

Tax Planning in England

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I. INTRODUCTION

The purpose of this paper is to give some account of the problems and practices of tax planning in England. It is intended as an outline only. There is no space for more, and much of the detail and technicalities will be omitted where they would confuse the main story. A reader who needs to have further details could find them by following up the footnote references.¹

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1. The leading works in this field are the following:

a. Books on Estate Duty:

DYMOND, *DEATH DUTIES* (14th ed. 1965 and Supp.); GREEN, *DEATH DUTIES* (7th ed. 1971); BEATTIE, *ELEMENTS OF ESTATE DUTY* (7th ed. 1970); HANSON, *DEATH DUTIES* (10th ed. 1966 and Supp.); LAWTON, A.D. *ESTATE DUTY IN ENGLAND AND WALES* (1970).

b. Books on Tax Planning:

POTTER AND MONROE: *TAX PLANNING* (6th ed. 1970); MORCOM, *ESTATE DUTY SAVING AND CAPITAL GAINS TAX* (4th ed. 1969 and Supp.); RAY, *PRACTICAL ESTATE PLANNING* (1970); HARRIS AND HEWSON, *LIFE ASSURANCE AND TAX PLANNING* (1970).

c. Compilations of Statutes:

SWEET & MAXWELL'S *GUIDE TO THE ESTATE DUTY STATUTES*: ed., G.S.A. Wheatcroft (1960); BUTTERWORTH'S *ESTATE DUTY STATUTES* (1971); BUTTERWORTH'S *TAX HANDBOOK* (1971); DYMOND'S *DEATH DUTIES*, Vol. II.

d. General.

BRITISH TAX ENCYCLOPAEDIA; PINSON, *REVENUE LAW* (5th ed. 1971); HANBURY, *MODERN EQUITY* (9th ed. 1969) [hereinafter cited as HANBURY].

No attempt will be made to present this material in the form of a comparison with California law. California trust and tax lawyers can easily make their own comparisons. There are clearly many situations in which a knowledge of both the California and the English law is necessary. There are, however, two points of difference which it may be useful to indicate at the outset:

A. As will be seen from the figures given below concerning tax and estate duty rates, the rate of taxation is much higher in England than it is in any part of the United States. Add to this the depressed economic situation of the last decade in England, and it will be seen that the problem of acquiring and retaining private capital is greatly increased. Tax planning therefore becomes a factor of great importance for those people in England who have any private capital with which to work.

B. There is no practice in England equivalent to the American revocable trust, giving the trustor a life interest with remainders over and a power of revocation. There are no tax or estate duty advantages in a revocable inter vivos trust (any more than there are in the United States) and there is, in England, no fear of probate. So an owner of capital will either make an inter vivos trust for tax planning reasons or will die with it and create a testamentary trust by his will.

The problem of management, of course, exists. This solves itself in the case of many widows, unused to business, because they will in most cases be income beneficiaries under a trust created under their husbands' wills. If a person is absolute owner, and not competent to manage his capital, there is sufficient advice available from financial advisers, stockbrokers and, in the case of large funds, the Merchant Banks.

II. THE BRITISH FISCAL SYSTEM

To appreciate the way in which estate planning is done in England, it is necessary to give a short account of the British tax system. Of course, this will be general and sketchy and is not an adequate basis on which to base practical decisions. The three most significant fiscal obligations which must be considered are income tax (and surtax), capital gains tax and estate duty. There is as yet no gift tax. Corporations are liable to pay corporation tax on all their

income and capital profits at the rate of 40%², but that is a matter outside the scope of the present inquiry. For income tax purposes, the financial year runs from April 6 to April 5.

A. *Income Tax.* The current system relating to income tax is the result of piecemeal legislation over many years. As would be expected, it contains many unnecessary anomalies and complications. The present Government has announced its intention of making substantial reforms which are expected to be effective in 1973; and, as will be seen, some of these provisions are included in the Finance Act 1971. I will attempt first of all to say something about the situation as it is at the present time, and then to refer in outline to some of the reforms which are to be expected.

1. *Standard Rate.* The British income tax system works upon the basis of a standard rate which is currently 38.75%,³ having been reduced from 41.25% as from April 6, 1971, pursuant to election promises of the present Government to reduce taxation. These odd figures arise because the standard rate of income tax was expressed in money terms and not in percentage terms prior to the decimalization of the currency in February, 1971 (the figures represent respectively 7/9d in the £ and 8/3d in the £. There used to be 12 pennies in a shilling, 20 shillings in a pound; and thus 240 pennies in a £. Since decimalization, there are 100 new pennies in the £.

2. *Allowances.* There are, of course, various allowances which can effectively reduce the rate which an individual has to pay, and which will bring his effective rate below the standard rate. The most significant of these allowances are:⁴

Personal Reliefs.	Single Person. Exempt up to £ 325 Married Person. Exempt up to £ 465 Married Couple. Relief in respect of wife's earnings: 7/9ths, up to maximum of £ 325.
Old Age Relief.	Single Person. Exempt if under £ 504. Married Couple. Exempt if under £ 786. Above these levels, 2/9ths.
Earned Income Relief.	2/9ths up to £ 4005; 15% on excess.
Child Relief.	For child under 10 years £ 155. For child between 11 and 15 years £ 280. For child of 16 and over £ 205.
Small Income Relief.	2/9ths on income up to £ 450.
Life Assurance Relief.	2/5ths of premium.

2. Finance Act 1971, § 14 [hereinafter cited as F.A.].

3. Income and Corporations Taxes (No. 2) Act 1970, c. 54, § 1.

4. Income and Corporation Taxes Act 1970 as amended, F.A. 1971, § 15 [hereinafter cited as T.A.].

There is no opportunity such as there is in the United States to treat the combined income of husband and wife as if they each earned half the family income, and to be taxed on that basis.⁵ In England, the income of a wife is aggregated with that of her husband, and is treated as his income for tax purposes. This means, of course, that the higher your earned income, and particularly the higher your wife's earned income, the more economical it is to live in sin than to marry. As from the financial year 1972-1973, however, a husband and wife, living together, may elect that the whole of the wife's earned income (i.e., not investment income) shall be assessed separately from the husband's income.⁶ So you won't need now to divorce your wife to be well off; just send her to work.

3. *Surtax*. An additional tax which is assessed separately from income tax, and which operates to impose further liability above the standard rate, is surtax. This is applicable to earned income above £ 5,500, and to all unearned income where the total income exceeds £ 2,500.⁷ Surtax is payable on a sliding scale.⁸ If translated into dollars at the rate of 2.4 to the £, it will be seen at what extremely low levels of income the tax system appears to consider that the 38.75% rate is inadequate.

4. *Trust Income*. Income of a trust is taxed at the standard rate of income tax. Any adjustments necessary in respect of payments to beneficiaries are made in the computation of that beneficiary's income; thus, the money paid to the beneficiary will already have borne income tax at the standard rate. If the beneficiary is liable to surtax, he will be so charged on the basis of his own tax return which will include a statement of the trust income. If his income is not sufficient to reach that level at which the standard rate is applicable, he will be able to claim repayments due to him under the various allowances to which he is entitled. Credit will be given for tax paid by foreign trusts under foreign law. It will be clear, however, that income from a substantial American trust will be likely to suffer considerable further tax in the hands of a British resident bene-

5. See INT. REV. CODE of 1954.

6. F.A. 1971, § 23, sched. 4.

7. F.A. 1971, § 13.

8. Starting at about 10% and reaching 50% on income of about £ 20,000. This is of course in addition to the income tax. See F.A. 1970, § 12.

ficiary, especially a woman married to a man with an income of his own—since her share of the trust income will be aggregated.

But there are further difficulties if the beneficiary is an infant. By legislation, first introduced in 1936, the income of a trust in favor of a child of the trustor is treated during the unmarried minority of that child, or until the attainment of the age of 21 by a child of the trustor who was not regularly working, as the income of the trustor.⁹ It should be remembered that infancy now ends in England at the age of 18.¹⁰ Since April 6, 1969 (and until April, 1972) the unearned income of an infant, who is unmarried and not regularly working, is to be treated as the income of the parent,¹¹ regardless of who created the settlement. Such liability applies only where the infant is entitled to, or receives the income; it does not attach where the income is accumulated—as it may be where the income arises under a discretionary trust, or where the infant is contingently entitled, and unapplied income is accumulated for the benefit of the infant under Trustee Act 1925.¹² Generally speaking, therefore, a trustor can obtain no income tax or surtax advantages by setting up a trust under which his own infant children receive the income. Whether or not a tax advantage arises where the property is given to or in trust for children of another depends upon the tax situation of the parents of the infant.

Section 16 of the Finance Act 1971, however, provides relief in these cases in respect of the financial year 1972-1973 and subsequent years. Income of a child which arises under a trust created *by a parent* is to be treated as that of the parent only until the child attains the age of 18 years. And the income of a child under a trust which was created by someone other than the parent of the child is no longer to be treated as that of the parent. The repeal of these aggregation provisions in relation to trusts not made by parents will once again enable grandparents (and others) to obtain tax advantages by setting up trusts for grandchildren (and others) or by entering into seven year deeds of covenant to pay money to them. These matters will be further explained in section IV; F.

5. *Methods of Collection.* Salaries and wages are taxed at source under what is called the P.A.Y.E. system; that is, the Pay-As-You-Earn system. Each taxpayer is assigned a code number which takes into account his personal reliefs and earned income relief. P.A.Y.E.

9. F.A. 1936, 26 Geo. 5 & 1 Edw. 8, c. 34, § 21, *as amended*, T.A. 1970, c. 2, § 437 *et seq.*

10. Family Law Reform Act 1969, c. 46, § 1.

11. T.A. 1970, c. 2, §§ 43-48, *amending* F.A. 1968, c. 44, § 15.

12. Trustee Act 1925, 15 & 16 Geo. 5, c. 9, § 31.

tables indicate to an employer the deductions which are to be made from an employee's pay. A detailed adjustment is made at the end of the year, if necessary. Income taxed at the standard rate is also deducted from dividends before payment and also from nearly all Government bonds and securities. Earnings of the self-employed, such as professional fees and casual earnings, are assessed upon the basis of a declaration made at the end of the year; the tax is paid in the following tax year.

6. *The Reforms Promised in the White Paper. Cmd 4653.*¹³ Part II, Chapter 3 of the Finance Act 1971 contains eight sections dealing with the charge to income tax for the year 1973-1974 and subsequent years. The alterations are intended to simplify the methods of computing and charging tax. They are not intended to effect changes in the amount of tax paid by individuals.

There is to be a basic rate, set for 1973-1974 at 30%.¹⁴ Higher rates will be applicable to higher income, and an additional rate will apply to higher levels of investment income.¹⁵ In this way the present reliefs granted to earned income will disappear,¹⁶ as will the surtax. A list of personal reliefs is given in section 33. There is no need to give further details at this stage. The alterations were introduced for the purpose of administrative simplicity and ease of comprehension. They have generally been met with approval, and success appears likely.

B. *Capital Gains Tax.* Because of the changes which have been made in the last ten years, it will be best to explain the legislation on capital gains tax in three stages. First, the short-term capital gains tax was introduced in 1962. The Finance Act 1962 provided that capital gains made within six months of a purchase should be treated as income.¹⁷ Second, the Finance Act 1965 continued the short-term tax, making it applicable to dispositions within twelve months, and introduced for the first time a long-term capital gains tax. Long-term gains are chargeable at the rate of 30% on a disposal of assets.¹⁸ There are, of course, some exceptions,¹⁹ of which

13. A summary of the White Paper will be found in 1971 New L.J. 389.

14. F.A. 1971, § 39.

15. *Id.*, § 32(1).

16. *Id.*, § 32(2).

17. F.A. 1962, 10 & 11, Eliz. 2, c. 44, technically called Case VII of Schedule D.

18. F.A. 1965, c. 25, § 20(3).

19. *Id.*, § 27.

the most significant is a taxpayer's main or only residence.²⁰ There were also provisions, now largely repealed, by which the tax was payable not only upon an actual disposal, but also upon a "deemed" or notional disposal. Thus, there was a deemed disposal on death,²¹ a deemed disposal of all the property in a trust when the life tenant died,²² and also a deemed disposal where a person became absolutely entitled as against the trustees.²³ Further, in a trust in which no person was entitled to the income—as in the standard form of discretionary trust described below—there was a deemed disposal of the whole capital assets of the trust every 15 years.²⁴ Third, the Finance Act 1971 has allowed some relaxation of these provisions. (i) Short term capital gains tax is abolished.²⁵ Gains are governed by a single set of rules, regardless of holding period. (ii) Death no longer constitutes a deemed disposal by the deceased.²⁶ Therefore capital gains tax is not charged at death. Gains which accrued during the lifetime of the deceased are indeed never taxed, for the personal representatives of the deceased are deemed to acquire them at their market value on the date of death.²⁷ (iii) There is no longer a deemed disposal at the conclusion of each fifteen year period for a trust which has no life tenant entitled to the income.²⁸ (iv) Relief is given in respect of disposals up to a value of £ 500 in any one tax year.²⁹ This was a much needed reform. The cost of taxing small disposals was out of all proportion to the revenue produced.

The extreme severity of capital gains tax as it applied before the passing of the Finance Act 1971 to trusts created by English trustors could be to some extent alleviated in the case of trusts where the majority of the trustees were resident and ordinarily resident abroad, and the general administration of the trust is ordinarily carried on abroad.³⁰ If the beneficiaries are resident or domiciled abroad, there is then no liability for capital gains tax. If the beneficiaries are domiciled and either resident or ordinarily resident in the United Kingdom, capital gains tax is payable in respect of gains attributable to each beneficiary's interest.³¹ In the case of a discre-

20. *Id.*, § 29.

21. *Id.*, § 24(1).

22. *Id.*, § 25(4).

23. *Id.*, § 25(3).

24. *Id.*, § 25(7).

25. F.A. 1971, § 56.

26. *Id.*, § 59(1).

27. *Id.*, sched. 12, para. 1.

28. *Id.*, § 59(2).

29. *Id.*, § 57(1).

30. F.A. 1965, c. 25, § 42.

31. *Id.*, § 42(2).

tionary trust, however, where no beneficiary has any "interest," capital gains tax is payable upon receipt of income within the last three years or upon distribution of capital.³² Thus, the ordinary buying and selling of stock by the trustee escapes any liability for capital gains tax. The transfer or "exporting" of trusts to tax havens overseas still has many advantages; and, although these are not so great as they were before the 1971 Act (in view of the abolition by that Act of the liability to tax upon the death of a life tenant and after the passage of 15 years), many trustors and beneficiaries have desired to replace their United Kingdom resident trustees by other trustees resident abroad or by a trust corporation which is resident in a tax haven overseas. A very substantial business in exporting trusts to tax havens, particularly the Bahamas, Bermuda and the Island of Jersey (which is a separate tax jurisdiction from the United Kingdom), has developed. There has been little litigation on the tax implications in this area, but doubts have been expressed as to the propriety of appointing overseas resident trustees unless the beneficiaries are resident abroad as well.³³ An English trust with beneficiaries in England should be administered by trustees who are within the jurisdiction. It is clear that the Court will refuse to appoint foreign trustees unless it is satisfied that the beneficiaries intend to reside permanently in that overseas country.³⁴ That is not, however, to say that a trustor may not appoint overseas resident trustees, nor that a person who has the power to appoint new trustees may not select trustees resident overseas. Turner L.J. in *Re Tempest*,³⁵ in discussing the court's power to appoint new trustees, stated that the court was reluctant to appoint a person who is a beneficiary, or who is related to a beneficiary, or who is the solicitor to the trust or to one of the beneficiaries. Further, it has been said that these principles should guide individuals exercising a power to appoint new trustees.³⁶ In practice, however, it is common for beneficiaries to be appointed as well as the solicitor to the

32. *Id.*, § 42(3).

33. *Re Weston's Settlements* [1969] 1 Ch. 223 (C.A. 1968). Other cases have upheld the appointment because of the connection of the beneficiaries with the foreign country. See *Re Seale's Marriage Settlement* [1961] 1 Ch. 574, *Re Windeatt's Will Trusts* [1969] 1 W.L.R. 692, *Re Whiteheads Will Trusts* [1971] 2 All E.R. 1334.

34. *Re Weston's Settlements* [1969] 1 Ch. 223 (C.A. 1968).

35. [1866] L.R. 1 Ch. 485.

36. SNELL, *EQUITY* 211 (26th ed. —).

trust. Whether therefore the court would make an appointment, or whether the court would consider an appointment to be proper, the court appears reluctant to rectify an existing appointment. Consequently, there seems to be no obstacle to the appointment of a trustee resident overseas,³⁷ and a large number of trusts have been exported in this way. But it is common to advise existing trustees that they may run some risk if they retire in order to facilitate such an "improper" appointment, since they may well remain liable in respect of breach of trust and in respect of the fiscal liabilities of the trust.³⁸ The law on this matter is still in a stage of development.

C. Estate Duty

1. *Passing of Property.* First, as a matter of terminology, let it be said that the word "tax" in England refers to income tax, capital gains tax and to some others. We do not have or speak of "estate tax" it is always spoken of as "estate duty." Indeed, one often refers just to "duty", and this means estate duty.

Estate duty is payable "upon the principal value ascertained as hereinafter provided of all property, real or personal, settled or not settled, which passes on the death." Such is the provision of Section I of the Finance Act of 1894, which is still the basic enactment dealing with estate duty. The meaning of "passing", as defined in Section 2, has been amended substantially by the Finance Act 1969.³⁹ Property which passes on the death includes not only the free estate of the deceased, that is to say the property which he owns himself and may dispose of by will, but includes also the capital value of any trust property in which the deceased had a limited interest, such as a life interest. Where this is the case, the free estate and the capital of the trust are aggregated together for the purpose of ascertaining the rate of estate duty payable upon each of these sources. This imposition of duty upon the capital of a trust where the deceased had only a limited interest, and the principle of aggregation are the two factors which make the English Estate Duty system particularly onerous. I will return to this matter in more detail later on.

2. *The Rates of Duty.* The rates of duty are laid down in Schedule 17 to the Finance Act 1969 (as amended by the Finance Act 1971, Section 61).⁴⁰ It will be sufficient for our present purposes

37. *Meinertzhagen v. Davis* [1844] 1 Coll. 353, *Re Smith's Trusts* [1872] 26 L.T.R. (n.s.) 820, 85 L.Q.R. 15 (1969).

38. F.A. 1894, 57 & 58 Vict., c. 30, § 8(4).

39. F.A. 1969, c. 32, § 36(2).

40. F.A. 1969, c. 32, sched. 17, part F, as amended, F.A. 1971, § 61.

to indicate percentages which have to be paid:⁴¹

Value of Estate £	Cumulative Amount of Estate Duty £	Estate Rate (average) %	Marginal Rate (on excess) %
12,500	nil	nil	25
15,000	625	4.167	25
17,500	1,250	7.143	30
20,000	2,000	10	30
22,500	2,750	12.222	30
30,000	5,000	16.667	45
35,000	7,250	20.714	45
40,000	9,500	23.75	60
45,000	12,500	27.778	60
50,000	15,500	31	60
60,000	21,500	35.833	60
65,000	24,500	37.692	60
70,000	27,500	39.286	60
75,000	30,500	40.667	60
80,000	33,500	41.875	65
90,000	40,000	44.444	65
100,000	46,500	46.5	65
125,000	62,750	50.2	65
150,000	79,000	52.667	70
200,000	114,000	57	70
300,000	184,000	61.333	75
400,000	259,000	64.75	75
500,000	334,000	66.8	80
750,000	534,000	71.2	80
900,000	661,500	73.5	85*

*On estates over £2,070,000, the rate is limited to 80% overall.

3. *Property Given Away.* There is, as has been pointed out, no gift tax in England, and it is possible to give away as much property as one wishes quite freely; but there is, of course, a liability to capital gains tax if the property given away is pregnant with gains, as this constitutes a disposal.⁴² So far as estate duty is concerned, property given away will be subject to duty on the death of the donor unless it was given away at least 7 years prior to the death, and bona fide possession and enjoyment of the property had been assumed by the donee to the entire exclusion of the donor.⁴³ The dutiable value of the property given is, however, reduced if the gift was made in the fifth, sixth, or seventh year prior to the death.⁴⁴

41. Compiled by Mr. R. P. Roly, Solicitor, and published in New L.J., July 1, 1971.

42. F.A. 1965, c. 32, § 22(4).

43. F.A. 1968, c. 44, § 35.

44. F.A. 1968, c. 44, § 35(2).

4. *Limited Interests.*

Property Passing. As was mentioned above, the capital of the trust passes on the death of the owner of a limited interest. Thus, if the life tenant, entitled to the whole income, dies, there is a passing of the whole capital value of the fund.⁴⁵ There is an exception to this in the case of the surviving spouse.⁴⁶ Where duty has been paid upon the death of the first spouse to die, then so long as the second spouse has only a limited interest in the fund, and is not competent to dispose of the capital, duty is not payable a second time on the death of the second spouse. If a husband has given his property to his wife absolutely, duty is payable upon her death as well. This exception is of course an advantage to the fund generally and to the remaindermen; it is of no advantage to the widow; and there is much to be said for the view that the estate duty should be payable, if this were administratively possible, upon the death of the second spouse, and not upon the death of the first.

The problem of the imposition of estate duty upon a termination of a life estate is one upon which many views can be taken. It is possible to argue that as the life tenant is now dead, his interest is worth nothing in his estate, and that no estate duty should be payable. It could also be argued, if it were desired to impose some estate duty upon it, that there should be added to the life tenant's estate some value which relates to the actuarial value of the life estate when he received it, or to the number of years during which he has in fact enjoyed it. The English legislation, however, as has been seen, takes a most extreme view; and this is explicable on historical grounds.

In the 19th century when estate duty first came into operation, much of the private capital in England was the subject of family settlements. Many of these were settlements of land and included successive life estates and estates tail. One of the objectives of these old settlements was to prevent any person from becoming absolute owner, for he then might be tempted to alienate the hereditary family land or his creditors might proceed against it. The technique of the English family land settlement was one whereby the fee was divided, often in a very complicated manner, among the various members of the family whom it was intended to benefit. If estate

45. *Earl Cowley v. Inland Revenue Comm'rs* [1899] A.C. 198; F.A. 1969, c. 32, § 36 (2).

46. F.A. 1894, 57 & 58 Vict., c. 30, § 5(2); F. (1909-1910) A. 1910, 10 Edw. 7, c. 8, § 55; F.A. 1914, 4 & 5 Geo. 5, c. 10, § 14; F.A. 1954, 2 & 3 Eliz. 2, c. 44, § 32, *amended by*, F.A. 1956, 4 & 5 Eliz. 2, c. 54, § 36; F.A. 1969, c. 32, sched. 17, part II, para. b.

duty legislation were to "bite" at all, it was necessarily directed to these large settlements of private capital, and to the limited interests which they contained. It is not surprising therefore, that limited interests were made subject to duty (originally to "settlement estate duty") and, since 1914, to estate duty. Where estate duty is payable upon the death of a person holding such a limited interest, the duty is payable by the trustees of the trust and not by the executors of the deceased.⁴⁷ Where therefore a person dies having property of his own *and* a limited interest in a trust, the executors are accountable for the estate duty payable out of the free estate, and the trustees for that due upon the trust fund.

5. *Aggregation.* Subject to exceptions⁴⁸ all property passing on the death is aggregated. Thus, in order to ascertain the rate of duty which is payable upon the free estate, it is necessary to make a valuation of that and add to it the capital value of all the property passing under the trusts in which the deceased has a limited interest. Duty is then payable upon *all* these funds at the rate applicable to the total aggregated value of the dutiable funds. For example, if a man dies with: (1) an estate worth £ 75,000, (2) a life interest in a marriage settlement of £ 75,000 and (3) a life interest in a trust made by his parents for £ 75,000, duty payable on his death would be that applicable to the aggregate sum of £ 225,000. The duty payable would be £ 131,500. If the value of these component parts of the aggregation had been greater, the amount payable would, of course, be higher, and it may well be that it would be higher than the actual value of the deceased's combined interests. In the example given, if he became entitled to the life interests late in life, these interests, valued actuarially, will be less than £ 25,000 each, so that the two life interests plus his own £ 75,000 will be worth less than the £ 131,500 which is chargeable upon the various funds at the death.⁴⁹

6. *Charities.* The only difference between gifts to charities and

47. F.A. 1894, 57 & 58 Vict., c. 30, § 9(1).

48. Where, for example, the deceased's own (unsettled) property does not exceed £ 10,000 in value, and the settled property in which the deceased has a limited interest was not settled by him. Such a "small estate" forms an estate by itself for estate duty purposes. F.A. 1894, 57 & 58 Vict., c. 30, § 4 *proviso*; F.A. 1968, c. 44, § 35; F.A. 1969, c. 32, sched. 21, part V.

49. HANBURY, *supra* note 1 at 184-5.

gifts to other persons is that the "claw-back" period is one year.⁵⁰ That is to say that if an inter vivos gift is made to charity and the donor survives one year, the property is free of estate duty in the hands of the charity. The equivalent period in the case of other gifts, it will be remembered, is 7 years. There is no reduction, however, in the estate duty liability where a testator gives property by his will to charity, nor is there any capital gains tax relief in respect of gifts to charity, nor is there any relief in respect of income tax in the case of inter vivos gifts to charity. However, a covenant to make a gift to charity for a period not less than seven years or for life is treated as the income of the charity, and free of tax in their hands, and the charity is able to recover from the Revenue the income tax which had been paid by the donor. This, of course, is a benefit to the charity and not to the donor.

It is hardly necessary to emphasize the tremendous significance which estate duty plays in English estate planning or to underline the great importance of estate planning to holders of private capital in England.

III. VARIATION OF TRUSTS

It is not surprising that beneficiaries under trusts in England have sought to change the terms of the trusts in such a way as to escape from the fiscal consequences of a succession of limited interests. Where all the beneficiaries are adult and not under any disability, there is no real difficulty. They may terminate the trust, if they wish, or may agree among themselves upon an alteration or variation of the terms. This can be done without application to the court.⁵¹

Where, however, there are infants who have interests in the trust and who are unable at law to make decisions on their own, the trust cannot be varied without the approval of the court. Until 1958 the English courts had held that they had no power to approve the variation of the beneficial interests under a trust where the object of the variation was to save estate duty.⁵² The courts could approve a compromise in a case in which there was a genuine dispute,⁵³ and there were many occasions on which considerable ingenuity was used to find a dispute which the courts would consider sufficient to justify its approval of a variation; and of course the variation, when

50. F. (1909-1910) A. 1910, 10 Edw. 7, c. 8, § 59(3), *as amended*, F.A. 1969, c. 32, sched. 17, part III, para. 6(b).

51. HANBURY, ch. 21. See Marshall, 17 M.L.R. 420 (1954).

52. Chapman v. Chapman [1954] A.C. 429.

53. *Re Downshire Settled Estates* [1953] Ch. 218 (1952).

it came, not only settled the dispute which was to be compromised, but also rearranged the trust in such a way as to reduce estate duty liability. Without the dispute, however, the courts felt that they were in an impossible position if they were required by the terms of a Finance Act to hold that estate duty was payable under certain circumstances, and then were asked by the parties to approve the variations of the trust so as to make the statutes inapplicable.⁵⁴ In 1958, however, the Variation of Trusts Act was passed which specifically gave the court power to approve "any arrangement . . . varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts."⁵⁵ This jurisdiction has been widely exercised and in most cases the exercise has been for the purpose of reducing estate duty liability.⁵⁶ Indeed, the statute may seem to be a strange piece of legislation and it has in fact deprived the Revenue of many millions of pounds in estate duty over the last 13 years. The justification for it is that it attempts to put infants in as favourable a situation as adults. Otherwise, the courts would be saying, paradoxically, that, in pursuance of their duty to protect the interests of an infant, they are unable to approve on his behalf something which is obviously for his benefit and which he could approve for himself if he were an adult.⁵⁷

Much of the chancery practice in England at the present time is in relation to the variation of such trusts. The legal adviser must consider in great detail every person who might possibly have an interest under the trust in any possible circumstances; in many cases these will be infants or unborn persons, and under the Act an application can be made to the court for a variation to be approved on their behalf. The new trusts on which the property is to be held are specially designed so as to escape the estate duty liabilities which would otherwise have attached. There is not sufficient space here to examine the ways in which the courts have exercised this jurisdiction; it is sufficient to say that the approval of a variation for the purpose of saving estate duty is now almost a routine event.

54. Lord Morton of Hemyton in *Chapman v. Chapman* [1954] A.C. 429, at 468 stating "... a most undignified game of chess between the Chancery Division and the legislature."

55. Variation of Trusts Act 1958, 6 & 7 Eliz. 2, c. 52, § 1(1).

56. The cases are reviewed in 33 Conv. (n.s.) 113 (1969).

57. The Act was based on the Law Revision Committee's sixth report.

IV. ESTATE PLANNING TECHNIQUES

In considering how to deal with his property, the trustor wishes to arrange his affairs in such a way that the minimum liability to estate duty, capital gains tax, income tax and surtax is suffered. He has to consider tax and estate duty liability in his own lifetime and on his death, and also the liability which will exist in respect of the lives and deaths of the beneficiaries. This section will contain an outline of some of the methods which have been used. It can be no more than an outline, and further detailed examination will be necessary to enable any tax planning decisions to be made. Where possible, references to sources of further information are given. It will be clear to the reader how effective recent legislation has been in blocking up a number of opportunities which have until the last few years been available to tax planners.

To avoid estate duty liability, an owner of property must dispose of it at least seven years before his death, and the donee must assume possession and enjoyment of the property comprised in the gift to the entire exclusion of the donor, or of any benefit to him by contract or otherwise.⁵⁸ The "claw-back" period is one which has grown gradually over the years, beginning in 1881 with a period of three months,⁵⁹ and being extended at various times, reaching seven years under the Finance Act 1968.⁶⁰ There is however, as has been pointed out, a reduction in the dutiable value of the property given where the death occurred in the fifth, sixth and seventh years following the gift.⁶¹

Income tax and surtax can be avoided by giving away the property which earns the income, and income tax can be avoided by covenanting to pay the income to another (who is liable at less than the standard rate) for a period of seven years or more or for life. The problems raised by legislation which already aggregates certain income of infants with that of their parents has been explained.⁶² No surtax is payable under a trust in which the income is accumulated under an express power to do so, for no beneficiary can make any claim to income not allocated to him. The only tax payable is income tax at the standard rate in accordance with the rule applicable to all trust income.

With this general background, it is now appropriate to look at

58. F.A. 1894, 57 & 58 Vict., c. 30, § 2(1)(c) incorporating the Customs and Inland Revenue Act of 1881, 44 Vict., c. 12, § 38(2); F.A. 1968, c. 44, § 35.

59. Customs and Inland Revenue Act 1881, 44 Vict., c. 12, § 38.

60. F.A. 1968, c. 44, § 35.

61. F.A. 1960, 8 & 9 Eliz. 2, c. 44, § 64; F.A. 1969, c. 44, § 35(2).

62. *Supra* note 12.

some of the methods used for tax planning purposes. As indicated, this is in many ways a disappointing list. It would have looked much more promising a few years ago.

A. Absolute Gifts. An absolute gift of property to children, grandchildren or other persons is the simplest form of an estate duty saving. It must be given away seven years before the donor dies. The income from the property disposed of will, if the donees are infants and unmarried, be aggregated with that of their parents.⁶³ Otherwise it is for all purposes the property of the donee. Capital gains tax will be payable upon the disposal. Such a form of estate duty saving is only satisfactory, however, if the donee can be trusted properly to look after a sum of capital and trusted, perhaps, to dispose of it himself seven years prior to his own death. Once given away, there is of course no way of controlling the manner in which the donee spends it, wastes it, invests it or otherwise deals with it.

A life tenant may similarly effect estate duty savings to the benefit of the remaindermen. If nothing is done, duty will be payable at the life tenant's death upon the whole capital of the trust, and at a rate applicable to the aggregated value of the capital of the trust plus the life tenant's free estate plus any other trusts in which the life tenant has a limited interest. A surrender of the life interest will free the trust of estate duty liability upon the life tenant's death provided he survives the extinguishment of his interest by seven years. No capital gains tax is payable, as this is a disposal, not of an asset, but of an interest under a trust.⁶⁴ If the life tenant needs some capital from the fund, he may come to an arrangement with the remaindermen, all being adult and under no disability, whereby a proportion of the capital is transferred to the life tenant and the balance to the remaindermen. Again, to avoid estate duty liability, the life tenant must survive seven years. If, as will usually be the case, some remaindermen are infant or unborn, an application must be made to the court under the Variation of Trusts Act 1958 for the approval of such an arrangement.⁶⁵

B. Children's Trusts. Where the intended beneficiaries are infants, it is common to create a trust which gives them interests con-

63. This rule will be amended as from April, 1972. F.A. 1971, § 16.

64. F.A. 1965, c. 25, sched. 7, para. 13(1).

65. *Supra* note 55.

tingent upon attaining a certain age: sometimes majority (18), sometimes 21, and sometimes a greater age. On reaching that age, the beneficiary becomes absolutely entitled to claim his share of the capital, and capital gains tax is payable at that time.⁶⁶ And the question again is raised whether it is desirable to provide blocks of capital to be available in the future for infant beneficiaries whose capability to deal wisely with such a windfall cannot yet be judged.

During the lifetime of such a trust, the situation, subject to provision to the contrary in the trust instrument, is governed by Trustee Act 1925, section 31. This gives to the trustees a statutory power to apply the income of the trust for the maintenance, education or benefit of infant beneficiaries. On attaining majority, the beneficiary, again subject to contrary provision in the trust instrument,⁶⁷ is entitled to his share of the income. During minority, surplus income is to be accumulated, and paid over to the beneficiary on his becoming absolutely entitled. The trustees also⁶⁸ have power to advance up to one half of the beneficiary's presumptive share of the capital, even though the beneficiary may only be contingently entitled.

Such a settlement provides a number of advantages. The income, if paid to or for the benefit of the infant beneficiaries, counts as their income. This has tax advantages, subject to the aggregation of income provisions, previously explained. If the income is accumulated instead of being paid out or applied, the income is taxed at the standard rate of income tax only, in accordance with the usual rule for trust income. Estate duty is payable upon the death of the beneficiaries whose interests have vested, but not in respect of the death of those entitled contingently, even if some of the income has been applied for their maintenance.⁶⁹

The power of advancement given by Trustee Act 1925, section 32 may also have tax planning advantages in a way similar to the surrender of a life interest. If the trust contains successive interests in favour of a life tenant and remainderman, an advancement of part of the capital of the fund in favour of the remainderman reduces the value of the fund, and hence the estate duty liability upon the death of the life tenant. The beneficiaries become entitled earlier than they otherwise would, and, subject to the usual seven year "claw-back" rule, will become entitled to a larger (es-

66. F.A. 1965, c. 25, § 25(3).

67. *Re Turner's Will Trust* [1937] Ch. 15 (1936); *Re McGeorge* [1963] Ch. 544.

68. Trustee Act 1925, 15 & 16 Geo. 5, c. 19, § 32.

69. *A-G v. Power* [1900] 1 R. 272.

tate-duty-free) sum. It was held in *Pilkington v. Inland Revenue Commissioners*⁷⁰ that this was a proper exercise of the power of advancement in that it was for the "benefit" of the advanced beneficiary, even though she was in that case a two-year old girl who was supplied with all the material comforts she could desire. Nor was it an objection that a child so young could not handle the money, for the House of Lords held that, in making the advancement, the trustees could settle the capital upon new trusts provided that this was for the benefit of the beneficiary.

C. *Discretionary Trusts*. The discretionary trust developed in England as the main method of avoiding liability to estate duty upon the death of beneficiaries under a trust. As has been seen, where a beneficiary dies who has a limited interest under a trust, the whole subject-matter of the trust passes and estate duty is payable thereon. If, however, the beneficiary had no property interest, then no property would pass on his death. This has been the basis of the success of discretionary trusts over the years, but, as will be seen, their usefulness for this purpose has been very much restricted by the Finance Act 1969.

Where property is given to trustees upon trust to apply the income and capital at their absolute discretion among one or more members of a class of beneficiaries, it has been held that no one beneficiary has an interest in the property,⁷¹ except in any property which the trustees see fit to give him in the exercise of their discretion. Such property would be in his free estate anyway. That apart, no property passes on his death and the capital of the trust is not therefore affected. The trustees must be free to exercise their own discretion and not be restricted or hampered in any way, but the trustor can of course make suggestions to the trustees, and it is common indeed for a document to be given to the trustees indicating the ways in which the trustor would like to have the income distributed and capital payments made, making clear of course that the document does not in any way restrict the free discretion which has been given to the trustees. None of the beneficiaries has any interest beyond that of requiring the trustee to consider the exercise of the discretion in his favour. This is not a property interest and therefore on his death,

70. [1964] A.C. 612 (1962).

71. *Gartside v. Inland Revenue Comm'rs* [1968] A.C. 553, 580 (1967).

no duty was payable upon the capital of the trust. Of course, it may well be, and indeed it is likely that, the trustees will make payments of the income and capital just as the trustor would wish, and just as the trustor would have provided if he had given specific fixed interests to the beneficiaries.

The operation of a discretionary trust can be made clear by taking an example of a family man making a will or making an *inter vivos* trust. He wishes first of all to benefit his widow and his children and, perhaps, other persons as well. If he were creating fixed trusts, he would give a life interest to the widow; he might then divide up the property and give life interests to each of the children with remainders over to his grandchildren. Duty would then be payable upon the death of all the persons concerned, unless the trustor died within seven years of the making of the trust and duty was paid on his death in respect of the property, in which case the second spouse exemption would cover the widow's death. The trustor's intentions could be met, and prior to 1969 could be effected without any liability to estate duty at any stage, provided the discretionary trust was created at least seven years before the death. The class of the beneficiaries would be the widow, the children, the grandchildren, and anyone else whom the trustor wished to include, and the trustees could, of course, pay all the income to the widow during her life and then the income in shares to the children during their lives and the capital over to the grandchildren after that. By effecting this means of a discretionary trust, rather than by a fixed trust, it has been possible for many years to avoid the liability to estate duty on the death of any of the beneficiaries.

Various points must be remembered in creating discretionary trusts. Firstly, it is extremely important to appoint co-operative trustees. If they have a disagreement with the trustor, then all the power is in them, and there is absolutely nothing the trustor can do about it. Secondly, there are questions relating to the class of beneficiaries. It is important not to have the class too large because that could be held void for uncertainty.⁷² On the other hand, it is important not to have the class too small because if it were reduced to a single person, then that person would be entitled to the income

72. The difficulties have been much reduced by the relaxation of the existing rules in *McPhail v. Doulton* [1970] 2 W.L.R. 1110. Previously, a trust would be held void for uncertainty, unless it was possible to list all the beneficiaries. See *Inland Revenue Comm'rs. v. Broadway Cottages Trust* [1955] Ch. 20. The rule for certainty of trusts is now the same as that established in *Re Gulbenkian's Settlements* [1970] A.C. 508, for powers, namely that it is valid if it can be said with certainty whether any given individual is or is not a member of the class. See HANBURY at 125 and supplement.

and there would be a passing of property on the death of that person.⁷³ The duration of the trust is also important, since each time the trustees exercise a discretion, it creates a new property interest in the person to whom the property is given, and such an exercise would be invalid if it were exercised outside the perpetuity period.⁷⁴ It is essential, therefore, that the trust be limited to the perpetuity period. Such a trust would normally start with a statement that it was to terminate at a certain time in the future, and specific property interests are given to persons at that time. In England the traditional practice has been to select, as measuring lives, certain members of the Royal Family under what we call a Royal Lives Clause, and the period ends 21 years after the death of the survivor. It is possible now, however, to choose a specific period of a number of years, not exceeding 80, as the perpetuity period under Section 1 of the Perpetuities and Accumulations Act 1964.

It is common also to include other powers in the trustees, of which two should be mentioned. Firstly, the power of accumulation which enables the trustees to accumulate for a permitted period of time any income which the trustees do not see fit to distribute to the beneficiaries.⁷⁵ Secondly, a power in the trustees to terminate the trust and to appoint the property upon new trusts which is of importance in order to avoid the possibility of fixed interests arising at the end of the period covered by the trust and also to enable the trustees to take advantage of opportunities which arise in the context of alterations to the estate duty or income tax law in the future.

Summarizing this, it has been possible for many years (though the moment of doom has now arrived) to put the family capital into a discretionary trust which will last for 80 years, or for lives in being plus 21 years in which the trustees have a complete freedom to distribute the income and capital among the beneficiaries—presumably doing this in exactly the same way that the trustor would wish them to—without paying estate duty at any stage during the

73. *Re Weirs, Settlement Trusts* [1970] 3 W.L.R. 860.

74. *Re Coleman* [1936] Ch. 528 (1935).

75. For the periods of accumulation permitted by English law, see Law of Property Act 1925, 15 & 16 Geo. 5, c. 20, §§ 164-166; Perpetuities and Accumulations Act 1964, c. 55, §§ 13-14; R. MAUDSLEY AND BURN, *LANDLAW: CASES AND MATERIALS*, 244-50 (2d ed. 1970). The usual period to use for this purpose is a period of 21 years from the creation of the trust.

currency of the trust. Such an easy way round the estate duty liability has made it possible to bear with less complaint the severity of the estate duty rate. Estate duty was commonly called a "voluntary tax," and, of course, it was the very rich who most needed to avoid it and who could be sure to be provided with the best legal advice to enable them to do so. It was surprising indeed that discretionary trusts were permitted for as long as they were. A very serious attack was made upon discretionary trusts by the Finance Act of 1969. This act provided that where there was a discretionary trust, estate duty will be payable upon the capital of the fund on the death of any beneficiary who had received *any* income; the proportion of the fund liable being *that proportion* of the income which the beneficiary had received during a certain prior period which, for simplicity's sake, I will call seven years.⁷⁶ Thus, if under a discretionary trust the income is paid to one individual, and that individual dies, duty is payable upon the capital of the trust in the same manner in which it would have been if that person had had a fixed interest. Where it is shared among a number of persons, then it is necessary to see what percentage of the income these persons had, and duty is payable upon the capital of the trust upon their death in the same proportion. In short, this is a way in which estate duty liability is imposed upon discretionary trusts by treating them as if the income benefits which the beneficiaries receive had been received by them under a strict entitlement instead of at the discretion of the trustees.

It is not clear what answers the estate planners will find to all this. The legislation has been in force for something over two years. Different people have different views on the way in which the matter shall be handled, and it is not yet clear what settled practice will develop. A few points, however, can be made.

1. Some have taken the view that discretionary trusts should now be terminated and no new ones created. That seems to me to be quite wrong. However disappointed one may be about the loss of the estate duty privileges which discretionary trusts had, they are at least in no worse position than fixed trusts, and the adaptability of such a trust enables the trustees to exercise their discretion in such a way as to take advantage of future changes in the law. Discretionary trusts have advantages independent of estate duty saving.

2. The trustees can maneuver the payment of income in such a way as to reduce estate duty liability to the minimum, and to

⁷⁶ F.A. 1969, c. 32, §§ 36(2), 37(3). See also, New L.J., July 31, 1969, (A.D. Lawton).

pay to the young, rather than to the old. For example, if there is one member of the class who has no capital at all and the other members are sufficiently well off, it will be advantageous from the income tax and the estate duty point of view to pay all the income to the impecunious member; on the death of that member duty will be payable on the capital of the fund, but, of course, it will not be aggregated with any other property because the beneficiary had none. The other members of the class could receive, instead, payments of capital. So long as all the income has been disposed of this would not give rise to the imposition of estate duty upon the capital of the fund on their death for this liability depends upon receipt of *income* from the fund.

3. It is possible to argue that the best way to handle the matter is to avoid any income being earned by the fund. This is perfectly satisfactory so long as it is possible to be sure that is so. The danger is that the fund may earn something that is income, or is treated as income, and if that receipt is paid to any member, perhaps without foreseeing the consequences, then estate duty may be payable on the whole of the fund on that beneficiary's death.

4. Provided the beneficiaries die in the right order, it is possible to maneuver the matter in such a way that full advantage is taken of the income without estate duty becoming payable. Assume that a grandfather creates a discretionary trust in favour of his children and grandchildren. The trustees could pay the income to the children during the period in which their families are growing up. A stage is reached at which those children (that is, now the parents) no longer have parental financial responsibilities and may have money of their own, and their children (the grandchildren) are bringing up their own families and in need of the income. If the income is paid to the children for a period of seven years, then no estate duty will be payable on the death of their parents who have not received any income during the previous seven years. Payments of capital can safely be made to the parents, provided that all the income has been paid out elsewhere.

5. It has also been suggested that with well-to-do people the trustees should be given power to pay the income to charity if they should see fit. The fund could then be invested in growth stocks yielding a small income, the whole of the income could be paid to charity, and capital distributions could be made to the benefi-

ciaries. The amount of income lost in this way to the family would, of course, be trivial in comparison with the estate duty which would be saved on their death, and if there is sufficient money, it may be desirable to have a proportion of it paid to charity in any case.

D. Marriage Settlements. It has been customary for centuries in England among well-to-do families to use the marriage of a child as the occasion to pass on a proportion of the family capital to the younger generation. In modern times, it has become more common to pass on a block of capital by absolute gift at any suitable time, or to make a discretionary settlement during the infancy of the children. Until 1963, a marriage was a suitable occasion for tax planning purposes to make a provision, whether by way of outright gift or by way of family settlement; for gifts, made in consideration of marriage—of any size and by whomsoever made—were free of estate duty on the death of the donor even if he died on the following day. Restrictions were imposed in 1963,⁷⁷ and the position is now governed by the Finance Act 1968, section 36.

This section imposes an upper limit for the estate duty advantages of £ 5,000 in the case of gifts by a parent or by a more remote ancestor or by a party to the marriage, and a limit of £ 1,000 in the case of gifts made by other people. The gifts must be made "in consideration of marriage," that is to say, "made before the particular marriage and in contemplation of it; or immediately after and in consideration of it [this in practice means the day of the wedding]; or at any time after the marriage but in pursuance of an agreement made prior to it."⁷⁸ There is no exemption from capital gains tax in respect of such a gift.

E. Life Insurance Policies. Policies of life insurance can usefully be employed for tax planning purposes, but, as may be expected, less effectively now than was possible a few years ago. They have advantages from the point of view of income tax and estate duty.

Firstly, income tax: Generally, the payment of premiums upon a policy of life insurance, whether or not it provides other benefits as well, and whether or not it has been assigned or charged or made subject to a trust, entitles the assured to relief from income tax (but not from surtax) in respect of 2/5 of the premiums.⁷⁹

It was at one time profitable for tax payers in the higher tax brackets to pay only the first premium upon a life policy, and to

77. F.A. 1963, c. 25, § 53(1).

78. POTTER AND MONROE, *TAX PLANNING* 198 (4th ed. 1970).

79. Full details are given in T.A. 1970, c. 2, §§ 19-21.

borrow money on the security of the policy for the payment of further premiums. This practice has effectively been ended by the withdrawal of tax advantages,⁸⁰ and by further restrictions upon tax relief upon borrowed money generally.⁸¹

Secondly, estate duty: It should be remembered that in England, a third party has no right to sue upon a contract of which he is intended to be the beneficiary. Thus, if A contracts with B Insurance Co., and the contract provides that the policy monies shall be paid to C, C has no legal right to sue for the money. To give enforceable rights to C, C can be made the beneficiary under a trust, either by express declaration of trust, or by taking advantage of the Married Women's Property Act 1882,⁸² or the policy could be assigned to C.

If a policy of life insurance is taken out by the deceased for his own benefit, it forms part of the assets in the estate of the deceased, like any other property. If a policy is given away, after being fully paid up, it is a gift of property which will attract estate duty liability,⁸³ unless the donor survives the gift by seven years. The usual case, however, is a gift of a policy which is not fully paid up, or a gift of premiums payable upon such a policy.

Here duty will be payable in the case of death within seven years in respect (a) of the value accorded to the policy at the date of the gift;⁸⁴ and also (b) if the donor continues to pay the premiums for the benefit of the donee, in respect of the gift of the premiums.⁸⁵ The valuation is worked out according to the provisions of Finance Act 1959, section 34, and is based upon the proportion in (a) which the premiums paid at the date of the gift bear to the aggregate

80. T.A. 1970, c. 2, §§ 403, 405.

81. See T.A. 1970, c. 2, §§ 57-64.

82. The relevant part of the section states: "A policy of assurance affected by any man on his own life, and expressed to be for the benefit of his wife, or of his children, or of his wife and children, or any of them, or by any woman on her own life, and expressed to be for the benefit of her husband, or of her children, or of her husband and children, or any of them, shall create a trust in favour of the objects therein named, and the moneys payable under such policy shall not, so long as any object of the trust remains unperformed, form part of the estate of the insured, or be subject to his or her debts. . . ." Married Women's Property Act 1882, 45 & 46 Vict., c. 75, § 11.

83. F.A. 1894, 57 & 58 Vict., c. 30, § 2(1)(c).

84. F.A. 1959, 7 & 8 Eliz. 2, c. 58, § 34(3).

85. F.A. 1959, 7 & 8 Eliz. 2, 58, § 34(2).

amount of premiums payable up to the maturity of the policy, and in (b) which the premiums paid by the donor in the seven years before his death bear to the aggregate amount of premiums paid at the maturity of the policy. There will thus be no liability in respect of premiums if the premiums are paid by the donee, and this will still be so even if they are paid with money given by the donor if it is possible to bring the case within the exception applicable to gifts which are part of the normal expenditure out of income by the deceased.⁸⁶

Duty will therefore be payable in respect of a life insurance policy if it was owned by the deceased and given away within the last seven years, or if the donor has paid the premiums within the last seven years. A policy on the life of the deceased which was held in trust for a beneficiary, and whose premiums were not paid by the deceased is not liable to duty. In the usual case, however, where the deceased has intended to benefit the donee, it was possible before 1968, but no longer, to take advantage of special rules which related to aggregation. Property which passed on the death "in which the deceased never had an interest shall not be aggregated with other property, but shall be an estate by itself . . ."⁸⁷ This requirement could be met by providing for the policy to be subject to a trust for the donee at the moment of its inception, so that the donor never had any interest in it. A policy taken out under section 11 of the Married Women's Property Act 1882 would qualify. It was therefore profitable for a man with a large estate to take out life insurance policies of this type. If he paid the premiums, they would be subject to duty under Finance Act 1969, section 34, as explained above,⁸⁸ but duty would be payable at the rate applicable to the amount calculated under the formula of section 34, regardless of the value of the remainder of the estate. Similarly, the remainder of the estate would not be affected by the size of the life insurance policy.

Freedom from aggregation, however, ended in 1968. Finance Act 1968, section 38(1) provided that, for the purposes of aggregation, any property which under section 2(1)(c) passes on the death shall be property in which the deceased had an interest. Some limited exceptions were allowed under subsections (7)-(13) which relate only to policies issued in respect of policies of insurance made before March 20, 1968. This situation was continued in Finance Act 1969, which repealed the basic provisions relating to nonaggrega-

86. F.A. 1968, c. 44, § 37.

87. F.A. 1894, 57 & 58 Vict., c. 30, § 4 *proviso*, as amended, F.A. 1900, 63 Vict., c. 1, § 12(1) and F.A. 1930, 20 & 21 Geo. 5, c. 28, § 40(2).

88. *Supra* at note 84.

tion,⁸⁹ but not so as to affect the limited exceptions allowed by Finance Act 1968, section 38.

F. Voluntary Seven-Year Covenants. It has been possible for many years to provide tax-saving benefits for another without setting up any trust or disposing of any capital. Money paid in pursuance of a covenant to pay an annual sum to another for a period of seven years or more or for life is treated as the income of the donee. If, therefore, as will be the usual case, the money paid under the covenant was money which had already borne tax, the tax may be reclaimed. If the donee is not liable to pay tax—perhaps because it is a charity—or is liable only to pay at a lower rate, as will usually be the case with a payment to a child—a saving is effected. In practice the method of dealing with the matter has been to arrange for the donor to pay “such sum as after deduction of income tax for the time being payable in respect thereof will leave . . . the clear yearly sum of £x.”⁹⁰ Therefore, instead of paying to the donee £ 100 and recovering the tax himself, the donor pays £ 61.25 (out of £ 100 of income from which tax at the rate of 38.75% has been deducted) and the donee recovers the tax from the Revenue. A covenant entered into before April 7, 1965 would save income tax, and in some cases, including covenants in favour of named individuals and in favour of charity, surtax too. Covenants entered into after that date save income tax only, and not surtax.⁹¹

This technique was and still is in common use as a method of making income tax-free gifts to charity. It will be remembered that the British tax system gives no tax allowance in respect of other gifts to charity. The technique was widely used also until 1969 as a means by which senior (and richer) members of a family could make financial provision for the children. There has been no advantage since 1936 in a parent doing this for his own children; for, as explained above, the income would be aggregated with that of the parent.⁹² Such aggregation applied until 1969 only to the case of parent and child. Grandparents, uncles and other relations executed such covenants in large numbers. The Finance Act 1968, section 15, however, as explained above, provided that as from April

89. The *proviso* in F.A. 1894, 57 & 58 Vict., c. 30, § 4 was repealed by F.A. 1969, c. 32, sched. 21, part V.

90. POTTER & MONROE, *TAX PLANNING* 41 (4th ed. 1970).

91. There are exceptions in T.A. 1970, c. 2, § 457.

92. *Supra* note 63.

1969 aggregation should apply to all income of infant unmarried children not regularly working. The fiscal advantages of a seven-year covenant then disappeared unless the income of the donee and that of his parent were together insufficient to attract the standard rate of income tax. Aggregation of children's income with that of their parents, other than that provided by parents for their own infant children, will end in 1972; and it is likely that the technique of the seven-year covenant will have a new lease on life—at least until the next election.⁹³

G. Particular Types of Property: Timber, Agricultural Land, Industrial Hereditaments; Objects of National, Scientific, Historical or Artistic Interest.

For various reasons, certain types of property have received special treatment in respect of estate duty liability. Tax planners have been quick to take advantage of them. As with so many of the situations previously discussed, the estate duty advantages of the favorite of these—objects of national interest, etc.—have been much curtailed. The one which currently gives the greatest advantages is the ownership of timber and woodlands, but not every property owner wishes to select such an investment for the bulk of his estate.

1. Timber. Where an estate comprises land on which timber, trees, woods or underwood are growing, the value of such timber, etc. is not to be taken into account in calculating the value of the estate. Nor is duty payable upon the timber until it is sold. Duty is then payable in respect of the proceeds or value of the timber at the rate applicable to the rest of the estate in which the timber last passed on a death.⁹⁴

Such a situation creates many tax planning opportunities. The whole of an estate may be invested in timber, so that the estate rate is nil. Or the estate of an elderly person may be charged with a loan (reducing the value of the estate), which is used to purchase timber. And the sale of the timber may be timed so as to take place subsequent to the death of an owner with a low rate of estate duty applicable to his estate. These provisions are unaffected by recent legislation.

2. Agricultural Property⁹⁵ and Industrial Hereditaments Used

93. POTTER AND MONROE, *TAX PLANNING*, ch. 1 (4th ed. 1970).

94. F. (1909-1910) A. 1910, 10 Edw. 7, c. 8, § 61(5); F.A. 1912, 2 & 3 Geo. 5, c. 8, § 9.

95. F.A. 1925, 15 & 16 Geo. 5, c. 36, § 23(1), *as amended*, F.A. 1949, 12 & 13 Geo. 6, c. 47, § 28(1).

for the Purpose of a Business.⁹⁶ These are charged only at the rate of 55% of the normal estate rate.

3. *Objects of National, Scientific, Historical or Artistic Interest.* Until 1969, the situation relating to such objects was similar to that affecting timber. The Finance Act 1969, section 39, has, however, greatly reduced the attractions of this type of property for tax planning purposes.

The objects which are here included are "such pictures, prints, books, manuscripts, works of art, scientific collections, or other things not yielding income as on a claim being made by the Treasury . . . appear to them to be of national, scientific, historic or artistic interest."⁹⁷ They are exempt from duty so long as they are retained,⁹⁸ but since 1950 it has been necessary to give to the Treasury an undertaking to the effect that the object will be kept permanently in the United Kingdom, that reasonable steps will be taken for their protection and that the Treasury will be given reasonable opportunities for examination for the purpose of seeing these steps taken for their preservation or for the purposes of research.⁹⁹

As stated above, no estate duty is payable if the objects are retained and the undertaking is complied with, nor is duty payable if a sale is made to the National Gallery, the British Museum, or any other similar national institution, any university, county council or municipal corporation in Great Britain, or the National Art Collection Fund.¹⁰⁰ Otherwise, in the case of sale or material breach of the undertaking, the estate duty position depends on whether the sale or material breach took place within three years of the death, or whether subsequently. If the object is sold or the breach occurred within three years of the death, it is included in the estate for all purposes. The valuation is as of the date of death, and this sum is aggregated with the estate, and estate duty is payable upon both at the rate applicable to that aggregate sum. Any capital gains tax which may arise upon a sale within three years of the death is not

96. F.A. 1954, 2 & 3 Eliz. 2, c. 44, § 28.

97. F.A. 1930, 20 & 21 Geo. 5, c. 28, § 40(3).

98. F.A. 1930, 20 & 21 Geo. 5, c. 28, § 40(1).

99. F.A. 1950, 14 Geo. 6, c. 15, § 48.

100. F.A. 1930, 20 & 21 Geo. 5, c. 28, § 40(2) *proviso*. See also, F.A. 1931, 21 & 22 Geo. 5, c. 28, § 40 for an exemption in the case of land given to the National Trust.

an allowable deduction against the object's value for the purpose of estate duty.¹⁰¹

If the sale takes place outside the three year period, the object is liable to duty at the rate applicable to the aggregate principal value of the estate plus the object; but this does not have any effect upon the estate duty liability of the estate itself. In valuing the object for estate duty purposes, capital gains tax payable in respect of the sale may in this case be deducted. The value is taken at the date of disposal,¹⁰² and this may well, with continually inflated values, be considerably higher than it was at the date of the death.

The distinction was explained in a Parliamentary statement by a Government representative in the debate on the budget in 1969.

If a work of art is sold within three years, that work of art and the rest of the estate is taken together and the appropriate estate rate fixed. For example, if a man had a general estate worth £50,000 and works of art worth £100,000 and the works of art are sold within three years, the appropriate estate rate on both the works of art and on the general estate will be that appropriate to a total of £150,000. If the works of art are sold more than three years after death, they will be aggregated with the rest of the estate and will bear duty at the rate of £150,000, but the original estate of £50,000 will be at the estate rate appropriate to £50,000. . . . Works of art will remain an extremely attractive investment, provided that they are kept for three years after death, because they will still be left out of account in fixing the estate rate payable on the rest of the estate.¹⁰³

The withdrawal of so many of the estate duty advantages which used to be available to private holders of such objects may well lead to an increasing number of sales to public institutions.

Sales to these national institutions may now become more attractive; before F.A. 1969 a sale to someone other than such an institution, although assessable, did not lose the non-aggregation benefit; but since F.A. 1969 a sale to someone other than an institution will result in full aggregation. The national institutions will not be slow to use such estate duty advantage as a bargaining factor in reducing the price offered by them.¹⁰⁴

V. SUMMARY

I have attempted to give only an outline of tax and estate duty law in England, and of some of the techniques which have developed to reduce the burdens. For the sake of clarity and brevity, I have omitted many of the details, and I hardly need to remind my readers of the great dangers of relying upon incomplete statements

101. F.A. 1969, c. 32, § 39(2).

102. F.A. 1969, c. 32, § 39(2).

103. Quoted in ROY, PRACTICAL ESTATE DUTY PLANNING 109 (1970).

104. *Id.* at 110.

of law, especially in this field. My hope, however, is that a general discussion of the subject may be of some interest for its own sake; and secondly that it may give to those who operate in the international trusts field, some idea of what is going on in Britain at the present time. It would be too much to hope that this paper can provide all the answers; but perhaps it may help those concerned with this branch of the law, at least, to formulate some of the questions.¹⁰⁵

105. This paper originated in talks given to meetings of the Trusts and Probate Sections of the San Diego and La Jolla Bar Associations. I take the opportunity to thank again my hosts on those occasions.