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FINANCIAL INSIGHT

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Investment strategies as you approach retirement

It's usually a good idea to start reducing the risk of your pension fund as you approach retirement. But it's important to strike the right balance so you can continue to power the growth of your portfolio for many years to come as well as draw an income.

As we move through the different stages of life it's important that our investment strategies adapt. Typically, your financial goals change when you retire. You may want a regular reliable income, which usually means you have to take less risk when it comes to investing. People nearing retirement traditionally switch savings out of risky investments and into safer assets to protect their portfolios from market downturns.

Reduce risk in your portfolio as you near retirement

Managing your portfolio's risk level (the possibility of losing the money you invest) as you get older is important to ensure you meet your financial goals. Younger investors with longer timelines to retirement (typically 30 to 40 years) are generally encouraged to take more risk in their portfolios as if there are any market falls, they have longer to recover.

As you get older and approach retirement the more important it is to preserve the wealth you have accumulated. This is

because as the timeline to retiring gets shorter, your portfolio has less time to recover in the event of a market decline.

So, it's a good idea to lower the level of risk to reduce the possibility of your investments falling in value. In most cases, this means reducing exposure to equities and increasing exposure to lower-risk investments that produce an income such as bonds to shield your investments from the ups and downs of the market.

Why it's important to diversify

Portfolio diversification is a way of reducing potential risks by spreading your investments across different assets, rather than having it concentrated in one place. By investing across different asset classes, companies, countries, and sectors, you can help reduce the impact of any major market swings on your portfolio.

While you can't eliminate all investment risk, diversification can help smooth out any fluctuations that happen over time. For instance, stocks can earn more money than other asset classes, but they tend to be more volatile. Therefore, most financial professionals agree that as you approach retirement it is best to reduce the allocation to equities in your portfolio.

Government bonds are less likely to lose money than stocks and are seen as a better bet for retirement thanks to their predictability and income-generating potential. Bond prices are also not

affected by the same market conditions that move stock prices. By shifting their investments out of stocks and into bonds, people nearing retirement can lower their risk and enjoy greater financial stability.

Finding the right balance

It's always important to review your investments before any big life changes, which is particularly true if you are approaching retirement. With any decision about your investments, there are trade-offs. The greater the risk you are prepared to tolerate, the more potential there is for your investments to grow.

While reducing risk with bonds can help shield you from any downturns in the market, your returns could be lower. As you approach retirement, it's important to strike the right balance between assets reducing risk in your portfolio so you can continue to power its growth for many years to come as well as draw an income.

A financial adviser can help you build a well-diversified portfolio appropriate for your risk tolerance and investment goals and adapt it, so the strategy always reflects your age and circumstances.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested.

Is it better to gift a property or leave it in your will?

Before passing away, Maggie gifted her house worth more than £700,000 to her son Bruce but still remained living there, paying a token amount of rent. Nine years later, following Maggie's death, Bruce was surprised to be landed with an inheritance tax bill for the property.

What did Maggie do wrong?

Maggie knew if she died within seven years of gifting Bruce her house that he may well end up paying inheritance tax on it. She also knew enough to pay Bruce rent after gifting him the property. However, the amount she paid was well below the market rate and this is where she fell foul of inheritance tax laws. By only paying a token amount of rent, the house remained part of Maggie's estate and Bruce was hit with a hefty inheritance tax bill.

How to decide whether to gift a property or leave it in your will?

There are no easy answers to this. There are a lot of complicated tax rules to consider and the best approach will depend on your individual circumstances. Whatever the situation, it's an important decision and one best made as a family. We've looked at the pros and cons of both to give you an idea of the kind of things you'll need to consider.

Leaving a property in your will

The first thing to do is find out the residence nil rate band (RNRB) allowance for the property in question. If, like Maggie, you're leaving your main home to a child or grandchild, they'll benefit from an extra £175,000 tax-free allowance on top of the standard £325,000. This means you could leave an estate worth up to £500,000 and there'll be no inheritance tax to pay. And if you and your spouse are leaving a joint estate, that doubles to £1m.

Maggie's husband Bill died in 2019 and the executors of the estate can also claim Bill's residence Nil Rate Band. This means that the £675,000 can be claimed as an amount where no inheritance tax is applied, meaning this £675,000 remains inheritance tax free.

The benefits of leaving a property in your will are that you'll retain control of it, it isn't generally at risk from anyone else's divorce, death, or bankruptcy and, currently, there's no capital gains tax to pay for the beneficiary.

Working with a professional financial planner, it would have been possible for Bill to leave 'assets to the value of the Nil Rate Band' and have what is called a 'Will Trust' written into the will. As this is a specialist area, it is important to discuss with a professional and consider the options.

Gifting a property

If, as in Maggie's case, the property is worth more than the RNRB, you may want to consider passing full ownership to a child. You then need to move out or, as Bruce found out to his cost, pay rent at the going market rate.

There are many reasons people choose to gift a property: to minimise inheritance tax; to provide financial help to loved ones sooner rather than later; or to avoid care home fees. If you're considering it for the latter reason, you should be aware that anti-avoidance rules are designed to stop people doing this.

If you gift a property, you'll lose control of it. But once the transfer of ownership takes place, so begins the seven year countdown for removing the property from inheritance tax liability.

Right sizing

Another option for improving your quality of life into old age and helping the kids out at the same time is right sizing. In other words, selling the family home and buying somewhere that is easier to manage and better suits your needs as you get older. This option generally releases equity, which can be used to give loved ones a financial boost while you're still alive. Alternatively, you could investigate a lifetime mortgage as an option for releasing money to gift away now.

Insuring against inheritance tax

Another possibility Maggie could have considered is taking out whole of life insurance. This would have provided a tax-free lump sum on death to cover Bruce's inheritance tax bill. Writing the policy into trust would have ensured any payout wasn't included as part of Maggie's estate.

However, policies can be expensive and HMRC would have treated the premiums as a lifetime gift if Maggie paid them herself. Bearing this in mind and considering Bruce would have been the person to benefit from the insurance cover, it would have made sense for him to pay the premiums if he was keen to go down this road.

Key takeaways:

- When deciding whether to gift a property or leave it in your will, you need to focus on what you're trying to achieve.
- The benefits of leaving a property in your will are that you'll retain control of it for the rest of your life, it isn't generally at risk from anyone else's divorce, death or bankruptcy and, currently, there's no capital gains tax to pay for the person who inherits it.
- Gifting a property can be used to minimise inheritance tax and allow you to provide financial support to loved ones before your death.
- Right sizing may improve your quality of life and release equity.
- It's possible to insure against inheritance tax but it can be expensive so it may be more appropriate for beneficiaries to pay the premiums.
- Professional advice can help you and your loved ones understand the various implications of the different options and allow you to make informed decisions.

The importance of professional advice

As you can see, estate planning is far from straightforward so it makes sense to work with a financial adviser who can look into different scenarios and help you and your loved ones make informed decisions.

Get in touch

If you'd like help to create a financial plan to structure your assets to be more tax-efficient before your death, we can help. Please get in touch to arrange a time to chat.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested. HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

Past performance is not a reliable indicator of future performance and should not be relied upon.

Approved by The Openwork Partnership on 19/07/23.