

VARYING WILLS AND INTESTACIES and DISCLAIMING GIFTS

The term "Deed of Variation" is normally used to refer to post-death variations or re-arrangements of Wills, intestacies and certain other dispositions taking effect on death.

A beneficiary who is entitled to any part of a deceased person's estate under a Will or intestacy or in other ways (for example, assets held in a joint tenancy passing by survivorship) may vary or rearrange the disposition of that property by means of a Deed of Variation.

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, the Revenue will, then treat the gift as having been made by the deceased person and not by the original beneficiary for inheritance tax purposes and/or for most capital gains tax purposes (but not for any other purpose).

It is not always possible to vary the dispositions effected by a Will. A Deed of Variation normally requires the consent of all beneficiaries who are interested in the property which is to be redirected. Problems will arise if some beneficiaries are children.

Why vary?

Some of the main reasons are:

- To save inheritance tax.
- To provide for someone who has been omitted from the Will or who has not been given adequate financial provision in the Will.
- To alter the interests under a Will; for example, to enlarge a life interest into an outright absolute interest provided that all the necessary beneficiaries agree.
- To redirect an asset held in a joint tenancy which would otherwise pass to the surviving joint tenant. (Assets held in a joint tenancy pass automatically to the surviving owner. By contrast, assets held in a tenancy in common pass under the Will or intestacy).
- To resolve any uncertainty or defect in the Will.

What is a Disclaimer?

A disclaimer is a refusal to accept property under a Will or intestacy. To be valid, a disclaimer must be made before accepting any income or other benefit from the property.

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 property passes according to fixed rules of law. It is not possible to disclaim in favour of a particular person. Hence, if a specific bequest is disclaimed the property falls into the residue under the Will; if it is the residue itself which is disclaimed, the property will pass under the law relating to intestacy. Property can also be disclaimed on intestacy. A disclaimer is, therefore, an all or nothing event; it is not generally possible to retain part and disclaim the rest of a single gift.

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:

- The Deed must be completed within two years after the death
- The appropriate tax statements must be contained in the Deed
- The Deed of Variation must be genuine and not a sham.
- No "extraneous" payment may pass between beneficiaries to induce them to sign the Deed of Variation. An exchange of inheritances by beneficiaries is, however, permissible.

It is not possible to have more than one Deed of Variation in relation to the same item of property. It is, however, possible to have more than one Deed of Variation in relation to the same Will or intestacy.

A Deed of Variation can be effected even if the administration of the estate has been completed and the property has been distributed. It is also possible to effect a Deed of Variation before a grant of representation has been obtained.

Main tax implications

Inheritance Tax ("IHT")

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

Capital gains tax ("CGT")

The alterations made by a Deed of Variation do not constitute a disposal for CGT purposes and are deemed to have been made by the deceased person for most but not for all CGT purposes. As for IHT, the variation must be made within the two-year period, but it is possible that it may be made for IHT purposes but not for CGT purposes, and vice versa.

A Variation stated to be made for CGT purposes does not constitute a disposal and there is no occasion of charge to CGT. Furthermore, any person who takes assets under the Deed of Variation will acquire those assets as "legatee" with the benefit of the personal representatives' acquisition cost (ie usually the market value at the date of death).

There was some uncertainty as to the identity of the settlor of a settlement created by a Deed of Variation; is it the deceased person or is it the original beneficiary making the Deed of Variation? In the case of *Marshall v Kerr* the House of Lords held that, if the variation creates a settlement, then it is the original beneficiary who redirects the property under the Deed of Variation (as opposed to the deceased) who will be

treated for CGT purposes as the settlor of the settlement created by the Deed of Variation. This will be relevant if, for example, the original beneficiary who creates a new settlement and/or their spouse has an interest in the settled assets. In that situation, the making of the variation will not be a disposal for CGT purposes and the assets will pass to the trustees of the settlement at probate value. However, the normal CGT settlement provisions will then apply so that any gains arising on a subsequent disposal of assets in the settlement will be regarded as the gains of the settlor who redirected the property (and not as the gains of the trustees). The settlor has a right to recover from the trustees any CGT which he has paid.

Income Tax

Notwithstanding that for IHT and CGT purposes a Deed of Variation may be retrospective to the date of death, it is not retrospective to the date of death for income tax purposes and is only effective from the date of its execution.

However, an element of retrospection for income tax purposes has been introduced by the back door because new rules were introduced for payments made on or after 6 April 1995 in preparation for self-assessment for personal representatives and beneficiaries of estates. The practical effect of these rules is that Deeds of Variation can now have 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 when the variation is made. The retrospective effect is simply the effect of the rules, including statutory provisions for successive interests in residue. If, for instance, payments had been made to the original beneficiary before the execution of the Deed of Variation, the Revenue would not accept that the Deed retrospectively changed any income tax liabilities based on such payments.

Under self-assessment a beneficiary with an absolute interest in residue is liable to income tax on payments made to him or her during the administration period in respect of his or her absolute interest. Any such payments are treated as income for the year of payment. It should, however, be noted that any such payments will only be treated as income to the extent that they do not exceed the aggregated income entitlement of the beneficiary at the time the payment is made. The aggregated income entitlement is the cumulative share of the estate income, for all years up to and including the year of payment, to which the beneficiary is entitled whether or not that share has actually been paid out. In other words, the beneficiary is liable to tax on his or her cumulative share of the estate income or on the amounts actually paid to him or her, whichever is less.

By way of illustration, if a testator dies on 1 June 2002 and if his widow signs a Deed of Variation on 1 December 2002 redirecting the whole of the residuary estate to her adult son, no part of the income will be assessed on the widow unless the executors have previously paid any sum to her in respect of her absolute interest.

A Deed of Variation will not be treated as a disposition by the deceased person for the purposes of income tax. The income tax legislation contains a wide definition of "settlement" and related expressions, and a person who makes an arrangement by means of a Deed of Variation may be making a "settlement" and may be treated as the "settlor" for income tax purposes. This has two important implications:

(a) If the person making the variation or their spouse has a beneficial interest under the settlement (eg as a potential beneficiary under a discretionary trust created by the Deed of Variation), they will be treated as the settlor for income tax purposes with

the result that all the trust income will normally be subject to income tax as their income during their lifetime.

(b) Even if neither the settlor nor their spouse is a beneficiary under the settlement if the variation is in favour of the settlor's children, any income arising from the assets varied in favour of the children 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 eighteen.

Conclusion

A Deed of Variation can present a major tax planning opportunity. It should be considered in virtually all cases. For example, a surviving spouse may wish to redirect part of his or her inheritance to the children in order to take advantage of the nil rate band of IHT for the estate. Alternatively, a beneficiary may be able to set up a discretionary trust arrangement from which he or she can be eligible to benefit but which should escape IHT on his or her eventual death. Other taxes need to be considered.