The Offshore & International Taxation Review

# *BILLINGHAM v COOPER* 3:[1] THE COURT OF APPEAL

Robert Argles[2]

**The Facts**

1. Readers will be familiar with this case. The decision of the Special Commissioner who found for the taxpayer and of Lloyd J allowing the Crown's appeal were both reported and have attracted comment. It seems sensible to restate the facts if only to avoid the need to look elsewhere as an *aide memoire*. There were two appeals. The second appeal involved a taxpayer called Charles Fisher. The essential facts of each case were with one exception, identical insofar as they had a bearing on the question of interpretation with which the Courts were concerned.

2. In Mr Cooper's case the settlement was made by him in 1982. He was at all times domiciled and resident in the United Kingdom. At all times the trustees were resident outside the United Kingdom. Under the settlement Mr Cooper had a determinable life interest. In the years from 1988-89 to 1993-94 and again in 1995-96 chargeable gains accrued to the trustees. Under powers given them by the settlement the trustees made a series of interest free loans to Mr Cooper. The loans were in each case repayable on demand. It appears that some loans were indeed repaid. The substantial balance owing by Mr Cooper of nearly £250,000 in 1988-89 only diminished by modest amounts in later years.

3. Mr Fisher's settlement was made by him in 1983. As with Mr Cooper he was at all times resident and domiciled in the United Kingdom. As with Mr Cooper the settlement trustees were non-resident. He too had a life interest and the trustees had power to advance capital to him. In December 1991 the trustees, who had not at that time realised any gains, made interest free loans to Mr Fisher repayable on demand. Subsequently (in 1993-94)

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[1] STC [2001] 1177.

[2] Robert Argles, Tax Counsel, 24 Old Buildings, Lincoln's Inn, London WC2A 3UP.
Tel: (020) 7242 2744 Fax: (020) 7831 8095.

chargeable gains accrued to them.

4. Each of Mr Cooper and Mr Fisher were assessed to capital gains tax on the footing that part of the gains that had accrued to the trustees of the settlements made by them could be attributed to them under the provisions of section 87 TCGA, or its predecessor section 80 of FA 1981, as amended. In order to succeed the Crown had to establish that a "capital payment" of an amount or value which was capable of assessment had been received by Mr Cooper and Mr Fisher.[3] It was accepted by each of the taxpayers that the actual making of the interest free loans was a "capital payment" for these purposes. It was also (apparently) accepted by the Revenue that the amount of that capital payment taken according to the value of the benefit conferred at the time the loan was made was nil. The Revenue's case proceeded on the basis that a "capital payment" in the form of the interest which the taxpayer would have had to pay to a commercial lender on the amount of the outstanding loans had they been at interest was received day to day for so long as the loans remained outstanding. Of course, it did not follow that the capital payment as calculated would fall necessarily to be assessed as a gain for the year in which it was received. In the case of Mr Fisher's settlement the trustees did not realise any gains until some years after the first loan was made and the first tranches of "assumed interest" which represented the Revenue's capital payment materialised. Not until gains are realised can the amounts or value represented by the alleged capital payments be brought into charge.

## The Contentions

5. The main contention advanced on behalf of the taxpayers throughout[4] was that the capital payment in the form of the interest free loan was received once and for all when the loan was made. It was at that stage and at that stage only that the valuation provisions of section 97(4) TCGA applied. Section 97(4) provides that:

> "For the purposes of sections 86A to 96 the amount of a capital payment made by way of loan, and of any other capital payment which is not an outright payment of money, shall be taken to be equal to the value of the benefit conferred by it."

3 Section 87(4) TCGA 1992.

4 One should not overlook the important subsidiary contention as to the value of the capital payment based upon the fact that each of the recipient beneficiaries was a life tenant.

6. What was the value of the benefit conferred by a loan repayable on demand at the time it was made? In practice it would have been considered both by the trustees making the loan and the beneficiary receiving it that the trustees would be highly unlikely to call for repayment at other than a reasonable time – or indeed at some indefinite time in the future. But it appears to have been agreed that this essentially subjective view based on the relationship of the trustees and the beneficiary-borrowers would not allow any value to be ascribed to the loan as at the date it was made. Once it was accepted that the loan agreement was not a sham and that the trustees could, had they been so minded, have called for repayment of the loan on the same day on which it was made or (allowing time for cheques to clear) on the day after, an objective valuation required that the value of the loan as a benefit at the time it was made was nil.

7. The Inspectors of Taxes in the cases claimed that a benefit valued by reference to the interest which the taxpayers would have had to pay to a commercial lender accrued from day to day. They did not attempt to justify the assessment on the basis that this interest was to be the value ascribed to the capital payment which was received when the loan was in fact made. A rough and ready solution of this kind would have avoided some at least of the problems both of logic and practical application to which the interpretation actually preferred by the Crown gives rise.

8. The argument for the Crown proceeded thus: On each day following the making of the loan the trustees had the opportunity of calling for repayment of the same. The omission by the trustees to call in the loan on each such day did itself operate to "confer a benefit" on the taxpayer and accordingly amounted to the receipt of a capital payment by each taxpayer within the meaning of section 97(2) TCGA. This provides:

> "References to a payment include references to the transfer of an asset and the conferring of any other benefit ..."[5]

9. The value of the benefit conferred by this supposed omission to call in the loan, the Revenue claimed, was the interest which would have had to have been paid to a commercial lender in the twenty-four hours preceding this act of forbearance.

10. With the greatest respect to Lloyd J and the Court of Appeal, who felt themselves able to accept this line of argument, it appears as a matter of first

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5 Reference will in due course have to be made to section 97(1)(a) in connection with the second but subsidiary point open to the taxpayers in both appeals.

impression an appalling nonsense. If such an argument had been advanced by the taxpayer it would doubtless have been met with the withering contempt it deserves. It is difficult to see how even a conscious omission to exercise some right such as a decision taken deliberately not to call in an interest free loan can, taken by itself, amount to the "conferring" of a benefit on some other person such as the borrower. If, to remove the factual situation from the topic immediately in hand, a landlord elects not to serve notice on his Agricultural Holdings Act tenant requiring an increase in the rent payable one year hence to the equivalent of the market rent, such decision may operate to benefit the tenant; but it does not "confer" a benefit on him. That, however, is by the way. Arguably, perhaps, a conscious decision not to call in a loan, deliberately entered into as a decision of the trustees, might be said to "confer" a benefit on the borrower. But I fail to see how it can be said that the daily failure by the trustees to meet or to discuss together whether to call in the loan and their consequential - and inevitable - omission to actually call it in can be said to amount to the conferment of anything at all. Walker LJ giving what was effectively the judgment of the Court pointed out in the course of his judgment that the trustees of settlements such as those made by Mr Cooper and Mr Fisher do not have daily meetings, let alone daily meetings at which the outstanding interest free loans are discussed. Indeed, when such meetings take place or in the course of correspondence in which trustee investments and dispositions are considered, the question of the repayment of the loans is unlikely to come up unless some purpose of the trust (the wish to make an investment or to make an advance to a beneficiary) requires the outstanding loans to be considered. The Crown's argument requires one to accept the proposition that a "benefit is conferred" by an omission of which both the person conferring the benefit and the person receiving the same are unconscious, at least at the time it is alleged to be conferred.

11. The problems for the Crown do not end there. Subsection (4) of section 97 requires one to calculate the capital payment conferred by the making of an interest free loan or, in this case, the omission to call in an interest free loan to be "equal to the value of the benefit conferred by" the alleged capital payment consisting of the conferment of such benefit. Now the Crown appears to have accepted that the date at which the value of the benefit has to be calculated is the date the benefit was in fact conferred. It is not some later date or some earlier date. To argue that the benefit should be valued at an earlier date is obviously wrong because no benefit has at that time been conferred. To argue that it should be valued at a later date is inconsistent with a valuation of the benefit conferred on the actual making of the loan as nil. There is much to be said for the Crown's approach here following from

the language of subsection (4). This refers to "the value of the benefit conferred", which suggests that one is looking at the point of conferment and not at some earlier or later date – let alone a time or times measured by reference to the history of the transaction.

12. The difficulty with this is that if the benefit consisting of the hypothetical omission to call in the loan is valued at the date that benefit is conferred the value of the benefit is still "nil". The value of the benefit cannot consist of the interest which would have been earned in respect of the loan in the preceding twenty-four hours or indeed in the preceding weeks since the loan was made. Valued at the date of the omission to call in the loan the lenders (the trustees of the settlement) had no right to any such interest because the terms on which it was originally lent did not require the payment of interest. Furthermore the terms on which each preceding omission to call it in had been made did not require the payment of any interest. So nothing of value was conferred on the taxpayers by the mere omission to call in the loan. At the time each hypothetical omission took place the position was no different than it had been at the time the original loan was made. The Court of Appeal recognised the problems which confronted the arguments of the Crown in a passage headed "Are Both Sides Wrong?". Walker LJ commented first "but the Inland Revenue's argument also seemed to depart from reality in treating the fiduciary lenders as making a series of day by day and moment by moment decisions (so as to confer an almost infinite number of benefits which could best be expressed in terms of differential calculus). In the real world trustees do not take decisions like that ..."

13. At paragraph 27 of his judgment Walker LJ continued:

> "These reflections (and the Judge's reference to the possible need for retrospective valuation) led the members of the Court to suggest an approach different from that advocated by either side. The agreed starting point is that an interest free loan, even if repayable on demand, is a capital payment. It is therefore necessary, under s.97(4), to quantify the benefit conferred by it. In the ordinary course of events that process takes place at the end of the year of assessment, so it is only at the end of the year of assessment that the "trust gains for the year" can be computed as required by s.87(2). If that involves an element of retrospection it is implicit in the scheme of the legislation; capital gains tax, like income tax, is an annual tax (see ss.1 and 2 of the 1992 Act)."

14. The Lord Justice proceeded to point out that Mr Fisher could not in fact be assessed even on that basis until the trustees in fact realised gains in the year of assessment 1993-94.

15. The Court of Appeal's suggested alternative was rejected by the Crown even though it would be likely in practice to produce precisely the same calculations of the assessable capital payment as the Crown's formulation. One suspects that the reason why it found no favour is owing to a lack of proper consideration of the same and its logical consequences.[6]

16. The approach of the Court of Appeal reflected in paragraph 27 of the judgment is not free from difficulties. But viewed simply as an alternative to the approach of the Inland Revenue to the interpretation of section 97(2) and (4) TCGA it is much to be preferred. Walker LJ starts with the unexceptional proposition that the making of an interest free loan, even if repayable on demand, is a capital payment. Then he continues with the unexceptional proposition that "it is therefore necessary, under s.97(4), to quantify the benefit conferred by it". The contention that the benefit must be valued once and for all at the time the capital payment was made was rejected by Walker LJ since, that as was generally recognised, would result in the value being reduced to nil. His proposition assumes that one is entitled to take the history of the interest free loan and calculate the value of the benefit by reference to the period over which the loan was outstanding. He does so by reference (somewhat unsatisfactorily) to years of assessment which, as he recognises, gives rise to problems where the gains by reference to which the capital payment is to be charged are only realised in a later year of assessment. But there is nothing intrinsically wrong with that in practical terms. A beneficiary who receives an outright capital payment at a time when there are no trust gains will only be assessed if and when there are in fact trust gains which may be assessed, and that may be in a year of assessment some time after the original capital payment was received by the United Kingdom beneficiary taxpayer.

## Are Both the Court of Appeal and the Crown Wrong?

17. The Court of Appeal's construction suggested to the Crown in the course of argument by Walker LJ is free of the weaknesses inherent in the Crown's interpretation of the provisions of sections 97(2) and (4) TCGA. There is

6 It would appear that the problem was only raised by the Court in argument and the probability is that the "experts" to whom Walker LJ referred felt they had inadequate time to consider whether the alternative suggested was viable or not.

no need to establish that an omission to do something does of itself amount to the "conferment" of a benefit. The apparent absurdity of establishing a series of day to day conferments of benefit consisting in successive omissions of the trustees (day to day) to call in the interest free loan is avoided. No longer is it necessary to compute the benefit by reference to something which is not conferred and which comprises what would have been earned if the loan had been at interest on the day preceding the hypothetical conferment of the benefit envisaged by the Crown. All that is necessary is to take what is admitted on all sides to be a "capital payment": *viz.* the actual making of the interest free loan, and then to value the benefit conferred by it. The analysis of the Court of Appeal would enable the value conferred to be assessable in any one of a number of situations. Take, for example, the sort of situation which is likely to arise (as was the case with Mr Cooper) where gains are realised by the non-resident trustees who then advance amounts equal to those loans to the United Kingdom beneficiaries. On the Court of Appeal's analysis there would be but one capital payment made when the loan was made but the "value" of that benefit would fall to be assessed year by year for so long as the loan remained outstanding. If the loan was repaid or if some other event, such as a capital payment which exhausted the remainder of the pool of chargeable gains made, for example, to some other beneficiary, occurred during a year, "time apportionment" of the benefit represented by the interest free loan during that year would be necessary. In that event the balance of the benefit flowing from the interest free loan would no longer be assessable. If (as was the case with Mr Fisher's settlement) the interest free loans had been made in advance of any trust gains accruing to the non-resident trustees, the "benefit" flowing from the loan could still be valued (but not assessed) on a yearly basis subject to time apportionment in the event of repayment of the loan or some capital payment being made to some other beneficiary during the year. The sole effect of section 87 in such circumstances is to defer the assessment of these benefits or aggregate benefits until the year in which the trustees realised gains which were not covered by "capital payments" made to other beneficiaries prior to the time at which the benefits represented by the interest free loan accrued to the beneficiary/borrower.

18. The Court of Appeal's construction would in most cases produce precisely the same result as that contended for by the Crown. Is this alternative construction advanced by the Court of Appeal one that can be sustained?

19. Leaving aside its obvious practicality, there is, as a matter of first impression, much to be said for the Court of Appeal's construction. Ostensibly there is no provision requiring the valuation of a capital payment

or benefit consisting of a loan at the date of the making of the loan. There is nothing that amounts to an express prohibition against valuing the benefit at some later time, such as the end of the year of assessment or successive years of assessment in which the loan remains outstanding. Nonetheless I do not think that the Court of Appeal's construction successfully defies analysis of the provisions.

20. The Court of Appeal (and I suspect the Crown) would accept that it is possible to construe section 97 TCGA so as to require one to value the benefit constituted by an interest free loan repayable on demand as at the date that loan is made. That value would, by common consent, be "nil" because of the knowledge at the time the loan was made that it could be repaid on the following day. The Court of Appeal would have it that section 97 is capable of a second meaning; *viz.* that it is permissible to determine the value of the benefit by reference to facts occurring after the date the actual capital payment was made. In the instant case of an interest free loan repayable on demand the facts in question are essentially the rates of interest which would have had to be paid to a commercial lender in respect of the balance of the loan outstanding.

21. Can this interpretation be said to represent a tenable alternative to one which would require a valuation at the date the capital payment was made and at no other time? If it can, then, in determining the choice of meanings, it is permissible to have regard to other considerations - e.g. the perception as to Parliament's intention as to the overall purpose of these provisions or the "anomalies" to which one or other interpretation might give rise – in deciding which interpretation is to be preferred. In the instant case one suspects that if the Court of Appeal's interpretation was one which was tenable, consideration of the overall purpose of section 87 would lead one to the conclusion that it was one which would be preferred as a means of valuing the benefit conferred by an interest free loan repayable on demand as against one which would determine that value at the date it was made as being nil.

22. But I do not consider the Court of Appeal's interpretation to be one which is tenable. Section 97(4), which is the operative provision to be construed in these circumstances, has to be interpreted in the light of the provisions to which it is supplementary. Examination of these provisions shows beyond doubt that it is really impossible to "value" a capital payment consisting of the conferring of a benefit whether in the form of an interest free loan or not on any other occasion than the time at which the benefit is conferred.

1. The main charging provision in section 87(4) refers to the trust gains for a year of assessment being treated as chargeable gains accruing in that year to United Kingdom resident and domiciled beneficiaries "who receive capital payments from the trustees in that year or have received such payments in any earlier year". Now there is no suggestion in the judgment of the Court of Appeal that the capital payment in the form of an interest free loan is to be treated as being "received" in any year other than that in which it is made. The Court of Appeal's reasoning involves acceptance of the proposition that there is only one capital payment: *viz.* the making of the loan. It is that (so the Court of Appeal asserts) which has to be valued. The valuation process does not involve the proposition that there are fresh capital payments made in each year of assessment. Yet section 87(4) requires the chargeable gains to be treated as accruing once and for all to the beneficiaries of the settlement who "receive" the capital payment in the year of assessment. Take a hypothetical case similar to that of Mr Cooper. In 1989-1990 non-resident trustees realise assets resulting in gains of £1,000,000. In the same year they lend a United Kingdom beneficiary £1,000,000 interest free and repayable on demand. By common consent the making of the loan is a "capital payment". It is a capital payment received in 1989-1990 – not a capital payment which is received in 1990-1991, 1991-1992 ,or for so long as the loan is outstanding. But the "value" of the benefit for the purposes of assessing the beneficiary has to be arrived at in 1989-1990. It cannot be valued in later years without there being some fresh conferment of benefit in such later years.

2. By section 87(5) the chargeable gains to be attributed to beneficiaries are not to exceed the amounts of the capital payments "received by them" either in the year of assessment concerned or in any earlier year of assessment. There can be only one "receipt" of a capital payment. In the case of an interest free loan repayable on demand that capital payment is received when the interest free loan is made. It cannot be regarded as "received" in later years of assessment during the time at which it remains outstanding because, if that was right, there would in fact be fresh "capital payments" made during that time and this would immediately give rise to the logical problems which were inherent in the Crown's argument to which I shall return below. Much the same point can be made by reference to section 97(5) and (8) which refer once again to the receipt of a capital payment. If the only capital payment here is

constituted by the interest free loan it is hard to see how the interest which might be payable to a commercial lender in later years by the beneficiary who was borrowing from the trustees can be said to be something which is regarded as "received" at the time the interest free loan is made.

3. The "matching" provisions of sections 92 to 94 which refer to capital payments being "made" by the trustees of a settlement cannot properly be equated with value in the form of interest foregone simply because the loan was interest free and repayable on demand.

23. The drawback with the Court of Appeal's reasoning, seductive as it is, is that it is inconsistent with the scheme of the legislation. The Court of Appeal purports to be "valuing" the benefit conferred by the interest free loan. But the reasoning by which they arrive at their conclusion effectively requires one to treat the capital payment as consisting not merely in the making of the interest free loan itself but in a whole succession of receipts in the form of value received in subsequent years of assessment. In other words the Court of Appeal's analysis involves a reverter to the Crown's proposition: *viz.* that there is a succession of capital payments, albeit made at the end of years of assessment, for so long as the loan remains outstanding. That is not an interpretation which can be sustained unless the Crown's interpretation is itself accepted.

24. I have not overlooked the fact that the Court of Appeal's interpretation, if correct, could give rise to anomalies of its own.[7]

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[7] For example, take a loan to a beneficiary for a term of years at a rate of interest corresponding to that which the trustees would then have received (with no provision for increase) had they lent the money in the open market. They make no provision for increase. Arguably this is not a transaction entered into at arm's length and therefore amounts to a capital payment. Given that there is no provision for an increase in the interest rate it may be that the "value" of the benefit conferred can be ascertained by reference to the term of years and the possibility that interest rates may be increased as at the date the loan was made. But suppose, then, that interest rates are increased by an amount which is not adequately reflected in the original "capital payment" when the loan was made. Is it to be the case that the value of the capital payment should be revised having regard to the increase in the interest rates notwithstanding the fact that the trustees could not call in the loan until the expiry of the term? There are no doubt other more striking anomalies to which the interpretation might give rise which may occur to readers than this.

**Conclusion**

25. In the end the Court of Appeal was prepared to accept the Crown's interpretation on which I have already commented. The reason for preferring the Crown's analysis to the Court's interpretation is set out in paragraph 32 of the judgment.

> "The Inland Revenue's analysis (a continuing series of payments) is, for all its difficulties, less unreal than the new suggested analysis (a single initial payment which is found, on successive valuations whenever they are necessary, to have conferred an ever increasing benefit)."

The problem with the new suggested analysis is not so much that it is unreal; the problem is that it simply does not accord with the scheme of legislation which requires one to treat the chargeable gains accruing to the non-resident trustees as accruing to the beneficiaries who receive capital payments which are treated as chargeable gains in the year in which those capital payments are received. Walker LJ continued:

> "In the real world trustees of a family trust do not make this sort of decision on a daily basis, but neither do they make a large interest free loan and then forget about it for years. They are under a duty to review the decision from time to time (either at regular meetings or under the pressure of unexpected events, which might include the changing views and prognostications of tax experts) and decide whether to continue the loan or to call in the whole or part of it."

In practice what I would suggest is more likely to happen is that, barring events such as the needs of some other beneficiary, the payment of tax or the making of a desired investment, the trustees are likely to do no more than have in mind the fact that the interest free loan is outstanding and provisionally, at least, available should the need so require. In a high proportion of cases most trustees making such interest free loans are more likely simply to take note of the existence of the interest free loan rather than to make, let alone state, any decision as to whether or not to call in the loan. Barring special circumstances or, perhaps, some communication from the beneficiary, they are unlikely to change what is, after all, a decision made for the benefit of the borrower/beneficiary in the exercise of what is essentially a dispositive power by the trustees.

26. Walker LJ prefaced his conclusions with the observation at paragraph 35

> "Whatever the difficulties the Court has to do its best to make sense of the statute, that means not only making grammatical sense of the text but also finding a rational scheme in the legislation ..."

I do not think that the function of the Court goes further than to ascertain the intention of Parliament in enacting the statute in question from the words actually used. The danger in embarking upon an expedition to "find a rational scheme" of the legislation is that the Court will substitute for the intention of Parliament manifest from the legislation its own views as to the reasons for the legislation which may or may not be manifest therefrom. An illustration of these dangers is found immediately in paragraph 36 where Walker LJ observes:

> "What I have called the second generation and third generation provisions were enacted in order to prevent the avoidance of capital gains tax, on a massive scale, by the appointment of non-resident trustees ..."

Now it may or may not have been the case that the provisions originally found in the Finance Act 1980 (together with their predecessor, section 42 of the Finance Act 1965) were enacted "to prevent the avoidance of capital gains tax on a massive scale". What is equally apparent is that, unlike provisions such as are found in sections 703 or 739 of the Income and Corporation Taxes Act, there is nowhere to be found in the sections 87 to 98A a statement that they are intended to prevent the avoidance of tax. The sole intention manifest from these provisions is to devise a means of bringing within the charge to capital gains tax gains accruing to non-resident trustees which would otherwise escape tax in cases where the person enjoying those gains is a United Kingdom resident and domiciled beneficiary. No doubt Parliament had in mind, in enacting these provisions, the prevention of avoidance of tax on a massive scale. But, as expressed, the only intention manifest is to provide this rational scheme for taxing gains in the hands of the United Kingdom beneficiaries. That is the only "rational scheme". The problem of interpretation which the Court had to determine had to be decided by reference to that background rather than some assumed anti-avoidance purpose in the legislation.

27. *I return to the Crown's argument: the Court of Appeal accepted that the* main argument advanced on behalf of the taxpayer (*viz.* that the benefit conferred by the interest free loan should be valued once and for all at the

time it was made) was a permissible interpretation of section 97 TCGA. The Crown's interpretation involved the proposition that there were a series of capital payments made as it were on a day to day basis by the omission to call in the loan and that those capital payments should be valued by reference to the interest forgone on the preceding day. The Court of Appeal treated this alternative as being one which was equally permissible to that advanced by the taxpayers. The Court preferred the Crown's alternative because it accorded with what it considered to be the general scheme of the legislation.

28. The first question was whether the Crown's interpretation was one which was permissible. The conclusion of the Court was expressed thus (paragraph 39):

> "The construction adopted by the Judge is in my view a permissible (though awkward) construction which gives effect to the manifest purpose of the legislation."

Previously in paragraph 38 the Court appeared to have tried to answer the question of whether the construction argued by the Crown was "permissible", Walker LJ said:

> "The need to establish the precise date of a capital payment is a theoretical requirement in every case but in many cases (including these appeals) it does not create any practical difficulties."

Pausing there, it cannot be said that the precise date of a capital payment is a purely theoretical requirement. The precise date of a capital payment is of crucial importance to the scheme of legislation – in particular the provisions of section 87(4) referred to above, the "matching" provisions, and the provisions of section 91 which provide for an increase in tax where there is delay in distributing the chargeable gains. The Judge continued:

> "There is no suggestion that any other beneficiary of either settlement received any sort of capital payment at any material time."

This is really quite immaterial to the question of whether the Crown's construction is permissible or not. Then he said

> "In a case where it was of practical importance, beneficiaries faced with assessments might be advised to ask their non-resident trustees

> for minutes of trustee meetings or other details of their decision-making processes, so that these could be put in evidence.[8] In the absence of such evidence time apportionment on a daily basis is the fairest course (and is consistent with the matching rules in s.92(4), the context in which the question is most likely to arise).

That is as far as one gets with any attempt by the Judge to establish that the Crown's interpretation is worthy of the description "permissible". At the risk of repetition I observe that the Crown's interpretation involves the proposition (a) that, notwithstanding that the trustees do not meet on a daily basis and, even when they do meet probably do not necessarily consider whether or not to call in the loan, the mere passive act of allowing the loan to remain outstanding does on each day involve the conferring of some benefit on the taxpayer/borrower; (b) that the value of the benefit conferred is not, the interest foregone in the twenty-hours which pass before the next hypothetical "capital payment" because it is accepted for these purposes that, in common with the benefit conferred by the actual making of the interest free loan, the future benefit of a repayable on demand loan on its failure to call it in is nil. The assessable benefit (it appears) is the interest which the trustees could have recovered on the same loan had they charged interest in the preceding twenty-four hours. This is not just an "impermissible" construction. It has but to be stated to be shown to be manifest nonsense and it is not surprising that the Court of Appeal did not attempt to analyse it further than is stated above.

29. It might be thought unnecessary to take the matter further and comment on the Court's views on statutory interpretation which led them to prefer the Revenue's interpretation of section 97 to the taxpayer's interpretation. At paragraph 35 Walker LJ started off with laudable intentions expressed as follows:

> "That is not to say that the Court should start off with preconceptions about what it expects to find, or that it should shrink from saying so in the rare case where a tax statute has 'plainly misfired'..."

The citation was from *IRC v Ayrshire Employers Mutual Assurance Association* (1946) 27 TC 331 at 347 per Lord McMillan. In that case a legislative provision which had apparently been enacted to cover only the

8 It would be surprising if in many cases the beneficiaries could compel production of these documents (compare *Re Londonderry's Settlement* [1965] Ch.918, a case with which Walker LJ would have been familiar).

situation which was then before the House of Lords had in fact wholly failed to achieve its object. The House found that the defects in drafting were such that the section achieved nothing whatever. One cannot say the same about the taxpayer's contentions as to the interpretation of sections 87 to 98A. These provisions plainly strike at a high proportion of capital payments made to United Kingdom beneficiaries. The question is whether they have "misfired" in the instant case of interest free loans. The fact that the charging provisions in an Act, which are clearly effective to catch a high proportion of the payments at which it is aimed, do not, on one interpretation, catch a particular benefit does not of itself entitle the Court to devise a construction of the Act which it cannot sensibly bear so as to ensure that the particular benefit concerned is caught. Walker LJ cites the passage from Viscount Simon LC's speech in *Nokes v Doncaster Amalgamated Collieries* [1940] AC 1014 at 1022:

> "If the choice is between two interpretations, the narrower of which would fail to achieve the manifest purpose of the legislation, we should avoid a construction which would reduce the legislation to futility and should rather accept the bolder construction based on the view that Parliament would legislate only for the purpose of bringing about an effective result".

In *Nokes v Doncaster Amalgamated Collieries* the Courts had to construe a provision in the Companies Act 1929 relating to the amalgamation of companies under which their "undertakings" might be transferred. The question before the House was whether an order of the Court for the amalgamation of the companies under the provisions of the Act operated - without more - to transfer of the benefit and burden of contracts of employment (the wider construction) or whether the Act should be narrowly construed as to be confined to that part of the undertaking which did not include such contracts. The House of Lords preferred the narrower construction with the consequence that the benefit and burden of the contracts of employment did not pass. It could have been said that it was manifest from the scheme found in the provisions of section 154 of the Companies Act 1929 that the benefit and burden of contracts of employment should pass. But the House concluded that they did not.

30. Now, in this case, I can see no justification for supposing from the language used in sections 87 through to 98A TCGA that it was the manifest intention of Parliament that the benefit accorded by the making of an interest free loan repayable on demand should be valued otherwise than at the time the loan was made. What other "manifest intention" is evidenced from the

legislation? Obviously the intention is to bring within the charge capital payments made out of chargeable gains accruing to the non-resident trustees where those capital payments are received by United Kingdom resident and domiciled beneficiaries. The Act then goes on to lay down provisions which in a high proportion of cases will be fully effective to achieve the result at which Parliament was aiming, providing a mechanism as to when and how those payments would be brought within the charge and what proportion of that would be charged and what indeed would be treated as a capital payment. The "manifest intention" of Parliament evidenced from this legislation is to provide a means for assessing the gain represented by that capital payment. It is not to provide some catch-all mechanism whereby anything which the Courts, at the behest of the Revenue, deem to be of benefit to the taxpayer should be brought within the charge.

31. The approach of the Court of Appeal is yet another illustration of the timidity of the Courts of the last twenty years when faced with what they perceive as tax avoidance or even a tax advantage. No judge wishes to give a decision which will be seized on by the tax avoider as a precedent or which necessitates a change in the law. But timidity does not justify an interpretation of the words used which they cannot sensibly or arguably bear - still less an interpretation which involves a redrafting of the provisions which the Court is called on to construe.

### The Secondary Argument

32. The secondary argument originally raised was that the taxpayers here derived nothing of benefit because, if the loans had been at interest, that interest would have belonged to them in any event as life tenants. In other words, assuming the first argument advanced by the taxpayer and considered above to be wrong, the "value" of the benefit actually derived by the individual taxpayers as life tenants on each omission to call in the loan was nil. The strength of this argument depended in large part on the view that the "value" of the benefit should be measured by reference to an objective view which would calculate the value of the interest free loan simply on the basis of what might have accrued if the loan had been at arm's length. Given that an interest free loan made to a beneficiary can usually only be made by the trustees in exercise of the dispositive powers to distribute property to beneficiaries, one cannot but think that the argument that the view which has regard to the "value" of the capital payment to the beneficiary concerned of the benefit is other than correct. If the loan had been at interest the life tenant would have been entitled to that interest.

Section 97(1)(a) TCGA would prevent that interest being assessed as a capital payment. Why therefore should the life tenant be treated any differently if the loan is not at interest but is interest free?

33. In the Court below[9] the view was expressed that a loan would of itself be of value to the beneficiary since he would have the ability to do as he liked with the money. But the key point is not whether the mere making of a loan is a benefit of value. After all, a loan at interest under which the interest was the market rate will "confer a benefit" on the borrower life tenant as giving him the ability to deal as he liked with the money borrowed. But that was not the "benefit" identified by the Court as having a value equal to the capital payment. The "benefit" (the Crown said) was the interest foregone to which the life tenant would automatically have been entitled as an income beneficiary. The value of that benefit is clearly nil. So the grounds on which Lloyd J in the Court below proceeded are clearly fallacious.

**The Future**

34. Leave to appeal to the House of Lords was refused by the Court of Appeal in *Cooper v Billingham*. Although the Appeals Committee of the House of Lords may yet be inspired to give leave by the untidy and unhappy judgment of the Court of Appeal, the chances of obtaining such leave must at best be considered problematic. So what does the future hold?

35. It is perfectly clear that the reasoning, if reasoning is not too flattering a description, which the Court of Appeal adopted in accepting the Revenue's interpretation of section 97 TCGA is as capable of being applied to other forms of transaction as it is to the loans which were under consideration in that case. Thus licences to occupy land revocable at the trustees' discretion, whether granted to life tenants or not, or the right to use and enjoy chattels are all potentially open to attack as "capital payments".

36. The obvious advantage of a loan to a beneficiary is that, save in cases where it is out of property derived from the borrower,[10] the loans will constitute themselves a debt owing by the borrower beneficiary to the trustees which

9 There is no adequate analysis of this in the Court of Appeal – possibly because the point was not argued.

10 When section 103 of the Finance Act 1986 may apply. This will only exceptionally affect the position now. If Mr Cooper and Mr Fisher had made their settlements after 19th March 1991 they would have been assessed on the trustees' gains under section 86 of TCGA without any capital payment having to be made to them.

will be deductible in arriving at his inheritance tax estate. By contrast some leases or licences to occupy land or other property may, depending on the circumstances, amount to the grant of interests in possession for the purposes of inheritance tax. In such cases the property in question will become part of the licensee beneficiary's inheritance tax estate. Of course, this is immaterial if the licensee is already the life tenant since the property will already have been comprised in his estate. But in other cases trustees would be obliged to proceed with caution when granting such licences. A lease other than a lease for life, or measured by some period other than the human life, usually avoids the problem. But a distinction will have to be drawn for the purposes of inheritance tax between loans and grants of rights to enjoy other property.

37. For immediate purposes it would be practicable to overcome some of the difficulties posed by *Cooper v Billingham* by procuring that the loans made to life tenants be at a rate of interest corresponding to the market rate. The trustees would (provided the trust instrument was suitably drawn for these purposes) simply refrain from collecting the interest. The interest (which would otherwise be charged under Case III of Schedule D) could not be assessed as the income of anyone unless in fact it was received by the trustees.[11] Of course, the failure by the trustees to collect the interest is a "benefit" to the beneficiary borrower. But in this case the benefit in the form of the interest not actually collected[12] is of no appreciable value because it remains outstanding as a debt. The same arrangement would not be readily open where assets consisted of land or chattels where (a) the rents are normally part of a gross sum (not pure income) against which expenses have to be set before the balance to which the life tenant is entitled is struck, and (b) any contractual rents have expressly to be foregone before the time the payment falls due if they are to escape the charge to tax in the hands of the recipient.

11 Receivability without receipt is nothing for these purposes.

12 This assumes for the Revenue that this is a capital payment "received" as they successfully claimed in *Cooper v Billingham*.