Montgomery Charles
Wealth Management

Generational wealth – don't let inheritance tax be the largest beneficiary

By Tim Collyer, Montgomery Charles Wealth Management Ltd

I have worked with wealthy families for over 25 years. Most have worked hard all their lives, saving hard, paying income tax on their earnings, and doing everything in their powers to ensure they and their families are fully provided for in the future. The inevitable 'Death and Taxes' phrase is made more unpalatable when these families see the largest inheritor of a deceased estate being the tax man. Inheritance Tax (IT) typically represents 40% tax on a couple's estate valuing above £650,000 or £1,000,000 when the main residence passes to children. In simple terms if your total wealth amounts to £3,000,000 your estate could pay £800,000 in IT upon death.

We worked with a couple I'll call Tariq, 73, and Yasmin, 71. Tariq, a retired dentist wished to retain control of his money in case either he or his wife needed medical care in the future. Tariq recently had a medical scare. Yasmin felt that they had enough to live on and was keen for money to pass to the children sooner rather than later.

The couple's current financial position valued at £850,000, a buy to let property valued at £400,000 which brings in a rental income of £1,675 per month and Individual Savings Accounts (ISAs) which contain £250,000 each. Tariq has a personal pension valued at £800,000 from which he takes an income of £2,500 per month. Yasmin has a personal pension valued at £200,000 but is not drawing an income from it. At present, they are living off their two state pensions and the £30,000 that Tariq draws from his pension together with rental income of £20,000. This allows them to save around £10,000 each into their ISAs annually. In total, Tariq and Yasmin have a property portfolio of £1,250,000 and investments of £500,000. Together, their pensions value at £1 million and are deemed to be outside their estate for IT purposes. The couple have mirror wills meaning they are leaving everything to one another and then to their children following both of their deaths.

Their current arrangement would benefit from IT Nil Rate Bands of £325,000 each and Residence Nil Rate Bands of £175,000 each. This means that the first £1 million is tax free, leaving an IT bill of £300,000. Both their pension funds are exempt from IT which has already made a massive difference in reducing their liability.

There is the potential for a sizeable gift which Yasmin was keen to make but Tariq was not. There are however, certain types of assets that can be used to provide Inheritance Tax Relief after two years, not seven, while still leaving the assets in the estate and accessible. Tariq liked the sound of this.

Tariq and Yasmin's primary home is a hub for family gatherings, something they expect to continue in the future. So, while there is the potential to downsize, neither Tariq nor Yasmin want to give up this property. We considered whether selling the other rental property might be an idea, or perhaps passing it to their children. Tariq is a firm believer that property is very important and did not wish to sell this property as it continues to increase in value. This is an asset he wishes to pass on, but at the moment was not prepared to forego the income or pay out the huge amount of stamp duty and capital gains tax a transfer to his children would create.

It is very important to take specific advice tailored to your exact circumstances and the solutions presented here may not be suitable for everyone. There were multiple ways we could have helped preserve this couple's wealth for the next generation and this was just one of our suggestions:

- Make an outright gift of the money in Yasmin's ISA to the children which would mean they would make an IT saving of £100,000 after seven years
- Convert Tariq's existing ISA to an Alternative Investment Market (AIM) ISA by changing the model portfolio applied to the plan. An IHT saving of £100,000 over two years – a shorter time as his health was not as good – the money is retained to pay for long term care if needed
- Future ISA contributions go into an AIM ISA
- Create a Limited Liability Partnership (LLP) with a minor share for Tariq and Yasmin and major share for the children (and potentially grandchildren), Tariq and Yasmin transfer the second property into the partnership. No stamp duty as no actual name change on the property. Capital Gains Tax is held over on the transfer – in exchange for a director's loan for the value of the property £400,000
- Director's loan is repaid (tax free) from the rent received by the Limited Liability Partnership at £20,000 per annum for up to 20 years
- On the first of Tariq and Yasmin to die, further adjustments can be made to the LLP to transfer the value back to the children and the grandchildren.

Their main home was retained along with the money to run it which meant they could continue to enjoy large family gatherings. Money was available for long term care from the loan repayments and/or pension. Their second property and both of their ISAs (total value £900,000) is removed from the estate, saving the full £300,000 IT! Tariq has kept control over the family money and Yasmin was able to give generous gifts to the family which helps them now rather than when they don't need it so much later in life. Yasmin and Tariq were reassured that they will have enough money to sustain their standard of living and also enough in the event they require care later in life.

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