

Unhappy families – challenging inheritance issues

The outcome of a recent High Court case is a warning for anyone challenging a will.

As inheritances become more valuable, the number of disputes about wills have increased. Court cases rose by almost 50% to 188 in 2019 compared to the previous year according to the latest Ministry of Justice figures. Many more are settled or abandoned along the way. The cases which do reach the High Court tend to be those involving the 'right' mix of large sums and elevated emotions. An example that appeared in April 2021 is *Miles v Shearer*.

Tony Shearer died in October 2017, leaving nearly all of an estate worth about £2.2m to his second wife, Pamela. His two daughters, Juliet and Laretta, born in the early 1980s to his first wife, received nothing. This prompted them to make a claim under the Inheritance (Provision for Family and Dependents) Act 1975.

Laretta wanted a payment from her father's estate to cover:

- The cost of a home, so that she could move out of her mother's property;
- Fees for training as a dog behaviourist, to enable her to support herself; and
- The expenses of caring for her autistic daughter.

Juliet sought funds to:

- Reduce her mortgage by about £245,000, so that it would become affordable for her on a repayment basis: and
- Buy out her ex-husband's share of a flat in which she was living – about another £100,000.

In 2008, shortly after his divorce, Tony gave £177,000 to Juliet and £185,000 to Laretta. At the time he made clear there would be no further financial support to his daughters. This was an important factor in the case as it reinforced the decisions Tony made in the creation of his will.

The judge rejected the claims of both daughters, stating that neither had established a need for maintenance to be funded from their father's estate.

Two lessons can be drawn from the case:

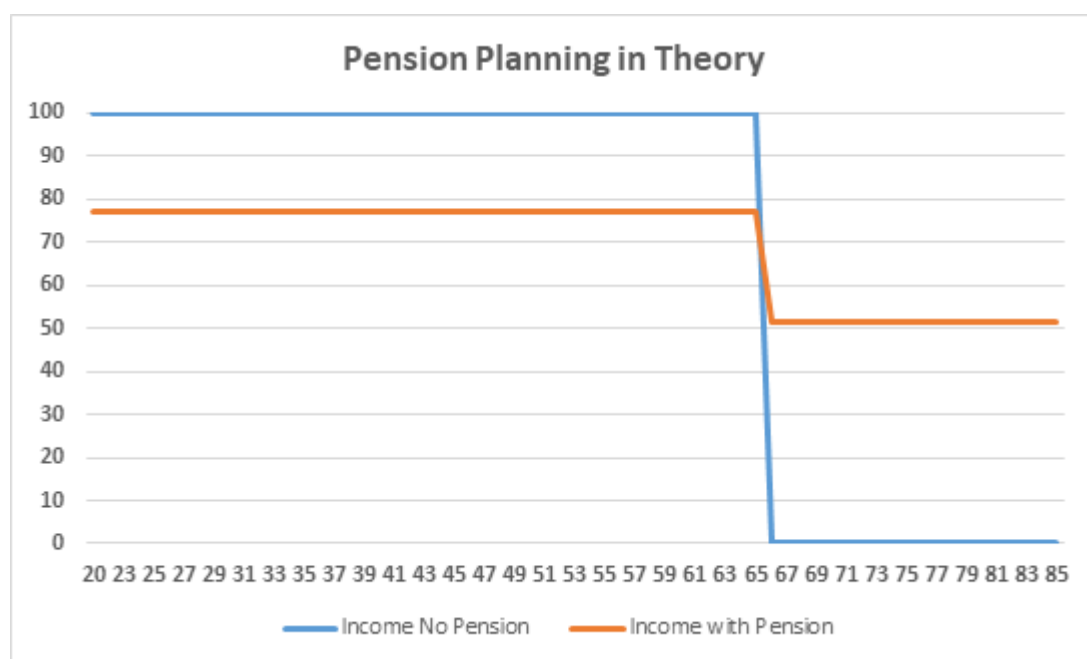
- Make your intentions clear in advance to try to reduce potential disappointment and the likelihood of legal action when a will is finally read.
- Tony's will achieved what he wanted to happen. Had he left matters to English intestacy laws, Pamela would have received only £125,000 and personal chattels outright, with Juliet and Laretta immediately jointly receiving half the residue (less about £285,000 of inheritance tax).

Timing retirement saving

Research from the Institute for Fiscal Studies (IFS) examines how pension contributions fit into life-cycle patterns.

Economists often seem to think in a way that is unique to their world. Many of their theories start with the assumption that people behave rationally, weighing up all the pros and cons before deciding what action to take. Impulse-buying doesn't compute with these expected behaviours.

One interesting economic viewpoint that holds some logic for the person on the street is the concept of pensions as deferred pay. The economist's notion of retirement planning can be summarised by this graph:



The economic argument is that a pension should be regarded as deferred pay, so that instead of income stopping in retirement (the blue line) a lower income is accepted before retirement to provide some income ($2/3^{\text{rds}}$ in this example) after retirement – the orange line. Income is therefore, in theory, smoothed throughout life and continues into retirement. Ignoring all inflation – as only economists can – the total income in both scenarios is the same. The difference is in how it is distributed over a lifetime: Earnings foregone during an individual's working life re-emerge as a retirement pension.

This deferred pay approach was the starting point for some research undertaken by the Institute for Fiscal Studies (IFS). It looked at both theory and practice and suggested the following pattern for pension contributions:

- Automatic enrolment rules mean that for employees, contributions should always be at least at the minimum level to require payment of an employer contribution.
- Families with children tend to make contributions above the minimum before children arrive and/or after they have left home.



In England and Wales any outstanding student loan debt (for those entering higher education from 2012) is currently written off after 30 years. Thus, from around age 52, many graduates will have an increase in net income that can be directed towards retirement contributions.

The IFS suggests that although this approach loads contributions to later in working life, it is an effective way of building up the retirement pot. Its baseline calculations, allowing for earnings growth, are that around 80% of contributions will be made between 45 and 66, providing around three quarters of total retirement wealth.

For a more tailored contribution pattern, based on your personal circumstances, please talk to us.

Claim your tax relief for working from home

If you have been working from home during the pandemic, don't forget you could be due some tax relief.

Employees, required by their employers to work from home (WFH, as it has become known), have been able to claim tax relief long before the pandemic hit. The relief is designed to recoup the additional costs of WFH, such as paying for heating, lighting and business phone calls.

In theory a claim can be made for the actual extra outlay incurred if those costs are supported by appropriate records. In practice, the alternative of claiming a flat weekly relief amount set by HMRC is much simpler and more widely used.

Until April 2020, that flat sum was £4 a week, but since the start of the 2020/21 tax year it increased to £6 a week. If you are a basic rate taxpayer, the relief is worth £1.20 a week, with that amount doubled if you pay tax at higher rate (£2.44 in Scotland, where higher rate is 41%).

Perhaps you think such a trifling amount is hardly worth claiming, especially if homeworking is limited to a handful of weeks in the year. Before Covid-19 arrived, many took that approach and WFH relief was largely confined to 'tax nerds' territory. Unsurprisingly, the pandemic changed matters.

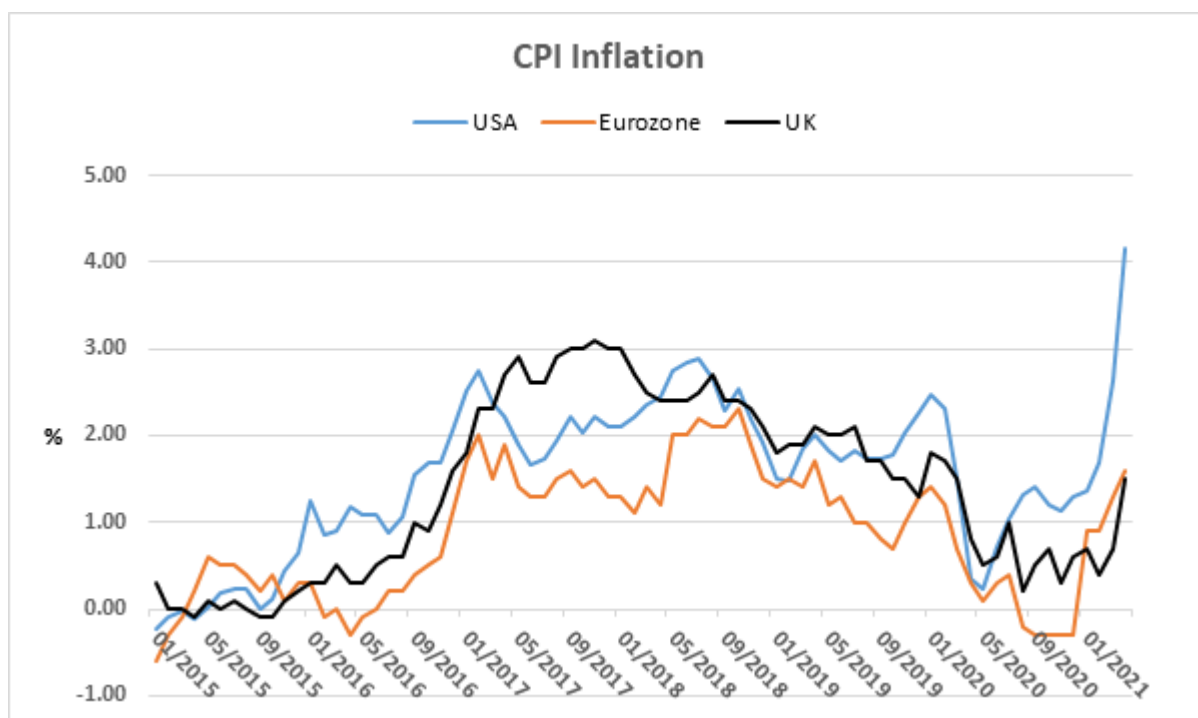
HMRC found itself facing a multitude of claims, many from employees who did not make self-assessment tax returns. In response it implemented two policies:

- In October 2020 it launched an online service (<https://www.gov.uk/tax-relief-for-employees/working-at-home>), allowing most claims for those outside the self-assessment regime to be made with a few keystrokes; and
- HMRC said that for 2020/21 it would pay a full year's tax relief (£62.40 for a basic rate taxpayer and £124.80/£127.92 for higher rate taxpayers) regardless of the number of WFH weeks in the tax year.

HMRC recently confirmed that the same process will apply for the current tax year. Last year over three million taxpayers registered a claim and so far over half a million have claimed for 2021/22. If you have not claimed for 2020/21 yet, you still can.

Is inflation creeping up?

A global jump in inflation in 2021 is raising the prospect of a broader upward trend beyond a short-term pandemic reaction.



Source: Various including fred.stlouisfed.org, www.euro-area-statistics.org and Office for National Statistics

The risk of the return of inflation has become a focus of attention in investment circles. As the graph shows, 2021 has seen a jump in the inflation rate in the US, UK and Eurozone. Inflation matters to investment markets because the standard central bank response is to raise short-term interest rates, which are currently around zero in all three areas. While an increase is inevitable from such a lowly base, the markets have not been assuming one anytime soon.

What is not clear yet is whether the 2021 rise in inflation is a temporary one in response to the vaccine-driven economic recovery or something longer term and more serious. At present there are some distortions in the annual figures which complicate matters. For example, in April 2020, the slumping oil price had driven petrol down to 109.0p a litre, whereas a year later it was 125.5p a litre – a 15.1% increase.

Across the Atlantic, where inflation shot up to 4.2% in April, used car prices climbed 10% in one month between March 2021 and April 2021. That was attributed to computer chip shortages which hit new car production and forced buyers to visit the used car lots. Distortions appear in the other direction, too. For instance, the UK hospitality industry VAT rate was cut to 5% in July 2020, although the saving was often not passed on in full (or, sometimes, at all) to the customer. The VAT rate is due to go back up to 12.5% in October and revert to 20% next April, both moves which could increase inflation.



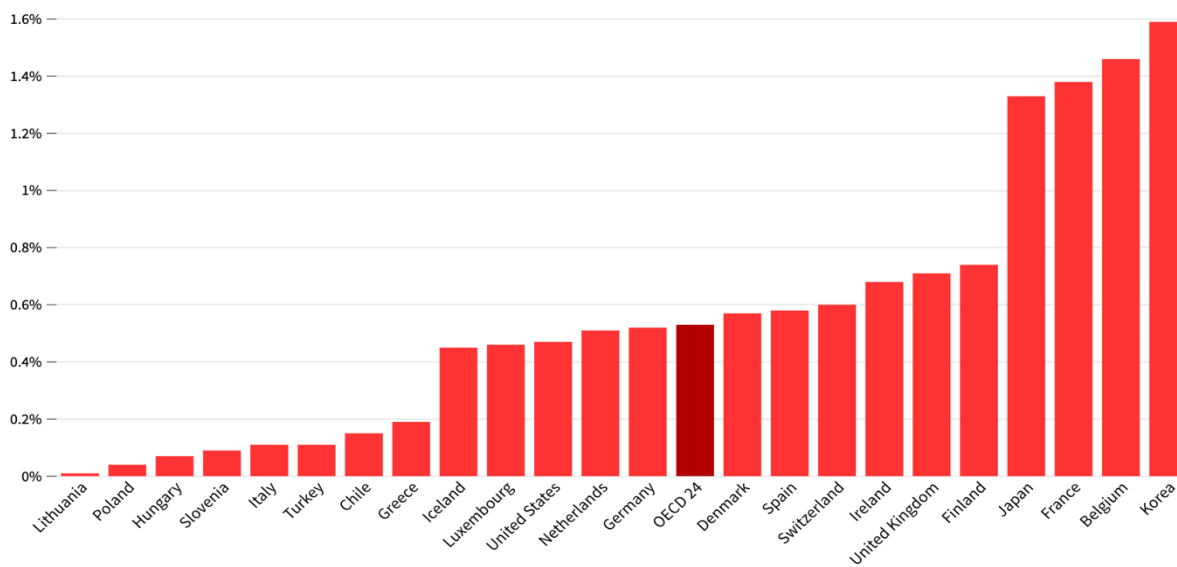
For the time being, the heads of the US, UK and Eurozone central banks are not concerned about the worsening inflation data. Their economists had forecast an increase as recovery took hold and expect that, as the bounce-back in the economy fades, so too will inflation.

Meanwhile these patterns remind us that inflation remains a risk and that any financial planning needs to take it into account. Over the last 10 years, the buying power of £1 has shrunk to 84.7p.

The OECD joins the inheritance tax debate

The Organisation for Economic Cooperation and Development (OECD) is the latest body to wade into the inheritance tax debate – on a global scale.

Inheritance, estate and gift taxes as a share of total tax revenues (%), 2019



Source: OECD May 2021

Inheritance tax (IHT) and similar gift/estate taxes raise a very small portion of overall tax revenues in the OECD countries that have them, as the graph above shows. Even in the UK, which levies that tax at above the OECD average, IHT produces less than £1 in every £100 of tax revenue. The OECD thinks this is a missed opportunity.

In a report published in May 2021, the OECD says, “Inheritance taxation can be an important instrument to address inequality, particularly in the current context of persistently high wealth inequality and new pressures on public finances linked to the Covid-19 pandemic”. The report makes a range of recommendations on how to structure inheritance taxation, including:

- It is preferable to levy tax on the recipients rather than on the donor’s estate – the opposite of the UK approach. However, the OECD did not support the idea that transfers should be taxed as income, a suggestion that has emerged from some think tanks in this country.
- Ideally, a tax based on beneficiaries should cover gifts and bequests they receive over their life, subject to a modest lifetime exemption. The OECD is no fan of regular or renewable exemptions – a feature of UK IHT – because of the scope they offer for avoidance. It accepts that the lifetime approach creates increased administrative and compliance costs.
- Exemptions or reliefs for business assets should be carefully designed and alternatives considered. The OECD questions the UK design, highlighting that “relief for business and agricultural assets predominantly benefit the wealthiest households, significantly reducing the effective tax burden on some of the largest estates”.

- Legislation should not allow planning through trusts to significantly reduce the tax burden on wealth transfers.
- There should be a consistent tax treatment of unrealised capital gains between gifted and bequeathed assets. Here the OECD echoes comments from the UK's Office for Tax Simplification (OTS) own reports on capital taxes.

Will the Chancellor pay any heed to the OECD's proposals? We await his response to the OTS reports on the future structures of inheritance tax and capital gains tax which could appear in the autumn Budget. In the meantime, if estate taxes concern you, it could be worth putting plans in place now, while the current rules exist.