

NOT SO FREELY GIVEN?

Where legacies are 'free of tax', the IHT is greater, because of grossing up. **NEIL LONG** explains why there can be a risk of negligence liability for the full tax position if this is overlooked

'GROSSING UP' NOT a particularly attractive term and, frankly, not an especially well-loved aspect of the inheritance tax rules.

But it is a crucial area to understand. Those who prepare wills must be able to identify where it is going to apply, understand its effects, and advise clients accordingly. The central theme of this article is that those who don't identify the issues, or identify them but then fail to advise their clients properly, may leave themselves open to negligence claims when the will comes into effect. For those reasons, you as a professional legacy officer need to be familiar with this area, so you can spot the problem cases and take the necessary action.

This article will give an overview of the rules on grossing up and will then go on to analyse the extent of the liability falling on the professional who prepared the will. We shall also look at some of the remedies available to charities who have suffered from the effects of poor quality advice being given to the testator during his lifetime.

What is grossing up?

Grossing up is a creature of the inheritance tax (IHT) rules and applies to estates where:

- ◆ the will contains gifts to non-exempt beneficiaries, the most common example being legacies to individuals;
- ◆ these legacies are 'free of tax' (whether expressly or by operation of law);
- ◆ the value of the tax free legacies exceeds the amount of the available nil-rate band; and
- ◆ part or all of residue passes to exempt beneficiaries, such as charities¹.

The IHT charge is based on the value transferred. The grossing up calculation is a mechanism for calculating the value of 'free of tax' gifts in terms of their 'before tax' value. After all, although the gifts are to be received 'free of tax', it doesn't mean that there isn't any tax on them.

IHT on 'free of tax' gifts is an expense borne by the estate, which reduces the amount of residue. The effect is that the burden of paying the IHT falls on the residuary beneficiaries, whether or not they are themselves

exempt from IHT. If the residue is only partly exempt, there will be IHT to pay in respect of the non-exempt part.

The position regarding 'free of tax' gifts should be contrasted with legacies which bear their own tax. Such legacies do not need to be grossed up, which means less IHT payable by the estate overall, and any IHT on the legacy is borne by the legatee, not the residue.

Grossing up also arises where residue is to be divided between exempt and non-exempt beneficiaries. The cases of *Re Benham's Will Trusts* (1995) and *Re Ratcliffe* (1999) are relevant here. In brief, these cases make it clear that the well-advised testator can decide whether grossing up should apply to the residue, and in expressing that decision can control both the amount of IHT and the part of residue from which it is to be paid.

Grossing up – some conclusions

It is crucial to remember that the amount of IHT which is payable on death can be significantly affected by whether legacies to non-exempt beneficiaries are free of or subject to IHT. The least amount of IHT will be paid where the legacies bear their own tax.

Where legacies are 'free of tax', the IHT will be greater, because of grossing up.

Let the testator decide

While all of the issues raised above are relevant in analysing the IHT consequences of the will, the main consideration is what the testator actually wants. Some testators want their wishes to be followed to the letter, regardless of the tax consequences. Others would be horrified to learn the tax impact of their instructions as for them, mitigating tax is more important than the amount going to each beneficiary.

This highlights the central argument being advanced by this article. The testator should be able to make an informed decision, making their will with the benefit of clear advice as to the IHT implications of his or her choices. Those who prepare wills need to know and understand all the relevant aspects of IHT and should advise accordingly.

Crucially, legacy officers need to know it

too, and should be on the lookout for these situations. The difficulty is that a will containing 'free of tax' legacies with all or part of the residue passing to charity will not, on the face of it, look as if it has got much wrong with it. But there are some complex IHT issues in play. Was the testator properly advised in relation to the tax consequences of the will? If that advice was absent or inadequate, has your charity suffered a disadvantage? If it has, does that failure to give proper advice give your charity any remedy against whoever prepared the will?

Finding out what advice was given

If you think your charity may have suffered a tax disadvantage because of grossing up, the first hurdle is finding out what advice the testator was given and what the testator's wishes were. The difficulty is that whoever prepared the will has a duty of confidentiality to the client, and the benefit of that duty passes to the client's personal representatives on death.

There are a number of ways to go about seeking the information.

- ◆ Ask the personal representatives to obtain a copy of the will file from whoever prepared the will. The contents of the file are likely to be covered by legal professional privilege, so the solicitor can supply the file only if the personal representatives waive privilege. Personal representatives may need to be 'encouraged' to co-operate with such a request, and may need to be reminded that they are obliged to act neutrally in relation to such claims.
- ◆ The Law Society advises² that where there is a dispute about a will, solicitors should provide a statement giving information regarding the circumstances in which the testator gave instructions for the will and those in which it was executed. Judicial authority for that advice came from the Court of Appeal in the case of *Larke v Nugus* (1979).

What the information may reveal

Obtaining that initial information should be a



relatively inexpensive and straightforward process by which your charity can establish the quality and extent of the advice given to the testator. The response may answer the question. The testator may have been aware of the tax consequences of his or her instructions, having been well advised. There may be no merit in pursuing matters further. But the information may also reveal where the IHT advice was unclear, wrong, or absent. In those cases, it is going to be necessary to carry out a detailed investigation of the solicitor's liability. If you can show the solicitor had a duty to advise; that the duty was breached and your charity has suffered loss, you have the basis of a claim in negligence against the solicitor.

Of course, many testators are keen that a non-charity legatee gets exactly the amount of the stated legacy, free of IHT, and regard the 'residue' as just that—whatever is left. The mere existence of a grossing up situation does not demonstrate negligence on the part of the will drafter. If the testator's instructions are 'I want X to have £10,000' and 'whatever is left can go to charity', it cannot be said that the same testator would say 'I want X to have £15,000, but he must pay the uncertain amount of IHT on that so the charities will pay less IHT.' Sometimes testators who leave their residue to charity are often quite unconcerned about the tax consequences.

Settling matters by agreement

Where the file reveals that incorrect or inadequate IHT advice was given, it may be possible to reach agreement between the beneficiaries (if all the beneficiaries are of full age and capacity) for the estate to be distributed differently; and more tax advantageously than the will provides. This option

should not be overlooked, especially as it is much cheaper than the alternatives.

Is the will-drafter liable?

There is very little case law about the extent of a solicitor's duty of care in giving tax advice in connection with the preparation of a will. *Cancer Research Campaign and others v Ernest Brown & Co (a Firm) and others (1997)* shows that a solicitor is under a duty to consider the IHT implications of the testator's instructions and should advise the testator accordingly. In taking instructions from a testator where there are chargeable legacies and residue is either fully or partially exempt, the solicitor is at least obliged to point out to the testator that arranging things one way will lead to more IHT being payable and that it is possible to arrange things in a different way which reduces the IHT. Any charity considering this type of claim must be able to show that if proper tax advice had been given, the testator would have made the will in a more tax-effective way.

Another issue to consider is whether the solicitor's contract with the testator attempted to limit the scope of their duty to advise on tax matters. Although not concerned with tax advice in the context of will drafting, *Hurlingham Estates Ltd v Wilde & Partners (1997)* shows that it is possible for a solicitor to exclude a duty to give tax advice. Retainers purporting to exclude the duty may or may not be successful depending on the terms and clarity of the exclusion and whether the tax advice was essential or peripheral to the task for which the solicitor was engaged.

Establishing that the solicitor had a duty to advise on IHT may not be straightforward, but depending on the amount of tax at stake, it may be worthwhile the charity

seeking advice to examine whether the duty arose and whether it was breached.

Further action

We have seen that it is perfectly possible to have a will which can, on its own terms, produce IHT results which would have surprised and indeed disappointed the testator. If that happens, was the testator properly advised?

Finding out if the advice was sound should be a relatively straightforward and inexpensive procedure. The charitable beneficiary under the will of a testator who was properly advised and understood the IHT consequences of his instructions can rest easy in having checked the position and found all to be well. If a charity finds the solicitor's advice was deficient in some way, and there is a reasonable supposition that the testator, properly advised, would have acted differently, the charity can then consider what remedies are available to it against the solicitor who prepared the will, and the economic advantages and disadvantages of pursuing any claim.

¹ If all the legacies are tax free and the whole of residue is exempt, a single grossing calculation is required. If some of the legacies bear their own tax, or if residue is part exempt and part chargeable, a more complex 'double grossing' calculation is required.

² The Law Society's *Disputed Wills Practice Note (16 April 2009)* clarifies this advice.

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