

TEN STEPS TO REDUCING INHERITANCE TAX

1 Make a Plan

Think about where you want your money to go and why many people have reservations about giving away assets too quickly - they trust their children but not always their children's marriage partners.

First, work out if inheritance tax will be an issue by adding up the value of your savings, investments, property and personal possessions. Do not forget personal equity plans (Peps) and individual savings accounts (ISAS) - though they are tax-free during your lifetime - they form part of your estate for IHT. Finally take off the value of any debts. If the total adds up to more than £650,000 for a married couple or £325,000. for an individual then IHT will apply

2 Write a Will

A Will makes your wishes concrete and clarifies who should get what. It will stop any assets being divided under the rules of intestacy, where even spouses are not guaranteed to inherit everything. It can also be the first step to reducing an inheritance tax bill.

Many married couples draft wills that pay part of their wealth into a trust on death. The surviving spouse can benefit from the legacy, but so can others such as children and grandchildren.

The aim is to give the option for both husband and wife to use their full inheritance tax allowance on death

3 Minimise your estate

You cannot be taxed on money that was never yours. So ensure that as much as possible is outside our estate. Write any new life insurance plans under trust.

Many existing life policies can be transferred into a trust. If your employer pays a death benefit complete a nomination form to make sure any money goes directly to the person you choose and not into your estate

It is also worth thinking about legacies you receive. Someone who benefit from a legacy can divert that gift to another person. You can apply for a "deed of variation" within two years of the death of the giver

4 Get married

Anything you pass on to a spouse is free of inheritance tax. The same concession applies to same-sex couples who register under civil partnership laws

However legacies between unmarried couples are not tax free - a serious problem when a couple jointly own their home. This can lead to people having to pay an IHT bill just to continue living in their home

5 Think about your home

For many families their homes are the biggest asset - and their biggest inheritance tax headache. The Government has clamped down on schemes to get round the “gifts with reservation” rules. These allowed people to give away homes but still live in them. Now, income tax can be charged for living rent-free in a home you once owned.

But there are still ways to reduce IHT. Most couples who own a home together are joint tenants. This means that if one person dies the other automatically becomes the outright owner of the property.

The alternative is to register as “tenants in common” each owning half the property absolutely. This means that on death, your share may be left to someone else to keep down the size of your estate.

6 Investments

Some investments are given favourable treatment for IHT purposes including shares in unquoted businesses, woodlands, farms and farmland. Many shares on the Alternative Investment Market (**Aim**) junior stock market also qualify for relief.

7 Explore trusts

Aside from will trusts, several others can help in estate planning. Depending on the type you choose it can still be possible to enjoy an income from money paid into trust, even though you are no longer the legal owner of that money.

Specialist advice from an adviser and a solicitor is essential for anyone considering setting up trusts.

8 Pay tax in instalments

Another option is to estimate how big an IHT bill your heirs face then arrange insurance to cover part or all of it. Whole-of-life insurance written under trust can provide a lump sum on death that is outside an estate. However, the premiums on this type of policy can prove expensive.

On death, the proceeds of the policy can be used to settle a tax bill. The premiums are treated for tax purposes as a gift from regular income. Think of this as building a fund to pay your tax. The advantage is that you retain your wealth through your lifetime and so have the funds, if for example you need to go into long-term care.

9 Spend it

Do not lose sight of whose money it is in the first place. If you are worried your wealth is simply building up a tax bill, then throw off the shackles and enjoy yourself.

10 Use annual allowance

Giving away money will reduce your estate but will not cut the tax liability immediately. You have to survive for seven years for most gifts to escape the IHT net. However within that last seven years the Revenue allows gifts of up to £3000 each tax year. Unlimited gifts up to £250 a person per tax year are exempt as are payments up to £5,000 for wedding gifts

The most powerful concession and one that is often forgotten, is that regular gifts made from normal income can be exempt from IHT. You must show you have been giving regularly and are not materially reducing your standard of living or running down savings.

This concession allows parents or grandparents to help children without fear of inheritance tax problems down the line. However, HM Revenue & Customs will demand details of these gifts when the giver dies.