CASCADING YOUR WEALTH DOWN THROUGH THE GENERATIONS

Cascading your wealth through the generations via your pension can be a great way to look after family members. However, what if you can't do that as you are in a Defined Benefit (DB) scheme? Or you just want to invest in your children or grandchildren's future as you know they will not be in the golden era of pensioners?

Contributions for others are a great way to provide for future generations. In addition, they are an excellent way of mitigating IHT without the need to make significant capital payments.

Why provide for future generations?

Final salary pension schemes are very rare now and most new employees won't be able to access these "gold-plated" pension schemes. The youth of today are struggling to cope with university fees and getting on the property ladder is much more difficult than it used to be. Although auto-enrolment is increasing the amount of people who are saving into pensions, the amount being saved is often not enough to fund a comfortable retirement.

Making contributions for young children or grandchildren can benefit them and their families in the future. However, making contributions for adult children who should be thinking about pensions but instead are paying large mortgages and childcare can be even more beneficial.

Why are pension contributions good for IHT planning?

The advantages of this strategy are;

- the estate of the donor reduces,
- basic rate Relief at Source from HMRC will effectively increase the gift by 25%,
- the recipient may benefit from a reduction in their tax bill if they are a higher or additional rate payer, perhaps they are affected by the child benefit or high earner's tax traps
- the fund enjoys tax free growth - it suffers no income tax or capital gains tax charges,
- it can be used to help them to fund for their pension at a time when resources may be stretched but benefits of pension contributions greatest,
- the recipient has no access to the gift until he/she attains at least age 55,
- should the recipient die prior to age 75 a tax free lump sum or income benefits may be payable from the pension pot.

Case study

Robert, 60 is a retired GP. He is widowed with one son, James who is 35. He has a large pension income from the NHS scheme but he doesn't need it all. He has assets in excess of £1 million and he is worried about IHT. James has just had his first child in January, Harrison.

Scenario 1: a pension for Harrison

Robert decides that he would like to save money for his new grandchild, Harrison. He doesn't want to be tied into large amounts into a trust so decides that pension contributions would be a good idea. He also wants to make sure that this money is not available for James to spend frivolously.

Robert sets up a pension plan for Harrison, paying £2,880 per year which is then grossed up to £3,600. He sets up an annual contribution every January around Harrison's birthday. If Robert pays this until just after Harrison is 18, with 5% growth (but excluding charges) there will be £101,276.58.

Even if no more contributions are made and still assuming 5% growth, then just after Harrison's 60th, the fund will be worth £786,067.08. A nice pension fund for Harrison and if the worst were to happen and Harrison died before he could access the fund, then his beneficiaries would still receive the benefit.

Robert could carry on paying contributions after Harrison is 18 or he could think about paying into something like the Lifetime ISA which could be accessed to help with house purchase but would still benefit from a government uplift.

As Robert has surplus income then the normal expenditure from income exemption may apply or the annual exemption of £3,000 could be used. The IHT saving would be 40% x £2,880 = £1,152.

Instead of sitting in a bank account which would form part of Robert's estate on death, it is moving into Harrison's future account. Harrison can add money himself in years to come or it can just grow in a tax efficient environment.

Scenario 2: a pension for James and increase in bank balance

Many people, if asked, will say that you can pay up to £3,600 for your children or grandchildren.

When the initial reply is followed up by the supplementary question; 'what if that child is in employment and earning over £50,000 per year?' the size of the opportunity becomes apparent. From a family point of view, the tax savings are even better.

In a few years' time Harrison has another 2 siblings. Robert's son James is feeling the pinch with three children, a large mortgage as well as childcare costs. As he earns £53,750 James is caught in the child benefit tax trap. Robert could decide to help out by paying into James' pension rather than (or in addition to) pensions for the grandchildren.

The impact of being in the tax trap are;

£3,750 - £1,500 (income tax) - £937 (child benefit tax charge) = £1,313

If Robert makes a pension contribution to James' plan of £3,000 it will receive basic rate relief and there will be £3,750 in his pension. That amount is deducted from his adjusted net income which means he is no longer in the tax trap.

James' bank balance will increase. Previously he had £1,313 but with the £937 child benefit tax saving and higher rate relief he will now have £3,000. An additional capital amount of £1,687.

There is an IHT saving of £1,200. From a family point of view, the total tax saving is;

Inheritance Tax	£1,200
Child Benefit	£937
Relief at Source	£750
Higher Rate Relief	£750
Total	**£3,637**

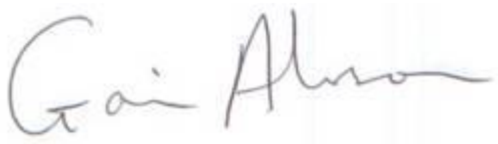
which is **121%** tax relief from an **£3,000** cheque!

A win for the family

In either of the scenarios above, Robert is helping out his family by providing money for their retirement and potentially for their families much further down the bloodline.

Pension contributions are often forgotten about when in reality they can be one of the most tax efficient ways to cascade wealth.

Regards



Gavin Anderson Cemap MIFS DipFA

29th June 2016