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Introduction

As Autumn approaches and the summer sun fades the longer evenings give us chance to take stock.

In this brochure we have selected a number of topical issues and reminders of opportunities to plan for the times ahead.

The Martineau team are receiving more and more enquiries from families and individuals wanting help in protecting their wealth in turbulent and uncertain times.

We have advised clients for over one hundred years and are always happy to talk through how best to protect your family and ensure you benefit them in a tax efficient manner.

> *"the ability to explain complex issues in plain language"*

LEGAL 500, 2010

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Safe storage of your Will. Minor detail or vital final stage of its preparation?

A sound Will is a must for every client but what if the document cannot be found? The cleverest Will full of tax planning opportunities and carefully carrying out the Testator's wishes is of no use if it cannot be found when the Testator dies.

Here, perhaps, are further reasons why it is important to have a Will prepared by a Solicitor. Martineau undertake the safe storage of any Wills they prepare and, unlike some banks and other firms, make no charge for this service even though, hopefully, there will be many years between the preparation of the Will and its coming into effect. Martineau also keep an electronic copy of the Will which is available for quick reference should a client need to refer to their Will as a matter of urgency and, should the unthinkable happen, and some natural disaster destroy the original documents there is a legal presumption that a Will stored with a Solicitor remains valid and the file and electronic copy can be used to reconstruct the original.

That the most august of us are not exempt from the loss of our Wills can be illustrated by the 1876 case of Sugden -v- Lord St. Leonards which also throws an interesting light on Victorian domesticity.

Lord St. Leonards would while away the long winter evenings by getting his daughter to read his voluminous Will to him. When he died the Will could not be found and usually in such circumstances it would have been considered to have been revoked. Exceptionally, however, the Court felt that a man like Lord St. Leonards would never have died without leaving a Will and by happy coincidence his daughter was able to step forward and explain that she could remember the contents of the long and complex document. Upon this the Court ordered that the Will as reconstructed from her memory should be admitted to Probate.

While not wishing to cast any aspersions on the memory or impartiality of Miss Sugden it is perhaps best not to have one's Will contained merely in the memory of a relative, and Clients would always be well advised to have a professionally prepared Will (drawn by Martineau of course) and to have this lodged in safe custody.

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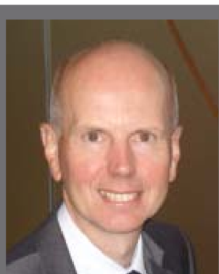

Too much income? What a relief...

Most people are aware of some of the exemptions and reliefs that can be used during lifetime to mitigate one's inheritance tax (IHT) position, such as spouse exemption, annual, small gifts allowance, charitable gifts exemption, for example.

However, there is one very useful exemption which, if applicable, can result in significant savings of IHT. This is the normal expenditure out of income exemption.

How Does it Work?

If a person makes an outright gift to an individual during their lifetime, no IHT is payable when the gift is made. However, the value of the gift is included in the value of the donor's estate if they die within 7 years of making the gift.

It may be possible for gifts to qualify as normal expenditure out of income and, if so, the gifts may be entirely free of IHT if three conditions are met.

Condition one

The gifts must form part of the donor's usual expenditure.

The donor must be able to show a pattern of giving. So, for example, a one-off gift every few years is unlikely to qualify but an annual or monthly gift should.

Condition two

The gifts must be made out of income.

Often there is a question over what constitutes "income" for the purposes of the exemption. Unfortunately, the position is not always straightforward.

It may be possible to include accumulated income in assessing one's income even though this may have been transferred to a deposit account. This is so providing the accumulated income has not been invested.

The capital element of an annuity payment is not income for these purposes even though part of the annuity payment may be subject to income tax.

Are 5% annual capital withdrawals from an investment bond income for the purposes of the exemption? The answer to this question is not free from doubt. Any claims that include the withdrawals as income are likely to come under scrutiny from HMRC. It is expected that in the future there will be a test case which will clarify the position. Until then, care needs to be taken and professional advice sought as to the merits of including such withdrawals as income in a claim.

Condition three

The donor was left with sufficient income to maintain his or her usual standard of living.

It is essential that the donor does not have to resort to capital to meet his living expenses and maintain his usual standard of living. It is the donor's standard of living that is considered, not the standard of living of the ordinary or reasonable man.

If all three conditions are satisfied it is likely that the gifts will qualify as normal expenditure out of income and therefore be entirely free of IHT on the donor's death.

Interaction with life policies

The exemption is often useful in relation to the payment of premiums on life policies.

Example 1: A takes out a life policy on 6 April 2004 and pays a one off lump-sum premium of £84,000.
A is the life assured but the policy is written in trust for the benefit of someone else. A dies on 1 April 2011.

A did not survive the gift by the required 7 years and therefore £84,000 is included in the value A's Estate for IHT purposes.

There is a potential IHT liability of £33,600 (£84,000 x40%).

Example 2: The facts are as in Example 1 but A pays premiums of £1,000 per month (£12,000 per annum).

A dies and his Executors claim that the premiums were paid from A's excess income. HMRC apply the normal expenditure out of income exemption.

A has paid £84,000 in premiums in the 7 years prior to his death. The IHT liability is £0.

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Beware!

Record keeping

Detailed and accurate records must be kept showing income, expenditure and the gifts made each year. If records are not kept, it will be for your Executors to try to assemble this information following your death. Not only is this time consuming and a difficult task, it may lead to inaccuracies and possibly an unecessary IHT liability.

Associated operations

Do you pay the premiums on a life policy of which you are the life assured but which is written in trust for another and have an annuity? If the answer is yes you should seek professional advice now as to whether the payment of the premiums might qualify for the exemption. HMRC may argue, in such circumstances, that a life policy linked with an annuity is an "associated operation". If this argument is successful the premiums may not benefit from the exemption and may be treated as chargeable gifts for IHT purposes.

We can advise you of the information you will need to assemble to show that the arrangement was not an associated operation. It is much easier for you to do this now than for your Executors to try to assemble this information on your death.

DIY probateers beware!

The number of people applying for probate personally has increased significantly over the last few years. In 2010, just under 36% of applications to the Court were made in person, as opposed to a solicitors application.

More and more people are willing to 'have a go' at dealing with an estate in an effort to save on legal costs and in the current economic climate who could blame them. However, many 'Do It Yourself' Probateers do not appreciate the potential risks and pitfalls involved.

Personal liability

A Personal Representative (PR) can face personal liability where an estate is subject to Inheritance Tax (IHT). HMRC take a tough stance against PR's mis-reporting or under-reporting estate assets. A penalty regime for IHT was introduced in April 2009 and inaccuracies, even innocent ones in the Estate Return can attract severe financial penalties.

PR's have a legal duty to produce a full inventory and account of the estate when required to do so by the Court. With more complex estates and without the benefit of specialist software many PR's may not have the necessary skills to meet this duty.

Time

Few PR's appreciate how time consuming and involved the estate administration process can be. PR's who run their own business, have a career or have family commitments, may simply not be in a position to give matters the time and attention that they need to.

Remember that unless a Will provides express provision for a PR to charge for their time then they can only claim for their expenses.

Do you know...

Applications for grants by solicitors are processed more quickly, taking an average of seven days from receipt of a complete set of papers, whereas for personal applicants it takes around one month.

Specialist knowledge

If an estate contains foreign assets, or complicated or specialist assets (such as a family business or the right to pursue a potential claim) or where there is potential for it to be insolvent, then the PR may quickly find themselves out of their depth.

A PR's lack of expertise may mean opportunities for mitigating tax by use of tax reliefs and deductions are simply lost.

The emotional impact

Losing a loved one is a difficult time. Death in itself is distressing and, unfortunately, the administrative procedures which must be followed can be an additional unwelcome burden.

Disputes

The growing trend of PR's applying for probate personally has inevitably led to an increased risk of tax fraud and incorrect distribution of assets. Legal disputes over inheritances are on the increase and contentious probate is a real growth area. Such disputes can be costly and so DIY probates may well be a false economy.

Will Trusts

Historically, nil rate band discretionary will trusts were used to mitigate the IHT position for married couples. Since the introduction of the transferable nil rate band in 2007, the need for such trusts has been diluted somewhat. Many PR's ignore the trust provisions in the will, failing to appreciate that action does need to be taken but only after weighing up the pros and cons of whether it is appropriate to retain the trust.

The decision to undertake the probate process personally should not be taken lightly. Never underestimate the benefit of taking clear, sound advice from the professionals.

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Beware cohabitants - make sure you have a cohabitation agreement!

In a case involving Cohabitants, (people who are living together but not married), the Court has re-confirmed that there would be no protection for a former partner to seek a financial share in a property owing to the fact of the parties' financial conduct.

The case is considered to be one of the most important cases in family law for ten years.

The facts of the case are astounding. The parties; known as Mr Kernott and Ms Jones, purchased a property in 1985. At the time of the purchase, they registered their interests in the property in equal shares. They separated eight years later. For thirteen years following their separation Ms Jones brought up their two children, and paid for the mortgage, household bills, and repaired and maintained the Property without any financial contribution whatsoever from Mr Kernott.

In 2006 Mr Kernott brought a claim for a 50% share in the property, in accordance with how their shares had originally been registered at the time they purchased the property 21 years earlier. He brought his claim notwithstanding the fact that he had not lived at the Property, or contributed towards it or the family for thirteen years!

Judgments

The first judgment of the Court in the case provided Ms Jones with 90% of the equity in the Property. The reason for this was that the Court recognised the significant financial contributions Ms Jones had made. It was confirmed that by virtue of their conduct, there had been a "common intention" of the parties. It was decided that the "common intention" was that over time the parties had shown that they intended to own the property in different shares.

Following this first Judgment the case then went to the Court of Appeal, who ordered in favour of Mr Kernott, awarding the parties their original equal shares in the Property. Understandably, although at great cost, Ms Jones has now appealed to the highest court in the land, and the final Judgment of the Supreme Court is awaited.

This case shows that there is no protection for parties to establish a claim by virtue of their financial contribution, or conduct, even over a period of many years. This clearly can cause a significant financial loss to a party who has placed reliance upon the fact that they will be benefiting from financial contributions made. Parties in a case such as this can end up spending significant sums in legal costs, which could outweigh the value of their interests at the end of the day!

When you consider the increase in the number of people living together, and the decline in marriage, it becomes abundantly clear that we need considerable reform of the law in this area, but there is no such major reform of the law planned. This case highlights the need now more than ever, for a Cohabitation Agreement when a couple are considering setting up home together. This document is the way couples ensure certainty and clarity in their financial arrangements.

This is crucially important when you consider that former partners, who have children may also find themselves parties to financial claims being made against them. Cohabitation Agreements are a vital tool to protect the financially stronger party!

It is also crucial to remember that if you split up with someone and sadly a reconciliation is not possible, then you should seek immediate good quality professional family law advice, without delay, as forewarned is forearmed.

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And the Greatest of these is Charity

As part of the 'Big Society', the Government are keen to promote philanthropy and charitable giving, and there are two Treasury initiatives currently on the table which have tax implications that may be relevant to you.

The 10% charity rule

The proposal is that where 10% of a deceased net estate (after the deductions of IHT exemptions, reliefs and the nil rate band), is left to charity the IHT rate applied to the Estate will be reduced to 36%. The new rate will apply where deaths occur on or after 6 April 2012. Whilst this initiative does have its positives, particularly if you were planning on making charitable donations; it is not a tax relief which will see your beneficiaries receiving more.

For example, if your net Estate (after deduction of any reliefs) was valued at £1m, the usual IHT charge would be £400,000, with £600,000 passing to your beneficiaries. However, if you leave 10% of your net Estate to charity, then the remaining Estate of £900,000 would be taxed at 36%. The tax charge would then be £324,000, and the amount passing to your beneficiaries would be £576,000. The positives are that your IHT bill is reduced by £76,000 and your chosen charities receive £100,000. However, your beneficiaries would receive £24,000 less. As George Osbourne said in the Budget: "Let's be clear: no beneficiaries will be better off, just the charities - to the tune of £300m."

The consultation formally closed on 31 August 2011, the draft legislation should be published before the Budget 2012.

Donation of pre-eminent works of art/historical objects

The second scheme deals with donations of pre-eminent works of work. In a bid to encourage individuals to donate pre-eminent works of art to the nation, the Government is proposing to introduce a lifetime scheme by which individuals can obtain tax relief on their gifts. Again, this scheme does not offer individuals a "like for like" tax deduction, e.g. a gift of a painting worth £100,000 will NOT allow you a £100,000 deduction from your tax bill, however, if you were minded to make a gift of a pre-eminent item, then the scheme will allow you to do this, in a tax efficient way.

The scheme is to run alongside two other schemes which currently exist for gifts of pre-eminent works of objects: the "Acceptance in Lieu" (AIL) scheme and the Conditional Exemption scheme ("CE").

Under the new proposals, items will be given to the nation, who will then lend them to public institutions (such as museums). The donor will be allowed to nominate a chosen institution and provided this is appropriate, this will be adhered to.

How the tax bill will be calculated is still under discussion, but the likely scenario is that the donation of a pre-eminent work of art with an agreed value of £100,000 will allow a tax reduction calculated at 25% of the object's value ie. you would receive a £25,000 deduction from your tax bill for that year.

There are still many outstanding issues; such as, how to define pre-eminent works of art, how the tax bill will be calculated and whether there should be a cap on the amount of tax reduction per object or per donor. The closing date for responses to the consultation is 21 September 2011.

> *"Landed estates work is in a class of its own"*
>
> LEGAL 500, 2010

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AIL allows individuals to give pre-eminent objects (and land and buildings) to the nation to be "accepted in lieu" of inheritance tax, whereas, CE allows a deceased individual's estate to defer inheritance tax liabilities in return for binding undertakings to make the pre-eminent objects available to the public on specific terms. Under CE, the objects remain in private ownership and the inheritance tax bill is deferred, not relieved.

The Battle of Hastings-Bass: One in the eye for the tax payer

It is rare in this day and age that circumstances arise whereby a court will exercise it's equitable jurisdiction to allow a person to undo the consequences of an erroneous decision after that decision has been made and put into place, simply on the basis of unforeseen consequences.

By claiming the '*rule in Hastings-Bass*' (from the decision in Re Hastings-Bass [1974] EWCA Civ 13) many trustees have sought to unpick some of their more unfortunate decisions and avoid the consequences of their errors. But not for much longer….. Appeal rulings in two cases earlier this year, Futter and another v Futter and others and Pitt and another v Holt and another [2011] EWCA Civ 197 appear to drastically narrow the rule's application.

Since 1975 the High Court (and courts outside England and Wales) have developed the application of the rule so that (as stated in Sieff and others v Fox and others [2005] EWHC 1312 (Ch)) when trustees exercise a discretionary power, the court can overturn their action if:

- the effect of exercising the power is different than they had intended;
- the trustees would not have acted as they did if they had not:
  - (a) failed to take into account considerations that they ought to have taken into account; or
  - (b) taken into account considerations that they ought not to have taken into account.

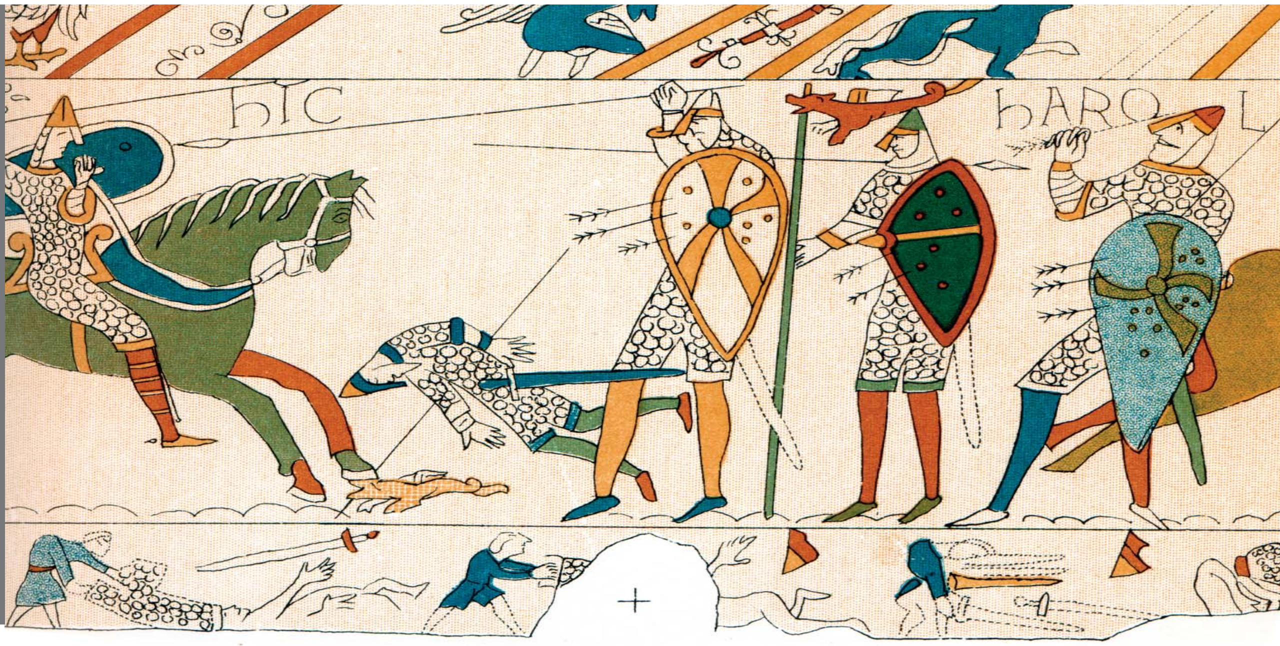
As you can imagine this was a handy tool available to trustees where the consequences of their actions are not as desired.

In *Futter v Futter* the advice given to the trustees was that there would be no charge to capital gains tax in making certain advancements from the client's settlement. This turned out to be incorrect. Lloyd LJ held that the trustees did not overlook the need to think about capital gains tax. They were given advice on the right point, but the problem was that the advice was wrong.

The facts in *Pitt v Holt* were that Mr Pitt had suffered a serious head injury, so Mrs Pitt was appointed receiver for her husband through the Court of Protection. Mr Pitt's damages were settled on a structured basis, with a lump sum being placed into a discretionary trust. Unfortunately the wrong precedent was executed and the trust did not qualify for the inheritance tax exemption of a special needs trust.

In both cases, the actions taken had followed professional advice but had resulted in adverse tax consequences. Lord Justice Lloyd, who also heard the case of *Sieff v Fox*, delivered his leading judgment and considered that some of the cases applying or developing the rule in Hastings-Bass had been incorrect. The correct principle was that acts outside the scope of trustee's powers were void. Trustees who followed advice on tax consequences from apparently competent advisers would not generally be in breach of their duties and therefore could not rely on the rule in Hastings-Bass to have their actions declared void and set aside.

Although an appeal is in the process of being made, if it stands, this decision strips back the rule in Hastings-Bass to pure trust law principles. Both cases highlight the need for trustees to instruct competent professional advisers to ensure that the consequences of their decisions are exactly as they would like. Otherwise the only winner will be HM Revenue & Customs.



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