The Offshore Taxation Review

WHAT DID *MARSHALL v KERR* DECIDE?

Robert Venables QC[1]

1 The Problem

A person who is unlikely to be domiciled and resident or ordinarily resident in the UK at the time of his death but who wishes to leave part of his estate to UK resident beneficiaries should create a non-resident testamentary trust, rather than make absolute gifts. Neither the Offshore Settlor Provisions[2] nor the Offshore Beneficiary Provisions[3] will apply to the trust, so that gains can be realised by the trustees and capital distributed even to UK domiciled and resident beneficiaries without any charge to capital gains tax. If the testator is not domiciled in the UK for inheritance tax purposes and the beneficiaries are, this could also involve substantial inheritance tax savings.[4]

Suppose that the estate of a person not both domiciled and resident or ordinarily resident at the time of his death has passed absolutely to a person resident in the UK. What would be the effect of his entering into a variation of the dispositions of the deceased's estate and making an election pursuant to Taxation of Chargeable Gains Act 1992 section 62 that the variation should be deemed to have been made by the deceased? The variation would normally result in the property passing on death being comprised, as from the time of the death, in a non-resident settlement. There is no dispute that, provided the conditions contained in section 62 are otherwise complied with, the variation would be effective to prevent any

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1 Robert Venables QC. An earlier form of this article appeared in *Taxation* in 1994.

2 Contained in Taxation of Chargeable Gains Act 1992 section 86.

3 Contained in Taxation of Chargeable Gains Act 1992 section 87.

4 See my *Inheritance Tax Planning* 3rd edition, published by Key Haven Publications in 1997, at D.15.

chargeable gain being realised by the legatee on making the deed of variation.[5] A hotly disputed question was whether for the purposes of the Offshore Beneficiary Provisions the deceased would be deemed to be the only settlor of the settlement, with the result that the Provisions did not apply.

2 *Marshall v Kerr* - The Result

While the House of Lords in *Marshall v Kerr*[6] held the beneficiary was a settlor of the settlement on the "facts" of that particular case, their judgments leave the true scope of the decision open to doubt. It will probably apply to a gift of residue under Irish law but not to a specific gift under English law; to a pecuniary legacy under New York law but not to a universal succession by the heir under French law. The quality of the reasoning and the unusual circumstances under which it was argued must make it a good candidate for overruling by a differently constituted House.[7]

3 The Facts

Mr Brooks died in 1977 domiciled and resident in Jersey and left half of his residuary estate to Mrs Kerr, his daughter. Within the two year period and while the estate was still being administered she entered into a variation of the dispositions of his estate whereby her share was settled on non-resident trusts principally for her own benefit. The trustees realised chargeable gains and made capital payments to her. The question was whether she, a United Kingdom resident and domiciliary, was the settlor of the settlement for the purposes of the Offshore Beneficiary Provisions,[8] or whether, by virtue of the deeming provisions in what was then section 24 Finance Act 1965,[9] she was deemed not to be the settlor so that, there being no settlor domiciled and resident or ordinarily resident

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5 See my *Non-Resident Trusts* 6th edition, published by Key Haven Publications in 1995, at 1.4.3.

6 [1994] STC 638.

7 When the case was first decided, it was feared that the Inland Revenue might argue that it severely curtailed the tax effectiveness of post-death variations not only for capital gains tax but also inheritance tax. The Capital Taxes Office have, rightly, since announced that such is not their view: see RI 101 (February 1995).

8 Then contained in Finance Act 1981 section 80.

9 Now section Taxation of Chargeable Gains Act 1992 section 6.

in the United Kingdom at any material time, the Offshore Beneficiary Provisions could not apply.

4 The Decisions

The Special Commissioner and the Court of Appeal found unanimously in her favour. Mr Justice Harman found in favour of the Revenue. So did the House of Lords, the Lord Chancellor all but dissenting.

5 The Statute

Finance Act 1965 section 24(11) provided:

> "If not more than two years after a death any of the dispositions of the property of which the deceased was competent to dispose ... are varied by a deed of family arrangement or similar instrument, this section shall apply as if the variations made by the deed or other instrument were effected by the deceased, and no disposition made by the deed or other instrument shall constitute a disposal for the purposes of this Part of this Act."

6 The Taxpayer's Argument

The argument for the taxpayer was that section 24(11) clearly applied to put the trustees in the shoes of Mrs Kerr for the purposes at least of section 24(7), which provided that on a person acquiring any asset as legatee, the legatee should be treated as if the personal representatives' acquisition of the asset has been his acquisition of it. As it was clear from subsection (1) that the personal representative was deemed to acquire the assets of which the deceased was competent to dispose on his death, it followed that the trustees were deemed to have acquired such assets at the time of the testator's death. There was therefore no moment in time when the assets could have belonged to Mrs Kerr and she therefore could not have settled them. One had here a deeming on a deeming on a deeming. One applied the deeming provisions literally and reached their logical conclusion because that did not result in injustice, absurdity or anomaly and did not defeat the obvious purposes of the statute.

7 The Browne-Wilkinson Point

This argument commended itself to the Court of Appeal. Nor could the House of Lords fault it. But by the hearing before the Appellate Committee of the House of Lords, the Inland Revenue had obtained the assistance of two powerful advocates, Mr Christopher McCall QC and Lord Browne-Wilkinson.

Lord Browne-Wilkinson freely admitted in argument that he found the result of the Court of Appeal decision unacceptable and he was trying to find a way round it. To escape the logical conclusion of the taxpayer's argument, Lord Browne-Wilkinson seized on the supposed fact that during the course of the administration Mrs Kerr had a right to have the estate administered, which right was not a proprietary interest in the assets of the estate.[10] It was that which she settled and nothing in section 24(11) deemed her not to have settled it. The argument for the taxpayer in reply to this proposition was that in asking, say, in 1983, who was the settlor of the settlement, one had to ask who had provided the then settled property. In one very obvious sense the testator had provided it, since his assets were deemed to have passed directly from him to the trustees. If one asked to what extent the settled property consisted of or represented the right to have the estate administered, the answer was 'not at all'. *After the event*, the personal representatives were deemed, by virtue of section 24(7), never to have owned the assets of the estate which in fact passed to the trustees. A right to have an empty estate administered was therefore worth nothing. An addition of that right to the settled property added nothing.

This argument seemed to me to be unanswerable. Given that it was unanswerable, it was not surprising to find that it was not effectively answered. The nearest Lord Browne-Wilkinson came to answering it was to state that if the variation had been made before assets of the estate were sold (and new assets acquired) by the personal representatives, then the trustees would not have been deemed to have acquired from the deceased the new assets they in fact acquired. Hence it would be unjust and absurd if the question whether the legatee were the settlor depended on whether assets had been sold in the course of administration. (The Revenue had expressly conceded that the taxpayer's argument gave rise to no injustice or absurdity!) The argument for the taxpayer which met *this* point was again unanswered because, in my respectful view, it was unanswerable. This was that, as the personal representatives' acquisition was deemed to be the trustees' acquisition, the trustees were deemed to have acquired the assets in question not from the personal representatives but from the vendor to the personal

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[10] This proposition, although jurisprudential nonsense, is at least a well settled mistake, having been decided by the House of Lords in *Lord Sudeley v Attorney-General* [1897] AC 11 and approved by the Privy Council in *Commissioner of Stamp Duties v Livingston* [1965] AC 694.

representatives for the consideration the personal representatives had themselves given and not by way of gift from the beneficiary. Whether or not the deceased was the settlor was irrelevant. All that mattered was that the beneficiary was deemed not to be a settlor.

8 A Case for the House of Lords to Overrule Itself?

Although the Revenue had obtained leave to appeal to the House of Lords on the basis that the cases involved a point of law of general importance, they instructed Leading Counsel only at the last moment. He developed a whole battery of new arguments, of which the taxpayer was given notice only two weeks before the hearing. Lord Browne-Wilkinson's point was in the Revenue's printed Case in embryonic form but was fully developed only during the course of the hearing and, it now appears, afterwards! In these circumstances, it is not altogether surprising that the wrong decision was reached. For this, and on account of the anomalies referred to below,[11] it might well be worthwhile for Mrs Kerr or some other taxpayer to take the case to the House of Lords a second time, under the leapfrog procedure, and to attempt to persuade their Lordships not to follow this decision on the grounds that it was decided *per incuriam*. Lord Lowry and Lord Templeman have retired, Lord Lowry being replaced by Lord Nolan who, unlike Lord Templeman, would find it 'difficult to resist' 'a narrow and technical argument' if that argument, no matter how narrow and technical, was right in law.

9 Estate Governed by Foreign Law

What if the dispositions of the estate of the deceased are governed by some foreign law, for example the Napoleonic Code, which is prevalent in all the civil law countries conquered by Napoleon and their possessions and former possessions, e.g. in most of Europe? Nor is it altogether fanciful to imagine that the dispositions of the estate of a foreign-domiciled testator might be governed by foreign law. If Mr Brooks had died domiciled in France and left the whole of his estate to his children in equal shares, what would have been the position? I believe that evidence could easily be led that French law knows nothing of the *Lord Sudeley* principle and that the entire legal and beneficial ownership of the estate would have vested in the children who would also have been the equivalent of the personal representatives. Hence one would be back with the Court of Appeal decision!

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[11] At 9 and 10.

As Leading Counsel for the taxpayer, I in fact protested that the dispositions of the estate were regulated by Jersey law and that law might well, being basically Norman law, be very different from English law so that *Lord Sudeley* might not apply. Lord Templeman laughed the point off. Their Lordships assumed Jersey law to be the same as English law. That would have been proper if the Revenue had adduced the argument based on *Lord Sudeley* no later than at Special Commissioner level, as the taxpayer would then have had the opportunity to adduce evidence to the contrary.[12] If any other court had allowed the Revenue to take for the first time a new point of law which depended on questions of fact which had not been resolved below, the House of Lords would have been the first to castigate it. Clearly, different principles operate in their Lordships' House.

10 Specific Gifts

What of the position where the dispositions of the estate are governed by English law, or by a law equivalent to English law, but the variation is of a specific legacy or bequest? In that case, *Lord Sudeley* has no application. It applies only to interests in residue. The common law applied a doctrine of relation back. When the asset vested in the legatee, he was deemed to have owned it since the date of death. The common law rule has been held to apply for income tax purposes: see *Commissioners of Inland Revenue v Hawley* 13 TC 327, a decision of the prestigious Mr Justice Rowlatt, which has stood unchallenged for two-thirds of a century.

11 Remaining Problems

In summary, the House of Lords decision has closed one volume and opened another. It has created more problems than it has solved. It has given rise to injustice and anomaly. Given the litigation it may well spawn, the Revenue Bar should be very grateful for it.

12 Construction of Deeming Provisions

Mr Justice Harman had made his own mind up *a priore* as to how far one should apply the deeming provision. He misinterpreted the classic cases on construction. That was a very important error as taxing statutes abound with deeming provisions and hypotheticals, to which the same rules apply. If judges were allowed willy-nilly to apply their own notions of what Parliament might have said had it thought

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12 This she can still do as regards years 1985/86 onwards, as there is no estoppel.

about the matter, rather than what it did say, the construction of taxing statutes would be wide open and the result in tax litigation would depend on the length of the judge's foot. The Court of Appeal set all that right and re-established the classic rules. In the House of Lords, Lords Templeman and Lowry adopted the approach of Lord Justice Harman. Lords Goff and Browne-Wilkinson approved the Court of Appeal decision on the principles of statutory construction to be adopted. The Lord Chancellor eventually sided with the latter in a short judgment which I decode to mean that he would have dissented but thought it better to ally himself with Lords Goff and Browne-Wilkinson and the Court of Appeal rather than with Lords Templeman and Lowry. That at least is one good result of the case.

13 General Advice

To avoid any argument, persons who are non-UK domiciled or resident should be invited to create a testamentary trust in their will. If they have died without doing so, it will normally still be advantageous for the will to be varied so as to create a non-resident trust, even if the beneficiaries are settlors for capital gains tax purposes. The trust will still have all the advantages of deferral (and possible avoidance) of non-resident trusts created by UK domiciled and resident or ordinarily resident settlors provided it is not caught by the Offshore Settlor Provisions. Moreover, the creation of the trust will not give rise to any charge to capital gains tax. If the deceased was not UK domiciled for inheritance tax purposes, the trust could have substantial inheritance tax advantages. The wording of Inheritance Tax Act 1984 section 142, which roughly corresponds to Taxation of Chargeable Gains Act 1992 section 62, does not admit of any sensible doubt that if a qualifying variation is entered into the deceased is deemed to be the only settlor of the settlement for inheritance tax purposes.[13]

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[13] Section 142 was almost repealed by Finance Act 1989. Its future cannot be taken to be entirely assured.