FINANCE UPDATES

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LEAVING MONEY TO THE WRONG PEOPLE

Guarding against accidental inheritance.

Soaring house prices around the UK over the last 20 years mean it's possible to leave a substantial windfall to the people or causes closest to our hearts.

But with more people filing for divorce and second or even third marriages becoming increasingly common, family structures are getting ever more complicated.

The potential to leave money to the wrong people when you die grows with the most complex family arrangements. That's why it's essential to take control of your estate, which includes any savings, property and investments.

An important first step to consider, especially if you are unmarried, is to write a legally-valid will to ensure you pass on your estate to the individuals you want to receive it.

For your will to be valid in the eyes of UK law, it needs to be made in writing, signed by you and your two witnesses. You must also be of sound mind and have made the will without pressure from anyone else. It can be digitally witnessed now because of changes to rules during COVID-19.

You need to update your will after a life-changing event, such as getting married, going through a divorce, having children, or becoming a widow. Failure to update your will can result in part of your estate going to people from your past.

This is particularly relevant to divorcing couples, many of whom had never discussed separating before the COVID-19 crisis. But lockdown restrictions have seen divorce applications skyrocket over the last 12 months.

UPDATE YOUR BENEFICIARIES

Writing a legally-valid will lets you make it clear who you want to inherit things like your main residence and any investments, but it might not include your pension pot or any life protection policies you might have. Both of these could be at risk of going to the wrong people.

Pensions

Over the course of your career, you might work for several different employers and build up quite a collection of different workplace pension schemes.

These are considered to sit outside of your estate when you die, which means they are not included in your will like other assets such as any property or investments you may hold, and will be paid directly to the beneficiaries you have nominated.

The average pension pot in the UK is worth £61,897, according to the Pensions and Lifetime Savings Association. Most people wouldn't want that to go to an ex-partner, for example, if it could be avoided.

If your pot is made up of defined contribution pension schemes, the full value is usually paid as a tax-free lump sum to your beneficiaries or dependants on death, providing you are under the age of 75 when you die.

All pension providers encourage you to list your beneficiaries and a percentage of your fund you want to leave to them when you die. You can update your beneficiaries after your life changes by contacting your provider.

If you have consolidated all of your personal pensions into a single pot, it obviously becomes much easier to update your beneficiaries whenever your circumstances change as it will only involve contacting the one provider.

Life protection policies

When you take out life protection policies, such as life insurance or life assurance to provide family or mortgage protection, you must name at least one beneficiary.

Much like a pension, you should contact your policy's provider after experiencing a life-changing event if you wish to update your beneficiaries to reflect your wishes.

Most providers let you do this online, either by logging into your account on their website or downloading a PDF for you to complete and submit.

INHERITANCE TAX

Everything with estate planning surrounds inheritance tax, which is charged at 40% if the value of your estate exceeds £325,000.

On top of this sits the £175,000 residence nil-rate band. This applies to the family home and kicks in if you pass it on to a direct descendant when you die, protecting up to £500,000 of your estate from tax.

Each individual can use both of these tax-free allowances. For married couples, this can protect the first £1 million in a joint estate from tax. If one of you dies, any unused threshold can be transferred to the surviving spouse.

THE ROLE OF A TRUST

Outside of having a legally-valid will, one of the simplest ways to protect your estate is to put assets into trust. This can mean they fall outside of your estate when you die.

However, there can be tax charges for gifts into trust if the donor dies within a few years of making the gift. For example, if you gift £500,000 into a trust and die three years after making that gift, there will be an inheritance tax charge.

Trusts are fairly simple to set up and placing pensions and insurance policies into trust is a tax-efficient estate planning strategy, especially when they are not covered by a will.

It is possible to write your pension pot into trust and ensure that any unused money is passed on to your family.

This is a relatively recent strategy following the introduction of pension freedoms back in April 2015.

In the same way, a life policy can be put into trust. This can be one of the most tax-efficient ways to financially provide for your family's future after you die.

For example, life insurance is designed to pay out a cash lump sum to your loved ones on your death, helping them to pay off the mortgage or provide a regular income.

However, the cash lump sums paid are treated like most other assets and form part of your taxable estate for inheritance tax purposes when you die.

Writing a life insurance policy into trust will result in the payout going directly to your beneficiaries, rather than forming part of your estate.

Setting up a trust involves appointing trustees, such as a family friend, to manage the policy on your beneficiaries' behalf. They essentially own the policy until you die.

Going down this route ensures the money paid out goes to the right people quickly and without the need for lengthy legal processes, such as applying for probate.

WHAT CAN YOU DO?

It is vital to regularly review all your financial policies. For example, a full financial review should be essential when you experience a life-changing event, such as a marriage, divorce or bereavement.

Come to us and we can look at your pension and protection arrangements to see if they are still suitable for your new circumstances.

We can also align any policies held in trust with your will, so the proceeds of your estate go to your loved ones, rather than someone from your past.

We can review your financial arrangements.