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Forward planning and prudence are key ingredients when exploiting the much-reduced options available for mitigating inheritance tax

Heir traffic control

By Robert Meyer, assistant director, specialist sales, Close Investments

Inheritance tax (IHT) raises just less than £4bn each year. However, what is unknown is the amount of money invested in tax mitigation schemes – but

the consensus view is that it must be very significant and growing.

Unlike most other investment planning, a specialist investment adviser may not be the first point of contact, which makes strong relationships with both lawyers and accountants essential.

IHT planning can also be very frustrating from an adviser's point of view. No sooner does a solution develop than the legislators, through HMRC, seem to move the goal posts again. That said, most people in the UK fail to make even basic IHT preparations. This was not so great an issue up until the last decade as few people faced of the prospect of liability for IHT. However, rampant house price inflation has changed all that; for most people it is the value of their property that tips the scales – the average detached house in the UK now costs over £340,000 and therefore wipes out the nil rate band (NRB).

Same story

Although this Chancellor has made plenty of noises about IHT, pretty much nothing has changed. The last Budget saw the NRB rise to £300,000 for the current tax year, followed by quite modest increases thereafter. The October 2007 Pre-Budget Report did introduce transferability of any unused NRB from a deceased spouse/civil partner to the survivor – inaccurately proclaimed as the doubling of the NRB – which went some small way to help more modest IHT 'victims' who had not already taken sensible steps to plan their wills, and the ownership of joint assets.

For all but a few seriously rich clients, IHT planning can be a series of informed guesses about what the future holds and how best to balance IHT solutions, with the need to retain funds in the

estate for issues such as longevity or the costs of potential long-term care.

Therefore, the starting point for IHT planning is not necessarily the ability to save the maximum amount, but the ability to do it within a framework of prudent forward planning.

Considerations

First consider some options for more liquid assets. First and foremost, the client should make use of their gifting exemptions and, where finance can justify it, regular gifts out of income. Advisers will then look at the prudent use of some capital to provide supplementary income using discounted gift trusts or other mechanisms. Then, assuming the clients have further spare capital, usually in excess of £50,000, there are several options that have business property relief (BPR) at the core.

To digress, it is worth the observation that investing in some rolling acres to obtain agricultural property relief, following the *McKenna* case in November 2006, is unlikely to be a successful strategy unless the client is fit and knowledgeable enough to don their wellies, lamb the sheep or milk the cows 24/7. HMRC's view is very clear – lifestyle farmers need no longer apply for APR.

Which brings us back to BPR – this can be used in a number of ways and many investment houses offer tailored solutions, all working to the same rules. BPR is available on relevant business property, which has been owned for two years, and it qualifies for IHT relief at a rate of 100%. 'Relevant business property' includes the shares of an unquoted company (including many AIM company shares) that is undertaking permitted business activities.

Permitted business activities are many and varied, but exclude businesses that make their money by investment – for instance, the trading of stocks, shares or any other financial instrument.

Using BPR has many attractions for IHT planning. Firstly, it is effective after two years, and not the seven needed for a potentially exempt transfer (PET). Secondly, the asset and any income derived

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from it remains within the estate, so the estate (that is the client) retains control; there is no change of ownership until death – until then, there is no gift made. This means that, should the client's circumstances change, the asset can be recovered and used for other purposes, such as to fund long-term care, although these assets will then re-enter the estate for IHT purposes.

As with any IHT vehicle, one of the questions is: will the rules change? The Government's rationale for BPR is that it encourages investment in small companies – the lifeblood for the future of any sound economy. The IHT issue is then: how much does the Exchequer lose though the relief given, versus the long-term economic gain? The simple view is that future corporation taxes will exceed any loss in IHT revenue, with so many more business and societal benefits.

There are two principal options for clients choosing the BPR route for their planning: a portfolio approach (normally of Aim shares) or direct investment in a BPR qualifying business.

A well-managed Aim portfolio, built from a thoroughly researched market, can diversify risk and manage down volatility, but nonetheless can be subject to the vicissitudes of the equity markets where it can often be current sentiment that undermines value, rather than any weakness of the Aim companies held within a portfolio.

Some firms also offer the trading company route, where the diversified trading activities are usually property related and backed by the property asset itself. These include both residential and commercial building, owning and managing public houses, commercial forestry, and owning and operating self-storage facilities. The rationale for these business areas is that while the matrix of activities are all in the property market, they are not highly correlated with each other; instead they rely on the soundness of the business case for the trade itself and not on mere property speculation.

Challenges

The family home and the IHT problem it presents is a much more difficult challenge for the adviser to address. Unlike liquid assets, bricks and mortar cannot be given away or invested in tax-efficient structures. Furthermore, as highlighted by the *Phizackerley* case in April 2007, HMRC is ensuring that allowable IHT mitigation is not being abused, deliberately or inadvertently.

To the best of my knowledge, the number of IHT solutions available for the family home is just one – Property Wealth Manager (PWM), marketed by Close Investments on behalf of Isle of Man Assur-

ance Group. PWM works without seeking to exploit any tax loopholes. It uses established financial planning tools to remove the value of the principal private residence from the estate, without the clients having to relinquish the occupation of their home, and without falling foul of pre-owned asset tax, gift with reversion rules, or with any other anti-avoidance measures.

Options for IHT planning are much reduced, but those that remain do so either because they make fiscal sense for any Chancellor, or because, rather than unreasonably exploiting obscure tax loopholes, they are based on benign, tried and tested financial solutions.

KEY

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Alliance transfers Close wrappers to open platform

Alliance Trust Savings has successfully transferred more than 4200 Close Investments Isas, Peps and share plan wrappers to its open architecture investment platform.

Alliance Trust said Close investors would now benefit from the greater versatility of its service, allowing them to choose from more than 3000 investments.

Investors will also be able to add to their investments by consolidating their Isas and legacy Peps, as well as Sipp and non tax-advantaged accounts on one platform.

Last month, Alliance Trust Savings also announced the transfer of almost 4500 cus-

tomers accounts from Allianz Global Investors to its investment platform, following similar moves last year by several investment trust managers including Martin Currie Investment Management and Investec Asset Management.

Kelly O'Donnell, managing director of distribution at Alliance Trust Savings, said: "This provides further evidence that the trend towards consolidation of investment administration is gathering pace.

"Rather than investment houses bearing the cost of providing their own non-core admin services, we will see migration of customer accounts to best-of-breed platforms."