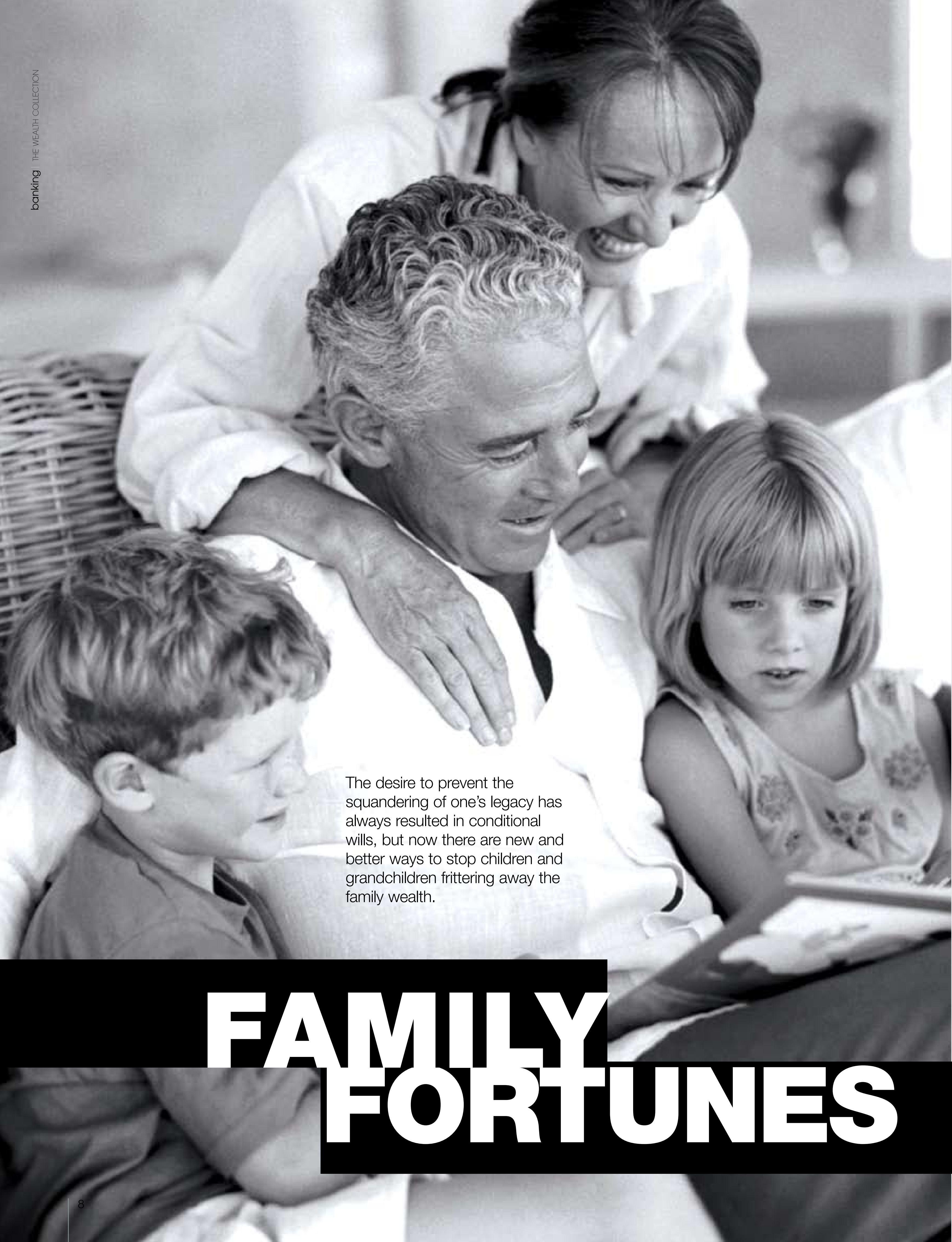

The desire to prevent the squandering of one's legacy has always resulted in conditional wills, but now there are new and better ways to stop children and grandchildren frittering away the family wealth.

FAMILY FORTUNES

Rod Zeeb is an Oregon lawyer who, in discussions with his former classmate Perry Cochell, suddenly saw a new way to help the wealthy protect their wealth, beyond the third generation. It seemed so simple. Suddenly there really seemed to be a mechanism for wealthy individuals to reach out from the grave and make sure that the fruits of their life's work were passed on in good order from their sons and daughters to their grandchildren, and then very possibly beyond to siblings they would almost certainly never live to see.

The trick, says Zeeb, is for the parent of both the fortune and the family, along with his or her heirs and beneficiaries, to focus on the values that underpin the wealth at issue, rather than the valuables that represent that wealth. Zeeb has put his professional weight behind the concept of what he calls the 'heritage process', by quitting his Oregon law practice and setting up as a full time 'heritage adviser' to wealthy individuals who wish to protect their fortunes both for and from their descendants. With Cochell, he has co-authored a provocative and amusing book, *Beating the Midas Curse*, which sets out the essence of the approach.

In short, the strategy is that there will be an independent adviser who interposes himself between the wealthy person and his lawyers and tax advisers and seeks an extra way to make the wealthy person's testamentary wishes stick.

Planning ahead

North American lawyers and tax accountants often encourage clients to fill in life-planning checklists. These will generally include details (including sometimes crucially the location) of life insurance policies, deeds, business succession plans, medical and durable powers of attorney, beneficiary designations and, most importantly, the last will and testament. Any amount of money, from the hoarded savings in the tea caddy to substantial holdings in an anonymous Liechtenstein Anstalt, needs to be recorded securely somewhere else. Practitioners in the City of London, and indeed among the house-clearing profession, have always enhanced their revenues thanks to overlooked and unclaimed policies, coupons, discreetly held investment portfolios and deposit accounts - or tea caddies packed with banknotes.

'The problem of setting out what is where has actually become a lot more difficult,' says a London-based Irish private banker specialising in wealth management. 'High net worth individuals (HNWIs) are often very busy people, even if they have sold on the original source of their money. They cannot themselves keep track of every particle of their wealth. It occasionally also becomes clear that there are areas where they do not wish their wealth to leave tracks.'

He continues: 'Given the regulatory changes of the last few years, most notably I would say here in the UK, accountants can no longer be party to clever but even marginally dubious schemes, to conceal wealth from the tax authorities. They are actually supposed to report their clients if they believe there has been any malfeasance. Now of course the reality is that hardly anybody does. The worst that generally happens may be that if a client tries to explain something that is frankly dodgy, the accountant suddenly starts humming and puts his fingers in his ears.'

Guided discovery

Life-planning checklists made with professionals can create some difficult choices, and also have to be kept up to date. No such reticence is necessary, or indeed desirable, when potential clients first sit down with Zeeb. They are invited to identify the principles on which they have based their working life and which have brought them great wealth. 'I would tell them that if being a self-made, self-motivated, self-reliant individual is an important value to them, one that has been of great benefit to them in their life, then it is also one of the values that can sustain and strengthen their children and grandchildren,' he says.

There follows a process which Zeeb characterises as 'guided discovery', as the wealthy person invests time and effort with the heritage adviser in pinning down how those values evolved and analysing what they really mean. The principles and an understanding of how they came about are then encapsulated in a 'vision statement'. Now comes the interesting part. A family retreat is organised, to which every sibling likely to benefit from the testator will is invited.

Perhaps because blood is thicker than water, anger and grudges flow more slowly and damagingly through a family than they do in other relationships. Wealthy families are not immune to disputes. Indeed, the presence of great wealth can actually exacerbate them. However, whatever the tensions, it is very rare that Zeeb cannot get all the siblings to attend the first family retreat. 'I simply tell each of them that the meeting is going to be all about their inheritance and they come, because they naturally think it is about the money,' he says.

Family conference

Once the meeting gets going, the beneficiaries quickly realise the day is going to involve a lot more than their expected, tangible legacy. Guided by the heritage adviser, the wealthy individual presents the vision statement and tries to get the siblings to understand how the principles it enshrines underpinned the creation of the family fortune, and will continue to underpin its protection and further growth, if the beneficiaries take it on board.

Then follow details of the estate plan, which also seeks to set out the role of the siblings in using their inheritance to pursue the wealthy individual's values. These often include charitable donations. It is at this point that siblings may receive, conditionally, a smallish part of their inheritance. The deal might be that they invest it productively in order to qualify for further money. Zeeb recalls three brothers who were jointly given part of their inheritance on the condition that they worked together to grow it. One brother could not have been less interested in business, but fortunately for the other two, acted as a cooperative sleeping partner while they did the work.

Zeeb recalls sitting through a few initial family retreats where siblings have been cynical, disinterested or merely jumped through the hoops to stay on the right side of their potential benefactor. But by and large he believes that these meetings are highly constructive, in part because of the way in which the wealthy individuals' revelations about themselves can reveal them to their families in a new and sympathetic light.

If the initial family retreat is a success, if it manages to engage the siblings in their future benefactor's vision and values, the heritage process suggests that it be held annually thereafter. Meanwhile, if participants deem it necessary, a family council can be formed to act on behalf of the whole family in and between the yearly retreats.

The process would continue until the wealthy individual died. At that point what ought to have become the shared values of the whole family kick in. The next generation would take up their inheritance with a better chance than many rich heirs of keeping and increasing their capital.

Through his Heritage Institute, Zeeb is training other heritage advisers, the majority of whom are American, with one Englishman. Within his own practice, he maintains that he meets with little resistance from lawyers and tax accountants, who generally welcome his input. How well the heritage process would transfer across the Atlantic, where the open and confessional approach of North America is still relatively rare, is, however, a moot point.

WEALTHY FAMILIES ARE NOT IMMUNE TO DISPUTES. INDEED, THE PRESENCE OF GREAT WEALTH CAN EXACERBATE THEM.

Traditional methods

In the UK, it's a slightly different story. Before the heritage concept arrived, the classic way of directing wealth from beyond the grave was the discretionary trust. Some jurisdictions, such as Jersey and the Cayman Islands, allow these trusts to go on in perpetuity. In the UK and Europe, they tended to be limited to between 60 and 80 years.

This is in reality about the same duration for most perpetuals. A US perpetual set up in 1907 was wound up last year and its near-century of existence was thought to be unusual. The creator of that structure therefore presumably managed to reach beyond the grave for fully four generations.

Recent changes in UK tax law have undermined the effectiveness of trust funds for tax mitigation for people with a UK domiciliary. Whether discretionary, interest in possession or accumulation and maintenance (A&M) trusts, all now seem to be viewed by the British Treasury as an unwelcome tying up of capital. This approach extends to A&M trusts, which hold funds until the beneficiary comes of age, whenever that may be set.

According to Tom Hewitt, a private client lawyer with UK tax and inheritance solicitors Burgess Salmon, the underlying government thinking seems to be that a person should not be prevented from inheriting assets when they reach the age of 18. He notes, however, that the majority of parents would consider such an age far too low for possessing considerable wealth.

Overseas investors running their tax and testamentary affairs out of the UK are unaffected. Nevertheless, there is concern that this attack on domestic trusts may undermine their confidence in continuing to use London as their financial centre.

'It is also inevitable,' says Hewitt, 'that wealthy UK taxpayers are going to keep overseas income offshore or, if the conditions become still less benign, will set about changing their domicile. It has happened before.'

Taxing problems in the UK

Hewitt certainly believes that the UK government has made an error with the trust tax treatment changes. 'It is driving trust business away from the UK,' he says. 'In reality I suspect people will not be using UK trusts so much, especially where they have the option of looking elsewhere. We also think it is an own goal in that the Inland Revenue are going to have to train an awful lot of people to understand and work these rules.'

The only major inheritance tax break for UK trusts is where the assets are either agricultural land or shares in an actively trading company. This currently favours the old-money estates, whose wealth is tied up in illiquid land and who are often cash-poor.

But at least the British still have primogeniture, where the elder son can succeed to the lot. (In fact, wealth can be bequeathed to anyone.) Under the Napoleonic legal code, most other European jurisdictions demand that the deceased's estate be shared equally among dependants from generation to generation. Thus in France there are farms the size of window-boxes and rural families whose members hardly ever speak to each other. ■

'PEOPLE WILL NOT BE USING UK TRUSTS SO MUCH, ESPECIALLY WHEN THEY HAVE THE OPTION OF LOOKING ELSEWHERE.'

Sailing into the future: supporting your children need not be a concern with organised distribution of inheritance funds.

Keeping faith in the trust

Patricia Mock, a private client services director at Deloitte, explains the changing regulations surrounding trusts in the UK.

Until earlier this year, trusts were a valuable and tax-efficient way of passing assets to children. Not only did they allow families to tie up money and assets to reduce the risk of unwise spending, but the legislation also allowed this to be done in a tax-efficient manner.

It was possible to make a transfer of an unlimited amount into certain kinds of trust and, provided the donor survived seven years from the date of the transfer into the trust, this would be free of UK inheritance tax (IHT). However, changes introduced in this year's Budget now mean that in most cases this is no longer possible.

The key change in the rules relates to the loss of the ability to make transfers into trust during lifetime free of IHT to the extent that they exceed the value of an individual's available nil rate band for IHT (currently £285,000).

UNTIL EARLIER THIS YEAR, TRUSTS WERE A VALUABLE AND TAX-EFFICIENT WAY OF PASSING ASSETS TO CHILDREN.

With the exception of very specific types of transfer into trust, such as those for disabled individuals, all transfers into trust in excess of the unused part of the nil rate band will now be subject to IHT at the rate of 20%, with a further maximum of 20% being payable in the event of the death of the donor within seven years of the transfer. In addition, virtually all new trust arrangements set up during the donor's lifetime will be subject to what is known as the 'periodic charging' regime.

THE ONLY WAY TO AVOID COMING UNDER THE NEW RULES IS TO AMEND TRUSTS SO THAT CHILDREN TAKE ALL ASSETS ABSOLUTELY BY AGE 18.

This means that they will, at worst, suffer IHT at a maximum rate of 6% of the value of the trust assets every ten years. Moreover, if distributions are made from such a trust, an IHT exit charge will be imposed. The calculation of the rate of tax applying on exit is complex but can be a maximum of 6%.

Special types of trusts that have been established specifically to provide for children (accumulation and maintenance trusts) will also fall under the ten yearly and exit charge regime, normally from 6 April 2008 at the latest – even though these were set up under the old regime whereby assets could be held free of IHT until such time as children took an interest in the income of the trust, which had to be by age 25. The only way to avoid coming under the new rules is to amend these trusts so that children take all assets absolutely by age 18. All such trusts need to be reviewed.

It is still possible to leave assets on trusts for children (and indeed others) under the terms of a will which, if appropriately structured, will not be subject to the ten yearly and exit charge provisions. For this reason it is recommended that all individuals should review their wills (or make a will) in order to ensure that any trust arrangements for children meet the relevant conditions.

Also, it is worth looking out for reliefs and exemptions on the conditions of the new rules governing trusts, as they do exist and can be used to keep legacies tax-efficient in certain circumstances.

While these changes to the IHT rules mean that the trust has become more difficult to make use of, with careful consideration of relevant circumstances, trusts will still play an important role in a family's overall strategy for providing for family circumstances. ■