Inheritance, Capital Gains & Income Tax Planning solutions

For investment professionals only

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The Inheritance Tax issue

- Taxable estates in excess of the nil-rate band (currently £325,000) are subject to 40% IHT[1]
    - Married couples/civil partnerships benefit from £650,000 of nil-rate band

- The nil-rate band has been frozen until 2021

- An additional nil-rate band is available when a residence is passed on death to a direct descendant (subject to conditions)
    - £100,000 in 2017-2018
    - £125,000 in 2018-2019
    - £150,000 in 2019-2020
    - £175,000 in 2020-2021

- A direct descendant is a child (including a step-child, adopted child or foster child) of the deceased and their lineal descendants

- Where the deceased's estate exceeds £2m (the taper threshold), the appropriate RNRB amount will be reduced by £1 for every £2 by which the taper threshold is exceeded to provide an 'adjusted allowance'

[1] *Rate of IHT payable is reduced to 36% if the deceased leaves 10% or more of their 'net estate' to qualifying charities'*

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The Inheritance Tax issue

- 2010/11: £2.7bn IHT receipts[1]
- 2014/15: £3.8bn IHT receipts[1]
- 2015/16: £4.6bn IHT receipts[1] – up 22% from 2014/15
- 2019/20: £5.1bn IHT receipts forecasted[2]

A growing need:

- Over 10 million people (17.68%) of the population are over 65[3]
- The number of over-85s has increased 31% since 2005[4]

[1] Source: HMRC: Inheritance Tax Statistics – analysis of receipts
[2] Source: OBR, Economical and Fiscal Outlook, November 2016
[3] Source: ONS Population Estimates Analysis Tool – mid 2015
[4] Source: ONS Population Estimates - mid 2015

The Inheritance Tax issue

In 2016:

- **14%** of adults know the current IHT threshold
- Almost **1/3** of homeowners over the age of 70 haven’t considered estate planning for IHT mitigation
- **45,000** death estates caught by IHT
- **80,000** dementia cases per year – Business Relief is often the only estate planning option where a Lasting Power of Attorney is in place

Source: Alternative Investment Report 2016: Business Property Relief Industry Report, powered by Intelligent Partnership

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Estate planning using Business Relief

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Business Relief overview

- Introduced in the 1976 Finance Act
- Up to 100% Business Relief (BR) after just 2 years

Two year holding period

- Shares must be held for two years and remain unquoted (or qualifying companies listed on AIM)
- Begins on date shares are purchased
- Spouse's period of ownership counts towards two-year clock

Replacement Relief

- Individual must have held a BR-qualifying asset for two out of last five years (and at the time of death) to benefit from BR

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Business Relief & estate planning

Potential clients for BR

Late IHT planning
No age limits
two-year clock

Ill health
No medical requirements
Those declined for life assurance
two-year clock

Business exits
Replacement relief

Quick succession relief

Clients requiring income*

Seeking to spread risk
Those wanting to diversify their IHT planning

Power of Attorney
Where gifts/transfers prevented

Younger clients
Where access/control is important

Trust applications
Avoid 20% lifetime charge

**Distributions are paid by selling shares (capital)*

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Business Relief & estate planning

Seven year timeline is too long

Lack of access and control

I don't want to give my money away yet

Advantages

- Two-year IHT clock
- Access to all capital and flexible income
- No requirement to gift money away
- No requirement for Trustees
- No periodic or exit charges

Disadvantages

- Capital at risk
- Returns are not guaranteed
- Change in tax rules
- No protection in the event of bankruptcy, divorce or need for long-term care

Inheritance Tax - case studies

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Case studies

Example 1: mitigating Inheritance Tax

- Edna: 80 years old, unmarried
- Annual taxable income: £88k (income tax £26k)
- Total estate: £1.325m, comprises:
  - £500k BP shares (with gains of £200k/Capital Gains Tax £40k if sold)
  - Other shares/cash £500k
  - House £325k (no mortgage)

Please note that these examples are set out for illustration purposes only. Risk profiles of these examples may be higher than other alternatives.

Case studies

Example 1: mitigating Inheritance Tax

Possible solution:

Sells BP shares & reinvest £500,000 proceeds

£200,000 into EIS

- CGT deferral of the £200,000 gain for the lifetime of the EIS (none if held to death)
- Income tax relief £60k
- £80,000 IHT saving after 2 years (if shares still held at death)

£300,000 into BR

- £120,000 IHT saving after 2 years (if shares still held at death)
- Up to 20% downside protection insurance (on death up to age 90)

= *total IHT saving £200k after 2 years (provided shares are held at death)*

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The Capital Gains Tax issue

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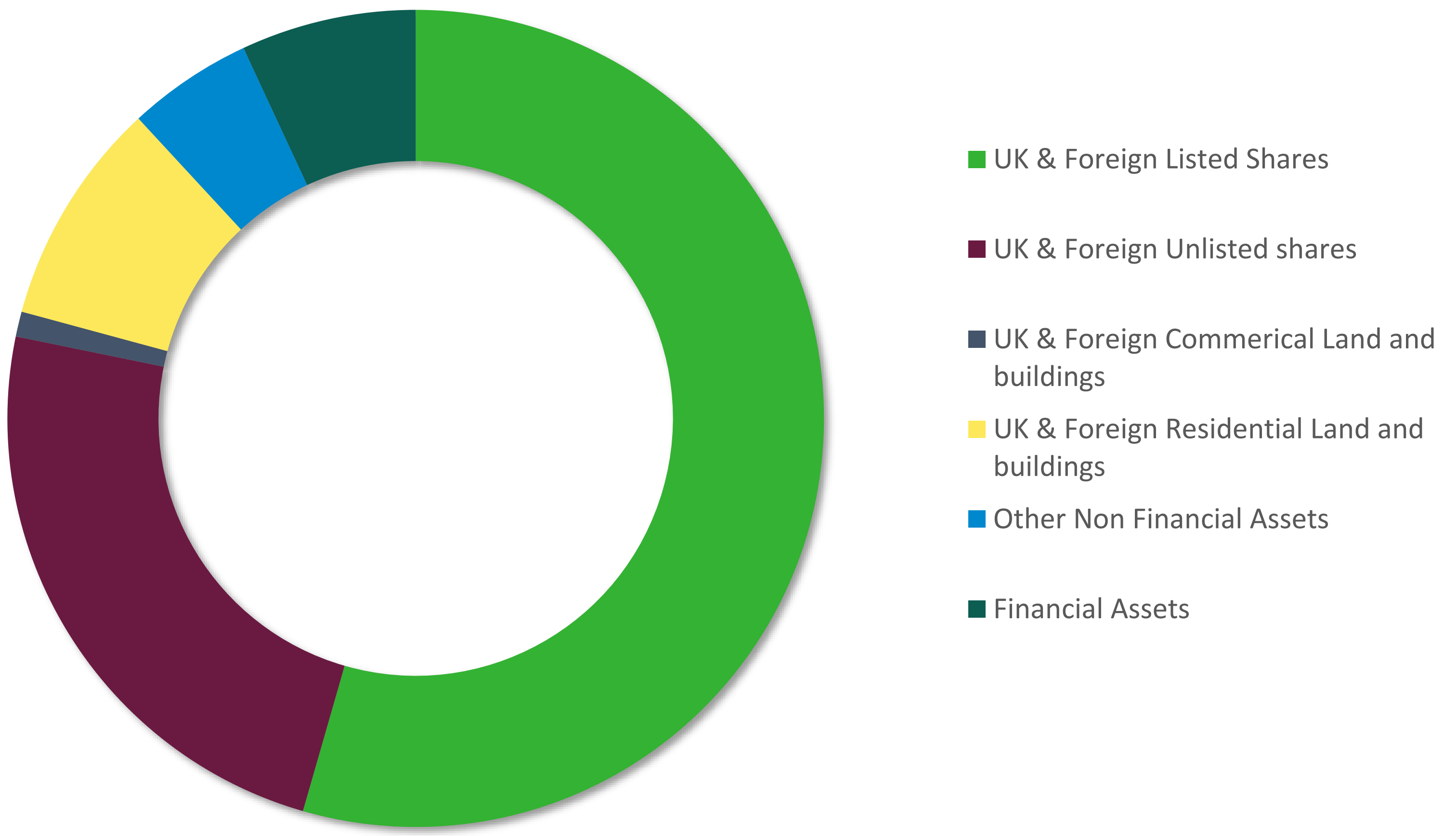
Tax planning
The CGT issue

- 2010/11: £3.8bn CGT receipts
- 2011/12: £3.4bn CGT receipts
- 2012/13: £3.5bn CGT receipts
- 2013/14: £5bn CGT receipts
- 2014/15: £6.1bn CGT receipts

Increases in Capital Gains Tax collected even though the payment rates have reduced.

HMRC Figures – CGT Statistics

Tax planning
Sources of capital gains



HMRC Figures – CGT Statistics

Capital Gains Tax – case studies

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Case studies

Example 2: mitigating Capital gains Tax

- John: late 60s, higher-rate tax payer
- Has portfolio of buy-to-let properties, currently valued at £1m
- Sale of portfolio would have capital gain of £240,000 = tax liability of £67,200 on sale (at his current CGT rates of 28%)

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Case studies

Example 2: mitigating Inheritance Tax

Possible solution

Sells property & reinvest £1m proceeds

£240K into EIS

- CGT deferral of the £240,000 gain for the lifetime of the EIS (none if held to death)
- CGT saving of £67,200
- Income tax relief £72,000
- Total immediate saving - £139,200
- £96,000 IHT saving after 2 years (if shares still held at death)

£760k into BR

- £304,000 IHT saving after 2 years (if shares still held at death)
- Up to 20% downside protection insurance (on death up to age 90)

= *total IHT saving £400k after 2 years (provided shares are held at death)*

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The Income Tax issue

The Income Tax issue

Key facts

- **Reduction in personal allowance**
  - For those earning over £100,000
  - Reduces by £1 for every £2 in excess of £100,000
  - Those earning over £123,000 will receive no personal allowance
- **Introduction of additional rate of Income Tax in 2010/11**
  - Applied to those earning over £150,000
  - Applied at 50%
  - Since reduced to 45%
- **Pensions are an effective way of mitigating Income Tax however restrictions apply**
  - For high earners (> £150,000)
  - Those already drawing benefits
  - Size of pot - £1 million pension lifetime allowance

What else can you do?

HMRC Figures - Income Tax Rates And Allowances

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Case studies

Example 1: mitigating Income Tax

- David: 50, higher-rate tax payer
- Owns an investment bond worth £200,000
- Gain is £50,000
- Fund has suffered basic rate tax but subject to 20% on gain
- **Objective: to mitigate Income Tax charge**

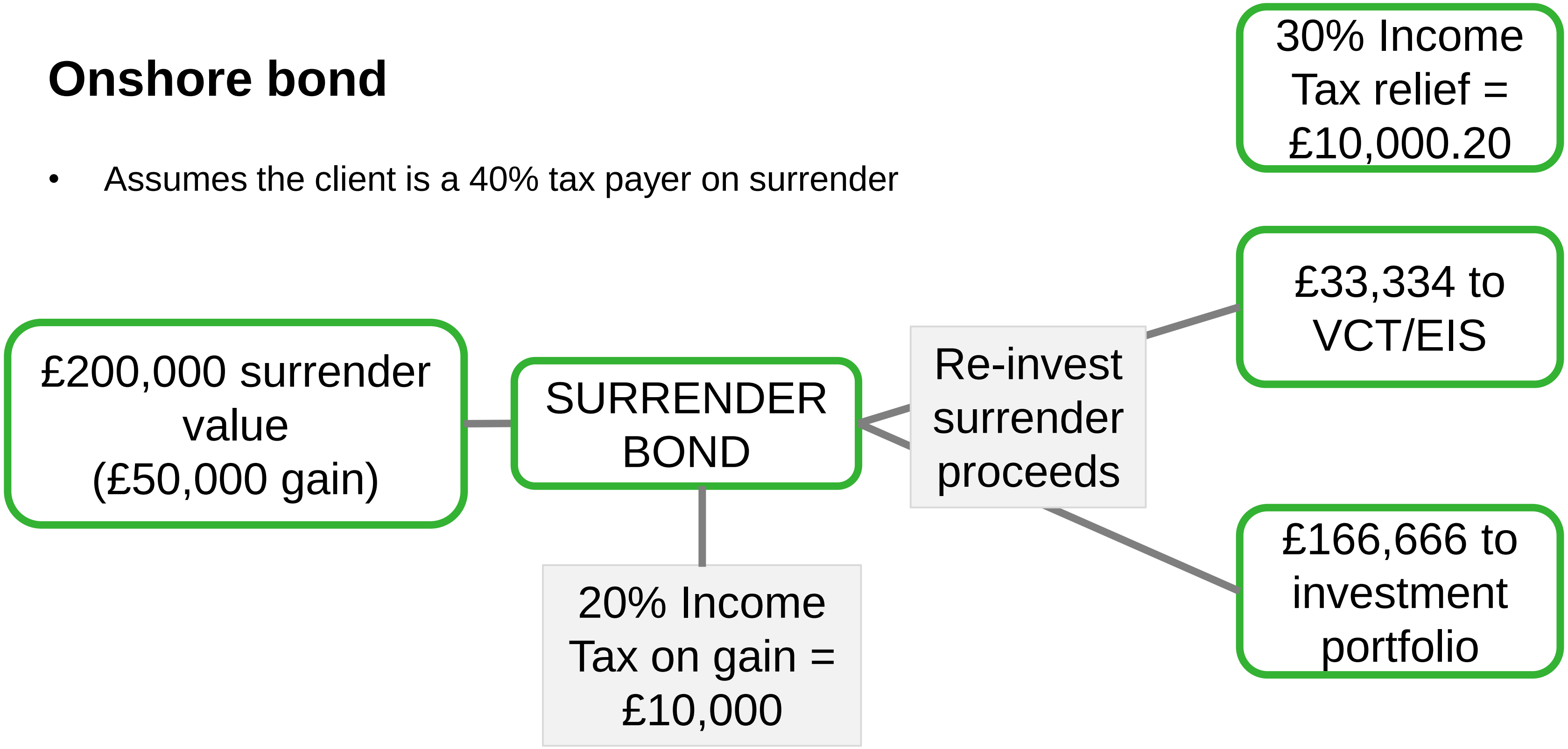
Please note that these examples are set out for illustration purposes only. Risk profiles of these examples may be higher than other alternatives.

Case studies

Example 2: surrendering investment bonds tax efficiently

Onshore bond

- Assumes the client is a 40% tax payer on surrender



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Case studies

Example 2: mitigating Income Tax

- Bob: 50, higher-rate tax payer
- Income: £220,000
- Paying £2,000 per month net pension contribution in 2015/16
- Limited to max £10,000 annual pension contribution in 2017/18
  - No more unused carry forward for 2017/18
  - Max net pension contribution of £666.67 per month

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Case studies

Example 3: mitigating Income Tax

- Bob makes the maximum contribution possible to utilise his annual allowance
  - £8,000 net plus tax relief of £2,000
- He claims additional 25% tax relief through his self-assessment

Please note that these examples are set out for illustration purposes only.
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Case studies

Example 3: mitigating Income Tax

£666 per month → Pension → £10,000

In addition:

£1334 per month → VCT → £16,000

Please note that these examples are set out for illustration purposes only.
Risk profiles of these examples may be higher than other alternatives.

Case studies

Example 3: mitigating Income Tax

£666 per month → Pension → £10,000

In addition:

£1334 per month → VCT → £16,000

- Excess into a VCT
- 30% income tax relief on VCT contribution of £4,800
- Total invested of £26,000

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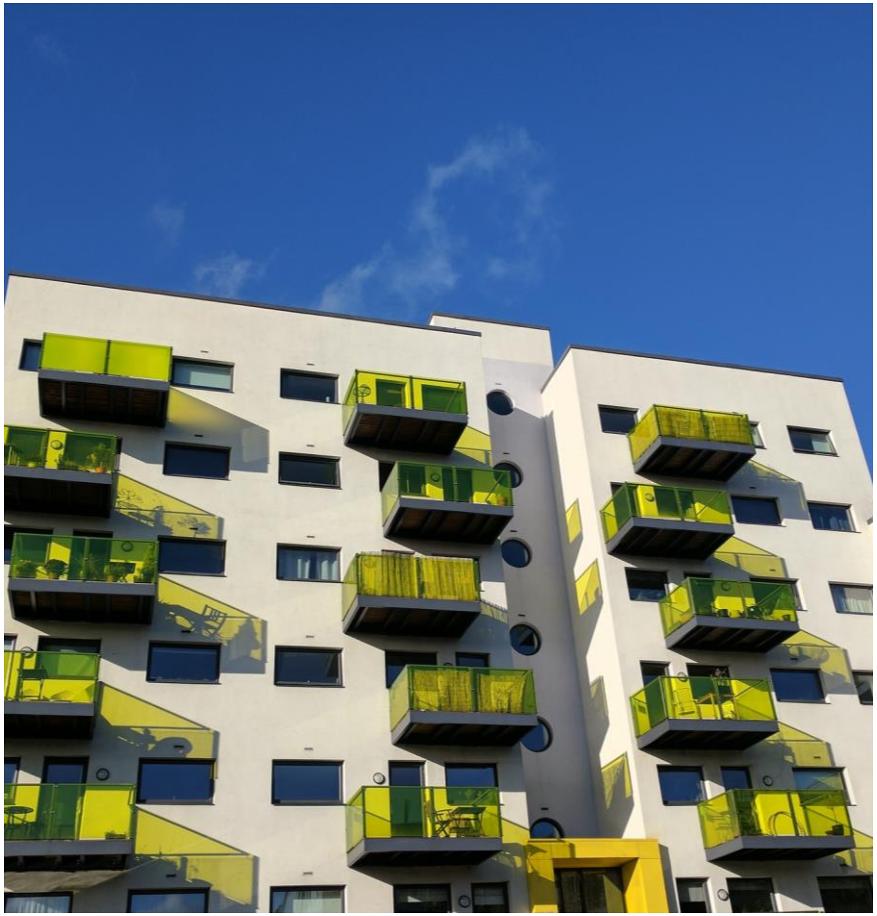
Case studies

Example 3: mitigating Income Tax

- Joseph: 50, higher-rate tax payer
- Income: £60,000 from portfolio of buy to let properties
- From April 17/18, he can no longer deduct the full mortgage interest
- Income Tax will be reduced by a basic rate tax reduction
- Phased in and will be fully in place from 6 April 2020.
- Deductions from property income will be restricted to:
  - 75% in 17/18
  - 50% in 18/19
  - 25% in 19/20
  - 0% in 20/21 and beyond



Source: Gov.uk

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Case studies

Example 4: mitigating Income Tax

Income Tax in 2016/2017		**Income Tax in 2020/2021**	
Gross Rents	£60,000	Gross Rents	£60,000
Repairs and other tax deductibles	£20,000	Repairs and other tax deductibles	£20,000
Interest on mortgages	(£35,000)	Interest on mortgages	N/A
Net Rental Profit	£5,000	Net Rental Profit	£40,000
Tax at 40%	**£2,000**	**Tax at 40%**	**£16,000**
Less Interest Relief at 20%	£0	Less Interest Relief at 20% on £35,000	£7,000
Total Tax liability	£2,000	Total Tax liability	£9,000
Effective rate of tax	**40%**	**Effective rate of tax**	**180%**

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Case studies

Example 4: mitigating income tax

- Contribute £23,334 to a VCT
- Secure 30% income tax relief
- Invest in a VCT to offset the additional income tax payable

Pay £23,334 into a VCT → Tax relief at 30% → £7,000 of income tax relief

Please note that these examples are set out for illustration purposes only.
Risk profiles of these examples may be higher than other alternatives.

Conclusions

- Many options available to mitigate tax
- May involve greater than one solution depending on client circumstances
- Perfect opportunity for accountants, solicitors and advisers to work together

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