Edison
Wealth
Management

Life Assurance

The guaranteed way to cover inheritance tax liabilities?

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Life Assurance and IHT liabilities

Life assurance has proved itself to be a dependable and a non-controversial way to fund for future Inheritance Tax (IHT). No complex planning required, just get through the medical and pay the premiums. Is it really as simple as this?

This Briefing Note looks at the typical uses of, advantages and disadvantages of life assurance for IHT planning. RNDs (Resident Non-Domiciled individuals) are increasingly using life assurance as a simple way of providing for IHT exposure on UK property.

Life assurance is far from straightforward when it becomes a valuable part of more complex estate planning. So, if you have any questions, please don't hesitate to contact us on 020 7287 2225 or hello@edisonwm.com.

Life Assurance and IHT liabilities

Types of policy typically encountered

As you will be aware there are a number of lump sum plans available (Discounted Gift Trusts and Loan Trusts being the main ones) but these are essentially investment based plans with very little insurance content. The most commonly used types of life assurance are:

Term Assurance Lump sum payable on death, with the term typically set at 10, 15 or 20 years.

Whole of Life	Lump sum payable on death but no set term. Policies can be on a guaranteed basis, where the premium and sum assured do not change. Policies on a reviewable basis are likely to see the premium increase or the sum assured decrease after the 10th anniversary.
Gift inter vivos	Covers the tax becoming due on a failed Potentially Exempt Transfer (PET)
Convertible term	Term assurance policy which can convert into a Whole of Life in the future

Cost of £1,000,000 in life assurance cover

The type and duration of the life assurance policy will depend on the IHT liability it is covering. Premiums will vary significantly from one type to the other. The table below gives some indicative premiums.

There are a number of life companies (both onshore and offshore) offering high-level cover, which is suitable for IHT planning and it is therefore important to work with an advisor, such as Edison, who has visibility over the entire market. Also premium rates do change regularly.

		Annual premium			
Age	Term	10 years	20 years	Whole Life	Gift inter vivos
40	Individual	£425	£510	£6,200	£430
	Joint life last survivor	£535	£580	£4,500	n/a
50	Individual	£1,000	£1,220	£9,700	£810
	Joint life last survivor	£830	£1,460	£6,400	n/a
60	Individual	£2,650	£3,900	£15,600	£2,005
	Joint life last survivor	£1,940	£4,950	£10,950	n/a

Based on £1m death benefit, nil commission and not subject to underwriting.

The figures shown here are whole of market, quoted before individual medical underwriting and include commission which can be reduced in certain circumstances or replaced by a fee if you or your client prefer this.

Assessing suitability

Type of plan	Advantages	Disadvantages
Term	Relatively cheap when compared to whole of life and does what it says on the lid i.e. it protects against death occurring during a certain term. Therefore, it can be attractive for a RND likely to be in the UK for a pre-defined period of time and looking to cover liability to IHT on a UK property or a family looking to cover IHT liability until their children are ready to start receiving gifts of assets directly.	The premiums are relatively cheap for a reason – there is statistically unlikely to be a pay out! Plans can change e.g. a RND might be in the UK for longer than anticipated. The value of the underlying asset, which the cover is designed to protect, may rise during the term leaving the policyholder underinsured.
Guaranteed whole of life	Although relatively expensive, providing the premiums are maintained throughout life, the sum assured will definitely pay out. Can be thought of as a very long term and tax efficient way of covering some of an IHT liability.	Expensive and so many policies do not go to full term, which conversely help to subsidise the ones that do. Remember the time value of money. A £1m sum assured now is not the same in real terms as the £1m that will be paid out in say 30 years' time. IHT liability is likely to increase over time with the value of underlying assets and so the cover taken at say age 50 may be inadequate if death occurs at say 85.
Reviewable whole of life	Relatively cheap – in fact often cheaper than a comparable 10 year term policy	Premiums often increase sharply after 10 years but providing this is clear at outset there is no need to discard reviewable.
Gift Inter Vivos (GIV)	It does the job that is intended i.e. covers a pre-determined liability and so you pay no more in premiums than you need to.	Practical point. There is currently only 1 provider offering GIV cover so the premiums may not be as competitive although it is possible to mimic GIV with a series of short-term policies.

Whole of Life (WOL) and the science behind the guaranteed return

Guaranteed WOL is what it says – guaranteed. Providing premiums are maintained for the rest of the insured's life and the insurer stays in business,[1] the sum assured will pay out on their death.

For this reason and the fact that life expectancy tables are regularly published, it is possible to calculate the likely return that the sum assured will represent when paid to the beneficiaries of the life insured following their death.

Example

John is aged 50 and in good health. He intends to provide £1m for his children in the future following his death. John's life expectancy is 31 years. The premium for a healthy 50 year old is approximately £7,010 pa and so the return to normal life expectancy is approximately 8.70% p.a. compound.

In other words if John set up a savings plan today for £7,010 pa and received an annual return of 8.70% pa his children would receive £1m after 31 years.

"This return will almost certainly be paid to his children free of all taxes."

There will be no income tax on a guaranteed WOL policy as there is no investment content and there is also unlikely to be IHT as the policy will be held on trust and will therefore not form part of the policyholder's estate on death. Nonetheless, the payment of premiums to a trust is a transfer of value and must be covered by an appropriate IHT exemption (such as the £3,000 annual exemption or gifts out of surplus income) otherwise, if exceeding the Nil Rate Band, an immediate charge to IHT can arise on the payment of the premiums

Of course looking at this another way, £1m today is not the same as £1m paid out in 31 years' time and if the estimated IHT liability is £1m today it is likely to be far higher 31 years into the future. And if John lives beyond 81 then the return starts to diminish.

			Equivalent Return (p.a.)		
Age	Term	Prem.	Male	Female	Joint
40	Individual	£6,200	6.06%	5.30%	-
	Joint life last survivor	£4,500	-	-	6.45%
50	Individual	£9,700	6.99%	5.89%	-
	Joint life last survivor	£6,400	-	-	7.86%
60	Individual	£15,600	8.81%	7.01%	-
	Joint life last survivor	£10,950	-	-	9.40%

Based on £1m death benefit.

The table opposite looks at WOL equivalent returns based on current premiums.

Although it is no longer permissible to differentiate between male and female lives in terms of premium, females generally live longer yet now pay equivalent premiums.

Therefore they are likely to pay these premiums for longer- hence the effective returns on their policies are likely to be lower.

[1] Compensation is available from the Financial Services Compensation Scheme. The max level of compensation for claims against firms declared in default: (a) on or after 3 July 2015 is 100% of the claim with no upper limit; (b) on or after 1 January 2010 and before 3 July 2015 is 90% of the claim with no upper limit, and; (c)before 1 January 2010 is 100% of the first £2,000 plus 90% of the remainder

Is it better to self-fund?

On the basis of the results in this table is it better to self- fund? Although the returns above may be achievable on a "one off" annual basis it is highly unlikely that they can be achieved year after year, consistently, net of fees. Furthermore, even if the required returns can be achieved, can they be delivered tax free?

Whole of Life and RNDs

For RNDs wishing to mitigate IHT on UK property there are few remaining solutions. UK residential property held by non UK companies can fall outside of IHT but this type of planning was impacted by the introduction of the Annual Tax on Enveloped Dwellings (ATED) in 2013.

A WOL policy can provide a solution, insuring the value of the UK property x 40% and is (one hopes) fairly immune from future legislative change. It may be possible to build in some indexation to the lump sum to keep pace to an extent with increases in the underlying property value.

Guaranteed WOL policies are generally written by insurance companies resident in the UK and can therefore constitute a UK situs asset for IHT purposes. An RND will therefore need advice on an appropriate trust in order for their estate to avoid UK IHT on the policy payout.

The importance of thoughtful advice

Edison Wealth Management is an independent fee-based financial planning firm. In other words, we do more than just broker life cover, we provide independent advice to help you and your clients achieve the underlying objective(s).

Life assurance is far from straightforward when it becomes a valuable part of more complex estate planning.

At Edison, we understand personal tax, estate and inheritance tax planning, so that we are able to work with you to ensure any life assurance we recommend enhances the planning you are putting in place for your clients.

We can provide you with support on:

- Suitability of various product types and how they meet the objective(s)
- Competitive premiums
- Review of existing life assurance cover

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Prior to joining Edison, Justin held a number of senior positions at Rensburg Sheppards, Towry Law and SEI Investments.

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If you would like to download or view this Briefing Note on our website.

The above is a simplification of the legislation. It does not constitute advice. The views expressed above are subject to changes in legislation. Please note that estate planning and trusts are not regulated by the Financial Conduct Authority. The Financial Conduct Authority does not regulate tax advice.

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