Inheritance tax planning **using regular premium protection plans**

Protection | Inheritance tax planning

ROYAL LONDON

What's Inside

Introduction

The Inheritance Tax trap

Over the years Inheritance Tax (IHT) has traditionally been seen as a tax on the wealthy which may lead many of your clients to think that IHT doesn't apply to them. But with the **average UK house price sitting at £239, 000**[1] – using up 73.5% of your clients' individual IHT allowance – they could be mistaken.

More and more people have been caught in the IHT trap. The Government's IHT receipts totalled £5.2 billion in the 2019/20 tax year compared to just £2.4 billion collected over the 2009/10 tax year[2].

How many of your clients are at risk of being caught in the trap?

What is IHT and what does it mean for your clients?

IHT is a tax payable upon death or a transfer of assets on certain lifetime gifts.

The tax is charged **at a rate of 40%** on the value of your client's estate that is above the **nil-rate band of £325,000,** depending on certain exceptions. The estate can't normally be distributed until the IHT bill has been paid, and usually needs to be paid **within six months**[3]. If the IHT bill isn't paid within this time, interest may be added. IHT may also be payable in other circumstances, for example if a person dies within seven years of making a gift.

Opportunities for Advisers

This situation creates an increasing need for effective IHT planning and this has led to more focus on how to reduce clients' IHT liability over time - either by gifting away assets during their lifetime, or investments into IHT friendly schemes - and ultimately how to provide for the IHT bill.

This provides you with the opportunity to:

- Advise individuals and couples planning for IHT on their own estates
- Advise potential beneficiaries on ways to meet a tax liability
- Advise beneficiaries on managing their inheritance – and avoiding a tax bill for their own heirs
- Establish or develop relationships with professional connections, such as solicitors and accountants as well as trustees.

IHT at a glance

£325,000 – The basic nil-rate band, up to which no IHT is chargeable on a deceased individual's estate.

40% – The rate of IHT payable on estates over the total available nil-rate band.

6 months – The period in which the IHT bill must be paid before interest is charged.

1. www.ons.gov.uk/economy/inflationandpriceindices/bulletins/housepriceindex/august2020 - assessed December 2020
2. www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicspending/timeseries/acch/edp2 - assesses December 2020
3. www.gov.uk/inheritance-tax

Selected reliefs and exemptions from IHT

What are the main circumstances under which there is no liability to IHT?

Nil-rate band – currently £325,000 (everyone has their own nil-rate band, which is transferable on death between married couples / civil partners therefore providing the survivor with a potential nil-rate band of £650,000).[3]

Residence nil-rate band (RNRB) – An additional relief introduced in 2017 when passing on a home to a direct descendant. The current amount of RNRB per person is £175,000.[5]

- The property must be left to direct descendants which includes children who are adopted, stepchildren, fostered children and grandchildren.
- Applies to the net value of the property which is the value after deducting any liabilities, e.g. mortgage, but RNRB is restricted to the lower of the RNRB threshold at the time and the property value.
- RNRB is transferrable to survivor where second death on or after 6 April 2017 for married couples and civil partners only.
- Only estates valued at £2m (net) or less will benefit in full. Tapering applies to estates valued at greater than £2m and will mean that £1 of RNRB will be lost for every £2 over threshold.
- When someone has sold, given away or downsized to a less valuable home before they die, their estate may still be able to get the RNRB if they qualify for a downsizing addition.

Gifts between married couples/registered civil partners – All gifts between UK-domiciled married couples or registered civil partners.

Normal expenditure out of income – These are gifts that must form part of normal expenditure and be made from income not capital. The Donor must also be left with enough income to maintain their usual standard of living.

Annual gift exemption – Gifts made up to £3,000 in total per tax year. Any unused part of this allowance can be carried forward but only for one year.[4]

Small gifts exemption – Gifts of up to £250 can be made to each of any number of people in the same tax year.[4]

Gifts on marriage or civil partnership – An amount of up to £5,000 from each parent, £2,500 from each grandparent and £1,000 from anyone else.[4]

Gifts to charities – A lower rate of IHT of 36% will apply where 10% or more of a person's net estate is left to charity, for deaths on or after 6 April 2012.[4]

Outright gifts to individuals & trusts – If the donor survives 7 years from the date of the gift (those between spouses and civil partners are automatically exempt).[4]

Business Relief

Also known as Business Property Relief, this is a valuable relief of up to 100% in respect of business transfers during life or on death. Shares in qualifying businesses (or funds which invest in such businesses) are exempt from IHT provided they've been held for at least two years at the time of death.

However, if the investor dies within two years, the investment will remain subject to IHT and therefore life cover would be needed to cover that period of IHT liability.

[3] www.gov.uk/inheritance-tax [4] www.moneyadviceservice.org.uk/en/articles/gifts-and-exemptions-from-inheritance-tax
[5] www.gov.uk/guidance/inheritance-tax-residence-nil-rate-band

Gifts

One way to reduce the IHT liability on an estate is to make gifts. However, when someone makes an outright gift to a person in their lifetime, there may be IHT to pay. These are known as Potentially Exempt Transfers (PETs).

Any gifts made more than 7 years before death are exempt and won't be included in the value of your client's estate. But gifts made within 7 years of death will be considered part of the client's estate again. Unless they fall within the client's nil-rate band or are covered by a different exemption, the beneficiary of the gift becomes liable to IHT.

The amount of IHT payable depends on when within the 7 years the death of the donor occurred. If less than 3 years, the full rate of IHT of 40% is charged. If between more than 3 years and 7 years the rate of IHT charged reduces. This is known as Taper Relief.

How does Taper Relief work?

It is important to understand that Taper Relief applies to the amount of tax payable, not the value of the gift.

The amount of tax that the recipient of the gift will have to pay will depend on the number of years between the gift and the death of the donor.

Taper Relief will apply if the donor died more than 3 years after making the gift. The rate of IHT reduces from the starting rate of 40% by 20% each year between years 3 and 7.

Years between gift and death	Taper Relief
Less than 3	None
3 - 4	20%
4 - 5	40%
5 - 6	60%
6 - 7	80%

For example

A person makes a gift of £600,000 and dies five-and-a-half years after giving the gift.

- Value of gift = £600,000
- Less nil-rate band = -£325,000
- Taxable amount = £275,000
- IHT at 40% = £110,000
- Taper Relief at 60% = £66,000
- IHT due = £44,000

PETs that fail to make the 7 years are applied first against the nil-rate band in chronological order. So, if the total of PETs is below the nil-rate band, no IHT is payable and Taper Relief is irrelevant. However, this will have the effect of reducing the nil-rate band available to the estate.

PETs that become chargeable to IHT use up the nil-rate band so that the whole estate attracts a 40% tax charge.

It's possible to compensate for this loss of the nil-rate band by insuring the resulting increased tax – £325,000 x 40% = £130,000 – via a 7 year level term assurance plan.

The recipient of the gift is the one who will have to pay the IHT, not the estate of the deceased. Once they have received the gift, the recipient may then also have a liability on their own estate which should be covered too.

Chargeable Lifetime Transfers (CLTs)

These are gifts into a trust (e.g. Discretionary Trust) other than a bare / absolute trust.

Discretionary Trusts are trusts where the beneficiaries can be changed / added to and the trustees use their discretion as to when and to whom benefits may be paid.

If the CLT gift amount exceeds the available nil-rate band it can be subject to an Entry Charge which is charged at a rate of 20% on the excess above the nil-rate band at outset. Previous CLTs will affect the amount of available nil-rate band.

Should you die within 5 years, additional tax will be payable, as the IHT death rate of 40% is chargeable. The tax due is recalculated accordingly. Taper Relief will apply if the death occurs more than three years after the gift. Any tax already paid is taken into account.

Gift Inter Vivos plans

PETs offer the opportunity for financial planning advice as any resulting IHT liability can be protected using what are known as Gift Inter Vivos plans.

What is Gift Inter Vivos?

Gift Inter Vivos plans have a fixed seven-year term, with cover reducing in steps to match the reduced liability as Taper Relief takes effect. Although the cover reduces, the premium typically remains fixed for the whole seven years. This gives your client the peace of mind that their gift won't mean a large tax charge for their beneficiary.

Gift Inter Vivos using the Royal London Menu Plan

Our Menu Plan could be a great way of setting up a Gift Inter Vivos plan by using a series of level term plans. 5 plans each equal to 20% of the initial liability are required for terms of 3,4,5,6 and 7 years. From year 3 onwards, 20% of the total sum assured falls away to match the reducing liability. The premium will reduce when using a series of plans, from year 3 onwards, as each plan ends.

Here's an example

Mary, 75, who has never been married, decides to gift £450,000 to her niece. She hasn't made any other gifts in her lifetime except using her £3,000 a year annual exemption. Mary knows that if she dies within seven years, then her niece will be responsible for the IHT on £125,000 (the amount the gift exceeds the current £325,000 threshold level). The amount of IHT will taper down but Mary doesn't want her niece to have to pay anything. A Gift Inter Vivos plan using a series of term assurance plans under our Menu Plan would therefore be a suitable solution to provide her niece with the funds to meet this tax liability. In this instance a plan starting with £50,000 of cover (40% of £125,000) which then reduces by £10,000 each year after year three would be recommended.

Cover	Term (years)	Premium
£10,000	3	£21.91
£10,000	4	£21.91
£10,000	5	£21.91
£10,000	6	£22.84
£10,000	7	£23.74
Total initial premium including £2.60 plan charge[6] = £114.91		

Remember, if a PET becomes chargeable to IHT then the whole nil-rate band is used up. This means that the whole estate would attract a 40% IHT charge. Mary doesn't want her beneficiaries to suffer this additional tax so she decides to cover this in her plan. She therefore adds a further amount of cover of £130,000 over a 7 year term (after which time the gift would be free of IHT) and thus the amount after tax that her beneficiaries will receive will be the same as if the full nil-rate band was available to her estate.

Chargeable Lifetime Transfers

A series of level term plans could also be set up under our Menu Plan to cover any IHT liability on death in respect of CLTs. If death occurs within 7 years of making the gift into the trust, the tax due is recalculated at the death rate of 40%. Taper Relief will apply and the tax already paid is taken into account, but no refund can be made. 3 level term plans would be required for terms of 3,4 and 5 years, mirroring the additional tax that would be payable. Note that plans wouldn't be needed for terms of 6 and 7 years as the IHT death rate liability would be less than the Entry Charge due to Taper Relief.

[6] Royal London Personal Menu Plan, Life Cover, March 2021. Client is 76 next birthday, non-smoker, Life cover, level lump sum, figures shown (other than the total £114.91) don't include £2.60 plan charge

Covering the estate's IHT liability on death

Whole of Life plans

If the IHT liability is expected to remain indefinitely (i.e. until death), then a Whole of Life plan will be needed to provide the beneficiaries with the required amount of money to pay HMRC. This will pay out whenever the person covered dies, regardless of age.

Guaranteed and Reviewable rates.

Royal London offers Whole of Life plans with both guaranteed and reviewable rates.

Guaranteed rates provide the security that the cost of the cover will not change in the future.

If however your client plans to reduce their IHT liability during their lifetime, for example, by gifting assets to their family, or by way of IHT-friendly investments, a Whole of Life plan with reviewable rates may be more suitable.

This type of plan provides cheaper cover in the early years compared to guaranteed rate plans. As the IHT liability of the estate reduces, the sum assured can be reduced accordingly therefore offsetting future premium increases at the rate review points (10 years and every 5 years thereafter with Royal London). Cover can continue to be maintained in respect of any remaining IHT liability, for as long as it is needed.

When spouses (or civil partners) leave their assets to each other, there will be no IHT liability on the first death. Therefore a Joint Life Second Death plan will be required.

Pure protection plans, such as those offered by Royal London, provide:-

- Certainty of cost – Guaranteed rates mean certainty of cost and certainty of money being available to pay the tax bill
- Certainty of access – Setting the plan up under a suitable trust (such as Discretionary Trust) means speed of pay-out on death as the sum assured is available to the trustees without having to wait for probate (confirmation in Scotland) to be granted. This allows the IHT bill to be settled quickly, allowing the estate to be distributed without delay.
- Certainty of outcome – as the sum assured is guaranteed to pay out on death
- The arrangement is tax efficient as the money is taken outside the client's estate and does not form part of it.

Royal London offers a choice of guaranteed and reviewable Whole of Life rates.

More than financial support

Royal London offers a range of additional features and award winning customer service.

Lifestyle Review: -

If Royal London accepts one of your client's covers on non-standard terms or charges smoker rates, and your client has changed their lifestyle in a way that they think reduces the likelihood of a claim, you can ask us to review the terms for that cover. So if they have an exclusion for a hazardous hobby that they no longer do, we may be able to remove the exclusion. Or if they've lost weight and kept it off or stopped smoking, we may be able to reduce their premium. **Premium rates used in respect of any change would be those applicable to your client's age at the time the plan was taken out.**

Insuring the Uninsurable -

You may think that if somebody is declined for cover they won't be able to get any cover.

Well, this isn't strictly true. If your clients require Joint Life Second Death cover, and one of the lives is declined, we will still be able to offer the plan on a Joint Life Second Death basis. The premium is based on the accepted life.

Tax and trust support

We have a range of trust literature from easy to follow trust guides to our interactive trust forms. Our team of specialists can provide information on protection related tax and trust issues whenever it's needed. Between them they have a wealth of knowledge and experience in this field. For help and support email us at **protection.techsupport@royallondon.com**

For more information on inheritance tax planning using regular premium protection plans, speak to your usual Royal London contact or visit adviser.royallondon.com/protection

Personal support with Helping Hand

Your clients and their families (spouse or partner and children) will have access to our Helping Hand support service at no extra cost.

They'll get tailored support from a personal nurse adviser provided through RedArc, an independent care advisory service. The nurse adviser can also arrange additional support services – such as bereavement counselling and second medical opinions.

Your clients can also get legal advice through our helpline service on a range of subjects. Our helpline gives you access to legal professionals who can answer questions on things like your employment rights, wills and probate or inheritance tax.

Claims

We know that when a claim needs to be made, your client's family are going through a challenging time. We're committed to treating each claim on an individual basis with as much care and attention as we can.

From a single point of contact in our claims team, to personal support from a dedicated nurse through our Helping Hand service, we aim to deliver a more positive claims experience throughout this difficult time.

Award-winning customer service.

We think you can tell a lot about a company by the industry awards and ratings it receives. The fact our performance has been recognised across not one, but many award categories is testament to the expertise of our staff and their commitment to doing all they can for your business and your clients.

- Voted Company of the Year and Best Protection Provider at the 2020 Money Marketing Awards.
- Won Best Underwriting Team at the 2020 COVER Customer Care Awards.
- Received 5 stars for our protection service, for the seventh year running at the 2020 Financial Adviser Service Awards.
- A Gold rating from Protection Guru across all our product categories.

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We're happy to provide your documents in a different format, such as Braille, large print or audio, just ask us when you get in touch
All of our printed products are produced on stock which is from FSC® certified forests.