Options for Varying your Inheritance

(For persons Inheriting Money or Property)

Guidance Notes

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Introduction

When a person dies, it is often automatically assumed that the beneficiaries can only receive the estate by receiving the inheritance as a 'gift'.

People making Wills (Testators) and persons benefiting from them (Beneficiaries) may not realise that there could be a 'better' way for the beneficiary to receive inheritance other than by the traditional outright 'gift'.

As a result, there often is little planning within the Will itself or little regard taken as to protecting the inheritance for the chosen beneficiary.

Likewise, people may not realise that within 2 years of the date of death, a beneficiary can 'vary' an inheritance to either benefit other person(s) directly or alternatively to establish a trust.

What sort of issues arise from inheriting as an outright gift?

- assets received as gifts are usually then subject to Inheritance Tax laws on the death of the beneficiary;
- assets received as gifts can be lost in a Bankruptcy/Insolvency of the beneficiary;
- assets received as gifts can then be 'attacked' on Divorce;
- assets received as gifts become the assets of the beneficiary and can be thus more susceptible to erosion by future Care fees;
- as such the 'inheritance' can be diluted and eroded such that future generations such as grandchildren do not ultimately inherit the full value.

Let us show this by way of a case study example:

A Mother has died some years ago. Her Will passed her estate to her husband. He has just recently died and by his Will he leaves his property and money equally between his eldest son John, his daughter Emma, his daughter Grace, and his youngest son Peter. It is effectively gifted to them by his Will. The total estate is £1,000,000. Let us assume for the purpose of this example that there is no inheritance tax payable on his death and therefore that each child therefore inherits £250,000.

Consider the beneficiaries position:

John

He is 45 years of age with two children. He is currently facing the prospect of divorce proceedings lodged by his wife. Proceedings are underway and not settled. The current value of the marriage divorce 'pot' is £500,000. With the inheritance due to him as a gift, that divorce pot increases to £750,000. His wife therefore could lay claim to (say) a 50% share on the overall divorce pot and therefore 50% of the inheritance he is receiving. He potentially loses £125,000 from the inheritance received.

Emma

She is 40, unmarried but with one child under 18. She owns her own flat but has no real savings. Her flat is worth £500,000. She is living on means tested state benefits. She is not very good in managing money. Standing now to inherit £250,000 her estate will increase to £750,000. As a result of the inheritance, she may will lose part or all her means-tested benefits. Also, the inheritance tax position for her own estate has changed such that the tax bill on the inheritance she receives could be 40% on £250,000.

Grace

She is 37 years old and is enjoying a very successful career. She already owns her own property outright and her estate is over £1m. She is not married and has no children. She has just made her own Will to say that she would pass her estate on her death to her brothers and sister. She is due to inherit £250,000 as a gift. This will mean that her taxable estate becomes £1.25m. If she dies, her brothers and sister pay an extra 40% IHT on the £250,000.

James

He is 35 years of age and is married with two children. He owns his own business, but this has not performed well, and he is facing bankruptcy. He is due to inherit £250,000. Will he actually receive this, or will it pass to his creditors under the bankruptcy? Depending on when the bankruptcy takes place, the inheritance could all be lost to his creditors.

Overall

The problems that arise from the above are for the reason that they each receive a **'gift'** of value that increases the value of their assets and as such are vulnerable to attack.

The fact is that:

- Divorce
- Bankruptcy
- Inheritance Tax
- Care Fees/Benefits

are generally all attacks on someone's **'net' assets**.

Net assets mean the net between assets vs liabilities. If a person therefore has money or property totalling £500,000 but debts or mortgage liabilities of £500,000, the 'net' estate is zero – and thus the gross assets are not subject to attack from any of the above.

So how can the inheritance be received but be protected?

In each case above, the child still does wish to receive the full use of their inheritance.

What is the possible solution?

If each child executes a 'Variation' to their inheritance received, the respective shares they inherit can be varied in such a way so as to do the following, namely

- to still provide full use of the money/assets for them;

  and to

- prevent and protect the 'net estate' of the beneficiary from increasing, so potentially protecting the inheritance from attack.

Note: The Variation itself is not in itself sufficient to achieve this. It is the use of a Discretionary Trust structure within the Deed that achieves the goals above.

The Variation re-writes the terms of the Will so that the share of the beneficiary that would have been received as a direct gift under the Will is instead passed to something called a "Discretionary Trust".

How does the Discretionary Trust work?

The Trust provides flexibility to provide the beneficiary with a lifetime **'loan'** of their share of the estate (the £250,000 above), rather than by an outright gift.

The real essence and advantage of our Trusts is the 'loan for life' of the estate to the chosen Beneficiaries in the order you prescribe rather than gifting it all outright to your first chosen Beneficiary with no protection offered due to change of personal circumstances

THEREFORE

The net estate of the beneficiary is not increased since she owes back what she receives.

Why use a Discretionary Trust format?

The Discretionary Trust format is used not only in Discretionary Trusts includes the fact that any beneficiary is just one of a list of named beneficiaries, none of whom are individually automatically entitled to receive the estate.

The reason for that structure is that if a loan is made from the Trust to a beneficiary who is automatically entitled to receive the asset as a gift, that loan might be deemed a sham transaction as the beneficiary could have no legal liability to repay the loan as he/she has the right to claim it as an outright entitlement.

Therefore, if the beneficiary is one of a class of beneficiaries and therefore not automatically entitled, it is not a sham for the beneficiary to receive a loan of the capital and therefore it should protect against the third-party claims on that basis.

If my beneficiary cannot afford to pay back the loan, what happens?

The loan from the Trust is usually only repayable out of the net estate assets on death of the beneficiary. If there are insufficient assets to repay the loan, the loan is simply unable to be repaid in full and any amount that cannot be paid from the assets of the beneficiary is written off.

Conclusion

Using a Variation structure including a Trust requires consideration for anyone who receives an outright gift in a Will. Take expert and experienced advice from us to ensure you understand all options.

Contact Us

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