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A Welsh rectification

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Vaughan-Jones and Another v Vaughan-Jones and Another [2015] EWHC 1086 (Ch)

It is possible for the beneficiaries of a will to agree to vary its terms by Deed. If the relevant Deed is completed within two years of death and includes the declarations required by the Finance Act 2002 (which amended section 142 of the Inheritance Tax Act 1983 and section 62 of the Taxation of Chargeable Gains Act 1992), the variation will be effective for the purposes of Inheritance Tax and Capital Gains Tax. Frequently, a variation of this sort can be used to channel assets to a spouse (thereby avoiding Inheritance Tax due to the spouse exemption) rather than to other heirs in relation to whom Inheritance Tax would be chargeable.

Such a situation arose in relation to the estate of Richard Vaughan-Jones, who died on 18 October 2007. His will divided his residuary estate equally between his wife and three sons. Most of his assets (in an estate worth £2.5 million) benefitted from either business or agricultural property relief, however the effect of the will as drafted was to give rise to a tax liability of c.£230,000 in relation to the share of the estate slated to pass to the three sons.

Mr Vaughan-Jones' family plainly did not find this tax exposure palatable, and shortly before the two-year deadline they instructed a solicitor, Gareth Evans, to effect a variation to the will which would have the effect of passing the entire residuary estate to Mr Vaughan-Jones' wife, Barbara, and thereby avoiding Inheritance Tax. Mr Evans' attendance note of a meeting of 6 October 2009 recorded that the goal was to pay as little Inheritance Tax as possible at this stage, but for Barbara to gift assets to the three children and to survive for the seven years required to take these transfers out of the Inheritance Tax net.

The Deed of Variation was prepared by Mr Evans and completed on 13 October 2009, within the required two-year period. The Deed however did not however include the declarations required by the Finance Act 2002. This was picked up by HMRC in correspondence with Mr Evans in May 2013, in which they asserted that the Deed of Variation did not have the required declarations and therefore would not have the effect of varying the will for the purposes of Inheritance Tax. Shortly afterwards Mr Evans died, probably as a result of suicide following being charged with an unrelated crime of forgery.

As a result, proceedings were issued- Vaughan-Jones and Another v Vaughan-Jones and Another [2015] EWHC 1086 (Ch)- for rectification of the Deed of Variation to insert the relevant statutory declarations. HMRC was not represented at the hearing, but did make representations that the Deed of Variation should not be rectified and that, even if it were, the Deed would not be effective for Inheritance Tax purposes because it was supported by consideration contrary to section 142(3) of the Inheritance Tax Act 1984- the consideration, as recorded in Mr Evans attendance note of 6 October 2009, being the transfer of the residuary estate to Barbara in its entirety in return for a promise on her part to gift assets back to the three children. Such gifts did in fact take place.

The Court reviewed the circumstances in which rectification can be ordered, being where (1) the document to be rectified does not give effect to the true agreement between the parties and (2) there is an issue capable of being contested between the parties. It was decided that the circumstances were "only just" sufficient to allow the Court to rectify the Deed of Variation, which it duly did.

No decision has been reached in relation to the consideration argument. HMRC have asserted that they will not treat the rectified Deed as having the desired Inheritance Tax effect, and that issue will likely be decided by the First-Tier Tribunal in due course.