M&G wealth

ESTATE PLANNING

GET STARTED ON PLANNING FOR WHAT YOU LEAVE BEHIND

Welcome to your estate planning guide

The aim of this guide is to help you get started with estate planning.

Like most people, you've probably spent a lot of time growing your savings, increasing your pension pot, and investing wisely. But what you might not have done yet is think about what happens to all the money and possessions you've accumulated after you're gone.

Getting your affairs in order is a crucial part of your financial plan. If you want to leave your money and valuables to the special people in your life and prevent an Inheritance Tax bill, planning is essential.

The following information is based on our current understanding of taxation law and practice in the UK, which may change. The amount of tax you pay and relief you receive depends on your own personal circumstances, which may also change in the future.

Estate planning is a complex subject and this guide just scratches the surface. We recommend speaking to your financial adviser to learn about your particular options and what's best for you and your family.

Why is estate planning important?

You might have heard the term 'estate planning' and wondered what it involved. The word 'estate' just refers to everything you own, and estate planning refers to the plans you make so your money and valuable possessions are distributed in a certain way after you die.

It's crucially important to have an estate plan. Without one, there's no guarantee your money or valuables will be passed on to your loved ones in the way that you wish. And not having a plan might mean they receive less if Inheritance Tax is due on your estate.

Having an estate plan can help:

- make sure your money and possessions go to who you want
- reduce or possibly eliminate the tax that your loved ones might need to pay on your estate
- ensure that all of the assets in your estate will be transferred as quickly as possible
- help reduce the costs associated with distributing your estate

What’s in your estate and why it matters

To find out if an Inheritance Tax bill might be due you’ll need to calculate the value of your estate.

Most people understand that their estate is made up of property, savings, investments and valuable possessions (eg cars, caravans and boats). But an estate also might include much more.

Imagine you could turn your house upside down and shake it. Anything that fell out would also be included in your estate, for example your TVs, laptops, furniture, antiques, jewellery and collections. Also, some trusts might need to be included in the value of your estate.

You can see how quickly it would all add up.

Do you know?

Although your pension can be a very valuable asset, it’s usually not counted with your other money and valuables when calculating Inheritance Tax. But you still need to make plans to ensure any pension death benefits go to your loved ones.

Understanding Inheritance Tax (IHT) and tax-free allowances

Once you've added up the value of your estate you can work out if IHT might be due. If the total value of your estate is more than the tax-free allowances, then IHT of 40% may be due on the amount that exceeds the allowances.

The main tax-free allowances

The good news is that everyone's entitled to a tax-free allowance of £325,000 – this is often referred to as the nil-rate band but it's simpler to call it a tax-free allowance.

There's also a tax-free property allowance of up to £175,000 called the residence nil-rate band. However, this allowance has some conditions that must be met. Broadly, it applies if your home is left to your children or grandchildren.

If you add the two allowances together (£325,000 and £175,000) you can potentially leave your loved ones £500,000 tax-free, as long as you leave your home to your children or grandchildren.

If you're married or in a civil partnership, you can also usually leave everything to your partner completely free from IHT.

Your husband/wife/civil partner will also inherit your unused allowances, so by using your tax-free allowances of up to £500,000 plus their own £500,000, they can potentially leave £1 million tax-free to your children or grandchildren.

IHT – a snapshot

Some important figures to keep in mind:

- **£325,000** is your tax-free allowance
- **£175,000** is your tax-free property allowance
- **40%** tax applies above the tax-free allowances
- **£214,000** was the average IHT bill in 2020/21*

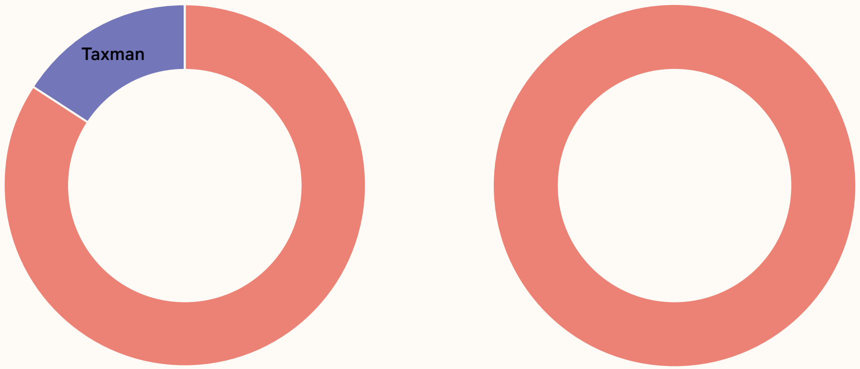
*Source: HMRC

What to do if you're going to leave an IHT bill

You can start planning early to help reduce or eliminate an IHT bill

The general aim of IHT planning is to reduce the value of your estate to bring it in line with your tax-free allowances. As you can see from the diagram, without IHT planning your loved ones may be liable for tax on what you leave behind.

Who do you want to leave your estate to?



Without IHT planning the taxman might take a bite

With IHT planning your loved ones could get more

Using gifts and trusts to reduce IHT

IHT planning is a complex subject and there are lots of different strategies that can be adopted. While we can't cover all of these in depth, we can look at two key approaches: gifts and trusts.

Using gifts to reduce IHT

Gift-giving can reduce your IHT liability by decreasing the size of your estate. On an emotional level, gifts also let you experience the pleasure of giving and bring joy to your loved ones at the same time.

But with tax, it's never simple. There are rules around gifts that need to be considered. For example, in some instances it takes a full seven years for a gift to become tax-free. It's worth thinking about giving earlier rather than later, as giving when you're younger can increase the chances of surviving seven years after the gift was given.

How timing impacts IHT on gifts

If the person making the gift passes away within seven years there may be IHT to pay. This chart shows how the rate of tax due to gifts within seven years decreases over time. This only applies if the gift is above the available nil rate band.

Years between gift and death	Tax paid
less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
7 or more	0%

Other rules about gifts

Not all gifts are subject to this seven-year rule. There are some exceptions. You can gift the following at any time without attracting IHT:

- up to £3,000 each year
- up to £250 to as many people as you like each year, as long as you've not used any of these other gift allowances
- gifts to charities and political parties
- wedding gifts of up to £5,000 for children, £2,500 for grandchildren and £1,000 for anyone else.

Gift-giving check list

To establish whether or not IHT is due, you'll need to show what gifts have been given. For example a bank statement can provide evidence that a gift of money was given. So when giving gifts, make a record and keep the list with other important papers. Take note of:

- who each gift was given to
- what gift they were given
- the date the gift was given
- and the value of the gift.

Using trusts to reduce or eliminate IHT

Trusts are another tool frequently used to reduce or eliminate Inheritance Tax. There are many different types of trusts.

This is a complex subject that's best explored with a financial adviser.

In general, you may choose to use a trust when you want to leave property, investments or money for loved ones but keep some control over how the money is spent.

A trust can ensure that the money you leave is used for a certain purpose, for example, school fees or to buy a house.

How one family saved £80,000 on IHT

Here's a story about how one family, the Andersons, used a trust to reduce IHT. The Andersons are not real, but their situation is common.

Meet the Andersons

The Andersons are in their mid-50s and have two adult children, Jack and Alicia. They're in good health, but are thinking about the future. The Andersons are concerned about leaving an IHT bill to Jack and Alicia. They set up a call with their adviser to discuss their options.

Their adviser asks them for a list of their assets to establish the value of their estate.

The Andersons' assets

House	ISAs	Cash	Investments	Household contents	Total value of assets
£500,000	£250,000	£100,000	£300,000	£50,000	£1,200,000

The Andersons also have pensions worth £500,000. However, their adviser checked with the pension provider and as their pensions aren't usually liable for IHT they're excluded from the list of their assets.

Assessing the Andersons' potential IHT liability

After reviewing the list of everything the Andersons own, the adviser asks about their Wills. They say they plan to leave everything to each other. After they both pass away, whatever's left will be split equally between their two adult children.

This means there won't be any IHT due when the first of them dies because a married couple can leave everything to each other tax-free. And their unused allowances will pass to the surviving spouse, giving them a tax-free allowance of £1 million.

The Andersons' estate is £1.2 million. This means when they've both passed away the portion of their estate exceeding the allowance is £200,000. This would be subject to tax of 40%, leaving Jack and Alicia with a tax bill of £80,000. The Andersons ask the adviser what they can do to avoid this outcome.

Talking to the Andersons about their priorities

Through their discussion, the adviser knows the Andersons will have a good level of pension income to cover their own needs for the remainder of their lives. And they're not interested in building up a large estate simply for the sake of it.

They would consider giving money to Jack and Alicia now to gain the benefit of seeing them enjoy it, but it's also important to them that their hard-earned money is used responsibly.

How the adviser saves the Andersons £80,000

Taking this all into consideration, their adviser suggests the Andersons set up a discretionary trust. This type of trust allows the Andersons' trustees to have a greater deal of control on how the money is used. In their case, they'd like the money to be put towards buying a house.

Putting £200,000 into a trust could completely remove their IHT liability if they both survive seven years. This will stop the taxman taking £80,000, leaving more for Jack and Alicia.

The Andersons are happy with their adviser's recommendation as it offers the IHT relief they seek, and also provides a way to ensure the money left to the children is used wisely.

Of course, the Andersons and their adviser will be periodically reviewing things to make sure everything is on track. If the value of their estate rises above £1 million, they may need to take more action to prevent an IHT bill.

This example is for illustrative purposes only. Please remember that it's just one of many approaches that can be taken to remedy IHT. Your adviser can tell you more about the best options for your particular circumstances.

Important legal documents you should have

Why you should make a Will

You may already know that your Will sets out what you want to happen with your money and valuables after you die. It's a very important document for estate planning, so if you haven't already done so, make a Will and review it regularly.

But it's not enough to just have a Will – it's also important that your family and your executor (the person you've appointed to carry out your wishes) knows that you have a Will and where they can find it. You don't need to tell them what you've written in your Will if you don't want to.

A Will can be used to:

- clearly identify loved ones or charities you want to leave your estate to
- reduce or possibly eliminate tax that your loved ones might need to pay
- specify who should look after any younger children you may have

What happens if you don't have a Will

If you don't have a Will, you'll have no say over who gets everything you leave behind. What happens to your estate will be dictated by special rules called 'intestacy rules'. These rules are complex and can work in ways that might surprise you.

The important thing to remember is that who receives what you leave may not be in line with your wishes.

Here are a few examples:

- if you and your partner aren't married or in a legal civil partnership your partner can't inherit any of your estate
- if you're separated but not legally divorced, your ex can still inherit – even if the relationship is over
- your step-children can't inherit – even if you want them to

Your adviser can tell you more about how this might apply to you. But the main point is, if you don't have a Will, you'll have no say over who gets everything that you leave behind.

Why a Power of Attorney matters

There may come a moment when something happens to you that prevents you from looking after your own affairs. A Power of Attorney, or POA, lets a family member or friend represent your interests and make important financial or medical decisions for you.

People sometimes make the mistake of thinking that the POA means they've automatically handed over control to someone else. This isn't true. The POA can start immediately or can kick in when you're no longer able to act in your own best interest, and can be a temporary measure.

If you haven't set up a POA, don't wait. If you become unable to make your own decisions, the court may appoint someone to manage your affairs for you. This may not be the person you'd want to be making decisions on your behalf.

Do you know?

It can help to think about the Will as something you do to help those you leave behind, whereas a Power of Attorney is something that helps you while you're alive.

Don’t forget about planning for your pension

Your pension is likely to be one of your most valuable assets (sometimes worth even more than the family home) and can provide income for your loved ones once you’re gone. So it’s really important to plan what happens to your pension. Here are some things to bear in mind:

Know where your pensions are and tell your loved ones

Most of us have held many jobs in our lifetimes and may have pensions attached to each one. It’s easy to lose sight of them and tracking down pensions can be a minefield. If the information about your pensions isn’t available, your loved ones might not get the money they’re entitled to. So make sure your family has this information.

Make sure your pension goes to the right people

The person who inherits your pension usually depends on whose name is on your nomination of beneficiary form and the rules of the pension scheme itself. Over time it’s easy to forget whose name is on your form(s). Make sure your money is going to the right people by keeping those forms up to date.

Understand your pension’s death benefit

Each pension has rules that dictate how it can be passed on to your loved ones. The rules can be complicated. If you don’t understand how they work, you may make an irreversible mistake. For instance, in some cases, once you’ve started to take your money you can’t change what happens to your pension when you die.

What to do next

It's always a good idea to take steps to get your affairs in order, and it can be a relief to know that you've taken the action needed to take care of those you leave behind.

Although deciding how to transfer your money and possessions can seem daunting, the process itself doesn't have to be difficult for you. Your adviser can help. He or she has the knowledge and experience to steer you in the right direction. Your adviser will listen to your needs and goals, assess your situation and set up a plan that's best for you and your family.

Please contact your adviser for more information or to start with your estate plan today.

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