Lifetime Tax Planning

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1 Potentially Exempt Transfers ("PETs")

The current Inheritance Tax free threshold for the 2014/15 tax year is £325,000 frozen until 2018/19. Up to double this amount is available for a surviving spouse, depending on the amount of the threshold used on the death of the first to die. If you make substantial gifts (to an individual only since March 2006) and these are not covered by any of the above exemptions, the value will count towards the threshold. You must survive for seven years after any such gift for the value to fall out of your Estate on death. Otherwise, the value is aggregated with all other assets owned at death for Inheritance Tax purposes. Tax payable is tapered on a sliding scale if death occurs between four and seven years after the gift but only where the lifetime gift exceeds the tax free threshold.
Note: Capital gains tax may also be payable on lifetime gifts of assets other than cash depending on the assets used.

2 Regular gifts out of surplus income

Inheritance Tax (formerly capital transfer tax) is a tax on capital. Accordingly, gifts made out of surplus income are not taxable, whatever the amount. You do not have to survive seven years. The payments can stop at any time without invalidating the exemption for the payments which have already been made. The payments must be from income, which ordinarily means income on which you are liable for income tax. This does not include regular withdrawals from bonds, which are returns of capital. There must genuinely be surplus income, i.e., you cannot make payments out of income and then live off capital. Further, you have to show that the payments are "regular". We think this would be a minimum of at least once a year. If you do decide to use this exemption, you should write a note "to whom it may concern" indicating your intention to make payments at regular intervals from your surplus income. It might be as well to get in touch with us at that time so that we can draft an appropriate letter for you. In addition, you should keep records of your income and expenditure so that, if you do die, it would be easy for your executors to demonstrate that you have surplus income.

3 Pensions

New rules have come in with regard to pensions. If you die before the age of 75, the amount in your pension pot can be paid to your beneficiaries as a lump sum tax free (up to the maximum allowance of £1.25 million) whether or not you have been taking your pension. If you die after 75 (in which case you will have been taking your pension), your pension pot remaining at death can stay in place tax free. Any withdrawals by your beneficiaries will be subject to income tax in their hands (there are transitional rules in place for 2015/6). It is possible to contribute an amount equal to your whole earnings (up to a maximum of £40,000 per annum) to your pension scheme each year and you will get income tax relief on those contributions. You can contribute more than that allowance, although you will not get income tax relief on the additional contributions. However, you cannot accumulate more than £1.25 million in your pension pot.

4 Gift and Loan Trust

In this scenario, you set up a Trust of which you yourselves are not beneficiaries. The beneficiaries would ordinarily be your children and their descendants. You lend money to the Trust, which it then invests. Because the money is lent to the Trust, rather than given, it does not leave your estate but the advantage is that you can ask for it back at any time. In addition, you can charge interest if you so wish. On the other hand, the Trust invests the money and any growth in value of that money is outside your estate immediately. This is a long term scheme. Quite a number of financial institutions offer appropriate products. Naturally there would be some setup costs but, over time, it is very tax effective.

5 Discounted Gift Trusts

These are usually appropriate for people who are in their 70s or older. Essentially, the person makes a gift into a Trust of a lump of capital, but retains a right to income for the rest of their life. There is an actuarial calculation of their life interest and this is immediately deducted from the value given away, and produces an immediate Inheritance Tax saving. The remainder of the sum given away is tax free after seven years.

In the meanwhile, although the donor has lost access to the capital, they retain a right to income. This is often done with bonds and the donor receives a return of capital, which is free of income tax, each year. Again, this is a financial product and there are set-up and management charges.

6 Gifts on Marriage

Each of the parents of a party to the marriage can give £5,000.00. Grandparents can give £2,500.00 each and unconnected parties can give £1,000.00. This is, of course, in addition to your usual annual exemption of £3,000.00.

7 Investments on the Alternative Investment Market (AIM)

The AIM is a stock exchange for companies which are younger, and smaller, than companies whose shares are quoted on the London Stock Exchange. Investments in these companies are, of course, riskier than ordinary stocks and shares, but they qualify for 100% relief from Inheritance Tax once you have owned them for two years. Several companies offer AIM funds which invest in a large number of AIM companies to spread the risk. In addition, we understand there are some products which invest in AIM companies and which guarantee to return at least your original investment. This is only suitable for a small part of your investment portfolio but is very tax efficient.

We hope that this information is of use. You will need a financial adviser if you want to go ahead with pensions, the discounted gift trust, the gift and loan trust or AIM investments and we can recommend some local advisers if you would like.

Contacts

If you have any queries please do not hesitate to contact a member of our dedicated team.

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