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In partnership with

Pure Retirement

Utilising a Lifetime Mortgage as Part of Estate Planning and Mitigating IHT

The Challenge

Steve (79) and Susan (80) are now both retired having been employed by the NHS for most of their careers. Steve was a radiologist and Susan was a nurse and they are both in good health.

Both Steve and Susan retired at the age of 65 and now receive income from both of their NHS pension schemes, their state pensions and a rental income from a second property. They also saved independently throughout their lives and have joint pension pots worth £400,000.

In 2012, Steve received a significant inheritance, so they decided to upsize, moving into their current home. They also used part of this inheritance to purchase their second property from which they receive rental income.

Steve and Susan have one son, Barry (52), and have been having conversations with him about inheritance tax. When Steve received his inheritance, he benefitted from his parents sensibly planning to mitigate their inheritance tax liabilities and Steve wants Barry to benefit in the same way.

They both have wills which transfer their estates to each other in the event of first death, and subsequently to Barry once both Steve and Susan have died.

Steve and Susan have an annual net income of £45,000 and typically spend around £40,000 per year.

Steve and Susan's current assets are:
Their home is worth £1,200,000
£30,000 in cash *(which they want to retain as an emergency fund)*
A rental property worth £400,000
Pension pots totalling £400,000

Steve and Susan's current Inheritance Tax situation:
IHT Estate = £1,630,000 *(main residence + rental property + cash)*
Estate not liable to IHT = £400,000 *(pension pot)*
Nil rate band* = £1,000,000
Amount above IHT Threshold = £630,000

IHT liability @ 40% = £252,000

The Window of Opportunity

Based on our research, average life expectancy, current interest rates, the value of their estate and the available nil rate band we have calculated the age range (based on the assumptions used) where the inheritance tax saving will be greater than the interest they are likely to pay on a lifetime mortgage. We have named this the 'window of opportunity'.

Steve and Susan's window of opportunity (i.e. the ages they should potentially consider using a lifetime mortgage to reduce their inheritance tax liability) is:

79 – 85 if they choose to gift the money to a member of their family or put it in a trust, or 79 – 97 if they choose to use a business property relief investment to mitigate inheritance tax.*

The Lifetime Mortgage Solution:

- As Steve and Susan are both over 55, they can access a lifetime mortgage via a qualified adviser.
- By obtaining a lump sum lifetime mortgage for £631,000, this would allow them to remove their inheritance tax liability above the IHT threshold.
- With a Pure Heritage Freedom 40 lifetime mortgage, they can release up to £632,400. This lifetime mortgage allows partial repayments of up to 40% each year without incurring any early repayment changes (ERCs), helping to reduce the impact of interest rollup on the loan balance.
- As with all lifetime mortgages the loan will only need to be repaid from the sale of the property once both Steve and Susan have either died or moved into long-term care. They will also benefit from a 'no negative equity guarantee' meaning that their estate will never owe more than the property value at the point of sale.
- This money could be gifted to Barry for a period of 7 years, as providing Steve and Susan are still alive by this point then the money will become exempt from IHT under the '7-year rule'.
- By gifting these funds, the estate would reduce below the nil rate band of £1,000,000 resulting in an **IHT saving of £252,000** which would have otherwise been payable.

It is important that Steve and Susan consider the impact of asset growth over time, as this could result in the estate exceeding the nil rate band once again. Therefore, further assets may need to be withdrawn from the estate.

* Nil rate band explained = the threshold above which Inheritance Tax is payable. For further information please refer to the Gov.UK website.

* Always seek advice from a Chartered Financial Planner

* Freedom 40 has a max-age of 80. All other products cap out at age 84 or 85 upon application, excluding Emerald (95).

All figures and calculations are based on the tax rules at the time of publishing but may be subject to change.

The ages discussed during the 'window of opportunity' part is based on National ONS data.

There are other factors to consider when building a holistic financial plan, such as the future need for care, health and attitude to risk.

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