DEATHBED SITUATIONS: IHT AND CGT

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No individual should leave his IHT planning to his deathbed, but some of course do. There is very limited scope for artificial arrangements such as were common, and a deathbed marriage of convenience to secure the spouse exemption may not have a wide appeal. There are, however, a number of steps which can be taken to reduce the burden of IHT and CGT or to facilitate further advantageous post-death planning; a selection is set out below:

- Advantage should be taken of the IHT *exemptions available only during lifetime*, in particular the £3000 and £250 p.a. gifts under ss.19 & 20; marriage gifts and settlements s.22; normal income expenditure s.21 (as to the regularity requirement and how to overcome it, see *Bennett v IRC* [1995] STC 54). If an individual is life tenant of a fund passing on his death to strangers, he can ensure his own family receive the full benefit of the nil-rate band by making PETs to them in his lifetime (i.e. by way of termination of the life interests) which become chargeable on death and earlier in the cumulative ladder, leaving the settled fund to bear the full rate of IHT on cumulation after his gifts.

- Make sure that **gifts by cheque** are completed; a gift by cheque is not completed until it is paid and cleared. Until then, it is simply a revocable authority to the bank which can, of course, be withdrawn by stopping the cheque. In *Re Owen, Owen v IRC* [1949] 1 All ER 901, the decision turned on whether gifts by cheque (drawn outside the statutory gift period but cashed within) were subject to estate duty; and it was held the gifts

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(All statutory references are to the Inheritance Tax Act 1984 unless otherwise stated.)

were completed only when the cheques were honoured, so that the gifts were made within the statutory period and were liable to estate duty. *Owen* was quoted with approval in *Parkside Leasing Ltd v Smith* [1985] STC 63 where it was held the date of entitlement to income for Schedule D Case II purposes was not the date the payee received the cheque (even though drawn on the Bank of England and therefore possibly as good as cash), but the date the cheque was cleared, which was in the next accounting period. The same principle was applied in *Barclays Bank Plc v Bank of England* [1985] 1 All ER 383 which makes it clear that when a presenting bank (i.e. that of the payee) receives from him a cheque for collection, its responsibility to him is discharged only when the cheque is physically delivered to the payer's branch for decision whether it should be paid or not.

This principle that a gift by way of cheque takes effect only when cleared should be kept in mind where time limits are approaching. It could be relevant, for example, at each yearly stage of taper relief if the time spent in clearing the cheque made the time of the original gift a few days late. Also in respect of the running of the seven-year period of PETs and the renewal of the nil rate band.

- Ensure that all gifts are outright ones, and not *donationes mortis causa*. Such gifts are those made in contemplation of the death of the donor and therefore are conditional and only take effect on the donor's death; and can include land as well as personalty (*Sen v Headley* [1991] 2 All ER 636, CA). Moreover, these gifts are automatically revoked if the donee predeceases the donor or if the donor recovers from the illness. It would therefore seem that the donor retains such an interest as would make it a gift with reservation. The amount of IHT is thus not affected.

It follows that donors should observe two criteria:

(1) Never make a gift *donatio mortis causa* unless it is genuinely desired that the gift should lapse on recovery.

(2) If it is wished to make an unconditional gift on a deathbed or in an illness and the gift is likely to be exempt only if made during lifetime (e.g. the annual £3,000, normal income gift, marriage or an exempt £250) the presumption that the gift is a *donatio mortis causa* should be firmly rebutted. For example, the donor could accompany the gift with a letter to the donee to the effect that the gift is unconditional, is to take effect forthwith and is not dependent on the donor surviving or any other contingency.

- Other important reliefs which have application on death include *business relief* ss.103-114, *agricultural relief* ss.115-124 and *woodlands* ss.125-130; and *works of art* ss.25-27, 30-35, 77-79 (which exceptionally have no stipulated period of ownership). Check also in the case of partnerships or private companies' shares that there are no 'buy and sell' arrangements - see Statement of Practice SP12/80 of 13.10.1980 which has recently been confirmed by the Capital Taxes Office. If they do exist, substitute option arrangements.

- Avoid mortgaging or charging business or agricultural assets as this will reduce assets eligible for relief. Wherever practical, charge *collateral* assets. It has been suggested that for business and instalments reliefs such charging of collateral assets may not work because these reliefs are available only in respect of 'net value' of the business (see s.110(1) and s.227(7)) and therefore if the proceeds of the borrowings are used for the purpose of the business, they reduce the reliefs for that reason. The solution could be to interpose a partnership so that the borrowings are used to provide the partnership capital. The problem does not apply to agricultural relief.

Even on a deathbed situation it should be possible to take a charge off business/agricultural assets and substitute *other* property as the security, e.g. portfolio shares, the home or other investment assets.

Although business/agricultural assets have to be held for a minimum period (2 or 7 years, depending on the circumstances), there are important succession and successive transfer provisions (ss.108, 109, 121) whereby the ownership by the original donor can be tacked on if the original gift or the gift by the original donee is made on a *death*!

Woodland relief is unlikely to be a practical solution as the asset has to be owned for 5 years prior to death; in any event the best solution is to claim business property relief if at all possible.

- If there is time, make **one or more small discretionary settlements and let the client settle assets by his will on those trusts**. This should also prevent operation of the *related settlement* provisions (see s.62). It is possible to create a settlement giving one's spouse a revocable interest in possession and, subject thereto, upon discretionary trusts; with the result that on revocation of the spouse's interest the rate of IHT will be determined by the spouse's cumulative ladder (s.80). Distributions within two years of death are at present treated as made under the will (s.144) and this allows more extended thoughts on destination. (No distribution to a spouse though in the 3 months from death; see *Frankland v IRC* [1996] STC 735). There is also the two-year precatory trust under s.143.

- If there is no time for a fresh will, consider the planning possibilities available in the two years after the death through a deed of variation or disclaimer of the will or intestacy under s.142. The benefit of this legislation is unlikely to remain for much longer, particularly as regards variations.

- Should the healthier spouse (say the wife) have chargeable assets showing large **capital gains**, they can be transferred to the husband during lifetime in order to obtain a new base value for CGT on his death and they can return to the wife exempt from IHT under his will.

The ailing spouse could also leave his assets to the surviving spouse, thereby obtaining CGT exemption and market value uplift. Thereafter, the surviving spouse may be in a position to make PET gifts to members of the family. Indeed, this may be the correct general formula to adopt where assets show a high CGT liability (e.g. a low or nominal base value) and hold-over relief is no longer available, leaving the bulk of one's estate to the surviving spouse.

For example:

○ Spouse A owns substantial assets showing a large capital gain.

○ Spouse A transfers these assets to spouse B (who is likely to die first) free of CGT and IHT.

○ Spouse B (dutifully) dies.

○ Spouse A receives the assets free of CGT on B's death and *uplifted* to the then market value. (BUT no uplift if A merely receives a *life interest*: TCGA s.73(1)(b).)

The arrangements should be carried out subtly and with *Ramsay* in mind. Consider using a s.144 discretionary trust with an appointment to spouse A *after* 3 months.

- One method whereby a testator before his death might at the same time **benefit both a charity and an individual** is a possibility. The suggestion makes use of a s.143 precatory trust whereby, if a legacy is bequeathed by will to a legatee with a non-binding request that the legatee carries out the request within two years of the death, the legatee's transfer should be treated for IHT as having been made by the testator. If the request was in favour of a charity, the benefit is then exempt from IHT. However, for purposes other than IHT, the transfer has been made by the original legatee. He therefore should be able (assuming sufficient taxable income) to take advantage for income tax of the gift aid provisions of FA 1990 s.25 as improved by FA 1993 s.67(2) and (4), whereby a gift of at least £250 can be treated as a net amount and qualify for tax relief.

Result/Example: Legacy of £6,000 from, say, father to son in former's will:

Tax saving:

		£
Testator's charitable gift - 40% (s.143)	=	£2,400
Beneficiaries' higher rate gift aid relief (gross up at basic rate = £7,895)	=	£1,263
Charity recovers basic rate on grossed up amount of £7,895	=	£1,895
		£5,558

$$\frac{£5,558}{£6,000} = 92.6\%$$

And charity receives 32% more (£7,895 - £6,000)

- **The position of the non-UK domiciliary**

Property situated outside the UK is excluded property for IHT if the person beneficially entitled to it is an individual domiciled outside the UK.

As mentioned in ss.6(1) and 48 there are two basic requirements for obtaining the IHT exemption:

(1) The property is situated outside the UK, and

(2) The person beneficially entitled to it is an individual domiciled outside the UK and not, despite that, deemed domiciled in the UK under s.267.

As to (1) there is not minimum time condition, and therefore our client near to death who has a non-UK domicile but assets in UK could consider various methods including: sale and remitting the proceeds abroad (but consider CGT carefully, the death market value uplift will be lost); transfer abroad chattels, money on UK bank deposits, bearer shares, use the spouse exemption; gifting fixed assets to a foreign company - again subject to possible CGT disadvantages; borrowing cash secured on the UK assets and depositing the cash abroad. These suggestions are covered in detail in the excellent Key Haven Publications PLC *Tax Planning for the Foreign Domiciliary* 2nd Edn by James Kessler and Peter Vaines.

- **The UK domiciled testator/settlor - unconventional wisdom (a quasi-deathbed situation)**

  Where valuable assets exist which are eligible for 100% IHT business or agricultural property relief, for tax purposes the main drawback to a lifetime gift of the property is now the capital gains tax position. Hold-over relief may well be available under s.165 Taxation of Chargeable Gains Act 1992, but the tax-free uplift to market value on death of the owner is clearly much the better alternative.

  In appropriate cases one should now consider whether the asset could be gifted to an elderly relative, i.e. near(er) to death, for example a grandparent. The gift to the elderly person would be free of IHT, and CGT hold-over relief will normally be available. On the elderly person's death, 100% IHT relief should be available, the normal minimum period of ownership may also be relaxed under ss.109 or 121 (see above). On the death of the elderly relative the property may then pass under the *relative's Will* to the intended beneficiaries with the benefit of the CGT uplift to market value.

Alternatively, the elderly person's Will could provide for the business or agricultural property to pass into a non-resident trust. The settlor charge TCGA 1992 s.80 would not apply to the trust, he or she being deceased and therefore having no domicile, and the assets would have a base cost equal to market value at death. The transfer into the offshore trust could not be done by way of deed of variation made by the beneficiaries, because, following the House of Lords decision overruling the Court of Appeal decision, any beneficiary effecting a deed of variation will be treated for CGT purposes as the settlor - the settlor will not be the testator: *Marshall v Kerr* 1994 [STC] 638.

Example:

Albert owns 75% of the family business Albert Engineering Ltd. He intends to gift this shareholding, currently worth £800,000 and showing a potential CGT of £300,000 after indexation, to his son Jim.

If Albert makes the gift, CGT will be incurred on this gain (assuming retirement relief is not available) subject only to hold-over relief deferment. Albert therefore gifts the shares to his father Jeremy aged 80, holding over the CGT and hoping that in his Will Jeremy will in turn leave the shares to Jim (and not the barmaid - there must clearly be no agreement or arrangements as to Jeremy's bequest). Jeremy then dies leaving the shares to Jim in his Will.

The effect:

IHT - nil
CGT - nil plus market value uplift; £300,000 CGT, being washed out on Jeremy's death, is saved by Jim.

- **IHT, CGT: non-domicile situation.**

  As regards a **settlor domiciled outside the UK when the settlement is made, provided the assets are also outside the UK** the settlement will be and remain excluded property for IHT purposes, the domicile of the beneficiaries being irrelevant.

So it may not be too late - even on a deathbed.