

The Personal Tax Planning Review

RE BENHAM'S WILL TRUSTS¹ AND RE RATCLIFFE DECEASED, HOLMES v MCMULLAN²

Ralph Ray³

A Problem Hopefully Resolved

Both cases concerned IHT Will construction where residue is left partly to exempt and partly to non-exempt beneficiaries.

On the specific wording of *Benham* the court held that it was necessary to gross up the non-exempt share so that after IHT, the net values of each share was equal (or pro rata). This clearly involved more IHT and the decision also favours non-exempt gifts of residue.

The moral is to clarify the position in the Will or, failing that, by way of a variation.

- The *Benham* decision is defeated if wording such as the following is used:

“I give the capital and income of my residuary estate to [my wife] and my [son] in [equal] shares and the division into shares shall be treated as made before deduction of IHT payable on my death in respect of my residuary estate”.

- The *Benham* decision may possibly apply – but see the *Ratcliffe* decision outlined below where the wording is to the following effect:

¹ [1995] STC 210.

² ChD [1999] STC 262.

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“..... to my [wife] and my [son] in such shares that after deducting IHT payable on my death in respect of my residuary estate the two shares are equal”.

It is widely considered that the *Benham* decision was wrong in that it conflicts with s.41 IHTA 1984 whereby the burden of IHT cannot be shifted onto an exempt share and ‘notwithstanding the terms of any disposition’ and see below. An exchange of correspondence between the British Heart Foundation and the CTO in December 1995 has been published (See Private Client Business (1996) Issue 5, p.295). The CTO appear to agree that *Benham* was decided on the special wording used as to *receipt of shares* and would not apply to the more normal wording of ascertaining residue – see below.

Re Ratcliffe deceased appears to overrule and distinguish the *Benham* decision. Mrs Ratcliffe’s residuary estate was divided as to one half for various IHT exempt charities and one half for the named sons of the testatrix cousin ‘the sons’. Blackburne H decided that the charities were entitled to their gross half share of the net residue, i.e. as an exempt share before charging or bearing any IHT.

The sons’ half share therefore bore all the IHT and in accordance with IHTA s.41. In particular the sons’ share was not to be grossed up and so that after IHT both half shares were equal. Accordingly *Benham* was not applied.

On the facts, out of the net residue (i.e. after certain expenses) of some £2.3m, the charities received approximately £1.15m – gross (without any IHT in accordance with s.41).

The sons received approximately £720K and paid all the IHT of some £430K.

If the *Benham* formulae had been followed, the sons’ and charities share would have been approximately £870,000 each and IHT some £500,000.

The case did not go to appeal and does seem to represent the better/correct view.

RESIDUARY ESTATE - WHO BEARS TAX

BENHAM **V** **RATCLIFFE**
 = NET = GROSS

Example of alternatives:

Data: net residue of £200k for division equally between surviving spouse 'SS' and child 'C'. Estate rate = 40%

	SS	C	Revenue = tax
Alternative 1	£80k	£80k	£40k
Alternative 2	£100k	£60k	£40k
Alternative 3	£75k	£75k	£50k

Notes:

Alternative 1: Deduct IHT on £100k and divide balance of £160k equally = £80k. (This is contrary to the strict wording of *Benham* and is also contrary to s.41).

Alternative 2: Divide residue equally, i.e. £100k each. C gets £60k and bears all the tax – probably the correct statutory s.41 position, i.e. the exempt party, SS, bears none of the tax. This corresponds to the *Ratcliffe* decision.

Alternative 3: = *Benham*. Gross up C's share so that SS and C get the same net amount after tax. However, notice that more IHT is paid.

Moral: Make position clear in the Will and obtain client's clear instructions.

Advice to Executors where there is an element of doubt as to the net (*Benham*) or gross (*Ratcliffe*) method of distribution:

- retain sufficient funds from residue until the position is resolved e.g. full agreement by adult beneficiaries
- take full indemnities from all adult beneficiaries (see *Law Society Gazette* 16.10.96 Matthew Pintus)

- consider applying to High Court Judge in Chambers – especially where minor or young beneficiaries involved.⁴
- Avoid grossing up problems e.g:
 - if practical avoid partly exempt residue e.g. entire residue to surviving spouse absolutely or for life
 - charitable gifts – make them as specific legacies
 - other legacies – cover by nil rate band or make subject to tax – (this avoids grossing up)
 - where estate is wholly taxable e.g. no surviving spouse and no charity benefits from residue – avoid mixture of tax free and subject to tax specific legacies.