemptions and reliefs.

Gifts

Annual exemptions There are three annual exemptions, each of which works on a tax-year basis:

- The most widely known is the £3,000 annual exemption, which can cover any type of lifetime gift, in whole or part.
- The small gifts exemption covers any number of outright gifts of up to £250 – useful if you have plenty of grandchildren.
- The least well known is the normal expenditure gift. Regular gifts are exempt from IHT if you make them out of your income and they do not reduce your standard of living.

Charities, etc Gifts and bequests to UK charities, political parties and for the public benefit are exempt from tax. Charitable bequests can also result in the IHT tax rate on your estate being cut to 36%, provided that overall the bequests amount to at least 10% of your net estate.

Wedding gifts Wedding gifts are exempt, but subject to very modest limits (no more than £5,000) based on the relationship between the donor and the bride/groom.

Reliefs

Business and agricultural reliefs Businesses and agricultural property can benefit from generous IHT reliefs, provided certain conditions are met:

- 100% relief is given for shares in unlisted trading companies (including those listed on the Alternative Investment Market or AIM), sole trader or partnership business interests, owner-occupied farms and tenanted farms where the lease started after 31 August 1995.
- 50% relief applies to property and other assets owned by an individual and used by a trading company that they control, or by a partnership in which they are a partner. The 50% relief also applies to tenanted farmland where the lease started before 1 September 1995.

Taper relief The amount of tax payable at death on a gift that was made within the previous seven years is subject to a sliding scale. For example, the tax payable on an outright gift made five and a half years before death is reduced by 60%.

To clarify, the taper applies to the *amount of tax*, not the value of the gift, so a gift that attracts no tax cannot benefit from taper relief but will still be treated as being in your estate at death.

Tax avoidance legislation has steadily increased over the years. For example, the 'gift with reservation' rules would prevent you making any IHT savings by putting your home in your children's names and then continuing to live there rent free.

Estate planning and IHT planning

Estate planning and IHT planning are often lumped together as a single process. If you have a spouse or civil partner, their long-term financial security will probably have a higher priority than tax planning.

Action point

Achieving your estate planning goals and minimising the impact of IHT will involve a range of actions, starting with making the all-important will.

Achieving your estate planning goals and minimising the impact of IHT will involve a range of actions, starting with making the all-important will and potentially including:

- **The use of trusts** Trusts are not just created to save tax. They are often set up purely for estate planning purposes, e.g. setting aside funds to meet the costs of educating grandchildren.
- **Lifetime gifts** Currently gifts made more than seven years before death can escape all IHT. Some people ignore this generous treatment of gifts because they are worried about their future income and security. Fortunately the tools of financial planning can help alleviate these concerns.
- **Maximising allowances, reliefs and exemptions** As far as is practicable you should take advantage of the annual IHT exemptions, particularly the normal expenditure gift rule if you have (or can generate) surplus income. If you own a business or a farm, you need to ensure that you use the appropriate reliefs to the maximum. This has been made more difficult by rules on related loans introduced

in 2013. You can also take advantage of IHT business relief by holding certain types of investment for at least two years; these include some (but not all) AIM shares, which can be held within ISAs.

- **Pension planning** Recent changes to the pension tax rules have increased the importance of pensions in IHT planning. A pension can provide you with the certainty of income that allows you to make lifetime gifts, and represents an IHT-free fund. It is now possible for some pension plans to be passed down from generation to generation, free of IHT and possibly also free of income tax on any payments.
- **Life assurance** There will almost certainly be tax due on the estate at death. For married couples and civil partners that tax bill will normally arise on second death, because there is generally no point in incurring a tax charge any earlier. Life assurance can provide for this in a way that does not increase the size of your estate and will take advantage of your annual exemptions.

The FCA does not regulate some forms of estate planning.

How we can help

We can help with your estate planning and inheritance tax planning in several ways.

- Working with your other professional advisers to optimise the estate and tax planning aspects of your will.
- Advising on the various tax implications involved in lifetime gifts.
- Reviewing your pension provision and suggesting ways to improve its role in your estate planning.
- Arranging investments and life assurance to help reduce or fund the eventual IHT bill.

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