

Passing on your wealth to your loved ones



Having arrangements in place to protect your family is very important. Taking out life insurance is one part of the financial planning process.

You will also want to ensure that you are able to pass on your assets to your chosen beneficiaries according to your wishes and in a tax-efficient manner, without compromising the quality of your life in later years.

This guide helps you to consider the key issues that can affect your plans for passing on your wealth, in a controlled and tax-efficient manner. It also summarises some potential actions that can make your planning simpler and more effective.

We do not give tax, legal or investment advice; please ensure you always speak with your financial adviser before making any decisions.

Essential considerations

It's important that you consider the following questions, to make things as simple as possible for your loved ones.

01 Do you and your spouse/partner have professionally drafted Wills in place and are they up to date?

02 Will your executors need to obtain Probate in the jurisdictions where your investments are based? Are there any steps you can take to avoid the need for Probate?

03 Will your estate be subject to UK IHT on your death and, if so, what is your exposure to it?

04 What simple steps can you take to reduce your exposure to UK IHT?

05 Should you consider more advanced forms of IHT planning?

With the help of a qualified financial adviser you can put steps in place to ensure that all of these questions are answered in line with your individual circumstances.

This should leave you free to enjoy life, secure in the knowledge that your financial planning has been taken care of.

01

Reasons for making a Will and keeping it up to date

It is very important for everyone to make a valid Will and to review it regularly, especially where personal circumstances change, such as getting married (or entering a civil partnership), getting divorced, or having children or grandchildren. Failure to make a Will means that an individual would die intestate, which means that the estate would be distributed in accordance with the 'rules of intestacy'. This could result in the estate not being distributed in accordance with the deceased's wishes.

In addition to avoiding the rules of intestacy, there are a number of personal reasons why an individual would want to make a Will, and could include the following:

- to distribute their assets and personal effects in accordance with their wishes
- to make provision for their children regarding guardianship and how they will be provided for
- to indicate their funeral requirements
- to help reduce death duties
- to make provision for their pets
- to leave money to their favourite charity
- to leave a legacy in trust to ensure the controlled distribution of your wealth

02

Executors may need to obtain Probate in the countries where your investments are based

Probate is the process whereby the executors that you have appointed in your Will are granted permission to take over your assets on your death and distribute them to your beneficiaries.

UK Probate cannot be granted until any UK IHT has been paid, so you will need to consider how any IHT will be paid in order that your assets can be released to your beneficiaries. Isle of Man Probate would be required for an international life insurance policy issued from the Isle of Man.

Steps you can take to avoid the need for Probate

You have a number of options available which will enable certain assets, including international life policies, to be passed on to your beneficiaries outside of the provisions of the Will. This approach will avoid the need for your executors to obtain Probate.

International life insurance policies – avoiding the need for Probate

1 Taking out a jointly owned policy

With jointly owned policies, the proceeds payable on first death pass to the survivor. If the proceeds are payable on the second death, the survivor retains full benefit of the policy until their death.

2 Nominating beneficiaries using the relevant appointment form

Completing a beneficiary nomination form is an expression of your wishes on who the policy proceeds should be paid to, in the event of your death during the policy term.

3 Placing the policy in trust

Setting up a trust involves transferring ownership of the policy to the trustees, who retain it on behalf of the trust beneficiaries. If you, as the life assured, die during the policy term, we will not need Probate, because the death benefit is paid to the trustees and not to your estate.

Using one of these three methods will mean the payment of the death benefit to the beneficiaries happens much more quickly and simply.

Other assets such as pension schemes and investments/ property held on a 'joint tenancy' basis are also capable of being inherited without the need to obtain Probate. Your professional advisers will be able to give you more information on this.

03

UK Inheritance Tax exposure

An individual's liability to UK Inheritance Tax (IHT) is primarily governed by their domicile. A person domiciled in the UK is liable to IHT on the total value of his or her assets wherever in the world these are situated.

The basic concept of domicile is that a person is domiciled in the country that he or she regards as their permanent home. Domicile is normally acquired through birth, through parents or through long-term residence. The UK concept of domicile goes beyond a mere physical presence in the UK, which means UK-domiciled individuals could find that their worldwide assets are subject to UK IHT even though they are not physically resident in the UK at the time.

The main categories of domicile:

- Domicile of origin
- Domicile of dependency
- Domicile of choice

Domicile of origin

Under English law, an individual acquires at birth the domicile of the person on whom he or she is legally dependent, which the individual retains until reaching the age of 16.

Domicile of dependency

If the domicile of the person on whom an individual under the age of 16 is legally dependent changes, he or she will acquire the new domicile automatically, which will be retained until the age of 16.

Domicile of choice

On reaching the age of 16, a person has the legal capacity to acquire a new domicile of choice. To acquire a new domicile of choice, the individual must leave the country of his or her current domicile and settle permanently in the new domicile of choice. A change of domicile to a new domicile of choice requires strong evidence (in addition to just living there) that the change of domicile is permanent.

Deemed domicile

For inheritance tax purposes, there is a concept of 'deemed domicile'. This means that, even if an individual was not at the time domiciled in the UK, he or she will be treated as being UK domiciled if:

- they were UK domiciled at any time in the previous three years, or
- were resident in the UK in at least 17 of the last 20 tax years

04

Steps you can take to reduce your exposure to UK Inheritance Tax

If you remain UK domiciled, you can put steps in place to reduce the amount of IHT payable including:

- Gifting assets away and making use of available IHT exemptions
- Investing in assets which qualify for certain forms of IHT relief
- Insuring the IHT liability using a suitable life assurance policy
- Using trusts for effective succession and IHT planning

The most appropriate course of action will depend on your individual circumstances. You should consider whether you are ready to make gifts of capital or whether you still require access to your investments.

Various exemptions, reliefs and other planning options are available to reduce the effect of IHT on your estate.

Inter Spousal Exemption

This provides full exemption from IHT on transfers made between UK domiciled spouses and civil partners, both during life and on your death.

It is possible for any unused nil rate band to be passed to the surviving spouse. As a result, the nil rate band can be increased by up to 100% meaning that up to **GBP 650,000** is available to the estate of the surviving spouse.

Potentially exempt transfers

These are outright gifts, not covered by the above exemptions, made by a donor who is prepared to give up all rights to any future benefit from the assets given away. If the donor survives seven years from when the gift is made, it will become fully exempt and no longer taxable in the donor's estate. If the donor dies within seven years, taper relief may be available between years four and seven to reduce the tax on the gift.

While these gifts may not have to be notified to HMRC at the time they're made, it is important that you keep proper records. This will save time and potential disappointment for beneficiaries of your estate in future.

You should also consider the 'Gift With Reservation' provisions, as these are designed to prevent a UK-domiciled individual giving away their assets in an attempt to save IHT, whilst still enjoying their use.

UK IHT rate is 40%

A UK-domiciled individual is subject to UK IHT on their worldwide net estate over the IHT nil rate band of **GBP 325,000**. With the excess taxed at 40%, not having mitigation plans could lead to a considerable amount of your wealth passing to HMRC, rather than to your chosen beneficiaries.

Insuring your IHT liability

If you are not in a position to make large gifts of capital, one of the most straightforward ways of covering an IHT liability is to take out a life assurance policy, with the sum assured set to match the IHT liability on your estate.

The policy is held in trust to segregate it from your estate otherwise the death benefit will potentially be subject to IHT at 40%. Provided the premiums qualify under the IHT 'normal expenditure out of income' exemption or fall within the **GBP 3,000** annual IHT exemption, they will be exempt from IHT.

If structured in this way, the death benefits will pay out free of any IHT and without the need to obtain Probate. This provides your beneficiaries with access to cash to meet any potential IHT liabilities or other estate expenses.

To qualify as normal expenditure out of income, premiums must be made on a regular basis from income and must not reduce an individual's standard of living.

Mixed domiciled spouses and civil partners

Care is needed with 'mixed domiciled' spouses when only one is a UK-domiciled individual. Where a UK-domiciled individual leaves assets to a non UK-domiciled spouse, there is no Inter Spousal Exemption. Instead, the non UK-domiciled spouse is entitled to a lifetime exemption of **GBP 325,000** plus any unused nil rate band. An option available to mixed domiciled couples is for the non-domiciled spouse to elect to be treated as UK-domiciled for IHT purposes. This enables the couple to benefit fully from the Inter Spousal Exemption, but means that the individual making the election will potentially become subject to IHT on their worldwide assets.

Deciding whether to make an election is a complex matter requiring advice that will need to take into account a number of factors including:

- Which spouse holds the majority of the wealth and whether the assets are based in the UK or not.
- The age and life expectancy of each spouse, whether they have children and their future plans.
- Whether or not the non UK-domiciled spouse intends to live permanently in the UK.
- The timing of the election.
- Whether any gifts have been made to either spouse in the previous seven years.

05

Considering more advanced forms of IHT planning

You may wish to consider some more advanced forms of IHT planning that could enable you to mitigate your IHT liability while also retaining access to your assets.

Business Property Relief

For some entrepreneurial individuals, their business is likely to be their main asset and possibly a substantial part of their retirement fund. UK-domiciled individuals can benefit from Business Property Relief (BPR) if they die having owned the relevant business for at least the last two years. This is a complex area for which we especially recommend you seek specialist advice.

BPR is also potentially available on investments in trading companies listed on the Alternative Investment Market (AIM) and in Enterprise Investment Schemes (EISs). This is providing certain qualifying criteria are met, including the need to have held the investments for at least two years.

IHT mitigation using trusts

You may be able to mitigate your UK IHT exposure by using an offshore bond issued by Friends Provident International, which is made subject to a trust. Trusts allow you to make a gift while at the same time placing controls over who benefits and when.

They are useful structures to use if you are not comfortable making outright gifts, perhaps because the recipient is a minor, or lacks the financial maturity to deal with potentially large sums of money or investments themselves. Instead, you appoint trustees to hold the trust assets for the beneficiaries, in some circumstances with the power to make distributions to the beneficiaries at their discretion. Typically you, as the investor, will act as one of the trustees.

Friends Provident International offers trusts which will allow you to put the above plan into operation. We also offer a range of specialist trusts, which allow you to make a tax-efficient gift for IHT purposes, while retaining access to a portion of the trust fund.

Trust types and the benefits they provide

Gift Trust

- Enables you to remove assets from your estate without being able to access the trust going forward.
- The gift will fall completely outside of your estate if you survive the transfer by seven years.

Loan Trust

- Enables you to freeze the ongoing IHT liability accruing to your estate as a result of increasing asset values.
- Future growth is immediately outside of the taxable estate and is effectively gifted to the trust beneficiaries.
- Additional advantage of a Loan Trust is that you are able to retain access to all of the initial capital invested.

For example: If **GBP 100,000** is invested in a Loan Trust which grows to **GBP 130,000** then the **GBP 30,000** growth is outside of your estate, while you retain full access to the **GBP 100,000** capital. If no action had been taken and the Loan Trust had not been set up, then the entire **GBP 130,000** would remain inside your estate and be subject to IHT.

Discounted Gift Trust

- You can make a gift to the trust but also retain access to regular fixed payments from the trust fund.
- Often appeals to retirees who want regular tax-efficient payments and also wish to receive an immediate reduction to the IHT value of the gift made to the trust.

Flexible Future Benefit Trust

- Enables you to make a gift to a trust and at the same time select dates on which you will be able to access portions of the trust fund.
- The gift made to the trust will fall outside of your estate after seven years.
- Has the flexibility to allow you to defer the dates on which you are scheduled to receive capital from the trust, should it not be required in any particular year.

Making an investment in any of the trusts above will remove the need to obtain Probate on your death.

Achieving your objectives

In this guide we have summarised some important points for you to consider when thinking about passing on your wealth to your family or other chosen beneficiaries. For example, we have covered the benefits of having up-to-date Wills in place and of using beneficiary nominations and trusts in conjunction with financial products such as pension plans and international life insurance policies.

Estate planning is a complex matter and to enable you to achieve your objectives we recommend that you obtain independent advice on how best to proceed.

About Friends Provident International

We are a leading financial services provider, with a reputation for trust, commitment and integrity, offering financial solutions to customers throughout their lives.

Friends Provident International has over 35 years of international experience in offshore savings and investments.

Important notes

The information given in this document is based on Friends Provident International Limited's understanding of UK and Isle of Man tax law and HM Revenue & Customs practice as at June 2015, which may change in future. Individuals are advised to seek professional independent advice and no liability can be accepted for the personal tax consequences of this Trust or for the effect of future tax and legislative changes.

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