

Please contact us to help you explore the personal impact of this issue's topics.

We also look forward to hearing from you soon on any broader financial planning or investment issues.

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Financial Services Update

You may not be aware but the Financial Services industry is facing one of the most radical changes to its landscape in years. The Retail Distribution Review, set for introduction in January 2013, will result in three consequences:

- A reduction in the number of Regulated Individuals able to offer financial advice
- Increased professionalism within the industry with a higher minimum qualification standard
- A ban on product based commission

Add to this a much tighter regulatory framework and it has become essential to review the changes and the implications to our business model to ensure we will continue to operate effectively in a world without commission.

With this in mind, the Oval group has over the last six months been reassessing its service proposition to clients and

professional connections alike in order to make the most of the undoubted opportunities in the UK tax and financial planning market.

We are confident this is positive news for our clients with our new model offering greater transparency by clearly defining the services we will provide and the cost of providing these services, all agreed in advance with the client. We would be more than happy to discuss this further with you.



Pilot Trusts take off!

With inheritance tax (IHT) planning now firmly back on the agenda, we have asked Tessa Till, who is a dual-qualified Associate within the Private Client team at Brodies LLP, based in Edinburgh, to comment on the continuing use of trusts as part of an IHT planning strategy.

"It is now a well established fact that the changes to the IHT treatment of trusts contained in the Finance Act 2006 (FA 2006) represented the most significant change to the IHT rules since their inception in 1986. This led to much speculation about the future of trusts within the realms of tax planning. One scheme which has evolved by which clients can still use trusts to maximise their inheritance tax saving, is that of pilot trusts.

The concept of pilot trusts arose from the case of *Rysaffe Trustee Co (CI) v CIR* (2003) and hence the principle is known as the "Rysaffe Principle". The basic facts of this case involved two brothers who established 5 identical discretionary trusts within a 35 day period. The brothers paid an initial sum of £10 to each trust and thereafter transferred one fifth of a single shareholding to each. HMRC stated that these trusts were associated operations and should be treated as one trust for IHT

purposes, which would mean that one nil rate band would be split between all 5 trusts. HMRC were unsuccessful and it was ruled that these trusts were not associated operations. Each trust would therefore have its own nil rate band for IHT purposes. The Rysaffe Principle was therefore effectively rubber stamped by the court.

This form of planning can be used both during a client's lifetime and after death through a series of legacies to pilot trusts under a will. This form of planning is best suited to the higher net worth client who is interested in long term IHT planning. Clients can use up their own nil rate band and pass assets into a series of trusts every 7 years without incurring an immediate charge to IHT and, by seeing this as a long term strategy, can still be successful in using trusts to pass a large majority of their assets out their estate.

On death, if these trusts already exist with a nominal initial trust fund, and tax has already been paid on the deceased's estate, then funds can be bequeathed to these trusts with no further tax consequences as long as the sums left to the trusts are under the nil rate band in force at the date of death. There may also be scope

to amalgamate the trusts at a later date, but still retaining their separate status for IHT purposes.

Pilot trusts give clients with a long term view a very successful way of maximising their IHT saving and using trusts to retain an element of control over the funds.

There are a number of practical points which need to be born in mind when considering this form of IHT planning. These are:-

- Each trust should be on slightly different terms from the others i.e. different trustees, amount initially settled etc.
- There will be ongoing administration charges for each trust
- The transfer is still classed as a chargeable transfer unless transferring fully relieved assets or a sum equal to or less than the settlor's available nil rate band.
- The effectiveness of this form of planning will very much depend on any future changes to the tax laws relating to trusts and also to the future growth of the trust assets relative to 10 yearly and exit charges."

A Pension Alternative

The restriction of higher rate tax relief on pension contributions for those earning over £130,000 has increased the importance for higher earners to look at additional ways to 'top up' savings for retirement. One such option is investing in an **Enterprise Investment Scheme (EIS)**.

What is an EIS?

It is a scheme that was set up by the Government, which is designed to help smaller higher-risk trading companies raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies. A qualifying company has to be unquoted with no more than 50 employees, and can not raise more than £2 million in any 12 month period via an EIS or other venture capital schemes.

Investment can either be via a single EIS company or a collective scheme with a portfolio of companies to spread the risk. Collective schemes are generally either managed by a Discretionary Fund Manager or structured as a fund.

Comparison of EIS and Pension

	Tax Relief on Investment	Maximum Annual Investment Amount	Maximum Total Investment Amount	Access to Capital
Pension	At least 20%	Currently £255,000 although proposals suggest a reduction to £30,000/£45,000	£1.8 million until 2015/16	Only 25% of the fund from age 55
EIS	20% - as long as the investment is held for at least 3 years	£500,000 annually	No maximum	At any time (although tax reliefs lost if within 3 years)

Other EIS benefits:

- An investor can elect to 'carry back' up to £500,000 of an EIS investment to the previous tax year so income tax already paid could be reclaimed. This means up to £1 million could be invested in a single tax year if no investment was made in the previous tax year.
- The value of an EIS is generally free of inheritance tax provided that the investment is held for at least 2 years.
- Gains on an EIS are exempt from capital gains tax but any losses can be used to offset any future gains made on other investments.

What are the risks?

- Investing in smaller, unquoted companies has inherent risks, with at least 1 in 10 start-up companies not surviving.
- Investors may well get back less than they invested even when taking tax incentives into account.
- The shares of EIS companies may not readily marketable and any requests for capital may be delayed until such a time that a sale is possible.

Inheritance Tax and Pensions

Often pension lump sum death benefits prior to age 75 are free of inheritance tax (IHT). However, a victory for HM Revenue & Customs (HMRC) in the Fryer and Others vs. HMRC case has highlighted that there are certain circumstances where this may be questioned.

In this instance, a member of a pension arrangement under trust did not take her retirement benefits at age 60, which was the selected retirement age. The member knew that she was already seriously ill and subsequently died less than 2 years later. HMRC successfully argued that IHT should apply to the lump sum death benefit paid out.

In simple terms, the argument is that the member made an active choice not to take

a lump sum or income from her pension so that the fund could pass to a dependent thus reducing the value of her estate and increasing the value of another's, a transfer of value in IHT terms.

The types of pensions that are likely to be at risk are those written under trust arrangements where the member can control the timing or format of benefits such as personal pensions, self invested personal pensions (SIPPs) or Section 32 buyout plans.

In this case, if an earlier review, prior to ill health, had identified that benefits were unlikely to be needed at age 60 and the pension age had been altered to, say, 65, it would have been difficult for HMRC to argue that this decision was motivated by a wish to provide lump sum death benefits.

It is clear that care in setting and regularly reviewing the stated pension age on your clients' pension plans could go a long way to avoid this scenario.

Of course it is not possible to predict future health so for someone who is already ill then an alternative could be to create a bypass trust and use an expression of wish to direct the lump sum death benefits to that trust rather than directly to any dependents. If the member's wishes are non binding, then this will not be considered as a gift or disposal because the pension trustees retain discretion as to where to pay benefits and the member's estate has never acquired a right to the benefit.