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Trusts and Estates: an interview with Stephen Parnham

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ROBERT: *As a Trust & Estate practitioner you are in a privileged position to advise on planning for inheritance tax and its implementation but what can you tell me about the practicalities in the real world ?*

STEPHEN: In the real world the blunt fact is that a stopwatch starts ticking on the day after you die. It stops just over 6 months later. That is the day your family must pay the inheritance tax due on your estate. If your family needs to obtain probate, and they will where your assets include shares or property, tax may be due at the time of the probate application itself. That is likely to be little more than a few weeks after you die. The crucial issue for the family is therefore how on earth to pay the tax ?

ROBERT: *What are the implications ?*

STEPHEN: The tax on property and certain shares can be paid by instalments over several years but most people feel that is a just a bit too much like taking out another mortgage. Where the value of your estate is concentrated in property or shares in your own company the result is often hasty sales or liquidations to obtain the necessary funds. At a difficult emotional time for the family they are also faced with impossible decisions – it is not quite the legacy they or you might have anticipated.

It is not just that the estate is significantly less, perhaps 25% or 30% less, than everyone thought as a consequence of the tax. It is the very practical issue of selling the family jewels or taking out loans to pay for it.

ROBERT: *Can you change that unintentional legacy ?*

STEPHEN: In almost every case the answer is ‘yes’ so long as you are prepared to take a medium term perspective.

ROBERT: *We have discussed inheritance tax in general but what about specific asset classes ? For instance, many of my clients run their own business through a company.*

STEPHEN: The good news is that shares in your own trading company can secure 100% relief from inheritance tax on your death. Investment companies are different even if the investments amount to a business.

The bad news is that HM Revenue & Customs will, given that the relief is so valuable, go through your last 3 years accounts with a fine tooth comb to disqualify you from the relief where there is any chance of them doing so …. and in many cases they will succeed simply because it has all been left to chance.

Common failings are excessive cash or investments on the balance sheet and inappropriate group structures which can dramatically reduce or even wipe out this valuable relief and expose the family to tax of close to 40%. Commercial property held outside the company will not benefit from the full relief. There are many, many other pitfalls. If you or your family don't really know the position by the time HM Revenue & Customs are reviewing your accounts then your legacy has been left all to chance.

It is a fact that all tax reliefs must be earned. That is because there are always stringent conditions which must be met to qualify for them. This relief is a complex one and there are many hurdles to cross and traps to avoid. It is equally true that very few businesses which do qualify really capitalise on the tax saving opportunities open to them as a result – with the right planning, for instance, even investments can be sheltered from inheritance tax using this relief. The result of leaving it to chance is often at least tens or even hundreds of thousands of pounds in unnecessary tax.

HM Revenue & Customs are certainly going to review your accounts and background in these circumstances, there are no exceptions. Are you gambling that your accounts and circumstances will withstand the scrutiny of HM Revenue & Customs best ? Get it wrong and the cost is high for the family.

Yet if you play this game cleverly, you can literally have your cake and eat it as well.

ROBERT: *...and what about property ?*

STEPHEN: Unfortunately, there are no specific reliefs for property or property companies and so one either accepts the inevitable tax charge of up to 40% or one looks to make a start with some smart estate planning. There are no magic bullets here. Time is your ally if you take the medium to long term view and take the initiative. It is your adversary if you leave it until the last minute.

The key to smart planning in this area is often to restructure the way that property is held and/or to gradually transfer some of your interest in it in such a way that the value transferred suffers neither capital gains tax nor inheritance tax at the time you do it. Giving it all away is not usually a very practical strategy whatever the tax savings may be.

In other words, you need to aim to make the whole thing painless and yet retain decisive control over your property while taking steps to reduce the longer term tax exposure of the family. All that is achievable. In the right circumstances, it is even possible to give property away and retain access to the rental income.

ROBERT: *Could you sum up ?*

STEPHEN: Live in the real world. Few people would knowingly leave a significant legacy of, say, 25% of their wealth to HM Revenue & Customs rather than their family. The family would definitely not wish you to make such a decision. That is, nevertheless ,the practical effect of doing nothing year after year in a significant number of cases. It just doesn't have to be like that.