Joint life first death policies

Synopsis: An extract from correspondence in 2004 with HMRC on the subject of joint life first death policies. The principles discovered still hold good.

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Where there is a joint life first death policy and the death of the first to die occurs, the value to be included in the deceased's estate is not necessarily as clear as it might seem. The core legislation is included in section 171(2) IHTA 1984.

Under section 171(1) it is provided that, in determining the value of a person's estate, one looks at the value of the estate immediately before death, but after taking into account changes in the value of their estate which have occurred by reason of their death provided such changes fall within section 171(2).

Section 171(2) refers to additions to or increases or decreases in the value of the property (with the exclusion of certain alterations to the rights attached to unquoted shares as mentioned in section 98(1) IHTA).

Critically, in the context of joint life policies jointly owned, the termination on death of any interest or the passing of any interest by survivorship does not fall within this subsection. This would seem to mean that it is not possible to just ignore the value of a deceased joint tenant's interest where that person is the first to die.

So, what is the position where the property in which the joint tenancy exists is a joint life first death life assurance policy? As a matter of fact, of course, the sum assured will be one payable on the death of the first to die. It was on this subject that correspondence with HMRC was based – albeit in 2004. The principles discovered still hold good.

The enquiry

Joint ownership of life policies and inheritance tax (IHT)

The key question is, where a joint life first death policy is owned by the lives assured (as joint tenants), what is the value transferred by the first to die?

The IHTA 1984 contains no specific provisions relating to the lifetime charge on jointly owned assets, and only s171(2) relating to such transfers on death (and even then, only to disapply 171(1) in certain circumstances). It follows that the "ordinary" rules must be applied.

Where property is owned as joint tenants, each owner is beneficially entitled to their severable share. We understand that HMRC's practice in the past has been to treat each joint tenant as owning an equal share of the property, unless it can be demonstrated that that is incorrect.

Generally, the value for IHT of an asset included in a person's death estate is the market value of that asset immediately before death (s4 and s160 IHTA 1984). However, s171 means that changes in the value of the estate "which have occurred

by reason of the death" are treated as though they occurred before death. Thus, the death claim value of a life policy can be included in an estate even though the claim only arises on death.

However, this rule only applies if the change falls within s171(2), and that subsection excludes "the termination on the death of any interest or the passing of any interest by survivorship".

Does that mean that, where a surviving joint tenant becomes entitled to the life policy proceeds, the death claim is not treated as occurring before death? That would appear to be the logical interpretation. From this, it would seem to follow that the value of a jointly owned joint life first death policy (where the deceased's interest does pass by survivorship) is not the death claim value, as would appear to be the intention of the last part of 171(2)?

However, HMRC's view on this interpretation is different. It takes the view that the reason for the last part of subsection (2) is to ensure that property owned as joint tenants does not escape the charge to IHT. Furthermore, those words do not have the effect of preventing the increase or decrease in value of any asset due to the death from being taken into account (i.e. without it, an interest passing by survivorship might escape a charge (under s4(1)) on death altogether, as it would be treated as happening before death).

Powell -v- Osbourne

The case of Powell v Osbourne required consideration of these issues. Mr and Mrs Powell were in the midst of divorce proceedings when Mr Powell died. A decree nisi had been pronounced, but it had not been made absolute.

Mrs Powell started proceedings under the Inheritance (Provisions for Family and Dependants) Act 1975. It was necessary to consider what assets were available in Mr Powell's estate.

When considering an endowment policy with a death benefit of £85,000 that had been in existence for less than 1 year (jointly owned by Mr Powell and Mrs Osbourne), the Recorder made the statement "it seems to me inescapable that the value of that beneficial interest in the policy proceeds immediately before the deceased's death was effectively zero".

However, in the Court of Appeal, Dillon LJ made the following statement…"One is looking at the moment immediately before the deceased's death, which is the last moment for severing the beneficial joint tenancy *[in the life policy]*, and to give effect to that it is necessary, to my mind, to keep in mind that the deceased is indeed about to die the very next moment or very soon, almost immediately, thereafter. Therefore, it cannot be right to value immediately before his death without regard to his assumed imminent death. On the actual facts, he died in hospital (where he had been admitted not long before) and the cause of death was cerebral haemorrhage and hypertension. That again seems to me to indicate that, immediately before his death, his actual prospects of surviving would have been virtually negligible.

Taking that into account, I conclude that the order should reflect that, though the property is subject to the mortgage, **the half-share of the policy monies is also to form part of the net estate**."

This judgement effectively means that the value immediately before death must take account of the imminence of death. It appears to remove any necessity for s171.

Murphy -v- Murphy

The Court of Appeal ruling in Murphy -v- Murphy and Others (2003) EWCA Civ 862 may have provided further guidance on this. This case concerned a joint life first death term assurance policy providing death and terminal illness benefits and the issue was whether the deceased was, immediately before his death, beneficially entitled to a joint tenancy of the right to death benefits under the policy.

The facts of the case were as follows…

In 1996, Mr and Mrs Murphy effected a joint life first death policy with Royal Life Insurance. They were both named as the policyholders and as the lives assured. The policy was a temporary term assurance for 25 years with benefit payable on the first death or on the acceptance by the company of a claim for terminal illness. There was no surrender value.

The parties were divorced but premium payments under the policy continued. After the divorce, Mr Murphy began living with a Ms Holland and they continued to live together until Mr Murphy died in June 2001. Six days later, Ms Holland gave birth to Mr Murphy’s daughter, Caitlin.

Mr Murphy made no provision for his daughter, Caitlin, under his will. In 2002, she began proceedings against her mother who was granted probate on the estate of the deceased so that the proceedings could be brought under the Inheritance (Provision for Family and Dependants) Act 1975. The other defendants were the former wife of Mr Murphy, the child of the marriage and Mr Murphy’s brother and sister who were named as executors but refused to take up probate. The sole asset in respect of which the claim under the 1975 Act was made was the insurance policy with Royal Life Insurance.

The 1975 Act provides that certain individuals, including a child of the deceased, may apply to the Court who can, at its discretion, make a reasonable financial provision for the claimant out of the estate of the deceased.

The application in this case was specifically under section 9.1 of the Act which provides that *“where a deceased person was immediately before his death beneficially entitled to a joint tenancy of any property…the court may order that the deceased’s severable share of that property, at the value thereof immediately before his death, shall…be treated for the purposes of this Act as part of the net estate of the deceased”.*

The leading judgement is by Lord Justice Thomas. He believed that the trial judge had addressed the wrong question. On the basis that the policy was a joint policy, the judge had proceeded on the basis there was co-ownership and, therefore, the issue was whether it was owned in joint tenancy or tenancy in common. However, there was a more fundamental issue, namely whether **the rights under the policy** were as a matter of construction joint rights.

The parties before the Court of Appeal accepted that the preliminary issue should be framed in a different way, namely “was the deceased, immediately before his death, beneficially entitled to a joint tenancy of the right under the policy to benefit from his death before the death of Mrs Murphy?”

Thus, the sole issue was whether, as a matter of construction of the policy in question, the right to the death benefit under the policy was a jointly held right in which the interest could be severed by a notice of severance or whether Mr Murphy and Mrs Murphy had separate rights to the death benefit.

The Court carefully analysed the relevant policy conditions which were obviously fundamental to the issue in question.

Much was said in the judgement about the nature of joint interests. In fact, it appears that the term “joint policy” is not particularly helpful. The terms in the language of the policy were said to be “of no real assistance”. In particular, given that there were two policyholders, what was lacking was a clear statement that, on the first death, the payment would be made to the survivor.

Much time was spent on the construction of the term “policyholder” where two individuals were in effect a policyholder and whether a payment to the policyholder following the death of one of them, where the policy provisions said that the “payment will be made to the policyholder or his assigns or executors….”, implied a payment to the sole surviving original policyholder or the surviving policyholder as well as the executors of the deceased policyholder.

The judge preferred a term of “a composite policy” rather than a joint policy. Here he relied on the decision in General Accident Fire and Life Assurance Corporation -v- Midland Bank (1940) 2KB388. Although a policy in that case was also described as a joint insurance, it was said to be more accurately described as a composite policy because “it comprised in one piece of paper interests of a number of persons”.

Simply because there is more than one policyholder, it does not follow that their rights are joint. Although the nature of insurance in General Accident and the circumstances were obviously very different, the judge accepted the argument put on behalf of Mrs Murphy that the policy issued to Mr and Mrs Murphy was in effect a composite policy. Although they had a joint interest in the terminal illness benefit (which was payable to both of them on the company’s acceptance of a valid claim), there were two separate contingent rights to the death benefit. The Court was satisfied that, even though there was no evidence, it was plain that the original intention of the couple was that the death benefit was to be paid to the survivor

and was to be for the exclusive benefit of the survivor to enable the survivor to deal with the financial consequences of the death of one of them.

Thomas LJ said that "that would be the ordinary inference to be drawn when a life assurance is effected for a fixed sum without profits, without a surrender value and without an endowment element, it was not a so-called savings product, but pure life insurance".

The Court found nothing to suggest that it was ever intended that the estate of the deceased was intended to benefit – there would have been no point. It was not an endowment policy where it would ordinarily be intended that the benefit payable on maturity would be available for them jointly.

The suggestion that there was a composite policy in respect of death did not contradict the intention that the terminal illness benefit was to be paid to them jointly. The benefit payable on terminal illness would be needed by both policyholders to defray the cost of illness, whereas the benefit on death would only be required by the survivor. Therefore, the purpose of the benefits was different and different treatment within a composite policy accorded with the obvious intention attributed to the parties in respect of the different nature of the benefits.

Based on the Murphy decision, it now seems that where the policy in question is a pure term assurance with no surrender value, the beneficial right is not in fact a joint right but a contingent right depending on who dies first.

In effect, if A and B take out a policy, then immediately before the death of A, what was in A's estate was a contingent right to benefit on death of B and nothing else. Given that B survives A, this would obviously have no value and the death benefit payable to B on A's death, has no value whatsoever in A's estate because it was not a right to which A was beneficially entitled.

This means that, if an unmarried couple takes out a joint life first death term assurance policy, there would be no IHT implications on the first death at all.

As this is an issue that has caused some confusion in the past, the clarification that the decision in Murphy has brought is of fundamental importance. Of course, whilst the decision was specifically based on the facts of the case, given that the facts were a relatively common example of a typical situation, it would be difficult to apply a different reasoning in a similar case.

Perhaps you can now confirm that, in cases where the policy has a wording similar to that of the Murphy case or specifically state the rights of each party on a composite rather than a joint basis, that there would be no value to include in the estate of the first to die."

HMRC's response to our enquiry on this subject of a joint life first death policy valuation was as follows…

"determining the interests in any joint lives policy is not a straightforward matter and each individual policy must be considered on its merits and taking into account

the specific wording of that policy. It follows from this that no single Court decision is likely to be readable across all joint lives policies and I am unable to provide a definitive answer that will apply to all situations.

However, in an effort to be as helpful as possible, I am happy to provide you with my personal opinions on the various questions raised in your letter. This opinion is not binding on the Board of Inland Revenue nor will it preclude the Board from raising such claims as may be justified in the circumstances of a particular case.

Both the case of Powell v Osbourne and Murphy v Murphy make a clear distinction between the treatment of an endowment policy and a term assurance policy with no surrender value. As you say, the decision in Powell v Osbourne effectively (though not completely) removes the need for section 171 IHTA in connection with the valuation of an interest in an endowment policy. If that logic were carried through to the case of Murphy v Murphy, then surely the imminence of Mr Murphy's death would have made the term assurance policy valuable at that time and would have formed part of his estate?

However, Lord Justice Thomas, having been referred to Powell v Osbourne, took the view that the case was not of direct assistance *"as the issue before us was one of the construction of the terms of the particularly policy"*. This, I think, reiterates the fact that each policy must be considered on the basis of the particular wording used in the contract, rather than by trying to generalise across policy "types".

With regard to the implications from the Murphy decision, where you have a joint life first death term assurance, no surrender value and the wording of the contract follows that of the Royal Life policy effected by Mr and Mrs Murphy, then the right to receive the death benefit is indeed a contingent right which is valuable only in the estate of the survivor. In these specific circumstances, if an unmarried couple held the policy, then there would be nothing to include in the estate of the first to die, as you suggest.

You go on to suggest that, in the case of a whole life policy (or endowment policy), the maximum amount that could be included in the estate of the first policyholder to die would be 50% of the surrender value of the policy before death. This does not seem to accord either with the decision in Powell v Osbourne, which concluded that the imminence of death should be taken into account (which would increase the open market value to virtually the claim value on death) nor the judgement in Murphy v Murphy.

Lord Justice Thomas stated in his speech that *"the plain inference to be drawn was that the death benefit was intended by the parties to be payable to the survivor of either Mr or Mrs Murphy;... That would be the ordinary inference to be drawn when a life insurance is effected for a fixed sum without profits, without a surrender value and without an endowment element"*. He is saying, I believe, that he has reached his decision due to the particular nature of this policy. It follows from this, in my view, that, if faced with a with-profits policy, a policy with a surrender value or a policy with an endowment element, then a different inference may have been drawn resulting in a different conclusion.

In summary, if faced with the identical facts as presented themselves in the Murphy case, then I would agree that nothing would be included in the estate of the first to die. That remains our view as has been set out in our Advanced Instruction Manual, Chapter T.48, a copy of which I enclose in case you do not have access to it. It appears, therefore, that the two cases referred to simply confirm the position as it was already understood to be, i.e. that, in the case of jointly owned life policies, every case must be considered individually. Certainly, neither decision appears to contradict my understanding of the Inheritance Tax position that would relate to the circumstances of each case."

The extract of the manual referred to (which is now at IHTM20303) is set out as follows:

"**IHTM20303 - Life Policies: joint life and joint name policies: the situations that can arise and the Inheritance Tax claims that can result**

If the joint policyholders are the beneficial owners of the policy (and not merely trustees), difficulties can arise in determining what beneficial interest each has and therefore what claims for tax there are – particularly on the death of the first to die. There are three possibilities…

- the policyholders are beneficial tenants in common and the interest of the first to die passes under their will.

In this case, the share of the first to die forms part of their estate and, subject to exemptions, Inheritance Tax is payable on the value of that share – please see IHTM20211.

- the policyholders are beneficial joint tenants and the interest of the first to die passes to the survivor.

In this case, the same consequences will follow. In husband and wife [and other married couples] or civil partner (IHTM11032) cases, however, spouse or civil partner exemption will usually be available.

- the policy created concerted and unseverable contractual arrangements. In other words, each policyholder held a separate and distinct item of property (the right to the whole policy if, but only if, they outlived the other).

In this case, the interest of the first to die is completely extinguished at that time and does not pass either under the Will or by survivorship. So, there is no property to tax on that event.

The case of Murphy v Murphy [2003] EWCA Civ 1862 considered the treatment of a jointly owned term assurance policy which also had a terminal illness benefit.

The Court of Appeal determined that the two benefits were held differently and that the intention of the joint owners in obtaining the insurance was the crucial factor [in] establishing their respective interests in the insurance.

Establishing the interests of a joint owner of a life policy depends on the specific

facts of the case. In view of the difficulties that can arise you should seek the early advice of Technical where the position is unclear or where the taxpayer or agent does not accept our view."

Lim and others v Walia [2012]

In a more recent case, Lim and others v Walia [2012], the High Court found that, immediately before death, a deceased was entitled to a joint tenancy of the right under a life policy to benefit from her assumed terminal illness, for the purposes of section 9 of the Inheritance (Provision for Family and Dependants) Act 1975.

This is despite the fact that the Court of Appeal decision in Murphy V Murphy [2003] found that in the event of the death of a joint policyholder of a joint life first death policy, the death benefits belonged to the survivor, as that was the intention of the parties.

In this case, the deceased married in 2003 and had a daughter shortly after in 2004. The couple subsequently separated (but did not divorce) and the deceased formed another relationship. She had a son with her new partner in 2009. The deceased died intestate in 2011 having been diagnosed with a terminal illness. Her next of kin to whom grant of representation was awarded was her husband.

The policy was taken out in 2002 by the deceased and her then partner (who she subsequently married) on a joint life, first death basis. The deceased was the first named life assured and the policy included provision for terminal illness.

The terms of the policy were…

- to pay a fixed cash sum (the sum insured) if the life insured died within a period defined as the policy term; or
- to pay the sum insured earlier if the life insured developed a terminal illness.

Neither the deceased nor her husband had made a terminal illness claim. In May 2012, the insurer paid a lump sum to the deceased's husband on the basis that the first life insured had died.

This particular case resulted in three claims (by the deceased's son, daughter and partner) being made under section 9 of the Inheritance (Provision for Family and Dependants) Act 1975. The claims came before District Judge Richmond who ordered the trial of the preliminary issue and raised the question as to whether the sum paid by the insurer was to be treated as part of the estate for the purposes of this Act.

A later order from District Judge Khan provided that, for the purposes of determining the preliminary issue, the Court should assume that the deceased had died from a terminal illness within the meaning of the policy. Although, if the decision went in favour of the claimant, it would be necessary to prove that the deceased had a terminal illness within the meaning of the policy. This was clearly a fundamental preliminary issue.

Counsel for the first claimant conceded that the deceased was not entitled to a joint tenancy of the right to benefit from her death under the terms of the policy – this had been decided in the previous case of Murphy v Murphy (please see above).

The question, therefore, arose as to whether she was entitled to a joint tenancy of the right to benefit from her assumed terminal illness? Looking at the position immediately before death it was found that the deceased did have an accrued claim, based on the fact that the deceased had developed a terminal illness. As a result, the deceased had the right to have her benefit brought forward. Therefore, the claimants had a case.

Cases such as this illustrate that an analysis has to be made on the facts of the case. In summary, the case of Murphy v Murphy [2003] considered the treatment of a jointly owned term assurance policy which also had a terminal illness benefit. In this case, the Court of Appeal determined that the two benefits could be held differently and that the intention of the joint owners in obtaining the insurance was the crucial factor is establishing their respective interests in the insurance.

So, for example, when the policy was effected, the parties could have intended...

i. That the money payable on the death of the first life assured was to be paid to the survivor.

ii. That the money payable on terminal illness could be held in a different way – for example so that both policyholders could benefit equally.

However, Murphy v Murphy [2003] did not address the issue of what the position was when a deceased had entitlement to terminal illness benefits, but the claim was made on death.

In Lim and others v Walia [2012], the Court held that immediately before her death...

- the deceased had a claim for terminal illness benefit. Whilst it was a joint claim, it was in theory severable; and
- the imminence of death should not be ignored. Therefore, both policyholders had a right to have the payment brought forward because of the terminal illness.

This goes to show that, in cases such as this, there is no specific straightforward answer and as such the Court will make its decision based on the facts provided and the terms of the policy.

In particular, care will need to be exercised in the case of a joint life first death policy where a claim could be made on terminal illness, but it is not made until the death of the terminally ill life assured.

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