Variations of trust

Marcus Flavin gives a refresher course on how to successfully apply for court approval of a variation of trust

The purpose of this article is to give an overview of the procedure for applications to the court for approval of a variation of trust under the Variations of Trust Act 1958. Such applications used to be common but come to court far less frequently now, and practitioners are less likely to be familiar with the procedure than they once were.

Taxation considerations

It can be desirable to vary a trust, or an estate, for a variety of reasons but the principal one is taxation considerations, either because the taxation consequences may have been ill thought out at the outset or because intervening events have changed the picture. Section 142(1) of the Inheritance Tax Act 1984 (IHTA) provides that:

Where within the period of two years after a person's death

a. any of the dispositions (whether effected by will, under the law relating to intestacy or otherwise) of the property comprised in his estate immediately before his death are varied, or

b. the benefit conferred by any of those dispositions is disclaimed, by an instrument in writing made by the persons or any of the persons who benefit or would benefit under the dispositions,

this Act shall apply as if the variation had been effected by the deceased or, as the case may be, the disclaimed benefit had never been conferred.

Section 62(6) of the Taxation of Chargeable Gains Act 1992 is expressed in similar terms. Use of those sections allows for the tax position to be improved, if possible, after the event, so long as there is strict compliance with the provisions.

In making any variation intended to have beneficial consequences in the tax sphere, the time limits (which must be kept firmly in mind, particularly if there is to be an application to court) and other requirements of those sections must be kept firmly in mind, including in particular the need to make an explicit election that one or other or both of those sections should apply. It is worth noting, in passing, that in some cases it may be worth taking advantage of the inheritance tax provisions but not the capital gains tax provisions (or vice versa): it should not be automatically assumed that if electing to apply one section the other is also desirable or necessary.

Variation of a trust out of court

Where all the possible beneficiaries are of full age and capacity then they can make the necessary instrument of variation without any need for an application to court: all that is required is a deed to which they are all party and compliance with the provisions of the relevant sections of the taxing acts. It is long established, under what is loosely known as the rule in *Saunders* v *Vautier* and related principles, that when all the possible beneficiaries of a trust together call on the trustees to bring the trust to an end the trustees must oblige, and similarly that the beneficiaries can together direct the trustees to hold on terms different from those of the original settlement or will or that arise by statute. Similarly, it seems to be generally accepted that where a group of beneficiaries are together absolutely entitled to some defined percentage of the fund, then those beneficiaries can call for that percentage to be divided among them or held on other trusts even if those entitled to the remaining shares do not agree, at least where the fund consists entirely of cash or other completely liquid assets.

While there is no binding English authority on this point, *Crowe* v *Appleby (Inspector of Taxes)* [1975] 1 WLR 1539 affd CA [1976] 1 WLR 885 tends to support the proposition, and there is authority directly on the point from Australia *(Trustees of the Estate Mortgage Fighting Fund Trust v Commissioner of Taxation* [2000] FCA 981). In any event it is a logical conclusion of the basic principle: for so long as a partial variation only affects the interests of those calling for it, the remaining beneficiaries have nothing to complain of and those who have called for it cannot complain. This can be of some assistance where some beneficiaries wish to bring such a trust to an end but others are holding out and/or some are minors and the expenses of a court application are too high to justify an application in the fund in question.

Seeking court assistance

It is only when those affected by the proposed variation cannot themselves consent that the assistance of the court must, and indeed can, be sought.

In *Chapman* v *Chapman* [1954] AC 429 the House of Lords held that there was no inherent jurisdiction in the court to approve a variation of a trust on behalf of a person under a legal disability. In consequence Parliament enacted the Variation of Trusts Act 1958, Section 1(1) of which gives the court jurisdiction to approve a variation on behalf of:

a. any person having, directly or indirectly, an interest, whether vested or contingent, under the trusts who by reason of infancy or other incapacity is incapable of assenting, or

b. any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the application to the court, or

c. any person unborn, or

d. any person in respect of any discretionary interest of his under protective trusts where the interest of the principal beneficiary has not failed or determined

Any arrangement (by whomsoever proposed, and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or

revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts:

> *Provided that except by virtue of paragraph (d) of this sub-section the court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person.*

It does not, of course, give the court jurisdiction to approve a variation on behalf of those who could consent themselves but have not. If a person of full age and capacity whose interest is affected by the proposed variation refuses to consent then that is the end of the matter, unless the proposals can be tinkered with so that their interest remains unaffected. Similarly careful regard must be had to the rather difficult wording of paragraph (b) to ensure that any individual falling within the rider is covered.

It can be important to remember that, from the point of view of trusts law, it is the beneficiaries who are party to the instrument who are effectively resettling the fund. The deeming provisions of the IHTA and TCGA, which allow the fund to be treated for the purposes of those taxes as though it had always been held on the varied terms, are statutory fictions that apply only for the provisions of those statutes.

A few further points need to be considered before moving to look at the details of the procedure. First, the jurisdiction extends to variation of the statutory trusts arising on intestacy under Sections 46 and 47 of the Administration of Trusts Act 1925 (see e.g. *S* v *T* [2006] WTLR 1461). Even where there is a will, when dealing with variation of trusts of an estate it is important to follow through all the possible contingencies to check whether there is a possibility of a partial intestacy and therefore of either ensuring that the interests of those who would take on that contingency are unaffected or obtaining their consent.

Secondly, there may need to be a double variation, i.e. of the dispositions of two different estates, for instance where the residuary beneficiary of an estate himself died intestate shortly after the first deceased.

Thirdly, the court's function is quite limited. The function of the court is purely and solely to grant (or refuse) consent to a variation on behalf of those whose interests are affected and who fall within one of the sections of the Act, primarily minors and the unborn or unascertainable, and its jurisdiction to grant consent depends solely on it finding that the variation proposed is in the best interests of the person on whose behalf it is granting consent, not that it is a particularly good idea, or that it is or is not to the benefit of competent adults who have agreed, or that a different way of approaching the matter could be even better. As Norris J put it in *Wright* v *Gater* at para. 11: *"What I am doing is not redistributing property according to some wise scheme of which I approve. The Court of Chancery never claimed a power to direct a settlement of the property of a minor, and the 1958 Act did not alter this."*

Finally, what is of benefit to the person on whose behalf the court is giving consent may well not be limited simply to tax consequences. Benefit is far wider than that, and can extend to preventing a minor becoming absolutely entitled to the whole of substantial assets on their 18th birthday. The courts recognise the risk of dissipation and that the receipt of substantial assets at an early age can impede the development of character. Thus in *Wright* v *Gater*, where under the original dispositions on a double intestacy an infant would have received some £750,000 on his 18th birthday, under the variation vesting of much (but not all) of the capital was deferred until he was 25, even though that meant the tax position was not improved as much as it might otherwise have been (because the trust fell into the 'relevant property regime' of IHTA 1984). Nevertheless, it is difficult to conceive of a court giving consent without consideration of the fiscal implications, nor is it the case that deferment of the vesting date to a later date than the beneficiary's 18th birthday will inevitably be seen as beneficial: in each case, where such a point arises, it will be necessary to establish that on the facts to the court's satisfaction.

Mental capacity issues

Save for cases involving mental capacity issues, the application to court will in practice invariably be to the Chancery Division – it is difficult to envisage a situation where the exercise would be worthwhile if it falls within the equity jurisdiction of the county court. Where mental capacity is in issue, so that the person whose interests are affected is a patient under the Court of Protection, the situation is slightly different. Subsection 1(3) provides that "the question whether the carrying out of any arrangement would be for the benefit of a person falling within paragraph (a) of the said sub-section (1) who lacks capacity (within the meaning of the Mental Capacity Act 2005) to give his assent is to be determined by the Court of Protection." In such a case, therefore, there needs to be an application to the Court of Protection pursuant to that court's rules to determine the question of whether the variation is to the patient's benefit first (brought on a Form COP1: see Part 9 of the Court of Protection Rules and COP Practice Direction 9A, with evidence directed to the question of benefit), and then an application to the Chancery Division for approval (see Re CL [1969] 1 Ch 587). The application to the Chancery Division falls under Part 64 of the CPR and must be brought by Part 8 claim form and witness statement. There are further directions in the Chancery Guide at paras 25-11 to 25-14 and 6-27 and these should be read with care.

Litigation friends

Ideally where there is a minor on whose behalf consent is sought they, through a litigation friend, should be the claimant, but it can also be the executors or trustees. Where the parents of a minor themselves have an interest in the proposed variation it is preferable if they do not act as litigation friend as well, due to the clear conflict of interest. The executors or trustees should be parties in any event. Where there are unborn or unascertained beneficiaries to be considered, the executors and trustees can, if they have no other interest, represent their interest, but if they are themselves beneficiaries, or parents of minor beneficiaries, then some other person will have to be found to represent their interests. If necessary, the directions of the court on this aspect can be sought at a preliminary hearing. Each person, or group of people with the same interest, should ideally have their own representation. While the court can and will if necessary deal with an application where only one interest is represented, it will almost always be inappropriate to proceed on that basis, not least because of the practical importance of having different points of view properly put before the court.

The witness evidence should put before the court the instrument sought to be varied, the proposed variation, and should set out in full all who are or may be interested in the fund. In many cases a family tree will need to be provided, making clear the position if a partial intestacy were to arise. The assessment of whether or not the variation

is in the interests of the person or class concerned may also require expert evidence on, for example, life expectancy and actuarial matters, for instance where the interest of a class is subject to that of a life tenant so that the value of that interest depends on how long the life tenant may live. Similarly there may be a need to give evidence on how the trustees might expect to exercise any discretionary powers, since that too can have a bearing on the practical value of the interest of a class of remaindermen, though in practice a variation application is unlikely to involve a fully discretionary trust: the trustees' discretionary powers will usually be sufficient, whereas convincing the court that the interests of all members of a wide discretionary class are improved may well be extremely difficult.

In addition, there should be evidence from the litigation friends of the minors or unborns, or the trustees, stating that they support the proposed variation as being in the interests of the relevant parties.

Counsel

As the provisions in the Chancery Guide make clear, in the vast majority of cases it is also essential to provide a written opinion of counsel appearing for each person or group of people on whose behalf consent is sought; setting out the consequences (with particular regard to fiscal consequences) of the proposed variation is also essential. The Master or judge can dispense with this requirement but unless there is very good reason or the case is utterly straightforward it is unlikely they will. The opinion should set out the formal instructions, if any, on which it was made or, if there are none, state in full the basis on which it is given. If the written opinion was given on formal instructions, those instructions must be exhibited. Otherwise, the opinion must state fully the basis on which it was given. One opinion for each group of minors or unborns with the same or a very similar interest will usually suffice and there is no need for an opinion on behalf of those falling within the proviso to Section 1(1) of the Act (discretionary interests under protective trusts). What the opinion needs to show is what will happen if the variation is not made, and how the variation will be to the benefit of the party concerned.

While it is not unheard of for very straightforward applications for a variation to be dealt with on paper, it is rare and the court will usually expect to hear counsel. It is common for counsel from the same set of chambers to be instructed to represent the various interests, and it may be acceptable for the same firm of solicitors to represent all parties, but care should be given to ensuring that all possible conflicts of interest are properly covered.

Timescale

It is vital to keep an eye on the calendar if the time periods under s.142 of IHTA 1984/s.62(6) of TCGA 1992 are in issue. If necessary, contact should be made with the court asking for expedition, and all parties should file their evidence and acknowledgments of service as quickly as possible. Judges will usually wish to assist as far as they can, and may be prepared to hear claims out of usual hours or fit the hearing in to their day somehow to ensure that the time limit is not missed.

The hearing

Once the claim is ready for hearing, the Chancery Guide directs that a hearing before the judge may be listed for hearing in the General List without any direction by a Master on the lodgment in Room WG4 of a certificate signed by advocates for all the parties, stating: (i) that the evidence is complete and has been filed; (ii) that the application is ready for hearing; and (iii) the estimated length of the hearing. The Guide indicates that skeletons are not essential if full opinions have been filed, but in practice it is sensible to file skeletons on behalf of the applicant summarising the position, particularly if the variation proposed is a complex one.

It is important to recognise that not all applications are approved: even if the court does find that the proposed variation is to the beneficiary's benefit, which of course it may not, it still has a discretion. But in practice a claim that has reached the stage of a hearing with an opinion in its favour from experienced chancery counsel is probably far more likely to succeed than not. If the court does have concerns it is likely to raise them and indicate how some amendments to the drafting would satisfy them. The key to success lies in careful preparation, consideration of as wide a variety of possible approaches as is possible, and a detailed opinion for submission to the court.

Marcus Flavin is a barrister at Radcliffe Chambers, Lincoln's Inn