Deeds of Variation - Turning the Tax Clock Back

An Inheritance from a relative might seem like a welcome windfall but many people do not realise that the financial bonus could be adding to their already mounting tax bill.

Increasing numbers of people in their 50s and 60s are receiving substantial inheritances from their parents or other relatives thanks to the property price boom, but many people of this age are already grappling with the prospect of inheritance tax on their own assets - and the legacy they are left could see the tax bill soar.

You are perhaps most likely to receive an Inheritance when your own finances are relatively well sorted. You might therefore wish to redistribute some or all of this windfall perhaps to give the younger generation a helping hand on to the property ladder or to set aside a nest egg for the grand-children. However, you need to beware of the 7 year tax trap.

For example, a couple who are in their 60s with assets just under the combined Inheritance Tax threshold of £650,000 and generous income from occupational pensions might receive a share in a relative's estate worth £80,000. This may seem like a welcome financial security blanket but in reality could prove to be surplus to the couple's needs. What is more, the amount inherited will push the couple into the Inheritance Tax net with all assets over £650,000 being taxed at 40% on the survivor's death (a potential tax bill of £32,000).

Should the couple decide to simply pass on some of the inheritance to children or grandchildren in an attempt to get around this problem, the onward gift could continue to be counted as part of the couple's own estate for Inheritance Tax purposes for up to 7 years.

Many people don't realise that this doesn't have to be the case. With a Deed of Variation you can actually redirect inherited assets to where you want them to go and keep them completely clear of your own estate. Such a Deed will allow you to redirect some or all of the inherited assets for up to two years after the death of the original owner, you can in this way effectively rewrite the will or intestacy of the deceased for tax purposes.

Perhaps the most effective way to do this is to create flexible family trust arrangements which will allow you access to the funds you have inherited whilst keeping the surplus outside of your estate for Inheritance Tax purposes. Moreover, you can act as Trustee of such an arrangement to arrange and control the access of children and grandchildren to the funds in the most appropriate way depending on their needs and circumstances.

This fact-sheet is intended only as an initial guide based on current laws and general principles and is no substitute for specific advice based on your individual needs and circumstances.

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