

Legacies, Abatement and Ademption

This month's CPD paper will cover the legal meaning and operation of "abatement" and "ademption". While these have been covered briefly in an earlier paper (Failure of Gifts) this paper will look at abatement and ademption in greater detail.

DEFINITIONS

Abridged from the Oxford Dictionary of Law:

Abatement n. (of legacies) The reduction or cancellation of legacies where a solvent estate is insufficient to cover all the legacies provided for in the will or on intestacy after payment of the deceased's debts.

Ademption n. The cancellation or reduction of a specific legacy because the subject matter of the gift is no longer part of the testator's estate at his death, or the testator no longer has the power to dispose of it, or there is nothing conforming to the description of it in the will.

But before we can tackle the incidence and effect of abatement and ademption we need to revise the use of legacies in wills and the relevance of the different types of legacies when considering abatement and ademption:

LEGACIES

There are three basic types of legacy i) general, ii) specific and iii) demonstrative. The category that correctly describes a particular gift and into which the legacy falls for legal purposes is a matter of construction.

General legacies

A general legacy does not specify a particular item or does not specify one item out of a particular class. A general legacy is provided out of the testator's general estate.

A general legacy is not made specific merely because the estate contains the property described by the legacy in the estate. The executors can decide whether or not to use that property to satisfy the legacy or alternatively to use estate residuary funds and purchase other property of the same form. The legacy is general unless the property is referred to specifically as belonging to the testator or otherwise described (and therefore distinguished) so as to exclude its replacement by other property from the estate.

A pecuniary legacy is by nature a general legacy, but can fall under any of the 3 types. The gift of £100 is a general legacy. The legacy, subject to contrary intention, carries the interest from the time that it is payable. That time depends on the express provisions of the will or of any relevant rules of law. Gifts that are to be paid immediately after the death, that is at the end of the "executor's year" unless the will provides otherwise attract interest immediately.

Specific legacies

A specific legacy identifies the subject-matter of a gift existing at the date of the will. For example “I give my grandfather clock to A”. Any words of possession or reference indicates that the testator intended to give that particular property and not some property of the same kind, purchased by the executors. Thus if the subject-matter of the gift does not exist time of the death, subject to there being a contrary intention in the will, the gift is adeemed and fails.

If however the subject-matter only changes in its perceived form, for example a gift of shares in a company that has been subject to reorganisation, then the legacy will usually be unaffected.

A gift of “my shares” is specific being possessive in construction, as is “such shares as I own in ABC Ltd at the date of my death” – assumes that the testator dies owning shares. But if there were no shares in the estate then the gift would lapse.

In the case of the alternative legacy expressed as “I give X (being a number) of shares in ABC plc then the executor would be required to purchase the specified number of share in ABC plc if the testator did not own those shares at the date of his death.

Demonstrative legacies

A demonstrative legacy describes the fund or the assets out of which the legacy is to be paid. Therefore sharing some of the attributes of a general legacy in that the payment is to be from a specified source, and that the payment represents but a (general) part of that source. Demonstrative legacies have the advantage that they do not adeem when the source itself is insufficient at the date of the testator’s death to satisfy the legacy in full.

If the fund or property specified is insufficient to meet the legacy in full then the remainder is payable out of the testator’s general estate, having the same priority as other general legacies.

INTEREST ON LEGACIES

General legacies carry interest from the time payable, subject to contrary intention expressed in the will. Immediate gifts are payable after 1 year from the date of death unless the will states otherwise. Interest applies even though executors have difficulty in making payment within that time.

Interest on general legacies held in trust for a first named beneficiary with remainder to a second beneficiary absolutely are subject to the same rule. The first beneficiary is not entitled to receive any interest for the first 12 months after the testator’s death.

The rate of interest which was 6% per the Rules of the Supreme Court, Order 44, defined now in Rule 10 has been amended by the Civil Procedures Rule, Part 40, Paragraph 15. The Practice Direction confirms that the rate should be the same as the rate payable on funds held in court, currently 3%. This rate is subject to contrary provision in the will. Interest is calculated as simple, unless the court decides otherwise. In *Evans v Westcombe* [1999] 2 All ER 777 the PRs knew that a beneficiary existed but they could not find the person; the court would not grant an order (involving the premium payable for an indemnity policy) awarding the payment of interest.

It is up to the will writer to keep an eye on the possible incidence of interest becoming payable where the will as drafted creates complexity leading to possibly lengthy estate administration.

The testator may instruct as to when interest on legacies becomes payable, for example a gift payable “immediately after my death” carries interest from the date of death irrespective of the distribution date.

A contingent or deferred legacy attracts interest only from the date that the legacy is payable. If the gift is payable at age 21 then interest runs from that date to the date that it is paid to the beneficiary.

There are 4 exceptional rules where interest on a legacy is carried from the date of death, they are:

- i) Where the legacy is in satisfaction of a debt; and
- ii) A vested legacy, which is charged on realty; and
- iii) A legacy to a testator’s own minor child; and
- iv) A legacy to any minor for the purpose of maintenance.

These rules are again subject to contrary intention expressed by the will. You should note that in all but the case of i) above there are circumstances where the rule as expressed above does not apply.

In the case of drafting gifts for the benefit of minors it is always better to provide express rules within the will for the executors to follow exactly, rather than having to rely upon the somewhat cumbersome, unwieldy provisions governing the payment of interest on legacies as contained in general law.

ABATEMENT

The rules by which legacies are necessarily reduced when an estate is insufficient to pay out the general legacies in full are referred to as abatement. The result of abatement is that each general legacy effected is reduced in the same proportion to the overall shortfall of estate funds needed to pay out the general legacies in full. The estate is the amount after tax, funeral and testamentary expenses and priority legacies.

Since the Trustee Act 2000 under s28 the executors’ charging clause is no longer treated as a legacy, it is now known as a remuneration clause. Charges and fees properly earned are payable even if the estate does not hold sufficient funds to meet the pecuniary legacies in full.

A legacy that is given by the testator in satisfaction of a debt abates together with pecuniary legacies. This rule applies when the (debt) legacy as provided by the will is accepted by the legatee and is “far in excess” of the debt. The authority for this proposition is *Re Whitehead [1913] 2 Ch56*. However a creditor seeking to recover payment of his debt may be given priority over legatees who are merely volunteers (that is beneficiaries under the terms of the will), see *Beyfus v Lawley [1903] AC411*.

As we have seen, from the above, a demonstrative legacy does not abate together with general legacies as long as there are sufficient funds available to pay out that legacy. The demonstrative legacy is paid in priority to general legacies. If the fund available to pay the demonstrative legacy is not sufficient the balance that is available is ranked on equal terms with the general legacies and abates at the same rate.

Specific legacies do not abate with general legacies but can abate along with other specific legacies when the general estate is not large enough to pay all the estate debts. In this eventuality, where the general estate is not sufficiently large enough to pay all the debts then the residuary estate is used to satisfy debts before the specific legacies are required to become abated.

The order of payment where the estate is solvent followed by abatement is found in Part II of the First Schedule of the Administration of Estates Act 1925. This gives the order in which legacies abate and says as follows:

- The residue will abate first as the residue is the value of the estate AFTER the specific legacies have been paid;
- General legacies abate after the residue: including demonstrative legacies where the designated fund is not sufficient to make payment, see *Re Turner [1908] 31 Ir. 274*;
- General legacies i) abate in proportion and ii) must be exhausted before the next category in order can be used to satisfy the legacies;
- Specific and demonstrative legacies abate according to the amount available to fund them from the designated fund and they abate rateably according to value.

The order of abatement can be varied from the above by express provision in the will. Where during the process of taking instruction the will writer anticipates that the estate may not be sufficient to meet all of the demands established by the testator's wishes a discussion about the order of possible abatement of legacies is encouraged.

The order of payment of debts in the event that the estate is Insolvent estates is governed by the Insolvency Act 1986, which applies regulation found in the Administration of Insolvent Estates of Deceased Persons Order 1986. These regulations have not been examined in this paper.

Inheritance tax is a testamentary expense and is paid according to the general rules; that is generally out of the residue, unless a contrary provision is expressed in the will. For example where a legacy is stated to be "subject to tax" the inheritance tax is payable from the gift and not out of the residue.

ADEMPMENT

Ademption is the non-existence of an asset at the testator's death as distinct from insufficient assets to meet the stated legacies (abatement).

Where the testator leaves a legacy in the will but the subject-matter is found to be non-existent at the testator's death, whether or not the beneficiary receives any benefit from the estate at all will depend on the type of legacy.

Where a specific legacy is named the non-existence of the subject-matter will mean that the beneficiary receives nothing, for example where the item cannot be found or has been replaced by another item. This raises issues of definition for the will writer – consider the difference between "I give my car RG64 XYZ to A" and "I give the car that I own at my death to A".

This rule applies even if the specific gift has been sold and the sale proceeds can be traced, or if the subject-matter has been destroyed and the proceeds of an insurance policy have been obtained (see *Durrant v Friend* (1852) 5 De G.)

However in the case of *Re Flemings's Will Trust* [1974] 3 All ER 323 the testator gave a legacy in his will of "my leasehold house 54 Narcissus Road" and later acquired the freehold the court held that the gift passed the testator's entire interest including the freehold.

Stocks and shares can cause problems as they are prone to change their description and nature over time. Companies are sold, bought, and reorganised. The result is that it can be difficult for administrators to decide whether a gift of shares (as defined by the will) adeems. In *Re: Slater* [1907] 1 Ch 665 the court held the appropriate test that should be applied to decide in the case of stocks and shares is "is the change (to the shares) merely in name or form, but substantially the same thing".

The current test to stop a gift of stocks and shares adeeming may be as follows:

- Is the change merely a name change?
- Is there "unity of security", has the underpinning capital structure of the company remained unchanged or is there a fundamental change to the company structure and the nature of the shares?
- Is the quantity involved the same or similar?

If a specific gift adeems the beneficiary is not entitled to compensation. If the deceased had entered a binding contract for sale, which had not been completed before the death the beneficiary is not entitled to the proceeds of the sale: known as the rule in *Lawes v Bennet* (1785) 29 ER 1111.

If the gift is a demonstrative gift, for example "£100 payable out of my building society account", the gift is payable from other parts of the estate – beginning with the residue. Where there is only sufficient funds available to pay part of the gift the balance is payable from the residue, see *Ashburner v MacGuire* (1786) 2 All ER 837.

If the gift is a general pecuniary gift, for example "I give £100 to A", the amount must be paid as long as the estate is not insolvent. The payment is made either according to the testator's express wishes or under the statutory legacy payment order. The amount reduces rateably (pro-rata) with other general pecuniary legacies if there are insufficient assets available to pay the legacies in full.

CONCLUSION

In conclusion as the reader can see the subject of legacies and the rules governing their possible ademption and abatement is wide and subject to much court attention over the years. Whereas it is the responsibility of executors to decide on the validity and distribution of legacies, the will writer plays a vital role in ensuring that the testator's express wishes can be carried out by the terms of the will once in the hands of the executors.

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