ARE YOU READY FOR THE GREAT WEALTH TRANSFER?

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It has been reported that in the UK alone over £300 billion will be passed down the generations over the next 10 years*. With this in mind, it's hard to argue that now is not the ideal time for professional advisers to redouble their focus on inheritance tax (IHT) and generation planning.

There's no doubt that the pandemic has played a significant part in focusing the minds of individuals of a certain age as well as their children, in terms of what future plans need to be put in place in the event of an unforeseen life event.

As a result of this, more and more forward thinking advisers are becoming aware of the need to engage and build a closer rapport with their clients' children as well.

The pandemic has also prompted the government to search for ways to plug the ever increasing black hole brought about by the furlough scheme and the economic cost of lockdowns.

Since the advent of IHT in 1986, wealthy individuals have always had the ability to mitigate the impact of IHT. Lord Jenkin so eloquently highlighted this when he opined, 'Inheritance Tax is, broadly speaking, a voluntary levy paid by those who distrust their heirs more than they dislike the Inland Revenue.'

Having just announced the Social Care hike to National Insurance and the increase in dividend tax on shares by 1.5% from 2022, taxes in general may also be under review. IHT receipts have increased from £2.4 billion in 2009/10 to £5.4 billion in 2020/21**. With the deceased unable to complain, IHT may be considered an easy target for further tax rises.

In recent times governments have consistently employed stealth taxation or 'fiscal drag' to surreptitiously claw back much needed funds. Recent examples of this can be seen in the freezing of the Nil Rate Band (NRB) until 2026 and never having increased IHT exemptions which stand at the same levels as when IHT was introduced in the 1980s.

There have also been adjustments to who pays IHT, with modifications in April 2017, meaning that UK domiciled individuals, who were born in the UK, but have been resident outside the UK for a period, can no longer benefit from 'Non Domicile' status when taking up residence in the UK again and will also not be permitted to take advantage of the 'remittance basis' of taxation. Further changes meant non UK domiciles will be treated as UK domiciles once they have resided in the UK for 15 years and will also lose the ability to elect to be taxed on the 'remittance basis' at that point.

Both UK domiciles and non UK domicile high net worth individuals have access to a raft of tried and tested, robust solutions to assist with the legitimate reduction and mitigation of IHT and now is the ideal time to explore those options.

So what steps should potential clients be taking to mitigate IHT and pass assets down through the generations?

STEP 1: MAKING A WILL

The starting point for any IHT and generation planning exercise is to ensure that an up to date will is in place which represents a true reflection of the client's wishes at the time, as dying intestate may result in assets being passed on to unwanted beneficiaries.

STEP 2: FOR COUPLES AND CIVIL PARTNERS, CONSIDER USING NIL RATE BANDS

Since the introduction of transferable NRBs, the use of mirror wills with discretionary will trusts, using up each partners NRB on death, has reduced significantly for obvious reasons. This said, in complex family situations,

often occurring after remarriages, where there are children from a previous marriage, the flexibility to gift assets at first death can offer an effective way to cascade wealth to other desired beneficiaries with certainty, rather than leaving such decisions to the remaining spouse or civil partner.

STEP 3: USING IHT EXEMPTIONS AND RELIEFS

Other than the NRB and the spouse exemption, which are widely understood and well publicised, there are a number of other less used exemptions, which may help to reduce IHT liabilities. Notably, there is the annual exemption of £3,000, the charitable exemption which is unlimited and also the ability to make regular gifts out of income should not be overlooked. In addition, Business Property Relief (BPR) and the Residence NRB can also greatly reduce potential IHT liabilities.

STEP 4: GIFTS TO TRUSTS OR OUTRIGHT GIFTS

Making gifts is a key step in reducing IHT liabilities. Gifts to trusts ensure that the right funds are available to the right people at the right time and depending on the type of trust used, will likely reduce the value of the client's estate by the value of the gifted portion, on the settlor's survival for 7 years. A trust structured with an International Portfolio Bond can provide for assets to be passed down the generations and be available as required by future beneficiaries or even their heirs, whilst being managed in a robust structure within a tax deferred environment, which can be adapted to the specific client's changing risk profile. This can be particularly favourable when compared to solutions making use of BPR by investing in AIM listed shares, which may be deemed too higher risk for those investing at a late stage in life. This said, such schemes do offer a reduced waiting period of 2 years for assets to be removed from the client's estate.

STEP 5: INSURE THE REMAINING TAX BILL

Once all gifting and other reliefs and exemptions have been maximised, it may be pertinent to calculate the likely remaining IHT bill due on second death, based on assets at today's value and insure the life / lives of the clients for the likely amount of tax due. The 'gift with reservation' rules mean that it may be appropriate for any premiums to be paid by the beneficiaries and, if jointly owned, the life policy should be set up on a whole life second death basis and assigned to a suitable trust from which the settlor/s are excluded from benefitting.

So take care to help your clients preserve their hard earned nest egg and pass it on for the benefit of the next generation and their progeny.

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*https://twitter.com/BrooksMacdonald/status/1428715444345708547

**https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary

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