

A Guide to Wills and Inheritance Tax

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Introduction

This guide sets out in a simple and straightforward manner the options available to individuals in their overall estate planning i.e. lifetime Inheritance Tax planning and Will planning. Having read this guide the reader will be aware both of the choices before him and also of the matters which require thought. It is not intended as a do-it-yourself manual but rather to put the reader in the best position to cover the subject with his financial adviser and solicitor and arrive at the most appropriate approach for him. It is very important when drawing up a will that account is taken of any lifetime planning that is or has been undertaken. To assist with this, checklists are included to ensure that, as far as is possible, no important areas are overlooked.

In many family situations it is often wished to build in flexibility (e.g. to allow for future unborn grandchildren) and/or control. It may be wished, for example to provide children with education funding but not to allow access to capital until some time later. In these cases the use of trusts can often provide the degrees of control, security and flexibility required. In most peoples' minds trusts are thought to be confusing, complex and costly. However this does not have to be the case. Modern trusts, while being extremely flexible, can provide significant financial and taxation benefits in a simple, straightforward and inexpensive manner. A section is therefore included on trusts and their practical benefits and uses which can apply equally to lifetime and Will planning.

During their lifetime many people acquire different life assurance policies and pension plans. Simple planning can ensure that the benefits from such policies and plans are received in the most tax efficient manner; this area is also covered in the guide.

As with all financial planning it is necessary to be aware of the main legal and taxation rules which apply. The main rules are therefore set out, in an easy to understand manner, to enable the reader to fit his thinking into an overall framework, relying on his financial adviser and solicitor to take care of the necessary detail.

Part I - Making a Will

Why make a Will?

- Without a Will your estate will be distributed on your death under rules laid down in the Administration of Estates Act 1925. These are known as the intestacy rules. Subject to rules concerning joint property (see below) if you die leaving a surviving spouse and children then the estate would be distributed as follows:
 - a) Your spouse would take the 'personal chattels'.
 - b) Your spouse would receive up to £125,000.
 - c) The rest of the estate would be divided into two. One half would be held upon trust for the children on them attaining eighteen. The other half would be held upon trust for the spouse for life (i.e. an entitlement to income only from that half) and on the spouses' death would be distributed to the children.
- Without a Will a surviving spouse does not necessarily inherit the whole of your estate. If there were no surviving children then a surviving spouse would receive £200,000 and then other relatives would benefit from the remainder in addition to the surviving spouse.
- In a Will you can choose who will administer your estate (executors).
- In a Will you can appoint guardians to look after minor children (i.e. children under the age of eighteen years).
- In a Will you can make gifts to persons who would not benefit under the intestacy rules.
- Administering an estate is easier where a Will has been made.
- Properly drawn up, Wills can reduce Inheritance Tax charges.
- Directions as to burial or cremation or donation of any part of your body for medical purposes can be made in a Will.

What property passes by a Will?

- All assets you own personally will pass under the terms of the Will. This includes everything from jewellery, cash, furniture and investments to your house.
- If you own some assets jointly (such as a house owned jointly with your spouse) then whether your half share passes under the Will or not depends upon whether you own as 'joint tenants' or 'tenants in common'. If you own as tenants in common then your share passes under the Will (or intestacy rules). If you own as

joint tenants your half share automatically passes to the survivor irrespective of the terms of the Will (or intestacy rules).

- Property held in trust does not pass by your Will but according to the terms of the trust.
- The proceeds of a life assurance policy will pass under your Will unless the policy is held in trust.
- Lump sums payable under death in service benefits or under pension plans pass according to the rules of the scheme. Some rules provide that the sum passes back into the estate and will therefore pass under your Will. Many schemes give the pension scheme trustees discretion as to who to pay the benefit to and in this case the lump sum does not pass under the Will.

Who can make a Will?

Any person over the age of eighteen can make a Will. The only persons under the age of eighteen who can make a Will are members of Her Majesty's Forces and even then only in specific circumstances.

To make a Will you have to be of a 'sound and disposing mind and memory'. This means you have to be capable of understanding the broad effects of the Will.

How should a Will be signed?

The Wills Act 1873 lays down strict rules as to how a Will should be signed if it is to be valid. Merely writing out your wishes and signing them will not be sufficient - such a document is not legally valid and is not effective.

We will explain carefully how the Will should be signed and will usually arrange for you to sign the Will in our office to ensure that all formalities are carried out.

Marriage and divorce

If you have made a Will and then marry the Will is automatically revoked and is invalid.

It is possible for you to make a Will in contemplation of marriage so that the Will is not revoked by that marriage. The Will needs careful drafting to do this. Apart from this you must remember to make a new Will on marriage.

A divorce does not automatically revoke a Will. However, any appointment of a spouse as an executor and any gift to a former spouse would not take effect. A Will should therefore be reviewed following a divorce. Merely separating from a spouse does not invalidate a Will which should therefore be reviewed.

If you re-marry following the death of a spouse or divorce then any existing Will is revoked and is invalid.

The main provisions of the Will

There are six main provisions you should address when you make a Will:

I Burial/Cremation

If you have any special wishes as to burial or cremation these can be included in the Will. Such wishes usually appear at the beginning of the Will so that your executors are immediately aware of your wishes when you die.

II Appointment of executors and trustees

You will need to consider who is going to administer your estate and, if you are creating trusts in your Will, who will act as trustees. It is usually convenient for the same persons to act as executors and trustees.

You may wish to appoint relatives or friends to act as executors. Many clients also wish to appoint their professional advisor such as a solicitor or an accountant as an executor to ensure that the estate is dealt with by an expert.

It is also possible to appoint one of the leading Banks or trust companies as an executor. The Bank's scale of charges can be very much higher than other professional's fees and you should compare fees before making such an appointment.

You may want to appoint one person to act as executor, such as your spouse, but to appoint other persons as executors (for example children) should your spouse die before you.

III Guardians

You can appoint guardians of minor children in your Will. Such an appointment would normally only take effect after the death of any surviving spouse. You should consult your proposed guardians before appointing them to ensure they are willing to act.

IV Legacies

You may wish to make a number of different types of legacies:

- (a) You may wish to leave a pecuniary legacy (e.g. £500) to a specific person (e.g. to a godchild or a charity). You should bear in mind that if that person dies before you the gift will not take effect and is said to 'lapse'. In this case the legacy will pass as part of the residue of your estate.
- (b) You may wish to leave a specific item of property to a specific person (e.g. 'my china tea service'). You should bear in mind that if you no longer own the item at the time of death then the gift will not take effect and is said to 'adeem', i.e. the person will not receive the specific item.
- (c) Rather than including a long list of specific items to go to specific people you could leave 'personal chattels' to a specific person or your executors to

distribute in accordance with your known wishes. You could then leave with your will a separate list which could be changed at any time without having to change your Will. Whilst such a list is not legally binding it does have great flexibility.

- (d) Mortgaged property. If you make a gift of mortgaged property then the property will pass to the beneficiary subject to the mortgage (i.e. the beneficiary will be liable for the mortgage and may then have to sell the property to pay off the mortgage). If this is not the intended result any gift of a mortgaged property should be stated to be 'free of mortgage' so that the mortgage is paid out of the residue of your estate.
- (e) Tax on legacies. If your estate is large enough to attract Inheritance Tax (see below) then in relation to a legacy you need to decide whether the legatee should pay tax on the gift or whether he should receive it free of tax so that the tax is paid out of the rest of the estate.

Example

If you leave '£500 free of tax to uncle John' then uncle John will actually receive £500. If you leave '£500 subject to tax to uncle John' then if your estate attracts Inheritance Tax uncle John will receive £500 less the tax on it.

V Gifts of residue

Having made any specific legacies, you then need to decide where the rest or 'residue' of your estate should go.

If you are married and wish to leave the residue of your estate to your spouse then you can either leave the residue to that spouse absolutely or in trust.

If the estate is left to your spouse absolutely then following your death your spouse will be free to do as he or she pleases with your estate, i.e. give it away (including giving it to a new spouse) or spend it. There would be no guarantee that your estate would eventually pass down to your children.

If this is of any concern then the estate can be left in trust for the surviving spouse so that he or she receives the income from your estate for his or her lifetime with perhaps the trustees of your estate having discretion to advance capital to the surviving spouse. Your Will would then provide where the estate goes following the death of your surviving spouse thus retaining control over the ultimate destination of your estate. Such a trust has no advantages or disadvantages for Inheritance Tax. The type of trust used would normally be 'an interest in possession trust' (see Part II 'What is a trust?' on page 21).

You will probably need to make some provision in your Will as to where your estate goes if your spouse dies before you. In this case, if you are leaving your estate to your children you need to decide at what age your children should become entitled on your death. If you specify an age for capital you need to decide at what age they should become entitled to income, if earlier.

VI Administrative powers and provisions

Your Will should also contain a number of administrative powers and provisions to facilitate easier administration of your estate, particularly if your Will establishes trusts.

If you set up a trust for minor children (which is usual) you will need to make sure that trustees have sufficient powers to invest funds, pay out monies for the children's maintenance or education, or even purchase or enlarge a house for them to live in with their guardians.

Inheritance Tax and Wills

If your estate, or the joint estates of yourself and your spouse, exceeds the Inheritance Tax 'nil rate band', from 6th April 2006 £285,000, then you may have Inheritance Tax liabilities. As explained in part II, rules and exemptions on page 11 the value of an estate over and above this threshold is charged to Inheritance Tax at 40%. Even a smaller estate may incur Inheritance Tax liabilities if you have made substantial gifts seven years prior to your death.

Any part of your estate which passes to a surviving spouse is exempt from tax. However, if you leave all your estate to a surviving spouse then while there will be no tax to pay on your death, Inheritance Tax will be payable on your spouse's subsequent death. At that time Inheritance Tax at 40% will be incurred to the extent that your spouse's estate (including the estate she or he has inherited from you) exceeds £285,000.

Inheritance Tax can be mitigated by ensuring that the £285,000 nil rate band is used on the assets of the first to die. This involves leaving £285,000 on the first to die to someone other than the surviving spouse. The gift can either be made directly down to children or grandchildren or if the surviving spouse needs access to those funds for the remainder of her/his life to a discretionary trust for the benefit of the surviving spouse, children and grandchildren.

Example

Mr Jones is married with two children. Mr and Mrs Jones have made Wills leaving all their estates to the survivor of them but otherwise to their children. His estate is valued at £463,000. Mr Jones dies. No Inheritance Tax is payable on his death. However, on Mrs Jone's subsequent death the £463,000 then passes through her Will down to the children incurring an Inheritance Tax charge of £71,200.

If instead Mr Jones had made a Will leaving £285,000 to the children and the remainder to his wife then no tax would have been incurred on his death. However, in addition no tax would have been incurred on Mrs Jones' subsequent death when £178,000 would have passed through her Will to the children.

We will be able to advise on these arrangements and their suitability to your circumstances.

Subsequent claims against your estate

Under the Inheritance (Provision for Family & Dependants) Act 1975 it is possible for certain persons to make a claim against your estate if you have failed to make reasonable financial provision for them. The persons who can make such a claim include a spouse and also a former spouse. A former spouse cannot however make a claim if she or he has remarried or if the Court barred such a claim on the grant of the divorce. A child can also make a claim as can any person who immediately before your death was being maintained wholly or partly by you. Such a claim would normally have to be made within six months of Grant of Probate of your Will. If there is a possibility of a claim then your executors will probably defer distributing the bulk of your estate until after this time period has expired.

Altering or changing a Will

Just as there are special formalities to be followed to make a Will there are similar formalities for changing a Will.

If you wish to make a few changes to your Will then we will normally draw up a 'Codicil' to your Will which needs to be signed in the same way as a Will. If there are substantial changes it is usually easier to make a new Will.

Merely writing over existing provisions in your Will will not be effective and in certain circumstances could have the effect of revoking provisions in your Will.

Probate

Following death, the executors will need to apply for a Grant of Probate of the Will. This is the formal authority from the Court which enables the executors to have access to the deceased's assets and deal with them in accordance with the terms of the Will.

The executors will be required to sign an 'Oath' before an independent solicitor under which they confirm they will deal with the estate as the law requires. Depending upon the size of the estate the executors will also be required to complete an Inheritance Tax Return for submission to the Capital Taxes Office.

Any Inheritance Tax payable on the estate has to be paid at the same time as the application for the Grant of Probate. This can in some cases cause a problem since the executors will be unable to have access to the assets of the estate until after they have obtained the Grant of Probate. In these cases the executors will need to borrow money from a bank to pay the tax which they repay out of assets of the estate once a Grant of Probate has been granted.

Enduring powers of attorney

The use of an Enduring Power of Attorney offers a very easy and inexpensive means of looking after the affairs of a person who has become mentally incapable of managing them themselves. Without an Enduring Power of Attorney in place, then

when a person becomes mentally incapable of managing their affairs a Receiver would have to be appointed by the Court of Protection. The powers of a Receiver are limited and authority of the Court is often required before certain actions can be taken; receivership accounts also need to be filed with the Court each year. The Court makes an annual charge.

Under an Enduring Power of Attorney, you can appoint persons who will look after your affairs in the event that you become mentally incapable of managing them yourself. The Enduring Power of Attorney needs to be drawn up in a form prescribed under the Enduring Powers of Attorney Act 1985.

The advantage of an Enduring Power of Attorney is that once the Attorneys you have appointed have reason to believe that you are or have become mentally incapable of managing your affairs all they need to do is register the Power with the Court of Protection (giving notice to next of kin). Once registered then your Attorneys can continue to manage your affairs without reference back to the Court of Protection (except for a very limited number of matters). The costs of appointing Attorneys under an Enduring Power of Attorney are very much cheaper than the costs involved in a Receiver being appointed by the Court of Protection.

Deeds of variation

It is possible, following a person's death, for the beneficiaries of the estate to vary their entitlement. To do this they need to be over the age of eighteen and have satisfied all conditions (if any) imposed on the gift to them. It can be difficult to carry out a Deed of Variation where assets are left in trust.

The most common use of Deeds of Variation is to carry out Inheritance Tax planning. For Inheritance Tax purposes, any variation carried out within two years of death is treated as if it were made by the deceased.

Example

Mr Dodds dies leaving £500,000 to his wife. He did not use up his Inheritance Tax nil rate band of £285,000. Within two years of his death his wife decides to carry out a Deed of Variation under which she redirects £285,000 to the children. This is not treated as a lifetime gift by the surviving wife of the children but as a gift made by Mr Dodds in his Will.

Notification has to be made to the Capital Taxes Office of the Inland Revenue within six months of a Deed of Variation being signed.

Of course, you cannot always rely on beneficiaries agreeing to carry out a variation following death. In addition, if there is any concern that beneficiaries could carry out a variation and you wish to prevent them doing so, this could be done by careful Will drafting. Although Deeds of Variation are effective for Inheritance Tax they may not be effective for other taxes, such as income tax, particularly if trusts are created by the Deed of Variation.

Part II – Inheritance Tax

Rules and exemptions

Inheritance Tax is chargeable on a person's estate at death and also takes into account gifts made within seven years of death. Additionally, transfers above a certain amount into discretionary trusts may attract Lifetime Inheritance Tax at the rate of 20%. Certain transfers are however exempt i.e. free of Inheritance Tax, most importantly those between spouses.

What is the rate of tax? As from April 2006 the first £285,000 of a person's chargeable estate (including gifts made within seven years of death) is free of tax; this is known as the Nil Rate Band, and assets in excess of this are taxable at a rate of 40%.

Example (a)

Husband dies with a total estate of £900,000. He leaves £440,000 to his wife and £460,000 to his children.

Inheritance Tax payable = $(£460,000 - £285,000) \times 40\% = £70,000$ i.e. only the assets which pass to the children are taxable.

Example (b)

Mrs. Baker, a widow, dies and leaves to her children £350,000. Inheritance Tax payable = $(£350,000 - £285,000) \times 40\% = £26,000.00$

What transfers are exempt?

The main exemptions which will be of general interest and use are as follows:

I Spouse exemption

As already mentioned transfers between husband and wife are exempt. This applies for transfers made during lifetime or on death. (N.B. for transfers to a non-UK. domicile spouse the exemption is limited to £55,000).

This exemption applies not only for outright gifts but also where the spouse is given a right to income in a trust; this type of trust is most commonly used in Will planning.

II Annual exemption

(Currently £3000). Each year an individual can gift up to £3,000 completely free of Inheritance Tax: thus a married couple can gift £6,000 in this year. If this exemption is unused in any one fiscal year it can be carried forward but only for one year.

It is worth noting that this is a lifetime exemption and therefore not available on death if unused in that year.

III Normal expenditure out of income

Gifts made out of income, which are regular and habitual, are exempt so long as they leave the donor with sufficient income to maintain his normal standard of living. There is no monetary limit on this exemption and thus the Inland Revenue are very keen to ensure that it is not abused.

For those with an investment portfolio which is providing a low level of income there may be the opportunity to rearrange the portfolio to provide higher income part of which could be gifted under this exemption.

N.B. This exemption will not be available where income is being gifted and the individual lives off part of his capital.

IV Small gifts exemption

Gifts up to £250 to any one person in any one year are free of Inheritance Tax. This exemption cannot be used as part of a larger gift to the donee (i.e. the person who receives the gift). This exemption is mainly of use for a grandparent who wishes to make smallish gifts to a number of grandchildren.

For example gifts of £250 to each of 8 grandchildren will enable £2,000 to be transferred free of Inheritance Tax; this can be repeated every year.

V Gifts in consideration of marriage

Gifts to the parties of a marriage, which are made before or at the date of a marriage are exempt up to various limits. These depend upon the relationship of the donor (i.e. the person who makes the gift) to the parties of the marriage as follows:

- (a) Parents £5,000
- (b) Grandparents £2,500
- (c) Others £1,000

VI Gifts for maintenance of family

Lifetime gifts for the maintenance, education or training of a child up to the age of 18, or when he ceases to undergo full-time education or training, are exempt. Thus, all costs of education of a child are exempt.

Other 'family' gifts can be exempt in particular those for the care or maintenance of a 'dependent relative'. A dependent relative is any relative of the donor or his spouse who is incapacitated by old age or infirmity from maintaining him/herself and also includes a mother or mother-in-law whether or not incapacitated.

VII Gifts to charities

Unconditional gifts to charities either during lifetime or on death are exempt.

The exemptions mentioned above are the ones which are most likely to be of use in the common family situation.

Potentially exempt transfers, gifts with a reservation and capital gains tax

There are two other Inheritance Tax rules which are very important for lifetime estate planning; these are potentially ExemptTransfers (known as P.E.T.'s) and Gifts with Reservation (G.W.R.'s).

Before Inheritance Tax was introduced in 1986 gifts made during your lifetime, above the Nil Rate Band, were subject to Capital Transfer Tax (C.T.T.) at the time they were made. Although the lifetime C.T.T. rates were lower than the death rates the fact that lifetime tax would become payable on substantial gifts limited the scope for significant estate planning.

On the other side of the coin it was possible, under C.T.T., to gift assets outside of one's estate for C.T.T. purposes but still be able to benefit from those assets in the future. This was usually achieved by the use of trusts.

Under Inheritance Tax two main changes were introduced, the first were Potentially Exempt Transfers which enable certain gifts to be made of unlimited amount (with no lifetime Inheritance Tax payable) which will be completely free of Inheritance Tax if the donor lives for seven years. The other was the introduction of the Gift with Reservation rules, which mean that for a transfer to be effective for Inheritance Tax. purposes the donor cannot be in a position to benefit from the assets he has gifted. Very importantly however, it is possible to make a gift into a trust in which one's spouse is a beneficiary; thus financial security can be provided for a potential widow/widower.

I Potentially exempt transfers

The main transfers which rank as P.E.T.'s are gifts to:

- (a) another individual;
- (b) certain types of trust being:
 - (i) accumulation and maintenance trusts;
 - (ii) interest in possession trusts (where one or more beneficiaries is entitled to the income of the trust);
 - (iii) trusts for the disabled.

A description of the different types of trust and their uses is set out in the section on trusts.

When a gift ranks as a P.E.T. then no Inheritance Tax. is payable when the gift is made and it is completely free of tax if the donor then survives seven years.

If death occurs within seven years then tax may become payable at the death rate but reduced by the following scale (this is known as tapering relief).

Year between gift and death	% of tax payable
3-4	80
4-5	60
5-6	40
6-7	20

A number of important points need to be made:

- (i) Tax payable (if any) on the P.E.T. is based on the value of the gift at the time it was made; thus any subsequent growth is free of Inheritance Tax.
- (ii) The reduction (shown above) is of the tax payable on the gift not of its value. If death occurs within seven years the full value of the gift is still taken into account when calculating the tax on the estate.
- (iii) In working out the tax on the P.E.T. and on the estate, any P.E.T.'s made within seven years of death are deemed to form the bottom of the estate and will therefore be set against the Nil Rate Band.

This last point can be very important when trying to benefit equally recipients of gifts and beneficiaries under a Will.

Example

Mrs. Peters, a widow, has two children, Sandra & Hazel.

Her estate totals £570,000.

In 2004 she makes a gift (a P.E.T.) of £285,000 to Sandra.

In 2006 she dies, leaving the balance of her estate to Hazel.

The Inheritance Tax position is as follows:

The P.E.T. to Sandra becomes chargeable (because of death within seven years) but no tax is payable since it is equal to the Nil Rate Band.

The £285,000 legacy to Hazel will all be taxable at a rate of 40% (the Nil Rate Band having been used by the P.E.T.) Inheritance Tax of £114,000.00 will be payable and Hazel's net inheritance will be £171,000.00.

This example clearly illustrates the importance of taking a whole view of estate planning and integrating lifetime planning with Will planning.

II Gifts with reservation

As already mentioned rules were introduced, when Capital Transfer Tax was changed to Inheritance Tax, which mean that if a gift is to be effective for Inheritance Tax purposes then the donor cannot benefit from any of the property gifted. Whilst the gift with reservation rules are complicated their main effect is to put an emphasis on the individual ensuring his own financial security and that of his spouse, both now and in the future, before making gifts.

In the introduction to this section, mention was made that whilst the donor cannot be in a position to benefit in any way from property that is gifted, nevertheless, by using trusts, the spouse, commonly expressed as widow or widower, can be a potential beneficiary under a trust without infringing the gift with reservation rules. This is a particularly valuable option for those people who are confident of their financial security in their joint lifetimes but are nevertheless prevented from doing any lifetime planning by the wish to make absolutely sure that the spouse will be looked after, following the first death. Gifts could be made for example by a husband into a trust, if the correct trust was used this would rank as a P.E.T., and thus if he lived for seven years the whole of the gift would be Inheritance Tax free; by including the spouse as a potential beneficiary in the trust; then if, after his death, it was required, capital could be appointed out of the trust back to the widow but if it was not required then the capital would be outside of her estate and thus not subject to Inheritance Tax. This form of planning commonly provides all the financial security that is required in a family situation.

III Capital Gains Tax (C.G.T.)

With the exception of certain assets, e.g. business and agricultural, gifts to individuals and most types of trusts can incur a C.G.T. charge at the time of the gift. C.G.T. on gifts can be deferred if the gift is made to a discretionary trust. Care should therefore be taken when making gifts to either transfer assets which are not subject to C.G.T. e.g. cash, insurance policies etc. or alternatively to transfer assets which are carrying little or no gain.

Another relevant point is that any potential C.G.T. liability is wiped out on the death of the owner of the asset; this has to be borne in mind when assessing the advisability of making lifetime gifts.

Life assurance and pension policies

I Life assurance

There are two main uses for life assurance policies: Firstly to provide a sum payable on death, either during a certain number of years (known as a term assurance) or at any time (known as a whole life policy). Secondly, as a savings/investment vehicle to provide a sum of money payable at a date, the maturity date, in the future in return for regular investment, the premiums, in the meanwhile (these policies are known as endowment or investment plans).

There are many different types of policy often providing a mixture of benefits, including critical illness and disability benefits. It is beyond the scope of this booklet to look at all the different types of policy but there are some very important points concerning inheritance planning.

The first, and most important point where the main purpose of the policy is to provide a sum on death, is that when death occurs the sum assured is payable to the owner of the policy or to his estate if he was the life assured. If the sum assured is payable to the estate of the deceased then it will be added to his other assets and will be subject to Inheritance Tax like any other asset. If all the estate is passing to the surviving spouse then no Inheritance Tax will be payable at that time (because of the spouse exemption, see above); but obviously this will not be the case for a single person, widow/widower or if significant assets are being left to the children.

In order to avoid the sum assured itself becoming liable to Inheritance Tax the policy should be written in a trust. In this way the sum assured will be payable to the trustees for the benefit of the beneficiaries and will be outside of the estate of the deceased and thus free from Inheritance Tax. If it is appropriate the spouse can be included as a beneficiary in the trust and this will provide flexibility on the destination of the sum assured. By the use of a trust the need for probate is avoided and thus money can become available quickly at a time when it might be most needed; it is essential that there are additional trustees other than the lives assured.

If a policy is written in trust the premiums will count as gifts but will probably be covered by either the annual exemption or gifts out of normal expenditure exemption.

Normally, where appropriate, policies should be written in trust at the outset, but policies already in force can be put into trust. In the latter case there will be a gift equal to the open market value of the policy at the time, subject to a minimum of the premiums paid, (special rules apply for term assurance policies).

II Pension policies/schemes

Many pension schemes and pension policies provide death benefits if death occurs before retirement. If these benefits are held on discretionary trusts then they will fall outside of the client's estate and be free of Inheritance Tax. With group pension schemes and many personal pension policies the benefits will automatically be held on trust; but this is not the case for retirement annuity policies (old style personal pension policies) and some personal pension policies. There are two steps to be taken in this regard.

Firstly, ensure that all pension death benefits are held on trust. If they are not then this can be set up now.

Secondly, and very importantly, a nomination form should be lodged with the trustees to tell them how the benefit is to be payable e.g. '50% to my wife, and 25% each to my two children'. Whilst this nomination, or expression of wish, is not binding on the trustees they will in normal circumstances follow it. In the absence of such a nomination they will typically pay all the benefit to the widow/widower.

For wealthier people, significant Inheritance Tax. benefits can be achieved by thoughtful use of pension death benefits, for example, if a widow/widower does not have immediate need for the funds they could be paid into a trust thus keeping it outside of the estate, but providing access to the capital if needed.

What is a trust?

A trust is a mechanism whereby one or more persons, called trustees, are obliged to look after and deal with assets (the trust property) for the benefit of the beneficiaries. The trust deed, which might be incorporated in a Will, will establish the obligations of the trustees and how they are to benefit the beneficiaries e.g. 'pay the income of the trust to my wife during her lifetime and thereafter divide the capital equally between my children'.

It is essential to have trusts properly drawn up since they may establish the control of assets for a long time, possibly decades. Also it is important to build in flexibility to allow for changing circumstances in the future.

Why should you use a trust?

I Family provision

A trust is useful for passing assets out of one person's estate without passing them directly into another person's. They are particularly useful where children are involved or perhaps where there are others who cannot manage their own affairs, e.g. mentally disabled people.

II Uncertainty

Often a person will want to make gifts to his family but is not in a position to decide how much each of them should get or it may be that he wants to control what happens to the gift if the donee should die.

III Tax advantages

For many years now trusts have been used to avoid or reduce income tax and latterly Inheritance Tax. In recent years the reduction of Capital Gains Tax has also become possible.

IV Family companies

Shares in a family company may be of significant value and this value could increase considerably in the future. For example, future plans for a full listing on the Stock Exchange or a flotation on the unlisted securities market could result in very substantial capital tax liabilities. At the same time, typically someone who has built up a company over the years will not be keen to pass over voting control, so here again trusts have a useful role.

Who should be trustees?

As the name implies trustees should be people who the person creating the trust can rely on to carry out his wishes. Usually it is best to have at least two trustees and often a trustee who is independent of the family, such as the family solicitor who will be familiar not only with the family circumstances but also the laws governing trusts.

What are the main types of trust?

I Discretionary trust

A discretionary trust is one where the payment or distribution of income to the beneficiaries is at the discretion of the trustees. No beneficiary has a right to receive the income and so there is no 'interest in possession' (see below). In some discretionary trusts the trustees are permitted to accumulate income and add it to the capital of the trust whilst in others they have to distribute all income within a reasonable time. The great advantage of discretionary trusts is their flexibility and they are most appropriate where the settlor wishes to benefit a group of individuals – for instance his wife, children and grandchildren - but has not yet decided what shares each should take.

II Accumulation and maintenance trusts

This is a special type of discretionary trust in which at the outset all the beneficiaries must be under 25. By the age of 25 one or more of the beneficiaries must at least become entitled to income from the trust. This type of trust is particularly useful for school fees planning and for providing for grandchildren (born and unborn) in general.

III Interest in possession trust

One or more of the beneficiaries must have a right to receive the trust income, or would do if there were any. These are most typically used where the settlor wishes the beneficiaries to enjoy the trust income or to have use of the trust property, but would like to defer the age at which they can use or dispose of the trust assets. These are also useful if the settlor wants one person to enjoy the income of the trust fund, perhaps during their lifetime, and for the trust assets then to pass outright to someone else e.g. 'the income to my widow during her lifetime and thereafter the capital for my children'.

IV Absolute trust

The main feature of an absolute trust is that the beneficiary is absolutely entitled and any income arising is treated as though it were his own for all tax purposes, with the exception of parental settlements. If 18 or over the beneficiary of an absolute trust can call for the assets in the trust to be transferred to him at any time.

V Taxation of trusts

This is a specialist area outside of the scope of this guide where correct decision-making can secure tax advantages. It is however important not to allow the tax tail to wag the overall planning dog.

The best approach is to establish your objectives and then allow your adviser to maximise the tax advantages using their expertise.

Lifetime planning

The basic rule of estate planning is to ensure financial security for oneself and one's spouse and thereafter planning can be undertaken.

In the previous sections mention has already been made of making sure that pension death benefits and life assurance policies are held in trust where appropriate; this is straightforward planning not to be ignored.

Basic planning methods

There are essentially four approaches to Inheritance Tax planning:

- (i) Reducing the taxable estate.
- (ii) Freezing the estate.
- (iii) Providing sums payable to beneficiaries free of Inheritance Tax.
- (iv) Investing in assets which attract relief.

A combination of these approaches is usually the most effective:

I Reducing the taxable estate

By making gifts of capital using the exemptions or as potentially exempt transfers.

It is important to make sure that enough assets/income are retained to provide security. By using trusts such security can be provided for the potential widow/widower.

II Freezing the estate

This means giving away the future growth on the estate; The most common way of achieving this is by using interest-free loans. Such loans are repayable on demand and thus the lender retains access to the original capital loaned. Growth on the capital loaned is not in the lender's estate and is therefore not subject to Inheritance Tax on his estate.

Many insurance companies market loan plans which also enable the lender to obtain an 'income' (in the form of partial repayments of the loan.)

III Providing sums payable to benef ciaries free of Inheritance Tax

A very straightforward piece of planning, which can often help with particular family situations, is to effect a whole life policy written in trust. The trust can be flexible and therefore allow for changing circumstances in the future.

Whilst not reducing the taxable estate, except by the premiums paid, this approach increases the total receipts of the beneficiaries.

An example where this can be very useful is one where there is a family business with some children involved in it and some not. If it is wished to leave the business to the 'business' children then an equal inheritance can be achieved by effecting a whole life policy for the 'non-business' children.

IV Investing in assets which attract relief

For example, investing in farmland or certain business assets can attract 100% or 50% relief.

Conclusion

Making a Will can be one of the most important decisions you make in your lifetime. A Will directs who will inherit your estate when you die. Bearing in mind your estate will include your house and furniture besides cash and investments the cost of making a Will is modest. The purpose of this guide is to help you understand what is involved in making a Will and to make our task as your solicitor much easier thus keeping the cost to a minimum.

Wills are also an important part of Inheritance Tax planning. This guide will also help you understand how Inheritance Tax works, not only in relation to your Will but also in relation to lifetime planning, pension schemes, life assurance and the use of trusts.

APPENDIX I

Check list of information for your solicitor for your Will If you run out of space please use a separate sheet

1. Full name:	
2. Address:	
Postcode:	
3. Burial/cremation?	
4. Full name of spouse:	
5. Names and ages of childre (a) (b) (c) (d)	n of present marriage
6. Have you or your spouse b	een married before?
7. If answer to 6 is yes names your spouse:	and ages of children of previous marriage of yourself
SELF	SPOUSE
(a)	(a)
(b)	(b)
(c)	(c)
8. Name and address of exec	ıtor:
9. Name and address of subst	itute executors:
(a) Full name: Address:	
Postcode:	
(b) Full name: Address:	
Postcode:	

10. Name and address of guardians:(a)Evil name:	(b)
Full name: Address:	Full name: Address:
Postcode:	Postcode:
11. Pecuniary legacies, amount, full name as (a) (b) (c) (d)	nd address of legatee
12. Specific legacies of property, full name	and address of legatee:
(a) (b) (c)	
(d)13. Beneficiaries of your residue (e.g. surviv	ving snouse):
13. Belieffelaries of your residue (e.g. surviv	ing spouse).
14. Substitute beneficiaries of residue (e.g.	children if spouse predeceases):
15. At what age do you wish children to inh	erit residue?
16. At what age will children receive incom later than the age of 25):	e from their residue (this should not be
17. Who will receive residue should both yo	our spouse and children die before you?
18. Have you considered Inheritance Tax? Chelp us assess the position.	Completing the following Schedules will

Extra Information:

APPENDIX II Schedule of Assets and Liabilities

	Approxir	T: 1 :6	
Assets	You	Your Spouse	Tick if owned jointly
House			
Contents			
Car			
Jewellery			
Cash at Bank			
Cash at Building Society			
Quoted Stocks & Shares			
Partnership Share			
Unquoted Shares (e.g. in a private company)			
Other Assets (specify)			
Liabilities			
Mortgage			
Other (specify)			

APPENDIX III Life Assurance Policies

Life Insurance Company	Policy Number	Sum Assured	Premiums	Purpose of Policy	In Trust Yes/No

Pension Death Benefits

Pension Scheme/ Policy	Amount of Death Benefit	Widow's/ Widower's Pension	Death Benefit in Trust Yes/No	Nomination Form Completed

APPENDIX IV Glossary of terms

Testator The person who makes the Will.

Intestate Dying without making a Will.

Executor A person who is appointed by Will to administer

an estate.

Administrator A person who administers an estate either where

there is no Will or where the Will fails to appoint

an executor.

Personal Representative Either an executor or an administrator.

Trustee A person who is appointed to act as a trustee of

any trusts established under the Will and usually

the same person as the executor.

Guardian The persons who you nominate to have physical

custody of your minor children.

Legacy A gift in your Will.

Pecuniary Legacy A gift of money in your Will.

Specific Legacy A gift of a particular item in your Will (e.g. 'my

china tea service').

Legatee A person who receives a gift under a Will.

Residue The remainder of your estate after all debts, liabilities,

legacies and testamentary expenses (e.g. inheritance

tax) have been paid.

Residuary Legatee: A person who receives the residue of your estate.

Codicil A document which varies the provisions of a Will.

Personal Chattels: The most common examples are jewellery, books,

furniture, clothes and household goods.

APPENDIX V - Contact Details and Other Sources of Information

Rigby Golding - www.rigbygolding.co.uk

Sunbury Cross Sunbury-on-Thames Middlesex **TW167AU** Tel: 01932 765 741

Fax: 01932 765 720

E-mail: mail@rigbygolding.co.uk

Please contact us for any more information or to discuss matters.

The Public Trust Office - www.publictrust.gov.uk

Stewart House 24 Kingsway London WC2B 6JX Enduring Power of Attorney Helpline: 020 7664 7327

For information of Trusts and Enduring Powers of Attorney

Society of Trust & Estate Practitioners – www.step.org

PO Box 13272 Eagle House 110 Jermyn Street London SW1Y 6ZH Tel: +44 (0) 20 7839 3886

Fax: +44 (0) 20 7839 3669 email: step@step.org

Susan Webster at Rigby Golding is a member of the Society of Trust & Estate Practitioners. The Society can also help you find other specialist Trust & Estate Practitioners such as accountants.