WILLS AND THEIR ALTERNATIVES IN THE AIDS ERA

Robert Venables QC[1]

1 Scope of the Article

This article is based on a seminar presented by CRUSAID[2] in which I discussed the following interrelated problems:

the making of a will by the terminally ill, say an AIDS patient;

the drafting of a will where the beneficiaries include a charity, such as CRUSAID;

special legal problems which may arise on the death of one of two cohabiting partners who are not lawfully married to each other;

related legal problems which may result from a terminal illness and particularly from lack of legal capacity.

I consider these problems both from a general legal point of view but with particular emphasis on tax considerations.[3]

Although these areas are conceptually separate, each of them is of concern to CRUSAID. A gay man dying of AIDS may have entered into a stable relationship with another man whom he may wish to inherit a substantial part of his estate. They may well have purchased a home together. The dying man may, out of

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1 Robert Venables QC, 24 Old Buildings, Lincoln's Inn, London WC2A 3UJ
Tel: (0171) 242 2744 Fax: (0171) 831 8095.

2 CRUSAID, the national AIDS fundraiser, of which I am Treasurer, is itself a registered charity. It is concerned both to raise funds and to give help and advice to those suffering from AIDS or HIV and their helpers.

3 The tax considerations are considered in more detail in an article 'Tax-Efficient Bequests to Charity' in *The Personal Tax Planning Review*, Volume 4, Issue 2, also published by Key Haven Publications PLC.

compassion for others in his predicament, or to help prevent the spread of AIDS, wish to include CRUSAID or some other AIDS charity amongst the beneficiaries of his will. He may fear that before his death he will become demented or unconscious and would wish in those circumstances that his affairs be controlled by his partner and not his next of kin.

A substantial part of the material contained in this article, particularly that relating to taxation, is of relevance to charities in general. Much of it is of relevance to charities for the relief of those suffering from bodily or mental infirmity.

2 Why Make a Will?

2.1 Effect of Intestacy Rules

Why should a dying man make a will at all? Why, indeed, should anyone make a will? The law does its best by providing for distribution of net assets in the case of an intestacy, i.e., when someone does not die leaving a valid will.[4] It makes the best guess it can as to what sort of will the average person would have made had he thought about the matter. Unless the deceased is very wealthy, it puts the surviving spouse in a privileged position. Next come the claims of the children or remoter issue. It would be unrealistic to expect the intestacy rules to be anything more than a very blunt tool. They are particularly inappropriate in the case of a person who has no lawful spouse or children but who is in a stable relationship with another person, whether of the same or of a different sex, to whom he is not married. The rules relating to intestacy ignore the claims of such a person altogether. If he is to have any claim at all it can only be on the grounds of dependency, see 2.2.1.

In default of a wife and children, his estate will pass to the deceased's parents. If they do not survive the deceased, then the estate will be divided between his brothers and sisters, including issue of any brother or sister who has failed to survive the deceased. The next claimants are aunts and uncles of the deceased or, if they do not survive the deceased, their issue. If there are none of these, all goes to the state.

When a gay man dies intestate in the prime of life, the intestacy rules may bring a windfall to those who, in the course of nature, would not have inherited at all or would have inherited only decades later. The surviving partner will in general be at the mercy of the statutory next of kin. They may consider it only right to make such provision for his partner as the deceased would have made had he given the matter proper attention. Or they may take a high moral tone, blaming the lover for the death of their relative and/or considering it is their religious duty to retain

[4] See Administration of Estates Act 1925.

for themselves the legacy which God in his wisdom has diverted away from the sinful survivor. Then again, they may be actuated by pure greed, stripped bare of any veneer of hypocritical morality.

2.2 Claims against the Deceased's Estate other than under his Will

2.2.1 Inheritance (Provision for Family and Dependants) Act 1975

It may be that one partner takes no interest in the estate of the deceased partner, whether because the latter died intestate or because his will was hopelessly out of date or even - a rather more difficult case - where he had, for perhaps irrational reasons, decided to cut the deceased out from benefiting during his last illness. In that case, the only claim of the surviving partner would be under the Inheritance (Provision for Family and Dependants) Act 1975. The Act enables a person to claim a share in another's estate on the grounds that reasonable financial provision has not been made for him. Here again, the claims of the lawfully wedded spouse are much stronger than that of any other person. Apart from a spouse, former spouse, child or step-child of the deceased only those who were being maintained by the deceased immediately before his death can claim.

The law is thus very curious in that it will enforce on the deceased a continuing dependency but will not make him on his death reward acts of kindness. Thus, if A and B are partners and B is parasitic on A, doing no more than preserving his body beautiful by long sessions at the gym, supervising the household staff, and exercising the dogs, then he may well have a good claim that on the death of A he should simply change from a parasite to a saprophyte.[5] If, however, the relationship is very much a balanced one, each, say, working full time and contributing equally, both financially and otherwise, to their home and household, then B is not dependent on A and thus has no claim to any part of A's estate under the Act. Worse still, even if A has conferred some benefits on B, such as free accommodation, the more it can be shown that B in fact earned those benefits, then the less dependent he can be shown to have been upon A. There may well be some logic somewhere in this Act which rewards the gold-digging partner but not the caring one. If so, it is a logic which has escaped my feeble intellect.

2.2.2 Contractual Claims

Where one party does care for another, informal arrangements may be made. A man may promise his partner a share in his estate on his death if he will cohabit with him and, possibly, in addition, look after him. It might therefore be thought that if the deceased failed to honour his promise, the surviving partner would have

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[5] A parasite is parasitic on the living, a saprophyte on the dead.

a good contractual[6] claim against the deceased's estate. Yet the pitfalls are legion. Firstly, the contract must be proved. If it is only verbal, the Court may well be reluctant to accept the *ipse dixit* of the person claiming the benefit under it, given that, *ex hypothesi*, the only person who can contradict him is dead. Then again, it must be clear that the deceased intended to create legal relations and was not simply entering into a merely moral undertaking or one binding in honour only. Furthermore, the terms of a common law contract have to be reasonably certain. The less formal an arrangement is, the less likely this is to be the case. Precisely how much of his estate did the deceased promise the surviving partner?[7] Further, it is problematical whether even in 1995 the Courts might refuse to enforce the contract on the ground that it is contrary to public policy. A contract between A and B whereby A agrees to maintain B in return for B's sexual services is unenforceable by either party. It is true that since the 1960s the Courts have given live-in lovers property rights over the estate of a living person even when there is something short of a common-law contract or equitable obligation, at least where the plaintiff and the defendant are respectively a woman and a man, whereas in Victorian times the shameless hussy would have been sent packing. Still, in 1995, anti-gay prejudice is very much a function of age, at least among the educated classes. The vast majority of judges fall currently on the wrong side of the line. In a nebulous area such as this, one should not underestimate the scope for a judge deciding, albeit unconsciously, in accordance with his prejudices, rather than with what most right-thinking persons under 50 would consider to be the merits of the case.

3 Capacity

3.1 Proving Capacity

If the next of kin are greedy or righteous or both, it will not necessarily be sufficient for the sick man to make a will cutting them out. For they may seek to challenge it on the grounds that he lacked full capacity. It is therefore very important to obtain contemporaneous written medical evidence as to capacity.

3.2 Providing for Incapacity

3.2.1 The Problem

Once incapacity, whether physical or mental, ensues, it is not unknown for the next of kin to freeze out the partner and other friends.

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[6] Or possibly quasi-contractual or other restitutionary.

[7] It may be possible to overcome the lack of certainty by relying upon equitable estoppel. That, however, poses yet another set of hurdles to clear.

3.2.2 Enduring Power of Attorney

Everyone who risks dying of AIDS (or any other terminal illness where incapacity may precede death) and who would not be entirely happy for his affairs to be managed by his next of kin should execute an enduring power of attorney.[8]

3.2.3 Revocable Trust

As an alternative, or as a belt and braces, to an enduring power of attorney, there is much to be said for a person putting all his assets into the name of his partner as trustee upon a suitably worded revocable trust. This would perform the double function of allowing his partner to manage the property held in trust for him without reliance on a power of attorney, enduring or otherwise, and without resort to the Court of Protection. The revocable trust could also double up as a *de facto* will, the beneficial interests limited to take effect after the death of the settlor (assuming no revocation during his lifetime) being those he would have otherwise placed in his will.[9]

The revocable trust is also useful as a means of avoiding probate, especially in the case of smaller estates.

3.3 Dealing with Incapacity

When a person who has not executed an enduring power of attorney becomes incapacitated, it will often be necessary to make an application to the Court of Protection to appoint a receiver. The natural inclination would be for the Court of Protection to appoint the patient's next of kin. Even in such a case, the partner may not be entirely without a remedy. Application may be made for the Court to write a statutory will for the patient.[10] If the patient had been in a long-term stable relationship, and would have provided for his partner had he been still of full capacity, then the Court would normally make provision for the partner. The difficulty of all applications to the Court of Protection is that they are expensive and time-consuming. Moreover, once the patient has died, the power to make a statutory will lapses. Reliance on a statutory will should therefore be regarded only as a last resort.

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8 Under the Enduring Powers of Attorney Act 1985.

9 See 5.7 for a discussion of a revocable trust of a joint bank account.

10 See Mental Health Act 1983 s.96(1)(e).

4 Assets with which the Will cannot Deal

4.1 What does the Testator Own?

Which assets can be dealt with by the will? Clearly, a person cannot bequeath what does not belong to him. The client's principal asset is likely to be his interest in his home. Where he is the sole legal owner, it would be prudent to enquire whether someone else, in particular his partner, has an equitable interest in it. Conversely, although the client may have no legal interest in his home, he may well have an equitable interest, by virtue of contributions made by him. The first step is to ascertain what the true position is. This is a topic in itself.

4.2 Joint Ownership

Where the home is vested in the client and, say, his partner as joint tenants at law, it will be necessary to investigate the position in equity. Ideally, matters should have been carefully structured when the home was acquired. In practice, the partners are likely to have employed a conveyancing solicitor at a cut-throat rate and not to have sought, or been offered, advice on the question of beneficial entitlement. Again, this is a topic of its own.

If the partners are joint tenants both at law and in equity, then the share of the client will pass on his death by right of survivorship to the surviving partner, despite the provisions contained in his will. If, however, there is an equitable tenancy in common, then the undivided share of the client will form part of his estate in the usual way.

Even when there is a joint tenancy in equity, one must take the home into account in drafting the will. The joint tenancy can be severed at any time so as to create an equitable tenancy in common. Provision must be made in the will for that eventuality. Then again, the client may be predeceased by his partner. It is not uncommon to find partners both of whom are suffering from AIDS where it is by no means clear which one will be the first to die. If the client is the survivor and the equitable joint tenancy has not been severed before his death, then he will become the sole legal and beneficial owner of the entire home.[11]

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[11] This is one aspect of a wider problem, namely, that in the case of AIDS sufferers there may be substantial changes in their estates within what are relatively short periods. Where a friend of the client predeceases him after the date of the client's will this can have a double importance. Firstly, the client may be a beneficiary under the friend's will, in which case the size of his estate will be increased. Secondly, the friend may be a beneficiary under the client's will, so that the bequest to the friend will normally lapse. Both of these factors make the will of such a person a more complex one than it would otherwise be, as all reasonable contingencies will need to be provided for. See further 6.2.

4.3 Pension Schemes

In the case of exempt approved pension schemes, i.e., ones established by an employer for the benefit of its employees and directors, it is usual for a very substantial lump-sum death-in-service benefit to become payable on the death of the scheme member before retirement. Under the rules of the scheme, the trustees will normally have a discretion as to whom to pay. In old-fashioned schemes, the objects of the discretion may be limited to the member's spouse and dependants. Most people are blithely unaware that their interest under their pension scheme is one of the most valuable assets they have, possibly being worth more than the rest of their estate! A more modern scheme would enable the member to nominate virtually anyone in the world as the recipient of the benefit. The trustees will then have the discretion to make the payment to that person. In practice, it will be unusual for them to fail to exercise their discretion in accordance with the nomination of the member.

Such nomination is normally made by written communication to the trustees *inter vivos* and not by will. Everything, of course, depends upon the rules of the particular scheme. In planning the overall distribution of his estate, the client clearly needs to make a nomination and then adjust the provisions of his will accordingly.

If the client makes no nomination, then under most schemes the lump sum will pass to his personal representatives. This is most unfortunate, as it would then become liable to inheritance tax on his death unless it is so dealt with under his will that some exemption, such as the charitable exemption, is available.

An AIDS victim may well decide to take premature retirement on the grounds of ill health. It might be tempting to him to receive an immediate pension from his scheme. In that case, he will lose the right to any death benefit. While one needs to look carefully at the rules of any particular scheme, it could well be the case that his beneficiaries are worse off in that the member will in effect have traded in a substantial death benefit in return for an annuity of short duration. Moreover, the annuity may well reduce state benefits to which the member would otherwise be entitled. The annuity will, unlike a purchased annuity, be fully subject to income tax in the normal way.

In some cases, there may be no scope for planning. The member may simply have to retire because he has been incapacitated for so long and the rules of the scheme may well give him no option to waive the annuity and to take a death benefit instead. The only general advice which can be given is that any solicitor worth his salt would, when instructed to draft a will, recommend that he be instructed to look into the question of the pension fund and what can be done. The other piece of advice is that where early retirement cannot be avoided and it will, in financial terms, be a disaster, one should seek to negotiate its postponement for as long as possible, in case the client should die in the interval.

Similar, but by no means identical, considerations must be taken into account where the testator has a personal pension plan.

5 Lifetime Gifts

5.1 Advantages

Should the client be invited to consider making gifts during his lifetime of assets which would otherwise have passed on his death? Here, the considerations will normally be overwhelmingly fiscal. One general observation: the fiscal tail must never be allowed to wag the real dog. The deceased should not give away assets and leave himself potentially destitute.

There are, of course, some other minor considerations. One advantage is that probate will not need to be obtained on the death of the client in order for title to pass to the beneficiary; another, that the executors will have no power to keep assets from the beneficiary during the administration period on the grounds that they may be needed to satisfy debts of the estate.

5.2 Undue Influence

If disappointed next of kin are likely to be a problem one must consider carefully the rules against undue influence. It would be very difficult indeed for them to prove that a gift in the will to, say, a surviving partner should be set aside on the grounds of undue influence. It is somewhat easier in the case of a lifetime gift. Contemporaneous evidence should therefore be obtained that the gift is being made by the client of his own volition and that he fully understands its nature and effect. Ideally, he should receive independent advice from a solicitor who is not also retained by the donee.

The gifting of assets during the lifetime of the client may reduce the size of his income and/or estate thereby entitling him to greater state benefits. Anti-avoidance provisions must, of course, be taken into account.

5.3 Inheritance Tax

Unless property passes to charity, or enjoys a 100% relief from inheritance tax,[12] inheritance tax will be exigible on the estate at a flat rate of 40% once the nil rate band, currently[13] £154,000, has been used up, whether on the death of the deceased or during the last seven years of his life. Gifts made less than three

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[12] Notably, in the case of agricultural and business property.

[13] The article is based on rates in force as from 6th April 1995.

years before death will be taxable on death at the full rate[14]. The only advantage which will have been obtained by a lifetime gift is that in that case the value of the gift will have been fixed at the time it was made. Between three and seven years, the rate of tax is progressively reduced by 20% per annum. Only where the deceased survives the gift by seven years will tax be avoided altogether.

The complicating factor is the gift with the reservation of benefit rules.[15] If a person gives away an asset, its value at the time of his death can be brought into charge as if it were part of his estate if the gift has not been enjoyed by the donee to the exclusion of any benefit to the donor by way of contract or otherwise. This rule is extremely technical. It would clearly catch the case where the home is vested in the client who then gives it to the other partner but continues to live there rent-free for the rest of his life. A gift of, say, a 50% undivided share in the house would normally not be caught by the rule if both partners then continue to live there, since the continued occupation by the client/donor is referable to the 50% share he has not gifted rather than to the 50% share he has gifted.

5.4 Capital Gains Tax

Another very important consideration is capital gains tax. On the death of a person his personal representatives and thus, normally, in turn his legatees, are deemed to acquire the assets of which he was competent to dispose at the time of his death for a consideration equal to their market value at that time.[16] No capital gains tax, however, is exigible. This means that if assets have increased in value during the lifetime of the deceased, the capital gain will be "washed" on his death. By contrast, a lifetime gift *prima facie* gives rise to a charge to capital gains tax on any increase in value after allowing for costs of acquisition and disposal and indexation relief. Where the gift is made to another individual resident in the United Kingdom, it may be possible to "hold over" the gain on the gift, depending upon the type of property. Yet when the donee ultimately comes to sell, he will have a reduced base cost.

Enormous care therefore needs to be taken to ensure that any inheritance tax savings which might result as the result of a lifetime gift are not more than outweighed by capital gains tax disadvantages. Where a person is already suffering from AIDS proper, and where an asset is already pregnant with considerable capital gain, it will, as a rule of thumb, normally be wiser for it not to be the subject matter of a lifetime gift.

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[14] I am here concerned principally with outright gifts to other individuals. There are special rules for gifts to discretionary trusts.

[15] Contained in Finance Act 1986 section 102 and Schedule 20. The provisions are discussed in *Ingram v Commissioners of Inland Revenue* [1995] STC 564.

[16] See *Marshall v Kerr* [1994] STC 638.

5.5 Income Tax Advantages of Lifetime Gift to Charity

A gift to charity will normally be exempt from inheritance tax whether it is made during one's life or on death. Likewise, it will not give rise to a charge to capital gains tax, either on the donor or on the charity, on the subsequent sale of the asset gifted. A lifetime gift, even a death-bed gift, can, however, have a substantial advantage over a testamentary gift. Provided it is an outright gift of cash, it would normally qualify under the Gift Aid rules for a deduction in computing the donor's income for income tax purposes. The result is that the charity will receive a larger amount at a lesser cost to the donor. How the benefit of this tax advantage is apportioned is entirely a matter for the donor. Thus, if a prospective donor who has left to charity £20,000 by his will decides that he has not long left to live and therefore makes a cash donation instead, revoking the legacy by a codicil, the tax position is much improved. If he is a basic-rate taxpayer, he can pay £20,000 to the charity. The charity can then reclaim £6,667 by way of income tax notionally deducted. Thus, the benefit of income tax saving accrues to the charity, the beneficiaries under the will being no worse off.

Alternatively, the donor could pay £15,000 to the charity, the charity then being able to recover £5,000 of income tax. The charity would be in the same position as if it had received a legacy of £20,000 by the will but the beneficiaries of the donor, under his will would have £5,000 more available for distribution between them[17].

Where the client pays tax at the higher rate, the saving is even more substantial. The charity could then receive £33,333. at the same net cost to the donor as £20,000. The mechanics in this case are slightly more complicated. Firstly, one must gross up the net gift of £20,000 by 100/(100-40), to give £33,333. The donor must then make this payment under the deduction of basic rate tax at 25%, so that he must actually pay over £25,000. The charity recovers £8,333 from the Revenue. The liability to income tax at the difference between the higher and basic rates, currently 15%, in this case £5,000, then falls to be deducted from the donor's income tax bill so that, once again, the net cost to him is only £20,000.

There is no objection to the donor borrowing in order to make the donation. The only real limitation is that he should have sufficient taxable income out of which to make the Gift Aid payment. It is not necessary to decide at the time of the gift whether the gift will be subject to the Gift Aid rules. It is sufficient if he afterwards completes the form and hands it to the charity. It is perfectly possible for the donor - or his personal representatives - to wait and see whether he had sufficient taxable income to cover the payment. If he did not, and still gave a Gift Aid certificate, the result would be that the charity would still receive an income tax refund from the Revenue but the donor or his personal representatives would

17 Subject to any inheritance tax which might be exigible.

then be obliged to pay that amount to the Revenue, so that the donor would unwittingly have increased the size of his gift.

Care must be taken if the client has to sell an asset pregnant with capital gain in order to realise the funds necessary to make the donation. To that extent, capital gains tax may well be payable which would not have been exigible had he retained the asset until death. A calculation will be needed of the net fiscal advantage in such a case. It should be remembered that a Gift Aid payment cannot be offset against a liability to capital gains tax.

5.6 Gifts of Life Insurance Policies

It may also be a good idea to consider giving away policies of life insurance. Once the client is dead and the insurers have paid up, their value will be beyond dispute. If they are given away during the client's lifetime, there will be considerable scope for arguing that their value at the time of the gift was nothing like the value ultimately received. The value cannot, of course, be less than the surrender value. Subject to that, however, the premium which the hypothetical purchaser would pay over and above the surrender value must be largely conjectural. Illness caused by HIV infection is highly unpredictable. A person may be dead in six months or survive for six years or more. Moreover, if a policy were taken out during the last decade there must always be a question as to whether the insurer would refuse payment on the grounds of material non-disclosure.

Life insurance policies are neutral so far as concerns capital gains tax. First, a lifetime gift would not give rise to a charge to tax nor would there be any loss of a tax-free uplift in the base cost on death. In the case of non-qualifying policies, there can be a charge to income tax where a policy is assigned for valuable consideration. Broadly speaking, where the policy is assigned by way of gift then the income tax position is neutral.

5.7 Joint Accounts

There may be something to be said, for purely practical reasons, in the deceased transferring any cash he may have into a joint account with his partner, the intention being that the partner will be free to deal with the money in the account as if it were his own if, and only if, he is predeceased by the client and the client has not in the meantime changed his mind.

While the joint account can very easily be opened up, a certain amount of formality is indispensable to avoid difficult questions arising on the death of the client. In the absence of any evidence to the contrary, if the client provided all the monies for the account, then it will be presumed that the joint holders held upon trust for the client. For while the special relationship between the partners might be relied upon as evidencing an intention to make a gift, the fact that the client was contemplating disability under a terminal illness would point in favour of arrangements having been set up for purely administrative reasons so that his partner would be able to act on his behalf.

The short answer might be expressly to provide that the account was held by the legal joint owners upon trust for themselves as tenants in common in equity. That, however, would constitute an immediate gift which might or might not be desirable. The client might take the view, rightly or wrongly, that while his partner might be able to cope with the pressures of his dying if he did not have a realistic economic opportunity to move out and could look forward to substantial benefaction only on his death, yet the partner might take a very different view if he were immediately put in funds.

Another problem is whether monies withdrawn from the account should be deemed to belong absolutely to the person who withdrew them or to whom they were paid or should continue to be regarded as still being held upon the same trusts as the account.

My own solution is to provide expressly that the joint account is held upon trust for the client for life, with remainder over to the partner. The client should, however, have power at any time in his life to revoke the trust. So far as the bank was concerned, one signature only would be necessary for a cheque. To the extent to which monies were withdrawn from the account and paid or applied to or for the benefit of the client, that should constitute a revocation of the trust, so that the monies, or goods or services obtained with them, belong absolutely to the client. To the extent to which monies were paid out of the account to the partner on the signature of the client, that would constitute a surrender of the client's life interest and an acceleration of the partner's entitlement in remainder, so that the partner became absolutely entitled to them. In any other case, the sums and any property acquired with them would still be held on the same trusts as the account.

This arrangement has the advantage of fully protecting the client. All the money in the account beneficially belongs to him, and his partner cannot lawfully make any of it his own, for example by withdrawing it or paying his own bills on the account. If the arrangement is not revoked, the partner becomes the sole legal and beneficial owner of the account on the death of the client and can deal with it immediately. If the client wishes to withdraw part of the money for himself, he is free to do so. Likewise, if he is incapacitated, his partner can withdraw money and use it to pay the client's bills and to provide benefits for him. The only way in which the partner can benefit from the fund during the lifetime of the client is if the client deliberately decides to sign a cheque in his favour by way of gift. In such a case, to avoid any conceivable doubt, it will be advisable for the client to write on the face of the cheque, underneath the place where the amount of the cheque appears in words, "Gift to payee".

6 Will Drafting

6.1 Executors and Trustees

Whom should the client appoint as his executors and/or trustees? It may or may not be appropriate for him to appoint the solicitors who are drafting his will. It is not uncommon for solicitors to offer a cut-price will-drafting service on the basis that they will obtain the rather more remunerative executorship. Such solicitors should bear in mind the decision of the House of Lords in *Wintle v Nye*,[18] where it was held that a beneficiary under a will must be able to show that the deceased knew and approved of the *contents* of the will and that where the beneficiary is the solicitor who drafted the will, then the onus of proof is very high indeed. It is certainly not enough to show that the will was properly executed and attested. It seems to me that exactly the same considerations must apply where a solicitor is appointed an executor and the will contains a clause allowing him to charge for his services as such. Unless a solicitor can show that the deceased specifically knew and approved of the provision allowing the solicitor to charge, then he will not be able to rely on the charging clause. The appointment of the solicitor as executor would probably remain valid, but once a solicitor had begun to act *qua* executor, he could not thereafter renounce his executorship and would therefore have to continue rendering his services *gratis*!

My own view is that in general it is better for the deceased to appoint a friend or relative to be his executor with a recommendation that he employ as his solicitors the solicitors who drafted the will. Here, however, it must be made very clear to the deceased that executorship is an onerous task which should be entrusted only to a person both able and willing to carry it out. The surviving partner may or may not be the best person. He should show his love and gratitude to his surviving partner by means of the provision he makes for him under the will and not by appointing him executor. The executor must be a businesslike person. It should ideally not be someone who is likely to be bowed down by grief or himself to be suffering health problems. Likewise, it would be unwise to entrust the executorship to, say, an aged parent.

On the other hand, executors have vested in them a certain amount of discretion in the realisation and administration of the estate. One cannot lay down hard and fast rules. Everything depends on the circumstances.

In most wills, the same persons are appointed as executors and trustees. Yet this is by no means essential. It may be, for example, that the surviving partner has no head for business or legal affairs but is intimately connected with the client's personal circumstances. Wills sometimes contain a provision authorising the executors to dispose of any chattels, not otherwise specifically disposed of, to

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18 [1959] 1 All ER 552.

whomsoever they think fit amongst the deceased's friends and relatives or charities. Now it would be perfectly possible to appoint, say, a solicitor as executor but to provide that the chattels should be held by the partner upon trust for such persons as he should in his absolute discretion think fit. In this case, the solicitor will be the executor but the partner would be the trustee.[19]

6.2 Review of Estate and Beneficiaries

The client should consider the totality of his assets and liabilities. He should then be invited to decide how the estate is to be divided, assuming it holds its value. In dividing up the estate in this way, account must be taken of the likely expenses of administration and any inheritance tax which it will suffer. The client may have strong reasons for making specific devises or bequests. He may, for example, wish to devise specifically to his partner his share in the home they jointly own or he may wish to bequeath specific chattels to named individuals. Subject to that, however, he may be concerned simply to devise his estate in shares or proportions.

Provision should be made, as far as possible, for changes in the value of the estate. This is particularly important in the case of an AIDS sufferer. While an elderly person may have mainly settled finances and a predictable income and expenditure, an AIDS victim may undergo several changes of fortune. He may receive a lump sum payment on early retirement from his pension scheme, with corresponding loss of death in service benefit. He may receive legacies from his partner or other friends who have been struck down by the disease. He may embark on a course of extraordinary expenditure, whether it be of luxurious items or holidays or medical or nursing expenses. Then again, the composition of his estate may change. He may cash in insurance policies or investments or sell his art collection. He may mortgage his home to provide cash for spending. Already suffering from dementia not readily obvious to third parties, he may make wild, successful bids at auction houses.

6.3 Specific v Residuary Gifts

It is particularly important to bring home to the client the difference between residuary gifts and other gifts. It should be brought home to him that expenses of administration and debts of the estate will firstly be borne out of residue, then out of pecuniary legacies and only last of all out of specific devises or bequests. He should be warned that gift of a specific asset will be adeemed if he no longer possesses the asset as of the date of his death and he must therefore make express provision for this eventuality.

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[19] Another way of achieving this would be to give the whole of the chattels to the partner so that he could then make personal gifts of them if he thought fit. Inheritance tax and capital gains tax considerations would need to be carefully considered.

It should also be explained to the client that if there are unexpected increases in the value of the estate, these would normally be to the advantage of the residuary legatees. Everything, however, would depend upon the wording of the will. If there were a gift of the deceased's second home to X and all his securities to Y, then a sale of the secondary home and the investment of the proceeds in securities would operate to detriment of X but to the benefit of Y, rather than the residuary legatees.

The *burden* of inheritance tax is also important. In the absence of any directions in a will to the contrary, the duty referrable to specific gifts and legacies would normally be borne out of residue. Failure to consider the burden of inheritance tax could thus adversely affect the residuary legatees.[20]

6.4 Inheritance Tax Considerations

On his death, the whole of a person's estate immediately before his death would normally fall into charge to inheritance tax unless it qualifies for some specific exemption or relief or is excluded property.[21]

The tax is imposed not simply on property passing under the terms of his will or on an entire or partial intestacy but also on his severable share under an equitable joint tenancy. Additionally, inheritance tax can be due on a trust fund if the deceased was entitled to the income of it immediately before he died.[22] If the deceased made a gift with reservation of benefit which did not cease until his death, the property gifted will likewise be dutiable on his death.

In order to determine the rate of inheritance tax applicable on the death, one must work out the cumulative total of chargeable gifts ("transfers of value") made by the deceased during the last seven years of his life. One includes in the total of these chargeable transfers of value gifts which were originally potentially exempt transfers ("PETs") made in the last seven years of his life and which have consequently become chargeable as a result of the death. One then ascertains how much of the deceased's nil rate band, for 1995/96 £154,000, was used up by these lifetime gifts. The balance is available to reduce the amount on which tax is

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20 The incidence of inheritance tax is extremely important where one of the residuary legatees is a charity: see 7.3.

21 Property can be excluded property only if the deceased was neither in fact domiciled nor deemed to be domiciled in the United Kingdom at the time of his death.

22 The taxation of trusts is extremely complicated and beyond the scope of this article.

charged ("the value transferred") on his death. The rest of this amount is then taxable at the flat rate of 40%.[23]

7 Testamentary Gifts to Charity

7.1 Method

The testator can leave money to charity in one of three ways. Firstly, he can establish a fully-blown charitable trust by his will. This is a most unusual course. If a client wishes to pursue this avenue, it will be far better for him to establish a charitable trust during his lifetime and then, once it was safely registered as such by the Charity Commissioners, to make a gift to it by his will.

Secondly, the testator can direct his trustees to pay or transfer money or assets to certain charities which they might select. The power of selection can be circumscribed, for example, so as to be limited to AIDS charities. This may be particularly appropriate in the case of AIDS charities, all of which are comparatively young and some of which have been set up and run with more zeal than efficiency. Their governing bodies, staff, volunteers and fortunes can change rapidly, so that a charity which may be a worthy recipient of the client's bounty at the time of making the will may fail to be so at the time of his death.

Thirdly, the testator may make a gift to a named charity. If the charity is not a corporation, it is usual to include a stipulation that the receipt of the treasurer shall be a sufficient discharge to the personal representatives. It is highly desirable that the name of the charity be correctly ascertained and that the number under which it is registered as a charity with the Charity Commissioners should also be included.

There is always the possibility of a charity becoming defunct before the will takes effect. That is particularly so in the AIDS world where the financial viability of certain charities, especially those depending heavily on government funding, is highly questionable, so that their demise within the short term cannot be ruled out. If the charity does not exist at the date of the client's death, then the gift will lapse unless a general charitable intent can be demonstrated. The safest course is either to include a series of default gifts or, my preferred option, to combine a primary

23 If the lifetime gifts which were or have as a result of the death become chargeable exceed the nil rate band, then inheritance tax will be exigible in respect of them. The personal representatives of the deceased can become liable for this tax. Sometimes, they are only primarily liable and sometimes secondarily liable, with a right of indemnity against the person primarily liable. Even in the latter case, however, the gifts cannot be entirely disregarded as the person primarily liable may be insolvent. For example, the deceased may have made substantial gifts to another AIDS victim who is now penniless.

gift to a named charity with a provision in default requiring one's trustees to select a charity having similar objects as the recipient of the legacy.

If a gift is made to a charity, then, in the absence of any stipulation to the contrary, that charity will be able to expend sums received in pursuance of any of its objects. Particularly in the field of AIDS, most donors are concerned to ensure that their gifts are applied directly for the benefit of sufferers or for the avoidance, by education, of future contamination. Few would wish their donations simply to relieve the government or the drug companies of the cost of general medical care or research. Some might be sceptical about AIDS charities with grand designs of building up large endowments and establishing jobs for life for their staff. Others may have more particular concerns. One gentleman of my acquaintance was particularly concerned that his legacy should not be used to finance jaunts by doctors to attend international AIDS conferences in attractive locations. "I know it happens," he told me, "because I've done it myself." In a case like this, it would be appropriate to add a stipulation that the legatee charity should use the legacy only for certain defined purposes. In principle, this is easier said than done. A gift to a named registered charity without any restrictions must be valid. Once one starts imposing restrictions, one must ensure that the recipient charity will be able to use the legacy in such a way that both complies with the restrictions and is not beyond its own powers. Care must also be taken to ensure that the gift is not so worded that the charity takes as trustee upon new, purportedly, charitable trusts. For in that case, the validity of the new trusts may be questioned by those in whose interests it is that the gift should fail.

We at CRUSAID recognise that many donors wish to ensure that their gift operates only to relieve individual hardship. We have therefore established the Individual Hardship Fund which dispenses several hundred thousand pounds a year to AIDS and HIV victims subject to stringent controls. I suggest:

> " I bequeath [my residuary estate] to CRUSAID, registered charity number 1011718, as an accretion to its Individual Hardship Fund, if such fund shall be in existence at the time of my death but otherwise to be applied in furtherance of any of its charitable objects; but if CRUSAID shall not be in existence at the time of my death then I direct my personal representatives to transfer [my residuary estate] to some other charity having like objects."

7.2 Inheritance Tax

7.2.1 Overview

Gifts made to charity are normally entirely exempt from inheritance tax. It does not matter whether they are lifetime gifts or gifts made only on death. Nor will they involve any charge to capital gains tax, whether they are made during one's life or on death. From an income tax view, it may be preferable to make a gift during one's life.[24]

Where the whole of one's estate is given to charity absolutely, no complication will arise. Where, however, there is only a conditional gift to charity or where only part of one's estate is given to charity, it is necessary to have regard to technical requirements in order to minimise the amount of duty payable on the estate as a whole. It is also very important to ensure that the incidence of the duty as between the various beneficiaries is that desired by the client. Here, considerable knowledge and attention is required.

7.2.2 Conditions for Relief

The general exemption from inheritance tax for gifts to charities is contained in the Inheritance Tax Act 1984 section 23. It is subject to conditions which are not generally appreciated.[25]

7.2.3 A Strategy

If the client were to leave property upon trust to pay an annuity to X during his life and subject thereto upon trust for a named charity absolutely, then the charitable exemption would not be available on his death as regards the amount of property needed to produce the income to pay the annuity. If, however, the testator were to bequeath the fund to charity A for its own use and benefit absolutely but were to provide that should charity A not in fact pay an annuity out of its own resources (which would be defined to exclude the gifted property or property from time to time representing it or the income therefrom) to X, then the gift to charity A should be defeated and the property should pass to charity B, the fund would qualify for the charitable exemptions. A whole series of defeasible gifts could be created in this way. The trustees of charity A would normally be acting within their powers if they were voluntarily to pay an annuity to X in order to secure the greater advantage of the bequest of the fund. They would merely be concerned to ensure that their charity were a net gainer. In my view, they are neither entitled nor obliged to consider the interests of charity as a whole.[26]

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[24] See 5.5.

[25] These are discussed more fully in my article 'Tax-Efficient Bequests to Charity' in *The Personal Tax Planning Review*, Vol 4, Issue 2.

[26] This strategy is discussed more fully in my article 'Tax-Efficient Bequests to Charity' in *The Personal Tax Planning Review*, Vol 4, Issue 2.

7.3 Advantages of Residuary Gifts to Charity

Part of the residue of a testator's estate will be consumed in defraying expenses of administration. As the inheritance tax charge on death is levied on the value of the estate of the deceased immediately before his death, and as it is not permissible to deduct the expenses of administration in calculating the value of the estate, such expenses must normally be paid out of funds which have borne inheritance tax. Where, however, a gift of residue enjoys an exemption, such as a charitable exemption, the CTO accept in practice[27] that the whole of the residue is exempt, including that part of the residue consumed in defraying the expenses of administration. Thus, suppose a client to have an estate of £350,000 and to have made no chargeable or potentially exempt transfers of value in the preceding seven years. He wishes to leave half of his estate to CRUSAID and the other half to his partner. It is estimated that the expenses of administration will be £10,000. Thus, he expects that each of CRUSAID and the partner should receive £170,000 before tax.

If the partner is given a legacy of £170,000 which bears its own duty, and the residue is left to CRUSAID, this will be the optimum solution. The £170,000 legacy to the partner will benefit from the nil rate band of £154,000 for 1994/95, and only the excess of £16,000 will be taxed at 40%, making a tax charge of £6,400. The remaining £180,000 will fall into residue and will be exempt notwithstanding that CRUSAID will receive only £170,000 of this, the difference being attributable to the expense of administration. If CRUSAID had been left a legacy of £170,000 and the partner had been entitled to the residue, then the £180,000 of residue would have been taxable at the rate of 40% on the excess over £154,000, making a charge of £10,400. If the residue had been left to CRUSAID and the partner in equal shares, then inheritance tax would have been exigible on half the total value of the estate, namely £175,000, resulting in a tax bill of £8,400.

Unless the client is literally on his death bed, there is always the risk of changes in the value of the estate between the making of a will and its taking effect. If the estate goes up in value, then the residuary legatee, namely the charity, will benefit and if it goes down the charity will suffer. One method of dealing with this is to make the pecuniary legacy to the partner depend on a formula. In a simple case, the executors could be directed to calculate the value of the estate at the date of death for inheritance tax purposes, deduct the estimated cost of administration and then divide the result by two in order to arrive at the amount of the pecuniary legacy.[28]

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27 I make no comment on whether this is justified in law.

28 The formula would have to be rather more complex where part of the estate qualified for a relief, such as agricultural property relief or business property relief.

I have spoken hitherto in terms of a pecuniary legacy. It may, of course, be that the client would like the partner to receive a gift *in specie*. While this might be rather more complicated, the principle remains the same.

7.4 Income Tax Savings Through Precatory Trusts

Consider the following scenario. The client bequeaths to his partner,[29] provided he has a sufficient taxable income, a pecuniary legacy of, say, £10,000. He earnestly requests and entreats the legatee, as a matter of moral obligation binding in honour only, to gift the £10,000 to CRUSAID. He makes it very clear, however, that the legatee is under no legal or equitable obligation to do so. Within two years of the death of the client, the partner receives the legacy and pays it to CRUSAID. He completes a Gift Aid certificate.

The result is that for inheritance tax purposes £10,000 of the estate qualifies for the charitable exemption: see Inheritance Tax Act 1984 section 143 (compliance with the testator's request). For inheritance tax purposes one deems the legacy to have been bequeathed by the will to CRUSAID. This deeming provision does not operate for income tax purposes. There is therefore nothing to prevent the gift qualifying for Gift Aid. The result is that, if the partner is a basic rate tax payer, there will be an income tax saving of £3,333 and, if he is a higher rate tax payer, there will be an income tax saving of £6,667, assuming, in both cases, that he has sufficient income taxable at the basic or higher rate respectively.

Whom will this strategy benefit? While the amount of tax saving is determined by (a) the amount which is paid to the charity and (b) whether the partner is taxable at simply the basic rate or also the basic and additional rates, the testator can within those limits choose on whom to confer the advantage of the income tax saving. If he intends CRUSAID to receive £10,000 in any event and bequeaths a legacy of £10,000 on a precatory trust to his partner, then, because of the technical rules of income tax, the benefit of the basic rate tax saving will enure for the benefit of the charity and that of the higher rate tax, if any, for the partner. If the client wishes the charity to benefit from the entire income tax saving, then he must adjust the amount of the legacy accordingly. One first grosses up the nominal amount at the basic and additional rates. With combined basic and additional rates of 40%, £10,000 grossed up is £16,667. One then subtracts from this income tax at the basic rate. As the basic rate is currently 25%, one subtracts £4,167 to leave £12,500. This will then be the amount of the legacy. A benefit of £16,667 will be conferred on the charity, as it will be able to reclaim £4,167 income tax. The partner will have paid over the legacy of £12,500 but will have received a higher-rate tax saving of 15% of £16,667, namely £2,500. If the estate is not liable to inheritance tax, the client will deduct £2,500 from the amount of another

[29] Or some other beneficiary whom he may wish to benefit.

testamentary gift[30] to the partner,[31] so that the partner finishes up in the same position as if he had not been bequeathed the legacy of £12,500. As far as the estate is concerned, although the legacy to the charity will have been increased by £2,500, this will be compensated for by the reduction in the testamentary gift to the partner which is not subject to a precatory trust. Thus, no other beneficiary will be worse off.

If the estate is subject to inheritance tax, there is a further saving, which results from the fact that the charitable exemption from inheritance tax will be available as regards £12,500 of the estate, rather than £10,000. Assuming that the partner would have suffered 40% inheritance tax on the extra £2,500 of the legacy for his own benefit which has in fact been reduced by that amount,[32] he will have made an income tax saving of £2,500 but lost only the net amount of the £2,500 legacy, after inheritance tax, namely £1,500. He is thus £1,000 better off. In principle, the testator could ensure that this benefit too passes to CRUSAID by increasing the amount of the legacy left to the partner on precatory trusts and decreasing further the amount of the legacy left to the partner for his own benefit. Because this results in further inheritance tax and income tax savings, which compound each other, the additional amount which CRUSAID will receive at the end of the day will be greater than £1,000 and will in fact, in the illustration, be £3,333. For the nominal amount of the precatory legacy will be £15,000 and the charity will recover £5,000 income tax, making a total benefit of £20,000, as compared with £16,667. The legatee will obtain a higher rate tax saving of £3,000. The precatory legacy will be £5,000 higher than a straight legacy to CRUSAID. The legacy to the partner for his own benefit will thus be reduced by £5,000. As he would have suffered £2,000 inheritance tax on the amount of the reduction, he has lost only £3,000 net, which is equal to his higher rate tax saving.

If, by contrast, the client wishes the whole of the tax saving to pass to his partner and/or some other beneficiary, then the calculation would be different. The charity will finish up with £10,000. The nominal amount of the legacy must therefore be £7,500, which is the amount the partner will pay over to the charity. The charity will recover £2,500 basic rate income tax notionally deducted while the partner will obtain a tax deduction of 15% (being the difference between higher rate and basic rate tax of 40% and 25% respectively) of £10,000, namely £1,500. The overall income tax saving of £4,000 is smaller simply because the payment made to the charity is smaller.

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30 It does not matter in principle whether the gift is a legacy, a devise or a bequest and whether specific or residuary.

31 This is the only way in which the income tax benefit conferred on the partner can be "reclaimed" from him.

32 I assume that the legacy bears its own tax. If it does not, the tax position is in principle the same, but in practice more complex.

What is the position of the partner? So far, he has obtained a tax saving of £1,500. The estate will have a further £2,500 which can be given to him (or some other beneficiary). If the inheritance tax nil rate band of the deceased has not been otherwise utilised, he will keep the whole of this amount, so that, by this strategy, the testator will still have given £10,000 to CRUSAID but he will have conferred an additional extra benefit on his partner of £4,000. If, however, the £2,500 is itself taxable in its entirety, at 40%, then the partner will receive only £1,500 extra directly from the estate and will thus obtain an additional benefit of only £3,000.

How exactly the testator decides to allocate the benefit of the income tax saving depends on his outlook. If he wishes to benefit CRUSAID as much as possible, then he will clearly allocate the benefit to CRUSAID. If he wishes as much tax to be avoided as possible, then he will likewise allocate all the benefit to CRUSAID. If he is content for CRUSAID to receive the same sum as if the strategy had not been adopted, and which is primarily to benefit his partner or some other non-charitable beneficiary, he can do so, but he should realise that the overall tax saving cannot be as great as if he had allocated the benefit to CRUSAID. He can, of course, share the tax saving in whatever proportions he thinks fit. He should realise, however, that the greater the amount of benefit which passes to the partner (or other non-charitable beneficiary), the less the amount of the overall tax saving.

7.5 Anonymous Donations to Charity

A will is a public document. Even in 1995, there are those who would not wish the world to know that they have made a legacy in favour of CRUSAID. The HIV virus is in most cases sexually transmitted. Some people understandably regard their sexual activities as a private rather than a public affair. Then again, they may not wish to expose their aged parents living in some hierocratic offshore island to un-Christian opprobrium. One solution is to employ a fully secret trust. Under the terms of the will, one would read "I bequeath the sum of £100,000 to Grosvenor Trustees Limited." Before the will has been executed, the directors of Grosvenor Trustees Limited will have written a letter to this testator, which will be kept on file with the will, to the following effect: "In consideration of your bequeathing £100,000 to Grosvenor Trustees Limited, we hereby undertake to hold such legacy upon trust for CRUSAID, registered charity number 1011718 absolutely."

This is all that is needed to create a secret trust of the legacy for CRUSAID. The trust is secret because it does not appear on the face of the will. It is nevertheless a fully valid trust. As in equity the legacy belongs to CRUSAID at all material times, it will enjoy the charitable exemption notwithstanding that the nominal legatee is not itself a charity.

One disadvantage of a fully secret trust is that if the nominal legatee does not survive the testator then the gift will normally lapse.[33] If the legacy is to an individual, there is always the danger of the premature death of that individual. A gift to a corporation is safer, although it must be remembered that a corporation can go into liquidation. Corporations cannot normally, however, be liquidated as speedily as individuals. Another possibility is to make the legacy a joint one to up to four individuals, the likelihood of none of whom surviving the testator is remote in the extreme.

7.6 Property Qualifying for Agricultural Property, Business Property or Foreign Taxation Relief

Agricultural property and business property comprising a deceased's estate may qualify for agricultural property or business property relief at the rate, in each case, of either 50% or 100% The rules are extremely complex. The basic principle is that if a will includes gifts which are exempt, such as gifts to charity, and gifts which are not exempt and also includes property qualifying for relief at a given rate and other property either not qualifying for relief at all or qualifying for relief at a lower rate, then one must ensure that as far as possible the exempt gift is of property which would otherwise be taxable at the highest rate and the taxable gifts are, so far as possible, of property which qualifies for the highest rate of relief. While the principle is a readily intelligible one, its application in a given case can be surprisingly complex.

Similar, if not identical, considerations apply where part of a deceased's estate is subject to death duties in another jurisdiction with a corresponding tax credit against United Kingdom inheritance tax. Few foreign jurisdictions would allow an exemption from death duties on the grounds that a gift was made to a UK charity.[34] In such a case, it will be necessary to consider the rate of UK inheritance tax borne by the gift. There is no point, for example in my bequeathing one of my French homes to a United Kingdom charity as it will bear French death duties at the rate of 60%. As this is greater than the maximum rate of United Kingdom inheritance tax - 40% - the gift is effectively exonerated from United Kingdom inheritance tax. It will therefore make more sense to devise it[35]

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33 There are arguments to the contrary.

34 The safer view is that the exemption from UK inheritance tax will apply only where a gift is made to a UK charity. In practice the CTO appear not always to take the point, especially where the recipient charity is established under the laws of one of the states of the European Union.

35 Insofar as French law allows me the testamentary freedom to do so.

by way of a gift which is in principle chargeable under UK law.[36] I ought rather to devise to the UK charity, say, UK residential accommodation which is leased to tenants, for that would otherwise bear inheritance tax at my full estate rate.

It might happen that the client does not wish to give property qualifying for agricultural property or business property relief to legatees who are not exempt from inheritance tax. He may, however, be perfectly content to give cash. Then again, the client's major asset may consist of a substantial holding in a private trading company, qualifying for 100% business relief, yet he may wish to make a large number of legacies. The last thing he would want is for the holding to be split up among several beneficiaries, thereby reducing its overall value or depriving his personal representatives of control. A strategy to be adopted in such a case is discussed in my article 'Tax-Efficient Bequests to Charity'.[37]

7.7 Deeds of Variation

I may be that a testator has died leaving a bequest to charity but has not had his will drafted in the most tax-efficient way. It will usually be possible for the beneficiaries to enter into a tax-efficient variation of the dispositions of his estate. The variation must be effected within two years of the death and appropriate elections[38] communicated to the Revenue within six months after the deed has been executed. Specialist advice will be required on a case-by-case basis.

7.8 Conclusion

Making bequests to charity as tax-efficient as possible is no simple task. An investment in advice from a specialist in tax and charity law, either before or after the will takes effect, can often benefit a legatee which is a charity and, possibly, in addition other beneficiaries.[39]

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36 The position is complicated further by the curious French rules which make the rate of succession duty depend on the relationship of the beneficiary to the deceased. It would therefore pay, so far as possible, to devise one's French realty to those who would pay the least French tax, reducing their share of UK assets accordingly.

37 Published in The Personal Tax Planning Review, Vol 4, Issue 2.

38 For either inheritance tax or capital gains tax or both.

39 For further reading, see *Tax Planning and Fundraising for Charities*, by James Kessler and myself, second edition published by Key Haven Publications PLC summer 1994.

8 General Conclusion

In this article, I have looked at several related problems from a variety of legal and practical angles. Inevitably, the ground covered has been so extensive that several topics have been covered in outline only. This article cannot, of course, be a substitute for specialist advice in individual cases. It will have achieved its purpose if it has highlighted problems and pointed to some solutions, especially ones of a prophylactic nature.