The Daily Telegraph

The Daily Telegraph Saturday 8 April 2023

Advice

Money Makeover

'Can I shelter windfall for my grandchildren?'

Extra pensions payments, gifts and a trust could help protect £1.6m made from the sale of land, writes Rachel Mortimer

A satisfying reward of a lifetime of hard work is knowing you can leave something behind to ensure your nearest and dearest are financially secure.

Derek Jarman, 60, hopes to soon enjoy the fruits of his successful gardening business and an early retirement. Far-flung travels are on the cards after the business is sold and Mr Jarman would like to visit family in New Zealand and the United States.

He has a well feathered nest egg to support him once he stops work, with a pension pot worth more than £1m, and has little debt, with less than £10,000 left on his mortgage.

Mr Jarman also has just over £20,000 invested in stocks and shares including BP, Vodafone, ITV and Lloyds – but these are not held in an Isa.

However, one of his greatest concerns comes after life. His two adult children are independent, but the green-fingered entrepreneur would like to ensure that his grandchildren are provided for.

He said: "My financial goals are for my wife and I to look after ourselves in a reasonable manner, and to shelter what we can for our grandchildren.

"I've had a few accidents recently and it makes you realise that you won't live forever. I've worked hard my entire life. Now I would like to enjoy it."

Mr Jarman's taxable estate is about to grow significantly in size. He is in the process of selling a plot of agricultural land that will give him a windfall of roughly £1.6m once capital gains tax is paid. Mr Jarman is keen to ring-fence what he can for his family.

Harry Bell,
Director of financial planning at Charles Stanley

Mr Jarman should ensure that his pension death nominations reflect his wishes to help his grandchildren. Pensions will fall outside of his estate and pass to the nominated beneficiaries, so it would be better for him to draw down on his other assets that are not shielded from inheritance tax (IHT) to fund his retirement.

Until recently Mr Jarman would have been close to the £1.07m lifetime allowance – the amount that someone could previously save for their private pension without incurring a tax charge. But the cap was abolished in the recent Budget and so he may wish to consider further pension contributions within the £60,000 annual allowance. He could also carry forward any unused allowances from the previous three tax years.

The Jarmans are able to make gifts of £3,000 each per year and they can also make regular gifts from excess income without them being classed as "potentially exempt transfers", sometimes called the seven-year rule, before they are considered outside of their estate.

If the land sale qualifies for agricultural or business relief then some or all of it could be shielded from inheritance tax. There are also transitional reliefs that could apply in the case of agricultural or business relief, if invested in other qualifying assets within three years of sale.

Mr Jarman and his wife could also consider setting up a trust for the grandchildren utilising their nil-rate bands. This would allow them to place up to £650,000 in a trust without an upfront tax charge. After seven years the funds would be outside of their estate and they could use their nil-rate bands again.

It is important to have a detailed understanding of what historical gifts have been made when tax planning. Using trusts would give the couple control over how the funds are spent for their grandchildren.

They could also consider investments that qualify for business relief (and don't attract inheritance tax once held for two years) and can still be accessed by the investor. Certain companies that are listed on the Alternative Investment Market (Aim) are an option. However, they are volatile and not all Aim-listed investments qualify for business relief, so it's important to receive appropriate advice to ensure the portfolio is adequately diversified.

In the same vein, enterprise investment schemes (EIS) could also be a consideration for a small allocation of the portfolio. These are high risk, as they involve investment in small, early-stage companies and as such are long term, illiquid investments and should only be invested in after appropriate advice.

Typically, one would assume it could take seven to 10 years for a capital return on all the investments.

The potential rewards and tax savings are significant. These schemes qualify for 30pc income tax relief on investment, as long as they are held for a minimum of three years, which would be claimed through your annual tax return. The investments would qualify for business relief after two years and there is no capital gains tax. Any investments that fail, as is often the case with these types of investments, can qualify for loss relief, which reduces the potential downside of failed investments.

EIS investments also qualify for capital gains tax deferral, so Mr Jarman could use funds that would have otherwise been used to pay a tax bill, to invest in EIS qualifying investments. The CGT bill would still eventually need to be paid and there is a risk that CGT rates could go up, but for the right type of investor, willing to take higher risk, this can be an attractive investment.

David Goodfellow,
Head of financial planning at Canaccord Genuity Wealth Management

If Mr Jarman and his wife have been living off their current earnings, then their income needs are relatively modest in comparison to the £1.57m of incoming cash – particularly with the potential business sale and pension fund.

Their finances could do with a little spring cleaning. For example, it may make sense to clear the minor debt. They could also tidy up the random shares, which could be used to fund one of this year's £20,000 Isa allowances.

Depending on their own needs, the couple could use some of the sale proceeds from the land to ensure both Isa allowances are fully used and could consider helping their children and grandchildren with their Isas too.

The Jarmans should ideally keep a year's worth of expenditure in cash and invest in a balanced portfolio with a view to capital growth.

They could also consider committing some funds to investments that attract business relief, but should probably wait until the next capital event to really give thought to IHT planning.

If it's not too late, they should ensure that the land is in both of their names, so they can benefit from both of their capital gains tax allowances. It won't make a huge difference, but this would be one of the limited ways of managing the impact of CGT other than through very high-risk EIS investments.

JAY WILLIAMS

➤ Derek Jarman aims to take early retirement from his garden business and enjoy some travelling

£60k

Annual allowance
With the lifetime limit for pensions abolished, the Jarmans can make extra pension payments

£650k

Trust limit
Amount that can be paid into a trust without an upfront tax charge