International FAMILY LAW GROUP LLP

# Pensions to PETs and Other Lifetime Gifting Family Law Considerations for Estate Planning Post the Autumn Budget 2024

## The Changes Announced

The Autumn Budget introduced some significant changes to Inheritance Tax (IHT) which are likely to mean family law aspects of succession planning will become more pertinent. This article seeks to explain why.

The rate of Inheritance Tax (40%), personal nil-rate threshold (£325,000) and the treatment of tax on spouses/civil partners' primary residences upon death, remain unchanged by the Budget. However, one very significant change is the introduction from 6 April 2027 of IHT being payable on gifts of unused pensions, meaning they will no longer pass outside a deceased's estate for IHT purposes.

For many years, unused pensions have been a helpful and popular tool for tax and succession planning. The changes to the treatment of unused pensions will also mean that if the deceased dies at or after age 75, or if the unused pension value exceeds the nil-rate threshold of £325,000, income tax as well as IHT will be payable by the recipient (meaning there might be a potential tax charge of up to 67% on these funds).

There have also been significant changes to the treatment of the gifting of agricultural estates upon death. These have also traditionally been exempt from IHT to encourage the sustainability of

green spaces, food production/security, and to enable farmers who are often asset rich but cash poor to continue to pass on their farms to family members without worrying that their farms will need to be sold to pay IHT.

Consequently, many families whose estate planning has previously involved passing on unused pensions or agricultural estates, will need to actively reconsider their IHT and succession/estate planning and alongside this, consider family law issues.

## Alternative Approaches PETs, Gifts of Surplus Income or Trusts

Other methods of estate planning include gifting surplus income, passing wealth through trusts (trust monies still pass outside the estate), or making potentially exempt transfers, ("PETs") which, provided the person making the gift survives 7 years or longer and retains no residual/beneficial interest in the asset, will not give rise to an IHT liability upon death. Also, a PET provides a tapering allowance from 3 years after the gift is made, thus at least reducing the amount of IHT payable on the lifetime transfer after 3 years.

However, owing to the fact no one knows how long a person will live, PETs inevitably provide less certainty about whether any IHT will be payable in full or part upon death.

## Why are Family Law Issues Relevant?

Consideration of the beneficiary's relationship status is an important factor in estate planning, which should not be ignored.

The most careful estate planning can be impacted if the beneficiary of a lifetime gift, legacy or a trust, marries, enters a civil partnership, divorces, or dissolves their civil partnership.

In England & Wales, upon divorce/dissolution, whilst the family courts would seek to exclude gifted/inherited assets where possible i.e. where marital resources permit, if the martial assets do not meet both parties' reasonable financial needs, the gifted/inherited assets can become vulnerable to division.

This risk can be far from contemplation when considering gifting assets to a much-loved child or grandchild. However, with 42% of marriages ending in divorce [1] it presents a potentially significant risk to undermining a family's estate planning.

If the recipient child or grandchild is cohabiting, the risk is lessened, as cohabitants' rights in England & Wales are currently not akin to married couples. (Although, it is important to be aware that many family law professionals are campaigning for significant legal reform to cohabitants' legal rights to make them more aligned with married couples).

Some of the hardest divorce/dissolution cases to settle or determine involve disputes about the potential division of inherited or gifted assets. (This is because it is particularly hard to accept that such gifts/ inheritances might be shared with ex-partners or spouses).

## Factors which Increase the Risks of Division of Gifted or Trust Assets upon divorce/dissolution

The risk of gifted/inherited or trust assets being shared upon divorce or dissolution varies considerably on a case-by-case basis, but where it does apply the impact can be significant.

## Mingling

Care should be taken when gifting assets or paying monies to beneficiaries of trusts to ensure that the recipient does not inadvertently, or unintentionally *'mingle'* those funds with marital assets, during the marriage.

One example might be if lifetime gifts, trust monies or inheritances are used to purchase joint assets, e.g., a family/marital home. Another example is where they are used regularly to pay for general family and household expenses.

In these instances, the gifted assets might be deemed to have become marital property and are therefore more susceptible to being 'shared' by both spouses/civil partners upon divorce or dissolution.

## The Financial Needs of a Spouse/Civil Partner

The individual circumstances and financial resources of each recipient and their partner/spouse are also relevant to determining the risk of lifetime gifts, inheritances or trust funds being shared upon divorce.

In England & Wales, the division of finances upon divorce or dissolution are determined by

reference to the section 25 factors in the Matrimonial Causes Act 1973 [2]

The decisive factor in most cases is the *'reasonable financial needs'* of the parties and the children of the family. Reasonable financial needs are a discretionary measure and are determined by various factors including the standard of living enjoyed during the marriage.

The risk of gifted family assets being shared increases when, amongst other things:

- The marriage is long
- If there are children of the marriage or civil partnership
- Where there is relative disparity in wealth between the spouses or civil partners
- Where there are insufficient marital assets to meet the needs of both spouses/civil partners

Where there are significant health issues which impact financial needs

## Protecting Lifetime Gifts or Trust Funds on Divorce/Dissolution – Some Practical Points

Few donors intend for their lifetime gifts or trust monies to be shared equally with their child(ren)'s or grandchild(ren)'s spouse or civil partner, particularly upon divorce or dissolution of their unions.

There are some practical points to consider when planning lifetime gifts and legacies. These include:

- Not paying them into a joint bank account.
- Not putting them towards the funding of a family home and if you really want to do so, adding further protections to define the beneficial and not just the legal ownership of the property (see declarations of trust below).

- Discussing with the recipient/beneficiary the possibly of them entering into a marital or a civil partnership agreement with their spouse or civil partner. (These can be entered into before and after marriage / civil partnership and whilst not binding in England & Wales they are holding considerably more weight in England & Wales as long as they are prepared with independent legal advice and full disclosure).
- Making declarations of trust when purchasing any joint assets or property using gifted/inherited funds. Declarations of trust cite the intended beneficial ownership of the asset or property.

## However, please be aware:

1. That upon divorce or dissolution, declarations of trust can still be adjusted by order of the Court to meet the family's financial needs.
2. There is often no equivalent concept of beneficial ownership abroad, although in many such countries, unlike England & Wales, upon divorce/dissolution the financial contributions made to marital assets are often a determining factor when dividing the separating couple's assets. Local family law advice should also be taken if the recipient is likely to live abroad during their marriage.
3. Educating the recipient/beneficiary about the impact of inadvertently mingling lifetime gifts.
4. Ensuring letters of wishes are retained by trustees, explaining why payments are being made from a trust and avoiding regular payments from trusts or other invested, inherited assets which upon divorce/dissolution might be deemed an income or capital resource which the couple relied upon during their marriage.

## Pre- and Post-Marital/Civil Partnership Agreements ("PMAs")

Where couples are happy and willing to do so, PMAs can provide greater protection against lifetime gifts, inheritance or trust monies being shared upon divorce or dissolution. If the spouse or civil

partner of the potential recipient of family wealth opposes entering into a PMA, this might also send a ‘red flag’ when a donor is contemplating to whom lifetime gifts will be made.

Whilst PMAs are not legally binding in England & Wales, they hold very strong evidential weight and can be a very useful tool for protecting family wealth. (They might also be binding abroad if the couple divorce or dissolve their civil partnership abroad, but advice from a local lawyer should be taken to ascertain this. An international Family Law specialist will be able to assist with this). The current test in England as to whether a marital or civil partnership agreement should be upheld is set out in the judgement of a case called *Radmacher* [3] which states:

“*The court should give effect to a nuptial agreement that is freely entered into by each party with a full appreciation of its implications unless in the circumstances prevailing it would not be fair to hold the parties to the agreement.*”

PMAs can also include clauses to seek to protect and avoid the sharing of assets which have inadvertently been mingled during the marriage, by including careful definitions of what constitutes *‘Separate Property’* (i.e., non-marital) and *‘Marital Property’*.

## Conclusion

Following the Autumn Budget 2024 many families will be reviewing their estate planning and succession planning.
This is likely to involve the increased use of tools like:

1. PETs
2. Lifetime gifts of surplus income; and
3. Trusts

However, these estate planning strategies present potential risks of dissipation upon divorce or dissolution.

Therefore, if you are in the throes of reviewing your estate planning, please consider whether you need family law advice, before it is concluded.

This article is not designed to give tax or financial planning advice. If you have questions about matters other than Family Law matters, you should contact a specialist financial planner or Independent Financial Adviser, (IFA).
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[1] ONS Report on divorces in England & Wales 2022
[2] https://www.legislation.gov.uk/ukpga/1973/18/section/25
[3] https://www.supremecourt.uk/cases/uksc-2009-0031.html