“The Divorce Fiction”

How the Courts deal with spousal/civil partner claims under the Inheritance (Provision for Family & Dependents) Act 1975

James Egan

Surviving Spouse/CP – Eligibility & Standard

- Was the Deceased domiciled in England & Wales? S1(1)
- Section 4 & Permission - cf *Cowan v Foreman* [2019] EWCA 1336
- Surviving Spouse/CP is an eligible claimant – s1(1)(a) IPFDA.
- Surviving Spouse/CP – such financial provision as it would be reasonable in all the circumstances of the case for a spouse/CP to receive, **whether or not that provision is required for his or her maintenance** (s1(2)(a)-(aa) IPFDA, as applicable).

The 1975 Act – What about former spouses?

- Former Spouse/CP is an eligible C – s1(1)(b) IPFDA (unless there is a s15/15ZA/15A/15B bar in place but cf *Chekov v Fryer* [2015] EWHC 1642)
- Former spousal/CP claims are *prima facie* limited to the 'maintenance' standard.
- That said, former spouses/CPs can apply for the Court to exercise its discretion under s14-14A (as applicable) to treat them (for the 1975 Act) as if no decree was made. In brief, effectively three limbs:
  - Deceased dies <12m of decree;
  - A claim under s23-24 MCA / Sch 5 Part 1 CPA had either not been made or had been made but not yet determined at the death; and
  - The Court thinks it *"just"* to treat the former spouse/CP as though the decree had not been made.
- No known appellate authorities on how/when the discretion is exercised

The 1975 Act – s3 Factors for Spousal/CP claims

- The Court must consider the s3 factors in the two stage enquiry:
  - Did the will/intestacy make *"reasonable financial provision"* for C?
  - If not, what (if any) RFP should now be made for C?
- In spousal/CP claims, must also consider under s3(2):
  - The age of the applicant and the duration of the marriage/CP;
  - The contribution made by the applicant to the welfare of the family of the deceased (including looking after the home/caring for family)
  - What provision the applicant might have expected to receive on divorce/dissolution? For deaths after 1 October 2014, the divorce cross check is neither the upper nor lower limit of provision.
  - S

The 1975 Act – Duration of the Marriage/CP

- Duration can have a significant impact upon the quantum of an award:
  - Shorter marriage/CP is usually asserted to reduce the award e.g. a 'good reason' not to share non-matrimonial property where not required for needs;
  - longer marriage/CP is usually to increase the quantum/duration of awards
- No statutory scale to determine if a marriage/CP is short, medium or long.
- **Pre-marital cohabitation**: *IX v IY* [2018] EWHC 3053*:* the focus should be on when the relationship acquired *"sufficient mutuality of commitment"*.
- **Ascertaining the end of the marriage/CP**: *GR v RW* [2003] EWHC 611: *"…the court has always looked at the position de facto rather than de jure. For example, the end of the marriage is always taken as the date of separation rather than the date of decree absolute."*
- Duration might not necessarily hold the same weight in 1975 Act claims as the marriage/CP was ended by death rather than a conscious decision – Distinction:
  - those cases where the marriage/CP is actually ended by death; and
  - those cases where the marriage/CP in fact ended long before death but was never actually dissolved

The 1975 Act – The Divorce Cross-Check

- Two stages:
  - Quantification of the available matrimonial assets;
  - Apply the principles of dividing the available matrimonial assets.
- On quantification, in 1975 Act claims, we do not have the benefit of the obligation to give full and frank disclosure in the 'Form E' statements. However, it is important to obtain as much disclosure as possible to properly quantify what the matrimonial assets likely were…
- Bear in mind that the fact of death might have released some assets which otherwise would not have been immediately available had the marriage ended in divorce/dissolution (e.g. widow's pensions, life insurance etc). If these are available to the Applicant, they are likely to constitute a *"financial resource"* which could be taken into consideration.

The 1975 Act – The Divorce Cross-Check

- On the principles applying to division, Lilleyman v Lilleyman [2013] Ch 225 summarises the principles thus:

"46. […] the fundamental principle which illuminates all the detail is that a marriage is now recognised to be an essentially equal partnership. In consequence, ***the division of the available property upon breakdown of the marriage must be conducted upon the basis of fairness and non-discrimination****, arising from the basic concept of equality permeating a marriage as is now understood.* ***But equality of treatment does not necessarily lead to equality of outcome.***

47. That basic concept gives rise to three requirements, which may be summarised as financial needs, compensation and sharing. ***Meeting each of the divorcing parties' frequently different financial needs is the first call upon the available property, and frequently exhausts it****. Compensation addresses* ***prospective economic disparity between the parties arising from the way they conducted their marriage*** *and usually, but not invariably, compensates the wife rather than the husband.* ***Sharing is applied when there is property still available after the first two requirements have been satisfied****, and in principle extends to all the parties' property but, to the extent that the property is 'non-matrimonial', there is likely to be better reason to depart from it…"*

Divorce Cross-Check & 1975 Act claims

- **Principles -** Need, compensation and sharing will be relevant under the 'divorce cross-check' in s3(2) whatever the size of the estate. But, the smaller the estate, there might not be a surplus to be 'shared'…
- **Assessing Needs –** Not limited to subsistence/basic needs – Generally assessed with reference to marital standard of living (*Mills; McCartney*).
- **The Home –** *Miller "The parties' matrimonial home, even if this was brought into the marriage at the outset by one of the parties, usually has a central place..."*
- **Sharing Principle -** There is no presumption of equality nor that equal division should be the automatic starting point (*P v G* at para 233). Although, where the sharing principle is engaged this is likely to give rise to equal sharing of the surplus unless there are good reasons for a departure.
- **What are 'good reasons' for a departure from the sharing principle?** Pre-acquired and 'non-matrimonial' assets (e.g. gifts/inheritance) can be a 'good reason' to depart from the sharing principle in shorter marriages (unless required for the parties' needs). The longer the marriage, the less likely it will be a 'good reason'…

Divorce Cross-Check : General Principles

- **Clean Break?** There is no clean break presumption within 1975 Act claims, but often practically desirable. Whilst the Court can make periodical payments orders, in so far as possible, the Court may look to capitalise the same as a clean break might be desirable on the facts.
- **Process & Procedure -** Inappropriate to replicate the entire ancillary relief process; the Court's task is to reach a sufficient conclusion on the divorce cross-check and give due weight to that along with the other factors (*P v G*).

Weight to be attributed to divorce cross-check?

- P v G [2006] 1 FLR 431 at [242]: *"…I am struck by the force of the repeated observations in the decided authorities about the difference between divorce where there are two surviving spouses for whom to make provision and death where there is only one. It seems to me probable that this difference will not infrequently be reflected in greater provision being made under the 1975 Act than would have been made on divorce, and that this may legitimately be so even where the estate is a relatively large one, as it is here…"*
- *Fielden v Cunliffe* [2006] Ch 361 at [21]: "…*Caution, however, seems to me necessary when considering the White v White cross-check in the context of a case under the 1975 Act. Divorce involves two living former spouses, to each of whom the provisions of section 25(2) of the Matrimonial Causes Act 1973 apply. In cases under the 1975 Act a deceased spouse who leaves a widow is entitled to bequeath his estate to whomsoever he pleases: his only statutory obligation is to make reasonable financial provision for his widow. In such a case, depending on the value of the estate, the concept of equality may bear little relation to such provision…"*

The 1975 Act – Relevance of Prenups?

- Significance of 'pre-nups' and 'post-nups' have increased enormously since *Radmacher v Granatino* [2010] 2FLR 1900 [75]: *"The court should give effect to a nuptial agreement that is freely entered into by each party with a full appreciation of its implications unless in the circumstances prevailing it would not be fair to hold the parties to their agreement."*
- BUT such agreements do not oust the jurisdiction of the family court to make a financial order nor bind its ability to make a financial award in different terms. Ultimately, a nuptial agreement is only binding on the parties from a court order approving its terms.
- In the context of spousal/CP '75 Act claims, nuptial agreements are very likely to be taken into account under s3(1)(g) and 3(2) of the 1975 Act. However, by analogy, they will not oust the jurisdiction of the court nor bind its ability to make a different order.
- The weight attached to the agreement ultimately will depend upon its terms and the circumstances!

The 1975 Act – Testamentary Wishes?

- What weight might be attributed to Deceased spouse's/CP's testamentary wishes?
  - In *Ilott* (not a spousal/CP case) the UKSC referred to a Law Commission report which noted, *"…The mischief to which the change was directed was the risk of a* ***surviving spouse finding herself in a worse position than if the marriage had ended by divorce rather than by death****."* Suggests less weight on testamentary wishes?
  - In *Miles v Miles* [2018] WTLR 1347 [52-54], the Court held *"…the deceased made a very clear decision when he was drafting his will. That was to exclude the respondent from his assets. It is open to this court to re-write the will but in doing so there again must be some regard that in so doing it is in the teeth of the wishes of the deceased […]* ***there must be some recognition of the testamentary wishes and the likely outcome of the financial remedy proceedings even though that will eat into the needs of the respondent in the foreseeable future****"*. Demonstrates the balancing of various section 3 factors?

Spousal/CP 1975 Act claims in practice

- **Potential Tax Savings?** Making additional provision for the surviving spouse/CP might result in tax savings so the cost to the other beneficiaries of making provision to the applicant might be mitigated. See also, s2(3A) – Court is to have regard to the value of the net estate after deduction of debts or liabilities *"…including any inheritance tax paid or payable out of the estate…"*.

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How the Courts deal with spousal/civil partner claims under the Inheritance (Provision for Family & Dependents) Act 1975

James Egan

15 July 2020

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Divorce, Death and Taxes
Settling 1975 Act Claims with Exempt Beneficiaries

Georgia Bedworth

Outline

1. Death and Taxes – a refresher!
2. Statutory Provisions concerning tax and the 1975 Act
3. Settlement prior to issuing proceedings
4. To read back, or not to read back?
5. CGT Issues
6. Conclusions

Tax and Estates – A Refresher

Inheritance Tax ("**IHT**")

- Tax payable on death on a deemed "transfer of value" of the estate
- Transfers on death are either:
  - **chargeable** (tax at 40% above the available nil rate band); or
  - **Exempt** (no tax)
- Exempt transfers:
  - Charity
  - Spouses: either an absolute gift or immediate post death interest in possession (e.g. life interest)

Tax and Estates – A Refresher

- IHT is not just payable on death – it may be payable on lifetime transfers of value and on termination of interests under a trust.

Capital Gains Tax ("CGT")

- CGT free uplift in value of assets to value at date of death
- Disposals made after death where there has been an increase in value will be chargeable to CGT unless disposal to a legatee
- Beneficiaries of an estate can agree to vary the disposition of the estate and have that "read back" into the will: section 142 Inheritance Tax Act 1984 & s.62(6) TCGA 1992

Why does it matter?

- 1975 Act and Inheritance Tax Act 1984 contain provisions for "reading back" awards for the purposes of IHT and other taxes
- This gives an opportunity to reduce the tax bill and (in a claim by a surviving spouse) potentially reduce the cost of a settlement to other beneficiaries
- If an estate is already exempt e.g. life interest to spouse but spouse has claimed capital provision, care must be taken to make sure tax benefits are not lost.

Statutory Provisions: section 19(1) of the 1975 Act

Where an order is made under section 2 of this Act then for all purposes, including the purposes of the enactments relating to inheritance tax, the will or the law relating to intestacy, or both the will and the law relating to intestacy, as the case may be, shall have effect and be deemed to have had effect as from the deceased's death subject to the provisions of the order

i.e. “Reading Back”

Section 19(1) of the 1975 Act

- Applies for **all** taxes i.e. CGT, IHT, SDLT, Income Tax
- Requires an order under section 2 of the Act – remember an order under section 2 can be made even if there is no contested hearing
- Will apply whenever the order is made – including more than 2 years after death
- Only applies to disposition by the will or law relating to intestacy
- Does not apply to orders under section 5 (interim provision) – order under section 2 should treat the interim provision as having been made on account of the final award if you want reading back

Section 146(1) IHTA 1984

Where an order is made under section 2 of the Inheritance (Provision for Family and Dependants) Act 1975 ("the 1975 Act") in relation to any property forming part of the net estate of a deceased person, then, without prejudice to section 19(1) of that Act, the property shall for the purposes of this Act be treated as if it had on his death devolved subject to the provisions of the order.

i.e. automatic reading back for final orders but not necessarily interim orders

Section 146(1) IHTA 1984

Similarities to s. 19 1975 Act:

- Applies where there is an order under section 2
- Applies whenever an order is made
- Application is automatic

Differences from s. 19 1975 Act

- Applies only to IHT
- Applies to the whole of the net estate including property passing by survivorship

Section 146(8) IHTA 1984

Where an order is made staying or dismissing proceedings under the 1975 Act on terms set out in or scheduled to the order, this section shall have effect as if any of those terms which could have been included in an order under section 2 or 10 of that Act were provisions of such an order.

- Reading back applies to *Tomlin* orders
- BUT the relevant provisions must be capable of being included in an order under section 2

Section 146(6) IHTA 1984: Trusts

Anything which is done in compliance with an order under the 1975 Act or occurs on the coming into force of such an order, and which would (apart from this subsection) constitute an occasion on which tax is chargeable under any provision, other than section 79, of Chapter III of Part III of this Act, shall not constitute such an occasion; and where an order under the 1975 Act provides for property to be settled or for the variation of a settlement, and (apart from this subsection) tax would be charged under section 52(1) above on the coming into force of the order

Section 146(6) IHTA 1984

- Deals with variation of trusts
- Ensures that termination of a qualifying interest in possession (usually a spouse's immediate post death interest in possession) does not trigger a charge under section 52 IHTA 1984
- Provides that property leaving a discretionary trust will not trigger an exit charge
- Care must be taken to ensure that spouse exemption is not lost by reading back the ultimate provisions of the varied settlement under s. 146(1) – any interest in possession in favour of a spouse should be kept in place

Settlement prior to issue of proceedings

- Still possible to secure reading back without an order under section 2
- To do so must comply with requirements of section 142 IHTA 1984 for IHT purposes or section 62(6) TCGA 1992 for CGT purposes
  - Variation made within 2 years of death
  - No external consideration – HMRC accept compromise of a 1975 Act claim does not count as relevant consideration
  - Instrument of variation must contain the relevant election
- Compromise without issuing ANY proceedings not possible where claimant is a minor or there are minor beneficiaries

To Read Back or not to Read Back?
Claimants who are exempt beneficiaries

- Reading back probably desirable to secure exemption on the estate – use the tax saving to expand the pot available for division
- Take care where partitioning an estate in which an exempt beneficiary had an IPDI but will end up with capital provision and termination of his/her IPDI to secure a clean break
- Think about Residence Nil Rate Band and Transferrable Nil Rate Band – particularly with second marriages – where will the ultimate benefit of that relief fall?

To Read Back or not to Read Back?
Claimants who are non-exempt beneficiaries

- A problem where the estate was originally fully exempt – reading back may not desirable

- Little that can be done if the claimant a minor or there are minor beneficiaries – a court order is required UNLESS use could be made of the variation of settlement provisions under section 146(6) IHTA 1984

- If everyone is adult, possible to settle without reading back – but beware section 29A IHTA 1984

Grossing Up

- An exempt beneficiary may not bear any part of the tax payable on an estate: section 41 IHTA 1984

- Consider the effect of grossing up when settling a claim by a non-exempt beneficiary where residue is exempt for a sum in excess of the available nil rate band

- If Claimant is an exempt beneficiary may be beneficial to make provision by legacy for the exempt beneficiary leaving residue to chargeable beneficiaries

- Avoid creating a situation where residue is shared between exempt and non-exempt beneficiaries

CGT Issues

If there is no reading back – in a word – [a] nightmare!

HMRC's approach is difficult to follow

Try to secure reading back:

- If compromise is reached within 2 years of death, include an election in the agreement that the provisions of section 62(6) TCGA 1992 should apply
- If more than 2 years after death, seek an order under section 2 of the 1975 Act, so that section 19 will secure reading back for CGT purposes

Conclusions

- Ignore potential tax consequences of a settlement at your peril
  - Settlement could end up being more expensive than intended
  - You may miss an opportunity to expand the estate by using tax savings
  - You may miss an opportunity to carry out other planning

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Approaching & Settling Inheritance Act Claims by Minor Children of the Deceased

James Poole

1. Identifying suitable litigation friend(s)

2. Matters to take into account when determining reasonable financial provision

3. Settlement

Litigation friend(s)

- Who?
  - Conduct proceedings fairly and competently: *Hinduja v Hinduja* [2020] EWHC 1533 (Ch)
  - Conflicts of interest
  - Are multiple LFs required?

Litigation friend(s)

- Pre-issue (N.B. CPR 21.3(4))
  - Appoint before issue and then apply to retrospectively validate actions (if necessary)

> "Provided everyone has acted in good faith and there has been no manifest disadvantage to the party subsequently found to have been a patient at the relevant time I cannot envisage any court refusing to regularise the position. To do otherwise would be unjust and contrary to the overriding objective of the Civil Procedure Rules, but in any given case the ultimate decision must depend on the particular facts."
>
> *Masterman-Lister v Brutton* [2002] EWCA Civ 1889

Matters to take into account

- s.3(1), especially (a) and (d)
- s.3(3)

  “the manner in which the applicant was being or in which he might expect to be educated or trained”
- *Ubbi v Ubbi* [2018] EWHC 1396 (Ch)
- Always consider matters like s.9 and s.14

Settlement

- CPR Part 21
- Trusts?
  - Will a variation of the will suffice?
- Lump sum vs periodic payments?
- Costs - from the estate?

Approaching & Settling Inheritance Act Claims by Minor Children of the Deceased

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VARYING NUPTIAL SETTLEMENTS AFTER DEATH

1. The Power
2. Jurisdiction
3. Nuptial settlements
4. Enforcement
5. Examples

The Power

Section 2(1)(f)(g):

“an order varying any ante-nuptial or post-nuptial settlement (including such a settlement made by will) made on the parties to a marriage to which the deceased was one of the parties, the variation being for the benefit of the surviving party to that marriage, or any child of that marriage or any person who was treated as a child of the family in relation to that marriage”

The Power

Compare: Section MCA 1973 s 24(1)(c):

“an order varying for the benefit of the parties to the marriage and of the children of the family or either or any of them any ante-nuptial or post-nuptial settlement (including such a settlement made by will or codicil) made on the parties to the marriage … ”

The Power

Note: Section 1(1):

“on the ground that the disposition of the deceased’s estate effected by his will or the law relating to intestacy, or the combination of his will and that law, is not such as to make reasonable financial provision for the applicant”

Jurisdiction

- Section 1(1): “a person dies domiciled in England and Wales”

- Territorial limits: None!

Nuptial

Prinsep v Prinsep [1929] P 225

"A settlement is nuptial if it is made upon the husband in the character of husband or upon the wife in the character of wife, or upon both in the character of husband and wife"

Brooks v Brooks [1996] AC 375

Will usually be one that makes some form of continuing provision for both or either parties to a marriage.

Ben Hashem v Shayif [2008] EWHC 2380

Meaning of settlement is very wide and may involve no trust at all

Nuptial

Burnett v Burnett [1936] P 1

The marriage must have been in contemplation at the time

AB v CB [2014] EWHC 2998 (*P v P* [2015] EWCA Civ 447)

Provision of a family home, with power to advance capital to H, was nuptial

Nuptial

C v C [2004] EWCA Civ 1030

A settlement that was nuptial is likely to remain so but it is possible for it to lose its nuptial character

Quan v Bray [2014] EWHC 3340

Joy v Joy-Morancho [2015] EWHC 2507

N v N and F Trust [2006] 1 FLR 856

Can a non-nuptial settlement become nuptial?

Or can part of a non-nuptial settlement be nuptial?

Enforcement

- *Prest v Petrodel Resources Ltd* [2013] 2 AC 415

- *DR v GR* [2013] EWHC 1196

"from assets held by a group of family companies then the entire set-up when viewed as a whole, is capable of amounting to a variable nuptial settlement. If the top company is owned by a trust of which the spouses are formal beneficiaries then the position is a fortiori."

Examples

Lomax : Substantial estate but much more substantial wealth held in settlements established in lifetime, wife of deceased husband seeking provision from these trusts.

S Trusts: Deceased husband's estate with almost no assets. He was the beneficiary of substantial family trusts which provided for both him and his wife. Trustees proposed 'cutting off' the wife altogether.