TECHNICAL ADVICE

FROM THE IPW TECHNICAL PANEL

Post – Death Variations

Virtually every client we come across has the incontrovertible expectation that what they put in their Will, will actually happen: those beneficiaries named will receive their exact inheritances without question.

Generally of course, that is exactly what happens – the testator's instructions are carried out exactly by the personal representatives of the estate.

However, occasionally those well intentioned gifts to beneficiaries are not wanted or needed, and sometimes inheriting from the deceased can cause more problems than inheriting the gift is worth.

Take for example, the following (over simplistic scenario): Testator T leaves £100,000 to beneficiary B. B has a Will leaving their entire estate to their children C and D.

B already has £325,000 in their estate, so when B inherits that £100,000 on T's death, their estate is now £425,000. The impact of this is when B dies, their children now inherit less due to an inheritance tax liability, the estate being £425,000.

B could simply accept the inheritance, and gift the £100,000 to the children. In their mind they have eliminated a potential IHT liability. However, all B has done is created a potentially exempt transfer (PET) and has to survive seven years before that gift is not read back into his estate for IHT purposes.

So, what can be done?

Disclaimers

B could 'disclaim' the gift. At law, the refusal to accept a gift is treated as if the beneficiary had predeceased the testator. So, in effect the gift lapses and falls back into the residuary estate.

Interestingly, if B was the testator's child, then a refusal to accept the gift by B would invoke section 33 of the Wills Act, which states (my words) if a child of the testator has predeceased then any issue of that child take the gift of their deceased parent.

So, under those circumstances, the £100,000 passes directly to the children of B from the estate of the deceased;

The practical steps someone disclaiming a gift needs to take are merely to refuse to accept the gift, but it is better to write to the personal representatives disclaiming the gift, usually in the form of a deed.

However, what if B was not the child of the testator, T, but wanted to disclaim the gift due to personal tax reasons and preferred the gift to pass to their spouse? Disclaiming the gift would be of no help since it would fall into residue to be distributed to whoever the residuary beneficiaries are.

Instruments of Revocation

Here, the distribution of the £100,000 can be re-directed to whoever the beneficiary chooses. Critically, any redistribution is read back into the Will as if they were the testator's original instructions.

The legislation relating to instruments of variation is covered by the Inheritance Tax Act 1984, section 142

There are a number of key criteria for an IoV to be effective. They are:

Time – limited

Any variation must be applied for within two years of the death of the testator. Whilst fixed at law under the IHT Act, Courts have nevertheless accepted applications considerably over the two year period.

However, acceptance of a late application to vary has always due to specific case-related reasons – for example, a beneficiary not being made aware they are due to inherit and the administration of the estate taking significantly longer than 2 years.

All those affected must agree

Most importantly, all beneficiaries who would be affected by the redirection of the estate must agree to the proposed instrument of variation. However, if one or more of the affected beneficiaries does not have the requisite mental capacity or are not of full age to agree to the variation, then it will fail. However…..

Capacity

The person who wishes to redirect their gift must have capacity. Importantly therefore, a child cannot choose to create an instrument of variation to redirect their gift and neither can someone who is deemed to lack the requisite mental capacity.

All is not lost, however. Their representative could apply to Court for a variation under the Variation of Trusts Act 1958 The Court has power to enter into a variation on their behalf but it must be in the best interests of the applicant.

However, the limiting factor is where an inheritance is being held in trust on behalf of a beneficiary. Not so difficult where an inheritance is held on trust for a minor, but not so if the adult incapacitated beneficiary inherits absolutely (i.e. not gifted in trust).

Where the variation creates a tax consequence

Where the variation might create an unforeseen tax consequence, then the personal representatives must also be party to the agreement to vary.

An example might be where a surviving spouse wishes to create an instrument of variation and redirect her inheritance to the children, to avoid an IHT liability on her subsequent death. If that gift to the children now from the deceased spouse creates an IHT liability then the personal representatives need to agree to the variation.

Reserved or not reserved activity?

Another question often asked is whether writing a deed of variation is a reserved activity. In other words, a document which can only be drafted by those regulated by statute (or more commonly known…solicitors).

Note this article references an instrument of variation. IHTA 1984 section 142 refers to an instrument, although this document is often referred to as a deed of variation. According to the Legal Services Act 2007, whether an instrument (or deed) can be written by a non-solicitor is a little ambiguous.

There are arguments on both sides of the point, and to the author's knowledge this has never been tested at Court to determine whether or not it is or isn't reserved activity.

In any case, there are two barriers to prevent (unregulated) Will writers from providing IoV services. Firstly, practically, most do not have specific competency training on this subject, and as we know IPW members cannot advise clients on issues for which we cannot demonstrate competency through appropriate CPD sign-off.

The second reason is that it follows that professional indemnity insurance would not be available to cover any loss as a result of advice pertaining to an instrument of variation.

Generally

Whilst there are time limitations described above, an application to vary can be undertaken whether or not probate has been granted.

One question often asked is if an instrument of variation, and for that matter a disclaim, is a deliberate deprivation of assets should that person subsequently enter long term care.

It hinges of course on whether the reason for the variation / disclaim was significantly to avoid care. And of course it was the significant reason then a Local Authority can consider it an act of deliberate deprivation with all the consequences that flow from that.

Nevertheless, where, for example there is a surviving spouse who was due to inherit a solely owned house absolutely, they could vary the deceased's Will such that not only could the house be gifted to the children, but more usefully, the variation could 'insert' a life interest trust for the survivor.

Clearly, care must be taken on any unforeseen tax consequences. That same house, being varied into a discretionary trust could result in relevant property taxation and worse an inheritance tax liability if over the nil rate band. So, sometimes there are trade-offs.

Another issue is that there have always been murmurings that the legislation allowing for instruments of variation may be renounced. Many practitioners – and it has to be said non-IPW members! – are less than thorough in the advice and documentation provided to clients. Some rely on the strategy that any problems can be sorted by using an instrument of variation when the testator has died. Clearly, a pretty negligent strategy and one which might fail if the supporting legislation is ever renounced, however unlikely that might actually be.

Summary

A good instruction form should include a prompt to ask whether the client is widowed, and if so whether the death has occurred in the preceding two years. It's often unclear what this question on the IPW instruction form is driving at.

In essence this prompt now allows us to consider whether the distribution of their spouses' estate was tax-efficient or whether it was in the client or indeed the other beneficiaries interests.

If so, a working knowledge of instruments of variation and disclaimers is quite useful to more fully advise the client.

By Paul Tansley

Reviewing Trust arrangements

I'm sure that everyone will be familiar with the requirement to **register** most lifetime Trusts, within 90 days, and most Will Trusts, normally after 2 years of its creation. Trustees must also manage and update Trust information going forward.

It is also very important for Trusts to be **reviewed**.

This has always been the case as failing to do so can lead to negative consequences, including the unnecessary payment of **tax**. Although it is the Trustees' responsibility to manage the Trust correctly, in accordance with the powers granted to them by the Trust Deed, the original advisor has a duty of care to provide them with sufficient information so that they can carry out their duties effectively.

Rather than considering a Trust review process in isolation, any estate planning business should consider reviewing a client's overall plans at regular intervals. Within this article I consider the reviewing of Lifetime Discretionary Trusts, whilst noting that all Trusts should be reviewed.

Changes that necessitate a review can be classified in the following manner:

- A change to the client's personal or family circumstances
- A change to the client's financial situation
- A change to legislation or evolution of case law
- Tax changes
- Changes to the clients attitudes

Personal and family circumstances

A change to a client personal or family circumstances is likely to impact on the personell involved across the Last Will and Testament, Lasting Power of Attorney (Or EPA), **and** any Lifetime Trusts.

Trustees

Careful consideration needs to be given whenever professional trustees are appointed, and questions should be asked:

- Is the professional Trustee able to carry out their duties?
- Are they named personally or is the appointment as a Trust Corporation for example?
- What are the cost implications for the client?
- Are their suitable family members that could be appointed?
- Are all appointed Trustees still able, willing and capable of acting and do they have the capacity to do so?

Any changes to Trustees are likely to require a new Deed – a Deed of retirement and/or a Deed of Appointment (DORA).

Beneficiaries

A comprehensive check of beneficiary details is appropriate. An updated list of beneficiary addresses should be maintained but the Trust Deed itself does not need updating if beneficiaries move.

In the case of a **discretionary** Trust, it is likely that the range of beneficiaries is set fairly wide. All beneficiaries are, in effect, *potential* beneficiaries only. Removing beneficiaries may not, therefore, be necessary. A revised **letter of wishes** would normally suffice. However, if client wishes to remove the beneficiary this can be achieved through the drafting of a **Deed of Amendment**.

Sometimes, additional beneficiaries will be included because they are included within a 'class' of beneficiaries defined in the Trust Deed. For example, if the Settlor has additional grandchildren they want included and the Trust Deed included remoter issue, there is no need for a change. However, if beneficiaries do need to be added this is normally by **Deed of Amendment**.

The client's financial situation

Trust Assets

A ledger of Trust Assets should be maintained and updated.

Many Trusts hold the Settlors share of their main property only.

It is important to check that the Settlor still lives in the property that is in the Trust. If the Settlor has moved house check that any replacement property has been purchased by the Trustees of the Trust. If this is not the case remedial action will be required to correct the matter. If the Trust contains a property that is **not** the Settlors *principle private residence,* Capital Gains Tax may be payable. The Trust will also only benefit from half of the normal CGT annual exempt amount. Care should be taken and independent Tax advice sought, where appropriate.

The Land Registry title should be checked to insure that property has been correctly transferred into the ownership of the Trustees.

If additional assets are held in Trust – for example Capital Investment Bonds – check that this is still appropriate and take steps if the Settlor wishes to have any assets transferred back to them.

Conversely, check whether the Settlor wants to add any further assets into the Trust.

Changes to legislation and case law and Tax

Taxation

It is very important to check that current Trust planning does not put the Settlor in a more negative tax position than would otherwise be the case. Failing to check and advice accordingly poses an existential threat to an estate planning business.

Residential Nil Rate Band

Understanding the clients overall financial situation is required when assessing whether the current Trust provisions are appropriate. Trust assets should not be viewed in isolation to the wider financial situation when providing advice and checking previous steps taken.

If your client's estate value, at death, is in excess of the Nil Rate Band (NRB) and the Residential Nil Rate Band (RNRB) is otherwise available to him/her, the client's property must **not** be held in a Discretionary Trust, other than a Vulnerable Beneficiaries Trust. This will mean the RNRB is not available, and more Inheritance Tax will be paid. This is because the property will not be 'closely inherited' under the RNRB legislation. Therefor

Appropriate action is likely to include amending the current Trust Deed resulting in a **Hybrid/Mixed** Trust, part Discretionary, part non- Discretionary Trust. This allows the right values to be held in the right Trust environments, so that the required RNRB can be applied.

Periodic charges

A Discretionary Trust is taxed as a **relevant property Trust.** One aspect of this involves anniversary tax charges, otherwise knows as Periodic charges. The Trust becomes liable to pay tax every 10 years, at the rate of 6% on assets over the Nil Rate Band.

As the Nil Rate Band hasn't increased since 2009 at the same time as house prices have continued to rise exponentially, more Trusts will be subject to more Tax, if action isn't taken before the 10th anniversary date. This indicates the importance to carefully value Trust assets periodically. Failing to do so could lead to considerable loss to the client, and risk to the estate planner.

As above in relation to preserving the RNRB, it is normally possible to amend a Trust so that only value up to the Ni Rate Band is held in the Discretionary Trust part of a Hybrid/Mixed Trust.

Income and Capital Gains Tax

Care should be taken to ensure that Trust assets do not create negative Income and CGT implications. Therefore, independent advice ought to be sought if assets other than the Settlors principle private residence is held in the Trust.

Changes to your client's attitudes

A review represents an opportunity to restate the potential benefits and limitations of Trust planning. It also enables you to ensure that current plans align with the client's own expectations, aims and objectives. Documenting your discussions, specifically in relation to **all** of the potential benefits of Trust planning, aside from any care cost protection aspects may be useful later when replying to a Local Authority, for example.

Summary

A structured, well thought through review meeting will help you and your clients reassess matters. It will enable you to provide peace of mind, or to help you advice, if changes are necessary. It will also help you tidy up your file and protect your business going forward. Additional business opportunities will also be identified.

Whether you decide to review Trusts annually or less frequently and whether you decide to do all this in house or by outsourcing, will be business decisions. The key is that the work of reviewing arrangements is done in a timely manner and in a competent and professional manner.

By Peter Burton