Report for Albert Simm [CS3]

(prepared in Aug-2014 in tax year ending 05-April-2015)

1.Objectives

Establish the potential Inheritance Tax (IHT) liability associated with your estate and consider the planning options available

Keep control of all of your assets to provide for potential future care costs, and keep arrangements simple and flexible

Where investments are arranged, they should keep up with inflation and provide a top-up income to cover living costs.

2.Assumptions

PA	
2.50%	Price_Inflation. Bank of England May 2014 Inflation Report . HMGovernment's CPI target 2%.
4.00%	House_Price_Inflation. In line with wage inflation assuming an approximate historic relationship of inflation+1.5%.
0.50%	Interest_rate_for_cash. Current Bank of England Base Rate.
3.00%	Return_on_Index-Linked_assets (inflation+0.5%).
2.00%	Return_on_Gilts (HMGovernment Securities) per redemption yields reported by Debt Management Office.
3.00%	Return_on_Corporate Bonds assume approximate historic 1.0% credit spread over gilts.
6.00%	Return_on_Equities assume approximate historic equity risk premium of 4.0%, being the difference between expected rate of return from equities and the risk-free rate from gilts (Barclays Equity Gilt Study 2013).
5.00%	Return_on_Commercial_Property. 10year total return to 31-12- 2013 per IPD-UK Annual Property Index was 6.3%pa, conservatively reduced by $^{1}/_{5}{}^{th}$.

All returns assumed to be total returns combining income and capital appreciation.

Average life expectancy is 89. Allowing another 5 years for luck I will also project to 94.

Albert's assumed date of birth 01 August 1932.

Care costs in today's terms assumed to be £641pw residential and £874pw nursing, Lang & Buisson, Care of Older People 2013/14.

All of Gladys' nil rate band assumed to carry forward to Albert.

3.Assets,_Liabilities_&_IHT

Your estate and IHT calculation are summarised below. There are no reported liabilities.

Cash	£505,000	
ISAs	£190,000	
House	£200,000	
Chattels/Other	None disclosed	
Total Estate	£895,000	£895,000
Less 2xNil Rate Bands	-£650,000	
Less 2xCapital Gift Allowances	-£6,000	
Taxable estate	£239,000	
IHT payable @40%	-£95,600	-£95,600
Estate passing		£799,400

The amount of estate lost to IHT is £95,600 or 10.68%, illustrated below as shaded area. The estate passing to beneficiaries is unshaded.

TAX ESTATE PASSING (89.32%)

How do you feel about this potential IHT liability? If you are concerned I suggest you consider ways of mitigating it.

Looking ahead, keeping things as they are the IHT liability will gradually increase over the next few years up to around £117,000 in 2017 as assets go up in value.

4.Income,_Tax_&_Expenditure

Your income and tax liability are calculated below.

Work pension	£12,000	
State pension	£5,881	
Interest (gross)	£5,050	
Total Gross Income	£22,931	£22,931
Less enhanced personal allowance	-£10,660	
Taxable income	£12,271	
Income tax @20%	-£2,454	-£2,454
Net income		£20,477

Your expenditure of £20,000pa exceeds your pension income and is being made good by drawing on your savings interest.

If expenditure increases with inflation within two years you will need to draw down on capital to top-up as the savings interest will not be sufficient.

In Section7. I have raised two queries about your pension details. For this report I will use the information you have provided.

5.Attitude_to_Risk_&_Capacity_for_Loss

You describe yourself as a relatively cautious investor. I relate the term “relatively cautious” to a cautious low-medium risk approach with no more than 50% exposed to equities.

Presently you have:

-£581,000 in cash (savings, ISA)

-£114,000 in global equities (ISA).

You recognise the financial planning need to change to:

-achieve returns ahead of inflation (not possible with 83.5% in cash)

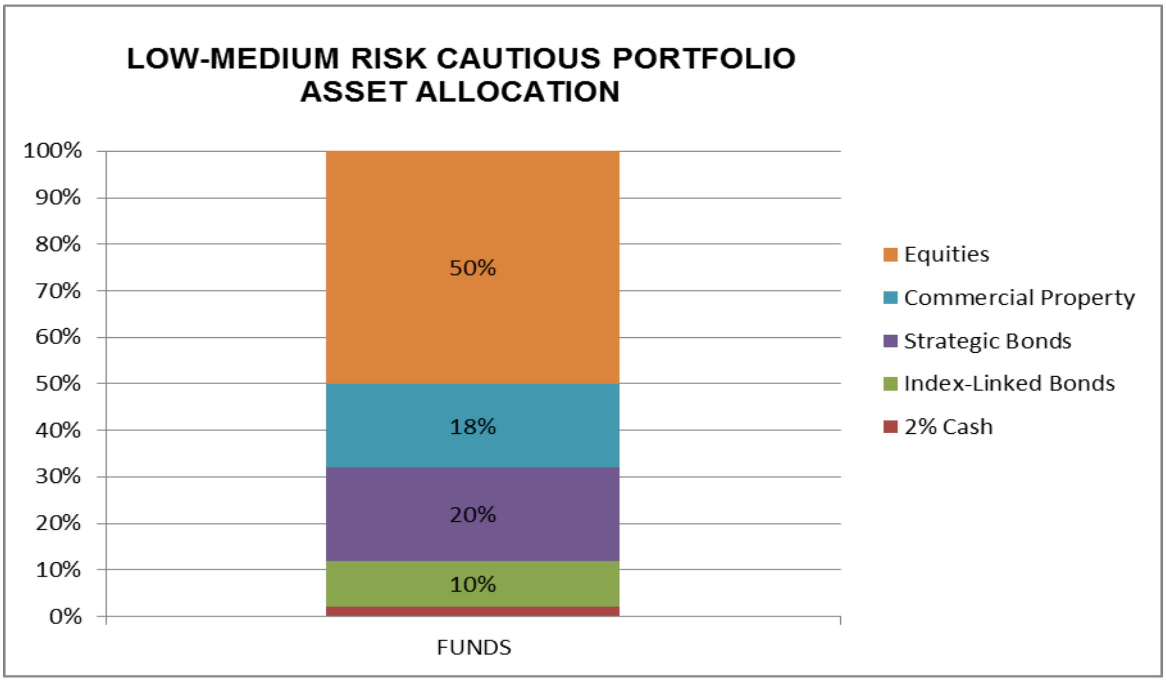
-provide for care costs, typically escalating ahead of inflation.

After providing for a cash emergency fund, I assume you are happy to adopt our asset allocation for a low-medium risk cautious portfolio for any investments arranged.

I view your capacity for loss as low-medium. Whilst your pension entitlements meet most of your living costs, you will rely to some degree on your investments to top-up and cover potential future care costs.

In the IHT mitigation planning below I have considered the use of a portfolio of shares on the Alternative Investment Market (AIM). Such an investment would have a very high exposure to risk which is in conflict with your attitude to risk and capacity for loss. You will need to consider whether the potential tax planning benefits outweigh the unattractively high exposure to risk.

6.Proposed_Portfolio_Asset_Allocation

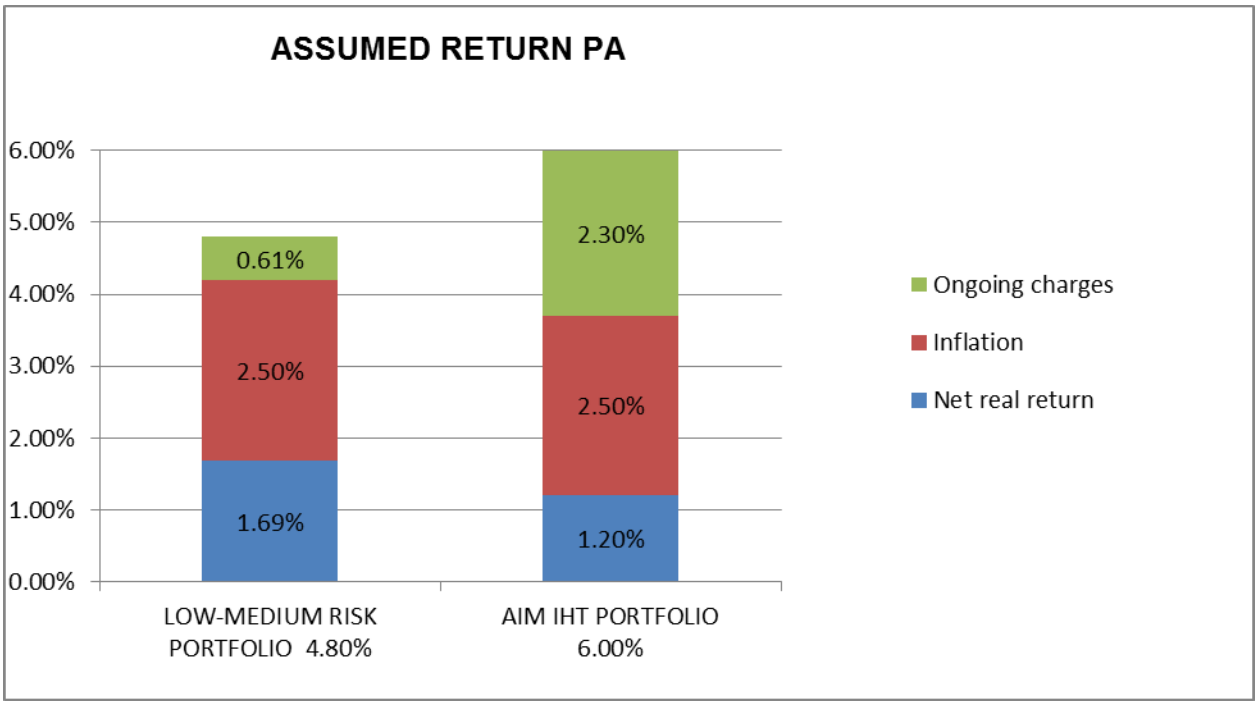


The allocation to cash will cover the wrap platform charges and provide a little liquidity.

I have not allocated to gilts or investment grade UK corporate bonds which I view as unattractive given the outlook for rising interest rates. Similarly I have slightly reduced the allocation to bonds in favour of UK commercial property where the outlook is more positive.

The equities element is normally invested 50%:UK, 40%:Overseas and 10%:Emerging Markets, however there is emerging markets exposure through the global funds and indirect exposure through blue-chip UK equities.

Applying our return assumptions to the portfolio allocation the estimated returns are summarised below (4.80%pa cautious portfolio and 6.00%pa AIM IHT portfolio).



If we provide an ongoing service, our fee of 0.5%pa is in addition to the green ongoing charges. Our fee charge will increase if assets grow or decrease if assets go down in value.

7.Pensions-Queries

Your role of bank manager prior to retirement is normally associated with a final salary pension entitlement which would usually escalate in payment, yet you describe a level pension annuity.

You held an employed role meaning you would have accrued entitlement through SERPS either by being:

-contracted-in to the state scheme

-contracted-out via Guaranteed Minimum Pension in a final salary scheme

-contracted-out via pre-1997 Protected Rights fund meaning an escalating annuity (lesser of 3% or RPI).

This is not consistent with receipt of basic state pension and level annuity.

8.IHT_Planning

Your planning options summarised below:

Planning_Options	Successful?	Meet_Objectives?
Gifts out of disposable income	NO - no suplus income to give away, BUT could generate income from cash / investments to give away	No - loss of control of money during lifetime
Gifts exempt from IHT: i) annual exempt allowance £3,000 per tax year (carried forward from previous year if unused) ii) £2,500 wedding gift per grandchild iii) £250 per person pa small gifts allowance	Yes in all three cases, but drawback in ii) is grandchildren may not be getting married for a while if at all	No in all three cases - loss of control of money during lifetime
Gifts of capital for children and/or grandchildren, directly or into a trust	Must survive gift by 7 years to be exempt from IHT, although tax will gradually reduce 3 years following gifts	No - loss of control of money during lifetime and trusts are not simple
Invest in assets eligible for business property relief (BPR)	Yes but only if investments held for 2 years or more, and on death HMRC decide the investments held benefit from BPR, then 100% IHT exemption.	Yes - Albert remains beneficial owner of the asset and can dispose (subject to liquidity) later if he wishes
Whole of life assurance under trust	Yes but only if premiums are paid to death. Very expensive.	No, premiums are unacceptably expensive and complicated.
Gift & loan trust, gift small sum and loan larger sum, investment growth on the loan is outside your estate	Only in part on growth in trust assets, subject to investment returns exceeding the loan repayments. The remaining loan stays in your estate.	No, loss of some control, complicated and only small amount of IHT mitigation.

I recommend investing part of your capital into an AIM portfolio for BPR, and part into a low-medium risk cautious portfolio of unit trusts whilst also retaining a cash emergency fund. The March-2014 budget introduced rules allowing ISAs to be transferred to a Stocks & Shares ISA investing in AIM shares, so that has been considered.

I have also considered a purchased life annuity which in view of your age would provide gross tax free payments and help to meet your income shortfall. However I have discounted this option as putting the capital at risk with nil guarantee will cause an outright loss to the estate on early death, whereas a guarantee period would return capital to the estate and put you in the same position as if you were drawing down from the capital.

I have prepared a cash flow forecast to determine how much to allocate to each to bring about the desired outcome.

9.Cashflow_Analysis

Cashflow analysis assumptions:

-State pension rises with inflation at 2.50%pa and employer pension remains level

-Expenditure of £20,000pa will rise with inflation in future years.

-Taking into account HMGovernment’s proposed changes to the income tax personal allowance and basic rate band, Albert’s personal allowance for income tax remains at £10,660 for two further tax years, then rises to £10,769 and with inflation thereafter. I have conservatively assumed the basic rate band will rise at 1.00%pa.

-Your ISAs totalling £190,000 transferred to Stocks & Shares ISA through Alliance Trust Savings (ATS) and a further £15,000 added. The ISA invested into low-medium risk cautious portfolio.

-Care costs commence in last 5years, with 3years residential care and 2years nursing care. Costs will escalate 4.00%pa (primary overhead wages).

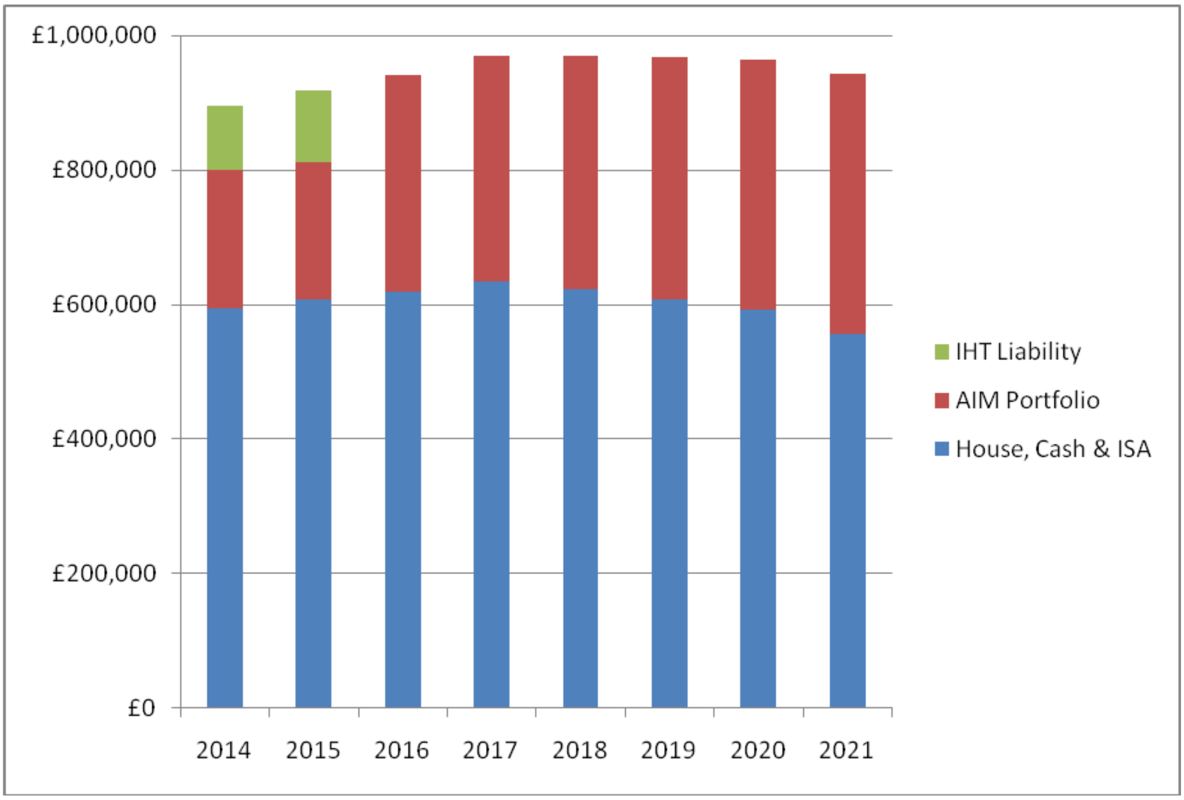
-General expenditure reduces by ½ when care commences

-Deficit in income drawn from, and surplus income invested in ATS portfolio

-Cash savings conservatively assumed to return 1.30%pa

-For life expectancy to 89, £300,000 invested into an AIM IHT portfolio.

The cashflow analysis shows after the AIM portfolio has been held for two years, the non-BPR assets in blue do not exceed the £650,000 threshold. I calculate that £300,000 is broadly the minimum sum you can put into an AIM IHT portfolio on this basis.



I have re-run the cashflow analysis to 94 and the minimum sum you can put into an AIM IHT portfolio on a similar basis is £370,000.

Of course you can start with £300,000 now and then add to it later.

10.Investment_Recommendations

Investment proposals summarised below:

AMOUNT	PROVIDER	ACCOUNT	ESTIMATED TOTAL RETURN	
£85,000	Investec Bank	1 Year Fixed Rate	1.56%	pa net
£40,000	NS&I	Premium Bonds	~ 1.35%	pa tax-free
£65,000	Coventry BS	Post-Save Easy-Acces(2)	1.12%	pa net
£205,000	Alliance Trust Savings	ISA Transfer & £15,000 subscription	~ 4.19%	pa
£300,000	Octopus	AIM IHT Portfolio	~ 3.70%	pa
£695,000		(weighted)	3.21%	pa

The estimated total return provides for the required income top-up and also growth in line with inflation.

I had considered using your ISAs to transfer to a new ISA invested in an AIM IHT portfolio, but the typical dividend yield is 1.7% pa and the ISA cannot reclaim the basic rate tax on the dividend, whereas the income yield from a low-medium risk cautious portfolio is 3-4%pa, much of which relates to tax-free fixed interest and property income.

With these recommendations your statutory total income will be £25,549 which remains within the age allowance income limit of £27,000, thus allowing retention of enhanced personal allowance.

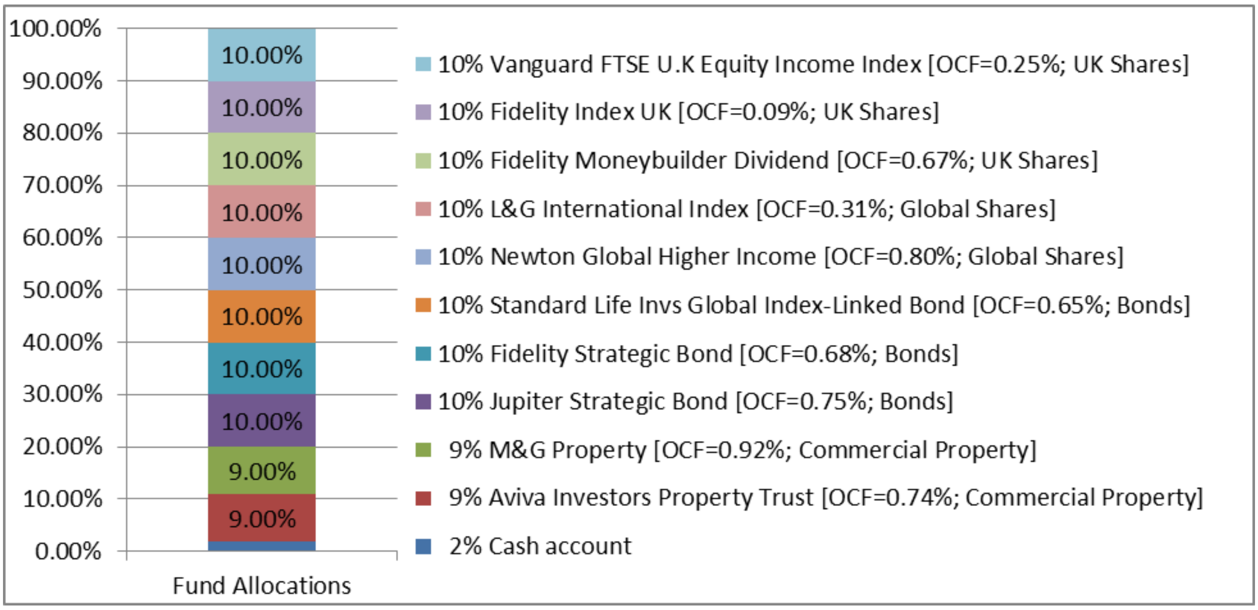
Cash

The NS&I and Coventry accounts are immediately accessible giving plenty of liquidity whereas the Investec account is tied up for a year to get the better interest rate.

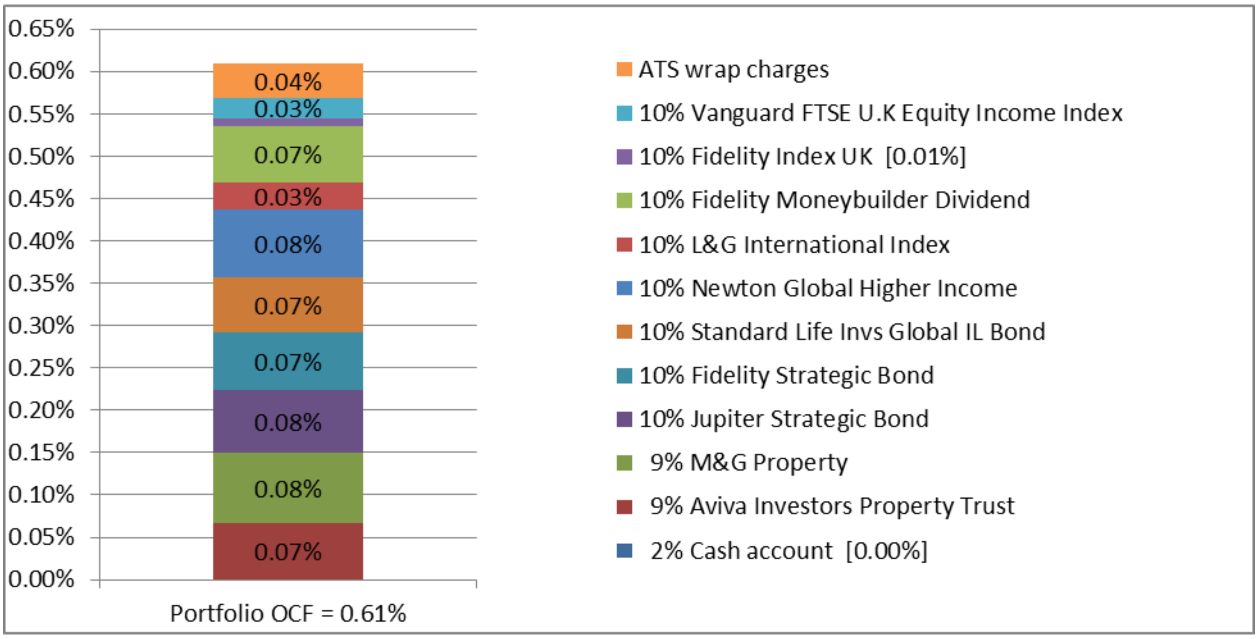
In 2015/16 and thereafter I recommend maximum Cash ISA subscriptions so progressively more interest payments are received tax free.

ISA

I recommend the following unit trusts or open-ended investment companies for your ISA investments with ATS. There is an administration charge of £75pa, and dealing charges of £12.50per transaction.



The overall OCF including ATS platform charges is 0.61%pa, illustrated below.



Allowing for a generous cash position, the portfolio is a good match to your cautious attitude to risk and your objectives.

I recommend:
-a blend of active-managed and tracker funds for equities
-only active-managed funds for fixed interest and commercial property as I am not satisfied an index tracker fund is suitable presently.

I have assumed annual portfolio re-balancing.

<u>AIM_IHT_Portfolio</u>

If you wish to mitigate current and future IHT liabilities, I propose investing £300,000 into an Octopus AIM IHT portfolio aiming for BPR after two years. The Octopus service is a discretionary managed AIM portfolio including 6-monthly assessments of the eligibility of investee companies qualifying for BPR.

This is very high risk which disagrees with your attitude to risk. Does the desirability of the IHT exemption persuade you to overcome the exposure to risk?

AIM is illiquid, it may take months to fully invest or conversely disinvest.

On your death, HMRC may subsequently decide one or more of the AIM holdings are not eligible for BPR.

The portfolio has an initial charge of 1.0% and ongoing charge estimated as 2.30%pa including 20% portfolio turnover.

HMRC does not like “death bed” solutions so I suggest obtaining a letter from your Doctor confirming your life expectancy is beyond 2 years.

I also suggest establishing 2 year level term assurance under trust to meet the potential IHT liability prior to qualification for BPR with sum assured of £106,000 for which premiums on standard terms with Aegon would be £274.49pm, to be paid from cash savings.

11.Will_&_Power_of_Attorney

Your Will divides your estate equally between your 4 children, who appear to take the view that their inheritance should pass straight on to their children. There are 7 grandchildren.

I suggest you seek advice from a solicitor on revising your Will noting that each grandchild receives an appropriate share of their parent's entitlement. In at least once case there is an only child who will receive ¼ of your estate.

I recommend asking family members to be Executors to reduce the impact of legal fees on estate assets.

If you do not revise your Will your children would need to arrange a Deed of Variation after your death which may cause family arguments and be more expensive in legal fees.

I suggest that your son Mark is present at meetings as he has Power of Attorney for you. Also consider appointing two more of your children as Attorneys for inclusivity.

If you do not have one, I suggest you enquire about a Health & Welfare Lasting Power of Attorney which allows your attorney(s) to make decisions for you about, for instance, your daily routine, medical care, moving into a care home or refusing life-sustaining treatment. The Office of the Public Guardian registration cost is £110per LPA.

12.Other_Issues_&_Next_Steps

Identification of potential capital expenditure items, for instance replace car, house maintenance, special holidays etc and consider impact of any new pension data.

The next steps are:

Item	Who	When
a)Pension clarification	Client	Immediately
b)Three cash investments	Client/planner	After-a)
c)ISA Transfer & 2014/15 subscription	Client/planner	After-a)
d)AIM IHT portfolio & term assurance	Client/planner	After-a)
e)Will and LPA	Client/solicitor	Immediately

Your plan will be reviewed annually.

WORDS 2394