

## GUIDE

# Deed of variation

Receiving an inheritance might be welcome, but for those already concerned about the likely Inheritance Tax (IHT) liability following their death, it may simply compound their estate planning concerns. A deed of variation can ensure that an inheritance is received in the most tax-efficient way possible.

### What is a deed of variation?

It is often presumed that an individual's Will, or the "intestacy rules" which determine how assets pass in the absence of a Will, set in stone how his or her estate must be distributed. Where an individual has died within the last two years, it is in fact usually possible for the recipient of an inheritance to vary how the assets pass and to "write-back" the effect for IHT and Capital Gains Tax (CGT) purposes.

If the deceased did not have in place a sophisticated, tax-efficient Will, a deed of variation can therefore be a very useful way of reinstating some of the benefits which such a Will could have offered, by assisting the original recipient with his or her own estate planning.

### When might a deed of variation be useful?

A deed of variation should be considered whenever an individual receives an inheritance, but in particular can be useful in the following situations:

Where the recipient does not want or has no need of some or all of the inheritance

The obvious course of action might be for the recipient to then give away some or all of the inheritance. This has numerous potential disadvantages:

- It would be a gift by the original recipient for IHT purposes, and so increase the IHT liability on his/her own death if he/she did not survive the gift by seven years.
- He/she would only be able to give up to his her available IHT nil rate band (currently a maximum of £325,000) to a trust without incurring immediate IHT on the gift.
- He/she would not be able to retain any possibility of ever in the future benefiting from the assets given away if he/she did not want them to remain in his/her estate for IHT purposes.
- If the inheritance has increased in value between the date of the deceased's death and the date of the gift, a CGT liability would potentially be triggered by the gift on the increase in value.

By using a deed of variation, the original recipient can provide that the inheritance instead passes to a trust, from which he/she and anyone else he/she wishes may potentially benefit. Provided certain conditions are met, there will be no immediate IHT or CGT liabilities triggered by the gift and the inheritance will immediately be outside the original recipient's estate for IHT purposes. The trust may offer ongoing asset protection advantages, for example if the recipient wishes to benefit individuals who are not yet sufficiently financially mature to receive substantial assets outright or if a beneficiary were to suffer a divorce or other financial claims.

### Where the recipient still wants potentially to benefit from the assets, but does not want to add to his/her own estate for IHT purposes

Usually, if the original recipient of an inheritance gave away some or all of that inheritance but retained any possibility of benefiting from the gifted assets in the future, the entire value would remain in his/her estate for IHT purposes and so be subject to IHT on his/her death (as well as on the new recipient's death). This is the case even if the original recipient does not in fact benefit, for example if he/she gave the inheritance to a trust of which he/she was a potential beneficiary purely for reasons of flexibility, but the trustees never exercised their powers in his/her favour.

Where assets are given to a trust by a deed of variation and the effect is written back for IHT purposes, the donor may nonetheless continue to benefit from the gifted assets as he/she wishes, without them being included in his/her estate for IHT purposes.

### Where the deceased was not UK domiciled for IHT purposes at the time of his/her death

Had the non-UK domiciliary left his/her assets to a trust, they could remain outside the scope of UK IHT indefinitely, so that they were not subject to IHT either within the trust or on the death of any UK domiciled beneficiaries of the trust. This allows any UK domiciled beneficiaries to benefit from the trust in a highly-IHT efficient manner.





### Where the inherited assets qualified for business property relief or agricultural property relief from IHT

Such assets may pass to a trust without any IHT liability. If assets qualifying for these reliefs pass to an exempt beneficiary, such as a spouse, the relief is effectively wasted should the assets cease to qualify for relief by the time of the surviving spouse's death. Instead, it is preferable to pass the assets to a trust to "capture" the relief on the first spouse's death. In certain circumstances, it is even possible to double the availability of the relief.

### Where the recipient has a limited life expectancy

This might be the case where an unmarried partner inherits (married couples and civil partners usually benefit from spouse exemption from IHT, meaning that no IHT is due when assets pass between them), or indeed any beneficiary of a similar age to the deceased or who is in poor health. If the recipient were to die shortly after the deceased, the assets could be subject to a further IHT charge not long after the first charge. Passing the assets to a trust enables the recipient to benefit from those assets whilst sheltering them from a further IHT charge on his/her own death.

### Does a deed of variation replace the need for a sophisticated Will?

Unfortunately, a deed of variation cannot achieve everything that a sophisticated Will does.

For example the variation is not written back for income tax purposes, so if an inheritance is varied into a trust, the income of the trust may be taxed in a less favourable way than would otherwise be the case. The variation is also likely to be treated as a gift made by the original recipient for all non-tax purposes, so that, for example, they are likely to be treated as belonging to the original recipient on a means assessment for care fees purposes. Additionally, those under the age of 18 or who lack mental capacity are unable to vary any inheritances they receive, so are reliant on the deceased's Will putting in place appropriate protections for them.

Accordingly, the ideal position is to have a Will which incorporates long-term IHT and asset protection advantages. However given in particular that those likely to receive an inheritance are unlikely to wish to discuss the matter with the testator, a deed of variation can be a useful way of achieving many similar outcomes.

### Costs

Our costs to prepare an initial letter of advice on the immediate and ongoing tax implications of a varying an estate are likely to start at around £2,000 plus VAT. Our costs to prepare the deed of variation itself and advise as to its terms are likely to start at around £3,000 plus VAT, depending on the assets involved. This must be considered against the potential saving of 40% of the value of the varied assets being due in IHT on death, in the absence of a variation.

## Our Team

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