

Deeds of Variation

Introduction

This information sheet sets out for general guidance the main features of Deeds of Variation and their tax implications. There is also some brief commentary about Disclaimers by beneficiaries. A number of important and technical points arise. Specific advice should be obtained before action is taken in any particular case.

What is a Deed of Variation?

The term Deed of Variation (which has replaced the expression Deed of Family Arrangement) is normally used to refer to post-death variations or rearrangements of Wills, intestacies and certain other dispositions taking effect on death.

A beneficiary who is entitled to part of a deceased person's estate under a Will or intestacy or in other ways (for example, property held in a joint tenancy passes by survivorship) may change the way the inherited assets are owned by means of a Deed of Variation.

The popular notion that it is possible to vary the Will itself (or the law of intestacy or the doctrine of survivorship) is a misconception since the Will itself cannot be varied after the testator has died. It is, however, possible for an original beneficiary to sign a Deed of Variation in order to make some sort of gift and to redirect all or part of an inheritance. By means of a statutory fiction, HM Revenue & Customs will, if required, treat the gift as having been made by the deceased person and not by the original beneficiary for all Inheritance Tax purposes and some Capital Gains Tax purposes but not in any other respect.

There are many reasons why beneficiaries may wish to vary or redirect assets held in a

deceased person's estate. Some of the main reasons are:

- 1 to save Inheritance Tax;
- 2 to provide for someone who has been omitted from the Will or who has not been given adequate financial provision in the Will;
- 3 to alter gifts under a Will, for example to enlarge a life interest into an outright or absolute interest;
- 4 to redirect the deceased's share of a jointly owned asset which would otherwise pass to the surviving joint tenant (further details about jointly owned assets are to be found in the information sheet Jointly Owned Property: Joint Tenants or Tenants in Common?);
- 5 to resolve any uncertainty or defect in the Will.

It is not always possible to vary the dispositions effected by a Will or otherwise. A Deed of Variation requires the consent of all beneficiaries who are interested in the asset which is to be redirected. Problems are likely to arise if some beneficiaries are under 18, or any greater age specified in a Will.

What is a Disclaimer?

A Disclaimer is a refusal to accept an inheritance under a Will or intestacy. To be valid, a Disclaimer must be made before acceptance of any income or other benefit from the deceased person's estate.

The law relating to Disclaimers is technical and obscure, and it is normally preferable to have a Deed of Variation instead. When a Disclaimer is effected, the inheritance passes according to fixed rules of law. It is

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not possible to disclaim in favour of a particular person. Hence, if a specific gift is disclaimed, it will fall into the residue of the estate. If it is the residue itself which is disclaimed, it will pass under the law relating to intestacy. An inheritance can also be disclaimed on intestacy. A Disclaimer is, therefore, an all or nothing matter. It is not generally possible to retain part of a gift, and disclaim the rest.

Disclaimers are not considered further in this information sheet.

Main Tax Requirements

If a Deed of Variation is to take retrospective effect for the purposes of Inheritance Tax and/or Capital Gains Tax, certain conditions must be satisfied. The main conditions are:

- 1 the deed must be completed within two years after the death;
- 2 the appropriate tax statements must be contained in the deed;
- 3 the Deed of Variation must be genuine and not a sham;
- 4 no extraneous payment should be made to induce a beneficiary to sign a Deed of Variation, but an exchange of inheritances by beneficiaries is acceptable;
- 5 it is not possible to carry out more than one variation in relation to the same asset, but several variations in relation to different parts of an estate are permissible;
- 6 a Deed of Variation can be effected even if the administration of the estate has been completed and assets have been distributed, and it is also possible to sign

a Deed of Variation before a grant of representation has been obtained.

Main Tax Implications

1 Inheritance Tax (IHT)

The main effect of a qualifying Deed of Variation is that the alterations made by it are treated for all IHT purposes as having been effected by the deceased person and not by the original beneficiary. Thus, if an asset is directed away from the deceased's spouse*, more IHT may be payable, but if it is given to the spouse or to a charity, the IHT bill may be reduced. The IHT anti-avoidance provisions relating to gifts with reservation of benefit do not generally apply if the original beneficiary retains an interest in the redirected asset.

2 Capital Gains Tax (CGT)

A variation made for CGT purposes does not constitute a disposal by the original beneficiary. Furthermore, those who take assets under the Deed of Variation will acquire them as legatee at probate value (i.e. the market value at the date of death) for future CGT purposes.

It is possible for a variation to be made for IHT but not CGT purposes, and vice versa.

3 Income Tax

A Deed of Variation is not generally retrospective to the date of death for Income Tax purposes and is only effective from the date of signature.

However, there can be some retrospective effect for Income Tax purposes if the Deed of Variation relates to the residue of an estate which is still in the course of administration. By way of illustration, if a testator dies on 1 June 2009 and his widow

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signs a Deed of Variation on 1 December 2009 redirecting the whole of the residuary estate to her adult son, no part of the residuary income will be assessed on the widow unless the executors have previously paid a sum to her in respect of her original entitlement.

Since a Deed of Variation will not be treated as a disposition by the deceased person for Income Tax, a beneficiary who sets up a trust by means of such a deed will be treated as the "settlor" for the purposes of that tax. This has two important implications:

- a if the person making the variation (or their spouse) is an actual or potential beneficiary of the trust, all trust income will normally be taxed as their income during their lifetime (whether or not it is distributed);
- b even if neither the settlor nor their spouse is a beneficiary under the trust, if the variation is in favour of the settlor's children, any income arising from the trust assets will be taxed in the settlor's hands if the children receive distributions of income (or of capital to the extent, if any, that income has been accumulated) while they are unmarried and under the age of 18.

Conclusion

A Deed of Variation can present a major tax planning opportunity. It should be considered in virtually all cases. For example, a beneficiary may wish to set up a Discretionary Trust from which he or she can be eligible to benefit but which should escape IHT on the beneficiary's death.

Disclaimer

This information sheet is written as a general guide. As any course of action must depend on your individual circumstances, you are strongly recommended to obtain specific professional advice before you proceed. We do not accept any responsibility for action which may be taken as a result of having read this information sheet.

If you require further information, please contact Stuart Goodbody or Mark Politz on 01892 510000 or by email at:

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* All references to the term 'spouse' include a civil partner as defined by Section 1 of the Civil Partnership Act 2004

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