The Charity Law & Practice Review

LADY BOUNTIFUL TO THE INLAND REVENUE?

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Re Benham's Will Trusts [1995] STC 210 Ch D 29th July 1994

Introduction

The conclusion reached in the article "Lady Bountiful's Will" (see the 28th February 1991 issue of *TAXATION*) by my fellow member of chambers, Christopher Sokol, has been supported by the decision of the High Court in *Re Benham's Will Trusts* [1995] STC 210 Ch D in relation to section 41 of the Inheritance Tax Act 1984. This decision is good for the Inland Revenue, bad for exempt beneficiaries such as charities, and, the writer will seek to show, incorrect. The worthy effort of the High Court in seeking to give effect both to s.41 of the Inheritance Tax Act 1984 and to the intention of the testatrix contravenes the plain words of section 41. In the writer's view, it is clear that in *Re Benham's Will Trusts* the non-charitable (i.e., non-exempt) gifts should have borne the whole of the inheritance tax attributable to them without their first being grossed-up. Charities and other non-exempt beneficiaries who may be prejudiced by the decision, which produces more tax for the Revenue and larger net gifts for non-exempt beneficiaries at the expense of exempt beneficiaries, will be particularly interested to read on in relation to a provision on which (along with its statutory forerunners) there is no previous authority.

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Section 41 ("Burden of tax") of the Inheritance Tax Act 1984 is found in Chapter III ("Allocation of Exemptions") of Part II ("Exempt Transfers") (ss.18 to 42) of the Inheritance Tax Act 1984 and provides:

> "Notwithstanding the terms of any disposition -
>
> (a) none of the tax on the value transferred shall fall on any specific gift if or to the extent that the transfer is exempt with respect to the gift, and
>
> (b) none of the tax attributable to the value of the property comprised in residue shall fall on any gift of a share of residue if or to the extent that the transfer is exempt with respect to the gift."

Section 41, it should be noted, only applies "Where any one or more of ss.18, 23 to 27 and 30 above apply in relation to a transfer of value but the transfer is not wholly exempt". See s.36 ("Preliminary") (the opening section of Chapter III of Part II) of the Inheritance Tax Act 1984. Where it applies, section 41 will in the case of conflict displace the general provision of s.211 ("**Burden of tax on death**") of the Inheritance Tax Act 1984. What s.41 leaves open is (1) for the tax attributable to the value of the property comprised in a chargeable *specific* gift to fall on exempt residue (after exhaustion of chargeable residue), and (2) for the tax attributable to the value of the property comprised in a chargeable gift of residue to fall on *chargeable* residue.

The decision in *Re Benham's Will Trusts* [1995] STC 210 Ch D

In *Re Benham's Will Trusts* the testatrix, by Clause 3 of her Will, disposed of her residuary estate in the following terms:

- I GIVE DEVISE AND BEQUEATH all the residue of my estate both real and personal whatsoever and wheresoever unto my Trustees to sell call in and convert the same into money with power in their absolute discretion to postpone such sale calling in and conversion for so long as they shall think fit without being liable for loss and to hold the net proceeds thereof together with ready money upon the following trusts namely

  (A) upon trust to pay thereout all my just debts funeral and testamentary expenses

  (B) as to the residue after such payment aforesaid to pay the same to those beneficiaries as are living at my death and who are listed in List A and List B hereunder written in such proportions as will bring about the result that the aforesaid beneficiaries named in List A shall receive 3·2 times as much as the aforesaid beneficiaries

named in List B and in each case for their own absolute and beneficial use and disposal.

Of the questions raised in the originating summons in the case only the first three were dealt with by the High Court and of these three only the second was directly a question of tax law. This second question posed the problem to which section 41 supposedly gives rise. For, one of the beneficiaries in list A was a charity and thus transfers of value to it are exempt for inheritance tax purposes (see s.23 of the Inheritance Tax Act 1984), the other beneficiaries being close friends and relatives of the testatrix (not attracting exemption), and of the list B beneficiaries several were charities (attracting exemption), the others being acquaintances (not attracting exemption). The second question in the originating summons was whether, having regard to s.41 of the Inheritance Tax Act 1984 which precludes the tax attributable to a chargeable share of residue from falling on any exempt share of residue, (a) the non-charitable beneficiaries should receive their respective shares subject to inheritance tax, or (b) the non-charitable beneficiaries' shares should be grossed up.

The High Court considered that there were three possibilities: (1) that the non-charitable beneficiaries should receive their respective shares subject to inheritance tax, which would mean that they would receive less than the charitable beneficiaries; (2) that the non-charitable beneficiaries were entitled to have their respective shares 'grossed up' so that the net result would be that equality would be achieved between the charitable and non-charitable beneficiaries; and (3) that the executors should pay the inheritance tax as part of the testamentary expenses under Clause 3(A) of the Will and distribute the balance equally between the exempt and non-exempt beneficiaries.

Counsel for one of the charities submitted, and the High Court held, that s.41 precluded possibility (3). The writer agrees with this clearly correct proposition.

Counsel for the same charity also submitted that on a proper construction of the Will the testatrix could be seen as intending the charitable beneficiaries to have the benefit of their exempt status with the result that there would at the end of the day be inequality in the amount which the non-charitable beneficiaries and the charitable beneficiaries would receive, and that this construction would accord with (a) a presumed intention on the part of the testatrix that her estate should pay as little inheritance tax as possible, and (b) the anticipation of the 'ordinary person' that the extent to which each beneficiary would receive an equal share would depend on that beneficiary's status as exempt or non-exempt.

The High Court did not agree with these latter submissions, and held that the "plain intention" of the testatrix was that at the end of the day each beneficiary, whether charitable or non-charitable, should receive the same as the other beneficiaries in the relevant list. The High Court considered that such a result was

also consistent with the express terms of the Will and the applicable statutory provisions.

The High Court accordingly answered the second question in the originating summons by holding that the non-charitable beneficiaries were to receive grossed-up shares so that the sum each of the beneficiaries (both exempt and non-exempt) received as between themselves in the relevant list was the same.

Comment

In the writer's view the High Court fell into the error of trying to give effect both to the intention of the testatrix and to s.41 of the Inheritance Tax Act 1984. This is understandable in view of the fact that the arguments of Counsel for (one of) the charities were also largely based on the alleged intention of the testatrix.

Before relating in detail why, in my view, the decision on section 41 is incorrect I will first set out in numeric terms the three alternative approaches to the "problem". This will indicate that of the two approaches not prohibited by s.41(b), the one adopted by the High Court was the best for the Inland Revenue and the non-exempt beneficiaries and the worst for the charitable (exempt) beneficiaries. For this purpose I will take the much simpler case of a gift of residue of £800,000 (i.e., the residue after deduction of liabilities *other than* inheritance tax on the residue) to one exempt beneficiary and one non-exempt beneficiary in equal shares after the payment of inheritance tax, and a 40% rate of inheritance tax applicable to the whole of the death transfer of value.

Method 1	**Method 2**	**Method 3**
Prohibited by section 41(b)	**Proposed by Counsel for one of the charities**	**Adopted by the High Court**
Tax of £160,000.	Tax of £160,000.	Tax of £200,000.
Borne as to £80,000 each by the exempt and the non-exempt beneficiary =	Whole £160,000 tax borne by the non-exempt beneficiary =	Whole of £200,000 tax borne by non-exempt beneficiary to whom there was however attributed a grossed up (ie pre-tax) gift of £500,000 =
Non-exempt beneficiary receives £320,000.	Non-exempt beneficiary receives £240,000.	Non-exempt beneficiary receives £300,000.
Exempt beneficiary receives £320,000.	Exempt beneficiary receives £400,000.	Exempt beneficiary receives £300,000.

Method 2 is, in the writer's view, the clearly correct method.

The true construction of the Will in *Re Benham's Will Trusts* is that the testatrix thought that one could:

(1) first, determine the amount of inheritance tax payable by ascertaining the chargeable amount of the testatrix's death transfer of value and applying to that chargeable amount the relevant rate of inheritance tax; and

(2) then, having deducted the inheritance tax payable, divide the distributable residue in the stated proportions as between exempt and non-exempt beneficiaries.

This is, of course, the approach which the High Court and Counsel for one of the charities agreed was prohibited by s.41(b) of the Inheritance Tax Act 1984. As stated above, the writer agrees with this clearly correct proposition.

The correct approach is, in the opinion of the writer, to make the non-exempt beneficiaries bear the whole of the tax as ascertained at (1) above; i.e., there should be no grossing-up of chargeable residuary gifts. The High Court rejected this approach on the grounds of giving effect to the testatrix' intention.

Now, in the writer's view, the whole point of section 41 is that in certain circumstances it will operate to defeat the intention of the testator, so that intention is no longer a consideration. See the opening words of section 41 "Notwithstanding the terms of any disposition". In the present case the intention of the testatrix was that the exempt and non-exempt beneficiaries should receive the specified proportions *after* tax. The testatrix clearly thought that this could be done by first ascertaining the chargeable amount of her death transfer of value, paying the tax on that chargeable amount, and then dividing the distributable residue between the exempt and the non-exempt beneficiaries in the specified proportions. This intention is defeated by section 41(b). What, then, should be done?

What, in the writer's view, one should *not* then do is what the High Court did in *Re Benham's Will Trusts*, namely seek to ascertain some supposed *alternative* intention which the testator would have had had he known that his ("primary") intention would be defeated by section 41.

What one *should*, in the writer's view, clearly do, is accept that the testator's intention as to the burden of tax has been defeated and then simply allow the burden of tax to fall in the one way permitted by section 41(b) in such circumstances; namely for the chargeable part of the residue to bear the whole of the inheritance tax attributable to the chargeable part of the residue. I.e., one should adopt **Method 2** of the three methods set out above in computational form. This is no less favourable to the Inland Revenue than the method prohibited by section 41(b). Where section 41(b) defeats the intention of the testator the burden

of tax should be allowed to fall in the way left open by section 41(b); i.e., without regard to intention, for s.41 expressly ignores intention in such circumstances.

The consistent desire of the parliamentary draftsman to exclusively reserve to exempt beneficiaries the benefit of exempt status as against non-exempt beneficiaries (save that the tax on chargeable specific gifts could always be borne by exempt gifts of residue were chargeable residue exhausted) can be perceived from a reading of the forerunners to s.41 of the Inheritance Tax Act 1984; namely paragraphs 16(b) and 22 of Schedule 6 to the Finance Act 1975 prior to re-enactment in amended form by s.96(2),(5) of the Finance Act 1976, and (in relation to estate duty, with some legitimacy) paragraphs 4 to 7 of Schedule 26 to the Finance Act 1972. A fairly natural corollary of this desire is that the chargeable residuary gifts should "stand on their own two feet" and bear their own tax without their grossing-up effectively eating into the exempt residuary gifts; albeit that this (merely additional reasoning) is circular, assuming the very thing it seeks to prove, namely that in ascertaining the *primary* fact of the *amount* of the chargeable (and hence also the exempt) residuary gifts one should *not* gross-up the amount of those chargeable gifts.

Conclusion

In the writer's view, the whole point of the opening words of section 41, "Notwithstanding the terms of any disposition", is that s.41 will in certain circumstances alter the ***burden*** of tax intended by the testator; i.e., that intention will be defeated, and this perhaps unpalatable fact is one which the courts should, in the writer's view, digest. There is no justification for allowing section 41 to effectively increase the *chargeable part* of the residue (to the detriment of the exempt residuary beneficiaries) and thus the ***quantum*** of tax, by applying a grossing-up method resulting from a misplaced, but perhaps understandable, concern to ascertain some supposed *alternative* intention which the testator would have had had he known that his ("primary") intention would be defeated by s.41.