Spotlight on private wealth

June 2019

Our quarterly update is designed to keep you up to speed with developments in disputes, and how you can avoid them, in the private client world. In this edition we examine knotty issues around succession planning and difficult art-related disputes with HMRC. We also ask if mediation is the answer to family fall-outs. If you have any feedback on this update or would like to know more about the issues covered, or anything else, get in touch.

The big question

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Private wealth disputes team

The big question

Is HMRC's scrutiny of artwork licences set to increase?

Owners of valuable artwork have often utilised chattel (or artwork) licences as a means of transferring the ownership of their art to their children while continuing to enjoy it during their lifetime and mitigating the effects of inheritance tax. These agreements have existed for some time - however HMRC appears dissatisfied with the status quo and is subjecting such agreements to increased scrutiny.

Inheritance tax at a rate of 40% is typically payable on artwork on the owner's death. To avoid this, the owner (the donor) sometimes chooses to gift the artwork to the intended recipient (the donee) during the donor's lifetime because no inheritance tax is payable if the donor survives the gift by seven years. If the donor wishes to continue displaying the artwork in their home they often enter into a licence agreement with the donee. Licence agreements usually oblige the donor to pay a "market" rent for the artwork, and include provisions in respect of its insurance, maintenance and security.

The question of what represents a "market" rent in such circumstances is a difficult one since there is a limited long-term rental market for artwork, outside of the context of chattel licences.

HMRC's inheritance tax manual offers little assistance and simply states that the appropriate rent depends on the circumstances of the case and what might be agreed under an arm's length deal between unconnected individuals.

HMRC used to take the view that an annual payment of 1% of the market value of a piece of artwork would be acceptable as a market rent. In recent years, however, it appears to have moved away from this approach and recent minutes from the "Chattels Fiscal Forum Meeting" indicated that HMRC would expect to be provided with evidence to support a rate of 1%, stating that there were, in HMRC's view, "clear pointers" that such a rate would not be tenable. HMRC's apparent change of view in this area could apply to existing as well as future agreements which causes difficulty for those who have such agreements already in place.

The consequences of failing to choose a rate acceptable to HMRC are potentially significant since if the rent under the licence is found to be something other than market rate, HMRC may argue that the artwork should be treated as part of the donor's estate and taxable accordingly.

HMRC's shift in approach, coupled with the dearth of guidance, has led to increased uncertainty and a concern that HMRC is waiting for an attractive case to challenge through the courts in order to undermine the chattel licences market.

It is important that where such arrangements are to be put in place both parties obtain valuation evidence, negotiate the rent payable and ensure the rent is paid in accordance with the agreement. Rent should also be reviewed periodically and recorded in the donee's income tax return. For those with agreements already in place, these steps can also be undertaken to prepare evidence of the suitability of current rates, or in order to remedy any potential defects. It is also important that the recipient of the rental income from the loan of the artwork ensures they are properly accounting for any tax (including VAT) which may be due.

There are a number of strategies which can be adopted either to discourage HMRC from challenging the applicable rent or to resolve any dispute with HMRC. In light of the increased uncertainties in this area and inherent difficulties in calculating market rent, those who have existing arrangements or are contemplating this form of tax planning should seek professional advice.

What's new?

Court warns that claims for a deceased's property need to be brought in time

If you are left out of a will you can make a claim for reasonable financial provision from the deceased's estate within six months of probate being issued. That period can be extended with the court's permission but the circumstances in which the court will extend are not clear cut.

In one case[1] a claim was brought 11 months late; the potential beneficiary and the executor had agreed between themselves that the application could be delayed. Despite this, an application to allow the claim was refused and the court commented that it would rarely be appropriate to allow a claim to proceed more than a few months out of time.

By contrast, shortly after this decision, an application to allow a claim more than 25 years late was successful[2]. The claimant had attempted to sell the property comprising the majority of the estate on a number of occasions, but the sale had been prevented by the deceased's children. If the application had been rejected, the children would have received a "windfall" having done nothing to assist in the administration of the estate and the claimant would have been left with very little.

These cases demonstrate that decisions to allow claims to proceed out of time will not only depend on the length of the delay but also all of the circumstances of the case. Potential claimants should not rely on agreements to delay the time for bringing a claim as these may not be honoured by the court. In the light of current case law the best practice is to issue a claim in time and invite the court to stay proceedings whilst settlement is explored.

Notes

1. *Cowan v Foreman* [2019] EWHC 349 (Fam).
2. *Bhusate v Patel* [2018].

What's new?

Beneficial ownership in all British Overseas Territories – House of Commons Foreign Affairs Committee recommends publication of public registers

In May 2018, the Sanctions and Anti-Money Laundering Act (SAMLA) was introduced, making provision for an independent post-Brexit sanctions and AML regime.

SAMLA requires the Foreign Secretary to assist British Overseas Territories (OTs) to establish beneficial ownership registers which are accessible by the public. An OT which has not done this by 31 December 2020 can be ordered to do so by the Foreign Secretary.

This has placed a strain on the OTs' relationships with the UK. Countries such as Bermuda, British Virgin Islands and the Cayman Islands, whose economies rely heavily on financial services, strongly oppose the legislation which is likely to have an impact on these financial centres, with reduced privacy afforded to those registering companies in the OTs.

In a recent report, The House of Commons Foreign Affairs Committee considered that the publication of such information was a matter of national security and said there is "evidence to suggest that money tied to autocratic regimes has been connected to OT-registered companies".

Whilst the Committee noted that many OTs have made constructive steps towards achieving a publicly available register, not all have done so, and many are not scheduled to be complete before 2023. The Committee considered that any concerns regarding a reduction in the competitiveness of the OTs' financial sectors cannot prevent action to tackle the risk of the OTs being used to launder funds. As such, the Committee called on the Foreign Secretary to lay out a clear and detailed timetable for the publication of registers of beneficial ownership in each OT.

What's new?

Court decides clear evidence needed that a will has been revoked

A certified copy of a will was admitted to probate where it was unclear what happened to the original, highlighting that clear evidence is required before a court might conclude that a will has been revoked.

In a recent case[3], the deceased had a certified copy of a will in her possession when she died. The original will was never found. Her daughter alleged that she tore up the will, and that the presumption should apply that where a will is last known to have been in the testator's possession, and is not found after their death, it is presumed to have been destroyed.

The court did not agree that the will had been revoked and a certified copy of the will was admitted to probate. The presumption of revocation did not actually arise since evidence showed that the original will was kept by the solicitors who drafted it and not by the deceased. In any event, the effect of revocation (ie intestacy) would have been contrary to the wishes she had expressed during her lifetime, rebutting any presumption.

Besides destruction, a will can be revoked by a marriage or civil partnership or by making a new will or codicil[4]. If a will is revoked without a replacement then the intestacy rules will apply which (as we discuss below) may not be attractive. To avoid disputes later down the line, it is advisable to revoke a will expressly in a new will.

Notes

3. *Blythe v Sykes* [2019] EWHC 54 (Ch).
4. Section 20, Wills Act 1837.

RPC asks

Is mediation the answer for family disputes?

It is a common misconception that all legal disputes end in a lengthy and costly trial. Statistics show that in fact the vast majority of disputes settle before any court hearing and many are resolved before litigation is even started. But how does that happen? How can you prevent matters escalating and ending up in an expensive courtroom battle?

- **Keep full and accurate records** – and take advice when you are unsure how to act. A study of in-house legal counsel in the US found that four out of five train their employees to be aware of the risks which might lead to a dispute. This strategy was considered by them to be most effective in preventing litigation.
- **Objectively assess the merits of the claim at an early stage**, before committing the resources to what could be an unsuccessful fight. Obtaining a legal opinion early may help determine whether it is worthwhile pursuing a dispute and how it may be resolved quickly and cost effectively.

Early steps have not resolved matters. What are the options?

- **Negotiation**. This sounds obvious but when tensions are running high, it is easy to stop talking; taking a step back and trying to take the emotion out can be beneficial. Negotiations can take place in correspondence, over the telephone or in person. It is usual to carry out negotiations on a "without prejudice" or "without prejudice save as to costs" basis. This means that the discussions will not be disclosed to the court in the event they are unsuccessful and the case proceeds to trial or, in the latter case, will only be disclosed after the litigation has concluded, when the court decides who pays the costs of that litigation.
- **Mediation**. This is a flexible process in which an independent, trained mediator (usually appointed by the warring parties) actively facilitates settlement discussions between the parties with the aim of achieving a negotiated settlement. The parties retain control over the decision to settle and its terms. A mediation usually lasts one day, with the parties (and their lawyers) gathering in one location but in separate rooms. The mediator typically shuttles between the parties in order to try and find a settlement with which both sides can agree.

Focus on mediation. Why do it?

- **It works**: The 8th Mediation Audit by the Centre for Effective Dispute Resolution found that 89% of disputes that went to mediation settled; 74% on the day and 15% shortly after.
- **It will probably be cheaper than litigation**: Litigation can be expensive and you will be unlikely to recover all your legal costs, even if you win.
- **Confidentiality**: The parties usually agree that discussions and any outcome will be confidential (especially useful if there are sensitive issues in dispute). Contrast this with court hearings and trials which are usually open to the public.
- **Maintaining relationships**: Litigation can be destructive to relationships as parties often feel it is necessary to carry out some "mud-slinging" in order to maximise their chance of success. Resolving the dispute amicably gives parties, especially family members, a chance to rebuild their relationship.
- **Moving on**: Disputes in the private wealth sphere often arise because of a culmination of grievances over a period of time, many of which would not be relevant in court proceedings. Mediation gives parties a chance to air these grievances or have their say and secure "closure"; something they may not achieve in court proceedings.
- **Commercial solutions**: Mediation can facilitate more creative solutions than can be ordered by a court. This is especially important when ongoing relationships are at stake. For example, in a dispute concerning a family business, the parties could agree a new shareholders' agreement as a term of the settlement, to regulate relationships going forward.
- **Independent perspective**: It can be easy for parties to become entrenched in their own position. Whilst mediators will not usually give their view on the merits of the dispute, the process usually helps parties to see the case from another perspective, and possibly the weaknesses in their own arguments and the risk of taking the case to trial.
- **Courts like it**: Whilst a court cannot order parties to mediate, it is strongly encouraged. Litigating parties must indicate at an early stage whether they wish to pause the court proceedings to attempt settlement through mediation.

RPC asks

Is mediation the answer for family disputes?/contd...

- **Refusal can be costly**: If a party unreasonably refused to mediate, the court can take this into account in deciding which party pays the costs of the litigation. The court will examine closely the circumstances in which mediation was refused. It is likely to be unreasonable to refuse to mediate just because there is a strong belief in success at trial.

But is it for everyone?

Whilst mediation is suitable in many cases, it isn't always the right solution.

- **It can't wait**: One of the parties may be seeking urgent redress, such as an injunction. In these circumstances pressing on with court proceedings may be the only option, though mediation may be appropriate later down the line.
- **Serious allegations**: There may be a history between some parties which would make it unsuitable for them to be brought together, or serious allegations of fraud.
- **Too little, too late**: The claim value may not justify the costs of mediation (which can run into thousands of pounds), or one party may suggest mediation late in the day as a tactic to try and delay trial.

RPC asks

What happens if you don't make a will?

Not making a will can have unexpected consequences. Loved ones may not have any right to property and there can be onerous tax implications.

When someone dies without a will the intestacy rules set out how the deceased's property will be divided. The rules cover all property that could have been left in a will – essentially any property not jointly owned by the deceased as a joint tenant or held on trust.

The rules provide for property to be distributed to family members in a specific order of priority, which is determined by the proximity of the family member to the deceased. Generally, property flows to the deceased's children (not step-children), and then their parents, brothers and sisters. If the deceased is survived by a spouse or civil partner, they take priority.

A popular misconception is that unmarried partners will inherit under the rules when in fact the concept of "common-law" marriage is not recognised.

Making a will gives the testator control over to whom to leave his property and so benefit individuals who would not fall within the default rules, or exclude those who would otherwise benefit. There are also other advantages:

- Each individual can pass £325,000 of assets tax free, and spouses and civil partners can pass their property to each other without tax liability. A will can structure the distribution of assets in the most tax efficient way.
- The testator can leave certain property, such as family heirlooms or items of sentimental value, to chosen individuals.
- A will is the only way you can leave some or all of your property to charity.

RPC asks

What do you do if your art is seized at the border?

Whilst news reports often focus on the seizure of illicit substances at the border, HMRC and the UK Border Force have a wide range of powers over goods being imported into the UK, including art and valuables.

Goods may be seized for a number of reasons. For example, it may be suspected that there is unpaid customs and/or excise duty, the import breaches regulatory requirements or the items are made from an illegal substance, such as an endangered species.

If your goods are seized you have two options (which you can pursue at the same time):

- **Challenge the legality of the seizure**: Where you do not accept that there is a lawful basis to seize your goods you have one month to challenge the seizure in the Magistrates Court. If you are successful, the item will be returned to you unless it has already been sold, in which case you will receive monetary compensation. If you are not successful, the goods will remain seized and you may be liable for costs.
- **Request that the goods are returned**: Goods can be returned in exceptional circumstances at HMRC/the Border Force's discretion, for example if they are of important cultural heritage, are irreplaceable or where a genuine mistake was made by a third party agent. Importers should act fast and may have to pay a fee or comply with other conditions before items are returned.

RPC is experienced in resolving these types of disputes and successfully securing the return of art and valuables to their rightful home. Always check that import and export requirements are complied with and if you run into difficulty at the border – get in touch.

And finally ...

RPC explores asset recovery in the English courts

Over Easter the RPC commercial disputes team went on an asset recovery egg-hunt. We explored how a victim of fraud can successfully recover an award of damages by identifying and securing assets, with some Easter themed puns thrown in for good measure. If you missed this series of blogs, catch up on them here.

The RPC private wealth disputes team

Disputes can get complex. As one of the few top law firms handling private wealth litigation, our large team of lawyers has an impressive track record of handling disputes both in and out of court. We act for trustees, family offices and other asset and wealth holders and commonly act against HMRC. Drawing on extensive tax, asset management and commercial expertise, we can help resolve any type of dispute, from family settlements and inheritance issues to conflicts over assets, including art and valuables. We have a global reach with offices in London, Hong Kong and Singapore, and access to the TerraLex network of lawyers in over 100 jurisdictions.

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