JM Wealth

Financial services newsletter

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Time to review your Will?

Until 2007, it was standard advice to people whose estates would potentially be liable to pay inheritance tax to include in their Will a trust into which part of the value of the estate would pass. In most cases, this is no longer appropriate.

The reason for the trust was that no inheritance tax is payable on the first slice of an estate, referred to as the 'nil rate band', which currently stands at £325,000. However, estates passing between spouses and civil partners are wholly exempt from tax, so the nil rate band would not be used.

The trusts drafted by solicitors to address the issue would name the testator's spouse as a beneficiary but avoid the tax consequences which would have arisen if the assets had been bequeathed directly to the spouse.

However, as increases in house prices pushed the value of an increasing number of estates above the nil rate band, the Government decided to allow all spouses to achieve a similar objective to the trust arrangement, by permitting the value of the nil rate band to be transferred to the surviving spouse.

Many wills still include these trusts, and they continue to be effective and indeed to offer some advantages over the transferable nil rate band.

All this will change as from 6 April 2017, when an additional nil rate band, known as the family home allowance, will be introduced for the benefit of home owners. This entitles 'direct descendants' of a deceased who inherit the family home to a further allowance which will increase each year until it reaches £175,000 by the tax year 2020/21.

Combining the nil rate band and the family home allowance will eventually provide exemption from tax for estates worth £1 million. However, since it is only available if the estate goes to 'direct descendants', it would not apply to trust arrangements, and wills containing such arrangements may need to be re-written.

The family home allowance is clawed back from estates worth over £2 million, so in these cases it might be decided to keep the trust arrangements in place.

Should I stay or should I go?

Occupational pensions have been in the news recently for a number of reasons. First, the near collapse of the BHS pension scheme. Then the Government plan to make it easier for employers who are struggling to maintain pension promises to water down their pensioners' benefits.

Add in the fact that the terms on which employees can transfer out of schemes are currently unusually favourable and that in April the charges for making transfers from occupational schemes to Self-Invested Personal Pension schemes or other 'defined contribution' schemes will be capped at 1%, and it is little wonder that an increasing number of members of occupational schemers are considering transferring.

This would enable them to enjoy the benefits of the so-called 'pension freedoms', including unrestricted access to benefits as from the age of 55 and inheritance tax advantages. But would transferring be the right thing to do?

Before the financial crisis or 2008 it was confidently assumed that the greatest advantage of final salary schemes was that the benefits were guaranteed. However, following the BHS scare, employees have come to realise that a guarantee is only as good as the guarantor – i.e. the sponsoring company.

There is, however, a government 'lifeboat' scheme, the Pension Protection Fund, which underpins pension entitlements. Pensions up to £10,000 are likely to be protected, but the scheme would not cover scheme pensions over £37,420 per year.

Apart from the question of the guarantee, what are the other factors affecting the decision as to whether or not to transfer?

First, there is the question of risk. The value of a defined contribution scheme depends on the value of the scheme investments, which depends on the stock market. The employee, rather than the employer, shoulders this risk.

The value of death benefits would be another consideration. Occupational schemes include widows' pensions and a lump sum payment on death in service.

Under a defined contribution scheme, life cover would have to be paid for separately, so individual family circumstances would be another factor in any decision.

Financial advisers usually take as their starting point that transfers will only be appropriate if there are real doubts about the viability of the occupational scheme. But if it seems that there could be a case for moving, the adviser will usually conduct a 'critical yield' analysis to determine what return would be required from the new scheme to match the benefits of the occupational scheme.

This analysis involves making assumptions on a number of issues, including the possible course of interest rates, stock market returns and personal health and family responsibilities.

The prediction of income would then need to be related to an analysis of likely expenditures, which would involve the use of cashflow forecasting software. However, there can be no guarantees that events will turn out as predicted. Hence the reluctance of financial advisers to recommend transfers.

State pension offer

A Government offer enabling savers to boost their State pension by making a lump sum payment to secure additional income of up to £25 per week, will expire in June.

The offer has been available since 2014, when it was introduced to enable people who lost out as a result of the replacement of the old basic State pension by the new flat rate pension to buy additional guaranteed pension income on favourable terms. Since then, continuing low interest rates have made the offer even more attractive.

The question of whether an individual saver should take up the offer depends on a number of factors, including age, health, marital status, tax bracket and inheritance plans.

What can be said is that the offer is unlikely to be attractive to higher-rate taxpayers in questionable health, but it should be given serious consideration by anyone else who might otherwise have intended to buy a retirement annuity.

No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice. Please remember that past performance is not necessarily a guide to future returns. The value of units and the income from them may fall as well as rise. Investors may not get back the amount originally invested.