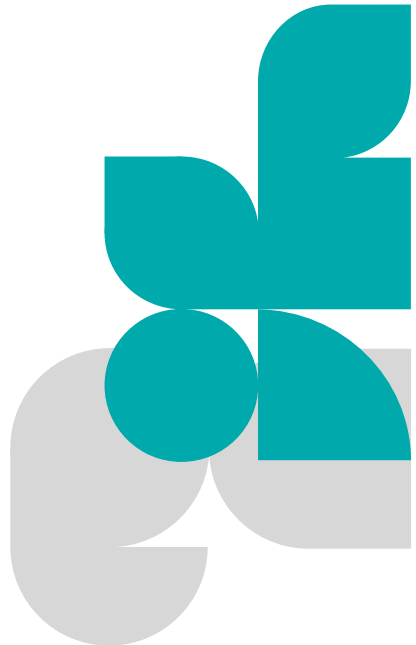


Financial planning

A guide to estate
planning

Rathbones
Look forward



The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance. You should always seek advice from a qualified professional, if you have any doubt as to the suitability of any aspect of your financial affairs.

It should be noted that trust and tax advice is not regulated by the Financial Conduct Authority.

Financial planning

A guide to estate
planning

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Scope

This guide highlights some of the benefits of estate planning and how this can be undertaken.

Effective estate planning aims to ensure that the wealth you have accumulated during your lifetime is distributed to the right people, at the right time and as tax efficiently as possible.

Estate planning is not a once in a lifetime arrangement and solutions should be reviewed from time to time, to ensure they are still fit for purpose, meeting both your requirements and any changes in taxation or legislation.

Generally, the earlier that estate planning is carried out the more options that are available. However, it is also likely that flexible solutions will be required, particularly in the early stages, if family life is not settled or if you are still accumulating wealth.

Estate planning is a complex area and we strongly recommend that you seek independent advice from your financial planner. When your financial planner proposes a solution they will consider affordability and aim to provide you with the level of control, flexibility and assets to meet your needs for the remainder of your lifetime.

What is inheritance tax?

In simple terms, inheritance tax is a tax paid on certain transfers of value during your lifetime and on death. The tax generally arises when your estate is distributed (transferred) on death.

The value of your estate includes any gifts you have made in the seven years prior to your death. If you are domiciled in the UK, the value of your estate will include any assets you hold overseas.

Assessing domicile can be a complex issue and those that believe they are non-UK domiciled should clarify their status before undertaking any estate planning.

Everybody is provided with a nil-rate band (NRB) exemption from inheritance tax. Upon death, assets above this level (which are not otherwise exempt) will be taxed at 40%, 36% or 0%. The NRB is currently* £325,000 and has been frozen at this level until at least April 2021. The NRB is also used up by certain transfers during your lifetime, but can be regained after a seven-year period. Transfers that exceed the NRB during your lifetime may be subject to inheritance tax at a rate of 20%.

*at June 2017



A new main residence NRB is being phased in over the next five years. For the 2020/21 tax year, the additional NRB will be £175,000 if the property is passed on death to a direct descendant. The additional NRB will be tapered for estates with a net value of £2 million or more.

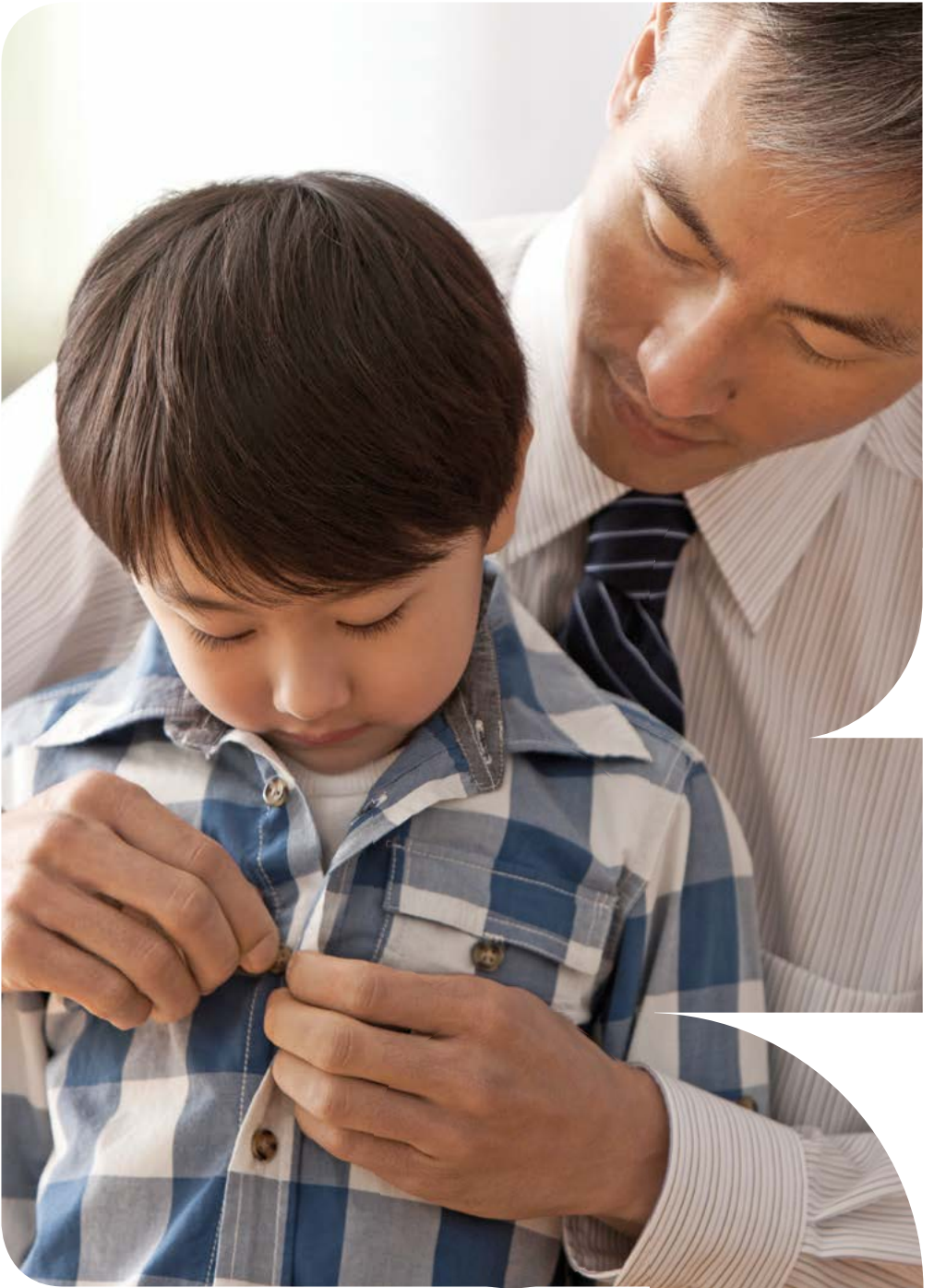
The NRB is transferable which means that on your death any unused NRB (in percentage terms) can be transferred and set against the estate of your surviving spouse or civil partner, if applicable.

Transferable nil-rate band example

John and Linda were married in 1965. John died on 22 October 2002 and Linda died on 10 March 2008. When he died, John's estate was worth £400,000. He left legacies to his children of £100,000 and the residual estate to his wife Linda of £300,000.

The NRB at the time of John's death was £250,000. The legacies that he left his children used £100,000 of his available NRB. This equates to 40% of the NRB so 60% is available to transfer.

On Linda's death the NRB was £300,000. The NRB available to her estate is therefore: $£300,000 + (£300,000 \times 60\%) = £480,000$.



Estate planning

Estate planning aims to reduce or plan for the eventual inheritance tax liability due on your death.

Possible estate planning methods are:

- effectively using inheritance tax exemptions
- effectively using inheritance tax reliefs
- gifting
- using trusts
- using insurance contracts.

While you are reading the rest of this guide, please consider:

- is estate planning a priority for me?
- do I want to commit assets to estate planning?
- do I have assets I can commit to estate planning?
- do I know whom I would like to benefit from my estate?
- do I want to reduce the potential inheritance tax liability on my estate, plan for it or remove it completely?
- have I undertaken any estate planning already? Is it still appropriate?

Inheritance tax exemptions

Not all of your estate will be liable to inheritance tax. Certain transactions are exempt if they are carried out during your lifetime, and others during your lifetime and on death.

Using the exemptions on an ongoing basis could remove significant value from your taxable estate for inheritance tax purposes.

Exemptions available during lifetime only

Annual exemption. Gifts of up to £3,000 per annum per donor are exempt. If the exemption has not been used in the previous year, it can be carried forward to the current year.

Small gifts. Gifts of up to £250 can be given to any number of individuals in a year. The exemption only applies if the total given to one person does not exceed £250 and the exemption is not combined with any others.

Gifts in consideration of marriage or civil partnership. The value of the gift which is exempt depends upon your relationship to the couple.

Gifts made out of income that do not reduce your standard of living. Regular gifts can be made free from inheritance tax providing they are made out of income and leave you with sufficient income to maintain your usual standard of living. Detailed record keeping is required to evidence the use of the exemption.



Exemptions applying both on death and during lifetime

Nil-rate band. Strictly this is not an exemption, but as detailed earlier the first £325,000 of chargeable transfers are taxed at nil percent, so are effectively tax free.

Spouse/civil partner. Transfers between husband and wife, or civil partners, are exempt from inheritance tax. This is without limit except where one spouse or partner is non-UK domiciled.

Gifts to charities. All gifts to UK-registered charities are exempt. Additionally, if 10% of your net estate is left to charity the rate of inheritance tax applicable on death is reduced to 36%.

Gifts to political parties and for the national interest. The value of the gift is exempt, however, specific requirements must be met to utilise these exemptions.

Planning considerations

- The exemption applies immediately.
- You must have sufficient assets to give away.
- You are unable to change your mind once the gift has been made.
- Records will need to be maintained to ensure the exemptions can be applied correctly.
- The exemptions are limited by amount and recipient.



Inheritance tax reliefs

Inheritance tax reliefs reduce the rate of tax payable on certain transactions during your lifetime and on death. The three key reliefs are:

Business property relief

Most shares of private trading companies, or interests in unincorporated business, will receive 100% relief from inheritance tax as long as the asset is retained. The relief is reduced to 50% for assets used but not owned directly by the business. Assets generally need to be held for at least two years from the date the qualifying investments are purchased to qualify.

Business property relief example

An individual invests £200,000 in a business property relief qualifying investment (assuming no investment growth or loss).

	Current situation	Two years after assets purchased
Estate value	£800,000	£800,000
Available NRB	£325,000	£325,000
Taxable estate	£475,000	£475,000
Estate subject to 40% inheritance tax	£475,000	£275,000
Estate subject to 0% inheritance tax	£0	£200,000
Inheritance tax liability	£190,000	£110,000
Inheritance tax liability reduction		£80,000

Agricultural property relief

Agricultural land, together with farm houses and other farm buildings, may qualify for 100% or 50% relief from inheritance tax. Assets generally need to be held for at least two years to qualify.

Taper relief

Reduces the amount of inheritance tax payable on lifetime gifts which take place between three and seven years prior to death, and where the NRB has been exceeded.

Taper relief example

Julia makes a gift of £375,000 on 1 February 2009. She dies on 20 June 2012. The gift exceeds her available NRB by £50,000. The full rate of tax on the gift would be $£50,000 \times 40\% = £20,000$.

As the gift is within three to four years of the date of death, taper relief can apply.

Taper relief allows you to reduce the tax rate by 20% in respect of the above example, which will reduce the tax payable to $£20,000 \times 80\% = £16,000$. Tax relief is £4,000.

Years between transfer and death	Percentage of full tax rate
0-3	100%
3-4	80%
4-5	60%
5-6	40%
6-7	20%
7+ years	0%

Planning considerations

- Business property relief and agricultural property relief are particularly useful estate planning tools due to the short period that the asset must be held in order to benefit from the relief.
- Some individuals may benefit from business property and agricultural property relief easily as a result of their occupation or family assets. Other individuals can utilise the reliefs by making inheritance tax efficient investments.
- Taper relief reduces the rate of inheritance tax payable on a gift in excess of the NRB on a sliding scale and can be a significant benefit.

Inheritance tax efficient investments

A number of schemes are available which make use of business property relief. The schemes can purely be focused on inheritance tax relief or can provide additional relief from income tax and capital gains tax.

In order to qualify for business property relief, the scheme must generally invest in a portfolio of small UK companies. The companies will be selected by your investment manager after due diligence. The investment manager will choose companies to help achieve a particular objective, such as high growth potential, capital preservation or income generating capability.

Investing in small companies is always considered high risk even if the investment manager is investing with a view to preserving capital. The government recognises this but also sees the benefit to the UK economy of encouraging entrepreneurship, which is why attractive tax reliefs are available.

Inheritance tax efficient investments will not be suitable for many investors due to their high risk nature, but in the following situations they can be a useful additional tool:

- where the investor has sufficient other assets/income to support them
- where there is no need to access the funds as the relief is only maintained while the asset (or equivalent) is held
- where life expectancy limits other estate planning alternatives
- where the investor has a speculative approach to investing
- where the investor can afford to lose the whole investment value
- where the investor has income and/or capital gains which could benefit from relief
- where the investor requires diversification.

It is important that you seek advice before investing in an inheritance tax efficient investment as there are a wide range of schemes available and the terms can be quite complex. Not all schemes will be suitable. It is also necessary to consider the timing and amount of the investment.

Example inheritance tax efficient investment to provide income tax relief example

A 45% income tax payer invests £10,000 into an enterprise investment scheme (EIS).

	Company doubles in value and you hold shares for three years	Company value stays the same and you hold the shares for three years	Company closes and your shares are worth nothing
Investment	£10,000	£10,000	£10,000
Income tax relief	£3,000 as a reduction in your income tax bill	£3,000 as a reduction in your income tax bill	£3,000 as a reduction in your tax bill
Capital gains tax	£0	£0	£0
Gain	£13,000 (£10,000 profit + £3,000 income tax relief)	£3,000 (income tax relief)	At risk capital £7,000 Loss relief on at risk capital at 45% = £3,150 Actual loss £3,850 (£10,000 – (£3,150 + £3,000))



Gifts

Gifts are a simple form of estate planning. Gifts can be made directly to an individual or they can be made through a trust as detailed in the next section.

Potentially exempt transfers

Generally, gifts made to individuals are potentially exempt transfers unless they utilise one of the exemptions detailed previously. The gifts will become exempt if you survive seven years after making them.

Gifts up to the NRB reduce the available NRB by the amount gifted for the next seven years.

Gifts over the NRB will benefit from taper relief as detailed earlier. Your NRB will be unavailable for the next seven years.

Potentially exempt transfers will not incur an immediate inheritance tax charge.

Chargeable lifetime transfers

Gifts made via a discretionary trust (where there is flexibility over the final beneficiary) during your lifetime are considered to be chargeable lifetime transfers, where they exceed the available inheritance tax exemptions.

Chargeable lifetime transfers will utilise part or all of your available NRB depending upon the value of the gift. It is necessary to look back seven years to determine whether any other gifts have utilised part of the NRB previously. If the gift exceeds the available NRB, an immediate inheritance tax charge will be incurred at a rate of 20%, half the current death rate.

Periodic inheritance tax charges and exit charges may also be due.

Your NRB will be unavailable for the next seven years and this may affect other gifts made for up to 14 years.

Taper relief may also be available in the event of death within three to seven years of making the gift.

The order of events which is potentially most effective in reducing tax liability

Exempt gifts: for example, premiums paid for regular premium policies inside the annual exemption or out of normal expenditure

Chargeable lifetime transfers (CLTs): for example, gifts into a discretionary trust

Outright gifts, or gifts into bare trusts which are treated as potentially exempt transfers (PETs): for example, single premium bonds

Planning considerations

- The order in which gifts are made can have a significant bearing on the potential inheritance tax liability.
- Generally any inheritance tax liability will fall on the recipient of the gift. However, you can decide to pay the liability, but the value of the gift for inheritance tax purposes will need to be increased to cover the gift and the tax liability.
- You must ensure that you have adequate resources to meet your future needs.
- You are unable to change your mind once the gift has been made.



Trusts

Trusts can be used in a variety of ways when undertaking estate planning. While there are a number of different trust variations there are only two types of trust – absolute and discretionary.

Trusts can be used to hold assets which can be used to provide you and future beneficiaries with a lump sum and/or income. Holding investments in trust has the advantage of moving investment growth outside your estate while also retaining control of the asset and access to income and/or capital.

Trusts can also be used to hold an insurance contract. In this case, the trust will generally not have a value until death when the insurance policy proceeds are distributed according to the terms of the trust. Holding insurance contracts in trust has the benefit of speeding up payment of the proceeds on death and allowing benefits to be paid in stages.

What are the benefits of using a trust?

Quicker payout for your beneficiaries. When you die, your personal representatives will need to obtain probate so that they have the authority to deal with your estate. In England and Wales either a 'grant of probate' or 'grant of letters of administration' is issued to your personal representatives. This process takes time and if you die without having made a will it takes even longer. Since the trustees are the owners of a policy placed in trust they do not have to go through this process in order to make a claim.

The money paid out is not in your estate for inheritance tax purposes.

When you die, if your estate is worth more than the NRB, inheritance tax may be due. In the case of a life assurance policy, if this is not held under trust it will become part of your estate, which could increase

the chance of inheritance tax being due, or increase the amount of tax payable. Placing your life assurance policy under trust will mean that your personal representatives will not have to pay inheritance tax on the proceeds, as it would not form part of your estate.

Ensures the money is given to those you wish to receive it. By placing your policy under trust, you can indicate how you want the proceeds to be distributed. If you were to die leaving children under 18, the trustees could use the trust to support your children without giving them full access to the money.

Absolute trust

Absolute trusts are also known as bare trusts. The beneficiaries of this type of trust must be chosen at outset and cannot be changed in any way. Absolute trusts are completely inflexible.

This type of trust is often used to gift money to children which they can only access on reaching adulthood. It can be used by you to retain a right to an income and/or capital during your lifetime while making provision for your beneficiaries to receive funds after your death. Provision can be made to provide funds for education or maintenance prior to your death. Alternatively, it may be used to hold an insurance contract where the beneficiaries are certain.

Any gifts into an absolute trust are potentially exempt transfers and will be included in your estate for inheritance tax purposes for seven years.

Any growth generated within the trust is taxable at the beneficiary's own rate, even as a child.

It is worth considering if you establish an absolute trust that the assets are deemed to be the beneficiaries' for the purposes of bankruptcy or divorce. The trustees will also have a statutory obligation to inform the beneficiaries of their entitlement under the trust, therefore control will be limited.

Discretionary trust

This type of trust is very flexible and it is possible to remove or appoint beneficiaries in line with the terms of the trust throughout the lifetime of the trust. The trustees have flexibility to distribute trust assets according to the needs of the beneficiaries providing that the overall trust objective continues to be met.

This type of trust can be used by you to retain control of capital and to receive an income and/or capital during your lifetime, whilst making provision for your beneficiaries to receive funds after your death. Establishment of a discretionary trust is a chargeable lifetime transfer where they exceed the available inheritance tax exemptions.

Where funds are gifted into a discretionary trust the inheritance tax treatment will depend on the value of the gift and the amount of NRB remaining.

Where an insurance contract is placed into the trust there is normally no immediate value for the trust unless an existing whole of life policy is transferred into trust or in cases of ill health. For gifts below the available NRB they will utilise part of your NRB for the next seven years.

Where the gift exceeds the available NRB there will be an immediate tax charge of 20% on the excess over the NRB. In addition, a periodic charge of up to 6% of the excess over the NRB may be payable at 10 yearly reviews. Exit charges could also apply. Your NRB will be unavailable for seven years.

Planning considerations

- The type of trust required must be selected at outset.
- Access requirements, including provision of income, must be established at outset and are unlikely to be able to be altered.
- Investments held within a trust will continue to be subject to income and capital gains tax where applicable.

Estate planning opportunities with discretionary trusts

The discounted gift trust is designed to provide an immediate inheritance tax saving, while enabling an income to be received. The plan is made up of two parts, the **'discount'** and the **'gift'**.

The 'discount'. When the plan is established the level of income to be taken is set at the outset and cannot be altered. Up to 5% per annum of the amount invested can be received without an immediate liability to income tax. This can be payable monthly, quarterly, half yearly or annually, and is dependent on you surviving the selected payment dates.

The insurance company will estimate the life expectancy of the settlor (the person/s who creates the trust via a transfer of money, assets or property - known as the settlement), based on their age and health, and thereafter calculates how much income they would expect to be payable throughout the settlor's lifetime. A calculation takes place to capitalise these payments and it is this figure that is deemed the 'discount' of the original investment and is deemed to be outside of the settlor's estate from day one.

The actual amount of the discount will be decided by HM Revenue and Customs (HMRC). The Life Office will give you an indication of what they consider reasonable.

The 'gift'. After calculating the 'discounted' element of the original investment the balance is then deemed the 'gift', and you would have to survive for a period of seven years in order for it to fall completely outside of your estate for inheritance tax purposes.

Illustration based on a couple aged 80 and 79 years and taking withdrawals of 5% per annum, the discount could be as follows:

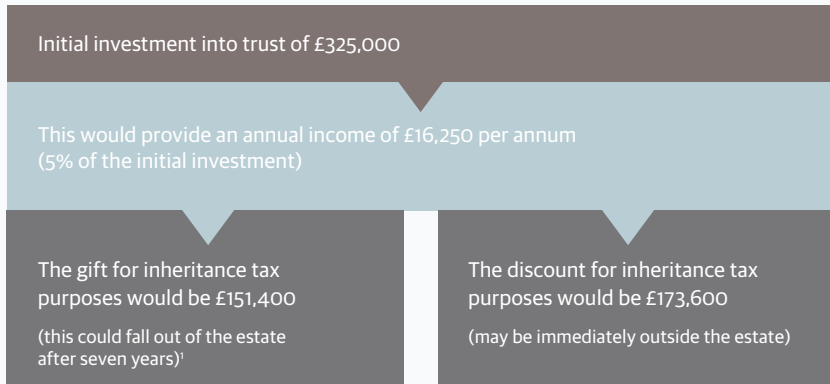
Based on an initial investment of £325,000

Discount of:	£173,600	could be outside the estate from day one
The gift for inheritance tax purposes is:	£151,400	and could fall outside of the estate after seven years
This would provide and income of:	£16,250 per annum	without an immediate liability to tax

As the estimated discount of £173,600 would no longer form part of the settlor's estate, this would instantly save £69,440 in inheritance tax from day one. An indication of the value of the discount would be calculated by the Life Office actuaries who would take into account age, state of health, etc.

If the settlor survives for a period of seven years from the date the scheme was established, the total investment/gift would be outside of their estate saving £130,000 in inheritance tax.

On death (if the trust was established holding an investment bond) the trustees can either potentially continue with the bond, encash the fund and distribute the proceeds between the beneficiaries or assign segments of the bond to the beneficiaries to potentially save further tax.



¹Assuming the order of previous gifts has not had a negative impact.

Under a discounted gift trust the settlor would automatically be a trustee with control over the funds held and influence over who can eventually benefit from the plan.

The policy could be written on the lives of the beneficiaries or additional trustees and placed into trust for the benefit of the beneficiaries, as defined by the settlor.

The flexible reversionary trust

Under this arrangement the settlor could invest an amount of £325,000 for example, into a series of 10 life assurance policies with a succession of annual maturity dates over a period of 10 years.

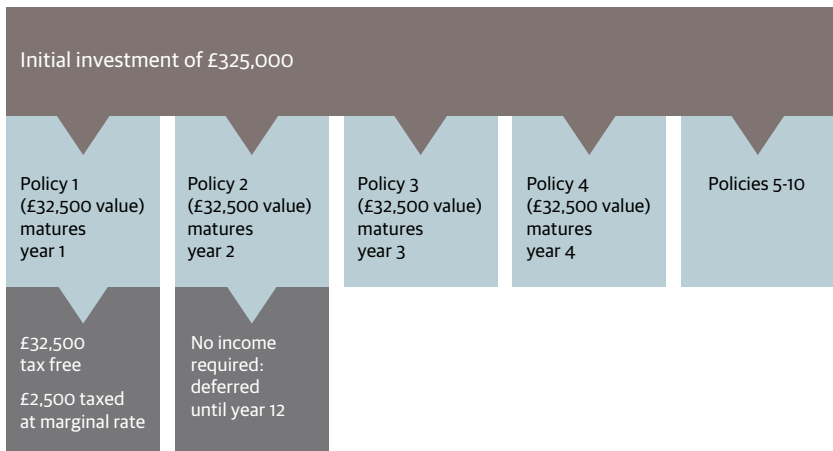
In year one, the first policy (amounting to the value of 10% of the original investment) will 'mature', thereby enabling the settlor to receive an 'income' in this instance of £32,500 plus investment growth should it be required (alternatively, the maturing policy can be deferred to a later date, see later).

Assuming that the value of this policy had grown to £35,000, the 10% initial investment will be returned free of tax. However, any growth on the policy will be returned subject to tax at the recipient's marginal rate. In year two, the second policy will mature and again, this will entitle the settlor to receive a further £32,500 (assuming the policy has not decreased in value), plus any investment growth should it be required. This process will continue until the earlier of all proceeds from all policies having been withdrawn, or death.

Flexible reversionary trust account based on initial investment amount of £325,000



Deferred flexible reversionary trust account maturity date example



The term of the policies can be extended each year so that if income is not required, the maturity date can be deferred. The usual term for extension is a further 10 years although this is not fixed and can be varied by the settlor.

After seven years of the initial investment being made, the value of any of the ten policies that have not been taken will be outside of the settlor's estate for inheritance tax purposes.



Protection

Insurance contracts are commonly used as part of the estate planning process as they are able to provide a lump sum on death payable to the beneficiaries of the estate. This can be used to pay an expected inheritance tax liability.

The advantages of using an insurance contract to fund the potential inheritance tax liability are primarily simplicity and speed. If a protection policy was not in place the personal representatives may need to sell assets from the estate to cover the liability. Selling assets can be time consuming particularly where property is involved. There may be reasons why the beneficiaries would prefer the personal representatives to retain the asset such as investment potential, poor market conditions or sentiment.

Whole of life insurance contract

This type of contract could pay a lump sum on the death of the last life or lives assured. The sum assured should be based upon the current or expected inheritance tax liability on death. Premiums will be based upon the sum assured, age and health of the lives assured and policy features.

Additional policy features which can be included are:

Guaranteed or reviewable premiums. Guaranteed premiums are fixed once the contract is in force and cannot be altered by the insurer. Reviewable premiums will be periodically reviewed by the insurer depending upon the plan conditions and life office experience. Guaranteed premiums are generally more expensive at the outset, although reviewable premiums can increase over time.

Benefit indexation. The lump sum provided by the contract can be indexed so that its purchasing power is maintained after the effects of inflation are taken into account. Some insurers will index the benefit each year automatically where this option is selected, while others give you the option of increasing it or not. Where the cover is indexed the premium (even for guaranteed premium contracts) will also increase.

Benefit basis. Some whole of life contracts can be established with an investment element. Premiums will partly be directed to life cover and partly invested. The proceeds on death will be based upon the combined value of the investment and insured elements. Investment-based contracts do not always provide a fully guaranteed death benefit and it is often the case that premiums may need to be altered if investment returns are not as expected.

Alternatively, the contract can be established on a pure protection basis so that the lump sum is guaranteed.

Gift inter vivos

This is a type of decreasing term assurance policy. The contract is designed to cover the potential inheritance tax liability arising from a gift which exceeds the NRB. The sum assured is designed to reduce according to the reduction in tax rate as a result of taper relief.

The inheritance tax liability on lifetime gifts generally falls with the recipient and they may not have sufficient accessible assets to cover the liability.

It is important that the policy is established at the same time as the gift is made otherwise the decrease in benefits will not coincide with the decrease in liability. Where this has not been done, your financial planner can explore other options with you.

Planning considerations

- Insurance contracts can be held in discretionary or absolute trust. The type of trust required needs to be determined at the outset.
- There may be some flexibility to alter the terms of an insurance contract such as increasing the sum assured.
- Policy premiums themselves are likely to be considered a gift for inheritance tax purposes unless they qualify under one of the exemptions detailed previously. The tax treatment of the premiums (gifts) will depend on the type of trust, if any, the contract is held in.
- Existing cover should be reviewed before taking out a new contract as life cover becomes increasingly expensive as you get older or your health deteriorates.
- Cover may be unavailable at a cost-effective rate depending upon your state of health.
- Premiums must be maintained in order for the cover to remain in place.



This guide has hopefully provided a general overview of the estate planning options available to you.

It is important that a detailed discussion is undertaken with your financial planner before proceeding with any action.

Before undertaking any estate planning, please ensure that you have a valid will in place and that it reflects your current wishes. You may also wish to consider setting up a lasting power of attorney, which will allow your representatives to act for you if you are unable to manage your affairs.

Taking the next step

If you would like further information or to arrange a meeting,
please contact one of the team, on 020 7399 0000
or email financialplanning@rathbones.com

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T3-FP-EP-07-17




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