UK INHERITANCE TAX PLANNING USING WHOLE OF LIFE ASSURANCE

This document looks at UK inheritance tax (IHT) planning using a whole of life assurance policy.

Domicile and UK IHT

Anyone who is UK domiciled or is deemed UK domiciled is subject to UK IHT on the value of his or her **worldwide estate**.

An individual could be UK domiciled by either having:

1. **Domicile of origin:** this is acquired at birth, usually the same as their father at the time.
2. **Domicile of dependence:** before the age of 16 a domicile status would follow that of their parents.
3. **Domicile of choice:** from age 16, it may be possible for an individual to acquire a domicile of choice.

Even if an individual leaves the UK, shaking off their UK domicile status can be a difficult thing to do unless they cut all ties to the UK and essentially take all the necessary steps to establish a permanent presence in another country. Effectively acquiring a new domicile of choice.

What many people are not aware of is that if a UK domiciled individual does establish a domicile of choice in another country, and that domicile of choice is abandoned for any reason, they automatically revert back to their UK domicile of origin. Their original domicile of origin then remains until they have a fixed and settled intention to acquire another domicile of choice. Therefore, it is important to have appropriate planning in place.

Just to finish off on domicile, an individual will be 'deemed UK domiciled' if they are resident in the UK for 15 of the last 20 years. Previously this was 17 out of the last 20 years but was reduced from 06 April 2017 and now affects individuals earlier.

Inheritance Tax

In the UK, the current rate of IHT is 40% and this is levied on the value of the estate once it exceeds what is known as the nil rate band (NRB). The NRB is currently £325,000 and will remain at this level until April 2026.

Now £325,000 might sound like a lot, however, when an individual starts adding up all their assets they may find that they could have significantly more than this and, as such, are likely to face a hefty bill.

CASE STUDY

John, a UK domicile, is 41 years old and has been working in Oman for the last 20 years. He has a partner and they spend most of his annual leave in the UK each year. John plans to work overseas for another 10-15 years and then move back to the UK on a permanent basis.

John has recently read an article about UK IHT and wishes to know more about how this may affect his estate upon his death. He decides to seek professional advice and provides his financial adviser with details of his assets.

Assets	Current value
Investments	£100,000
Bank Accounts	£30,000
Other assets (including holiday home in Spain	£235,000
Total	**£365,000**

John's adviser points out that at this point in time his exposure to UK IHT is approx. £40,000 (total assets of £365,000, minus the NRB of £325,000), which would mean a potential tax IHT bill of **£16,000** (£40,000 x 40%). John is not too worried about this and suggests that there will be enough money in his bank accounts to cover the tax charge.

What would the position be in 15 years' time?

If we assume a modest growth level of 5% across all of his assets, then in 15 years' time, his estate would be valued at around £760,000 leading to an IHT exposure of **£174,000** ((£760,000 - £325,000) x 40%). If, on his death, there were not sufficient liquid assets to cover this amount, other assets (such as the holiday home) may have to be sold.

All of this is explained to John by his adviser, resulting in dental surgery being required when his jaw drops to the floor. John asks his adviser what planning options are available to mitigate against this potential IHT liability.

Planning opportunities

To avoid his estate being placed in this position, John's adviser recommends a Whole of Life Assurance policy such as RL360's LifePlan, with the level of life cover being sufficient to pay his intended IHT liability.

On his death, the policy would pay out a fixed lump sum amount allowing his IHT bill to be paid without any of his assets having to be sold. This would preserve the value of his estate for his intended beneficiaries/family.

Based on certain assumptions, John decides that he requires life cover of £200,000. This is slightly more than his intended IHT liability; however, he thinks it is best that there is a 'cushion' built in to cover any unforeseen circumstances. John is surprised to find out that having this level of cover could cost as little as £154 per month.

John's adviser also points out that for the planning/ IHT mitigation strategy to work as intended, the policy should be written into a suitable trust. The trust will help achieve the following:

- ensure that the amount of life cover (£200,000) does not fall back into his estate on death, making the position even worse.

- enables the life cover to be paid to the trustees to ensure that his IHT liability is settled

NB: Where the policy is held in a trust, each premium payment will either be classed as a potentially exempt transfer (PET) or a chargeable lifetime transfer (CLT). Each payment will remain inside of the estate for seven years and potentially reduce the available NRB. However, if the payments were considered *'normal expenditure out of income'*, they would be exempt from UK IHT and not reduce the NRB.

IMPORTANT NOTES

RL360 Insurance Company Limited. Registered Office: International House, Cooil Road, Douglas, Isle of Man, IM2 2SP, British Isles. Registered in the Isle of Man number 053002C. RL360 Insurance Company Limited is authorised by the Isle of Man Financial Services Authority.