

CASE STUDY

Estate planning for clients with large pension pots



**PUMA
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OVERVIEW

Two major changes to inheritance tax will impact investors over the next few years.

First, unspent pension pots will form part of the taxable estate for deaths after April 2027. This will significantly increase the impact of inheritance tax on what investors leave behind, and cause previous estate plans to be revisited.

Second, a new Business Relief Allowance has been introduced. This enables everyone to benefit from 100% relief from inheritance tax on up to £2.5 million of Business or Agricultural Relief-qualifying assets. Many clients will benefit from revisiting existing plans.

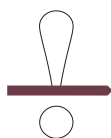
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CASE STUDY

Meet Joe and Maura

Both 82 years of age



The problem

Joe and Maura have an estate worth £3.5 million that includes their home, owned mortgage-free and worth £1 million, a rental property worth £500,000, ISAs and other investments of £1 million and a pension pot of £1 million. Their Financial Adviser had created a plan designed to meet their expected lifetime needs as well as their goal of passing on as much of their unutilised wealth as possible to their children on death.

They have been meeting the majority of their living costs from rental income plus growth and capital drawn from their non-pension investments, expecting to leave their pension as the last pot of capital to access. This allowed it to grow tax-free during their lifetime and enable anything they didn't need to pass free from inheritance tax. Their children would pay income tax at their marginal rates when they access the pot post inheritance.

The couple worry that this approach may no longer meet their goals. Inheritance tax will be payable when they pass their pension pot on, in addition to income tax paid by their children when they draw it down, meaning an effective tax rate of more than 65%. They also worry that their estate will now face an inheritance tax bill of more than £1 million, without easily accessible wealth for their children to pay the bill.



The solution

Joe and Maura's Financial Adviser considers their lifetime financial needs and goals, risk profile and capacity for loss. He suggests starting to draw down from the pension pot to fund lifetime living costs, and using other assets to create a capital pot that they can plan to pass-free from inheritance tax.

As they haven't previously accessed the 25% tax-free withdrawal from their pension they could do this now, investing that capital plus the proceeds of selling their rental property into a Business Relief-qualifying portfolio. If they hold the investment for two years and at the point of death, it should pass to their children free from inheritance tax. As a married couple, only one of them needs to survive for two years in order for their estate to benefit.

While this would be a higher-risk investment than their current investments, the higher-risk profile feels appropriate – the couple have sufficient other wealth to meet their needs, and the future tax burden on the pension pot and rental property will significantly erode the wealth they want to leave to their family.

With the help of their Financial Adviser, the couple invest £750,000 in a portfolio that qualifies for Business Relief, utilising their Business Relief Allowance.

Without BR investment

£3.5m

Couple own £3.5m in assets, spending income from non-pension portfolio

After one year

Joe passes

After two years

Maura passes

£650,000

Nil Rate Band

£1.14m

Inheritance tax due

£2.36m

Passed on



With BR investment

£500,000

Couple sell rental property for £500k and withdraw £250k from pension tax-free

£750,000

Couple invest £750k into BR-qualifying investment

After one year

Joe passes

After two years

Maura passes. £750k investment qualifies for 100% relief from IHT

£650,000

Nil Rate Band

£840,000

Due in inheritance tax

£2.66m

Passed on

Plus, £112k income tax saved on pension drawdown

£400,000

Total saving

This example is for illustration purposes only and should not be read as advice. No investment growth or loss assumed. The couple do not benefit from the Residence Nil Rate Band due to the value of their estate. Joe and Maura are assumed to be fully invested in BR-qualifying companies.

The detail provided here is intended to provide a high-level informative summary of inheritance tax liability, and therefore should not be read as advice. Please consult an independent Financial Adviser for personalised advice that takes into account your specific circumstances.

Get in touch

We're here to help

Contact us on 0207 468 7900,
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Past performance

Past performance is no indication of future results and share prices and their values can go down as well as up.

Tax reliefs are not guaranteed

Tax reliefs depend on individuals' personal circumstances, minimum holding periods and may be subject to change.

Long-term investment

An investment in the Service should be considered a long-term investment.

You may lose money

An investment in smaller companies is likely to be higher risk than other investments. Investors' capital may be at risk and investors may get back less than their original investment.

Potentially illiquid investment

Shares in private trading companies are illiquid. It may prove difficult for investors to realise immediately or in full proceeds from the sale of such shares.

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