



HEWITSONS

Private Client

Briefing

Summer 2009

***Make sure you sign
your Will correctly***

***Vulnerable
beneficiaries***

Welcome



Welcome to the second Private Client Briefing of 2009. We cover a number of subjects in this issue, including the increase in probate litigation, practical and tax efficient ways of giving to charity, and a brief overview of the budget changes.

Our aim is to keep you up to date with all the changes which may affect you.

If there is any issue in this briefing you would like to discuss, or any other matters you would like to raise, please contact me, Clare Colacicchi on

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ON THE COVER: Helen Drayton, Partner, with Chris Philpot of Barleylands.

Understanding joint bank accounts



Often when an elderly person is worried about managing their money they will take a practical and pragmatic approach to this and transfer a bank or building society account into their name and the name of a member of the family.

The Budget 2009 – A sigh of relief(s)

It may be rare for taxpayers to breathe a sigh of relief after the Chancellor of the Exchequer has unveiled the Budget for the year.

However, this time around landlords with income from furnished holiday lettings in European Economic Area (EEA) countries and executors and personal representatives dealing with agricultural property and woodlands in EEA countries will be doing just that. Unfortunately, for the former it will be a short-lived sigh of relief.

Under the Furnished Holiday Lettings rules tax relief currently only applies to property situated in the UK. If the property in question qualifies for the relief, the letting business itself is treated as a trade for certain taxation purposes. Consequently, any losses can be set off against other income and any gains made on the property can be rolled over.

It has now been found that the Furnished Holiday Lettings (FHL) rules may not comply with European law. The tax relief for furnished holiday lettings will therefore be withdrawn in its entirety from April 2010. Until then the FHL rules will be regarded as applying to property in the EEA. Landlords with income from furnished holiday lettings in the EEA will now be able to make claims for the associated reliefs where the relevant claim periods are still open.

Claims for property in the EEA may be worth consideration for tax returns which have already been submitted. Late claims and amendments will be accepted in relation to this matter until

31 July 2009. This will apply to personal tax returns to 5 April 2007 and corporate returns ending on or after 31 December 2006.

Meanwhile, certain tax rules that restrict tax relief to land in the UK clash with European law. These rules include the inheritance tax reliefs for agricultural property and woodlands.

Agricultural property relief reduces the value of agricultural property chargeable to inheritance tax while woodlands relief allows inheritance tax to be deferred on the value of timber or underwood until it is sold. Until now both agricultural property relief and woodlands relief only applied to land in the UK, the Channel Islands and the Isle of Man.



Inheritance tax agricultural property relief and woodlands relief will now be extended to cover property in the EEA. Property qualifying for this extended inheritance tax relief will also qualify for capital gains tax hold over relief.

Hold over relief will be available in respect of disposals of agricultural property located in the EEA in the past. The time limit for claiming hold over relief is five years from 31 January following the tax year to which the claim relates. Claims to relief in respect of the tax year 2003/04 can therefore be made until 31 January 2010. It is important to note that legislation in the Finance Act 2008 reduced time limits for hold over relief claims to four years from 1 April 2010. Claims in respect of 2004/05 and 2005/06 will therefore also need to be made by this date.

For deaths before 22 April 2009, property located in the EEA will become eligible for woodlands relief. The time limit for obtaining woodlands relief is usually within two years of the date of death.

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The result is that the account is then held in joint names. As far as the bank or building society is concerned this is a joint account which can be operated by either party and which passes to the survivor if one of them dies.

However, it is important to be clear what the purpose behind putting the money into joint names is and who the money really belongs to.

Suppose a mother decides to put her building society account into the joint names of herself and her daughter. All the money in the account before it was put into joint names had belonged to the mother. But how the money in the account is treated for inheritance tax purposes on the mother's death may well depend on how it is treated in the period after the account was put into joint names.

For example all the income from the account is paid to the mother, the only deposits into the account are of the mother's money and the only withdrawals are spent on the mother. In this situation all the money in the account will be treated as having belonged to the mother.

The whole value in the account will be included in the mother's estate for inheritance tax purposes.

Although the bank will pass the account into the daughter's name after the mother's death the balance should in fact pass in accordance with the mother's Will as the money still belonged to her.

If after the account is put into joint names all the income and withdrawals are shared equally by the mother and daughter it is possible that the mother gave half the value in the account to her daughter at the time it was put into joint names. This gift will have inheritance tax consequences if the mother does not survive it by seven years. It should also be remembered that half the account balance belongs to the mother and should be included in the estate for inheritance tax purposes.

The recent case of *Smith v HMRC*, which was decided by the Special Commissioners, related to the inheritance tax treatment of a joint account. In this case Mrs Smith had transferred a building society account into the joint name of herself and her son. The understanding between them was that she would be entitled to the interest earned on the account in her lifetime and her son would become entitled to the capital on her death.

The Special Commissioner found that in this situation there was a trust of a type known as an interest in possession trust. The effect of this was that the value of the building society account had to be added to the value of the mother's other assets to calculate inheritance tax on her death. Tax payable was then apportioned between the trust and her other assets. The trust's proportion had to be paid by the son who was the joint owner of the account and the remaining tax had to be paid by the people who inherited under her Will, in this case her two sons.

If it had been assumed the money in the building society account really belonged to Mrs Smith, the overall amount of inheritance tax would have remained the same but it could have resulted in the wrong people paying the tax. In that situation the joint account would have passed automatically to the son who was the joint owner but all the tax would have been paid by him and his brother with the result that his brother would have paid too much of the tax.

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Making personal welfare decisions for someone else

It is not possible to appoint a guardian for an adult whether they are mentally capable of managing their affairs and looking after themselves or not.

But the Mental Capacity Act, which came in to force in 2007, has made some changes in this area. It is now possible for someone to be appointed as a Personal Welfare Deputy who can make decisions about matters such as where someone is to live, how they are to dress and what diet they should follow.

The most fundamental change the Mental Capacity Act has introduced is to assume that people are able to make decisions for themselves. If they have difficulty making decisions they must be helped to make them. It is only when someone cannot make a particular decision for themselves that somebody else can make the decision for them.

A Personal Welfare Deputy is appointed by the Court of Protection to make decisions on behalf of somebody who cannot make decisions for themselves. But there are some matters which only the Court can decide.

The court will prefer to make a decision itself than appoint a deputy and if one is appointed it will make their powers as limited as possible.

However, it is understood that the court may be reluctant to appoint Personal Welfare Deputies. This is because the Mental Capacity Act allows actions or decisions to be taken for someone who lacks mental capacity. The person making the decision must be acting in connection with the care or treatment of the person who lacks capacity and must establish that the person concerned lacks capacity and must act in their best interests. This means anyone involved in the day to day care of someone who lacks capacity can make day to day decisions about their care.

It is thought that most personal welfare decisions can be dealt with in this ad hoc and informal way without the need for a deputy.

But the deputy cannot make a decision for another person if they know or have reasonable grounds for believing that the person has the capacity to make the decision themselves. The deputy cannot prohibit a named person from having contact with the person in their care or direct those responsible for the health care to

allow someone else to take over that role. However, these are matters which the court can decide, if necessary.

If somebody wants to be appointed as a personal welfare deputy they must apply to the Court of Protection for permission to apply. If permission is given the application will involve completing an application form giving as much information as possible about the circumstances of the person for whom decisions are to be made. A medical certificate has to be provided giving information about the health and mental capacity of the person who cannot make decisions.

Those making decisions for people who cannot make decisions for themselves, for example medical staff or other carers, must make the decisions in that person's best interests. In order to do so they will consult with, and be informed by, a range of people including the person's family members, friends, his professional and paid carers and any court appointed deputy.

It is difficult to know when Personal Welfare Deputies will be appointed. On the one hand anyone undertaking the care of someone who lacks capacity and who makes decisions in their best interests can decide questions of personal welfare. On the other, the Mental Capacity Act has specifically created Personal Welfare Deputies who can be appointed to make these very same personal welfare decisions for people who lack capacity.



Case highlights novel way of avoiding inheritance tax

The case of Ogden v Trustees of RH Griffiths 2003 has proved very interesting for those considering inheritance tax planning.

In January 2003, aged 73, Mr Griffiths received some detailed inheritance tax planning advice. Most of the advice depended on him entering into transactions which would be treated as potentially exempt transfers.

In other words the transactions would have no inheritance tax consequences if Mr Griffiths survived making them by more than seven years, and reduced inheritance tax if he survived more than three but less than seven.

In April 2003 Mr Griffiths carried out the first of the transactions which he had been advised to make with the final one completed in February 2004. But in October 2004 he was diagnosed with lung cancer and in April 2005 died. Crucially this was less than three years after the first transactions.

Mr Griffiths' Will left his estate on trust for his wife. Anything passing under his Will was therefore exempt from inheritance tax. But because he had failed to survive the potentially exempt transfers by seven years, £1m of tax was due on them. Had he not made the transfers the assets involved would have passed under his Will and no inheritance tax would have been payable.

Mr Griffiths' executors went to court to have the transactions undertaken in April 2003 and February 2004 set aside on the grounds that they had been entered into as the result of a mistake. The mistake being that if Mr Griffiths' had known that he would not survive by seven years he would never have entered into the transactions.

The judge held that there was no mistake about the earlier transactions as Mr Griffiths was unlikely to have been suffering from lung cancer at the time they were made. However, the later transaction had been entered into as the result of a mistake and could be set aside.

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Inheritance disputes on the rise

Pivate client practitioners across the UK and overseas are consistently reporting a marked increase in the number of disputes concerning testamentary documents or estate administration.

Statistics show the number of these disputes reaching the courts has risen by 175% since 2006 and it seems the trend is set to continue.

The most common forms of inheritance disputes include challenges to the validity of a Will, either on the basis of want of testamentary capacity of the deceased, want of knowledge and approval of the Will's contents, or undue influence and forgery, and challenges to the provisions of a valid Will under the Inheritance (Provision for Family and Dependents) Act 1975.

In comparison with many other types of disputes that progress through the courts, the costs of inheritance disputes tend to be substantial and usually out of proportion to the amounts of money at stake in the proceedings. The main reasons for this are that the disputes are fact-heavy, expert evidence is nearly always necessary, and it is usually the case that the trial of the claim will last for at least a week. Often the disputes are emotionally charged which increases the potential for disproportionate costs where families wish to litigate over points of principle.

So, why is it, given the costs deterrent that claims of this nature appear to be on the increase?

Possible explanations include testators living longer, therefore increasing the likelihood of a

challenge to a Will for lack of testamentary capacity, and family wealth suffering under the global financial crisis, making people keener than ever to hold onto what they consider to be rightfully theirs.

Lucinda Rowley, a solicitor in Hewitsons' contentious trust and probate team comments: "Although it seems likely that the trend of increased litigation in this area will continue, these disputes are well-suited to forms of alternative dispute resolution such as mediation which can result in huge costs savings for aggrieved family members seeking to protect their inheritance."

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Survivorship Clauses

Before the introduction of the transferable nil rate band (TNRB) in October 2007, if a spouse or civil partner left everything to the survivor there was only one nil rate band available on the second death. If the spouses or civil partners both died within 30 days, the survivorship clause ensured the two estates remained separate, both benefiting from a nil rate band. It was therefore perfectly sensible to include a survivorship provision in your Will.

Since the introduction of the TNRB, a married couple or civil partners are entitled to claim two nil rate bands on the second death, if the first to die leaves everything to the survivor. For second deaths occurring in 2009/2010, this equates to up to £650,000 passing free of inheritance tax, in other words double the current nil rate band of £325,000. In light of these changes, it is arguable that the survivorship clause has outlived its usefulness and could well bring disadvantages.

Consider an example. Arthur and Elizabeth are married and each have wills leaving everything to the other on the first death, provided the other survives for 30 days, failing that their estates pass to their children.

Arthur's estate is valued at £600,000 and Elizabeth's estate is valued at £100,000. Arthur and Elizabeth are involved in a car accident, Arthur dies and Elizabeth dies two weeks later. Arthur's Will leaves his estate to his children (because Elizabeth has not survived for 30 days) and there will be an inheritance tax liability of £110,000. Elizabeth's estate passes to the children tax free because her estate is within the nil rate band.

Many wills contain survivorship clauses to both avoid property passing through two estates in quick succession, for example where husband and wife are involved in a common accident and one dies shortly after the other, and escape unnecessary inheritance tax charges.

If Arthur's Will had not included a survivorship provision and simply left his estate to Elizabeth outright, the inheritance tax could have been avoided. Elizabeth would have inherited Arthur's estate and on her death her estate would amount to £700,000. Elizabeth's executors would claim the TNRB, which, when added to her own would result in a combined nil rate band of £650,000. The inheritance tax due on the combined estate would be £20,000. The survivorship clause results in a tax bill of £110,000 as opposed to £20,000.

However, there is another solution. Within two years of Arthur's death, the children could enter into a Deed of Variation which would effectively "re-write" Arthur's Will for inheritance tax purposes, excluding the survivorship provision. This process will become more complex if any of the children are minors.

Excluding a survivorship clause can also have inheritance tax benefits in the extremely rare situation where it is impossible to know the order in which husband and wife died. Even if they die as the result of the same accident one may be pronounced dead at the scene and the other may die on the way to hospital.

Where it is impossible to be certain which of two people died first the law generally assumes that the elder died before the younger. However, the Inheritance Act says that for inheritance tax purposes they are assumed to have died in the same instant.

When calculating an estate for inheritance tax purposes one looks at the assets the deceased owned immediately before they died. This means

if husband and wife died in the same instant the estate of the younger could not have included what they had been left under the Will of the elder.

For example Arthur and Elizabeth die in a plane crash and it is impossible to know which of them died first. Arthur's estate was worth £900,000 and Elizabeth's £325,000. They have each left everything to each other with the estate then passing to their children.

Arthur was the elder, so his estate is treated as passing to Elizabeth and is free of inheritance tax as passing to a spouse. Elizabeth's estate passes to the children. In reality what passes under Elizabeth's Will is £900,000 + £325,000 = £1,225,000. But for inheritance tax purposes she is treated as leaving only £325,000 to the children, because she did not own Arthur's assets immediately before she died. This is within the nil rate band and so free of inheritance tax.

To avoid these adverse inheritance tax consequences as just described, a survivorship provision should only be included in your Will if each spouse's or civil partner's estate is equal to or greater than the nil rate band. Of course, if both estates are within the nil rate band, there should be no inheritance tax disadvantage to including the survivorship clause. A review of your Will may therefore prove beneficial.

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So you want to give to charity? – Part Two

In the second article in our series designed to help those who want to donate to their favourite charities and save tax, we focus on Gift Aid, as well as looking at other ways of giving to charity.

Making gifts of cash – using Gift Aid

Individuals and businesses can obtain tax relief when they give money, either as a one-off gift or a regular payment, under the Gift Aid scheme.

A cash donation to a charity will qualify for Gift Aid if you:

- i) pay at least as much UK tax (Income or Capital Gains Tax) as your chosen charity will reclaim on your gifts in the financial year in which you make them;
- ii) make a simple declaration to the charity that you want your gift to be treated as a Gift Aid donation.

When basic rate tax-payers use Gift Aid a charity can claim another 28 pence for each pound donated from HMRC. The amount of Gift Aid is calculated using the basic rate of Income Tax. In the Pre-Budget Report in November 2007, it was announced that the basic rate of Income Tax would decrease from 22% to 20%, with charities concerned this would reduce the amount of

Gift Aid received. However, transitional relief, allowing the same amount to be reclaimed as previously, is now in place until 2010/11.

Higher rate tax-payers are entitled to claim the difference between the basic rate of tax and the higher rate. This is achieved by entering the amount given on your self-assessment return and HMRC will work out the relief owed.

An example of Gift Aid in action:

You would like a charity to receive a gift of **£1,000**, and you would like to use Gift Aid.

£1,000 less the basic rate of tax (taking into account the transitional relief) of 22% means that you make a gift of **£780**. The charity then claims back tax on your donation, and receives a further **£220**.

As a higher rate tax-payer, you would then include details of the gift in your annual return and claim back tax on the gross value of the donation. In this case, it would be **£200** – 20% of £1,000.

Therefore, the actual cost of a **£1,000** donation to a higher rate tax-payer is **£580!**

Using a Community Foundation

Community Foundations are charities which manage funds donated by individuals and businesses. They have an in-depth knowledge of the communities they help, and can link people and causes.

They are able to receive a variety of donations, including gifts of cash, shares or property. Donors can direct their funds to a favourite cause, organisation or specific geographical area. It is possible to create a new fund, or donations can be pooled into themed funds to address a particular issue. Alternatively, a donation to a general endowment can be used more flexibly.

For more information on community foundations found in the Eastern region, visit:

Northampton Community Foundation
www.ncf.uk.com

Cambridge Community Foundation
www.cambridgeccf.org

Essex Community Foundation
www.essexcommunityfoundation.org.uk

Milton Keynes Community Foundation
www.mkcommunityfoundation.co.uk

Community Foundation Network
www.communityfoundations.org.uk

Other ways of giving

Charities Aid Foundation – Charity Account:

Works like a bank account designed specifically for charitable giving, allowing you to receive all the tax benefits of the gifts made, and to give the gross amount to the charities you wish to support. For more information visit: www.cafonline.org

Justgiving.com:

Allows you to create a webpage for a particular charity event, so that people can donate or sponsor online. Gift Aid is claimed by Justgiving.com, and a transaction fee is deducted from that, with the remaining Gift Aid being passed to the charity. For more information, see: www.justgiving.com

Affinity schemes:

Many charities have entered into affinity schemes with service providers to promote the charities' work to the service providers' clients or suppliers. For example, a charity might team up with a bank to produce a special credit card for

supporters, and the charity will receive a donation each time the credit card is used. You will not receive tax relief on the amounts that the charity receives, but it can be a useful year round source of income for your chosen charity.

If you would like to discuss ways of making gifts to charity, or ways of making your gifts to charity more tax efficient, please contact a member of the Private Client team.

Correction: Eagle eyed readers of the last issue of Private Client Briefing may have noticed that in the calculation of the deduction allowable against income for Income Tax purposes when a gift of land or qualifying investments is made to a charity, the incidental costs of the gift were incorrectly deducted from the market value of the gift. These costs should, of course, have been added to the market value, giving an allowable deduction against income for Income Tax purposes of £5,050.

Next time: how to set up your own charity.

Sounds simple but make sure you know what your Will says

The House of Lords has allowed a farmer to claim right to a deceased relative's farm, overturning the Court of Appeal's ruling.



The case of *Thorne v Major* concerned the estate of Somerset farmer Peter Thorne whose wife died in 1976. His cousin Jimmy and Jimmy's son, David, helped Peter in the aftermath of his wife's death and continued to help run the farm. David in particular devoted a huge amount of time to helping run the farm until Peter's death in 2005 but was never paid.

Without it ever being said, it became understood that David would inherit the farm from Peter. In 1997 Peter had made a Will which gave some legacies including £50,000 to a friend, Sam. The Will left the rest of his estate to David. But at some point Peter fell out with Sam and regretted his generous legacy, so he destroyed his Will and thereby revoked it.

Peter never made a new Will and when he died in 2005 he was intestate. This meant that his estate including the farm passed to his surviving brothers and sisters and the children of his brothers and sisters who had died before him.

For David to get any share of the farm, he had to bring a case showing that Peter had promised to give him the farm and that he relied on that promise to continue working for nothing.

Unfortunately, Peter had never made any express promise to leave the farm to David, it was simply understood.

David's case was that in 1990 Peter handed him a bonus notice relating to two life policies on Peter's life which he said was for his death duties. This would have implied that David was to be his successor to the farm. Peter had also made other indirect remarks on subsequent occasions indicating his intention that David should inherit the farm. The judge found in favour of David's claim and awarded him the farm and the other assets of Peter's farming business.

Focusing on the bonus notice incident in 1990, the Court of Appeal had decided that the oblique assurances given by Peter to David were not sufficiently clear and unequivocal to constitute a promise to leave him the farm. But in a unanimous decision the House of Lords found that David had proved his claim that Peter had intended to leave the farm to him, even though he had never expressly stated it.

Lord Walker said: *"The relevant assurance must be clear enough. What amounts to sufficient clarity, in a case of this sort, is hugely dependent on context."* He said the bonus notice 'marked the transition

from hope to expectation' for David and Peter's conduct for the rest of his life caused David to believe that he would inherit the farm.

Lord Walker added: *"Peter's assurances, objectively assessed, were intended to be taken seriously and to be relied on."*

The House of Lords consequently overturned the Court of Appeal's decision and reinstated the original judge's order in favour of David giving him the farm and assets of the farming business.

The case illustrates how important it is to be sure you know what your Will says and that this is what you want. If you revoke a Will or want to change a Will you must make sure that there is something to replace it so as to avoid any later disputes.

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