

A HIGH COURT OF JUSTICE
(CHANCERY DIVISION)—10, 11 AND 18 JULY 1980

COURT OF APPEAL—28, 29 AND 30 OCTOBER AND 2 NOVEMBER AND 16
DECEMBER 1981

B HOUSE OF LORDS—19, 20, 21 AND 22 JULY AND 14 OCTOBER 1982

Leedale (H.M. Inspector of Taxes) v. Lewis⁽¹⁾

C *Capital gains tax—Gains accruing to trustee resident outside the U.K.—U.K.-resident beneficiaries being both potential objects of discretionary power and having interests contingent on surviving to a specified day—Whether apportionment of gains amongst beneficiaries mandatory—Whether relevant to consider hardship—Manner of apportionment—Finance Act 1965, s 42.*

D Under a settlement made by a U.K.-resident grandmother in 1968, foreign-resident trustees had powers, which had not been exercised, to appoint the capital and income for the benefit of members of the specified class, viz., any grandchild or remoter issue born before “the Perpetuity Day” (defined by a “royal lives” clause) or their wives, husbands, etc. and subject thereto a discretion to pay or apply the income for the benefit of such members, any income applied to be accumulated. A letter of intent set out her wishes (*inter alia*) (i) that the trustees “should regard the settlement as existing primarily for the grandchildren in equal shares and . . . should accumulate income for the time being”; (ii) that when a grandchild attained 21 the income of his or her prospective share should be paid out “until such time as circumstances make it necessary or desirable to pay out the capital as well”; (iii) in the absence of special circumstances the grandchildren should not receive any large sums of capital before reaching 30.

F At the perpetuity date the then funds were to be held “in trust absolutely for such of the grandchildren and remoter issue of the settlor” as should then be living “and if more than one in equal shares per stirpes”.

In 1968–69 and 1969–70, no discretionary distributions of income having been made, gains accrued to the trustees which the relevant Inspectors apportioned equally by assessing the five grandchildren under s 42(2) of the Finance Act 1965.

G At the hearing of appeals on behalf of the grandchildren, it was common ground between the actuaries that the current *market* values of each

⁽¹⁾ Reported (Ch D) [1980] STC 679; 124 SJ 631; (CA) [1982] 2 All ER 644; [1982] STC 169; (HL) [1982] 1 WLR 1319; [1982] 3 All ER 808; [1982] STC 835; 126 SJ 710.

grandchild's "fixed interest" (which would not vest until the perpetuity date) were very small and differed little *inter se*. A

The Special Commissioners discharged all the assessments on the grounds: (a) that the "interest" of a grandchild, as an object of discretion, was not an "interest in the settled property" within the meaning of s 42(2) and must therefore be ignored; (b) that the "fixed" interests (in remainder) of each grandchild, being of negligible market value, ought reasonably to be disregarded; (c) that the "letter of intent" could not affect the value of the rights of any grandchild; (d) that s 42(2) only required them to apportion the said gains if they thought it just and reasonable so to do, which they did not. B

The Chancery Division, allowing the Crown's appeals, held (I) that "interests in the settled property" for the purposes of apportionment in s 42(2), did not include such an "interest" as has the object of a discretion; (II) that as the apportionment directed by s 42(2) had to be both "as near as may be according to the respective values of [the] interests [of the beneficiaries concerned]" and "in such manner as is just and reasonable", the latter requirement could only have effect in relation to the selection of the persons between whom the gain was to be apportioned; (III) that it was just and reasonable to take into account the letter of intent and the prospects of the grandchildren receiving income or capital as objects of the trustees' discretionary powers; (IV) that in the circumstances the only solution was to apportion the gain in each year equally amongst the five grandchildren. C D

Per curiam: (V) that the words "defeasible interest" in the phrase "disregarding in the case of a defeasible interest the possibility of defeasance" at the end of s 42(2) did not include "all contingent interests"; (VI) that phrase meant (a) that an interest in default of apportionment was to be considered without regard to the possibility of its value being diminished by the exercise of the relevant power of appointment; (b) that the interest of a beneficiary who would take merely by way of defeasance of a defeasible absolute interest was to be ignored. E

The Court of Appeal, dismissing appeals on behalf of the grandchildren, held that: (1) the object of a discretionary trust qualified both as a "beneficiary under the settlement" and as a "person having an interest in the settled property" for the purposes of an apportionment under s 42(2): *dictum* of Lord Wilberforce in *Gartside v. Inland Revenue Commissioners* [1968] AC 553 at page 617 applied; (2) s 42(2) accordingly required the whole of the amount to which the trustees would have been chargeable to be apportioned between the five grandchildren as having such interests; the words "in such manner as is just and reasonable" related solely to the mode of apportionment between them; (3) on the facts, the apportionment in each case equally between the Appellant beneficiaries, decided by Dillon J., was correct, there being no reason for distinguishing between them in point of value. F G

Held, in the House of Lords, unanimously dismissing appeals on behalf of three of the grandchildren, that the reasons given by the Court of Appeal were correct: further as to (1), an additional reason for construing "interest" widely was that s 42 had also to apply to settlements governed by other systems of law and, by virtue of subs (7), to "arrangements"; as to (2) and (5), the words "in such manner as is just and reasonable" and "as near as may be, according to the respective values of those interests" suggested a broad rather I

A than an actuarial approach, in which all relevant considerations might be taken into account: the relative poverty of one discretionary beneficiary would only be relevant in a case where he was likely to have the trustees' discretion exercised more generously in his favour; as to (6), in this case, there being decisive legal reasons for preferring the Crown's construction, considerations of hardship were irrelevant.

B In re *Latham dec'd.* [1962] Ch 616 at pp 641–2, considered.

CASE

Stated under the Taxes Management Act 1970, s 56, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

C 1. At a hearing before the Commissioners for the Special Purposes of the Income Tax Acts held on 4 December 1978 Thomas Rosling Haselden Lewis (hereinafter called "Mr. Lewis") appealed against the following assessments to capital gains tax:

	As guardian of Miss Fiona E. Lewis	
D	Year	Amount
		£
	1968–69	228
	1969–70	101
	As guardian of Edward R. Lewis	
	Year	Amount
E		£
	1968–69	228
	1969–70	101
	As guardian of Richard T. Lewis	
	Year	Amount
F		£
	1968–69	228
	1969–70	101.

2. At the same time, by agreement between the parties, we heard appeals against assessments to capital gains tax by Rodney Colin Page (hereinafter called "Mr. Page") as parent and guardian of his two minor children.

3. Shortly stated the questions for our decision were

G (1) whether each minor had in the year of assessment an interest in the property settled by the settlement dated 16 March 1968 and made between Hannah Elsie Lewis of the one part and the Bank of N.T. Butterfield & Son Ltd. of the other part within the meaning of s 42(2) of the Finance Act 1965;

(2) if so, whether s 42(2) authorised the apportionment in equal shares to each minor and other persons with minute interests under the settlement of the whole or any part (and if so what part) of the amount on which the trustees

would have been chargeable to capital gains tax under s 20(4) if domiciled and either resident or ordinarily resident in the United Kingdom in the year of assessment. A

4. Mr. Lawton appeared for Mr. Lewis and Mr. Page. Mr. Jackson appeared for the Solicitor of Inland Revenue.

5. The following documents were proved or admitted before us:

(1) Copy settlement dated 16 March 1968 made between Mrs. H.E. Lewis and the Bank of N.T. Butterfield & Son Ltd. B

(2) Copy letter dated 18 March 1968 from G.M.H. Lewis and H.E. Lewis to the Bank of N.T. Butterfield & Son Ltd.

(3) Copies of actuarial reports prepared by:—

(i) Mr. R.T. Kablean of the Capital Taxes Office, and

(ii) Mr. T.A. Warren of Messrs. Lane, Clark and Peacock. C

Copies of such of the above as are not annexed hereto as exhibits are available for inspection by the Court if required.

6. The following facts were admitted between the parties:—

(a) By a settlement dated 16 March 1968 (“the Settlement”) and made between Hannah Elsie Lewis (“the Settlor”) of the one part and the Bank of N.T. Butterfield & Son Ltd. (“the Original Trustee”) of the other part a sum of money was transferred to the original trustee to be held upon the trusts contained in the settlement. The material provisions of the settlement are as follows:— D

“This Indenture of Settlement is made the Sixteenth day of March One thousand nine hundred and sixty-eight Between: Hannah Elsie Lewis of the Old Farmyard, Givons Grove, Leatherhead, Surrey, Married Woman (hereinafter called ‘the Settlor’) of the one part and the Bank of N.T. Butterfield & Son Limited a company incorporated under the laws of the Islands of Bermuda (hereinafter called ‘the Original Trustee’) of the other part. Whereas:— E

(A) The Settlor is desirous of making provision for the members of the Specified Class as herein defined in manner hereinafter appearing and with this intention has on or before the date hereof paid to the Original Trustee the sum of money specified in the First Schedule hereto to be held by the Original Trustee or other the trustee or trustees for the time being and from time to time hereof upon the trusts and with and subject to the powers and provisions hereinafter contained F

(B) It is contemplated that further sums of money or property may hereafter from time to time be paid or transferred to or into the control of the trustee or trustees hereof to be held upon the trusts of this Settlement Now in consideration of the premises This Indenture Witnesses as follows: G

1. In this Settlement the following expressions have the following meanings (that is to say): H

‘the Trustee’ means the Original Trustee or other the trustee or trustees for the time being of this Settlement; ‘the Perpetuity Day’ means

A the day on which expires the period of twenty-one years calculated from and after the death of the last survivor of the descendants of His late Majesty King George the Fifth living at the date of this Settlement;

'the Specified Class' has the meaning attributed to it in the Second Schedule hereto;

'the Trust Fund' means:—

B (i) the said sum of money specified in the First Schedule hereto and

(ii) all sums of money or other property paid or transferred to or into the control of and accepted by the Trustee as additions to the Trust Fund and

(iii) all accumulations of income added to Trust Fund and

C (iv) all money investments and other property from time to time representing the said sum of money specified in the First Schedule hereto and the said additions and accumulations or any part or parts thereof

2. The Trustee shall stand possessed of the Trust Fund and the income thereof upon such trusts for the benefit of the members of the Specified Class or any one or more of them to the exclusion of the other or others in such shares and proportions and subject to such terms limitations and provisions as the Trustee shall from time to time by deed or deeds revocable or irrevocable executed before the Perpetuity Day but without infringing the rule against perpetuities appoint Provided Always That

E (1) no exercise of the powers conferred by this clause shall invalidate any prior payment or application of the income of the Trust Fund or any part or parts thereof made under the powers conferred by sub-clause (a) of clause 3 hereof and (2) The Trustee may at any time or times by deed or deeds extinguish (or restrict the future exercise of) the powers conferred by this clause

3. In default of and subject to any such appointment as aforesaid

F (a) The Trustee may until the Perpetuity Day pay or apply the whole or such part if any as it shall think fit of the income of the Trust Fund as it arises to or for the benefit in any manner of the members of the Specified Class for the time being in existence or any one or more of them to the exclusion of the other or others and in such shares and in such manner and upon such terms and conditions (if any) as the Trustee shall in its discretion from time to time think proper and so that no such payment or application shall give any right to enjoyment of any future income of the Trust Fund Provided Always That the Trustee may at any time or times by deed or deeds extinguish (or restrict the future exercise of) the powers conferred by this sub-clause

H (b) The Trustee shall until the Perpetuity Day deal with the income of the Trust Fund or so much thereof as shall not be paid or applied as aforesaid by accumulating the same at compound interest by investing it and the resulting income thereof in any investments hereby authorised and adding the accumulations to the capital of the Trust Fund but with power nevertheless to apply any such accumulations or any part or parts thereof as if they were income arising in the then current year

I 4. In default of any appointment as aforesaid and in so far as any such appointment or appointments shall not extend the Trustee shall stand

possessed of the Trust Fund on the Perpetuity Day upon the trusts set forth in the Third Schedule hereto. . . A

8. Every discretion or power hereby conferred on the Trustee shall be an absolute and uncontrolled discretion and power and no trustee shall be held liable to any loss or damage occurring as a result of his concurring or refusing or failing to concur in any exercise of any such discretion or power. B

The Second Schedule Above Referred To In the above written Settlement the expression 'The Specified Class' shall mean the following persons who are already in being or who shall be born before the Perpetuity Day (that is to say):—

(i) all the grandchildren and remoter issue of the Settlor (and in ascertaining such remoter issue any person lawfully adopted by a grandchild of the Settlor according to the law of such grandchild's domicile at the date of the adoption shall be reckoned a child of such grandchild) C

(ii) all the wives and husbands and widows and widowers of the grandchildren and remoter issue (ascertained as aforesaid) of the Settlor D

The Third Schedule Above Referred To In Default of any appointment under the provisions of Clause 2 of the above written Settlement and in so far as any such appointment or appointments shall not extend the Trustee shall stand possessed of the Trust Fund on the Perpetuity Day:—

(a) in trust absolutely for such of the grandchildren and remoter issue of the Settlor as are living on the Perpetuity Day and if more than one in equal shares per stirpes E

(b) subject to the trusts of sub-paragraph (a) hereof in trust for the Settlor's children now living in equal shares absolutely."

(b) On 16 March 1968 additional assets were transferred by the settlor and by Guy Lewis her husband to the original trustee to be held upon the trusts contained in the settlement. F

(c) On 18 March 1968 the settlor and her husband wrote a letter to the original trustee in the following terms:

"Dear Sirs, we have recently transferred 55,000 (fifty-five thousand) shares in Ready Mixed Concrete Limited into the Settlement dated Sixteenth March 1968 of which you are the Trustee.

The Settlement gives you wide powers and discretions to apply the Trust Fund for the benefit of our grandchildren, their issue and certain other beneficiaries. Our wishes as to the exercise of the powers and discretions are that you should regard the Settlement as existing primarily for the benefit of our grandchildren in equal shares and that you should accumulate income for the time being. When each grandchild attains the age of 21 years, we would like the income of his or her prospective share paid out to him or her until such time as circumstances make it necessary or desirable to pay out the capital as well. In the absence of special circumstances we would not wish our grandchildren to receive any large sums of capital before attaining the age of 30 years, but of course circumstances may arise which render it desirable that either some income or capital should be paid out to them before attaining that age. So far as the Trust Fund is not exhausted by payments to our grandchildren we wish you to regard their issue as the main beneficiaries. We request you to G
H
I

A have regard to these wishes and to any other wishes which we or the survivor of us or after our deaths our children Thomas and Susan may make known to you but none of them is of course to place any obligation on you and we appreciate and believe that you will exercise your powers and discretions as you think best for our family. Yours truly”

B (d) The present trustee of the settlement is the Bank of Butterfield Executor and Trustee Co. Ltd. The original trustee and the trustee for the time being of the settlement are hereinafter referred to as “the trustee”.

C (e) By clause 2 of the settlement the trustee was directed to stand possessed of the trust fund as therein defined and the income thereof upon such trusts for the benefit of the members of the specified class as the trustee should from time to time appoint. No appointment has been made under this clause.

D (f) The specified class is defined in the second schedule to the settlement as the following persons who were already in being at the date of the settlement or who should be born before the perpetuity day, meaning the day on which expired the period of twenty-one years from the death of the last survivor of the descendants of His late Majesty King George V living at the date of the settlement: (i) all the grandchildren and remoter issue of the settlor; (ii) all the wives and husbands and widows and widowers of the grandchildren and remoter issue of the settlor. The present members of the specified class are the following grandchildren of the settlor, all of whom are minors: (1) Richard Lewis, Fiona Lewis and Edward Lewis (“the Lewis children”), (2) Anthony Page and Catherine Page (“the Page children”).

E (g) By clause 3 of the settlement, in default of and subject to any appointment under clause 2, the trustee was given power until the perpetuity day to pay or apply the income of the trust fund for the benefit of the members of the specified class as the trustee should in his discretion from time to time think proper and the trustee was directed until the perpetuity day to accumulate the income of the trust fund or so much thereof as should not be paid or applied as aforesaid. All income arising to date has been accumulated.

F (h) By clause 4 of and the third schedule to the settlement, in default of any appointment under clause 2 and in so far as any such appointment or appointments should not extend, the trustee was directed to stand possessed of the trust fund on the perpetuity day: (a) in trust absolutely for such of the grandchildren and remoter issue of the settlor as are living on the perpetuity day and if more than one in equal shares *per stirpes*; (b) subject to the trusts of sub-para (a) above in trust for the settlor’s children living at the date of the settlement in equal shares.

G (i) The Lewis children and the Page children are at present the only grandchildren of the settlor and there are no remoter issue of the settlor. The children of the settlor living at the date of the settlement were the Respondent H T.R.H. Lewis, the father of the Lewis children, and Susan Page, the mother of the Page children.

I (j) In the years of assessment 1968–69 and 1969–70 certain chargeable gains accrued to the trustee. Apportionments in respect of these chargeable gains were made, under s 42(2) of the Finance Act 1965, to the Lewis children and the Page children, all of whom are and were at all relevant times domiciled and resident and ordinarily resident in the United Kingdom. On the basis of the apportionments the assessments under appeal were made.

(k) On 22 November 1978 the Appellants obtained an actuarial report from R.T. Kablean. The following is a copy:

"1. I am, and have since October 1951 been, employed in the Capital Taxes Office, formerly the Estate Duty Office, of the Board of Inland Revenue. I hold a Second Class Honours Degree of the University of London in Law and qualified as an Associate of the Institute of Actuaries in 1964 and for that Institute's Certificate in Finance and Investment in 1970. A

2. I have been engaged in actuarial duties since April 1957 with the exception of a short period in 1974. B

3. In the course of those duties, I have regularly attended as an observer at the public auction sales of reversionary interests, life interest, annuities and analogous property held by Messrs. H.E. Foster & Cranfield at the London Auction Mart and I am concerned to advise and negotiate the market value of such property and the equitable apportionment of settled funds (particularly in cases where following the death of a reversioner, upon whose death the payment of estate duty was deferred, there are dealings with the trust fund so that the reversionary interest falls into possession before the life tenant's death). C

4. There is no universally accepted method of equitable apportionment. Commonly, actuaries advising on an impartial apportionment adopt a theoretical model based on the net yield of the fund after allowing for the deduction of income tax at the standard or basic rate and an annuitants' mortality table, but so that no beneficiary is apportioned less than the market value of his interest. D

5. I am instructed that, by agreement, the values are to be calculated as at 1 January 1970. E

6. In the absence of actual income payments falling within the provisions of Section 42(3)(a) Finance Act 1965 I am unable to attribute any value to any single beneficiary's rights under clauses 2, 3 and 6 of the settlements.

7. Of the possible remaindermen, I understand that there were living at the 1 January 1970 five grandchildren of the settlor, F

- i Richard Lewis, born 18 April 1959 aged 10
- ii Fiona Lewis, born 1 June 1961 aged 8
- iii Edward Lewis, born 15 March 1966 aged 3
- iv Anthony Page, born 2 February 1962 aged 7 and.
- v Catherine Page born 9 April 1964 aged 5

who had contingent interests under clause 4 and sub-paragraph (a) of the Third Schedule, and two children G

- i Mr. T.R. Lewis, and
- ii Mrs. S. Page,

who had vested but defeasible interests under that clause and sub-paragraph (b) of the Schedule.

8. The values of the various remaindermen's interests are to be ascertained disregarding in the case of a defeasible interest the possibility of defeasance. Accordingly, I have assumed, for the purpose of valuing the interests of the settlor's two children, that I should disregard the very likely possibility that any grandchild or remoter issue of the Settlor might be living on the Perpetuity Day. H

A 9. In my opinion, the terms of the Letter of Intent dated 18 March 1968 do not affect the value of the interests of any of the remaindermen, although I understand that, having regard to the terms of that letter, it may be considered that it would not be just and reasonable to apportion any part of the gains to the settlor's two children.

B 10. I have been instructed that the possibility of the trustee's exercise of the discretionary powers is not considered to be a possibility of defeasance which should be disregarded for the purposes of the valuations required by Section 42(2).

C 11. I have been instructed to proceed on the footing that the contingency of a grandchild's not surviving until the Perpetuity Day is not a possibility of defeasance which is to be disregarded in valuing that grandchild's interest. (If this is incorrect, it follows that each grandchild is effectively assumed to survive to the Perpetuity Day and the five grandchildren's interests would be of equal value.)

12. I consider the market value of the individual interest of each possible remainderman to be nil or negligible, say $\frac{1}{2}p$, since

D i the period before the Perpetuity Day, when in default of an earlier appointment, the interest would vest in possession, was likely to be very long, and

ii no purchaser could count on the trustee's refraining from exercising his discretion in favour exclusively of beneficiaries other than the vendor or his assignee.

E It is also my opinion, in view of the possibility of an adverse exercise of the trustee's powers, that, as at 1 January 1970, the interest of each remainderman was not measurable or definable in extent and was hence incapable of valuation on a theoretical actuarial basis.

F 13. If I were asked to calculate the proportional likelihood, as between themselves, of the grandchildren's attaining age 30, that is the age mentioned, in relation to capital distribution, in the Letter of Intent, then I should put the proportional percentage chance for each (based on English Life Tables No. 12*) at:

G	i	Richard Lewis	—	19.96;
	ii	Fiona Lewis	—	20.12;
	iii	Edward Lewis	—	19.89;
	iv	Anthony Page	—	19.93; and
	v	Catherine Page	—	<u>20.10</u>
		Total		<u>100</u>

(*HMSO: Registrar-General's Decennial Supplement England & Wales 1961 Life Tables)."

H (I) On 29 November 1978 the Respondents obtained an actuarial report from T.A. Warren, partner in Messrs. Lane, Clark & Peacock, with Burton & Co., actuaries. The following is a copy:

"Dear Sirs, The Lewis Bermuda Settlement

1. I am instructed that by a settlement dated 16 March 1968 a Fund was placed in Trust by Mrs. Hannah Elsie Lewis. The ultimate

distribution of the Fund is determined under Clause 4 of the Deed whereby the Trustees may stand possessed of the Trust Fund on the Perpetuity Date on the following terms: A

(a) in trust absolutely for such of the grandchildren and remoter issue of the Settlor as are living on the Perpetuity Day and if more than one in equal shares per stirpes

(b) subject to the trusts in sub-paragraph (a) in trust for the Settlor's children now living in equal shares absolutely. B

2. The Perpetuity Day was defined as the day on which expires the period of twenty-one years calculated from and after the death of the last survivor of the descendants of His late Majesty King George the Fifth living at the date of the Settlement.

3. I am asked to make certain calculations as at 1 January 1970 regarding the interests in 1(a) above of the beneficiaries therein specified who at that date were: C

Richard Lewis	born	18	4	1959	
Fiona Lewis	born	1	6	1961	
Edward Lewis	born	15	3	1966	D
Anthony Page	born	2	2	1962	
Catherine Page	born	9	4	1964	

4. The Fund on the 5th April 1970, being the nearest convenient date to the valuation date for which records are available consisted of a portfolio of British, European and United States securities valued at £56,971 and £9,908 cash making a total of £66,879. E

5. I have calculated in the first place the actuarial probability that each of the beneficiaries specified above will survive to the Perpetuity Day as follows:

	Chances in one million		
Richard Lewis		5	F
Fiona Lewis		35	
Edward Lewis		100	
Anthony Page		20	
Catherine Page		161	

6. I have also calculated, ignoring the possibility of remoter issue of the Settlor being alive on the Perpetuity Date, the approximate values on 1 January 1970 at rates of interest of 4% and 7% of each beneficiary's interest in the amount of the fund. G

	4% values	7% values	
Richard Lewis	less than 1 penny	less than 1 penny	
Fiona Lewis	6 pence	less than 1 penny	H
Edward Lewis	15 pence	1 penny	
Anthony Page	3 pence	less than 1 penny	
Catherine Page	26 pence	2 pence	

I am, Yours faithfully,"

A 7. It was contended on behalf of Mr. Lewis that:—

(a) while persons having interests under s 42(2) of the Finance Act 1965 are not confined to life tenants and reversioners, they nevertheless only include persons with “fixed interests”, as opposed to persons who are objects of a discretionary trust or power;

B (b) the only interests of the beneficiaries in the present case should be ignored as “de minimis”;

(c) alternatively, if discretionary objects are to be included, the values of their interests in the present case are microscopic, and it would not be just and reasonable to apportion any part of the gains to any of them;

(d) the proper and fair course, as indicated by the provisions of s 42(3) and (4) is to wait and see;

C (e) the letter of 18 March 1978, being only precatory, cannot turn mere rights to be considered by the trustees into “interests” within the meaning of s 42(2) or affect the value of the interests of the beneficiaries;

(f) the appeals should be upheld and all the assessments discharged.

8. It was contended on behalf of H.M. Inspector of Taxes that:

D (a) section 42(2) enacts that the whole of the relevant gain must be apportioned; the only “drop-out” of any part of that gain takes place where one or more of the beneficiaries, among whom it is apportioned, are neither resident nor ordinarily resident in the United Kingdom;

E (b) there is no conflict in s 42(2) between the direction to apportion “in such manner as may be just and reasonable” and the direction to apportion “as near as may be, according to the respective values of those interests”; read together, they show the prime consideration to be that the manner should, as between apportionees, be equitable; and that broad and relative values, as distinct from rigid mathematical computations, should be adopted;

F (c) objects of a discretionary power are within s 42(2), giving “interest” a wide sense; s 42(3) and (4) only come into play for quantification purposes: *Gartside v. Inland Revenue Commissioners* [1968] AC 553 was distinguishable;

(d) great weight should attach to the letter of 18 March 1968, because it is proper to infer that the trustees will conform to its tenor, and no apportionment that disregarded it could be reasonable or just;

(e) taking a broad commonsense view and applying the maxim “Equality is Equity”, the gains should be apportioned equally between the five minors;

G (f) the equity of the latter approach is in line with s 42(5);

(h) the appeals should be dismissed and all the assessments confirmed.

H 9. The following cases were cited to us:—*Gartside v. Inland Revenue Commissioners* [1968] AC 553; *Burrell and Kinnaird v. Attorney-General* [1937] AC 286; *Cape Brandy Syndicate v. Commissioners of Inland Revenue* 12 TC 358; [1921] 2 KB 403; *Vestey v. Commissioners of Inland Revenue* 54 TC 503; [1980] AC 1148.

10. We, the Commissioners who heard the appeal, took time to consider our decision and gave it in writing on 6 April 1979. A copy of the decision is annexed.

11. The Appellant, immediately after the determination of the appeal, declared to us her dissatisfaction therewith as being erroneous in point of law and on 24 April 1979 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s 56, which Case we have stated and do sign accordingly. A

12. The question of law for the opinion of the Court is whether our decision was erroneous in point of law. B

B. James }
J.D.R. Adams } Commissioners for the Special Purposes
of the Income Tax Acts

Turnstile House,
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18 March 1980

Decision

These are appeals by the parents and guardians of five minors against assessments for capital gains arising under the settlement of 16 March 1968. As the trustees are neither resident nor ordinarily resident in the United Kingdom, the claim is made by the Inland Revenue under s 42(1) of the Finance Act 1965 on the grounds that beneficiaries having "interests" within the meaning of s 42(2) are assessable to apportioned parts of the gain. The question before us is whether the claim is well founded. D

The material provisions of the settlement may be summarised as follows. By clause 2, capital and income is held upon such trusts for such members of a class as the trustees may appoint. The class includes (among others) all the settlor's grandchildren and remoter issue born within the defined perpetuity period. Clause 3 gives the trustees power to pay or apply income to or for any of the class, or to accumulate it. Under clause 4, any funds undistributed at the close of the perpetuity period go to: (a) such of the grandchildren and remoter issue of the settlor then living *per stirpes*; (b) subject thereto, to the settlor's son and daughter equally. Clause 6(10) gives the trustees power to apply capital or income for the benefit of any person aged under 21. E F

The settlement of 16 March 1968 was followed by a letter to the trustees dated 18 March 1968, in which the settlor and her husband expressed their wishes (without imposing any obligation) that, in short, no grandchild should receive income before reaching the age of 21 years, or capital before 30 years, and that in so far as the trust funds should not be exhausted by payments to grandchildren the latter's issue should be regarded as the main beneficiaries. G

To date, no distribution of capital or income has been made, and the only potential beneficiaries in existence are the five minors, who are the settlor's grandchildren, and their respective parents and guardians, Mr. Lewis and Mrs. Page, who are the settlor's son and daughter. H

The Appellants and the Crown have put in the reports of their respective expert witnesses. The reports of the two actuaries (Mr. Warren for the Appellants and Mr. Kablean for the Crown) have been read to us. By different

- A routes both experts reach the conclusion that the market values of the interests of the remaindermen are nil or negligible. Mr. Kablean also gives the proportional percentage for each grandchild's chance of attaining the age of 30 as slightly under or over 20 per cent. according to age or sex. It is clear that if and when any of the minors receives a distribution of income or capital that minor will be assessable to an apportioned part of any chargeable gains, under s 42(3) (a) or (b) as the case may be. Until such a distribution, Mr. Lawton, Counsel for the guardians, submits that the minors are not assessable, on various grounds. First, while persons having interests under subs (2) are not confined to life tenants and reversioners, they nevertheless only include persons with "fixed" interests, as opposed to persons who are objects of a discretionary trust or power. Second, if discretionary objects are to be included, the values of their interests in the present case are microscopic, and it would not be just and reasonable to apportion any part of the gains to any of them. Third, the proper and fair course, as indicated by the provisions of subs (3) and (4) is to wait and see. Fourth, the letter of 18 March 1978, being only precatory, cannot turn mere rights to be considered by the trustees into "interests" within the meaning of subs (2) or the value thereof.
- D Mr. Jackson, on behalf of Solicitor of Inland Revenue, argues as follows. First, the whole gain must be apportioned, the only beneficiaries exempted being those neither resident nor ordinarily resident. Second, there is no conflict between the two limbs of the apportionment direction in subs (2), which should be construed as apportionment in a broad and equitable manner. Third, notwithstanding *Gartside v. Inland Revenue Commissioners* [1968] AC 553 objects of a discretionary power are within subs (2), giving "interest" a wide sense. The two cases of *Vestey v. Commissioners of Inland Revenue* 54 TC 503 are examples of discretionary interests which are very valuable. Subsections (3) and (4) therefore only come into play for quantification purposes. Fourth, great weight should attach to the letter of 18 March 1968, because it is proper to infer that the trustees will conform to its tenor. Fifth, the gains should be apportioned equally between the five minors, taking a broad commonsense view and applying the maxim "Equality is Equity". Sixth, the equity of the above approach is in line with subs (5), whereby any capital gains tax payable by a beneficiary, if paid by the trustees, is not to be regarded as payment to the beneficiary. Mr. Jackson said that it can be assumed that the trustees will appoint funds to cover the beneficiaries' capital gains tax liability and subs (5) prevents that appointment attracting any further capital gains tax.

Having considered the rival contentions we have reached the conclusion that the appeals should succeed, for the following reasons:

- H (a) The only benefit that could constitute a "fixed" interest under the settlement would be the possibility of participating in any distribution of unappointed residue under clause 4. That possibility is so remote and of so little value (if any) at this stage that it should in our view be ignored. Where the value of an interest is negligible, the "just and reasonable" course is not to appoint any part of the gain to that interest.
- I (b) As to what constitutes an "interest" for the purpose of s (2) we think we should apply the reasoning in *Gartside*. That case, though concerned with a particular estate duty provision, does indicate that the right of a discretionary object does not amount to an interest in the fund in question. That view is,

we think, also consistent with the way in which discretionary payments are dealt with in subs (3)(a) and (b). In our view the decisions in the *Vestey* cases⁽¹⁾ do not throw any light on the meaning of "interest" in s 42(2). On this aspect we derive no assistance from subs (5) and we do not accept Mr. Jackson's sixth argument. We accept Mr. Lawton's first argument. A

(c) Other benefits which could accrue to the minors under clauses 2, 3 or 6(10) will most probably accrue along the lines suggested in the letter of 18 March 1968. But the letter imposes no legal obligation on the trustees and cannot therefore, in our view, affect the value of the beneficiaries' right to be considered by the trustees for possible benefit. Until an occasion arises on which a distribution in favour of a particular minor is exercised, the as yet unknown appointee, even if (contrary to the conclusion above) he has an "interest", cannot be said in our view to have at this stage an "interest" in the settled funds sufficiently identified or one capable of quantification or valuation. B
C

The effect of the Board's approach has been to treat the situation which is likely to obtain if the wishes expressed in the letter of 18 March 1968 are broadly carried out as though it had already occurred. That we think is at this stage too hypothetical and an unjustified anticipation. Accordingly, even if the minors have an "interest" at present, its value is nil or negligible and therefore the "just and reasonable" course is not to appoint any part of the gain to the minors at present. If there are distributions of capital or income to the beneficiaries in future the Inland Revenue will have the opportunity to apportion the gains to them under subs (3). D

Accordingly we allow the appeals and discharge the assessments. E

B. James }
J.D.R. Adams } Commissioners for the Special Purposes
of the Income Tax Acts

Turnstile House,
94-99 High Holborn,
London WC1V 6LQ F

6 April 1979

Pearson v. R.C. Page. The Case stated in this appeal was in all material respects identical to the above Case.

CASE

Stated under the Taxes Management Act 1970, s 56, by the Commissioners for the General Purposes of the Income Tax, for the Division of South Birmingham, in the Metropolitan County of the West Midlands, for the opinion of the High Court of Justice. G

1. At a meeting of the said Commissioners, held at Ladywood House, 45-46, Stephenson Street, Birmingham 2, on 15 March 1977, Mrs. S.M. Toovey (hereafter called the "Appellant") appealed against an assessment to H

A capital gains tax in the sum of £6,840 made upon her for the year 1970-71 under the provisions of s 42 (2) of the Finance Act 1965.

2. The Appellant was represented at the hearing by a Mr. Skellum, a member of the firm of Trevor Jones and Co., chartered accountants.

3. The following document was admitted and is appended to this case⁽¹⁾:—extract from A.A.P. Southall settlement trust deed of 16 March 1966. It was agreed between the parties that the document contained all the material provisions of the said deed.

4. The following facts were admitted or proved:—

(a) The Appellant is one of five beneficiaries, each of whom was at all material times resident and ordinarily resident in the United Kingdom, and each of whom has interests in the property which was on 16 March 1966 settled, by means of the above-mentioned settlement, by a settlor who was at all material times domiciled, resident and ordinarily resident in the United Kingdom.

(b) The trustees of the said settlement were at all material times resident and ordinarily resident in Jersey in the Channel Islands.

(c) During the year of assessment 1970-71 the said trustees would, if in that year domiciled and either resident or ordinarily resident in the United Kingdom, have been chargeable to capital gains tax under s 20 (4) of the Finance Act 1965 on a chargeable gain of £34,204.

(d) There being no other beneficiaries having interests in the settled property, the assessment under appeal (and likewise each of the four assessments raised on the other four beneficiaries) had been computed by apportioning the said amount of £34,204 equally between the Appellant and each of the four other beneficiaries.

5. It was contended on behalf of the Appellant:—

(a) that for the purposes of assessment to capital gains tax the amount of the capital gain had not been apportioned in such a manner as was just and reasonable in accordance with s 42 (2), Finance Act 1965;

(b) that the appeal hearing be adjourned.

6. It was contended by H.M. Inspector of Taxes:—

(a) that on the evidence adduced the proper inference to be drawn was that none of the five beneficiaries had an interest in the settled property which was either more or less valuable than that of any of the other four;

(b) that it was accordingly just and reasonable to apportion one-fifth of the said amount of £34,204, in accordance with the provisions of s 42 (2) of the Finance Act 1965, to the Appellant and to each of the other four beneficiaries;

(c) that the assessment on the Appellant should be confirmed.

7. We, the Commissioners who heard the appeal, held that the chargeable gain was properly assessable on the Appellant under the provisions of s 42, Finance Act 1965, and that the apportionment equally between the five

⁽¹⁾ Not included in the present print.

beneficiaries was just and reasonable. We accordingly determined the assessment in the sum of £6,840. A

8. Following our determination of the appeal, dissatisfaction therewith was expressed on behalf of the Appellant, who subsequently required us to state a case for the opinion of the High Court, which case we have stated and do sign accordingly.

9. The question of law for the opinion of the Court is whether on the facts and evidence before us our decision as set out in para 7 was correct in law. B

17 February 1978

R.A. Southall v. Pepper; S.J. Southall v. Pepper; M.T. Southall v. Pepper and *P.T. Southall v. Pepper*. The Cases stated in these appeals were in all material respects identical to the above Case. C

The cases were heard in the Chancery Division before Dillon J. on 10 and 11 July 1980 when judgment was reserved. On 18 July 1980 judgment was given in each case in favour of the Crown with no order as to costs where the Crown was Appellant and with costs otherwise.

C.H. McCall for the Crown. D

J.P. Lawton for Mr. Lewis and Mr. Page.

D.G. Goldberg for the other taxpayers.

The following cases were cited in argument in addition to those referred to in the judgment:—*Attorney-General v. Farrell* [1931] 1 KB 81; *Commissioner of Stamp Duties (Queensland) v. Livingston* [1965] AC 694; *Ronald Arthur Vestey v. Commissioners of Inland Revenue* 54 TC 503; [1979] 3 WLR 915; *Rose v. Humbles* 48 TC 103; [1972] 1 WLR 33; *Burston v. Commissioners of Inland Revenue (No. 1)* 24 TC 285. E

Dillon J.—I give judgment first in the two cases of *Leedale v. Lewis and Pearson v. Page*. These two cases are appeals by the Crown against decisions of the Special Commissioners, who discharged assessments to capital gains tax raised under s 42 of the Finance Act 1965. Both appeals concern the same settlement and what the Crown is seeking to do under s 42 is to apportion to minor beneficiaries under the settlement the capital gains tax which would have been recoverable from the trustees of the settlement if the trustees had been resident in the United Kingdom. F

Capital gains tax was first imposed by the Finance Act 1965. The gains taxed are referred to as chargeable gains accruing to a person on a disposal of assets, and under s 20(4) the tax is to be charged on the total amount of chargeable gains accruing to the person chargeable in the year of assessment. So far as trustees are concerned, s 25(1) of the Act provides: G

“In relation to settled property, the trustees of the settlement shall for the purposes of” the Act “be treated as being a single and continuing H

A body of persons (distinct from the persons who may from time to time be the trustees), and that body shall be treated as being resident and ordinarily resident in the United Kingdom unless the general administration of the trusts is ordinarily carried on outside the United Kingdom and the trustees or a majority of them for the time being are not resident or not ordinarily resident in the United Kingdom."

B Obviously, there would be difficulties if the Crown sought to bring proceedings abroad to recover capital gains tax from trustees who are not resident in the United Kingdom. Accordingly, s 42(1) of the Act provides:

C "This section applies as respects chargeable gains accruing to the trustees of a settlement if the trustees are not resident and not ordinarily resident in the United Kingdom, and if the settlor, or one of the settlors, is domiciled and either resident or ordinarily resident in the United Kingdom, or was domiciled and either resident or ordinarily resident in the United Kingdom when he made his settlement."

It is not in dispute that the conditions of s 42(1) are satisfied in relation to the settlement with which I am concerned. That settlement was made on 16 March 1968 by a Mrs. Lewis, a married woman, of Leatherhead in Surrey, as settlor. The original trustee was the Bank of Butterfield in Bermuda. The present trustee is a trust company of the Bank of Butterfield, also in Bermuda. Clause 1 of the settlement contains definitions. Apart from common-form definitions of the trustees and the trust fund, the specified class is defined by reference to a second schedule as meaning the grandchildren and remoter issue of the settlor, and their wives, husbands, widows and widowers, whether in being at the date of the settlement or born before the perpetuity day. The perpetuity day is defined as meaning the day on which expires the period of 21 years calculated from and after the death of the last survivor of the descendants of his late Majesty King George V living at the date of the settlement. By clause 2 of the settlement it is provided:

F "The Trustee shall stand possessed of the Trust Fund and the income thereof upon such trusts for the benefit of the members of the Specified Class or any one or more of them to the exclusion of the other or others in such shares and proportions and subject to such terms limitations and provisions as the Trustee shall from time to time by deed or deeds . . . executed before the Perpetuity Day but without infringing the rule against perpetuities appoint."

G By clause 3(a) it is provided:

H "The Trustee may until the Perpetuity Day pay or apply the whole or such part if any as it shall think fit of the income of the Trust Fund as it arises to or for the benefit in any manner of the members of the Specified Class for the time being in existence or any one or more of them to the exclusion of the other or others and in such shares and in such manner and upon such terms and conditions (if any) as the Trustee shall in its discretion from time to time think proper and so that no such payment or application shall give any right to enjoyment of any future income of the Trust Fund."

I By clause 3(b) it is provided: "The Trustee shall until the Perpetuity Day deal with the income of the Trust Fund or so much thereof as shall not be paid or applied as aforesaid" by accumulating it at compound interest and adding the accumulations to the capital of the trust fund. By clause 4 it is provided that in default of appointment, and in so far as any appointment shall not extend, the

trustee shall stand possessed of the Trust Fund on the perpetuity day upon the trusts set forth in the third schedule; that is to say, "in trust absolutely for such of the grandchildren and remoter issue of the Settlor as are living on the Perpetuity Day and if more than one in equal shares per stirpes", and, subject thereto, in trust for the settlor's children living at the date of the settlement in equal shares absolutely. The settlor's children living at the date of the settlement were Mr. Lewis and Mrs. Page. There are five grandchildren of the settlor in being, three being children of Mr. Lewis and two of Mrs. Page. All five were minors in the relevant years of assessment. The settlor wrote a letter to the trustees immediately after the creation of the settlement, in terms which are merely precatory and in no way binding on the trustees, in which she expressed the wish that the trustees would regard her grandchildren as the primary beneficiaries under the settlement. She envisaged that each child might receive income on attaining 21 and capital, in the absence of special circumstances, on attaining 30.

Down to the end of the years of assessment with which I am concerned, the trustees had not exercised their overriding power of appointment under clause 2 at all; nor had they made any distribution of income in the exercise of their discretion under clause 3(a). Instead, all income had been accumulated under clause 3(b). The law of Bermuda contains no statutory restrictions on accumulations like s 164 of the Law of Property Act 1925. The trustees did however realise certain capital gains, and the claim of the Crown is to apportion those gains under s 42 of the 1965 Act in equal fifths between the five grandchildren. This the Crown did by assessing the fathers in respect of their children's liabilities. Nothing turns on that part of the machinery; the assessments can be regarded as if they were assessments on the grandchildren themselves. The details of the gains do not matter—they were modest in amount—and the case has been opened to me by Mr. McCall as a test case on the operation of s 42. I therefore turn to that section.

Subsection (2) is the operative subsection. It is a subsection which I do not find at all easy to understand or apply, not least because it is attempting to cater in a very few lines with the whole multifarious range of conceivable trusts. Subsections (3) and (4) cast some light on the operation of subs (2), but the remaining subsections of s 42 do not assist. I therefore read subs (2), (3) and (4). Subsection (2):

"Any beneficiary under the settlement who is domiciled and either resident or ordinarily resident in the United Kingdom during any year of assessment shall be treated for the purposes of this Part of this Act as if an apportioned part of the amount, if any, on which the trustees would have been chargeable to capital gains tax under section 20(4) of this Act, if domiciled and either resident or ordinarily resident in the United Kingdom in that year of assessment, had been chargeable gains accruing to the beneficiary in that year of assessment; and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion, and so that the chargeable gain is apportioned, as near as may be, according to the respective values of those interests, disregarding in the case of a defeasible interest the possibility of defeasance."

Subsection (3):

"For the purposes of this section—(a) if in any of the three years ending with that in which the chargeable gain accrues a person has received a payment or payments out of the income of the settled property

- A made in exercise of a discretion he shall be regarded, in relation to that chargeable gain, as having an interest in the settled property of a value equal to that of an annuity of a yearly amount equal to one-third of the total of the payments so received by him in the said three years, and (b) if a person receives at any time after the chargeable gain accrues a capital payment made out of the settled property in exercise of a discretion, being
- B a payment which represents the chargeable gain in whole or part then, except so far as any part of the gain has been attributed under this section to some other person who is domiciled and resident or ordinarily resident in the United Kingdom, that person shall, if domiciled and resident or ordinarily resident in the United Kingdom, be treated as if the chargeable gain, or as the case may be the part of the chargeable gain represented by
- C the capital payment, had accrued to him at the time when he received the capital payment.”

Subsection (4):

- “In the case of a settlement made before 6th April 1965—(a) subsection (2) of this section shall not apply to a beneficiary whose interest is solely in the income of the settled property, and who cannot, by means of the exercise of any power of appointment or power of revocation or otherwise, obtain for himself, whether with or without the consent of any other person, any part of the capital represented by the settled property, and (b) payments of capital gains tax chargeable on a gain apportioned to a beneficiary in respect of an interest in reversion in any part of the capital represented by the settled property may be postponed until that person becomes absolutely entitled to that part of the settled property, or disposes of the whole or any part of his interest, unless he can, by any means described in paragraph (a) above, obtain for himself any of it at any earlier time.”
- D
- E

- Subsection (4) shows that under a post-1965 settlement (i) a beneficiary whose interest is in income only may none the less have to pay some proportion of capital gains tax and (ii) a capital beneficiary may have to pay capital gains tax while his interest in the trust capital is still an interest in remainder and the capital has not yet become distributable. The final words of s 42(2), which require that in the case of a defeasible interest the possibility of defeasance shall be disregarded, seem, if unqualified, to be well capable of causing hardship in that the holder of a defeasible interest is *prima facie* to be taxed without regard to the possibility of defeasance, even though in actual fact the probability of defeasance is overwhelming. Indeed, it would appear that the only effect of these words must be to tax the holder of a defeasible interest by reference to a value which is greater than the value of what he actually has. Mr. McCall has none the less contended that the Court should give the term “defeasible interest” a very wide meaning as comprehending all contingent interests. In other words, he submits that all contingencies must be treated as already satisfied, and the holders of merely contingent interests must, however remote the contingencies, be treated as holders of absolute vested interests. This I decline to accept. Parliament has seen fit to use the phrase “a defeasible interest”, which is a well-known technical phrase, and there is no basis for extending the meaning of that phrase beyond its ordinary signification. These final words of s 42(2) do however have the effect, in relation to the present settlement, that any interest in default of appointment is to be considered without regard to the possibility that it will be defeated by a future exercise of the trustees’ overriding power under clause 2 of the settlement.
- F
- G
- H
- I

Mr. McCall attaches importance to the generality of the opening words of s 42(2)—“Any beneficiary under the settlement who is domiciled and either resident or ordinarily resident in the United Kingdom during any year of assessment shall be treated”, etc. As I read the subsection, however, the first half is merely introductory. The operative provision is in the second half, beginning with the words “and for the purposes of this section”. I would add that, as under the final words the possibility of defeasance of a defeasible interest is to be disregarded, any beneficiary who took merely by way of defeasance of a defeasible absolute interest could not be taxed despite the generality of the opening words. The words “Any beneficiary under the settlement” cannot therefore be read literally so as to include all beneficiaries. Under the second half of s 42(2) the amount referred to is to be apportioned “between persons having interests in the settled property . . . according to the respective values of those interests”. It is therefore necessary to consider what the interests of the relevant beneficiaries are within the contemplation of s 42(2). In particular, do the interests of the five grandchildren include their respective rights or expectations as possible objects of the trustees’ discretionary powers over income under clause 3(a) or of the trustees’ overriding power of appointment under clause 2?

It was held long ago in *Attorney-General v. Heywood* (1887) 19 QBD 326, that in an appropriate context the rights of an object of a discretionary trust may amount to an interest in settled property for the purposes of a taxing Act. By contrast, in *Gartside v. Inland Revenue Commissioners* [1968] AC 553, the context indicated, particularly because the quantum of duty imposed was related to the extent of the interest, that an object of a discretionary trust did not have an interest in the settled property. The context in the present case is not the same as the context in *Gartside*, but analogous reasoning is applicable. The context shows that the interest must have a value, and the rights of a mere object of a discretionary trust of income or of a power of appointment cannot have a value. Therefore, such rights cannot amount to an interest in the settled property within the meaning of s 42(2). This conclusion is underlined by s 42(3)(a). Where a person has received a payment or payments out of income of settled property in the exercise of a discretion, two things are to happen under s 42(3)(a): firstly, he is to be regarded as having an interest in the settled property, and, secondly, there is machinery provided for valuing that interest as if it were an annuity. But where, as here, he has not received any payment of income under the discretion, his rights as an object of the discretion do not amount to an interest in the settled property within the meaning of s 42(2). It follows that the only interests of the grandchildren in the present case for the purposes of s 42(2) are their contingent interests in capital under clause 4 of the settlement, contingently on their being alive on the perpetuity day. In the evidence before the Special Commissioners, the Respondents’ actuary, Mr. Warren, put the chances of the grandchildren surviving to the perpetuity day at from 5 to 161 chances in 1,000,000. Mr. Kablean, the Crown’s actuary, did not consider quite the same questions, but he estimated the value of the grandchildren’s interests at $\frac{1}{2}$ p. each having regard to the length of the period before the perpetuity day and the possibility of the trustees exercising their overriding powers.

I come, therefore, after these preliminaries, to what I regard as the most difficult question in this case. Mr. McCall says that the section is mandatory in requiring that the whole amount of the chargeable gain must be apportioned between “persons having interests in the settled property”. Therefore he says that as (1) the five grandchildren have interests in the settled property, and as (2) in the years of assessment there was no-one else in being who had an

- A interest in the settled property, apart from the very remote interest of the settlor's two children, and as (3) the interests of the five grandchildren are of broadly equal value, the chargeable gains of the trustees must be apportioned equally between the five. Mr. Lawton, for the Respondents, points, however, to the words "just and reasonable" in the second half of s 42(2). He submits that the contentions of the Crown fail to give any effect to these important
- B words and that the only just and reasonable course is not to apportion any part of the gain to interests so microscopic as the contingent interest in capital of each of these grandchildren under clause 4 of the settlement. That submission was accepted by the Special Commissioners and Mr. Lawton accordingly submits alternatively that the question what is just and reasonable is a question of fact on which the Special Commissioners' conclusion is unappealable. Mr.
- C Lawton further submits that on any consideration of what is just and reasonable the settlor's letter to the trustees must be disregarded because it is merely precatory and does not give the grandchildren any rights; and the possibility of the grandchildren receiving benefits by appointment under clause 2 must also be disregarded.

- D Since Parliament has expressly provided in the subsection that there is to be an apportionment "in such manner as is just and reasonable", it would be a very drastic course to adopt a construction of the subsection which necessarily denied all effect to those words. But the subsection expressly provides that as between the persons concerned the apportionment is as near as may be to be according to the respective values of their interests. There is thus no margin for justice and reason to operate in relation to the values of the interests of those
- E persons. I can therefore see no scope left in the section for what is just and reasonable unless those words are to govern the selection of the persons, with interests under the settlement, between whom the amount of the chargeable gain is to be apportioned.

- F Accordingly, in my judgment it would be permissible to limit the apportionment to those persons with interests, albeit contingent, in the settled property who were likely to take income or capital, and to exclude others with microscopically remote interests if it was not just and reasonable to include them in the apportionment. It must, in my judgment, follow that there could be cases in which justice and reason would require that there be no apportionment at all because the interests of those with interests, within the meaning of s 42(2), in the settled property are too remote; for instance, if
- G the only persons interested within the meaning of the subsection were charities entitled at the end of a long accumulation period, such as that in clause 3(b) of the present settlement, and only then entitled subject to and in default of exercise of overriding powers of appointment and discretionary powers exclusively for the benefit of members of the settlor's family, such as those in clauses 2 and 3(a) of the present settlement.

- H But justice and reason are very wide concepts, and the apportionment under s 42(2) is to be between the persons who have interests in the settled property, and not just between their interests. I cannot therefore see why the prospects of the minors receiving benefits under clause 3(a) and clause 2, and the precatory wishes expressed by the settlor in her letter, should not be taken into account in considering whether it is just and reasonable that there should
- I be apportionment of the amount of the capital gain between the five grandchildren in the proportions of the values of their interests under clause 4.

Under s 42(4) it is clearly envisaged that, with a settlement made after 6 April 1965, some part of a capital gain may be apportioned to and be payable

by a capital beneficiary, including, as it seems to me, a beneficiary only contingently entitled, notwithstanding that the capital is not presently distributable. I see nothing less just or less reasonable in apportioning this gain to these grandchildren. The Special Commissioners have themselves found that other benefits will most probably accrue to the grandchildren along the lines suggested in the settlor's letter. These prospects of the grandchildren are not marketable and do not themselves amount to an interest in the settled property. But I do not see why they should be disregarded in considering the justice and reason of applying the section to the interests in the settled property which the grandchildren admittedly have. Section 42(4) indicates the clear contemplation of the section that a beneficiary who is to take capital may be taxed before he takes the capital, and it seems to me that apportionment to the grandchildren is not an unjustified anticipation if all the prospects of the grandchildren are taken into account. I conclude, therefore, that the Special Commissioners misdirected themselves in law in considering only the grandchildren's interests in capital under clause 4, and that these appeals should be allowed. There is nothing in the settlement or in the settlor's letter to suggest division among the grandchildren otherwise than *per capita*. On the evidence of both actuaries the differences in value between the respective interests of the grandchildren are either nil or minimal. Accordingly, the only solution is that the gain should be apportioned to the five grandchildren in equal fifths. The original assessments should therefore be restored and confirmed.

I give judgment now on the five appeals of Mrs. Toovey and the four Southalls. These are appeals by the taxpayers against decisions of the General Commissioners for the South Birmingham Division who upheld assessments to capital gains tax raised under s 42 of the Finance Act 1965 and approved the apportionment of the amount of a chargeable gain equally between the five living beneficiaries, the five Appellants, under the relevant settlement. By an obvious error, the wrong settlement was initially appended to the Case Stated, but I gave leave for the Case to be amended by substituting the correct settlement. That is a settlement dated 16 March 1966 and made by a Mr. Southall, who is domiciled and resident in England, as settlor. The original trustees were also domiciled and resident in England, but Channel Islands trustees were appointed, and it is the Channel Islands trustees who were the trustees at the material time and who realised the capital gains which the Crown seek to apportion among the persons having interests in the settled property. It is not in dispute that the conditions of s 42(1) are satisfied.

The settlement provided for a trust period which was to be the period of 80 years from the date of the settlement but determinable at any time by the trustees by written declaration. The beneficiaries were defined as being all children and remoter issue of the settlor living at the date of the settlement, or born during the trust period, and their spouses, widows and widowers, with a possible extension to include a widow of the settlor. The beneficial trusts were declared by clause 4. Under clause 4(A), the trustees were to hold the trust fund

“upon such trusts and with and subject to such powers and provisions and in such manner generally for the benefit of all or any one or more exclusively of the others or other of the Beneficiaries as the Trustees . . . shall at any time or from time to time before the expiry of the Trust Period by any deed or deeds revocable or irrevocable appoint.”

By clause 4(B) “subject as aforesaid” the trustees were to hold the trust fund

- A “upon trust during The Trust Period to pay or apply the income of the Trust Fund to or for the benefit of all or any one or more exclusively of the other or others of the Beneficiaries for the time being in existence and ascertained in such shares and manner generally as the Trustees shall in their discretion from time to time determine but so that for a period of Twenty-one years from the date” of the settlement “it shall be lawful for the Trustees to accumulate all or any part of such income in augmentation of the capital of the Trust Fund in lieu of paying or applying the same under the foregoing trust.”

By clause 4(C) the trustees were to hold the trust fund

- C “subject as aforesaid upon trust as to income and capital in equal shares if more than one for all or any the children or child of the Settlor living at the end of the Trust Period and for all or any of the issue then living of any child of the Settlor who shall earlier have died such issue to take through all degrees according to their stocks in equal shares if more than one only the shares which their parent would have taken if living at the end of The Trust Period and so that no issue shall take whose parent is, living at the end of the Trust period and so capable of taking.”
- D By clause 4(D) the trustees were to hold the trust fund, “subject as aforesaid upon trust as to income and capital for such of the children of the Settlor as are living at the date” of the settlement “and if more than one in equal shares absolutely”.

- E The taxpayer and Appellants are, I understand, all the children of the settlor. There had by the relevant year of assessment been no appointment of capital under clause 4(A) or distribution of income under clause 4(B). There is no letter from the settlor to the trustees, but in no other respect is there any conceivably relevant difference between this settlement and the settlement which I have had to consider in the cases of *Leedale v. Lewis* and *Pearson v. Page*. The General Commissioners’ conclusion was that the chargeable gain was properly assessable on the Appellants under the provisions of s 42, and the apportionment equally between the five beneficiaries was just and reasonable.
- F That conclusion is unimpeachable in the light of my judgment in *Leedale v. Lewis* and *Pearson v. Page*, and the appeals of Mrs. Toovey and the four Southalls accordingly fail.

- G I should add that while Mr. Goldberg, for these Appellants, adopted the arguments of Mr. Lawton in the other appeals, his main argument was somewhat different from the arguments of Mr. Lawton which I have mentioned. Mr. Goldberg submitted that there should first be an apportionment between income interests generally and capital interests generally; that is to say, income interests as a group including as interests rights as objects of the discretionary trust in clause 4(B), and capital interests as a group including as interests rights as objects of the power of appointment in clause 4(A). There ought then, on Mr. Goldberg’s submission, and if the section is to apply, to be a further sub-apportionment as is just and reasonable of the income group interest and the capital group interest as between the individual beneficiaries with interests in each group. But, Mr. Goldberg submitted, the sub-apportionment could be effected only in so far as any individual beneficiary’s interest had the necessary quality of definable extent to enable it to be taxed. Apart from s 42(3) there is no machinery in the section to enable the extent of an interest as an object of a discretion or power in relation to income or capital to be measured or valued. Accordingly, Mr. Goldberg submitted that the machinery of the section could not be operated so as to

impose any liability on his clients, whose rights or interests included rights under clauses 4(A) and 4(B). I cannot accept this argument. I have already expressed my view of what is an interest within the meaning of s 42(2). Beyond that I can see no warrant for the suggested two-tier or two-stage apportionment and, as I have already commented, the apportionment under s 42 is to be as between persons and not as between interests. As I have already indicated, these appeals fail.

Leedale v. Lewis; Pearson v. Page—Appeals allowed. No order as to costs.

Toovey and Others v. Pepper—Appeals dismissed, with costs.

The taxpayers' appeals were heard in the Court of Appeal (Lawton, Brightman and Fox L.JJ.) on 28 October, 3 and 4 November 1981 when judgment was reserved. On 16 December 1981 judgment in each case was given in favour of the Crown, with costs.

E.G. Nugee Q.C. and C.H. McCall for the Crown.

D.C. Potter Q.C., J.P. Lawton Q.C. and R. Walker for Mr. Lewis and Mr. Page.

D. Goldberg for the other taxpayers.

The following cases were cited in argument in addition to those referred to in the judgment:—*Yuill v. Wilson* 52 TC 674; [1980] 1 WLR 910; *Roome and Denne v. Edwards* 54 TC 359; [1981] 2 WLR 268; *Re Latham* [1962] Ch 616; *F.P.H. Finance Trust Ltd. v. Commissioners of Inland Revenue* 28 TC 209; [1946] AC 38; *Peter Buchanan L.D. and Machary v. McVey* [1955] AC 516; *Government of India Minister of Finance (Revenue Division) v. Taylor* [1955] AC 491; *Mangin v. Inland Revenue Commissioner* [1971] AC 739; *Rank Xerox Ltd. v. Lane* 53 TC 185; [1981] AC 629; *Luke v. Commissioners of Inland Revenue* 40 TC 630; [1963] AC 557; *Ayrshire Employers Mutual Insurance Association Ltd. v. Commissioners of Inland Revenue* 27 TC 331; 1946 SC 1; *Vestey v. Commissioners of Inland Revenue* 54 TC 503; [1980] AC 1148; *Clifforia Investments Ltd. v. Commissioners of Inland Revenue* 40 TC 608; [1963] 1 WLR 396; *In re Gulbenkian's Settlement* [1970] AC 508; *Re Braden* [1971] AC 424; *Attorney-General v. Farrell* [1931] 1 KB 81; *Re Bristols Settled Estates* [1965] 1 WLR 469; *Commissioners of Inland Revenue v. Berrill* 55 TC 429; [1981] 1 WLR 1449; *Customs & Excise v. Top Ten Promotions Ltd.* [1969] 1 WLR 1163.

Fox L.J. (read by **Lawton L.J.**):—The judgment which I am about to read is the judgment of the Court.

There are before us appeals by adult beneficiaries under a settlement made by Mr. A.A.P. Southall and further appeals by the parents of minor beneficiaries under a settlement made by Mrs. H.E. Lewis. The appeals relate to assessments to capital gains tax upon or in respect of those beneficiaries. The cases were heard before Dillon J., who dealt with them, in effect, in one judgment.

A We heard argument in the two groups of cases separately but since substantially the same questions of law arise in all the cases it is again convenient to deal with them in the same judgment. The cases are concerned with the mode of apportionment between beneficiaries resident in the United Kingdom of capital gains realised by non-resident trustees of discretionary trusts.

B We will deal first with the law and then with its application to the two groups of cases. The law is contained in the Finance Act 1965, which imposed the long-term capital gains tax. The crucial enactment is s 42. By s 42(1) the section applies to capital gains accruing to trustees of a settlement if the trustees are not resident and not ordinarily resident in the United Kingdom and if the settlor when the settlement was made was domiciled and either resident or ordinarily resident in the United Kingdom. These conditions are satisfied as regards both the Southall and the Lewis settlements. Sections 42(2), (3) and (4) are in the following terms:

D “(2) Any beneficiary under the settlement who is domiciled and either resident or ordinarily resident in the United Kingdom during any year of assessment shall be treated for the purposes of this Part of this Act as if an apportioned part of the amount, if any, on which the trustees would have been chargeable to capital gains tax under section 20(4) of this Act, if domiciled and either resident or ordinarily resident in the United Kingdom in that year of assessment, had been chargeable gains accruing to the beneficiary in that year of assessment; and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion, and so that the chargeable gain is apportioned, as near as may be, according to the respective values of those interests, disregarding in the case of a defeasible interest the possibility of defeasance. (3) For the purposes of this section—(a) if in any of the three years ending with that in which the chargeable gain accrues a person has received a payment or payments out of the income of the settled property made in exercise of a discretion he shall be regarded, in relation to that chargeable gain, as having an interest in the settled property of a value equal to that of an annuity of a yearly amount equal to one-third of the total of the payments so received by him in the said three years, and (b) if a person receives at any time after the chargeable gain accrues a capital payment made out of the settled property in exercise of a discretion, being a payment which represents the chargeable gain in whole or part then, except so far as any part of the gain has been attributed under this section to some other person who is domiciled and resident or ordinarily resident in the United Kingdom, that person shall, if domiciled and resident or ordinarily resident in the United Kingdom, be treated as if the chargeable gain, or as the case may be the part of the chargeable gain represented by the capital payment, had accrued to him at the time when he received the capital payment. (4) In the case of a settlement made before 6th April 1965—(a) subsection (2) of this section shall not apply to a beneficiary whose interest is solely in the income of the settled property, and who cannot, by means of the exercise of any power of appointment or power of revocation or otherwise, obtain for himself, whether with or without the consent of any other person, any part of the capital represented by the settled property, and (b) payment of capital gains tax chargeable on a gain apportioned to a beneficiary in

respect of an interest in reversion in any part of the capital represented by the settled property may be postponed until that person becomes absolutely entitled to that part of the settled property, or disposes of the whole or any part of his interest, unless he can, by any means described in paragraph (a) above, obtain for himself any of it at any earlier time, and for the purposes of this subsection, property added to a settlement after the settlement is made shall be regarded as property under a separate settlement made at the time when the property is so added.”

The section gives rise, for present purposes, to two questions. The first is the meaning of the word “interest” in s 42(2); does it include the rights of an object of a discretionary power of trustees? The second question concerns the manner in which the apportionment required by the section is to be carried out. We will deal with those questions in turn. The word “interest”, as Lord Reid observed in *Gartside v. Inland Revenue Commissioners* [1968] AC 553 at page 603, is an ordinary English word which is capable of having many meanings. As a matter of language it is certainly wide enough to cover the rights of discretionary objects. These rights are “a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a Court of equity” (see *per* Lord Wilberforce in *Gartside v. Inland Revenue Commissioners (supra)* at page 617). These rights could quite accurately be called an interest in the trust property. Indeed in *Attorney-General v. Heywood* (1887) 19 QBD 326 it was held that the rights of a discretionary object did constitute an interest for the purposes of a taxing statute (the Customs and Inland Revenue Act 1881). In *Gartside v. Inland Revenue Commissioners (supra)* the House of Lords held that such rights did not constitute an interest for the purposes of s 43 of the Finance Act 1940.

In the present case Mr. Goldberg, for the Appellants in the Southall cases accepted that such rights do constitute interests for the purposes of s 42 of the Finance Act 1965. Mr. Potter for the Appellants in the Lewis cases asserted that they did not. Dillon J. held that they did not. The matter must be one of construction of the section considered in the light of the purposes of the statute.

Section 42(2) opens with the words

“Any beneficiary under the settlement who is domiciled and either resident or ordinarily resident in the United Kingdom during any year of assessment shall be treated . . . as if an apportioned part of the amount, if any, on which the trustees would have been chargeable to capital gains tax . . . if domiciled and either resident or ordinarily resident in the United Kingdom . . . had been chargeable gains accruing to the beneficiary . . .”

The Judge regarded those words as introductory and so, in a sense, they are. But, in our view, they are of value in determining the ambit of the section. The words “any beneficiary” are wide. They must, we think, include the object of a discretionary power. Such a person must be a beneficiary under the settlement. He is entitled to the benefit of being considered by the trustees as a potential recipient of the settlor’s bounty. The section then continues

“and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion.”

This is the first reference to “interests” in the subsection. It is so closely connected with the reference to “any beneficiary” in the earlier part of the

A subsection as to suggest that the rights which qualify the holder to the description "beneficiary" would also qualify for the description "interest" for the purpose of the subsection.

Our attention is drawn to the words "whether a life interest or an interest in reversion". We do not think that those words give guidance on the ambit of s 42(2). They are not comprehensive and cannot have been intended to be so.

B There are rights which are clearly "interests" and which are neither life interests nor interests in reversion; for example, an absolute interest which is subject to defeasance by the exercise of a power or upon a specified event; an immediate contingent interest, and a right to income for a term of years certain.

C The main argument which was pressed upon us in support of the contention that discretionary objects do not have interests for the purposes of s 42(2) is to be found in s 42(3). That provision, it is said, establishes a full code in respect of discretionary trusts which are thus removed from the scope of s 42(2) altogether. We do not feel able to accept that. The principle provision is s 42(3)(b). In our opinion that provision is not dealing with all capital payments in exercise of powers. It is, in our view, dealing only with the case where, in the year of assessment in which the gain arose, either there were no beneficiaries who were domiciled and resident or ordinarily resident in the United Kingdom (so that no apportionment could be made under subs (2)) or only some of the beneficiaries were so domiciled and resident or ordinarily resident (so that only part of the gain could be apportioned under subs (2)). We think that the important words in the provision are "except so far as any part of the gain has been attributed under this section to some other person who is domiciled and resident or ordinarily resident in the United Kingdom".

Those words are necessary to give protection against double charging. But if subs (3)(b) is intended to deal comprehensively with all appointments of capital it fails altogether to give protection to an appointee to whom part of the gain had already been apportioned under subs (2) (on account, for example, of a reversionary interest to which he was entitled in the settled property). The language of subs (3)(b) does not cover that. We do not think that is an oversight by the draftsman. It is the consequence of the fact that the draftsman intended the paragraph to apply only to persons to whom no apportionment could have been made under subs (2) when the gain arose either because they were not in existence or were not then United Kingdom residents.

G The present case, in our view, is not like *Gartside v. Inland Revenue Commissioners*⁽¹⁾ (*supra*) where, if the rights of a discretionary object were treated as an "interest", it was not possible to operate the mechanism of the statute because of the need to identify with precision the property on which the interest subsisted; the precise extent of the interest was important. In the present case we are concerned with much more imprecise tests. The apportionment has to be in such manner as is just and reasonable; and the valuation merely "as near as may be". The section, it seems to us, is not contemplating a market value (it merely uses the word "value").

H We should add that it is said that it is not possible at all to give a value to the rights of a discretionary object. In the sense of market value that is true. But within the very broad approach of the section it seems to us that, in practice, the respective values of the discretionary interests *inter se* and of discretionary interests as opposed to fixed interests can be adequately judged.

(1) [1968] AC 553.

The provisions of s 42(3)(a) do not, we think, take the matter much further. They merely quantify the extent of an interest in certain, fairly common, circumstances. If they are consistent with the view that s 42(3) is a code in relation to discretionary trusts they are equally consistent with the contrary view. There is no difficulty, on the assumption that the rights of discretionary objects are "interests" within s 42(2), in applying s 42(3)(a). Suppose that a fund is held upon discretionary trusts for 20 years and subject thereto for B absolutely. And suppose that, in consequence of the provisions of s 42(3)(a), Y is to be treated at the relevant date as being entitled to an annuity of £1,000 *per annum* (being less than the whole income of the fund). The result for the purposes of s 42(2) is that the fund is to be treated as being held upon trust to pay Y's annuity and subject thereto upon the discretionary trusts for 20 years and subject thereto for B absolutely.

Accordingly, we see nothing in the language of s 42 which compels the conclusion that subs (3) is a code in relation to discretionary trusts—which should therefore be regarded as outside the ambit of s 42(2). And looking at the matter more widely, we think it is unlikely that Parliament can have intended such a limitation upon the scope of s 42(2). The statute is imposing a tax upon capital gains. The obvious time for collecting such a tax is in the year of assessment after the gain arose. But under s 42(3)(b) the Revenue could be kept out of its tax for many years after the gain arose. Moreover it is necessary to keep in mind the reality behind the structure of discretionary trusts. A discretionary trust is intended for the benefit of the discretionary objects. If property is settled upon discretionary trusts for the benefit of the children and remoter issue of the settlor and subject thereto for X, it is unlikely that X will ever take anything under the ultimate trust. If a capital gain arises during the subsistence of the discretionary trust it is reasonable that it should be apportioned in the main, if not wholly, to the living discretionary objects. We deal at a later stage with the question of hardship upon beneficiaries of meeting assessments out of their own resources. Our conclusion is that s 42(3) is merely auxiliary to the wider provision of s 42(2) and is not setting up an independent system in respect of discretionary trusts.

We come to the second question. That concerns the mode of apportionment directed by s 42(2). An example of the problem in its most acute form is the following. Suppose a fund is held upon discretionary trusts during a period of 50 years with a trust to accumulate income during 21 years so long as no discretionary object is living, and subject thereto for X (who is not a discretionary object) absolutely. Suppose that a year after the settlement was made and while no discretionary object is living, but there is every likelihood that one or more would be born, a capital gain is realised. Does s 42(2) require that the whole gain be apportioned to X who is the only living person with an interest in the fund? The value of X's interest, by any test, is small; the possibility is that X will receive nothing from the fund at all. Mr. Goldberg for the beneficiaries in the Southall cases contended that, to avoid unfairness a beneficiary with an interest which is subject to an overriding power of appointment should not be required to bear a greater percentage of the gain than the percentage value of his interest in the fund. Thus if, in the example, the value of X's interest is only two per cent. of the value of the fund, there should be apportioned to him not more than two per cent. of the gain. The remainder of the gain would not be apportioned to anybody unless and until an appointment was made which attracted the provisions of s 42(3)(b).

Section 42(2) requires that "an apportioned" part of the amount if any to which the trustees would have been chargeable to capital gains tax under

A s 20(4) if domiciled and either resident or ordinarily resident in the United Kingdom in that year of assessment “be treated... [as] chargeable gains accruing to the beneficiary in that year”. The word “amount” must mean the whole amount of the gain to which the trustees would have been chargeable. The section then continues

B “and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property... and so that the chargeable gain is apportioned as near as may be, according to the respective values of those interests...”.

The word “amount” in this passage clearly has the same meaning as in the earlier part of the subsection.

C In our opinion, therefore, what has to be apportioned is the whole of the amount to which the trustees would have been chargeable. It is that amount which has to be apportioned. That is mandatory; there is no discretion given to any person to alter that. The amount is to be apportioned in such manner as is just and reasonable between persons having interests in the settled property. The words “just and reasonable” relate solely to the mode of apportionment
D between the persons having interests. Thus the words enable account to be taken of the circumstance of the case, for example, the existence of a letter of intent by the settlor as to the manner in which the trustees should exercise their discretionary powers. The words do not, however, alter the total burden to be borne. In short, the section requires that the amount shall be apportioned in such a manner as is just and reasonable; it does not require that such an
E amount as is just and reasonable shall be apportioned.

In our opinion, therefore, the whole of the gain, in the example which we have given, would be assessed upon X (assuming him to be domiciled and resident or ordinarily resident in the United Kingdom at the relevant time). In reaching that conclusion we differ from the view of Dillon J., who at page 695 of his judgment said⁽¹⁾:

F “It must in my judgment follow that there could be cases in which justice and reason would require that there be no apportionment at all because the interests of those with interests, within the meaning of s 42(2), in the settled property are too remote.”

For the reasons which we have indicated, we do not think that is correct. Section 42(2) concludes with the words “and so that the chargeable gain is
G apportioned as near as may be according to the respective values of those interests...” We do not think that the introduction, in this passage, of the words “chargeable gain” is of any significance. In our view it is merely a stylistic change; the draftsman, it seems to us, is still referring to the “amount” previously mentioned in the subsection. As to the general effect of the direction for apportionment as near as may be according to value, we think
H that it is a limitation upon the “just and reasonable” principle. There is to be a just and reasonable apportionment as near as may be according to value. Thus the fact that one beneficiary is poor and another is rich might, purely on a just and reasonable test, result in the apportionment of a larger amount to the rich beneficiary. The reference to value prevents that. On the other hand, the requirement that the apportionment shall be just and reasonable permits
I account being taken of, for example, the likely effect of a letter of intent. Our conclusion is that the whole amount of the chargeable gain must be

(1) [1980] STC 679; page 521 *ante*.

apportioned between the persons having interests in the trust property at the relevant date. The word "persons" in the section must mean living persons; an unborn person cannot, we think, have an "interest" for this purpose. A

We come to the question of hardship. On the construction of s 42 which we have adopted it is possible that a person having a remote interest in the trust property would be required to pay the whole of the tax on a gain realised by the trustees; or that a discretionary object who has received no payment out of the fund will have to bear tax. So far as settlements which were subsisting before the passing of the Finance Act 1965 are concerned, a wide protection is given by the provisions of s 42(4). Insofar as that protection does not extend to certain discretionary beneficiaries (there may be a question whether an object of an immediate discretionary trust of capital could be said to fall within either para (a) or (b) of s 42(4)) the trustees can always give protection to the beneficiary by making an appointment of capital to them with which to pay the tax. As regards settlements executed after the passing of the Finance Act 1965, the settlor himself can always provide protection by directing the trustees to pay any capital gains tax out of the trust property. And if he does not do so, the trustees of a discretionary trust can, so far as a discretionary object is concerned, put him in funds to discharge any tax payable in consequence of an appointment to him. B C D

In general it seems to us that the construction which we have adopted imposes no strain upon the language of the section and is likely to secure, so far as possible, that the tax burden falls upon the persons who, in truth, are likely to be the main beneficiaries of the settlement. We see no reason to put a restrictive construction upon s 42. Settlements created by persons domiciled and resident in the United Kingdom but with trustees abroad are potential instruments of tax avoidance. Section 42 is the recognition of that. It is contended on behalf of the Appellants in the Lewis cases that the section has simply failed in its purpose. The discretionary objects, it is said, do not have "interests" and are therefore outside s 42(2). So far as persons having fixed interests are concerned, it is said that the effects of the section may be so burdensome that Parliament cannot have intended them. We do not accept that. As we have indicated, we think that the language of the section is sufficiently clear. And so far as burdens are concerned, they will result from the deliberate choice of the settlor or of the trustees or both. E F

We come to the facts of the two sets of appeals. The Southall cases—The settlement was made in March 1966 by Mr. Southall. The trusts so far as material were as follows: (1) Upon such trusts for the benefit of any one or more of the beneficiaries as the trustees should before the expiry of the trust period appoint. The beneficiaries were defined, in effect, as the children or remoter issue of the settlor then living or born during the trust period. The latter was the earlier of a period of 80 years from the execution of the settlement or such date as the trustees should declare. (2) Subject as aforesaid, upon trust during the trust period to pay or apply the income of the trust fund to or for the benefit of any of the beneficiaries for the time being living: there was also a power to accumulate during a 21 year period. (3) Subject to the foregoing, upon trust as to both capital and income in equal shares for the children of the settlor living at the end of the trust period with substitutionary provisions for the issue then living of any child then dead. (4) Subject to the foregoing trusts, upon trust for the children of the settlor living at the date of the settlement. G H I

The settlor had had five children—who are the present Appellants. At no time material to any of the issues in this case did he have any remoter issue. No

A appointment has been made by the trustees in exercise of the powers conferred by the settlement. The Appellants were at all material times resident or ordinarily resident in the United Kingdom. The trustees were at all material times resident and ordinarily resident outside the United Kingdom. In the year of assessment 1970–71 the trustees realised certain capital gains.

B The Lewis cases—The settlement was made on 19 March 1968 by Mrs. Lewis. The settlement defined a “Specified Class” consisting of the grandchildren and remoter issue of the settlor their spouses widows and widowers whether then living or born before a perpetuity day (defined by reference to a Royal lives period plus 21 years). The settled property was directed to be held upon such trusts and in such shares for members of the Specified Class as the trustees should appoint before the perpetuity day. The settlement conferred power upon the trustees until the perpetuity day to apply income for the benefit of any of the Specified Class. Subject as aforesaid, the trustees were to accumulate the income until the perpetuity day.

D Subject to the foregoing trusts and provisions, the settled property was to be held upon trust as to both capital and income for the grandchildren and remoter issue of the settlor living on the perpetuity day equally *per stirpes*; and subject thereto for the children of the settlor living at the date of the settlement. There were two children of the settlor living at the date of the settlement. There were five grandchildren living in the relevant year of assessment; they were all at the relevant time domiciled and resident or ordinarily resident in the United Kingdom. The settlor delivered a letter of intent to the trustees indicating that she wished the grandchildren to be regarded as the primary beneficiaries and to receive income at the age of 21 and capital at 30. All income has been accumulated. There has been no material exercise of the power of appointment. The trustees realised capital gains of modest amount in the relevant tax year. The trustees were at all material times resident and ordinarily resident outside the United Kingdom. The five grandchildren were at all material times domiciled and resident in the United Kingdom.

Dillon J. held that: (i) in relation to the Southall settlement that the gain should be apportioned to the five children equally; (ii) in relation to the Lewis settlement, that the gain should be apportioned to the five grandchildren equally.

G Having regard to our conclusions as to the effect of s 42 it seems to us that the Judge reached the correct decision in each case. In our judgment, the whole capital gain fell to be apportioned in each case. And in each case the five beneficiaries were the persons to whom the apportionment properly fell to be made. In the Southall cases they were the only living beneficiaries (whether one treats discretionary objects as having interests or not). There is no reason for distinguishing between them in point of value; the apportionment should be in equal shares.

I The Lewis cases are not, in substance, any different. There are two matters to which we should refer. First, the letter of intent. That reinforces the case in favour of apportionment to the five grandchildren in equal shares. Secondly, the interests of the children. We think, as did the Judge, that these should be disregarded. They are remote, in the extreme, and, particularly having regard to the letter of intent, it is just and reasonable that they should be disregarded. The only living persons who, in the year of assessment, were substantially interested in the trust property were the five grandchildren. There

is no reason for distinguishing between them; the apportionment should be in equal shares. A

Accordingly, we would dismiss the appeals.

Appeal dismissed, with costs. Leave to appeal granted by the Appellate Committee of the House of Lords.

B

The taxpayers' appeals against the above decision came before the House of Lords (Lords Scarman, Wilberforce, Roskill, Fraser of Tullybelton and Brandon of Oakbrook) on 19, 20, 21 and 22 July 1982 when judgment was reserved. On 14 October 1982 judgment was given unanimously in favour of the Crown, with costs in the House of Lords and the Court of Appeal.

P. Horsefield Q.C. and *R. Walker Q.C.* for the taxpayers. C

E.G. Nugee Q.C. and *C.H. McCall* for the Crown.

The following cases were cited in argument in addition to those referred to in the speeches:—*Luke v. Commissioners of Inland Revenue* 40 TC 630; [1963] AC 557; *Chamberlain v. Commissioners of Inland Revenue* 25 TC 317; [1945] 2 All ER 351; *Stanton v. Drayton Commercial Investment Co. Ltd.* 55 TC 286; [1982] 3 WLR 214; *F.P.H. Finance Trust, Ltd. (in liquidation) v. Commissioners of Inland Revenue (No. 2)* 28 TC 209; [1946] AC 38; *W. T. Ramsay Ltd. v. Commissioners of Inland Revenue* 54 TC 101; [1981] 2 WLR 449; *Rank Xerox Ltd. v. Lane* 53 TC 185; [1981] AC 629. D

Lord Fraser of Tullybelton—My Lords, this appeal is concerned with the liability of beneficiaries for capital gains tax on gains realised by trustees of settled property who are not resident in the United Kingdom. It involves construing s 42 of the Finance Act 1965. Section 42 is in Part III of the Act, which is the part that introduced the long-term capital gains tax. Like income tax, it is chargeable on individuals. E

The main charging section is s 20(1) under which a person is chargeable to the tax "in respect of chargeable gains accruing to him in a year of assessment during any part of which he is resident in the United Kingdom, or during which he is ordinarily resident in the United Kingdom". (For brevity, I shall hereafter use "resident" to include ordinarily resident.) So far as trustees are concerned, s 25(1) provides that the trustees of a settlement are to be treated as being a single and continuing body of persons resident in the United Kingdom, unless the general administration of the trust is ordinarily carried on outside the United Kingdom and the trustees or a majority of them for the time being are not resident in the United Kingdom. The case of a United Kingdom settlement, the trustees of which are not resident here, is provided for in s 42. Plainly it required special provision because of the difficulty of recovering the tax from non-resident trustees. The solution adopted in s 42 is to impose the liability which would have been chargeable on the trustees, if they had been resident in the United Kingdom, on the beneficiaries who are resident here. The beneficiaries are not just made responsible for paying tax which is chargeable on the trustees; the beneficiaries themselves are made directly chargeable. That is to say, the section provides machinery of charge and not F G H

A machinery of collection. The issue in the appeal is whether persons who are merely objects of a discretionary power vested in the trustees are within the class of persons who are chargeable to the tax, if they are resident in the United Kingdom.

By subs 42(1) it is declared that the section applies to capital gains accruing to trustees of the settlement if the trustees are not resident and if the settlor, or one of the settlors, is domiciled and resident in the United Kingdom or was so domiciled and resident when he made the settlement. There is no dispute that the section applies to the settlement in this appeal. The most material provisions of s 42 are subss (2) and (3) which are as follows:

C “(2) Any beneficiary under the settlement who is domiciled and . . . resident . . . in the United Kingdom during any year of assessment shall be treated for the purposes of this Part of this Act as if an apportioned part of the amount, if any, on which the trustees would have been chargeable to capital gains tax under section 20(4) of this Act, if domiciled and . . . resident . . . in the United Kingdom in that year of assessment, had been chargeable gains accruing to the beneficiary in that year of assessment; and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion, and so that the chargeable gain is apportioned, as near as may be, according to the respective values of those interests, disregarding in the case of a defeasible interest the possibility of defeasance. (3) For the purposes of this section—(a) if in any of the three years ending with that in which the chargeable gain accrues a person has received a payment or payments out of the income of the settled property made in exercise of a discretion he shall be regarded, in relation to that chargeable gain, as having an interest in the settled property of a value equal to that of an annuity of a yearly amount equal to one-third of the total of the payments so received by him in the said three years, and (b) if a person receives at any time after the chargeable gain accrues a capital payment made out of the settled property in exercise of a discretion, being a payment which represents the chargeable gain in whole or part then, except so far as any part of the gain has been attributed under this section to some other person who is domiciled and resident or ordinarily resident in the United Kingdom, that person shall, if domiciled and resident . . . in the United Kingdom, be treated as if the chargeable gain, or as the case may be the part of the chargeable gain represented by the capital payment, had accrued to him at the time when he received the capital payment.”

Later subsections of s 42 have only an indirect bearing on the question in this appeal. Section 42 has been replaced, for any year of assessment beginning on or after 6 April 1981, by different machinery provided in the Finance Act 1981, s 80, but s 42 continues to apply to any cases arising in earlier years of assessment.

I The trust with which this appeal is concerned is an *inter vivos* trust set up on 16 March 1968 by a lady who was domiciled and resident in the United Kingdom. Her husband contributed additional funds to the trust after it had been set up. The sole trustee has always been a company registered in Bermuda, originally a bank, later a trust company. The law of Bermuda is expressed to be the law of the settlement. The trust purposes may be summarised sufficiently for the present appeal as follows. The settlement defines a Specified Class consisting of the grandchildren and remoter issue of the settlor and their spouses, widows and widowers, whether already living or

born before a perpetuity day defined by reference to royal lives. Clause 2 of the settlement confers on the trustees a power of appointment over the capital and income of the trust fund, exercisable before the perpetuity day in favour of the members of the Specified Class. Until the perpetuity day, and subject to any such appointment, clause 3 of the settlement provides that income shall be accumulated. By clause 4 the trusts which will come into force on the perpetuity day, subject to any prior appointment, are in favour of the grandchildren and remoter issue of the settlor living on the perpetuity day and, subject thereto, in favour of the children of the settlor living at the date of settlement, in equal shares. No appointment had been made at the material times under clause 2 of the settlement, nor had any distribution of capital or income been made. Five grandchildren of the settlor were in life at the material dates and they were the only members of the Specified Class then in existence.

During the years 1968–69 and 1969–70, the trustee made certain capital gains on which it would have been chargeable to capital gains tax if it had been resident in the United Kingdom. During those years, and at all material times, all five grandchildren were minors, and all were resident in the United Kingdom. The Respondent Inspector of Taxes apportioned the gains of the trustee equally among the five grandchildren. Three of them are children of the Appellant who, as their parent, is liable for their tax—see Taxes Management Act 1970, ss 73 and 77. The question is whether that apportionment was in accordance with s 42.

The Special Commissioners decided that it was not, and they allowed an appeal by the present Appellant. They held that the possibility of participation in any distribution of the unappointed residue under clause 4 of the settlement was so remote and of so little (if any) value that it ought to be ignored, and that the rights of the grandchildren as objects of the trustee's discretionary power did not amount to "interests" in the settled funds. From that decision Dillon J. allowed an appeal by the present Respondent by way of Case Stated. The learned Judge held that, although the rights of the grandchildren as objects of the discretionary power did not amount to "interests", they were enough to make it just and reasonable to apportion the gains equally among them. The Court of Appeal (Lawton, Brightman and Fox L.JJ.) held that the grandchildren's rights did amount to "interests" in the settled funds, and they affirmed the order of Dillon J.

The main question is what is the meaning of the word "interests" in s 42(2). It is a word that is capable of many meanings, the appropriate meaning depending on the context. In *Attorney-General v. Heywood* (1887) 19 QBD 326 the settlor had provided that trustees had a discretion to apply the trust income for the benefit of himself and his wife and children or any one or more of them. It was held that he had reserved an "interest" within the meaning of the Customs & Inland Revenue Act 1881. But in *Gartside v. Inland Revenue Commissioners* [1968] AC 553 this House decided that a beneficiary under a discretionary trust did not have an "interest" in the sense of s 43 of the Finance Act 1940. Lord Reid expressed approval of the decision in *Heywood, supra*, but distinguished it because of the different context in which "interest" was used in the 1940 Act. He said (at page 612) "If so vague a word as "interest" is used in different Acts dealing with different problems there is only, in my view, a slender presumption that it has the same meaning in both;...". Lord Wilberforce, after referring to *Heywood* and also to *Attorney-General v. Farrell* [1931] 1 KB 81, declined to treat those cases as having settled the meaning of "interest" in the different setting of the Finance Act 1940. He said (at page 617) "No doubt in a certain sense a beneficiary

A under a discretionary trust has an 'interest'; the nature of it may, sufficiently for the purpose, be spelt out by saying that he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity".

I turn therefore to consider the setting in which the word is used in s 42, and particularly in subs (2). Subsection (2) is in two parts, separated by a semi-colon. The first part refers to an apportioned part of "the amount, if any, on which the trustees would have been chargeable to capital gains tax . . . if . . . resident in the United Kingdom". The second part directs that "any such amount shall be apportioned in such manner as is just and reasonable". It is, in my opinion, clear that the amount to be apportioned is the whole amount on which the trustees would have been chargeable if they had been resident.

C Dillon J. considered that there could be cases in which justice and reason would require that there should be no apportionment at all because the interests of those with interests were too remote. With respect that does not seem to me to be a sound construction; it involves reading the second part of the subsection as if it provided that the amount was to be apportioned "if and so far as is just and reasonable", but that is not what the section says. An alternative construction, which appealed to me at one time, would be to treat the subsection as providing for, or at least permitting, apportionment to a group of beneficiaries, such as the objects of a discretionary power, without making an immediate apportionment to any individual member of the group. But I have reached the view that that also would be wrong, both because the second part of subs (2) requires the amount to be apportioned between

E "persons" having interests in the settled property, and persons in the context of this personal tax must mean individual persons, and also because it would not permit the ascertainment of an apportioned part on which any individual beneficiary in the group could be treated as chargeable under the first part of the subsection in the year of assessment.

Although the provision for apportionment of the gain between persons

F having interests in the settled property comes in the second part of the subsection, it is the first step chronologically and, I think, logically. The first part of the subsection deals with what must be a later step, which is that "any beneficiary" who is (reading short) resident in the United Kingdom during any year of assessment shall be treated as if "an apportioned part of the amount" (that is a part apportioned to him under the second part of the subsection) had

G been chargeable gains accruing to him in that year of assessment. It is common ground between the parties that non-resident beneficiaries will not be so treated under that subsection, even though they may be persons having interest in the settled property and may have had a share of the gains apportioned to them. But the contention for the Crown is that, as regards beneficiaries who

H *are* resident in the United Kingdom, the words "any beneficiary" in the first part of subs (2) and "persons having interest in the settled property" in the second part mean the same thing, and that both include persons who are the objects of a discretionary power.

The contention for the Appellant is that beneficiaries under trusts fall into two classes. First, there are persons who have fixed interests, typical examples of which are a life interest and an interest in reversion in a definite part of the settled property. Secondly, there are persons who are merely objects of a discretionary power ("discretionary beneficiaries"). According to this contention discretionary beneficiaries are not persons having interests in the settled property in the sense of subs (2), and therefore not persons to whom any part of the capital gains can be apportioned. They would become chargeable to

capital gains tax only if and when they received actual payments of income or capital, in accordance with subs (3) which was said to provide a separate code for taxing discretionary beneficiaries. Reliance was placed on the provision in the second part of subs (2) to the effect that apportionment is to be "as near as may be according to the respective values of [the] interests" and it was argued that, while fixed interests can be, and regularly are, valued by an actuary, the rights of discretionary beneficiaries are in their nature impossible to value, and cannot have been intended to be included in subs (2). Further, it was said that the words "whether the interest be a life interest or an interest in reversion" are to be regarded as indicating the genus of fixed interests, capable of valuation, to which subs (2) is intended to apply. Otherwise, it was said, it was difficult to see any reason for those words being included in the subsection, since they cannot have been intended as an exhaustive list of all possible interests, for, as the Court of Appeal pointed out, they do not include, for example, an absolute interest which is subject to defeasance by the exercise of a power or on a specified event, or an immediate contingent interest or a right to income for a term of years certain.

I recognise that the Appellant's contention is a possible one, but I have reached the conclusion that it is not well-founded. One indication against the Appellant's contention is that, if it were correct, I would have expected the second part of subs (2) to be in a separate subsection, which would deal only with the case of beneficiaries who had fixed interests. It would balance the present subs (3) which would deal only with beneficiaries who had discretionary interests. The fact that the section has not been drafted in that way is, in my view, a pointer which is entitled to some weight in arriving at its true meaning.

Another fact which I regard as being against the Appellant's contention is that s 42 was apparently intended to secure, as far as possible, that beneficiaries resident in the United Kingdom of a trust with trustees also resident in the United Kingdom should not be at a disadvantage, in relation to capital gains tax, compared with beneficiaries in a trust with non-resident trustees. Resident trustees are normally bound to pay capital gains tax in the year after the gains have accrued—s 20(6)—but, if the Appellant is right, resident beneficiaries in a trust with non-resident trustees would not be taxable on their shares of capital gains until such time as they received actual payment of income or capital. They would then be taxable under subs (3)(a) or (b), but that might be many years later, and apart altogether from the effects of inflation, a tax liability which is deferred is less onerous than one that is immediate. The possible hardship to discretionary beneficiaries who are resident in the United Kingdom by being taxed on benefits which they have not received, and which some of them may never receive, is at least mitigated by the provision of s 42(5) whereby if any capital gains tax payable by a beneficiary under s 42 is paid by the trustees, the amount paid shall not for the purposes of taxation (any taxation) be regarded as a payment to the beneficiary. In any event I agree with my noble and learned friend, Lord Wilberforce, that hardship is not a relevant consideration.

The main reason why the Crown's contention is, in my opinion, correct, is that in the second part of subs (2), the primary direction is that the amount that would have been chargeable if the trustees had been resident, "shall be apportioned in such manner as is just and reasonable". The later direction that the gain is to be apportioned "as near as may be according to the respective values of [the] interests" is only a qualification of the primary direction. Accordingly, what is envisaged is not a strict apportionment by reference to

- A the actuarial or market values of the interests, which would be impossible in the case of discretionary interests, but a much looser apportionment by reference to what is just and reasonable in view of the real probabilities under the particular settlement. That view is fortified by the final direction in subs (2) that the possibility of defeasance of defeasible interests is to be disregarded. Any attempt to arrive at precise values of the various interests, while disregarding the possibility of defeasance of those which are defeasible, would be likely to reach results that might well seem unjust and unreasonable in a case, such as the present, where the settlor's children have interests under clause 4 which are defeasible and which, according to evidence that was before the Special Commissioners are almost valueless.
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- Accordingly I agree with the Court of Appeal that the present case is not like *Gartside, supra*⁽¹⁾, where the mechanism of the statute could not be operated unless the precise extent of the interests could be identified. In s 42(2) the direction is that the gain is to be apportioned only "as near as may be" according to the respective values of the interests, and I think the purpose of the direction is to show that the justice and reasonableness are to be judged by the respective values of the interests, and not by the relative wealth or poverty of the discretionary beneficiaries, except in a case where the poverty of the beneficiary might mean that he was likely to have the trustees' discretion exercised in his favour more generously than if he had been wealthy, and might thus increase the value of his interest.
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- Subsection (3) of s 42 is, in my view, only subsidiary to subs (2). Paragraph (a) of subs (3) is concerned with the problem of converting a discretionary payment of income into an annuity to which an approximate value can be attached for the purposes of subs (2). That appears to me to be all the draftsman had in mind as the function of a valuation under subs (3)(a), as is shown by the lack of detailed guidance as to the assumptions to be made about the annuity. Nothing is said about its duration; is it to be assumed to be for the life-time of the annuitant or for the (possibly shorter) period that the discretion lasts? Is it to have any other conditions? Without more detailed guidance on the nature of the annuity it cannot be valued accurately, although it may be given some approximate value which is adequate for the purpose of subs (2).
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- Paragraph (b) of subs (3) is intended to secure that tax will be collected from a resident beneficiary to whom a discretionary payment of capital is made out of the settled property, if it is a payment which represents previously untaxed chargeable gains. The paragraph prevents double taxation, in the sense of taxing the same gains twice, by making an exception of the case where any part of the gain has already been attributed under the section to some other person who is domiciled and resident in the United Kingdom (and who will therefore have paid tax on it). It would only have been previously untaxed if, or in so far as, it had been attributed to a non-resident beneficiary. I think it is significant that paragraph (b) contemplates that part of the gain may have been attributed to a non-resident beneficiary, but does not contemplate that it might not have been attributed to anyone at all. That is a further indication that subs (2) requires the whole amount of the gain to be apportioned. The reason why the exception applies only when the gain has been attributed to some *other* person is that, if it had been attributed to the person to whom the discretionary payment is made, he would already have paid the tax himself and would naturally not be taxable again on the same gain. The draftsman
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(1) [1968] AC 553.

assumed that that was so obvious that express provision against double taxation of the same person was unnecessary. Finally, with regard to paragraph (b), I think that the concept of a payment which “represents” the chargeable gain is somewhat lacking in precision, and that the use of that expression gives some support to the Crown’s contention as to the meaning of subs (2). A

A further reason why the words “interests” in s 42(2) should receive a wide meaning, and not a narrow technical meaning, is that the section has to apply not only to English settlements but to settlements governed by other systems of law. And by s 42(7) “settlement” has the extended meaning which is given to it by what is now the Income and Corporation Taxes Act 1970, s 454(3), and it includes any arrangement. Reference was made in argument, by way of example, to the case of *Archer-Shee v. Garland*⁽¹⁾ [1931] AC 212, B C where the evidence was that by the law of New York no beneficiary has any interest in the settled property but has only a claim against the trustees. It would be absurd in s 42, which is dealing with non-resident trustees, to give to the word “interests” a technical meaning which would apply to an English settlement but not to a settlement governed by the law of New York. It is, D indeed, not necessary to go so far afield as New York to make this point; in *Inland Revenue v. Clark’s Trustees* 1939 SC 11 at page 24, Lord President Normand referred to the *Archer-Shee* case and said “My conclusion is that there is no difference between the law of Scotland as regards the beneficiary’s rights and the law which is admitted in the record to be the law of the State of New York”. There is no doubt that s 42, which forms part of a United Kingdom taxing statute, should if possible be construed in such a way as to E apply to beneficiaries in a Scottish trust as well as to beneficiaries in an English trust—see *Gartside, supra*,⁽²⁾ per Lord Reid at page 602.

The settlor, and her husband who contributed an addition to the trust fund after it had been set up, wrote a letter to the trustees dated two days after the settlement setting out their “wishes” as to the exercise of the powers and discretions vested in the trustees. These were, in brief, that the trustees should F regard the settlement as existing primarily for the benefit of their grandchildren in equal shares, and should accumulate the income at first. When each grandchild attained the age of twenty-one years he should receive the income of his prospective share, but he should not receive any large sums of capital before attaining the age of thirty years. The Appellant contended that the letter, being merely precatory and not binding on the trustees, should be G disregarded when apportioning the capital gains. The Crown contended, on the other hand, that it should be taken into account as one relevant factor in making a just and reasonable apportionment of the gains. In my opinion the contention of the Crown on this matter is right. The apportionment is a question of fact for the Inspector, subject to a right of appeal to the Special Commissioners—see S.I. 1967 No. 149—and it should be carried out in the H light of all the circumstances, including the practical probabilities of how the trust estate is likely to be applied. Clearly the letter is one such circumstance which may be highly relevant. Even without taking account of the letter, the apportionment of liability equally among the grandchildren would, in my opinion, have been reasonable and proper. In the light of the letter, it appears I to me to be the only possible course.

For these reasons I would dismiss the appeal. The Respondent must have her costs in this House and in the Court of Appeal. In accordance with an

(1) 15 TC 693.

(2) [1968] AC 553.

- A agreement between parties which is referred to in the order of Dillon J., there will be no order for costs in the High Court.

Lord Wilberforce—My Lords, the Court of Appeal decided this case in favour of the Crown and refused leave to appeal to this House. In my opinion they were right, and since I agree with the single judgment prepared by Fox L.J., with which I understand that your Lordships also concur, I shall be brief.

- B The key question is as to the meaning of the word “interests” in s 42(2) of the Finance Act 1965, the alternatives being whether this word refers only to such interests as can be assigned a value, or whether it is a word of more general significance capable of covering any interest, quantifiable or non-quantifiable, of a beneficiary under a trust. That either of these is a possible meaning in fiscal legislation is made clear (a) by the general observations of Lord Reid in *Gartside v. Inland Revenue Commissioners* [1968] AC 553, 603 (see also those of Stephen J. and Wills J. in *Attorney-General v. Heywood* (1887) 19 QBD 326) and (b) by a comparison of the cases just cited. In *Heywood*, which arose under s 38 of the Customs and Inland Revenue Act 1881, and where the question was whether the settlor had reserved “an interest” by including himself among a discretionary class of beneficiaries, the word “interest” was given the more general meaning. To require that it meant something to which an ascertainable value could be assigned would, it was held, be contrary to the scheme of the statute. In *Gartside*, on the other hand, which arose under s 43 of the Finance Act 1940, and where the question was whether estate duty could be charged in respect of the determination of a discretionary interest, this House held that the word must bear the narrower meaning because the statute necessarily required ascertainment of the quantum of the interest. In *Gartside* I expressed the opinion, from which the other members of the House did not dissent, that these two cases could stand together. The word “interest” is one of uncertain meaning and it remains to be decided on the terms of the applicable statute which, or possibly what other, meaning the word may bear.
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- F The Appellant contends for the narrower meaning, and can find some support in the section. There is the reference to “values” in subs (2): there is subs (3) which, he contends, sets out a code for assigning values to discretionary interests in income or capital—an exclusive code within one of whose provisions a case must fall if a charge to tax in respect of a discretionary trust is to arise. There is, thirdly, the reference, in subs (2), to a life interest or an interest in reversion, but, in my opinion this does not survive a first critical look: the reference is clearly illustrative and nothing more.
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- The two main arguments are by no means negligible, but they are, in my opinion, greatly outweighed by those on the other side. I simply state them as they impressed me: they are developed in discussion in the Court of Appeal’s judgment. 1. The initial words of subs (2) are “any beneficiary”. Unless clearly directed otherwise, I would assume that “persons having interests” was correlative to these words. Discretionary objects are clearly “beneficiaries”, so I would suppose them also to be included in “persons having interests”. 2. The apportionment to be made under the subsection is mandatory. The amount of the gains—i.e. the whole amount—must be apportioned in the relevant year of assessment. This can only be done if discretionary objects (who may be the only “beneficiaries” in that year) can be the objects of apportionment. 3. The words, in subs (2), “in such manner as is just and reasonable” and “as near as may be, according to the respective values of those interests” suggest a broad rather than an actuarial approach in which all
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relevant considerations may be taken into account. They permit (*inter alia*) consideration of the settlor's letter of intent which shows, at least, that the settlement was to be regarded as for the benefit of the grandchildren, not of the settlor's two children. 4. That subs (3) represents an exclusive code is in my opinion not supported by the form of the section. On the contrary, the structure of it suggests that subs (2) is the main and general charging provision, subs (3) being auxiliary and confined to particular cases.

These considerations together convince me that an apportionment in respect of "interests" under a discretionary trust can, indeed must, be made.

I would only refer to one other argument, that based on the alleged "hardship" of accepting the Crown's contention. I do not think that this is a relevant consideration at all. If there were two equally possible constructions of this subsection, it might be correct to choose that which is the more favourable to the taxpayer, on the basis that subjects can only be taxed by clear words. This principle cannot apply where there are decisive legal reasons for preferring one construction rather than another. Once this step has been taken considerations of "hardship" do not enter into the discussion. The "hardship" (if any) consists in imposing a tax on discretionary beneficiaries at a time when they may have received no benefit from the trust out of which the tax can be paid. But if that is the effect of the section, it represents the Parliamentary intention. We cannot characterise it as in itself a hardship. Settlers, after 1965, make their settlements with knowledge of the legislation and of its consequences. They can avoid the use of discretionary trusts, or, if they decide to use them, make provision to meet hard cases. The section itself (subs (5)) recognises that trustees may take remedial action.

Reference was made in argument to the case of *In re Latham deceased* [1962] Ch 616, as supporting a proposition that the taxed beneficiary can, under the general law, recover any tax he pays from the trustees of the settlement. While I have no inclination to question the correctness of that decision, it would represent an extension, I do not say an unjustified extension, but certainly an extension to apply it to this different tax and in relation to this specific section (s 42). Since the argument from "hardship" can be met without resort to the principle of that case, I prefer to reserve my decision as to its applicability.

I would dismiss the appeal.

Lord Scarman—My Lords, I agree with the reasons for dismissing the appeal which have been developed in the speeches of my noble and learned friends, Lord Fraser of Tullybelton and Lord Wilberforce. I add some observations of my own only because of the differences of opinion that have emerged in the Courts below.

The appeal is concerned with the incidence of capital gains tax in relation to property settled on discretionary trusts, the beneficiaries being resident but the trustee being not resident in the United Kingdom. The question is whether persons who are the objects of discretionary trusts but to whom nothing has yet been paid in the exercise of the discretion have a sufficient interest in the trust fund to be liable to the tax in respect of a capital gain accruing to the non-resident trustee; and the answer has to be found in the true construction to be put upon s 42 of the Finance Act 1965.

Capital gains tax is charged in respect of chargeable gains computed in accordance with statute. For the purposes of this appeal the statute is the

- A Finance Act 1965. The gains are those accruing in the year of assessment. A person to whom chargeable gains accrue is liable to tax if during the year of assessment, any part of it, he is resident in the United Kingdom, or if during the year he is ordinarily resident in the United Kingdom. The tax is a percentage tax on gains after deducting losses allowed by the statute and is payable before the expiration of three months following the year in which they accrued, or at the expiration of thirty days beginning with the date of making the assessment, whichever is the later.

- Structurally, it is a simple tax. Three of its general features require to be borne in mind in this appeal: (1) the tax is levied on the person to whom the chargeable gain accrues, irrespective of the nature of his interest; s 19(1): (2) the tax is levied only on persons resident, or ordinarily resident, in the United Kingdom during the year in which the chargeable gain accrued; s 20(1): (3) the tax is immediately payable, i.e. within a very short time after assessment; s 20(6).

In adapting the tax to settled property the Act has adhered faithfully to this simple structure. My noble and learned friend, Lord Wilberforce, has described the effect of the Act in relation to settled property:

- D “it has attached the liability to pay capital gains tax to the trustees of settlements, not to funds held on distinct trusts, and (in this in contrast to estate duty legislation) has not concerned itself with questions of incidence of the tax between beneficiaries or funds within a settlement.”

Roome and Denne v. Edwards(¹) [1982] AC 279 at page 295F.

- E Section 25 contains the detailed provisions for charging the tax in relation to settled property. Trustees of the settlement are liable to pay the tax only if they are, or are to be treated as being, resident or ordinarily resident in the United Kingdom during the year in which the chargeable gain accrues: s 25(1). Section 42 deals with the problem where there is a United Kingdom settlement the trustees of which are non-resident, but the beneficiaries, or some of them, under the settlement are resident or ordinarily resident in the United Kingdom during the year in which the chargeable gain accrued to the trustees. It is this section which the House is called upon to construe in this appeal.

- Its formulation is very similar to s 41 which applies as respects chargeable gains accruing to a non-resident “close” company. Each section provides basically the same answer to the problem of the chargeable gain which, though it accrues to a non-resident person, benefits persons who are resident in the United Kingdom (namely, beneficiaries under the settlement and shareholders in the company). The answer is that resident beneficiaries, or shareholders, shall be treated as if part of the gain had accrued to them so that they are liable to pay the tax on the part properly attributable to each of them.

- H The critical facts in the present case are these: (1) on 16 March 1968 a United Kingdom family settlement was made by a grandmother for the benefit of her grandchildren, their spouses, and their issue; (2) property was settled on discretionary trusts in respect of income and capital, with power to the trustee to accumulate income; (3) a non-resident trustee was appointed; (4) the living beneficiaries of the discretionary trusts are now five grandchildren (all of them minors); (5) no payment of income or capital has yet been made by the trustee

(¹) 54 TC 359, at pp 391–2.

to any of the grandchildren; (6) in default of appointment, there is an ultimate trust (arising at the expiry of a "royal lives" perpetuity period) for the grandchildren, their spouses, or issue then living; otherwise for the settlor's children absolutely; (7) on 18 March 1968 a letter of intent, having no binding effect, was addressed to the trustee by the settlor and her husband in which she made plain her wishes that the settlement should be regarded primarily for the benefit of her grandchildren and that income should be accumulated at least until they reached the age of twenty-one.

Assessments for capital gains tax were made by the Revenue upon each of the five grandchildren for the years 1968-69 and 1969-70. There is no dispute but that chargeable gains accrued to the trustee during these two years of assessment. The two questions which lie at the centre of this dispute are, first, whether the gains were properly treated by the Revenue as accruing to the grandchildren, and secondly, what, if any, is a just and reasonable apportionment (a zero answer being possible to the second question).

It will be convenient to clear one question out of the way. The grandchildren have an interest in the trust fund which is contingent on default of appointment of the fund and very remote in time; it could arise only at the expiry of the perpetuity period. Its value is, according to the evidence (and in common sense), negligible. The Special Commissioners, therefore, ignored it, taking the view that it would not be "just and reasonable" to apportion to that interest any part of the capital gains accruing in the years 1968-69 and 1969-70. The decision was for them, and, being one of fact, is not appealable. This appeal is concerned, therefore, solely with the problem whether there should be an apportionment between the grandchildren as objects of the discretionary trusts and, if yes, what is a just and reasonable apportionment.

It is no longer disputed that the grandchildren are by reason of their expectation as objects of the discretionary trusts beneficiaries under the settlement. They are, therefore, caught by the opening words of s 42(2). They are liable to apportionment if their expectation constitutes an interest which can be valued by application of the formula contained in the second sentence of the subsection. That sentence directs an apportionment "in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion". The Appellant (the parent of three of the grandchildren) submits that the formula restricts apportionment to fixed interests recognised by the property law. If this be right, it follows that the expectation of the grandchildren is not such as to constitute them persons having interests in the settled property. The submission is reinforced by reference to subs (3) which is said to be an exhaustive code governing the apportionability of gains to the objects of discretionary trusts and basing it on actual payments to them of capital or income in the exercise of the discretion.

The Appellant further submits that, if contrary to the first submission the grandchildren have an apportionable interest, it falls to be valued on a market basis and in the circumstances of this case its value is, as the Special Commissioners found, nil. If both submissions fail, an equal division of the gains between the five grandchildren is accepted as appropriate.

The first submission does not accord with what seems to me, on first impression, to be the most likely interpretation of subs (2). I would expect persons who are the objects of a discretionary trust to be treated under the subsection as persons having an interest in the settled property. But it is a

- A possible interpretation. A close look at the language and context of the subsection is, therefore, necessary.

“Interest” is an ordinary English word which takes its meaning from its context. In the context of discretionary trusts it has been held that each one of the objects of a discretionary trust has an “interest” in the trust fund: *Attorney-General v. Heywood* (1887) 19 QBD 326 and *Attorney-General v. Farrell* [1931] 1 KB 81. The word was considered by the House in *Gartside v. Inland Revenue Commissioners* [1968] AC 553. Being an estate duty case, the decision has no relevance to this appeal: but there are some general observations of value. Referring to the use of the word in the Finance Acts 1894 and 1940, Lord Reid observed, at page 602:

- C “The word ‘interest’, as an ordinary word of the English language, is capable of having many meanings, and it is equally clear that in these provisions its meaning cannot be limited by any technicality of English law. Not only do these provisions also apply to Scotland, but they may have to be applied where duty is claimed in respect of interest under deeds which have to be construed under the laws of other countries.”

- D I would observe that in the present case the settlement is to be construed according to the law of Bermuda until and unless a contrary intention is declared. Lord Wilberforce in the course of his speech in the *Gartside* case reminded the House that it was invited to overrule the *Heywood* and *Farrell* cases. He found it unnecessary either to overrule or to uphold those decisions, but he added that he thought them to be acceptable in principle: *loc. cit.* pages 620–621.

- E Discretionary trusts have during the twentieth century featured largely in family settlements. The non-resident trustee has also become a well-known feature of such settlements. Being, as the Court of Appeal said in this case, “potential instruments of tax avoidance”, they have attracted their fair share of attention in our tax laws. I would expect, for a number of reasons, that the objects of discretionary trusts in such settlements would be treated for the purpose of s 42 as persons having interests in the settled property. First, by treating their expectation as an interest the legislative purpose of the section is achieved in that no advantage is gained by United Kingdom beneficiaries with a non-resident trustee over those whose settlement is in the hands of a resident trustee. Secondly, it secures payment of the tax with the immediacy which is an integral feature of capital gains taxation. Thirdly, so to treat their expectation is realistic: for the terms of the settlement make it abundantly plain that the grandchildren (with their spouses and issue, if and when they arrive) are the true objects of the settlor’s provision. Fourthly, there is, in my judgment, as I shall show, no hardship upon the grandchildren (always assuming, as I am not to be taken to assume, that hardship is a ground for avoiding an interpretation of a taxing statute which upon analysis of its language and context appears to be most likely to accord with the legislative intention).

- I Against this general background I turn to consider the formula for apportionment to be found in s 42(2). The apportionment is to be carried out on a “just and reasonable” basis so that “the chargeable gain is apportioned, as near as may be, according to the respective values of those interests”. The governing words are “just and reasonable”: they confer upon the Inspector and the Commissioners of Tax a wide latitude in judgment. The task is to apportion the chargeable gain, as near as may be, according to respective values. The language is apt to cover a valuation of interests where factors other than the market value of a property interest have to be considered. The only

difficulty is the reference to a life interest or one in reversion as illustrating “interests in the settled property”. I cannot treat these words as intended to restrict the otherwise clear intendment of the subsection that the interests of any beneficiary, a term which everyone is agreed includes persons who are the objects of the discretionary trusts, are to be valued. Admittedly the reference to these two interests in the second sentence of the subsection is obscure. It may be that the draftsman intended to do no more than emphasise specifically that interests in income and reversionary interests must be valued.

When one turns to the provision for valuation, the formula, with its emphasis on what is just and reasonable and its direction to apportion “as near as may be” according to the respective values of the interests in the settled property, is carefully drafted so as to admit into the valuation interests other than fixed property interests and to require, where appropriate, a valuation not tied to market values. It is a formula apt for the valuation of the interest of an object of discretionary trusts under a settlement where the expectation of future benefit is real, although the discretion to make a payment has not yet been exercised. For the purpose of valuation, the intention of the settlor, as evidenced by the deed and its recitals, is a significant factor to which value is to be attached to the extent that is just and reasonable and in a manner which, as near as may be, reflects the respective interests under the settlement. Further the letter of intent, though not by itself of great weight, is admissible as supporting the intention manifested in the settlement itself. Accordingly, I reach the view that subs (2) is apt to cover the interests of the grandchildren and to require a valuation in the manner I have described so that the capital gain may be apportioned between them.

When I turn to subs (3), I find nothing which would compel me to revise the view I have formed as to the most likely interpretation of subs (2). Though, no doubt, it is possible to read subs (3) as limiting the liability to tax of persons who are the objects of discretionary trusts to situations in which a payment of capital or income has been made in the exercise of the discretion, the language admits of another interpretation which is consistent with the view I have formed as to the meaning of subs (2). Subsection (3) can equally well be construed as confined to two specific situations; and, so confined, it is perfectly consistent with the possibility of an apportionment to such persons under subs (2). It deals with two situations in which a person who is the object of the discretionary trust has received a benefit in the exercise of a discretion; paragraph (a) deals with an income payment and paragraph (b) with a capital payment. The subsection can be read as ensuring that in addition to any apportionment of a person’s discretionary interest under subs (2) he so be “regarded” (paragraph (a)) or “treated” (paragraph (b)) as having an interest for the purpose of the tax. Accordingly, I find nothing in the subsection to compel the interpretation that in no situation other than that of the receipt of an actual payment in respect of income or capital is a person who is the object of discretionary trusts to be subject to apportionment: and, because it is consistent with the view I have formed as to the preferable construction of subs (2), I accept the construction which confines subs (3) to two specific situations.

There remains the argument of hardship. It was said to be a harsh consequence—so harsh that Parliament could not have intended it—if the object of a discretionary trust were to be made liable to capital gains tax although he had received not a penny of the gain. He might be poor: the chargeable gain might be great. There would be the possibility that he was being made liable for the sum which he could not afford. There are two

- A reasons why I do not find this to be a compelling argument (even if it be a relevant argument which, as I have already indicated, I doubt). First, the settlement was made in 1968, three years after the capital gains tax was introduced. A settlor, resident in Leatherhead, making provision for her grandchildren resident in the United Kingdom, chose to appoint as trustee a Bermudan corporation. She acted under advice. Presumably, she, or her
- B advisers, saw some advantage in a foreign trustee for a settlement made in the United Kingdom for the benefit of grandchildren living in the United Kingdom. But, presumably, she was also advised as to the disadvantages. Secondly, if the grandchildren (through their parents) are liable to the tax, the trustee can pay it. For by s 42(5) it is provided that, if the trustee does pay the tax payable by a beneficiary, the amount paid “shall not for the purposes of taxation” be regarded as a payment to the beneficiary. Indeed, though the
- C point was not the subject of full argument, I would, as at present advised, accept that a beneficiary paying a tax, or part of a tax, properly attributable to the whole fund, has a right of reimbursement either unconditionally or at least so far as is necessary to give an equitable balance between those interested in the fund. The principle was recognised by Wilberforce J. in *In re Latham deceased* [1962]Ch 616, at pages 641–2, and I would expect it to be recognised in Bermuda—there is nothing to indicate otherwise.

- In my view, therefore, the Special Commissioners erred in law in two respects. First, they interpreted incorrectly the word “interest” where used in s 42(2). Secondly, they erred in thinking that the apportionment must be based on market values. Their errors were errors of law. I think the Court of Appeal
- E was right in holding that the Inspector’s assessments must be restored. I would, therefore, dismiss the appeal.

- Lord Roskill**—My Lords, I have had the advantage of reading in draft the speeches of my noble and learned friends who have preceded me. On the principal issue argued before the House, I am in complete agreement with those speeches and with the judgment of the Court of Appeal delivered by Fox
- F L.J. I only wish to add two observations of my own. First, in agreement with my noble and learned friend, Lord Wilberforce, I cannot think that the “hardship” alleged to arise were the Crown’s contentions to be accepted, can in any way be a relevant consideration when the question for determination is the true construction of this or any other fiscal legislation. If that legislation, upon its true construction, has the consequences for which the Crown
- G contend, it cannot be a legitimate ground for giving that legislation some other (*ex hypothesi* wrong) construction that those consequences involve some “hardship”. Parliament must be taken to have intended that that legislation should have those particular consequences.

- Secondly, and again in agreement with my noble and learned friend, Lord Wilberforce, I prefer to reserve until the matter arises for direct decision, the
- H possible applicability of the principle enunciated by my noble and learned friend (then Wilberforce J.) in *In re Latham deceased* [1962]Ch 616 at page 641, to the position between the beneficiaries upon whom the statute casts this liability to pay capital gains tax and the trustees of the fund from which the interest of the beneficiaries derives, so as to entitle the former to claim reimbursement of the tax from the latter. That decision was not concerned
- I with capital gains tax—indeed it was given some four years before the introduction of that tax in this country and different considerations may possibly arise in connection with the ultimate incidence of that tax.

I would dismiss this appeal.

A

Lord Brandon of Oakbrook—My Lords, I have had the advantage of reading in advance the speeches prepared by my noble and learned friends, Lord Fraser of Tullybelton, Lord Wilberforce and Lord Scarman. I would, like Lord Wilberforce, prefer to reserve my opinion on the question whether the principle on which In re *Latham deceased* [1962]Ch 616, was decided, assuming that decision to have been correct, is applicable to the present case. Subject to that qualification, I agree with all three speeches and, for the reasons set out in them, would dismiss the appeal.

B

Appeal dismissed, with costs.

[Solicitors:—Solicitor of Inland Revenue;
Messrs. Norton Rose, Botterell & Roche.]

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