Financial Planning with Trusts

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John Woolley

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14. Trusts and deeds of variation

14.1 Introduction

Despite having been threatened with removal several times, the deed of variation is still alive and kicking and remains a very useful IHT planning tool. In the first 2015 Budget, the then Coalition Government announced that they would be undertaking a review of deeds of variation to determine whether they were being used as a tax avoidance device. The subsequent conservative Government then announced that no changes will be made as a result of the review.

Under the terms of IHTA 1984, s. 142 it is possible for an individual beneficiary to redirect an inheritance received from a deceased person's estate – be it an entitlement under a will, via an intestacy or by survivorship. The impact of such a variation is that there is a deemed transfer for IHT purposes from the original now-deceased owner to the recipient beneficiary under the deed of variation. The beneficiary (or beneficiaries) making the deed of variation is (are) not treated as making a transfer for IHT purposes.

Example: Julie and David

So, for example, let's assume Julie died leaving all of her estate to her adult son David. David could, within two years of Julie's death, enter a deed of variation which redirected all or part of the bequest to his adult daughter (Julie's granddaughter) Kerry. In these circumstances, for IHT purposes the asset will be treated as passing from Julie to Kerry and will not touch David's estate at all.

Because the transfer is treated as made by Julie, had David made the redirection into a trust under which he was a beneficiary, then the gift with reservation rules would not apply – David has not made a gift for IHT purposes. Moreover, due to a specific exemption in the legislation the pre-owned asset tax (POAT) charge would also not apply.

A deed of variation is therefore an effective way of transferring an inheritance out of the estate of the person inheriting with no IHT consequences for that person. What's more, by using an appropriate trust the person doing the redirecting can continue to have control and, perhaps more importantly, access to the redirected property by being a potential beneficiary under the trust.

Deeds of variation into trusts can be used in a variety of planning ways. Before 9 October 2007 by far the most popular was as a means of retrospectively using the nil rate band of the first spouse to die yet with the surviving spouse still having access to the redirected assets (see **14.3** below). Such planning may still have its place, albeit in more limited circumstances. A deed of variation into a trust can also, however, be used in a number of other planning scenarios, as we will consider later.

Where any deed of variation might directly or indirectly affect the destination of an interest in a family residence, thought will have to be given to the impact of this on the additional main residence nil rate band which became effective from 2017-18. This will be worth £175,000 in 2020/21 (£350,000 to a survivor on the second death).

Law: IHTA 1984, s. 142

14.2 Legal formalities of a deed of variation

14.2.1 General

To be effective a deed of variation needs to satisfy a number of conditions:

- It does not need to be a deed but it needs to be in writing.
- The beneficiary executing the deed must be *sui juris* (adult and of sound mind) and absolutely entitled – either alone or with others – to the asset being redirected;
- If a person has an income entitlement under a trust created by the deceased that he wishes to transfer, it may be preferable to transfer that interest by way of a disclaimer.
- The main difference between a variation and a disclaimer is that, in the case of a variation, the beneficiary redirects the dispositions as he chooses, i.e. names the new beneficiary or decides on the trust provisions. In the case of a disclaimer, the original beneficiary normally has no choice as to the new beneficiary and the disclaimer simply means that the particular legacy which is disclaimed would

fall into the residue of the estate and be subject to the will provisions in respect of the residue. Additionally, whereas a variation can be made in respect of part of a gift, a disclaimer can only be made in respect of the whole interest and then only if the beneficiary has not in any way benefited from the gift;

- The deed of variation (DoV) has to be finalised and signed by all relevant parties (see below) within two years of the death of the deceased. It used to be the case that HMRC had to be informed within six months of the creation of the DoV. That requirement has now been replaced by the need to include a statement in the instrument that the DoV is intended to be effective for tax purposes;
- There is only a need to send the variation to HMRC if there is a change in the IHT payable on the estate or the variation affects the IHT or valuation requirements of another estate.
- The statement referred to above could make reference to inheritance tax (IHT) or capital gains tax (CGT), or both. HMRC have helpfully included the following suggested wording on their website:

  > "The parties to this variation intend that the provisions of section 142(1) Inheritance Tax Act 1984 and section 62(6) Taxation of Chargeable Gains Act 1992 shall apply".

- Including this, or a similar, statement, in the DoV will mean that, for the purposes of IHT (and/or CGT), a fiction will be created to the effect that the will of the deceased (or, where applicable, the rules of intestacy) was changed to reflect the provisions of the DoV. In other words, the DoV is rather like a codicil that is written by the affected beneficiaries after the death of the deceased, but takes effect as if it had already been included in the will of the deceased;
- Where the CGT statement is included, the variation will not constitute a disposal by the outgoing beneficiary for CGT purposes. Instead, the new beneficiary will be deemed to acquire the asset at the value at the date of death. For all other CGT purposes, however, the person making the

variation is treated as the donor (or settlor if the property is redirected to a trust);

- There is no equivalent statement for the purposes of income tax. This is because a DoV can have no impact on income tax liabilities. One consequence of this is that, if the DoV creates a settlement, the settlor(s) for the purposes of income tax will be regarded as the beneficiary or beneficiaries who have created the DoV (see *Marshall v Kerr*);
- The DoV must be signed by all of the beneficiaries who have a reduced or lost entitlement as a result of the DoV. In addition, in the unusual circumstances of the DoV resulting in an increased IHT liability, the personal representatives of the estate also have to sign;
- No consideration must be given in return for receiving a benefit under a deed of variation (IHTA 1984, s. 142(3)). Otherwise any IHT benefits will be neutralised.
- A variation may be made to a charity – perhaps with a view to ensuring that 10% of the net estate is left to charity and thereby secure an IHT rate of 36% on the rest of the estate. To secure this benefit, for all deaths after 6 April 2012, the variation will only be treated as being made by the deceased under s. 142(1) if it is shown that the charity has been notified of the variation. This provision has presumably been included to ensure that charities actually know of their entitlement under the revised provisions of the will – a deed of variation not being a public document.

Provided the above conditions are satisfied, the provisions of the DoV will be treated for IHT purposes as having been made by the deceased. In practice, the way a deed of variation is drafted is to set out new clauses that replace the relevant clauses of a will.

Law: IHTA 1984, s. 142(1), (3); TCGA 1992, s. 62(6)
Case: *Marshall v Kerr* [1994] BTC 258

14.2.2 Joint tenancy interests and variations

Property that a deceased person owns on a joint tenancy passes automatically to the survivor(s) – outside of the terms of the deceased's will. This raises the question of whether it is possible to vary the destination of such property using a deed of variation.

HMRC have confirmed that it is possible to effect a deed of variation in respect of an asset which was jointly owned (ie. on a joint tenancy basis, not on a tenancy in common basis) by the deceased with another person and therefore passed automatically to the survivor (*Inland Revenue Tax Bulletin*, October 1995). This is because the legislation (IHTA 1984, s. 142) refers to assets passing by "will, intestacy or *otherwise*". This is so notwithstanding the fact that it is not possible to sever a joint tenancy in a will (although it is possible by a simple declaration to sever such a tenancy during lifetime).

In the past, this provision has been useful where no advantage has been taken of the nil rate band and part of the estate was comprised of assets jointly held with a surviving spouse/civil partner. The surviving spouse/civil partner could vary his inheritance by redirecting one half of such previously jointly owned assets, say, to the children. This is no longer as important following the introduction of the transferable nil rate band on death from 9 October 2007 (see **14.4** below).

Law: IHTA 1984, s. 142

14.2.3 Double death variations

Although it is not possible to make more than one variation in respect of the same assets, it is possible to effect a deed of variation in respect of the wills of both a deceased husband and deceased wife (or civil partner), provided it is done within two years of the first death (i.e. the surviving spouse having also died within that period). This is sometimes referred to as a "double death variation". The executors of both spouses would normally be party to the deed as well as the beneficiaries although, strictly speaking, the executors of the first spouse are only required to join in if there is more inheritance tax to pay.

Historically, this type of variation would have been appropriate where the first spouse to die did not utilise his or her full nil rate band on death yet left assets to the surviving spouse, with assets then passing to children on the second death. The variation could then have given a legacy to the children on the first death to use the first to die's nil rate band, with the balance passing to the survivor.