

Trusts set up by a deed of variation

Synopsis: The tax and Trust Registration Service (TRS) implications where a trust is set up by a deed of variation. If a trust is created by a deed of variation, what is the date of the trust and who is the settlor of this trust?

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A deed of variation

A deed of variation is an instrument in writing. It is a document in writing which is basically executed by someone who has inherited property, whether under a will or intestacy, and, rather than accepting the inheritance, they want to redirect it to somebody else. This is done by a deed of variation, which has a special place in tax legislation.

Although this is sometimes called a variation of a will, it is important to remember that it is not a variation of a will as such, because some provisions of a will cannot be altered. It has to be a variation of disposition of the property. So, for example, an individual cannot vary the executors or certain other administration provisions included in a will.

As mentioned, a deed of variation is a variation of the disposition of property.

For example, Nicole has inherited assets and she would rather pass them to her children or grandchildren or into a trust. Nicole executes a deed which basically will say that instead of her receiving the funds, they are going into a certain trust, and Nicole is perfectly entitled to then set out the terms of the trust.

It is important to remember that this needs to be done by the person who has inherited, or anybody else who is affected by the deed of variation. And, such a person must be over 18 and of sound mind. So, for example, if the legacy was to a discretionary trust, where it is not known exactly who are the beneficiaries, because potentially there are future beneficiaries not yet born, then it will not be possible to make such a variation.

The variation must take place within two years of the death of the person who has died. It applies to the estate of whoever died, whether with or without a valid will, so that intestacy applies, and must not be done for consideration.

Effectively, the redirection of the property is read back into the will as if the deceased included it in their will. This is, in effect, a deeming provision, or a legal fiction, because they are not physically changing the will. What happens is that the original beneficiary executes this document which says what should happen. And then there is a deeming provision which says that the disposition is treated as if made by the deceased. This is in section 142, Inheritance Tax Act, 1984.

However, what is important to remember is that even though a trust is read into the will, effectively, it is actually made in a deed of variation. And, legally, the person

who is setting up a trust is the person who is making the variation, the person who inherited the assets to start with and is redirecting those assets to somebody else. The inheritance tax provision is a deeming provision. It is a legal fiction. What actually happens is that the original beneficiary or beneficiaries execute a deed of variation.

There is no need generally to include executors or administrators in the deed of variation, unless the amount of tax that is payable on death is increased.

The date of the trust

For the purpose of the TRS, the date the trust is set up is actually the date of the deed of variation, even though the provisions are read into the will. So, then the question is, who is the settlor of this trust?

The settlor of the trust

As mentioned above, for inheritance tax purposes, the settlor is treated as being the deceased. This has obvious inheritance tax implications, because, if the deceased is treated as the settlor for inheritance tax, it means that the person making the variation can, for example, be included as a beneficiary of the trust without there being a gift with reservation for inheritance tax. So, this all works very well for inheritance tax planning.

However, for general purposes, the question of who the settlor is has to go back to the actual deed of variation, the person making the deed. So, it is the person who actually executes the deed that is the settlor for other tax purposes or for general purposes.

There are definitions of settlor for inheritance tax, capital gains tax and income tax purposes. And, at the moment, they are pretty much similar. For inheritance tax, there is Section 44, Inheritance Tax Act, which says that it is any person by whom settlement was made directly or indirectly, and in particular any person who has provided funds directly or indirectly.

For income tax and capital gains tax, there is a uniform definition, which refers to a person who has provided or undertaken to provide property directly or indirectly to the settlement. So, again, looking at an actual situation, the person who has inherited funds is taking this position, they are redirecting it to somebody else. They are the person who is providing funds. So, they will be the settlor.

For capital gains tax purposes, generally speaking, provided an appropriate statement is in the deed of variation, the variation itself will not be a disposal for capital gains tax purposes. However, for the purpose of future capital gains tax liabilities, the usual provisions will apply and the settlor is the person making variation.

For income tax purposes, it is always the person who is making the variation that is the settlement settlor. That may have implications for subsequent income tax assessment on any income or chargeable event gains.

Looking at the registration of a trust on HMRC's TRS, unfortunately, who the settlor is has not been clarified in the TRS manual. However, HMRC has expressed a view on this and, basically, for the purpose of the TRS, the settlor is any person receiving less under the deed of variation than they would have received under the will. So, if it is just one person making a redirection of the legacy, it is going to be that person. If it is more than one, it will be more of them.

However, if the variation is into a trust that has been set up under the will of the deceased already, then the settlor of the trust will be also the deceased. So, in effect, there will be more than one settlor. There will be the settlor, the deceased, because that individual settled the original trust and there will be the settlor for other purposes, the person making the variation. So, both of them will have to be named as the settlor.

Equally, if the redirection is into a trust created by the deceased prior to their death, like a pilot trust, for example, then, again, the settlor for the purposes of the TRS will be both the person making the variation and the deceased.

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