NO. 1339—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—12TH, 13TH AND 16TH APRIL, 1945

COURT OF APPEAL—17TH, 18TH, 19TH AND 20TH DECEMBER, 1945

(1) CUNARD'S TRUSTEES *v.* COMMISSIONERS OF INLAND REVENUE [1]
(2) MCPHEETERS *v.* COMMISSIONERS OF INLAND REVENUE

Income Tax and Sur-tax—Annual payments—Capital or income—Payments made to life tenant of residuary estate out of capital of estate, by way of addition to income, prior to ascertainment of residue—Income Tax Act, 1918 (8 & 9 *Geo.* V, *c.*40), *Rule* 21 *of General Rules*; *Finance Act,* 1938 (1 & 2 *Geo.* VI, *c.*46), *Section* 30.

(1) *By her will the testatrix, who died in* 1935, *devised a freehold property to trustees (the Appellants in the first case) on trust to permit her sister (the Appellant in the second case), who had lived with her there, to reside therein rent free for life. The trustees were also directed to hold the testatrix's residuary estate on trust during the sister's life to pay out of the income thereof all rates, taxes and other outgoings for the maintenance and upkeep of the said freehold property, and subject thereto to pay or apply the remainder of the income of the residuary estate to or for the benefit of the sister during her life, with remainder over on the death of the sister to a nursing institute absolutely. The will further provided that, if in any year the income of the residuary estate were insufficient to enable the sister to live at the said residence in the same degree of comfort as during the testatrix's lifetime, the trustees were empowered to apply such portion of the capital of the residuary estate by way of addition to the income as they might think fit.*

The residue of the estate was not ascertained until 7th February, 1940, *and during the period of administration the trustees, in exercise of the aforesaid power, raised and paid to the sister sums out of the capital of the estate during the years* 1936–37 *to* 1939–40 *inclusive.*

On appeal to the Special Commissioners against assessments to Income Tax made upon the trustees under General Rule 21, *and in view of Section* 30 *of the Finance Act,* 1938, *for the years* 1938–39 *and* 1939–40 *in respect of the said capital sums (grossed up), the trustees admitted that, as the law then stood by virtue of the decisions in* Brodie's Trustees *v.* Commissioners of Inland Revenue, 17 T.C. 432, *and* Lindus & Hortin *v.* Commissioners of Inland Revenue, 17 T.C. 442, *any capital sums so paid between 7th February,* 1940 (*the date of ascertainment of the residue*) *and 5th April,* 1940, *were correctly assessed upon them; but they contended that, as regards the payments out of capital made between 6th April,* 1938, *and 7th February,* 1940, *they were not payments in respect of the sister's limited interest under the will within the meaning of Section* 30 *of the Finance Act,* 1938, *and they were not annual payments assessable to tax. The Special Commissioners rejected the trustees' contentions and confirmed the assessments.*

[1] Reported (K.B.) 173 L.T. 258; (C.A.) 174 L.T. 133.

(2) *The Appellant in the second case appealed against assessments to Sur-tax made upon her for the years* 1937–38, 1938–39 *and* 1939–40 *to include the sums paid to her out of the capital of the estate. The Special Commissioners, following on their decision in the first case, confirmed the assessments.*

Held, *that under the terms of the will the purpose for which the payments were made was an income purpose and nothing else; that the payments were "annual" within the meaning of Rule* 1 *of Case* III *of Schedule D, and that the payments were properly chargeable to both Income Tax and Sur-tax.*

The Court was of opinion that the payments were not made in respect of a limited interest in the residue of the estate and that Section 30 *of the Finance Act,* 1938, *did not apply.*

CASES

(1) *Cunard's Trustees* v. *Commissioners of Inland Revenue*

CASE

Stated under the Income Tax Act, 1918, Section 149, and the Finance Act, 1927, Section 26, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 16th September, 1942, the trustees of the will of Mrs. Florence Cunard, deceased (hereinafter called "the Appellants"), appealed against two assessments to Income Tax in the sums of £2,826 12*s.* 3*d.* and £2,923 6*s.* 8*d.* made upon them for the years ending 5th April, 1939 and 1940, respectively, under the provisions of Rule 21 of the General Rules applicable to Schedules A, B, C, D and E of the Income Tax Act, 1918, as amended by the Finance Act, 1927, Section 26.

2. The sole question raised in these appeals is as to whether certain payments made out of realisations of capital from the estate of Mrs. Florence Cunard, deceased, to her sister, Miss Ella McPheeters, are assessable under the provisions of the said Rule 21 and in view of the provisions of the Finance Act, 1938, Section 30.

3. Mrs. Florence Cunard died on 24th January, 1935. By her will dated 16th May, 1931, she devised under clause 3 the property known as "The Grove" to her trustees in fee simple upon trust to permit her sister, Miss Ella McPheeters (who already lived there with her), to reside therein rent free during the remainder of her life, the trustees keeping the same in good repair and fully insured and paying all outgoings as in the will provided; and in the event of The Grove becoming unfit for habitation through fire or other cause, of which fact they, the trustees, were to be sole judges, the trustees were to provide a suitable house at the expense of the estate of the testatrix.

By clause 10 of the will the trustees were directed during Miss McPheeters' lifetime to hold the residuary estate upon trust as follows:—

"(*a*) My Trustees shall pay all rates taxes and other outgoings of every "kind and description whatsoever for the maintenance and upkeep of "The Grove and the cottages and outbuildings connected therewith "including all repairs of every kind and insurance out of the income of "my residuary estate and subject thereto and to the payment of any

" other outgoings properly chargeable to the income of my residuary " estate they shall pay or apply the whole of the remainder of the " income to or for the benefit of my sister during her life.

" (*b*) If in any year the income of my residuary estate shall not be " sufficient to enable my sister to live at The Grove in the same degree " of comfort as she now lives there with me then I empower my " Trustees to apply such portion of the capital of my residuary estate " by way of addition to the income as they in their absolute and " uncontrolled discretion may think fit moreover any capital so " applied shall not be replaced out of the income of a subsequent " year but shall be treated as an additional bequest to my sister."

By clause 11 of the will the trustees were directed after the death of Miss Ella McPheeters to stand possessed of the residuary estate both as to capital and income for such purposes as the testratix might by codicil direct.

By clause 6 of the second codicil to her will the testatrix, subject to the bequests as contained in the will and the first and second codicils thereto and to the payment of any duties, devised and bequeathed the remainder of her estate, including The Grove (if not sold or otherwise disposed of by her), unto The Queen's Institute of District Nursing absolutely.

Our attention at the hearing was drawn in particular to clauses 3, 9, 10 and 11 of the will, and clause 6 of the second codicil to the said will. A copy of this will is annexed hereto, marked " A ", and forms part of this Case(1).

4. The administration of the estate took a considerable time and the residue was not ascertained until 7th February, 1940. During the period of administration the income of the estate was not sufficient to enable Miss Ella McPheeters to live at The Grove in the same degree of comfort as she had lived there with the testatrix. The executors of the said will, therefore, in exercise of the discretion conferred upon them thereunder, realised certain capital investments and the moneys resulting therefrom were paid to Miss Ella McPheeters to enable her to maintain her position at The Grove.

5. The following payments were made to Miss Ella McPheeters by the executors of the said will during the four years ended 5th April, 1940 :—

	£	s.	d.
Year ended 5th April, 1937	2,502	1	11
,, ,, ,, ,, 1938	2,910	10	6
,, ,, ,, ,, 1939	3,107	15	7
,, ,, ,, ,, 1940	2,946	9	0

6. In order to make the above payments the following amounts were transferred from capital account, the money being raised by sale of investments from time to time, viz. :—

	£	s.	d.
Year ended 5th April, 1937	303	1	2
,, ,, ,, ,, 1938	1,501	18	4
,, ,, ,, ,, 1939	2,049	5	11
,, ,, ,, ,, 1940	1,900	3	4

The sums of £2,826 12*s.* 3*d.* and £2,923 6*s.* 8*d.*, being the amounts of the said assessments, are the gross equivalents of the net amounts of £2,049 5*s.* 11*d.* and £1,900 3*s.* 4*d.*, respectively.

(1) Not included in the present print.

7. The trust accounts for the years ended 5th April, 1936, to 5th April, 1940, are not annexed hereto but may be referred to as part of this Case.

A summary of the yearly income accounts for the years ended 5th April, 1936, to 5th April, 1942, and payments made to Miss Ella McPheeters is annexed hereto, marked " B ", and forms part of this Case(1).

8. It was admitted on behalf of the Appellants that Miss Ella McPheeters had, during the administration period, a limited interest in the residue of the said estate within the meaning of the Finance Act, 1938, Section 30.

9. It was further admitted on behalf of the Appellants :—

(1) That all payments made to Miss Ella McPheeters during the years ended 5th April, 1938, 5th April, 1939, and 5th April, 1940 (other than those made out of capital, referred to in paragraph 6 hereof), fell within the provisions of Part III of the Finance Act, 1938.

(2) That if it were found that the said payments referred to in paragraph 6 hereof made during the years ended 5th April, 1939, and the period 6th April, 1939, to 7th February, 1940, fell within the provisions of the said Part III, then the said assessments were correctly made in the respective gross figures of £2,826 12*s*. 3*d*. and £2,923 6*s*. 8*d*.

(3) That, as the law now stood, all payments of the nature described in paragraph 6 hereof made between 7th February, 1940 (the date of the ascertainment of the residue), and 5th April, 1940, were correctly assessed upon the Appellants.

10. It was contended on behalf of the Appellants :—

(*a*) That the payments referred to in paragraph 6 hereof were not payments made in respect of the limited interest of Miss Ella McPheeters.

(*b*) That the provisions of the Finance Act, 1938, Section 30, did not apply to the present case.

(*c*) That the sums paid were not annual sums.

11. It was contended for the Respondents :—

(*a*) That the payments out of capital made during the years ended 5th April, 1938 (for the purpose of charging Sur-tax only), 5th April, 1939, and 5th April, 1940, must be deemed for all the purposes of the Income Tax Acts to have been paid to Miss Ella McPheeters as income for the said years, respectively, in accordance with the provisions of Part III of the Finance Act, 1938.

(*b*) That the said payments were annuities or other annual payments within the meaning of Rule 21 of the General Rules applicable to all Schedules of the Income Tax Act, 1918.

(*c*) Accordingly, the assessments made upon the Appellants under the said Rule 21, as amended by Section 26 of the Finance Act, 1927, were properly and correctly made.

(*d*) Alternatively, it was contended that the decision in *Corbett* v. *Commissioners of Inland Revenue*, 21 T.C. 449, had no application to the facts hereinbefore mentioned, and that the sums referred to in paragraph 6 hereof were income in the hands of Miss Ella McPheeters.

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(1) Not included in the present print.

12. We, the Commissioners, held that under the provisions of the Finance Act, 1938, Section 30, any sums paid during the administration period to a person who has a limited interest in the residue of an estate must be deemed to have been paid to that person as income for the years of assessment in which the sums were paid. We held that Miss Ella McPheeters was a person who, during the administration period, had a limited interest in the residue of the said estate and that sums were paid to her out of realisation of capital during this period. We further held that the sums so paid were annual payments, and that the appeal failed. We confirmed the said assessments.

13. The Appellants immediately after the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, and the Finance Act, 1927, Section 26, which Case we have stated and do sign accordingly.

R. COKE,
MARK GRANT-STURGIS, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C.1.

5th January, 1944.

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(2) *McPheeters* v. *Commissioners of Inland Revenue*

At the same meeting of the Special Commissioners Miss E. McPheeters appealed against assessments to Sur-tax for the three years to 5th April, 1940, which included sums paid to her out of realisations of capital of the estate of Mrs. Florence Cunard, deceased: the facts and contentions are as set out in the preceding Stated Case. The Special Commissioners held that the appeal failed.

The cases came before Macnaghten, J., in the King's Bench Division on 12th and 13th April, 1945, when judgment was reserved. On 16th April, 1945, judgment was given against the Crown, with costs.

Mr. Cyril L. King, K.C., and Mr. A. C. Nesbitt appeared as Counsel for the Appellants, and the Solicitor-General (Sir David Maxwell Fyfe, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Macnaghten, J.—By her will dated 16th May, 1931, the late Mrs. Florence Cunard appointed the Appellants in the first of these two appeals to be the executors and trustees thereof. By clause 3 of the will she devised her freehold property known as The Grove at Stanmore in Middlesex to her trustees upon trust to permit her sister, Miss Ella McPheeters (the Appellant in the second appeal), who lived with her there, to reside therein

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free of rent during the remainder of her life; they, during that time, keeping the place in good repair and fully insured and paying all outgoings as thereinafter provided.

Clause 10, paragraphs (*a*) and (*b*), provided as follows: "(*a*) My "Trustees shall pay all rates taxes and other outgoings of every kind and "description whatsoever for the maintenance and upkeep of The Grove and "the cottages and outbuildings connected therewith including all repairs of "every kind and insurance out of the income of my residuary estate and "subject thereto and to the payment of any other outgoings properly charge-"able to the income of my residuary estate they shall pay or apply the "whole of the remainder of the income to or for the benefit of my sister "during her life. (*b*) If in any year the income of my residuary estate "shall not be sufficient to enable my sister to live at The Grove in the "same degree of comfort as she now lives there with me then I empower "my Trustees to apply such portion of the capital of my residuary estate "by way of addition to the income as they in their absolute and uncontrolled "discretion may think fit moreover any capital so applied shall not be re-"placed out of the income of a subsequent year but shall be treated as an "additional bequest to my sister."

By clause 11 of the will the trustees were directed, after the death of Miss McPheeters, to hold Mrs. Cunard's residuary estate for such purposes as she might by codicil direct. By clause 6 of the second codicil dated 11th July, 1933, Mrs. Cunard, subject to the bequests contained in her will and the first and second codicils thereto and to the payment of any duties, devised and bequeathed the remainder of her estate to The Queen's Institute of District Nursing absolutely.

Mrs. Cunard died on 24th January, 1935. During the years ended 5th April, 1939, and 5th April, 1940, the income in the hands of the trustees, after discharging all outgoings properly chargeable to the income, amounted to no more than £1,058 9*s*. 8*d*. and £1,046 5*s*. 8*d*. The trustees were of opinion that these sums were not sufficient to enable Miss McPheeters to live at The Grove in the same degree of comfort as she had lived there with her sister, and they, accordingly, in exercise of the power conferred upon them by clause 10(*b*) of the will, applied capital by way of addition thereto. In the year ended 5th April, 1939, they raised by the sale of investments and paid over to Miss McPheeters £2,049 5*s*. 11*d*., and in the year ended 5th April, 1940, £1,900 3*s*. 4*d*.

Assessments to Income Tax in the sums of £2,826 12*s*. 3*d*. and £2,923 6*s*. 8*d*. (the gross equivalents of the net amounts of £2,049 5*s*. 11*d*. and £1,900 3*s*. 4*d*.) were made under Rule 21 of the All Schedules Rules, Income Tax Act, 1918, as amended by the Finance Act, 1927, Section 26, upon the trustees, who now appeal to the Court from a decision of the Special Commissioners confirming those assessments.

The administration of Mrs. Cunard's estate took a considerable time, and the residue was not ascertained until 7th February, 1940, more than 5 years after her death. Before the Special Commissioners the Appellants admitted that so much of the £1,900 3*s*. 4*d*. as was paid to Miss McPheeters out of capital between 7th February and 5th April, 1940, was correctly assessed upon them; but they denied that any part of the capital paid to her in the year ended 5th April, 1939, and between 6th April, 1939, and 7th February, 1940, was so assessable.

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The trustees made this admission because they were advised that the Special Commissioners were bound by the decisions of Finlay, J., as he then was, in the cases of *Brodie's Trustees* v. *Commissioners of Inland Revenue,* 17 T.C. 432, and *Lindus & Hortin* v. *Commissioners of Inland Revenue,* 17 T.C. 442. In the former case, the testator, Mr. Brodie, gave a life interest in certain property to his widow, with the proviso that if in any year the income therefrom did not amount to £4,000, his trustees should raise and pay to her out of capital such a sum as added to the income would make a total of £4,000, it being his expressed intention that the income payable to her should not be less than £4,000 a year.

In the case of *Lindus & Hortin* v. *Commissioners of Inland Revenue,* the headnote sufficiently states the facts, as follows: " The trustees under a will " were directed, on the death of the testator's widow, which occurred in " 1909, to hold in trust one-half of the residuary estate and to pay the " income thereof to his daughter for her life without power of anticipation " and, on her death, for her children in equal shares. The income from the " daughter's moiety proved insufficient for the maintenance of herself and " her home and by a deed of family arrangement executed in 1925, in which " the daughter and all her children joined, the trustees were authorised to " supplement the income of the daughter arising from the trust funds by " payment to her out of the capital of the fund of such sums as the trustees in " their absolute discretion thought necessary and proper for the maintenance " of herself and her home. During each of the years 1925–26 to 1929–30 " inclusive the trustees paid the daughter sums out of the *corpus* of the trust " fund in addition to the income of the fund, while they also paid for her " the rates, taxes, etc., on her house and other household expenses." It was held by the learned Judge in each of these cases that the sum raised out of capital, in addition to the income bequeathed by the will, was the taxable income of the recipient. In my opinion those cases cover the present one.

It was suggested that it was possible to distinguish the present cases from those cases, but I am unable to do so. It seems to me that, where money is directed to be paid out of capital in addition to an income bequeathed by the will, the addition must always be taxable income in the hands of the beneficiary, and the trustees who pay a net sum are assessable for the tax which should have been deducted and paid over to the Exchequer.

As to the payments which were made by the Appellants in the present case to Miss McPheeters out of capital before 7th February, 1940, under the power conferred upon them by clause 10(*b*) of the will, they contended that those payments were not assessable to tax on the authority of the decision of the Court of Appeal in *Corbett* v. *Commissioners of Inland Revenue,* 21 T.C. 449. The facts in that case were: " Under the will of her father, " who died on 22nd April, 1934, the Appellant's wife ", Mrs. Corbett, " was " entitled to a life interest in a share of his residuary estate. The executors " made up a balance sheet and income account as at 5th April, 1935, in " which appeared a large sum credited to the Appellant's wife . . . but the " residuary account of the estate could not be made up until 7th May, 1935." Before that date the executors had paid to Mrs. Corbett a sum of £6,000, part of the amount shown in the balance sheet of 5th April, 1935, as being due to her. That sum of £6,000 was paid on account of the life interest to which she was entitled in a share of the residuary estate. The Court of Appeal, consisting of the Master of the Rolls, and Romer and MacKinnon, L.JJ., held that they were bound by the decision of the House of Lords in

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The King v. *Special Commissioners of Income Tax* (ex parte *Dr. Barnardo's Homes*), 7 T.C. 646, to hold that the £6,000 paid before the residue had been ascertained was not income of the beneficiary and was not assessable to tax.

I can see no distinction between the present case and the case of *Corbett* v. *Commissioners of Inland Revenue*(1), and, therefore, I hold, subject to one further point to be mentioned, that the sums of money paid to Miss McPheeters out of capital before the residue had been ascertained were not assessable to Income Tax.

In answer to that plea, it was contended on behalf of the Crown that the sums paid to Miss McPheeters out of capital before 7th February, 1940, were assessable by reason of the provisions of Section 30 of the Finance Act, 1938, which is in Part III of that Act. It is to be observed that that Act was passed in the year following the decision of the Court of Appeal in *Corbett's* case.

Section 30, Sub-sections (1) and (2), of the Finance Act, 1938, provides as follows: " (1) The following provisions of this section shall have effect " in relation to a person who, during the period commencing on the death " of a deceased person and ending on the completion of the administration " of his estate (in this Part of this Act referred to as ' the administration " ' period ') or during a part of that period, has a limited interest in the " residue of the estate or in a part thereof." It is admitted that Miss McPheeters had a limited interest in the residue of the estate of Mrs. Cunard: she was entitled to a life interest. Sub-section (2) provides: " When any " sum has been paid during the administration period in respect of that " limited interest the amount thereof shall, subject to the provisions of the " next following subsection, be deemed for all the purposes of the Income " Tax Acts to have been paid to that person as income for the year of " assessment in which that sum was paid, or, in the case of a sum paid in " respect of an interest that has ceased, for the last year of assessment in " which it was subsisting."

It was argued by the Crown before the Special Commissioners, as it was argued before me, that these payments of capital to Miss McPheeters, in addition to the income to which she was entitled under the will of Mrs. Cunard, were sums paid during the administration period, and that they were sums paid during that period in respect of her limited interest; that is to say, in respect of her life interest in the estate.

Before the Commissioners that argument was successful, and they held that these payments out of capital were payments within the meaning of Section 30 (2) in respect of the life interest given to her under the will. That appears to me to put a very forced and unnatural construction on the words, " in respect of ". The words, " in respect of ", as used in that Sub-section, appear to me to be the same as, " on account of ". It cannot, I think, be said that a sum paid by way of addition to the income bequeathed by the will is a sum paid " in respect of " that income within the meaning of those words as used in the Finance Act, 1938, Section 30 (2). Therefore, in my opinion, the decision of the Special Commissioners was erroneous, and the assessment in respect of the payments made in the first of the two years should be discharged, and that made in respect of the second year must be reduced to the appropriate figure.

(1) 21 T.C. 449.

(Macnaghten, J.)

Unless the parties are agreed as to what reduction ought to be made, the case must go back to the Special Commissioners to fix the amount.

Mr. Nesbitt.—I do not think there will be any difficulty about that.

Macnaghten, J.—I should not have thought so.

Mr. Nesbitt.—It is the period the 7th February and the 5th April.

Macnaghten, J.—Yes. The Case does not disclose what the amount of those payments was.

Mr. Nesbitt.—No, my Lord.

Macnaghten, J.—The second appeal is an appeal by Miss McPheeters against assessments to Sur-tax made upon her upon the footing that the decision of the Special Commissioners in the first appeal was correct. The same adjustments must be made with regard to the assessments made upon her.

The Appellants in both cases are entitled to their costs.

The Crown having appealed against the decision in the King's Bench Division, the cases came before the Court of Appeal (Lord Greene, M.R., and MacKinnon and Morton, L.JJ.) on 17th, 18th and 19th December, 1945, when judgment was reserved. On 20th December, 1945, judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below.

The Solicitor-General (Sir Frank Soskice, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. Cyril L. King, K.C., and Mr. A. C. Nesbitt for the trustees and Miss McPheeters.

JUDGMENT

Lord Greene, M.R.—I have the authority of **Morton, L.J.**, to say that he has read the judgment I am about to deliver and agrees with it.

The question which falls to be decided is the same question in both appeals and relates to the assessability,in the first appeal, to Income Tax, and, in the second appeal, to Sur-tax of certain sums paid by the executors and trustees of the will of Mrs. Florence Cunard to her sister, Miss McPheeters, under a special provision in the will of Mrs. Cunard. The Special Commissioners decided in favour of the Crown; their decision was reversed by Macnaghten, J., and the Crown appeals to this Court.

The payments in question were made out of the capital of the estate of the testatrix pursuant to clause 10 (*b*) of her will. They were made before 7th February, 1940, the date when, according to the finding of the Special Commissioners, the residue of the estate was ascertained. The testatrix had died on 24th January, 1935, and payments out of capital in varying amounts were made to Miss McPheeters during the four Income Tax years ending respectively 5th April, 1937, 1938, 1939 and 1940. The assessments with which we are concerned are in respect of the payments made in the two last-mentioned years.

The main argument for the taxpayer, shortly stated, was to the effect that the payments in question, having been made out of capital at a time when the

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residue had not been ascertained, were not the taxable income of Miss McPheeters, and that, accordingly, the Crown's claim to recover Income Tax from the trustees under Rule 21 of the All Schedules Rules and its claim to include the payments in the total income of Miss McPheeters for Sur-tax purposes could not be sustained. In support of this argument reliance was placed on the case of *Corbett* v. *Commissioners of Inland Revenue,* 21 T.C. 449. It was argued on behalf of the Crown that the principle of that decision had no application to the present case and that if, contrary to this view, it would have applied, the sums in question were to be regarded as taxable income of Miss McPheeters by virtue of Section 30 of the Finance Act, 1938, a Section which admittedly was passed in order to prevent the operation both of that decision and of the leading decision in the case of *The King* v. *Special Commissioners of Income Tax* (ex parte *Dr. Barnardo's Homes*), 7 T.C. 646, on which it was based. To the latter argument reply is made that, on its true construction, Section 30 has no application to such a case as the present.

The argument based on *Corbett's* case assumes that, on the true construction of the will and in the events which have happened, the payments in question, if they are to be regarded as payments of an income nature, were made out of the gross estate of the testatrix before the residue was ascertained, and are to be regarded in the same light as the income was regarded in *Corbett's* case. In addition to the argument based on *Corbett's* case it was argued that the payments in question could not in any event be assessable to Income Tax under Case III and, in consequence, could not be regarded for purposes of Sur-tax by reason of the special nature of the provision under which they were made. In order to appreciate the arguments it is necessary to look closely at the language of the will.

By clause 3 the testatrix devised her freehold property known as The Grove to her trustees on trust to allow Miss McPheeters to reside there rent free. She gave a number of specific and pecuniary legacies, including annuities, and by clause 9 she devised and bequeathed her real and personal estate not otherwise disposed of upon trust " that my Trustees shall sell call " in and convert the same into money ", with the usual power to postpone conversion and a provision that the net income arising from her unconverted property should " as from my death be applicable as income of my residuary " estate."

By clause 10 the testatrix directed that out of the clear moneys to arise from the sale, calling in and conversion, the trustees were to pay her debts, funeral and testamentary expenses, and her legacies and annuities and duties thereon, and at their discretion to invest the residue. Then followed this direction: " And shall stand possessed of the proceeds of the sale calling in " and conversion of my said real and personal estate and any money belonging " to me at my death and any part or parts of my said real and personal estate " for the time being unconverted as well as the said investments (hereinafter " called ' my residuary estate ') upon trust during the lifetime of my sister " as follows".

This provision is inartistically drafted, but it seems to me impossible to construe the words " my residuary estate " as meaning the same thing as " the " net residue of my estate ascertained in due course of administration." The words " my residuary estate " are here defined as including the proceeds of sale, calling in and conversion referred to in clause 9. But these proceeds are gross and are not the net residue remaining after payment of debts, legacies,

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etc. As will presently appear, this view is confirmed by other provisions in the will.

The testatrix then directed as follows:

(*a*) The trustees were to pay all outgoings in respect of The Grove " out " of the income of my residuary estate ", and subject thereto and to other income payments, to pay the remainder of the income to or for the benefit of Miss McPheeters during her life;

(*b*) " If in any year the income of my residuary estate shall not be " sufficient to enable my sister to live at The Grove in the same degree of " comfort as she now lives there with me then I empower my Trustees to apply " such portion of the capital of my residuary estate by way of addition to the " income as they in their absolute and uncontrolled discretion may think fit " moreover any capital so applied shall not be replaced out of the income of " a subsequent year but shall be treated as an additional bequest to my sister."

The payments now in question were made by the trustees under this last provision.

My view that the phrase " my residuary estate " is not used in the sense of what is, strictly speaking, the " net residue " of the estate when ascertained in due course of administration, is confirmed by several indications. In paragraph (*a*) the direction to pay the outgoings in respect of The Grove is to pay them out of the income of " my residuary estate "; but it is quite clear that these payments are to be made as from the death of the testatrix, that is, at a date when the net residue could not have been ascertained. Again, in paragraph 7 (*d*) the testatrix directs that, pending appropriation, annuities bequeathed by her were to be charged on her " residuary estate ". There are other indications in the will to the same effect.

Mr. King argued that the payments in question, having been made at a time when the net residue had not yet been ascertained in due course of administration, were made by the executors without authority and, assuming them to be of an income character, stand in exactly the same position as the payments in respect of income which were in question in *Corbett's* case (1). I am unable to accept this view. The payments, in my opinion, could be made by the trustees in strict accordance with the power given by the will at any time after the death of the testatrix, irrespective of the fact that at the date of any particular payment the " net residue " had not been ascertained. The payments were to be treated as additional bequests and would attract Legacy Duty. Of course, in framing the accounts of the estate, the payments must be debited to the ultimate net residue, and these " additional legacies " could not compete with the other legacies bequeathed if the estate was insufficient to provide for both. But there was no question of this.

The payments, therefore, in my opinion, were properly made and at the moment of payment became income of the recipient, Miss McPheeters. They were in their nature entirely different from the payments in question in *Corbett's* case. Miss McPheeter's title to the income arose when the trustees exercised their discretion in her favour and not before. At that moment a new source of income came into existence. The payments came to Miss McPheeters

(1) 21 T.C. 449.

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under the express terms of the will and not by virtue of what I may call the quasi-interest enjoyed by a residuary legatee pending the completion of administration, as was the case with the payments in the cases of *Dr. Barnardo's Homes*(1) and *Corbett*(2).

That the payments were " income " in Miss McPheeters' hands is, in my opinion, beyond dispute, and the fact that they were made out of capital is irrelevant. The payments were to be made " by way of addition to the " income " in order to enable Miss McPheeters to live in the same degree of comfort as before. The testatrix was in fact providing for a defined standard of life for her sister, that provision being made in part out of income and in part (at the discretion of the trustees) out of capital. The purpose was an income purpose and nothing else. A similar point was decided by the late Lord Finlay in *Brodie's Trustees* v. *Commissioners of Inland Revenue,* 17 T.C. 432, which was, in my opinion, correctly decided. It is true that in that case the trustees were bound to make payments out of capital as required and had not merely a discretion, as in the present case. But that is immaterial on the question whether the payments ought to be regarded as being of an income character. It is relevant to the entirely different point (referred to hereafter) that the payments here ought to be regarded in the same way as purely voluntary payments.

But Mr. King argued that those payments were not taxable because, on the true construction of the statutory provisions relating to Case III of Schedule D (under which the case so far has been treated as falling), they were, first, not annual payments, and, secondly, discretionary and therefore voluntary payments which Miss McPheeters could not claim as of right.

Under Case III the tax chargeable in respect of annual profits or gains is charged in respect of profits " of an uncertain value and of other income " described in the rules applicable to this Case ". Rule 1 of the Rules applicable to Case III (to quote the relevant words) provides that the tax is to " extend to any . . . . other annual payment . . . . either as a charge on any " property of the person paying the same by virtue of any deed or will or " otherwise, or as a reservation thereout ". In order to be annual within the meaning of the Rule, the payment need not necessarily be in fact recurrent year by year. It is sufficient, to use the language of Lord Maugham, if it has " the quality of being recurrent or being capable of recurrence "—*Moss' Empires, Ltd.* v. *Commissioners of Inland Revenue,* 21 T.C. 264, at page 299. It is quite clear that a payment under clause 10 (*b*) of the will is one that is capable of recurrence, because in its very nature it may be paid in any year when the income of the estate is insufficient for the purpose contemplated. The payments were in fact recurrent, and the circumstance that they varied in amount does not remove their quality of being capable of recurrence.

The second argument also, in my opinion, fails. Even if it be assumed that the general words are to be read as limited by the phrase, " a charge on " any property " (as to which see *Smith* v. *Smith,* cited below), it is not suggested that the phrase means a charge in the strict sense. It was suggested, however, that the Rule does not extend to mere voluntary payments. But the payments here were of a totally different character. They were not voluntary in any relevant sense, but were made in the exercise of a discretion conferred by the will out of a fund provided for the purpose by the testatrix. It is true,

(1) 7 T.C. 646. (2) 21 T.C. 449.

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of course, that the trustees had an absolute discretion whether to make a payment or not. But the question whether they should do so is one which they were bound to take into their consideration. They could not refuse to consider whether the income of the estate was sufficient to give Miss McPheeters the required degree of comfort, and the fact that, after examining that matter, they might come to the conclusion that it was sufficient, and so decline to make a payment out of capital, does not, in my opinion, give to a payment, if and when made, the character of a voluntary payment in any relevant sense. The money, when received by Miss McPheeters, was received by her through the joint operation of the will and the exercise of their discretion by the trustees. This very question was considered by the late Lord Finlay in the case of *Lindus & Hortin* v. *Commissioners of Inland Revenue,* 17 T.C. 442. There, as here, the trustees had a discretion to supplement the income of a tenant for life out of capital. This discretion was absolute and it was argued there, as here, that the payments were not income because there was a discretion on the part of the trustees, and there was no right in the beneficiary to claim them. I am in agreement with the decision of Finlay, J., on this point. The observations of Lord Russell in the case of *Williamson* v. *Ough,* 20 T.C. 194, at page 211, appear to me to confirm this view. That case, like *Lindus'* case, and the present case, fell under Case III of Schedule D. I may also refer to the language of Lord Sterndale, M.R., in *Smith* v. *Smith,* [1923] P. 191, at page 197, on the general question of the construction of Rule 1 of Case III.

The Crown contends that the payments in question are brought into charge as taxable income of Miss McPheeters under Section 30 of the Finance Act, 1938. It is unnecessary for the Crown to rely on this argument in view of the opinion which I have formed, since tax would be payable in any event, quite apart from the provisions of the Section. But the point was fully argued and it is right that I should express my views upon it. The Section relates to a person having what is called " a limited interest " in the residue of an estate or part thereof. By Sub-section (2) any sum paid during " the " administration period " (i.e., the period between the death and the completion of the administration of the estate) " in respect of that limited interest " is to be deemed to be income of the person having the limited interest. The expression " limited interest " is not expressly defined in the Act, but Section 35 (3) provides that a person shall be deemed to have a " limited interest " " during any period . . . where the income of the residue or of that part " thereof . . . for that period would, if the residue had been ascertained at " the commencement of that period, be properly payable to him . . . " In contradistinction to the case of a " limited interest ", Section 31 deals with the case of a person having an "absolute interest", that is (Section 35 (2)) a person who would be entitled to the capital of the estate or part thereof if the residue had been ascertained.

Here Miss McPheeters was obviously and admittedly a person with a " limited interest " by virtue of her " right " to the income. But the payments in question were not paid to her in respect of her " right " to the income; they were paid under a discretionary power and were quite different in character. It appears to me that the words " limited interest " must be read as meaning an " interest " of the kind described in Section 35 (3), in fact what I have called earlier in this judgment, a quasi-interest. The language is necessarily involved, dealing as it does with the special position of

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residuary legatees before the residue is ascertained, that is, at a time when, as appears in *Dr. Barnardo's* case(1), they have, strictly speaking, no interest in any property forming part of the unadministered estate. This appears to me to explain the use of the colourless words " in respect of " in Section 30 (2), and I cannot construe them as covering the payments here in question.

For convenience I have disregarded the fact that part of the last payment in question is referable to the period between the close of the administration on 7th February, 1940, and the end of the financial year on 5th April, 1940. As in the result the whole of the payment is subject to tax, I need say no more about this.

The appeals are allowed with costs here and below.

MacKinnon, L.J.—I agree.

[Solicitors:—Markby, Stewart & Wadesons; Solicitor of Inland Revenue.]

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(1) 7 T.C. 646.