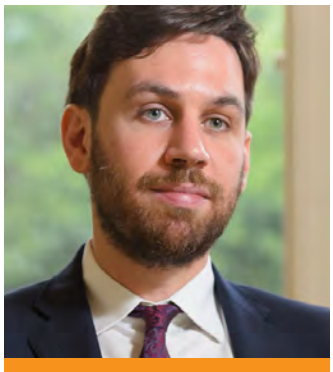
Avoiding the suggestion of undue influence

Adam Carvalho and **Richard McDermott** look at recent developments in relation to the tests for capacity and the courts' approach to the construction of wills



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Two recent cases examined the relationship between the common law tests for capacity and the tests under the Mental Capacity Act 2005 (MCA 2005).

In *Re Estate of Joyce Smith (Deceased)*; *Kicks and another v Leigh* [2014], the High Court held that the test for establishing mental capacity to make lifetime gifts is the common law test (applying *Re Beaney* [1978]), and not the test set out in the MCA 2005.

Mrs Smith died in December 2011 and was survived by her grandchildren (her deceased daughter's children) and by her second daughter. Smith had sold her family home during her lifetime, and the proceeds were transferred to the second daughter and her husband. The grandchildren claimed that the transfer of the sale proceeds should be set aside on the grounds that either:
i) Smith lacked capacity to make the transfer; or, ii) the transfer was effected by the second daughter exercising undue influence over Smith.

The second daughter was debarred from defending the claim, having failed to file a defence (or comply with a number of court orders). She ultimately appeared in person, assisted by her husband.

It was held that:

- Smith had capacity to make the transfer; and,
- the gift of the proceeds of sale was effected by the second daughter exercising undue influence over Smith.

In deciding the issue of capacity, the court held that the common law test applies. The test is, essentially, whether the donor would have been capable of understanding the effect of the transaction if the consequences had been fully explained to them. Practitioners will appreciate that the level of understanding required will depend on the significance of the transaction, with a high bar applying to, for example, a gift of the donor's family home.

Section 3(1) of the MCA 2005 provides that a person is unable to make a decision if they are unable to: i) understand the information relevant to the decision; ii) retain that information; iii) use or weigh that information as part of the process of making the decision; and, iv) communicate their decision.

Stephen Morris QC (sitting as a deputy High Court judge) held that the test contained in the MCA 2005 did not apply to a civil court's retrospective consideration of the capacity to make a lifetime gift. He also noted that the burden of proof (per the test in *Re Beaney*) falls initially on the party claiming incapacity. If that party adduces evidence which raises sufficient doubt as to capacity, then the burden shifts to the defendant. It was not strictly necessary for the judge to rule on the burden of proof in relation to the test under the MCA 2005, but he noted that in those circumstances the burden remains throughout on the party claiming incapacity. Although the outcome in this case would have been identical whether the common law or statutory test was applied, the judgment nonetheless represents a welcome clarification of the law.

The second daughter clearly raised the judge's hackles, but even in cases where the court is sympathetic to the recipient of funds (for example, a child who acted as their parent's carer), it is still important to avoid, where possible, circumstances that might lead to the suggestion of undue influence.

In *Walker v Badmin and others* [2014], which was decided within weeks of *Re Estate of Joyce Smith*, Nicholas Strauss QC considered whether the *Banks v Goodfellow* test for testamentary capacity overrides the (arguably) stricter test under the MCA 2005. Practitioners will be perhaps unsurprised to hear that *Banks v Goodfellow* continues to stand the test of time. >>

>> The facts of the case need not be recited for these purposes, save to explain that the deceased was suffering from the effects of a brain tumour when she executed her will around a month before her death. Her daughters argued that the will was invalid for, among other things, want of testamentary capacity.

Nicholas Strauss QC held that, where the validity of the deceased's will is in question, the "only test for testamentary capacity…is the common law test as set out in *Banks*". The test under the MCA 2005 will be more relevant to living incapable individuals (for example, in the context of an application for a statutory will).

Some commentators have noted that these issues will only really be resolved when they are considered by a higher court, and it remains to be seen whether the above cases will be appealed. The Law Commission's review on the law of wills is, of course, due to begin this year, but the earliest we can expect draft legislation is at least three years from now, and it may take twice as long for it to reach the statute book. The four key areas to be covered by the review are testamentary capacity, the formalities for a valid will, the rectification of wills and mutual wills.

Nil-rate band legacy

Valerie Smith died on 1 September 2011 with a residuary estate valued at £680,805. In July 2014 the Court of Appeal ruled on the correct construction of a nil-rate band legacy in her final will, which was executed in 2001.

In clause 5 of her will, Mrs Smith instructed her executors to hold for her grandchildren "such sum as is at the date of my death the amount of my unused nil-rate band for inheritance tax". Clause 6 left the remaining residuary estate to the Woodland Trust.

At the date of Smith's death, the amount of her single unused nil-rate band was £325,000. The effect of clauses 5 and 6 of the will would, therefore, have been to give £325,000 to the grandchildren in equal shares and £355,805 to the Trust.

However, Smith's husband had predeceased her, leaving an unused nil-rate band. Following her death, Smith's executors had claimed a 100 per cent increase on her nil-rate band under section 8A of the Finance Act 2008.

The court at first instance found the clause 5 'sum' had been retrospectively increased as a result of the executors' section 8A election. The grandchildren would therefore receive £650,000 equally from the estate, and the Trust would receive £30,805.

The Trust appealed, arguing that:

- the amount of Smith's unused nil-rate band at the date of her death was £325,000 and the executors' claim under section 8A could not alter that;
- Smith's reference to 'my' unused nil-rate band was an indication that the intended legacy was limited to £325,000;
- the effect of a valid section 8A claim was merely to increase the nil-rate band for the purpose of determining the estate's inheritance tax liability; and,
- Smith could not have intended the amount of her legacy to the grandchildren to vary according to the exercise of discretion by the executors.

The Court of Appeal upheld the first instance decision. Sir Colin Rimer found that the clear inference of clause 5 of the will was that Smith knew the amount of the unused nil-rate band at the date of her death might be different from what it was at the date of her will (and probably larger).

Lord Justice Lewison took a broad, purposive approach. Smith's implicit intention was to give as much as she could to her family without incurring inheritance tax and to give the remaining residue to charity. He accordingly agreed the appeal should be dismissed.

Lewison LJ's recognition of Smith's 'implicit intention' can be seen as going further than *Marley v Rawlings* towards a contractual construction of wills. It will be interesting to see whether there is further movement away from the traditional, literal approach.

The broad, purposive approach taken by the Court of Appeal may dissuade charities (or other default beneficiaries) from pursuing similar claims or advancing arguments based on technical, literal interpretations (although such cases are inevitably fact specific).

In the meantime, the case underlines the importance of reviewing wills regularly to ensure that they continue to embody the testator's intentions. It may be that testators choose to leave a broad statement of their wishes accompanying their wills to aid their construction.

Stamp duty land tax

Practitioners will be aware of the changes to stamp duty land tax introduced on 4 December 2014. We wish to express our admiration for all those solicitors who spent the evening of 3 December pushing through transactions and ensuring that contracts were exchanged before midnight to take advantage of the previous rates. **SJ**

> ***Banks v Goodfellow* continues to stand the test of time**