RT FINANCIAL PLANNERS LTD

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Proposals for Updating the Inheritance tax System

Last year, the Office of Tax Simplification (OTS) was asked to conduct a review of Inheritance Tax (IHT). The OTS has now set out a series of proposed measures, although they are not a policy-making body, so there is no guarantee their recommendations will be taken up. There are some key areas from the report below that, if adopted, would be significant for mainstream IHT and wealth transfer planning:

Lifetime Gift Exemptions

One recommendation is that there should be a single annual personal gifts allowance on a "use it or lose it" basis. This would replace the current £3,000 annual exemption along with the exemption for gifts on marriage, neither of which have increased for many years. It could even include an amount to replace the more complex exemption for normal expenditure out of income, as it is not always clear what is included as income, or what level and regularity of gifting is regarded as 'normal' expenditure.

Gifting Periods

The OTS proposed that the seven year 'inter vivos' period for making gifts is cut to five years. Currently, lifetime gifts made in the seven years prior to death are taken into account for IHT. If accepted, over a 20-year period this reduction could equate to the availability of an extra nil rate band (NRB) - and potentially an extra IHT saving of £130,000 (based on the current £325,000 NRB).

Taper Relief

The report recommends abolishing taper relief on the basis that it is frequently misunderstood. The rule reduces tax on lifetime gifts by 20% for each year the donor survives the gift after year three. The common misunderstanding is that taper reduces the value of the gift, rather than the tax on that gift. This measure could mean more tax to pay for some individuals, but it removes the complexity and may help balance the tax saved by shortening the gifting period above to five years.

The Residence Nil Rate Band (RNRB)

There are no recommendations for change to this at the moment, as the allowance is still relatively new. The OTS received a lot of comments on the complexity and fairness of this legislation and the report does offer some potential solutions, including an increased NRB for everyone, and axing the 'downsizing provisions' in favour of a RNRB for everyone who has owned and lived in a residential property in their lifetime, but change in the near future is unlikely.

Liability for Payment

The OTS would like to simplify and clarify who has liability to any tax that may arise on a lifetime transfer. The issue centres on the perceived fairness of how the NRB is allocated on death between lifetime transfers and the estate. It doesn't make specific recommendations but it does consider possibilities such as making the estate responsible for any IHT on lifetime gifts, or allocating the NRB on death so that lifetime transfers and the estate receive a fair share.

Interaction with Capital Gains Tax (CGT)

Another recommendation is to remove the CGT uplift that assets receive on death if those assets also benefit from other reliefs or exemptions. It is accepted almost without question that, when someone dies, there is no CGT charged on the assets they own, just IHT. The beneficiaries of the estate will acquire assets at market value at the date of death, to avoid both IHT and CGT being charged on the same asset. However, concerns have been raised that where the asset is subject to an IHT relief or exemption neither tax is payable. This change would mean there would still be no CGT on death but assets would be transferred on a 'no gain, no loss' basis, so the beneficiaries would acquire the asset at the cost at which the deceased acquired it.

AIM Shares and Business Property Relief (BPR)

The report questions the availability of this relief on investments in the Alternative Investment Market (AIM), which have become a popular investment as a quicker way of reducing a potential IHT liability. The allowance of BPR on most AIM shares means they are exempt from IHT after being held for only two years. However the relief was primarily intended to prevent the break-up of smaller businesses on the death of a principal owner – and not for widespread AIM investing. Withdrawing this concession would be unpopular as it could have a negative impact on AIM share prices and make it harder for smaller businesses to raise finance.

Term Assurance Policies

The OTS recommends that death benefits from term assurance policies are not subject to IHT, even if they're not written under trust. Those who take advice will normally put the policy in trust to ensure proceeds aren't subject to IHT and avoid the need to wait for probate. The OTS conclude that they should not be subject to IHT even if they aren't written in trust, but speed of payment may remain a motive for using a trust.

Summary

The Government is not obliged to implement any of the recommendations from the report, so they may never see the light of day, but it shows thinking on future legislation.

Long Term Care Funding

The question of funding long term care costs is one that is asked often but is not easy to plan for. This is largely due to the complexity of the rules, the fact that they differ between England, Scotland, Wales and Northern Ireland, and that local authorities have a tendency to interpret them differently.

In general, the local authority is responsible for assessing an individual's care needs and separately making an assessment of their ability to pay for their care. Each local authority will have a maximum rate they will contribute, based on the level of care the individual needs. Where the cost of the chosen care home exceeds the maximum rate they will pay, the individual, or their family, will be required to meet the excess. The local authority will also look to recover some, or all, of the care costs from the individual based on a detailed financial assessment of their income and capital.

Once the care needs assessment has been completed, a financial assessment (means test) is carried out to determine whether the individual is able to self-fund their care costs. Income is assessed, regardless of the amount of capital held. A small amount of income can be excluded from the assessment as a Personal Expenses Allowance to pay for items such as newspapers and toiletries. In addition to the income one would expect to be included (eg pensions, savings income etc), a "Notional Income" may be added if it is considered that applicants have deprived themselves of, or failed to claim income - perhaps not having taken any income from a personal pension, for example.

Capital is also assessed and this will include all assets such as investments and property, although the family home may be excluded where there is a spouse or dependent relative living there. Capital in a pension fund is typically disregarded unless someone has failed to access their pension benefits. Insurance company investment bonds which include even a small element of life cover are disregarded from the capital means test. However, this exclusion may not apply if an investment is arranged in an investment bond only shortly before a claim for long term care is made.

As with income, "Notional Capital" can be added where someone has deliberately deprived themselves of capital. This is when a person intentionally reduces their capital and includes gifting assets – either directly or to a trust, selling assets below the market value, or transferring ownership of their home to someone else. The local authority will look at the timing of when assets are reduced and the intention behind this, to establish whether they consider deliberate deprivation has taken place. If they think this has occurred, they can include the value of those assets in the means test.

In England anyone with capital over £23,250 will currently pay the full care fees. From April 2020 it is proposed that anyone living in England will have a more generous means-testing threshold and a cap on lifetime care costs. However, this does not include 'hotel costs' such as board and lodgings and the cap will only apply once needs are established as being 'substantial'.

This is a complex area so please do ask if you would like any personal or specific advice on any aspect this.

Woodford Investment Management

In June we were notified that trading in the Woodford Equity Income Fund was suspended – this followed a run of redemption requests after a period of underperformance. Prior to the suspension, we recognised that the fund had been disappointing, but identified a number of reasons - for example, the fact that Neil Woodford held domestic earning stock that would be better placed for recovery in the event of any deal being agreed with Brexit, as he had positioned some holdings feeling they were particularly undervalued.

It has now been announced that this fund will be wound up and the money from it will be returned to investors. This process will begin in January 2020. The fund administrators have now concluded that an orderly realisation of the fund's assets allows the return of money through interim payments to investors more quickly than if the fund had remained suspended for a longer period of time. No date has been set by which capital payments to investors will be completed.

Perhaps unsurprisingly, an announcement followed almost immediately to notify that the Woodford Income Focus Fund will now also be suspended from trading – managing withdrawals any other way would be very difficult. We have no additional news on this position at the time of writing.

Neil Woodford commented that he did not agree with the proposal to wind up the fund as he felt this didn't represent the best option for value for investors. He has since resigned from the role of portfolio manager.

We will continue to keep you updated when we have more information or any other update on this position.

Updating Our Data

We make every effort to ensure that the data we hold on file for our clients is accurate and up to date, so we will be undertaking an exercise over the coming months to review this, to ensure it reflects the current position correctly. We will be gathering updated information in a number of ways; your own adviser may collect this at a review meeting or during a phone call. We will also be writing to some clients to ask for updated details or to check that our records are accurate. Alternatively, a member of the RT administration team may contact you to ask some questions so we can update our files.

We are mindful of security, so if you receive a call purporting to be from our firm asking for personal information, and it is someone you are not familiar with, the caller will be more than happy to phone you back at a convenient time after you have verified with our company or directly with your adviser that it is a genuine call.

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