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How to Plan an Estate for Multiple Generations

Inheritance Tax (IHT) is a consideration for many families, particularly as the nil rate band has been frozen for many years, while asset values have continued to rise.

But if you have worked hard to build up wealth, saving tax is unlikely to be your only goal. You also want to preserve the assets for your family, and to protect them as far as possible from bad luck and poor judgment. There is no single ideal solution, but several options can help protect wealth across generations.

Make a Will

The first step is to make your will. This means that your assets can be distributed according to your wishes, and that someone you trust will administer your estate. The rules of intestacy are unlikely to work in your family's favour, particularly if you have a large estate or complex family situation.

You should also review your will regularly. Births, marriages, deaths, and divorces can all impact your wishes, as well as the legality of your will. It's worth taking legal advice to ensure that your will is effective and complies with the law.

A will has its limitations, as you can only specify what should happen on your death. You can't influence what your beneficiaries do with the money thereafter or what happens when they die. They may overspend, invest poorly, or lose some of the money to a divorce. If you pass your estate to a spouse and they remarry, the assets could end up out of your family's hands altogether.

Setting up trusts can help to mitigate some of these risks.

Consider a Trust

You can set up a discretionary trust in your will, with your spouse, children and wider family as potential beneficiaries. This means that no one individual will own the assets, and that they will be under the care of trustees. Trust assets may be better protected from claims in the event of a beneficiary's bankruptcy or divorce, although this is not guaranteed.

There is no limit to the value of trust that you can set up, but there are tax implications for exceeding the nil rate band (£325,000 for an individual and £650,000 for a couple). The settlement is not exempt from IHT, as a transfer to a spouse would be, even if one of the beneficiaries is your spouse. Additionally, the trust may face periodic and exit charges throughout its lifetime if it is valued over the nil rate band.

You can also set up discretionary trusts during your lifetime. It's possible to move substantial sums out of your estate over the years and ring-fence the money for your beneficiaries. You can transfer £325,000 into a trust (£650,000 for a married couple) without immediate IHT implications. Gifts above this level are subject to an entry charge of 20% on the excess, as well as the periodic and exit charges mentioned above.

If you die within seven years, the gift is added back into your estate, using up your nil rate band and increasing the IHT liability on your estate. Additionally, any gifts into trust within the previous seven years are added back into the estate, potentially looking back up to 14 years. Leaving a seven-year gap between gifts and keeping the value under the nil rate band can help to minimise the tax implications.

Bare trusts are another option, but as beneficiaries can't be changed, they are more akin to outright gifts in terms of control and taxation.

Make Gifts

As well as making gifts into a trust, you can make outright gifts.

You can give away up to £3,000 per tax year per donor (£6,000 for a couple), which is immediately outside your estate for IHT purposes. Additionally, if you have genuine surplus income from employment, dividends, rental, or a pension, you can make regular gifts of any amount. Larger outright gifts may fall outside your estate if you survive seven years, subject to taper relief and the rules for potentially exempt transfers (PETs).

Of course, you will give up access and control of the money, but you can decide how, when, and to whom the money should be distributed during your lifetime. Outright gifts also avoid the complexity of trusts.

What if You Need Access to the Money?

To be effective for IHT, a gift to an individual or a trust must be irrevocable, leaving you with no access to the money.

If you need to retain access to income or capital, for you or your spouse, some specific types of trust may be suitable.

For example, a discounted gift trust is structured in two parts – a gift into trust and a pot designated to provide you with an income. This offers an immediate reduction in the value of your estate, a full exemption after seven years, and a regular income. Investment growth is also outside your estate.

Loan trusts are similar, but more flexible. Your initial investment is considered a loan, which remains inside your estate. Investment growth accumulates outside your estate. You can reduce the value of the loan (and therefore your IHT liability) by writing it off over a period of years (which is subject to the gifting rules outlined above) or by withdrawing money and spending it.

If you need to provide security for your spouse, an interest-in-possession trust could offer a solution. This allows your spouse (or any other beneficiary) to receive a lifetime income from the assets, while preserving the capital for the other beneficiaries (e.g. your children) on their death.

Usually, the more tax-efficient the option, the less flexible it is. It's a good idea to take advice if you are considering any kind of trust.

Family Investment Companies

For larger estates that have exhausted the options for trust planning, a family investment company may offer another solution.

This means a company is set up to invest in assets, for example, shares or property. Shares in the company can be allocated to family members, with their holdings gradually increased. The original owner's estate is reduced as shares are transferred, while they may retain some influence over the company depending on the share structure.

A controlling stake is worth more than a minority stake as it offers more benefits. The difference between gifting a 49% holding and a 51% holding is significantly more than 2% in terms of valuing an estate.

Unlike trading companies, investment companies do not benefit from business relief. Any IHT reduction comes from managing the allocation of the shares within the usual gifting rules. More shares can be issued, allowing other family members to join the company later.

This is a complex area, and tax advice is recommended.

Pension Funds

Pensions are designed to provide retirement benefits, but they are equally useful as an estate planning tool. There are limitations on how much you can pay in and build up, but your pension fund can complement your other estate planning strategies.

Pensions can be passed on free of income tax if you die before age 75. After age 75, beneficiaries only pay income tax (at their marginal rate) if they withdraw money. They can also pass on the fund to their own beneficiaries.

Estates can be complex, particularly when it comes to inter-generational planning. It's worth taking advice to determine the best strategy for you.

Please don't hesitate to contact a member of the team if you would like to find out more about estate planning.

Please note:
The information provided is for general guidance only and does not constitute financial or legal advice. The value of investments and the benefit of any tax reliefs depend on individual circumstances and may be subject to change. Trusts, gifts, pensions, and company structures are complex areas, and the use of such arrangements should only be undertaken after seeking regulated legal and tax advice. The Financial Conduct Authority does not regulate tax advice, estate planning, or trusts.

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