WHEN A DEED OF VARIATION DOES NOT VARY

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It is well known that for inheritance tax and capital gains tax purposes it is possible to enter into a written variation of the dispositions of the property comprised in the estate of a decedent immediately before his death and to elect that the relevant provisions, whatever they may be,[1] of the IHT and CGT legislation shall apply as though the variation had been effected by the deceased.

But what of a variation which in reality is not a variation at all but of which the sole purpose and only substantial effect is, if it is successful, to reduce or avoid a liability to taxation? Can it be said, as a matter of ordinary English, that the dispositions have been "varied" at all? Alternatively, could the rule in *Furniss v Dawson*, or some analogous common law rule, apply to deprive the taxpayer of the expected fiscal benefit?

The problem arises acutely in a case of the following type: A dies leaving all his property to B. B dies a year or so afterwards leaving all his property to C. While quick succession relief from IHT may provide some relief, it will not be the complete answer, especially where the estate of A has increased in value between A's death and B's death. Advice might therefore be given that the dispositions of the property comprised in A's estate immediately before his death should be varied by substituting C for B as his legatee. In principle, if an election is made this should avoid IHT on the value of A's estate on B's death without increasing the IHT on A's death.[2]

Now as a matter of general law such a variation would achieve nothing. It cannot prejudice B's creditors. If C is B's residuary legatee it similarly cannot prejudice any of the other of B's legatees. True, there will be some differences. After the variation, B's personal representatives will have no right to demand that on completion of the administration of A's estate the residue be handed over to them to be retained by them until the completion of the administration of B's estate. No doubt, if one looked long enough one could find other minor differences. Still, the fact remains that they are very minor and highly theoretical in the circumstances envisaged. A court determined to do down the taxpayer could easily dismiss them as *de minimis*.

Could *Furniss v Dawson* apply? The Revenue might argue that the deed of variation is an inserted step which has no purpose or effect other than tax avoidance. The

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[1] For a dispute in the case of capital gains tax, see *Marshall v Kerr*, which is the subject of a separate article in Volume 2, 1991/92, Issue 2, *The Offshore Tax Planning Review*.

[2] Of course, if the gift from A to B qualified for some sort of exemption or relief, as if, for example, B were the wife of A, then the strategy might not be viable.

taxpayer might reply that the deed of variation is not an inserted step because it is the only step. It is itself a single transaction. The rejoinder of the Revenue might be that alongside the "inserted step" principle of *Furniss v Dawson* there is the circular series of transactions rule in *Ramsay v IRC*. In effect, here you have a "circle" of one transaction which has no real purpose or substantial effect beyond tax avoidance. If one can ignore a self-cancelling series of transactions then one can equally ignore a single transaction which is, fiscal considerations apart, a nullity. The Revenue might argue that the rules in *Furniss v Dawson* and *Ramsay* are simply sub-divisions of a more general rule that a transaction which has no purpose or effect beyond tax avoidance is to be ignored for fiscal purposes.

It seems to me that the answer to the Revenue is that we are dealing with the special case of an express statutory fiction, the deliberate purpose of which is to enable the taxpayer to avoid tax in designated circumstances. The legislature realised that we cannot all be constantly updating our wills and that a person's testamentary dispositions may, shortly after his death, seem entirely inappropriate. Death is unfortunate at the best of times, especially if it brings with it a tax bill. It is not unreasonable to give the legatee an opportunity to rearrange the affairs of the deceased and to pretend that the deacsed had done it himself.

While this is my view, the contrary is not unarguable. It might be said that the provisions were intended to apply only to real variations and not to paper variations.

What is the attitude of the courts likely to be? Some years ago, I appeared in an application under the Variation of Trusts Act 1958 before Walton J. The facts were a variant of the basic theme mentioned above. One complication was that C was several persons including minors and the variation therefore had to be approved by the Court under the Act. One of the questions which arose was whether the variation was for the benefit of the minors. Walton J said that it was as plain as a pikestaff that it was.

While this decision is of some comfort to taxpayers, one should not rely on it too much. Firstly, the Revenue was not represented and no argument was addressed as to the possible fiscal inefficacy of the variation. Secondly, Walton J often found the answers to difficult questions as plain as a pikestaff. Unfortunately, as he himself was apparently well aware, men of his clarity of vision are rare and the judiciary is by and large stocked with lesser men who do not always see things the way Walton J saw them. Some of these men might well constitute a majority in the Court of Appeal. Moreover, there is a wide-spread opinion at the Bar that there is a real problem in such a case. One of the barristers who entertains that view today could be the judge who decides such a case tomorrow.

What, if anything, can be done? The answer is that the variation should be a real variation. C, for example, could direct that under the variation the relevant property passes to his or her spouse or children. If C is not feeling particularly generous, he could settle his inheritance upon interest in possession trusts for himself, with powers of appointment and remainders over. The trustees could be given power to terminate the trust by paying capital to him. Naturally, the exercise of this power would be in no way predestined. It would simply be one option which would be open to the trustees. In deciding whether to exercise the power and, if so, when, they would no doubt take into account that too premature an exercise might simply result in an extended *Furniss v Dawson* attack by the Revenue on the fiscal efficacy of the deed of variation.