PROTECTION OF ESTATE

Where there's a will...

Members of the legal profession seem to be among the least organised when it comes to estate planning. Tim Sharp takes a look at the available options

Warren Buffett, the legendary American investor, is reported to have put in place arrangements for his legacy long before his fortune reached $40bn. Even the highest-flying City lawyer of some years standing would struggle to match Buffett's wealth, but the lesson that it's good to have your plans in place early on in case the worst should happen is a useful one for members of a profession notorious for eschewing the most basic of estate planning provision.

Such is the relaxed attitude in the profession towards such matters that one lawyer told *The Lawyer* that he estimated half of the partners in his firm had not written a will.

Jason Butler, certified financial planner at Bloomsbury Financial Planning, notes the old adage about the cobbler's children wearing the worst shoes. "You always think you should be doing chargeable work for someone else rather than unchargeable work for yourself," he says.

Andrew Goldstone, head of the personal tax and estate planning practice at Mishcon de Reya, is more charitable: "If you're a corporate lawyer or property lawyer, why would you know about this stuff?" He adds: "There's having a will in place and having a good will in place and lawyers are the worst at doing this."

At its most basic, estate planning means having a plan for what will happen if you happen to die earlier than expected.

Butler says: "The very simplest plan is what happens to your affairs if you're unable to handle them yourself, or if you're dead, to ensure the right people get the right things at the right time. That's nothing to do with giving money away or doing anything complicated, it's just planning out that situation."

This means having a will in place and powers of attorney arranged.

There is another aspect to looking after your family and that is ensuring you have assets to leave them.

It is about knowing what money will be available if the worst happens. Many workplaces provide life insurance. They pay out a lump sum on death and the sum paid will be classed as outside your estate for inheritance tax (IHT) purposes if placed in a trust.

If you need to make personal provision, the policy will be cheaper the younger you are when you take it out.

Many financial advisers will suggests topping this up with critical illness cover that gives you a payout if you develop one of a list of conditions.

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But Butler is deeply dismissive of critical illness policies. "While it may be good to have a lump sum, it's just a luxury," he says. He prefers income protection policies that pay out a regular tax-free income after a minimum period off work due to illness or accidental injury. Group policies are almost always cheaper than those arranged individually.

There are several strategies for keeping the cost down on an income protection policy. One is to extend the deferred period before pay-outs start to, say, six months and ensure you have six months of income in cash or other easily accessible assets.

This suits the insurance company because only a quarter of claims would qualify for this, Butler says. The upside is that it protects the policyholder's family against a very difficult scenario.

The other thing is to ensure that the period ceases at a reasonably early age, such as 55 or 60. Butler says: "Hopefully by then you'll have built up money in your pension and built up other assets."

Private medical insurance can also be a way of protecting your family. Serious ailments will be treated on the National Health Service and invariably treated quickly, but non-life-threatening problems can disrupt an individual's ability to work to their full capacity or perhaps at all.

A TAX TO GRIND

Only once these relatively minor considerations are taken care of is it worth looking at the best way of managing large sums of money, and in particular how to avoid paying too much tax on it.

For many people a large, perhaps their largest, asset might be their pension. Butler suggests that many people should look at a pension by-pass trust so that you rather than your scheme determines who the money goes to.

Such a trust simply ensures that instead of the assets being distributed according to whomever the trustees deem worthy of it – normally the spouse and other dependents – they are distributed according to the letter of wishes.

Notably it means the assets do not get caught by IHT when the surviving spouse dies, or disappear when one of the children falls into bankruptcy.

Then it is worth thinking about other assets. The price of indecision can be high. Intestacy rules in England would see the first £250,000 go to the surviving spouse or civil partner and a life interest in half the remainder of the estate. The children take the other half of the remainder of the estate and the capital comprising the spouse's life interest fund when the spouse dies. Rules differ in Scotland and if the deceased has no partner or children.

Only estates up to £325,000 escape the 40 per cent IHT charge, although a rare bit of liberalisation in this area from Gordon Brown meant that from 2007 the unused portion of a nil-rate band could be passed from one spouse to the other.

Nevertheless, the risk is that your money is going to the wrong people –

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Andrew Goldstone, head of personal tax and estate planning, Mishcon de Reya

“Lawyers aren’t the greatest at keeping their marriages together, with the long hours and so on. There are a lot of lawyers with second marriages and stepchildren and all of that gets complex”

perhaps including HM Revenue & Customs – or the right people at the wrong time in their lives. What would you have done with a windfall in your teens?

When starting to think about IHT, which kicks in at 40 per cent, on assets over £325,000, many financial advisers will suggest a life insurance policy. If this is written in trust the proceeds will not fall into the estate for IHT purposes and can relieve the beneficiaries of a tax headache.

CHARITY BEGINS AT DEATH

A more effective approach, although it might feel painful, is to look at ways of giving away your hard-earned assets.

Ian McNally, director at financial advisory firm Saunderson House, suggests that after this stage people should ask themselves several key questions:

- How much can I afford to give away?
- How much of that do I you want to give away?
- Who do I want to give it to?
- When do I want to give it?
- How do I want to give it?

McNally says: “Inheritance tax can be avoided by giving assets away and surviving for seven years, or by carefully using the various allowances that are available. Therefore mitigating IHT is really a financial planning issue.”

When thinking about how much you can afford to give away, or conversely how much you need to live on, a financial planner can do an assessment based on your expenditure, assets and liabilities to assess how much you need to retain to live on. Of course that can be very different from how much you want to give away and is based on your attitude to risk.

McNally says: “A cautious person might want to retain more assets than their financial plan indicates.”

Who you give it to is essentially a choice between family and friends and charities or, if you are particularly blasé, then the Inland Revenue too.

There is a choice of timing to make. Julie Hutchison, head of estate planning at Standard Life, says: “The initial decision is to ask whether I’m taking action in my lifetime or doing something in my will?”

If you are considering gifting in your lifetime there are various allowances. Individuals are entitled to give gifts up to a value of £3,000 in any one tax year, plus any unused balance of £3,000 from the previous tax year. These sorts of sums could help a child or favoured nephew or niece get on the property ladder.

Also exempted are wedding gifts of up to £5,000 to each child, including stepchildren and adopted children, £2,500 to grandchildren or £1,000 wedding gifts to anyone else.

Maintenance payments to a spouse or ex-spouse or children under 18 or in full-time education are exempted. So too are outright gifts in any tax year up to a total of £250 each to any number of people. Indeed, any gift given outright is not liable for IHT if the donor survives seven years. There is also an exemption for gifts made out of normal income, which can be surprisingly generous.

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Goldstone at Mishcon de Reya says: "As long as it doesn't affect your standard of living you don't even have to survive seven years. It could be several thousand pounds a year or more if you're a rich lawyer."

Hutchison of Standard Life adds: "If they're a corporate lawyer it's a fantastic opportunity. If their income is say £1m, they could put £400,000 of that income to a discretionary trust. Comfortable well off people in retirement can use it too."

Hutchison's reference to trusts is important. The advantages of trusts are not immediately obvious. Sums put into a trust above the nil-rate band attract a 20 per cent upfront IHT charge for any sums above the nil-rate band level. There is also an additional 6 per cent charge on assets above this limit every 10 years.

There can also be a 6 per cent charge on funds worth more than the IHT threshold when the trust is closed.

That said, trusts can add an important element of control. Giving large sums directly to your children might not seem a wise idea. They can blow it, they can go bankrupt, they can lose some of it in a divorce. Using a trust can mitigate this problem.

There is an argument that lawyers need this more than others. Goldstone of Mishcon de Reya says: "Lawyers aren't the greatest at keeping their marriages together, with the long hours and so on. There are a lot of lawyers with second marriages and stepchildren and all of that gets complex."

But it has to be thought through carefully. Goldstone highlights a potential issue if assets were left to a second wife with the instruction that on her death they were to go to his children. However, if she decides to make gifts to her own children in her own lifetime and doesn't survive seven years, their combined nil-rate band could be used up. This means that assets that pass on to the children on her death would be taxed at 40 per cent.

Goldstone suggests that a good use of money is to put assets into a trust for children up to the level of the nil-rate band. If you survive seven years the money is outside your estate for IHT purposes. In fact several trusts can be created over those several years.

Goldstone says: "Someone in a City firm earning £1m or £500,000 a year can probably afford it and you have a decent sum that is rolled up in a trust."

Another option is to fund a stakeholder pension on behalf of a child. Donations to charity will have a similar impact on an individual's estate.

But you don't always have to give it away if you are prepared to take certain risks. Goldstone notes that business property relief provides 100 per cent protection against IHT after two years. "It's particularly an issue for lawyers who maybe do have some other business interests," he says.

Goldstone adds that it is common for lawyers to have made investments in private companies, perhaps those run by friends, with the same relief by buying certain assets such as forestry or shares in companies listed on AIM.