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Don't burden your children with unnecessary debt?

Like many people Steven and Judith believed that inheritance tax was something that was only paid by the very rich. They bought their house 30 years ago, when the area was a little "less desirable" and had worked and saved hard. They had made their Wills, were still in good health and were enjoying their newfound freedom now that the children had gone to University. Steven's death in a car crash, followed shortly by Judith's death though illness was a shock to everyone, and unfortunately the shock did not end there.

Philip and Amanda discovered that although their parents had made Wills, they hadn't reviewed them over time. The Wills sadly didn't reflect the value of their parents' estate and in particular the huge increase in property prices had pushed the value of their estate well over the Inheritance Tax threshold. So not only were the children dealing with the loss of their parents, they now also had to cope with the burden of a very large Inheritance Tax bill, which with a little planning, could have been reduced.

What is the current situation?

Inheritance Tax is charged on all estates at a rate of 0% (the 'nil-rate') up to £285,000 (currently) and thereafter at 40%. When calculating the value of your estate, you must include not only the value of your home, but also your car, your savings and shares, any personal items such as jewellery and your share of any jointly owned assets. Certainly in the South East many homeowners now comfortably exceed this limit and broadly speaking the amount by which your estate exceeds this 'nil rate band' is subject to Inheritance Tax at 40%.

Husbands, wives and Civil Partners are taxed separately and can each make tax-free transfers up to the nil rate threshold to one another via the spouse exemption. This does however miss the opportunity to make a substantial tax saving, as in effect one of the spouses' nil rate exemptions has been wasted. As such it is best to use the spouse exemption in conjunction with a well-drafted simple Will in order to maximise the savings made on Inheritance Tax.

Steven and Judith had a combined estate of £675,000. Their Wills provided that when Steven died everything passed to Judith free of tax. When Judith died she left everything to Philip and Amanda, yet Judith only had an inheritance tax free allowance of £285,000 with the rest being taxed at 40%. When calculated, the chargeable value of her estate was £390,000 (£675,000 minus the £285,000) and forty percent tax on this equates to a massive £156,000!

How can you minimise Inheritance Tax?

There are a number of ways of mitigating Inheritance Tax and with sensible advice and planning, Inheritance Tax can often be reduced to nil. The first area to consider is often your Will. Whilst assets pass tax-free between spouses, this doesn't help reduce the tax bill to your children. If you can afford it, you could consider using the nil rate band of the first spouse to die to give a tax-free sum to your children, rather than waiting until both spouses have expired - the trap that Steve and Judith fell into. As you can't be sure which spouse will die first, it's also important to split the assets as equally as possible between yourselves during your lifetime, so that you both have sufficient assets with which to fund the gift.

An alternative is to consider setting up a Discretionary Will Trust, which allows the whole family access to a fund at the discretion of trustees.

What affect has the Budget had?

If you have been considering Inheritance Tax planning recently, you will no doubt have heard about the Chancellors proposals in relation to Inheritance Tax. The proposed tax charges will affect almost all existing and new trusts. In addition, many individuals use trusts to protect assets for their children until they are able to take financial control of their own affairs – rather than primarily as tax shelters. The new changes propose that unless children receive the assets outright at the age of 18, punitive Inheritance Tax charges will apply. Would you be happy giving control of large sums of money or property to an eighteen year old?

The proposed changes seem intent on sweeping away with the flick of a hand the efforts of generations of parents and grand parents to give young beneficiaries a good start in life. Whilst the full impact of these changes will not be known until the legislation is finalised, it is clear that once the dust has settled, all trusts will need to be reviewed.

What can you do in the meantime?

In the meantime you can still act to reduce your potential Inheritance Tax liability. You can give away as much as possible whilst you are alive with most gifts or transfers made more than seven years before your death being exempt. Certain other gifts, such as wedding gifts, gifts out of excess income, gifts to charities, political parties and any number of small gifts of no more than £250 each and £3,000 given away each year are also exempt - but don't forget , whilst tax-planning is important, so is financial security in old age.

It needn't cost a fortune, but it could save one!

Whilst the future is still uncertain at present in relation to the tax situation for trusts, it is clear that sensible planning and a little foresight can still have a considerable effect on the size of your Inheritance Tax bill. An investment in some professional advice now can really pay dividends in the future. Nicola Dudley is the Head of the Private Client Department at Howell-Jones Partnership solicitors. To contact her to discuss your Inheritance Tax plans, please call 01372 860650 or email on nicola.dudley@hjplaw.co.uk