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Adviser insight

Don't flinch from IHT planning

Minimising inheritance tax liability is a complex area that forms a core part of the financial planning service that today's highly qualified IFA should offer their clients

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When the then Chancellor Alistair Darling announced the introduction of the transferable nil-rate band in his October 2007 pre-Budget report, many couples heaved a sigh of relief. It was undoubtedly good news and many estates have fallen out of the inheritance tax (IHT) bracket as a result. However, there are still far too many estates, perhaps as many as one in five, whose heirs will be saddled with considerable duties to pay.

The financial services industry has had a hard time over the past few years. With the challenges of the stock market and recent falls in investment values, it has been all too easy for advisers to focus on fire-fighting rather than looking at the bigger picture.

Both clients and advisers have been guilty of taking their eye off the IHT ball; in an increasingly litigious society, advisers should beware the dangers of failing to take action to minimise clients' IHT liabilities. Indeed, we have lost one potential legal safety net, the Hastings-Blass rule, that allowed the courts to undo tax decisions that had a detrimental impact on IHT liabilities. If we get it wrong, there is no way back.

Keep up with legislation

It is not rocket science. The fact is IHT is a voluntary tax. It is completely avoidable with the right planning and the right investment vehicles. It is vital advisers review their clients' IHT liability regularly to take account of changing rules and legislation. For example, schemes set up to minimise IHT liability in the past may now fall foul of anti-avoidance rules.

Changes in family circumstances can have a substantial impact on IHT planning too. For example, divorce and remarriage may muddy the waters, and parents may want to change their wills and IHT planning to ensure interests of children from an earlier marriage are protected.

Increasingly, a pension scheme can be one of an individual's greatest assets, and changes to pension

legislation will have an impact on how heirs can benefit from unused pension savings. The recent removal of compulsory annuitisation at age 75 may lead to an increasing number of deaths during pension drawdown and those affected should be thinking of how best to ensure remaining funds are maximised for the benefit of their spouse or other heirs. Equally, measures should be taken to ensure heirs benefit if death occurs before pensions have been crystallised.

IHT planning tools

One of the simplest pieces of advice given under the IHT planning umbrella is to just give it all away. However, with longer life expectancy and the increasing likelihood of needing to fund care, advisers should be wary of suggesting such generosity. It is critical that any lifetime cashflow planning allows for longevity and care fee needs to avoid any chance of the money running out.

Having said that, moderate gifting is a useful tool in planning: the rules include a tax-free gifting allowance of £3,000 per year as well as specific allowances for wedding gifts and other exemptions.

The most valuable asset for most estates will be the family home. The ruse of gifting a family property to the children was once common as a means of reducing IHT.

However, the rules covering this type of transaction have been considerably tightened and, where a reservation of benefit exists (for example if the person making the gift is still living in the property without paying rent), then it will still be considered part of the original estate for IHT purposes.

One of the most effective IHT planning tools is the trust. A range of trust structures can be used – spousal bypass trusts, pilot trusts and discretionary trusts to name a few – all of which can be used to take assets out of an individual's estate.

There is a tax framework around trusts and the gift into trust is subject to the IHT potentially exempt transfer (PET) seven-year rule. However, when compared with the full

IHT rate of 40%, the value of using trusts can easily be appreciated.

Core offering

Minimising IHT liability is a complex area that should be handled by specialists. Some firms may regard it more appropriate to pass this task on to accountants or solicitors, who will be touting for this type of work. However, it is a core part of the financial planning service that today's highly qualified IFA should be offering.

While it is appropriate to work closely with other professionals to ensure a cohesive strategy is adopted, IFAs have a duty to tackle the issue themselves. They should be raising clients' awareness; they should reassess and remind clients of the importance of planning in this area as an integral part of every review.

Tools are available to create lifetime cashflow forecasts so future needs can be assessed accurately and any surplus wealth measured.

From a client viewpoint, assessing potential IHT liability is as important as delivering investment valuations and pension projections.

IHT mitigation is straightforward but it requires knowledge, expertise and careful planning. IFAs will be better qualified than ever before following the retail distribution review, and they have all the tools and information at their fingertips. They should not flinch from taking it on.

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