Newsletter

BURGES SALMON

Private Client Briefing

Issue 19

Welcome

Welcome to Issue 19 of **Private Client Briefing**, our periodical aimed at keeping you informed of current issues and news.

For further information on any issues raised in **Private Client Briefing** or individual legal advice generally please email **tom.hewitt@burges-salmon.com.**

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Pre-nups - What to believe?

Pre-marital agreements (pre-nups) have been in the news a great deal recently. In February The Law Commission published a report supporting their role, recommending a change in the law so that they could become binding. However, there have also been a number of high profile court cases in which the courts have overruled pre-nups. So, what to believe?

The most recent court decision on pre-nups involved Victoria Luckwell, whose father created the company which gave the world Bob the Builder.

Miss Luckwell had a pre-nup which was designed to protect property she had inherited from her father. But, the court overruled the agreement because it would have left her husband with no assets at all.

However, the fact that they had entered into an agreement still had a profound effect on the terms of the settlement and her husband received substantially less than he would have otherwise.

The case was very bitter and shows how difficult it can be to predict the precise outcome where the court considers a pre-nup to be unfair. In our experience it is often preferable to have an agreement which provides for needs to be met as that is more likely to be upheld in its entirety by the court.

Since Miss Luckwell's case The Law Commission has published a report on pre-nups. The report recommends a change in the law so that properly entered into pre-nups would be binding contracts, called Qualifying Nuptial Agreements.

For such agreements to be binding, they would need to meet certain safeguards and crucially provide for the basic needs of the parties. If they did not, although they might still be influential, the court would still have the power to overrule them.

It remains to be seen whether this or a subsequent government adopts The Law Commission's proposals but, even if they do not, the courts are still likely to take them into account.

Whilst hardly romantic and not for everyone, pre-nups are undoubtedly something to consider if seeking to regulate what would happen in the event of a divorce.

In particular, we have seen interest in pre-nups from the following groups of people:

- couples who want to protect assets for their children from a previous relationship;
- the children of parents who would like to pass on assets for future generations;
- those with specific inherited or family assets; and
- those with international connections.

Increasingly we are being asked to advised on pre-nups as part of a wider estate-planning exercise and The Law Commission's proposals suggest that this will only become more commonplace.

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Where there's a Will, there's a way to correct it

Brooke v Purton and the Court's powers to interpret Wills

Following in the wake of the Supreme Court case of *Marley v Rawlings* in February this year, a decision in the High Court has found that where a Will does not reflect the testator's intention, the court may intervene to interpret the Will to give effect to their wishes.

The Supreme Court's decision in *Marley v Rawlings* involved mirror Wills made by a husband and wife, where each had signed the other's Will at a meeting with their solicitor: at face value both Wills were invalid. The mistake only came to light on the second death, and the Court found that they could use their powers of rectification to amend the Will on the basis that there had been a clerical error in executing the Will.

Rectification of a Will is a statutory remedy which can be used only where there has been a clerical error or a failure by the draftsman to understand the testator's instructions, which in turn has led to the Will not reflecting the intentions of the testator. The Supreme Court held that the "clerical error" in this case was the mixing up of the Wills when they were signed, and ordered rectification.

However, the wider significance of the case lies in the approach to the interpretation of the Will: the Court gave weight to the concept that a Will might be interpreted in light of the intentions of the parties to it, much in the same way as any other legal document, without necessarily the need for it to be rectified under the statutory powers. Though not necessarily an entirely new approach, the judgment may open up a new interest in approaching the courts for remedies where Wills do not fit within the route of rectification.

Such a case has recently come to the High Court. In *Brooke v Purton* the draftsman had erroneously used a precedent Will clause without fully considering its effect, which was that the testator's business assets, which were clearly intended to be passed to a discretionary trust, would pass to his young children outright. This was not what was intended either by the draftsman or the testator.

The High Court followed the approach advocated in *Marley v Rawlings* and interpreted the meaning of the Will in light of the testator's intentions and the surrounding circumstances, and gave effect to these intentions by construing the meaning of the Will as if certain terms were omitted. The judge decided that he did not need to use his powers of rectification to do this, but could as a matter of construction ignore the offending terms to give effect to the testator's intention.

Though both cases illustrate a relaxation of the court's approach to allowing a reinterpretation of a Will after death, this is not to say that every effort must still be made to get a Will right in the first place! Costly litigation is no substitute for a properly drafted Will.

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Employees' rights to flexible working: a right to ask

From 30 June this year the right to request flexible working will be extended to nearly all employees. Any employee with 26 weeks' continuous service will be able to make a request to work flexibly, regardless of whether they have any caring responsibilities for either children or adults. This will apply to all types of employees and not just in a traditional business environment; nannies, gardeners and domestic staff will be within the rules, as well as farm and estate workers.

In dealing with requests, employers will be required to demonstrate that they have complied with a proper procedure. The previous complex statutory procedure will no longer apply. Employers are instead advised to follow the ACAS Code of Practice. Central to this process is the need for an employer to give reasonable consideration to a request and the whole process, including any appeal, must be completed within three months.

The right is only to make a request to work flexibly; the employer does not have to agree to this. However, an employer can only turn down a request where there is a good business reason for doing so. The ACAS code still includes the eight statutory grounds on which a request may be refused, which includes cost to the employer, the ability to meet customer demand and the impact on quality and performance that a flexible working arrangement may have.

If an employer agrees to a request, this will normally result in a permanent change to an employee's terms of employment, although the employer may be able to negotiate a change on a temporary or trial basis.

Case law has shown that if an employer refuses a request, they run the risk of claims for discrimination (in particular sex discrimination) and possibly constructive dismissal. It is, therefore, very important to follow a suitable process when considering requests and to be able to demonstrate good, objective business reasons for any decision to refuse the request.

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The spread of ATED: Property taxes extended

Chancellor George Osborne is set to extend his tax raid on property owners over the next two years, bringing more modest tax payers within his sights. We look at the extension of these tax charges over the coming years.

Pushing the envelope

April 2013 saw a new term enter the lexicon: the "enveloped dwelling". An enveloped dwelling is a residential property owned by a company (or equivalent).

Two new tax charges were introduced to counter the perceived use of such "envelopes". Initially these taxes just caught properties worth over £2m, mainly in the South East. But the taxes are now being extended.

One of the new taxes will soon apply to properties worth more than £500,000 held in envelopes: barely twice the UK's average house-price. The other will apply to all properties whether or not enveloped.

The Taxes: the current regime

Since 1 April 2013, owners of enveloped dwellings pay an "annual tax on enveloped dwellings" or "ATED", where the property had a value of £2million or more on 1 April 2012.

Corporate bodies are usually outside the capital gains tax ("CGT") net, instead paying corporation tax at a lower rate. The changes also extended CGT to disposals of properties subject to ATED, meaning a higher rate of tax for structures when a property is sold.

A higher 15% rate of Stamp Duty Land Tax ("SDLT") also applies when residential properties are bought by companies.

Widening the net

In the 2014 Budget, the Chancellor announced that ATED is to be extended over the next two years to apply to more modest enveloped dwellings. Two new bands will be created for ATED:

- Properties valued at between £1m and £2m be caught from 1 April 2015, with an annual charge of £7,000; and
- Properties valued at between £500,000 and £1m will be caught from 1 April 2016, with an annual charge of £3,500.

The annual charge for each of these new bands will increase in line with the rate of inflation, but the bands will remain at the same level.

The ATED-related CGT charge will also be extended to include these lower valued properties, applying from 6 April in 2015 and 2016 respectively. However, CGT will only apply to gains on the properties that have accrued on or after those dates.

Finally, from 20 March 2014 onwards the 15% SDLT rate will also be extended to properties worth more than £500,000.

Non-resident owners

Currently non-residents do not pay CGT on disposals of UK property. In March, the government published its consultation on how it will implement plans to change this, making non-residents pay CGT on disposals in the same was as their resident counterparts but only in relation to UK residential property.

The new CGT charge will come into effect from April 2015 but only on gains from that date. All residential property will be caught, whether let out or occupied by the non-resident, and it doesn't matter if the owner is an individual, company, trust or partnership.

Details of how this will interact with the ATED-related CGT charge have yet to be set out, but it is clear that there will be different rules, exemptions and reliefs across the two regimes.

Beating the ATED charges – farmers and property businesses

Companies have become more commonplace in farming in recent years. Where these companies own land which includes the farmhouse, they may come within the ATED charge.

However, relief is available. If a company owns a farmhouse that is occupied by either a farmworker or a retired farmworker it will be relieved from the ATED charge.

There are broadly two conditions; first the farmhouse must form part of land occupied for the purposes of a farming trade, and crucially, the company owning the house must also carry on the farming business; second, the farmworker must work an average of 20 hours a week in the business, either in a management role or out on the tractor.

There are also reliefs available for property letting businesses, property development businesses and property dealers.

Even if a relief is available a tax return must be made claiming the relief, which may be an unwelcome burden for businesses.

Options for the future: to restructure or pay up?

As these extensions have been announced well ahead of their introduction, there is time for those who may be affected to consider restructuring to take themselves out of the charging regime.

However, it is important to seek advice before "de-enveloping" regarding available reliefs and the impact of removing properties from their current structures. Holding property at company level may offer IHT protection, particularly for overseas individuals, who may feel that the relatively small annual charge (£7,000 on properties worth between £1m and £2m) compares favourably to any potential IHT exposure holding the property directly. There are also potential benefits for inheritance tax reliefs which need to be considered.

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PCB bulletins

Taxation of Trusts: HMRC consults for a third time

On 6th June HMRC published its third consultation document over attempts to simplify IHT charges on Trusts. This concentrates on the nil rate band ("NRB") available to the trustees of a settlement.

As the rules currently stand it is possible to create a series of trusts on successive days by settling assets with a total value across all the trusts within the NRB. The benefit of this approach becomes apparent at the first 10 year anniversary when each trust is treated as having its own NRB for the purposes of the IHT calculation. The result is that there is a far greater headroom for assets increasing in value before an IHT charge arises (although in truth this approach is quite unwieldy and the extra costs need to be weighed carefully against the benefits).

The proposed rules allocate only one NRB to a settlor that he or she must then "elect" to split between trusts created after 6th June 2014. Trusts created before 6th June will retain their NRB, but the proposals would apply to property to them added after 6th June.

The consultation document retains the proposal to apply a flat charge of 6% to all 10 year anniversary or exit charge calculations.

The closing date for responses is 29th August 2014.

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Capital Gains Tax: Principal Private Residence Relief

The "final period exemption" for principal private residence relief ("PPR") has been reduced from 5 April 2014 from 36 months to 18 months. This relief allows homeowners to claim PPR in full despite having moved out prior to the sale. Previously, a person could not live at a property for 3 years before sale and still claim the relief in full, but now this period has been reduced to 18 months.

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Employee Benefits: NICs Pitfalls

A recent Supreme Court decision has found that where an employer makes a payment for an employee's benefit to, for example, a pension fund or insurance company, National Insurance Contributions ("NIC") should not usually be charged. The key determining factor is whether the payments are "earnings" - they won't be if the employee has no right to the payment itself but only to the benefit procured by the payment. In that case NIC should not be levied.

The Supreme Court suggested that earnings for NIC purposes are more narrowly defined that "emoluments" for income tax purposes. However, in many cases the rules on disguised remuneration may well apply and bring the payments within both the NIC and the income tax net in any case.

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Consultation on the use of Charities in tax avoidance

HMRC consulted earlier in the year on the use of charities in tax avoidance schemes. HMRC has stated that it wishes to target only "extreme cases of abuse", and allow normal charities and charitable giving to continue unaffected.

The draft legislation issued as part of the consultation is aimed at preventing the establishment of charities where securing a tax advantage is the main purposes, or one of the main purposes of the establishment of that charity. If this is found, HMRC would not recognise the charity for tax purposes from the outset. It does not currently affect the legislation regarding charitable giving.

The proposals have proved controversial in the charities world. Bodies such as STEP have suggested that obtaining a tax advantage is part of the nature of charitable status, and legislation should focus on the abuse of those reliefs, and not on the establishment of charities per se. HMRC's proposals suggest that it would have the power to refuse the registration of charities, leading to uncertainty and possibly a deterrent to those seeking to establish genuine charities. The results are due in the summer.

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