

# Working together

**Julie Butler and Angela Evans** discuss the importance of will drafting and the role played by the tax adviser.

**A** recent decision in the First-tier Tribunal, *N Hall and another (as trustees of Carolina Raboni deceased)* (TC8691), concerned whether an interest in possession arose in a ‘cash poor’ estate where a ‘companion’ occupied the house after the widow left her house to her five nieces and nephews. The deceased had granted her friend and companion the right to live in the house rent-free other than insurance and maintenance costs for the rest of his life. The property was not to be sold without his consent. The companion moved into the house after she died in 2004. It could be argued that with the value of the family home having increased and the nil rate band staying frozen that there could be more estates in 2023 coming into inheritance tax. The *Taxation* article ‘Whose house is it anyway’ by Katherine Bullock (9 March 2023), looked at tax planning around the family home.

## Complex decision

In the *Hall* case the First-tier Tribunal decided that, contrary to the way in which a beneficiary with a right of occupation had commonly been treated, an occupying beneficiary had not in fact enjoyed an interest in position in the deceased’s property under her will. This was notwithstanding the fact that his occupation of the property was until his own death in 2017.

The decision was due to several factors. The legacy to the beneficiary was a right to occupy the named property only and did not extend to a substitute property. Apart from the property, the deceased’s estate consisted only of a small amount of cash which was not enough to discharge the inheritance tax liability. The executor correctly advised the residuary beneficiaries that the property would have to be sold to pay the tax, in the absence of alternative funding, but wrongly advised that the sale would be subject to the beneficiary’s rights of occupation. Mindful of that advice, the residuary beneficiaries decided that the property should be retained as an investment, and that they would settle the inheritance tax liability themselves. This they did, taking advantage of the ten-year instalment option. These

### Key points

- In *Hall*, the tribunal decided an occupying beneficiary had not enjoyed an interest in possession.
- When drafting wills it is important to consider the future administration of the estate.
- The potential impact of inheritance tax should be considered.



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decisions highlight – among other interesting points – the problem of judgment calls of the executor.

## Inheritance tax bill

The deceased had left her estate, including the house, to her nieces and nephews and a friend who was the occupying beneficiary. The ‘occupying beneficiary’ was a companion who had supported and cared for the deceased. At the end of her life the companion was given a right to continue living in the house for as long as he wished.

When the widow died in 2004 the value of the house put the estate over the threshold for inheritance tax and there was a bill to pay of £15,600. Unfortunately, there was no money in the estate to pay it, so the executors consulted the beneficiaries and explained the legal position. One way or another, the tax bill had to be paid. They had no unilateral power to mortgage the property and if they had they ran the risk of being sued for reducing the value of the property by burdening it in that way.

The tribunal was of the view that to decide what right the companion had under the will, it was necessary to consider what the executors could have done, in the absence of any consent by any of the parties. Had they done nothing, the residuary beneficiaries could have compelled administration of the estate, and HMRC could have compelled the payment of their liability. The only option then would have been to sell the house and, in that case, there would be no interest in possession because the house was sold.

The executors believed the only option was to sell the property subject to the companion’s right of occupation – which would impact on the open market value. Faced with this, and considering the wishes and intentions of the deceased, the beneficiaries opted to pay the inheritance tax bill themselves and to wait until the companion died before selling the property.

## Higher property value

The companion continued to live in the house until 2017, during which time the house increased in value to £827,000. When the companion passed away the executors paid the inheritance tax on the basis that the companion had an IIP in the house. This is legally defined as ‘a present right to the present enjoyment of the property’. If it is land then it is a right to either occupy

or receive the net rents but it is not a right to the capital value of the asset. Where an interest in possession arises the whole value of the asset is included in the estate when calculating inheritance tax hence, in this case, the bill of £190,000.

At a later date, on advice, the widow's executors requested a refund. HMRC refused, stood their ground and issued a notice of determination. The executors appealed that determination to the tribunal. Their argument was that the companion did not have an interest in possession and never could have under the terms of the will because of the tax liability.

### Gratuitous licensee

The tribunal concluded that without the intervention of the other beneficiaries paying the tax the executors would have had no choice but to sell the house and could never have put into effect the owner's wishes under the will. The companion could never have held an interest in possession and therefore only ever occupied the property as a gratuitous licensee.

It therefore followed that due to the presence of a creditor the companion could not enforce a right under the will to live in there. The tribunal concluded that, at the date of the companion's death, the companion did not have an interest in possession in the property, as he had no immediate right to occupy.

### Tribunal decision in Vincent

The *Hall* case contrasts with the ruling in *Vincent* (TC7432). On the face of it the circumstances appear very similar in that a right to occupy was granted in the will of Mrs Hadden. However, the 'life tenant' Mr Thom already held a beneficial interest in five-eighths of the property. The property was held as tenants in common and, following the ruling in *Bull v Bull* [1955] 1 QB 234, Mr Thom was entitled to the enjoyment of the whole property without restriction, but subject to the obligation to contribute proportionally to the property costs.

Mr Thom continued to reside at the property after Mrs Hadden's death and paid all of the costs for the property, including essential capital repairs.

Mrs Vincent inherited the three-eighths share from her mother Mrs Hadden, subject to Mr Thom's right to occupy. When Mr Thom died HMRC contended that Mrs Hadden's will had created a qualifying interest in possession, whereas Mrs Vincent contended that her mother had not intended to create an interest in possession.

The tribunal found that as the trustees were directed to permit him to occupy the property subject to paying all the income expenses, this was not a request, and the trustees had no discretion as to whether to permit Mr Thom to reside. The requirement to pay all expenses of an income nature separated the interests in the income and the capital of the three-eighths share. Therefore, his right to reside was protected by Mrs Hadden's will and gave him a life interest in the three-eighths share, albeit accidental.

### Will drafting and impact of inheritance tax

These cases show that when drafting wills it is important to consider the subsequent administration of the estate in practical terms but this often does not happen. Likewise, executors must consider the full responsibilities of judgment calls.

The likely inheritance tax liability and the impact on the distribution must be considered by the will drafter. One of the problems in practical terms is the marginal nature of potential inheritance tax liabilities. For example, in the *Hall* case the value of the house was significant. It is key to understand the values of the assets in the estate and to have professional advice as to potential values. If necessary, this should be on regular review of the will.

### Working together

This is a clear example of how tax advisers and will drafters must work together. Those drafting wills must consider the impact of future inheritance tax liabilities on the wishes of the testator and advise accordingly. How the companion could live in the house with the creditor of the inheritance tax liability should be considered in practical terms. It is surprising how often the will does not consider the practical reality of the administration of the estate. By the time a large number of UK testators die the estates will be cash poor due to a combination of the cost of living crisis and care costs, and testator wishes must consider this. The companion being granted the right to live in the house rent free and just having to pay for insurance and maintenance costs is a 'grand gesture' that can't always be fulfilled.

The beneficiaries in *Hall* acted with united understanding and foresight for all beneficiaries to agree to pay the inheritance tax and to look on the property as an investment. Achieving unanimous agreement from five beneficiaries is unusual in practical terms as is finding beneficiaries who can fund the tax. In this quite uncommon set of circumstances the beneficiaries made remarkable commercial decisions. By turning the interest in possession trust into a licence to occupy due to insufficient liquidity was surprisingly positive planning. By the presence of the inheritance tax creditor the companion could not enforce the right under the will to live there.

Following the facts of these two cases, careful drafting of the will and the wording in respect of a right to occupy can be used to ensure that an interest in possession is created or, if more beneficial, avoided. Ironically, some of the measures suggested by Gareth Hughes in his article 'The time is now', (*Taxation*, 23 February 2023) could solve some of the problems of this case. HMRC has been given leave to apply for permission to appeal. What happens next will be keenly awaited. ●

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