How financial planning can help clients bridge the generation gap

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Recently, the Resolution Foundation suggested 25-year-olds should all be handed £10,000 to help tackle the financial generation gap. There is no doubt that many millennials have felt that economic distribution in the UK has not been working in their favour. The difficulties of getting a first foot on the property ladder make frequent headlines. Whilst previous generations saw homeownership as an inevitability, for many young people today owning a home is simply an unattainable dream. Looking up to a generation of baby-boomers soaking up the sun on expensive holidays, safe in the knowledge that rental income from their second and third properties is keeping their bank accounts in a healthy shade of black, renting millennials may well be feeling hard done by. Getting turned down for a bank loan they needed to start their very small business only serves to rub salt in the wound. This is a reality for some, so it is hardly surprising that the £10,000 helping hand suggestion generated debate in the press, albeit perhaps a less palatable suggestion for the over-50s.

A comprehensive answer to the financial generation gap, including the substantial challenges of affordable housing and university fees, remains undiscovered. Whilst the debate will rage on about tackling the population-wide challenges, many families will not be waiting around for legislative changes to support their offspring. In the meantime, advisers can expect to see increasing numbers of families wishing to tackle their own inter-generational gap in fortunes. Advisers need to be armed with strategies to approach a redistribution of accumulated wealth. Such strategies must consider tax implications and the use of trusts, in order to provide solutions that will work for all the generations.

Understanding objectives – a giveaway, a helping hand, or just wanting an education and somewhere to live?

With the grey pound burning a hole in their pockets, today's baby boomers are enjoying their retirement and going on more long-haul and adventure holidays than their younger peers. Whilst no-one would want to deny a hard-working generation an enjoyable retirement, such moments give people an opportunity to reflect on their life goals. Giving children or grandchildren a financial leg-up is not the same as putting everything on a silver plate and removing a sense of pressure to work. It may be entirely reasonable for affluent elders to wish to contribute towards a house deposit, school or university fees, or capital to set a business up. Gaining an understanding of these objectives and the reasons behind them must be at the heart of financial planning. Likewise understanding the objectives of the beneficiaries will ensure advisers are even better positioned to recommend a strategy that works for all.

Inheritance tax planning is not just about inheritance tax

Often dreaded and seldom understood, inheritance tax should always be considered when transferring accumulated wealth. Awareness of the tax, let alone understanding of the technicalities, is not usually considered general knowledge. Advisers therefore have a clear opportunity to demonstrate the value of informed advice. Inheritance tax must not be considered in isolation though. Investments in a plan may be subject to Capital Gains Tax, which may offer better tax-efficiency for some clients, whilst WAY's Portfolio funds, for example, are managed under nil income yielding mandates, which removes or reduce income tax implications.

Questions, questions, questions

There are many options available when it comes to trusts. Key questions for advisers to ask their clients include:

- **Do clients wish to give a single financial gift or make ongoing contributions?**
  A house deposit may require a one-off contribution. The annual gifting allowance of £3,000 forms a good, though often under-used, starting point, but won't go far with the average UK house price standing at £218,255. Meanwhile a family of two children, spaced three years apart, choosing private education can expect the school fees bills to keep rolling in for 16 years, which can lead to some challenging conversations for parents looking to grandparents for financial support.

- **What access to capital is needed?**
  Advisers need to understand from their clients whether they can afford to lose access completely or will need to retain the option to access funds at a later date.
- **How much flexibility is needed in the future?**
  Reducing future inheritance tax liability is only one side of the story. Families don't stand still, so loss of access and control in the future is a concern for many clients, particularly when looking at future care provision. Trusts however can be more flexible than many people realise.

Weighing up the options

Equipped with an understanding of the client's objectives and their financial requirements, advisers should consider a number of gifting strategies and trust structures.

Single gift into a Flexible Reversionary Interest-in-Possession Trust

This may be suitable for clients who wish to make a significant gift, in the process reducing their inheritance tax liability, yet retaining access to the capital at a future date should their circumstances change. Using this option means that the original gift falls outside the estate if the investor survives 7 years, and any future growth is immediately outside the estate. The investor can retain potential access to a proportion of the trust fund each year (via flexible reversions). The trustees being able to defer a reversion in whole/part to a future date if the payment is not required whilst also being able to distribute capital or make loans to the beneficiaries at any time.

Gifts from Income into a Flexible Reversionary Interest-in-Possession Trust

For clients with surplus income, advisers should make sure consideration has been given to the 'normal expenditure out of income' inheritance tax exemption. Paying gifts from income into a flexible reversionary interest in possession trust will mean that the gifts will result in an immediate reduction in the investor's estate for inheritance tax. There is no monetary limit to the gifts made provided they meet all criteria for the exemption to apply and any investment growth is immediately outside the estate. At the outset, access to the trust in the future can be defined – for example, with the WAY Gifts from Income Inheritor Plan, the investor has potential to access 50% of the trust fund on both the 5th and 10th anniversaries. The trustees can postpone these reversions in part/full to a future date if not needed at the time, and can appoint or lend capital to beneficiaries whenever they wish.

Fixed reversionary interest in possession trust

Some clients may only be able to afford to make a significant gift if they can continue to receive an income from it. With a fixed reversionary interest in possession trust, an income basis is fixed at outset and clients cannot have any other access to their capital. Medical underwriting is also required so that the level of any discount on the original gift can be determined. The investment is gifted into a fixed reversionary interest in possession trust for the chosen beneficiaries. If the investor survives 7 years, the gift is removed from their estate. If death occurs within 7 years, the inheritance tax value of the gift will usually be lower than the amount invested. Again, future investment growth is outside of the estate from the outset. The trustees cannot distribute capital/make loans to beneficiaries during the investor's lifetime.

Potentially exempt transfers into a bare trust

This structure may appeal to clients who wish to make a potentially exempt transfer, require an annual 'income' but want control over whether to draw this in full each year. Clients must be prepared to undergo medical underwriting so that the level of any discount on the original gift can be determined, as well as accept the restrictions of a bare trust. Again, gifts will fall outside the estate for inheritance tax purposes after seven years. For investments in a bare trust, the death benefits are held for named beneficiaries and the maturity benefits are held for the investor absolutely. The IHT value of the initial gift may be discounted. Extending the maturity date is a potentially exempt transfer and may also benefit from a discount as well.

Retaining access to capital through a loan to a flexible interest-in-possession trust

Families who wish to carry out inheritance tax planning but cannot afford, or are unwilling, to give up all access to the capital, may wish to consider a loan to a flexible interest-in-possession trust. The client makes an interest free, repayable on demand, loan to the trustees of a flexible interest in possession trust, who will then invest the monies. Investment growth is held for the beneficiaries, whilst any outstanding loan will remain part of the investor's estate for inheritance tax. The investor has full control over and access to the original capital, and regular loan repayments can be used to provide an 'income' to the investor until the original loan is repaid. Unlike the structures discussed above, no gift has been made and therefore inheritance tax benefits can only be achieved on a gradual basis. These will rely on loan repayments being taken and spent and the investment growth obtained. The trustees can make capital payments to the beneficiaries, subject always to their ability to repay the loan on demand.

Inheritance tax planning can be complex. Advisers and their clients need complete confidence that any recommended plans are legally and fiscally robust, as well as sufficiently flexible to cope with future changes in family circumstances. Furthermore, families may need more than one approach, using more than one type of trust to achieve their goal of passing on wealth to the next generation. Wishing no more than the best for their children and grandchildren, **t**he need for families to seek informed advice is clear.