WAY Investment Services

Planning for the unplanned: talking to clients about care costs and preserving family wealth

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There are aspects of financial planning that drive towards a happy objective – such as planning for a move to a bigger home, or saving for a wedding, or providing funds for education of children or grandchildren. Then there is another topic that is unlikely to ever bring the same joy: planning for care. The trouble is, whether we like it or not we are getting older by the day, and ageing bodies can need a lot of looking after.

Most people are unlikely to actually spend their final days in a care home – just 4% of the population 65 and over and 16% of the over-85s live in care homes, according to a 2016 survey by Laing and Buisson. But the likelihood of needing other forms of care is much higher. As we age, so our care needs are likely to increase, perhaps beginning with just some help around the home, growing to more healthcare related support in later years. Like it or not, the subject of provision of care can very quickly become highly significant for a person and their family, and not least financially.

Looking for solutions

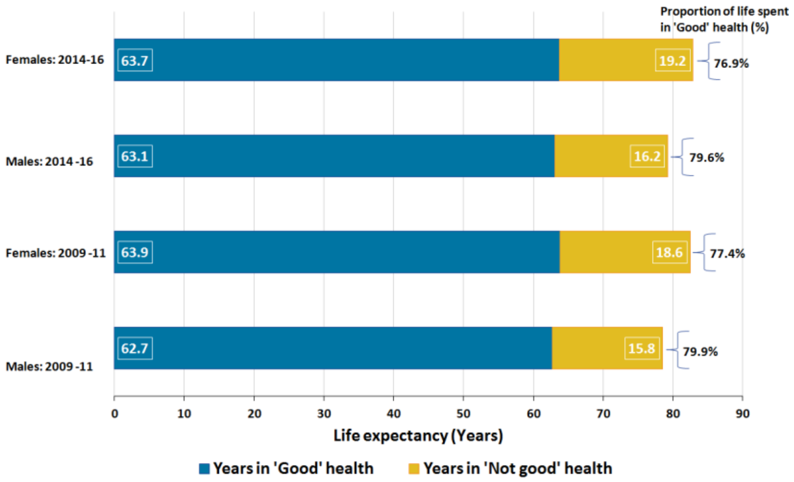
There is no doubt that the funding of care nationally is in crisis, and that nobody has come up with a perfect solution to fix it. New suggestions hit the headlines frequently – recently including a one-off £30,000 charge paid by people when they reach 65 as suggested by the Social Market Foundation(1). Other possible options mooted include increasing income tax or national insurance, or a tax or social care premium for the over-40s. So far, no strategy proven to be vote-winning has really come to the fore. Whilst politics continues to try and come up with new ideas, the growing elderly population doesn't have time to wait and nor should your clients' personal financial plans. No matter what political solutions may be dreamt up this year or over the next ten, financial advisers need to be prepared today to offer solutions to clients to help them prepare for an uncertain future. In the meantime, advisers also need to keep abreast of ongoing developments, not least any announcements that may or may not come out of this year's Budget.

What do clients want from their later years?

So what exactly is it that actually needs planning for? According to a survey of almost 5,000 people carried out by the charity MHA in 2015 (2), alongside health and wellbeing, and companionship or loneliness, one of the most significant concerns for people about the ageing process was personal finance –whether people would be able to afford a *good retirement*, including paying for care and support if they needed it. Of course the definition of a 'good retirement' can be very personal, so asking a few searching questions of clients is a good place to start. How would they actually define their own 'good retirement'? How do they want to live at age 60, 70, 80 or 90? Do they envisage support from family as they age? Are there others they wish to provide for financially?

How long will I live?
No-one knows how long anyone will live, but we do know life expectancy figures, which in the latest release of data has been shown to be unchanged in the UK at 79 and 83 years from birth for males and females respectively (3). Within the headline life expectancy figure, are figures of the proportion of life spent in 'good health', the converse of which demonstrates the proportion of life a person can, on average, expect to live in 'not good health' – which is 16.2 years for males and 19.2 years for females. These figures alone provide a strong argument as to why planning financially for care is so important.

Figure: Healthy life expectancy, life expectancy and the proportion of life spent healthy at birth, by sex in the UK, 2009 to 2011 and 2014 to 2016



Note: Survey respondents who answered their general health as 'very good' and 'good' were classified as having 'Good' health. Those who answered 'fair' 'bad' and 'very bad' were classified as having 'Not good' health.

Source: Annual Population Survey, Office for National Statistics
https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/bulletins/healthstatelifeexpectanciesuk/2014to2016

What can go wrong? Losing choice and leaving it too late
If advisers find that clients still need some convincing of the need to plan ahead for care, it may be worth considering what might go wrong if they don't plan at all. Firstly, if people are unable to fund their own care then there may be state provision available – but potentially at the cost of personal choice. If a person can pay for it, they can choose who provides their care and where it is provided, but options are likely to be far more restricted if it is state-funded.

Some clients may wish to pass on some of their wealth to family but be reluctant to in case they need it to fund care at a later date. The inclination to pass on assets may grow as health deteriorates, but it is important for clients to be aware that passing on of assets immediately before care bills are due can be treated as deliberate depravation of capital – in which case the Local Authority may seek to reclaim those assets in order to fund a person's care bills.

Saving for care, and paying inheritance tax instead

Balanced against the need to fund future care, many clients may also be concerned about a growing inheritance tax liability. Whilst growing family wealth through ISA wrappers in younger years may have made sense, the ISA structure may well not be the best place to hold funds set aside for care. Famed for their tax efficiency, clients may not be aware that ISAs are subject to inheritance tax where assets exceed the nil rate band. Prudent savers who have become ISA millionaires are unlikely to want to see 40% of their investment taken as tax, so should be wary.

Whatever the size of any ISA pot, advisers need to ensure clients are clear on the gifting rules for IHT. There have been many calls for changes to the allowances, especially as the annual exemption of £3,000, marriage gifts of up to £5,000, and individual gifts below £250 have remained the same for the past 30 years. In addition, the results of the Office of Tax Simplification's review into Inheritance Tax are expected this Autumn, so advisers need to keep abreast of developments as well as when any changes might come into force.

How much money will I need?

So what alternatives can advisers suggest? The first assumption that needs testing is that care will have to be funded from capital rather than income. Whilst the recently-retired may well be enjoying their newly-discovered availability of time to travel the world and burn through their savings at the same time, weekly expenditure is likely to be lower for those twenty years older. Government figures show that whilst 65- to 74-year-old households are the greatest spenders on recreation and culture, spending nearly a fifth (18%) of their total spending on it, but the amount of time spent on leisure peaks for those aged 65 and over (4). In fact, the over-75s are the lowest spenders across all categories in Government data on household expenditure (5), and are more likely to have paid off their mortgage (6), so may find initially that their income is sufficient to cover increasing care needs as the amount they spend elsewhere decreases.

Flexible options for changing needs

So if an adviser has determined that a client's objectives are about preserving family wealth inter-generationally, and being able to fund care fees whilst retaining the ability to have choice over how and where care is received, what options should be considered? Clearly an uncertain future needs flexible planning options. For some clients, it may be appropriate to consider trust structures that offer flexibility. For example, with a flexible reversionary interest-in-possession trust, clients can set aside an amount of capital that can be used to fund future care if needed or passed on to beneficiaries if not. Rather than avoiding paying care fees, this method can actually provide the client with the ability to fund care and therefore retain the ability to have choice over how and where care is received whilst retaining capital within the family to pass down the generations.

Once inside the trust, the original gift falls outside the estate after seven years, with any investment growth immediately outside the estate. Crucially, the investor retains potential access (at the trustees' discretion) to a proportion of the trust fund each year via flexible reversion payments, which can be deferred in whole or part to a future date, in any year in which they are not required. Should the need arise, the trustees can also distribute capital or make loans to the beneficiaries at any time.

Another option is to make gifts from surplus income into a trust through the 'normal expenditure out of income' rules. Again, if made into a flexible reversionary interest-in-possession trust, potential access to capital can be made at a future date. This does not provide unrestricted access to the gifted sums but provides potential access to a portion of them if needed – for example to fund additional care needs – effectively providing a means of planning for a situation that may or may not occur.

Keeping thorough records is essential in order to demonstrate that the gifts were from surplus income and that they were made to mitigate Inheritance Tax, and not made in order to avoid paying for care.

Conclusion

The future may be uncertain, but it doesn't mean it can't be prepared for. Rules can (and do) change, so advisers will need to stay informed of developments, but planning ahead remains as important as ever. A key challenge for advisers is understanding what clients want from their retirement, so the adviser can devise an appropriate financial plan to help them achieve their goals. If clients wish to retain the ability to make choice over how, where and by whom care is provided whilst retaining the opportunity of retaining wealth within the family, it is crucial to start planning sooner rather than later.

References

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