

# Private Client Bulletin

Summer 2009

## Asset Protection and the 4 Deadly D's

• DEATH • DIVORCE • DEBT • DOMICILE

The popular understanding of the words “asset protection” is the secret squirreling away of ill gotten gains into a dummy corporation or trust in an obscure tropical tax haven to keep them hidden from creditors, the taxman and the ex (or indeed current) spouse. Such action will inevitably prove to be ineffective, illegal, or both.

In this briefing, we outline the threat to assets from the 4 D's and outline the extent the threat can lawfully be countered.

### DEATH

The main claims against an estate on death are:

1. Inheritance Tax;
2. Creditors
3. Claims under the Inheritance (Provision for Family and Dependents Act) 1975 (the “1975 Act”).

Royds will be happy to advise on the mitigation of Inheritance Tax (“IHT”).

Debts of a deceased do not die with them; the executors will be responsible for meeting the debts out of the deceased's estate, by selling property in the estate as necessary. Executors are not personally liable to any creditors who do not present their claim within the 2 month time limit specified in the “statutory advert” that the executors are required to publish in the London Gazette and a local newspaper, though the debt may still be valid against the estate itself.

Failure to sufficiently provide on death for a dependent may trigger a claim against the estate under the 1975 Act. It is imperative to identify potential claimants at the time of making a will and to consider appropriate provision for them under the will or by other means (such as life insurance). One cannot prevent a claim against the estate but careful provision can reduce the risk of a claim being brought and the substantial legal costs which will necessarily be incurred.

For persons in business with others, the death of a partner or co director/shareholder can be a major headache in

that funds will have to be found to buy out the deceased's share, or the business will need to be sold, or the deceased's executors/family will need to be allowed to involve themselves in the business. A well drafted partnership agreement or shareholders agreement is a must (and more important than a will in these circumstances) and, where cost effective, “key man” life insurance should be arranged to fund the purchase of the deceased's share of the business from the estate.

### DIVORCE

**Business interests are similarly a source of worry where parties divorce.** Not only are business interests difficult to value and so often become a major cause of financial wrangling but a divorcing business person will usually be loathe to see part of the business passing to an ex spouse.

The first thing to make clear is that the ramifications of divorce for the business person are no different than those for a person who makes their living through salaried employment. For practical purposes, however, two specific points should be made:

- A wife/husband on divorce will NOT get their hands on the business – but the value of the business interests will be taken into account in determining an appropriate financial settlement
- If both spouses are in business together, the extrication of one or other of them from that business needs to be effected.

It's not strictly possible to arrange affairs in such a way as to minimize the impact of a divorce. Transactions designed to take assets out of the pot to be divided on a divorce can be set aside by the courts. Further, for the most part, it matters not which assets are in which name; the courts will throw everything into the pot and then determine how that pot should be divided. The courts are well aware that where the family income derives from a personal business, putting undue financial strain on that business is in no party's best interests- nobody wants to see killed the goose that lays the golden egg.

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Parents wishing to make a valuable gift to a child and worried about the possibility of the child divorcing may choose to make a gift into trust or directly to grandchildren to limit the impact on the financial settlement on divorce.

The best advice is to seek legal advice early if a marriage is showing signs of strain, to be aware of the likely financial implications of a marriage breakdown and the tax consequences.

**Pre nuptial agreements.** Can you agree before a marriage the division of the assets should you subsequently divorce? A pre nuptial agreement is an indication of how the parties at the time of the marriage feel their joint assets should be reasonably divided should they divorce but has no more than a persuasive value which will diminish as time goes on and circumstances change. Nevertheless, the English courts are beginning to give weight to a reasoned agreement reached before marriage as was evidenced last month in the widely reported divorce case of German heiress Katrin Radmacher.

## DEBT

**We are frequently asked whether gifts can be made which will put the gifted assets beyond the reach of creditors. The answer is generally "no".**

Any gift made with the "substantial" intention (*IRC v Hashmi & Hashmi [2002]*) of putting assets out of the reach of creditors, whenever made, can be set aside if the person who made the gift becomes bankrupt (Section 423 Insolvency Act, 1986).

Further, a trustee in bankruptcy can apply for a gift to be set aside, regardless of the motive for making the gift, if it was made within the "Relevant Time" as defined by Section 341 Insolvency Act 1986.

Any gift made within 2 years of the presentation of the bankruptcy petition will be set aside. If made between 2 and 5 years before the presentation of the petition, the gift will be set aside if the donor was insolvent when the gift was made or became insolvent as a result of the gift. Insolvency will be presumed if the gift was made to an associate of the bankrupt or to a spouse or child.

Often the concern is not the potential bankruptcy of the person making the gift but rather the precarious financial position of the intended recipient of a gift made during a client's lifetime (for the purposes of IHT planning, perhaps) or on death, by will.

While it is quite straightforward to make the gift via a trust vehicle to safeguard the property given from the attentions of the recipient's creditors or the effects of the recipient's profligate lifestyle, changes to the taxation of trusts under Finance Act 2006 have made gifts into trust that exceed the IHT nil rate band (currently £325,000) somewhat unattractive.

## DOMICILE

**Persons with a non UK domicile (born overseas and yet to have become sufficiently physically and emotionally tied to the UK to lose that domicile) still enjoy certain tax advantages over UK domiciled persons, despite the best efforts of the current Chancellor of the Exchequer.**

The chief advantage is the ability to create an "excluded property settlement" for the benefit of themselves and / or members of their family. Provided the assets in the settlement are offshore, those assets can remain free of UK IHT indefinitely.

Remember, however, that, uniquely among UK taxes, IHT has a "deemed domicile" rule. Once a person has lived in the UK for 17 out of the last 20 years, they are deemed domiciled in the UK and the chance to take advantage of their non domiciled status will be lost.

### BULLETINS BY EMAIL

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