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HIGH COURT OF JUSTICE
(CHANCERY DIVISION)—22, 23 AND 24 NOVEMBER AND 13 DECEMBER 1982

COURT OF APPEAL—25 AND 26 JUNE AND 18 JULY 1984

HOUSE OF LORDS—16, 17 AND 18 APRIL AND 16 MAY 1985

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(1) Carver *v.* Duncan (H.M. Inspector of Taxes)
(2) Bosanquet *v.* Allen (H.M. Inspector of Taxes)([1])

Income tax—Additional rate—Settlements—Trustees apply income in maintaining policies of assurance—Whole life and term—Whether premiums C *expenses of trustees properly chargeable to income—Finance Act* 1973, *s* 16(2).

Carver v. Duncan

1. In November 1972, P gifted property to trustees to hold on the trusts of his 1964 settlement. The trustees effected a term assurance policy to secure the payment of sums equal to those that would be payable by the trustees on D the death of P within seven years of the gift. Pursuant to an express power in the settlement, the trustees paid the premiums on the policy out of the income of the fund.

Bosanquet v. Allen

2. In November 1969 D assigned to the trustees of H's marriage settlement 20 assurance policies on H's life to hold on the trusts of the E marriage settlement. The following year the trustees effected two endowment policies on the life of B. At all times the trustees maintained the policies out of the income of the fund. The marriage settlement contained an express power for the trustees to effect and maintain out of income life policies. Additionally, until 31 December 1977, the trustees employed a firm of investment advisers, whose fees they paid out of income pursuant to an express F power.

In each appeal, the Inspector contended that the premiums were not expenses of the trustees; and further, in any event, the true construction of s 16(2)(*d*) permitted only the deduction of expenses properly chargeable to income under the general law and that the premiums (if they be expenses) and

([1]) Reported (ChD) [1983] 1 WLR 494; [1983] STC 310; 127 SJ 54; (CA) [1985] AC 1082; [1984] 3 WLR 1209; [1984] STC 556; 128 SJ 704; (H.L.) [1985] AC 1082; [1985] 2 All ER 645; [1985] STC 356; 129 SJ 381.

the investment advisers' fees were properly chargeable to capital under the general law. A

In both cases, the Special Commissioners upheld the Crown's contentions except that they held that the premiums on the term policy were expenses. The trustees appealed.

The Chancery Division, allowing the appeals, held that on the true construction of s 16(2)(*d*), if de facto paid out of income the following expenses were deductible: those chargeable to income under the general law, those expressly charged to income in the settlement and those chargeable to income under the general law but expressly charged to capital in the settlement; and as the payment of the premiums on the life policies was neither an accumulation of income nor an application of income to or for the benefit of a beneficiary, the payments constituted deductible expenditure. B C

Basil v. *Lister* (1851) 9 Ha 177 followed. The Crown appealed.

The Court of Appeal, allowing the Crown's appeal, held that (1) the words "but for" have a permissible meaning of "in the absence of" or "apart from", and, on its true construction, s 16(2)(d) allows only the deduction of expenses properly chargeable to income under the general law; (2) as in *Bosanquet*, the life policies were maintained as an investment of capital for the benefit of capital, the premiums (in the absence of express direction) must be chargeable to capital, so that they could not be "expenses properly chargeable to income" and it was unnecessary to consider whether or not they were "expenses"; (3) the premiums in *Carver* and the fees in *Bosanquet* were expenses properly chargeable to capital under the general law. The trustees appealed. D E

Held, in the House of Lords, dismissing the trustees' appeals; (1) although recurrent, payments made in respect of the policy premiums and the fees of the investment advisers were made for the benefit of the respective trust estates and were of a capital nature; (2) (Lord Diplock dissenting) the nature of expenses cannot be altered by express provision by a settlor as to their allocation between capital and income, and s 16(2)(*d*) permits the deduction of expenses of an income nature and disallows the deduction of those only made chargeable to income by an express provision in the settlement. Accordingly the premiums and the fees were not deductible expenses for the purposes of s 16. F

Per Lord Fraser: "I do not wish to be taken as impliedly deciding that the expenses 'properly chargeable' (in the sense explained by Lord Templeman) to income under s 16(2)(d) of the Finance Act 1973 in a Scottish trust would fall to be regulated by English trust law, if there were a relevant difference between the laws of England and Scotland." G

Quaere: whether the Crown's concession was rightly made (in the Paul settlement appeal) that premiums on gift protection policies were properly classifiable as expenses. H

A Carver *v.* Duncan

CASE

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

1. On 8 June 1981 the Commissioners for the Special Purposes of the B Income Tax Acts heard appeals by John Humphrey Roberton Carver against the following assessments at the additional rate made upon him as trustee of the G. H. Paul 2nd Discretionary Settlement:

Year of assessment 1974–75 : £1,400
Year of assessment 1975–76 : £1,600

2. Shortly stated, the questions for our decision were:

C (i) whether upon the true construction of clause 7 of the said Settlement the trustees thereof were authorised to effect and keep up at the expense of the trust fund a certain policy of assurance; if so

(ii) whether the premiums paid under the said policy fall within the meaning of the words "expenses of the trustees ... which are properly chargeable to income (or would be so chargeable but for any express D provisions of the trust") in para (d) of s 16(2) of the Finance Act 1973.

3. We heard no oral evidence. The parties to the appeals produced before us an agreed statement of facts and an agreed bundle of documents comprising copies of:

(i) A deed of Settlement dated 4 November 1964 ("the G. H. Paul 2nd Discretionary Settlement");

E (ii) Two deeds of appointment, dated 1 December 1964 and 26 March 1976 respectively, supplemental to the Settlement;

(iii) A deed of gift and assignment dated 20 November 1972;

(iv) Sun Life Assurance Society Limited Policy No. 1,575,555 dated 9 January 1975; and

(v) The accounts of the trustees of the Settlement for the two years ended F 5 April 1976, with the balance sheet at that date.

None of these documents is annexed hereto as an exhibit but copies of all or any of them are available for the Court if required. The terms of clause 7 of the Settlement dated 4 November 1964 are set out in full in our Decision which is annexed to and forms part of this Case.

4. The following Cases were referred to in argument: *Basil* v. *Lister* G (1851) 9 HA 177; *In re Vaughan* (1883) WN 89; *Cathcarts' Trustees* v. *Heneage's Trustees* (1883) 10 R 1205; *Elizabeth Murray* v. *Commissioners of Inland Revenue* 11 TC 133; *MacFarlane* v. *Commissioners of Inland Revenue* 14 TC 532; 1929 SC 453; *Mangin* v. *Commissioners of Inland Revenue* [1971]

AC 739; *Pearson and Others* v. *Commissioners of Inland Revenue CTTL*(4) [1980] STC 318; *Leedale* v. *Lewis* 56 EC 501; [1980] STC 679; *Roome and Others* v. *Edwards* 54 TC 359; [1981] STC 96; *Piratin* v. *Commissioners of Inland Revenue* 54 TC 730; [1981] STC 441. A

5. We the Commissioners who heard the appeal took time to consider our decision and gave it in writing on 7 August 1981. As stated in para 3 above a copy of our Decision, which sets out the admitted facts and the contentions of the parties, is annexed hereto. In brief, we decided the first of the questions set out in para 2 above in the affirmative, but the second in the negative; and accordingly upheld the assessments in principle. B

6. Figures were subsequently agreed between the parties and on 24 February 1982 we formally determined the sums assessable to income tax at the additional rate as follows: C

Year of assessment 1974–75 : £21,176
Year of assessment 1975–76 : £45,022

7. The Appellant immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and on 5 March 1982 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970 s 56 which Case we have stated and do sign accordingly. D

8. The question for the opinion of the Court is whether our decisions on the questions set out in para 2 of this Case were correct in law.

B. M. F. O'Brien } Commissioners for the Special Purposes
A. K. Tavaré } of the Income Tax Acts

Turnstile House E
94–99 High Holborn
London WC1V 6LQ
9 June 1982

Decision

These appeals are against assessments to income tax (at the additional rate) for the years 1974–75 and 1975–76, made under s 16 of the Finance Act 1973. The sole issue for our determination is whether, in computing the amount of the trust income upon which tax at the additional rate is chargeable, the premiums paid by the trustees in respect of a "gift protection policy" of assurance are allowable as a deduction under s 16(2)(d). F

The relevant facts can be very shortly stated. By the combined effect of a Settlement made by Geoffrey Hamilton Paul ("the settlor") on 4 November 1964 and an Appointment made thereunder on 1 December 1964 the capital and income of the Trust Fund established by the Settlement was held throughout the fiscal year 1974–75 and up to 26 March 1976 in the fiscal year G

A 1975–76 upon trust for Michael Alexander Paul (the settlor's son, born on 20 November 1959) contingently on his attaining the age of 25 or being alive on the defined Vesting Day. On 26 March 1976 a new Appointment displaced that trust and thereafter the Trust Fund (less certain cash sums appointed outright to certain individuals) has been held upon trust, broadly, for such members of a defined class as shall attain the age of 60 or shall be living on the Vesting B Day. All the members of that class, which includes Michael Alexander Paul, were under the age of 18 throughout the two fiscal years under consideration, and the maintenance etc. and accumulation provisions of s 31(1)(i) and (2) of the Trustee Act 1925 applied to the income.

On 20 November 1972 the settlor assigned to the trustees, as an addition to the funds comprised in the 1964 Settlement, his undivided one third interest C in his father's residuary estate. The settlor was then aged 55 and had recently suffered a heart attack; and the trustees appreciated that a substantial liability to Estate duty would arise in respect of the added asset if the settlor were to die on or before 20 November 1979. Because of the settlor's state of health the trustees were for some time unable to insure against the risk but on 9 January 1975 the trustees entered into a contract of insurance with the Sun Life D Assurance Society under which they would receive £175,000 in the event of the settlor dying on or before 20 November 1976, and smaller sums in the event of his dying thereafter up to an including 20 November 1979. (The extent of the potential Estate duty liability reduced by stages after 20 November 1976 by virtue of the relief granted under s 64 of the Finance Act 1960, as amended). It was not suggested to us that the sums assured exceeded the amount of the E Estate duty which might become payable. The first two premiums payable in respect of this policy of assurance (on 9 January 1975 and 9 January 1976 respectively) were each in the sum of £9,223.52. These premiums were duly paid and were charged to income in the trust accounts for the years ended 5 April 1975 and 5 April 1976 respectively. These premiums are the sums which the trustees seek to deduct in computing their liability under s 16 of the F Finance Act 1973.

Because of the lack of authority on the construction of para (d) of s 16 of the 1973 Act ("para (d)") much of the argument in the case before us reflected points which had arisen in *Piratin* v. *Commissioners of Inland Revenue*[1], a case recently decided by Slade J. (but not yet reported). That case was concerned in part with the operation of s 455(b) of the Income and G Corporation Taxes Act 1970 in relation to a gift protection policy of the same type as that in our case. Section 455(b) performs (at first sight, at least) a function in its context comparable to that performed by para (d). It will be convenient to summarise the issues and decision in *Piratin* before setting out the contentions of the parties in our case.

Section 455(b) of the Taxes Act 1970, so far as relevant, reads: "... any H expenses of the trustees of the settlement paid in that year which, in the absence of any express provision of the settlement, would be properly chargeable to income ..." The words "any express provision of the settlement" appeared to be capable of bearing either of two meanings. On a wide construction, the settlement should be treated as one containing no

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(1) 54 TC 730.

powers beyond those authorised by the general law; but the words could be read in a more limited way, directing one merely to disregard any special provision in the settlement relating to the incidence of expenditure as between capital and income. Slade J. favoured the former interpretation. That led to the result that since the trustees would have had no authority to effect the insurance if they had not been given express authority by the settlement, the expenditure was not "properly chargeable" at all, for the purposes of the section. Alternatively, Slade J. held that if one were simply required to treat the settlement as silent as to the incidence of the cost of insurance, so that that question would be determined by the general law, the nature of the insurance and the quantum of the expense were such as to lead to the conclusion that (under the general law) the premiums were properly chargeable to capital rather than to income. Slade J. did not need to express a concluded view on the meaning of the words "expenses of the trustees", and did not do so.

We now turn to para (d), in which different language is employed, and the contentions of the parties before us upon it. The provision reads:

> "16(2) This section applies to income arising to trustees in any year of assessment so far as it—....(d) exceeds the income applied in defraying the expenses of the trustees in that year which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)."

Mr. Milne, for the Appellant trustee, contended generally that the purpose of s 16 was to ensure that the investment income surcharge imposed on individuals should not be escaped by accumulating income in trusts; that the following section (s 17) demonstrated that the charge under s 16 amounted to an advance payment of the surcharge on behalf of the beneficiaries; and that the beneficiaries should accordingly not, in effect, ultimately bear surcharge on so much of the income of the trustees as could never become their income. Section 16 should be so construed that that result was achieved. On specific issues he contended:

(1) The trustees had power under the express terms of clause 7 of the 1964 Settlement to effect the gift protection policy of assurance.

(2) The premiums payable under the policy were "expenses of the trustees" within the meaning of those words in para (d). They were neither accumulations nor distributions to or for the benefit of the beneficiaries: and must therefore be categorised as expenditure on trust administration.

(3) The premiums were "properly chargeable to income" within the meaning of those words in para (d) because the trustees were authorised by the terms of the 1964 Settlement so to charge them. Those words would necessarily mean "properly chargeable to income under the general law" in any case where the settlement in question was silent on the matter, but their meaning was not so restricted in any other case.

(4) Even if, contrary to (3), the premiums were deductible only if they were properly chargeable to income under the general law, irrespective of the terms of the Settlement, these premiums satisfied that condition. (This contention was made formally, but was not pursued: it conflicts with the decision in *Piratin*[1]) on this point in relation to premiums under an indistinguishable policy).

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[1]) 54 TC 730.

A For the Crown, Mr. Bousher contended that the appeals should fail either because of the terms of clause 7 of the 1964 Settlement (A below), or because the expenditure was not "properly chargeable to income" within the meaning of those words in para (d) (B below), or for both reasons.

A. Clause 7 of the 1964 Settlement is an investment clause. If the expenditure on the policy constituted an investment of trust income it could B not be counted among the "expenses of the trustees" for the purposes of para (d); if, on the other hand, the expenditure did not consititute an investment it was not authorised by the clause and was not "properly chargeable" at all, let alone properly chargeable to income (as in *Piratin*[1]).

B. Paragraph (d) performs exactly the same function in relation to s 16 of the Finance Act 1973 as s 455(b) of the Taxes Act 1970 performs in relation to C s 451(1) of that Act (and, indeed, as s 428(1)(a) of the Taxes Act 1970 performs in relation to s 427 of that Act). The words "properly chargeable to income" in s 455(b)—the section with which *Piratin* was concerned—mean "properly so chargeable *under the general law*"; and the same words in para (d) should be given the same construction. It was held in *Piratin* that premiums under a gift protection policy are not so chargeable.

D The first issue in this case is raised by Mr. Milne's particular contention (1) and Mr. Bousher's corresponding arguments lettered A above. The only Clause in the 1964 Settlement upon which the trustees rely as the source of their authority to effect the gift protection policy and to pay the premiums is clause 7. When setting out the facts of the case earlier in this decision we omitted any reference to that clause because it is of some length and is more E conveniently dealt with at this stage, when it is necessary for us to come to a conclusion upon it. The clause reads:

> "7. *TRUST MONEYS* (including any accumulations of income) may be invested or laid out in the purchase or otherwise in the acquisition of or at interest upon the security of such stocks funds shares securities or other investments or property (whether moveable or immoveable) of F whatsoever nature and wheresoever situate and whether involving liability or not and whether producing income or not or upon such personal credit (whether to a Beneficiary or not) and with or without security as the Trustees shall in their absolute discretion think fit to the intent that the Trustees shall have the same full and unrestricted powers in all respects of making transposing and dealing in any manner whatever with investments G of every description (including without prejudice to the generality of the foregoing powers full power to effect acquire keep up (at the expense of capital or income as the Trustees may think fit) surrender and deal in any way with assurance policies of every kind or any interest therein and to acquire improve or repair any real or leasehold property or chattels for the beneficial occupation use or enjoyment thereof by any of the H Beneficiaries) as the Trustees would have if they were absolutely and beneficially entitled thereto and in the professed exercise of this power the Trustees shall not be liable for any loss to the trust premises arising from any investment or purchase made in good faith."

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[1] 54 TC 730.

We have here a wide investment clause of a not unusual character into which there has been inserted, somewhat clumsily we think, a substantial passage in parentheses—"(including without prejudice ... any of the Beneficiaries)". If the substance of that passage had appeared as a separate clause, we do not think that the question of the trustees' power to insure would have formed an issue in this case. The problem arises because the power to insure is contained in the passage, and the passage has, apparently deliberately, been included in what is otherwise a clause relating to investments.

Mr. Milne not unnaturally relied on the words "full power to effect ... keep up ... assurance policies of every kind". The first question which we have to answer is, should the words "of every kind" be cut down by the context to "of an investment kind": for example, a with-profits endowment policy?

In our view the answer is no. Although the general context is one of investment (in the ordinary sense), the remainder of the passage in parentheses forms part of the context and there is, in that remainder, a clear indication that the concept of "investment" in this Clause is not a strict one. The trustees are authorised not only to acquire (and improve) real and leasehold property and chattles but also to *repair* it. Expenditure on repairs cannot, we think, be regarded as "investment" in a strict sense; but it is not unnatural to find a power to repair associated with a power to invest because repair constitutes the preservation of the value of an investment. Insurance against ordinary risks, such as fire or theft, is directed to the same end and we hold that "assurance policies of every kind" do, and were intended to include policies of that kind. It may be that insurance against Estate Duty risks was not in the direct contemplation of the parties in 1964—the occasion for it arose later—but in our view such insurance is of the same kind. That is not to say that there may not be distinctions between fire insurance (for example) and gift protection policies, for other purposes. *Piratin*[1] shows that the two may not be the same for the purpose of deciding whether the cost should be borne by the income beneficiaries. But both are aimed at the preservation of the trust assets in the event of a foreseeable occurence and we find ourselves unable to accept that there is any distinction between them for present purposes, namely in determining the extent of the trustees' powers under this Settlement. We accordingly hold that the trustees' expenditure on the gift protection policy was not made in breach of trust.

That brings us to Mr. Milne's particular contention (2) and the other half of Mr. Bousher's argument on clause 7. We readily accept that the expression "expenses of the trustees" in para (d) is not a term of art with a more restricted meaning than would ordinarily be given to it; but it is clear from the context that the expenses referred to are expenses incurred in administering the trust. The application of the net funds available to the beneficiaries (whether that application takes the form of distribution or of accumulation and investment) is not a relevant "expense".

It is evident that if clause 7 were solely concerned with investment in the strict sense, then the premiums paid on the policy would as a matter of logic

(1) 54 TC 730.

A have to be categorised as investments rather than as "expenses". But we have already made it clear that in our view clause 7 extends beyond investment in the strict sense and extends to expenditure by way of insurance for the purpose of preserving or protecting investments. On that view the premiums are not prevented from being "expenses" by reason of the purely logical argument which Mr. Bousher presented. He did not seek to argue that the premiums B were inherently not "expenses" within para (d) and we understood him to accept for the purposes of this case that if his logical argument failed (as it has, on our construction of clause 7) the premiums in issue qualify as "expenses". We would only add, on this aspect of the case, that it would be highly artificial to regard these premiums, if not "expenses, as some form of accumulation. Although the policy constituted an asset of the trust it was one that had no C value save in the uncertain event insured against: and in that event would merely have made good the resulting loss. We were referred to *Cathcart's Trustees* v. *Heneage's Trustees* (1883) 10 R 1205 in this connection, and while we appreciate that that case was concerned with accumulations in the special context of the Thellusson Act, the general observations on the nature of accumulation to be found in that and other like cases can, in our opinion, be D appropriately applied to policies of insurance against risks, such as that with which we are concerned.

The trustees having succeeded in showing that the premiums were legitimately incurred expenses, and it being common ground that they were paid out of income, we now have to decide whether they were "properly chargeable to income" within the meaning of those words in para (d). If those E words mean, and mean only, "properly chargeable to income under the general law", we are bound by *Piratin*[1] to hold that the premiums were not so chargeable. The gift protection policies in that case and this are indistinguishable and the fact that the two cases are not concerned with the same statutory provisions would not entitle us to differ from Slade J. on this issue even if we felt so inclined. If, on the other hand, the words mean, in any case where the F Settlement is not silent on the matter, "properly chargeable to income in accordance with the terms of the Settlement", then it is clear that the premiums were so chargeable because the trustees were empowered by clause 7 to effect the policy at the expense of capital or income as they thought fit.

Although para (d) appears to play a part in s 16 corresponding to that played by ss 455(b) and 428(1)(a) of the Taxes Act 1970 in their respective G contexts, we cannot place any reliance on that fact because the formula adopted in 1973 differs from that appearing in the earlier legislation (effectively the Finance Act 1938). For the purposes of comparison we set out again the relevant words: (1938) "... expenses ... which, in the absence of any express provision ... would be properly chargeable to income ..." (1973) "expenses ... which are properly chargeable to income (or would be so H chargeable but for any express provisions ...)." The 1973 wording happily avoids the ambiguity of the words "express provision" which was exposed in *Piratin*: it is clear that the "express provisions" referred to in para (d) are provisions relating to the incidence of the expenses as between capital and income, and nothing more. Less happily, it is now not so immediately apparent what "properly chargeable to income" means. The 1938 formula I clearly requires any express incidence provision to be ignored, so that attention is directed solely to the manner in which the expenses should be treated as a matter of general law; that that is equally the effect of the 1973 formula is not

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[1] CTTL(4).

so plain. The words "properly chargeable to income", standing alone, are ambiguous. A

Those words do not, however, stand alone for they are accompanied by the words which follow in brackets. The clue to the meaning of "properly chargeable to income" in para (d) lies, in our view in those following words just as the meaning of "properly chargeable to income" in s 455(b) of the Taxes Act 1970 is dictated by the corresponding words ("... in the absence of ...") in that section. B

In para (d) the reference to "express provisions" is not only, in the context, a reference to provisions going to the incidence of expenses as between capital and income: it must in fact be a reference to provisions directing expenses to be charged to *capital*. This is the effect of the words "but for". An express provision allowing (or directing) expenses to be charged to income would not prevent their being chargeable to income—only an express provision directing expenses to be charged to capital could have that effect. In our view it follows that "so chargeable" (inside the brackets) can only mean "chargeable to income under the general law". Any other reading makes the words in brackets self-contradictory. C

Our immediate concern is with the meaning of the words "properly chargeable to income" before the words in brackets; but the clear implication of the word "so" before "chargeable" in the latter place is that "chargeable" is used in the same sense in both places. It follows from what we have already said that "properly chargeable to income" must mean, in effect, "properly chargeable to income under the general law", and we so hold. It seems to us that the only indication to the contrary to be found in the wording is the "or" at the beginning of the words in brackets, which suggests that the latter words provide an alternative to the preceding "properly chargeable to income". We do not, however, believe that the second phrase would have been put between brackets if it constituted a true alternative. The purpose of the second phrase is, in our opinion, to clarify what would otherwise certainly not be clear, namely that in the (perhaps unlikely) case of "income" expenses being directed to be charged to capital these expenses are nevertheless "properly chargeable to income". Being a gloss on the latter words, the phrase is put in brackets. D E F

That is sufficient to dispose of this case in the Revenue's favour. There are however one or two things we would like to add because we understand that the matter may go further. G

First, we have some sympathy with the general argument with which Mr. Milne opened his case. The "investment income surcharge" (which replaced earned income relief) is very much a matter of personal taxation and if the charge under s 16 of the Finance Act 1973 is regarded as an equivalent charge it is not easy to see why (as a matter of policy) the charge should fall on income which the beneficiaries will never receive. H

Secondly, the construction of the words in brackets in para (d) which seems to us to be inescapable produces a result of a somewhat surprising nature. The words take care of the case where the settlement requires the expenses to be charged to capital: but the opening words of the paragraph show that the allowance can only be made if the expenses have actually been defrayed out of income. An appropriate adjustment has, presumably, to be made in the trust accounts, so that the expenditure is in fact borne ultimately I

A by capital. In the circumstances one might have expected expenses of an income nature to be deductible, however defrayed.

Thirdly, we wonder what the result would be if para (d) did not exist. It seems to us that the result would not be to bring the whole of the income arising to the trustees within the charge because under para (a) of s 16(2) only income "which is to be accumulated or which is payable at the discretion of B the trustees ..." is (at most) chargeable. We would expect that income to be quantifiable only after administrative expenses had been provided for. The structures of the parallel provisions emanating from the Finance Act 1938 do not appear to give rise to the same question.

The two assessments under appeal were made in estimated amounts and we were asked at the hearing for a decision in principle only. We accordingly C adjourn the appeals for one month to enable the parties to agree the figures (if possible) on the footing that the Crown succeeds.

B.M.F. O'Brien } Commissioners for the Special Purposes
A.K. Tavaré } of the Income Tax Acts

Turnstile House
94–99 High Holborn
D London WC1V 6LQ
7 August 1981

Bosanquet v. Allen

CASE

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

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 26 and 27 March 1981 David Graham Bosanquet (hereinafter called "the Appellant") appealed against the following assessments to income tax:

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	£
1973–74	7,054.53
1974–75	7,038.72
1975–76	7,234
1976–77	7,088
1977–78	11,196

G 2. The questions for our decision are set out in paras 2 and 6 of our written decision a copy of which is annexed hereto and forms part of this Case. (References hereafter to numbered paragraphs are to paragraphs of that decision.)

3. There was no oral evidence. A

4. The documents proved or admitted before us are listed in para 4. (Document (5), omitted from that list, is the statement of facts reproduced in para 3.)

None of the documents is annexed hereto as an exhibit; they are available for inspection by the Court if required.

5. As a result of the evidence adduced before us we find to be proved or admitted (having noted the comments of the Revenue recorded in para 3.2) the facts set out in 3.1.1 to 3.1.20, and in para 3.3. B

6. The contentions made on behalf of the Appellant at the hearing are set out in paras 7 and 9; the further contentions referred to in para 10 are set out in para 11.

7. The contentions made on behalf of the Inspector of Taxes are set out in para 8, and the further contentions in para 12. C

8. The only cases referred to (on interpretation) not mentioned in our decision, were: *Leedale* v. *Lewis* 56 TC 501; [1980] STC 679; *Roome and Denne* v. *Edwards* 54 TC 359; [1981] 2 WLR 268.

9. We, the Commissioners who heard the appeal, took time to consider our decision and gave it in writing on 10 August 1981. It is set out in paras 13 to 19. D

10. Figures were agreed between the parties on 8 September 1981 and on 6 October 1981 we adjusted the assessments accordingly.

11. The Appellant immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and on 29 October 1981 required us to State a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970 s 56 which Case we have stated and do sign accordingly. E

12. The questions of law for the opinion of the Court are (i) whether our interpretation of s 16(2)(d) Finance Act 1973 is correct (ii) whether we were correct in finding that (a) the life assurance premiums and (b) the investment management fees are not allowable deductions under that section. F

E. Wix
R.H. Widdows } Commissioners for the Special Purposes of the Income Tax Acts

Turnstile House
94–99 High Holborn
London WC1V 6LQ
4 March 1982 G

A Decision

1. The assessments before us are:

	£
1973–74	7,054.53
1974–75	7,038.72
1975–76	7,234
B 1976–77	7,088
1977–78	11,196

2. The question for determination is whether, on the true construction of s 16 Finance Act 1973, certain payments made by Mr. D.G. Bosanquet ("the appellant") and others, as trustees of the Marquess of Hartington's Marriage Settlement, namely: (i) payment of premiums on life assurance policies; and C (ii) payment of investment management fees, are allowable deductions under s 16(2)(d) Finance Act 1973 in computing the liability, if any, of the said trustees to additional rate tax. The assessments for the first three years are in respect of the whole of the trust fund, and for the last two years in respect of the children's fund only (paras 3.1.5 and 3.1.12(b)).

In addition, we are asked to decide whether a proportion (£7) of a D premium relating to an album of etchings, was an allowable deduction for the year 1975–76.

3.1 A statement of facts to the following effect was put before us on behalf of the trustees:

3.1.1 Mr. D.G. Bosanquet, Mr. Chippendale Keswick and Lord Brabourne ("the trustees") are the trustees of a settlement ("the settlement") E dated 4 April 1967 and made between the eleventh (and present) Duke of Devonshire ("the settlor") (1), the Honourable Peregrine Cavendish, Marquess of Hartington ("Lord Hartington") (2), Miss Amanda Heywood-Lonsdale ("Lady Hartington") (3) and the trustees (4).

3.1.2 The settlement was made by the settlor shortly before and in consideration of the marriage of his only son, Lord Hartington, to Lady F Hartington. Lord Hartington and Lady Hartington were married on 28 July 1967 and have had three children:

(a) William (who has the courtesy title of Lord Burlington) born on 6 June 1969;

(b) Celina, born on 4 October 1971; and

(c) Jasmine born on 4 May 1973.

G 3.1.3 The general form of the settlement, so far as material, can be summarised as follows:

(a) The settlor settled (clause 2) assets to the value of £300,000, and covenanted (clause 3) to add assets (which could include life assurance policies) to the value of a further £100,000 in the event of a son of the marriage being born and attaining the age of 6 months.

H (b) Lord Hartington entered into a personal covenant (clause 4) to pay Lady Hartington an annuity during her life or until she became entitled to settled capital as mentioned immediately below.

(c) There was a first overriding trust (clause 6) under which Lady Hartington was entitled to £50,000 on her forty-fifth birthday, and a further £50,000 on her sixty-fifth birthday, if she was then the wife or widow of Lord Hartington, and with power for the trustees to accelerate, in whole or in part, the sums to which Lady Hartington was prospectively entitled. A

(d) Subject to Lady Hartington's overriding entitlement the trustees had (clause 7) a wide overriding power of appointment exercisable in favour of the "primary beneficiaries" as defined in clause 1(d) of the settlement—that is Lord Hartington, Lady Hartington, the children and remoter issue of their marriage, and certain other beneficiaries. B

(e) Subject to the foregoing provisions there were various beneficial trusts and powers operating in default of appointment (clauses 8 to 14) including (clause 10) a power for the trustees to accumulate income of the trust fund arising during the period of 21 years from the date of the settlement and (clause 11) a trust of capital (carrying the intermediate income) for the first son of the marriage to attain the age of twenty two. C

(f) The remaining clauses (15 to 44) of the settlement contained administrative and similar powers and provisions, including (clause 15) a very wide power of investment, (clauses 16 and 17) wide powers in relation to land, (clause 19) a power to effect and keep up assurance policies, (clause 23) provisions in relation to chattels forming part of the trust fund, and (clause 32(b)) power to employ and pay agents to transact any business. D

(g) Clause 19 (which related to assurance policies and may be of particular importance to these appeals) was in the following terms:

> "The Trustees may effect purchase or otherwise acquire a policy or policies of assurance of any kind intended to form part of the Trust Fund and pay the premiums on any policy so effected purchased or acquired (or on any policy vested in them as an addition to the Trust Fund) out of income or capital of the Trust Fund or partly out of each in such manner as the Trustees at their discretion think fit and the Trustees shall be at liberty at any time or times to sell surrender exercise any option under or otherwise deal with any such policy or to agree upon any variation of the terms or conditions thereof" E F

(h) Clause 26(b) was in the following terms:

> "The Trustees may at any time or times apply any income of the Trust Fund in or towards the payment or discharge of any duties taxes costs or other outgoings which but for the provisions of this clause would be payable out of or charged upon the capital of the Trust Fund." G

3.1.4 Following on the birth of Lord Burlington in 1969, the settlor performed his obligation under the covenant in clause 3 of the settlement and added assets to the value of £100,000 to the trust fund. These additions were made by a deed of assignment ("the 1969 assignment") further particulars of which are set out in para 3.1.8 below. H

3.1.5 After the introduction of capital transfer tax by the Finance Act 1975, the trustees exercised their power of appointment under clause 7 of the settlement so as to divide the trust fund into two separate funds, one (called "Lady Hartington's fund") held on trusts under which Lady Hartington has an interest in possession, and the other ("called the children's fund") being held on flexible "accumulation and maintenance" trusts for the children of I

A Lord Hartington. These changes were made by a deed of appointment ("the 1976 appointment") dated 18 March 1976 and made by the trustees. The 1976 appointment also provided (clause 3) that the capital sums to which Lady Hartingdon was prospectively entitled under clause 6 of the settlement should be charged on Lady Hartington's fund, in exoneration of the children's fund.

3.1.6 The settled property continues to be regulated by the trusts and B powers of the settlement and the 1976 appointment (except for two deeds of release making minor changes not material to these appeals).

3.1.7 The trust fund initially settled by the settlor consisted of stock exchange investments and cash to the value of £300,000. This fund of investments has been largely retained by the trustees, with some changes of investment, except that in 1975 the trustees raised approximately £60,000 and C laid it out in purchasing from Lord Hartington the freehold property known as West Lodge, Christchurch Road, London SW14, together with its contents. This property immediately adjoins the freehold residence (Percy Lodge, Christchurch Road) owned by Lord Hartington and occupied by him with his family. West Lodge has, throughout almost all the trustees' period of ownership, been let furnished and the rent taxed under Case VI of Schedule D. D In 1975 the Appellants also acquired, by purchase for the sum of £2,000 from Lord Hartington, a book of etchings by Henry Moore called The Sheep Album; this is held by the trustees as an investment.

3.1.8 The property added to the settlement by the 1969 assignment, in performance of the settlor's covenant under clause 3 of the settlement, consisted of: (a) stock exchange investments to the value of £21,804 (which the E trustees accepted at their mid-market value) and (b) twenty policies on the life of Lord Hartington to the value of £78,248 (these being their aggregate surrender value in November 1969, when the covenant was performed).

3.1.9 All the policies on the life of Lord Hartington assigned to the trustees by the settlor were endowment policies (effected mostly in 1946 or 1947) under which the sum assured was to be payable on or shortly before F Lord Hartington's sixtieth birthday, or on his earlier death. All the policies were at level annual premiums payable throughout the term of the policy, except that four Alliance Assurance policies had already become fully paid before being assigned to the trustees. Lord Hartington was born on 27 April 1944 and will therefore attain the age of sixty in 2004. Further particulars of the assigned policies appear from a memorandum dated November 1969 ("the G 1969 memorandum") signed by the trustees.

3.1.10 As a protection against the risk of estate duty in respect of the funds added to the settlement by the settlor in November 1969, the trustees effected a seven-year gift protection policy for £100,000 on the life of the settlor at six annual premiums of £2,907, the last of which fell due in December 1974. The premiums on that policy are not material to these H appeals, since for estate duty reasons the premiums were paid out of the capital of the original trust fund.

3.1.11 During the year of assessment 1970–71 the trustees effected two endowment policies on the life of Lord Burlington, one with Sun Alliance & London Assurance Group for the sum of £25,000.00 (with profits) maturing in his fiftieth year at an annual premium of £518.75, and the other with Standard

Life Assurance Company for a sum assured of £25,000 (with profits) maturing in his fiftieth year at an annual premium of £585.75. Under the Sun Alliance policy there was life cover from the inception of the policy, whereas under the Standard Life policy, life cover will not commence until age fifteen, when evidence of health will be required. A

3.1.12 The division of the trust property by the 1976 appointment was broadly as follows: (a) Lady Hartington's fund consisted of (i) some stock exchange investments (ii) West Lodge and its contents (iii) the Henry Moore Album and (iv) the four fully-paid policies on Lord Hartington's life. B

(b) The children's fund consisted of all the rest of the trust property (that is the other stock exchange investments, the other policies on the life of Lord Hartington, and both policies on the life of Lord Burlington).

3.1.13 During the years of assessment to which these appeals relate, the trustees paid premiums on the endowment policies out of income of the trust fund (or, after the 1976 appointment, the children's fund) as follows: C

Year	Policies on life of Lord Hartington	Policies on life of Lord Burlington
1973–4	2,740	1,105
1974–5	2,740	1,105
1975–6	2,740	1,105
1976–7	2,740	1,105
1977–8	2,740	1,105

D

3.1.14 After the acquisition of West Lodge and its contents, and the Henry Moore Album, the trustees also paid annual premiums under a comprehensive policy with Sun Alliance & London Assurance Company to cover the contents of West Lodge, and the album, against fire, theft and similar risks. The proportion of the premium paid in respect of the contents of West Lodge was taken into account in determining the trustees' income tax liability under Case VI of Schedule D, but the proportion attributable to the album was not (or ought not to have been) taken into account for that purpose. During the 1975–76 year of assessment the premium was £36.45, the cover on the contents of West Lodge being £8,000.00 and that on the album £2,000.00. The proportion of the premium attributable to the album was therefore one-fifth, or approximately £7.00. After the execution of the 1976 appointment the album was included in Lady Hartington's fund and the premium was no longer material for the purposes of these appeals. E F

3.1.15 During the relevant years of assessment the trustees made certain other payments out of the income of the trust fund (or, after the execution of the 1976 appointment, the children's fund). Particulars of those other payments are set out in the following paragraphs. G

3.1.16 The trustees decided to employ John Govett & Co. Ltd. ("John Govett") of Winchester House, London Wall, London EC2 to manage the trust investments. John Govett are professional investment managers who, in addition to running a well-known group of public investment trust companies, have a department specialising in the management of investment portfolios for private individuals and trustees. John Govett charged a half-yearly fee for their services calculated on a percentage of the investments under their management. The arrangement with John Govett was terminated on 31 December 1977, since when the trust investments have been managed by stockbrokers. H I

A 3.1.17 The trustees paid bank charges to their bankers, National Westminster Bank Limited, in each of the relevant years of assessment. These charges were not in respect of interest, but were for the services of the bank's nominee company, Control Nominees Ltd. The amounts of these bank charges are shown in the schedule mentioned below.

3.1.18 Two of the policies on Lord Hartington's life were with a South B African life office, and the premiums were payable in Rhodesian dollars. For that reason, the trust investments included a small holding of Southern Rhodesia Development Loan Stock 1968–78 on which interest was paid in the same currency. The trustees paid a small annual fee (the amount of which is shown in the schedule) to Pulbrook, Underwood of Salisbury, Rhodesia, for collecting the interest and paying the annual premium. In preparing the C schedule the income on the Rhodesian investments, and the premiums paid, have been converted to sterling at an assumed rate of R$2 to the pound in each relevant year of assessment.

3.1.19 The accounts of the settlement for the year 1973–74 (and for the previous year) were audited by Price Waterhouse & Co., and the accountants' fees were paid out of the income of the trust fund. Thereafter, on grounds of D expense the trustees decided to dispense with an audit, the trust accounts continuing to be prepared by their solicitors. In addition, in each of the relevant years of assessment the trustees incurred solicitors' and other legal fees, part of which were paid out of the income of the trust fund or (after the execution of the 1976 appointment, and so far as attributable to the children's fund) out of the income of the children's fund. The amounts of these E accountants' and legal fees are shown in the schedule.

3.1.20 In debiting the payments mentioned in paragraphs 3.1.13 to 3.1.19 (inclusive) above to income account, the trustees were acting in accordance with the advice of their solicitors and (where it was thought necessary to take Counsel's opinion) the advice of Chancery Counsel.

3.1.21 The Appellants' solicitors have prepared a schedule (dated 6 F March 1981 and for the purpose of identification signed by the Appellant) which sets out in summary tabular form information as to all the payments mentioned in paras 3.1.13 to 3.1.19 (inclusive) above, and other information relevant to these appeals.

3.2 The facts stated in para 3.1 are not challenged by the Revenue; Mr. S. Bousher of the Office of Solicitor of Inland Revenue says only that he would G prefer para 3.1.17 to 3.1.19 inclusive to have been omitted, the sums referred to having been allowed in the assessments under appeal, and para 3.1.20 to have been omitted as being irrelevant because there is no suggestion that the trustees acted in breach of trust.

3.3 We found the following additional facts:

3.3.1 Clause 8 of the settlement made provision for younger sons and for H daughters of the marriage.

3.3.2 The specimen of policies on the life of Lord Hartington (document 7(a)) is dated 5 October 1946, when Lord Hartington was two years old; the annual premium was £825. In the event of Lord Hartington's death before 26 April 1965 (the eve of his 21st birthday) a sum equivalent at least to the

amount of the total premiums paid was to be refunded. Upon Lord Hartington's attaining 21 there was a right to exercise any one of four options, to take a cash payment of £16,900 or to convert the policy into without profits endowment assurance maturing at age 60 to produce £71,280, or endowment assurance, with or without profits, maturing at age 50, to produce either £45,688 (with profits) or £56,603 without profits. None of these options was chosen. A B

4. The bundle of agreed documents put before us at the hearing consisted of:

(i) the settlement [document (1)]

(ii) the 1969 Assignment [document (2)]

(iii) the 1969 Memorandum [document (3)]

(iv) the 1976 Appointment [document (4)] C

(v) a schedule of payments signed for the purposes of identification by the Appellant and dated 6 March 1981 (referred to in para 3.1.21 above) [document (6)]

(vi) specimen life assurance policies, viz Alliance Assurance Policy No 176190 on the life of Lord Hartington and Standard Life Assurance Policy No 276859 on the life of Lord Burlington [documents 7(a) and 7(b)]. D

5. There was no oral evidence.

6. What has to be decided is:

(a) whether each of the disputed payments is a payment of "expenses" within the meaning of that word in s 16(2)(d) Finance Act 1973

(b) whether the expenses deductible under the paragraph are only those properly chargeable to income under the general law as the Revenue contends or whether they include, as the Appellant contends, expenses expressly chargeable to income under the terms of the settlement regardless of whether they are so chargeable under the general law. E

Submissions of the Parties

7. Mr. R. Walker's submissions of law on behalf of the Appellant may be summarised as follows: F

7.1.1 Three of the four rules of interpretation laid down by Lord Donovan in *Mangin* v. *Commissioners of Inland Revenue* [1971] AC 739, at p 746 are particularly relevant: that words are to be given their ordinary meaning; that Parliament intended neither injustice nor absurdity; the history and the reasons for passing an enactment may be used as an aid to construction. G

7.1.2 The purpose of the legislation was to impose a flat rate of tax on accumulated income, and to encourage distribution. If those are the two main legislative purposes, income which is neither accumulated nor distributed but simply spent is not within the scope of the provisions, there is no need to impose additional rate tax and therefore no need or justification to read the provisions restrictively. H

7.2 The four limbs of s 16(2) are not in parallel. Para (a) is the most important; paras (b), (c) and (d) are ancillary and merely define the area of

A operation more precisely, and the effect of para (a) would not be greatly different if it stood alone. Paragraph (d) in particular does not add to para (a), and could well have been omitted. Even if that view is wrong, it is a relevant consideration when deciding the meaning of "expenses" that income which has been spent is not available to be accumulated.

7.3.1 It is possible to distinguish between undoubted technical terms, e.g. B "interest in possession", "interest in expectancy", semi-technical terms (not in point here), and non-technical terms, which are not to be treated as terms of art unless they are given a definition, or the context shows clearly that that was intended. "Expenses" is a non-technical word which should be read in its ordinary natural meaning. "Expenses" in the context of s 16(2) means payments which are neither made to or for beneficiaries, nor accumulations. C There are three distinctive ways of dealing with trust income: to distribute it, to accumulate it, or to pay it out as expenses. These three possibilities cover the whole ground, without gaps, without overlapping. The dividing line may sometimes be difficult to discern, but the distinctions should be recognised. The simple approach is to be preferred to a complicated construction.

7.3.2 The same fundamental difference which exists between accumu- D lation, distribution and payment of expenses is to be found between the beneficial and the administrative provisions of a settlement. The administration of a trust is to be distinguished from the dispositive powers of trustees. (*Pearson* v. *Commissioners of Inland Revenue* [1980] 2 WLR 872(1) *Per* Lord Dilhorne, at p 880 G—p 881B.) Just as the beneficial interest are material for capital transfer tax purposes, so they are in relation to s 16.

E 7.3.3 Unless expenses are incurred directly and exclusively for the tenant for life of a fund, e.g. payment of rates on a house occupied by him, income used by trustees to pay expenses is left out of account in computing the income of the life tenant (*Murray* v. *Commissioners of Inland Revenue* 11 TC 133, *Macfarlane* v. *Commissioners of Inland Revenue*(2) 14 TC 532, *Wolverton* v. *Commissioners of Inland Revenue* 16 TC 467). If the policies had formed part F of Lady Hartington's fund, the premiums would have been paid out of the income of her fund, and she would have been liable for higher rate tax only on the net income remaining after payment of the premiums. It would be remarkable if the premiums escaped in that fund, but suffered a higher burden by being in the children's fund.

7.4.1 "Accumulated" is a technical word, which is to be given a G technical, and not a wider, meaning. The use of income to pay life assurance premiums is not accumulation in the technical sense. "Accumulation" is a very old, pre-*Thellusson*, term of art. Section 164, Law of Property Act 1925, the successor to the Thellusson Act, is not infringed when income is used in this way (*Bassil* v. *Lister* (1851) 68 English Reports 464; *In re Vaughan* ([1883] WN 89). *Cathcart's Trustees* and *Heneage's Trustees* (1883) 10 SC 1205, where H there was a direction to accumulate, strongly supports this proposition. Although the decision may have rested on the construction of the instrument, the principles set out at page 1216 are correctly stated, and on that aspect there was a clear majority. The premiums in that case "were not accumulated, they were expended" (*Per* Clark L.J., at p 1216; they were "periodical payments of contract debts" (*Per* Lord Young, at p 1217).

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(1) CTTL(4). (2) 1929 SC 453.

7.4.2 *Piratin* v. *Commissioners of Inland Revenue*(1) (11 March 1981)* is to be distinguished. A settlor might for estate duty reasons direct income already accumulated to be used for premiums. (See para 11 below). A

7.5 The administrative powers of trustees derive from four sources, the general law, statute, the trust instrument, and the Court. It is difficult to draw a dividing line between the four sources. Authorities differ about whether certain expenses are to be charged to capital or income. Nevertheless, the pattern that emerges is that ordinary recurring expenses are taken out of income. B

7.6 The position under the general law is not material to the question whether expenses are chargeable to income for the purposes of s 16(2)(d). There are four reasons why the only possible construction of the parenthesis is to widen, and not to narrow, its meaning. C

7.6.1 The Revenue's construction involves reading "or" as "and", with the effect that a payment is only deductible if, in the absence of any express power in the trust, it would properly be chargeable to income. That interpretation must be rejected in order to avoid injustice or absurdity.

7.6.2 The draftsman of s 16 must have had s 455 Income and Corporation Taxes Act 1970 in mind; it was an obvious model to use as a precedent, yet he had deliberately rejected it and used another form of words. Whether one looks at s 16(2)(d) on its own, or together with s 455(b), there is no way in which one can read it in the same sense as s 455; nor any rational explanation why, if so, the phrasing was altered. In addition, s 16 and s 455 are not in *pari materia*, the latter being connected with s 451, a penal section, and other artificial arrangements. Section 16 deals with discretionary trusts in general, and is in no way penal. D E

7.6.3 If the parenthesis means what the Revenue says it means, it would produce difficulties for trustees who would have to pause and dissect every payment. If trustees under an express power in the trust instrument insure paintings, to their full value, against fire, on the Revenue's construction of para (d) they would be entitled to say that, as the statutory power conferred by s 19 Trustee Act 1925 permits them to insure not more than three-fourths of the value, one-quarter of the cost of insuring is to be disallowed. The Revenue's interpretation would involve that the trustees would only be entitled to claim for a deduction against income in the rare case where the Court had authorised the trustees' remuneration under its inherent jurisdiction. Since Parliament must be taken not to have intended absurdity, the interpretation which the Revenue sought to place on the parenthesis must be rejected. F G

7.6.4 There is no absurdity in the Appellant's construction. The trustee has a lien for his costs and expenses on both the capital and the income of the trust property, subject to subsequent adjustment between the two. Income from capital invested is the natural source for payment of all expenses, even though ultimately an item may be debited to capital in accounts. H

7.6.5 The effect of the parenthesis is to widen the scope of deductible expenses.

(1) 54 TC 730; [1981] STC 441.

A 7.7.1 It was, however, appropriate to review the general law because it might throw light on the meaning of "expenses" in s 16(2)(d).

7.7.2 *In re Duke of Norfolk's Settlement Trusts* [1979] 1 Ch 37 (though under appeal on a different point) is authority for the proposition that in exercising its inherent jurisdiction the Court ought to direct that any remuneration allowed should come out of income. *Stott* v. *Milne* (1884) 25 Ch B 710, at p 715 is authority for the right of trustees to retain their costs out of income. Underhill, *Trusts and Trustees*, 13th edition, at pp 449–460 analyses the duty of a trustee in relation to the payment of outgoings out of corpus and income respectively, and deals specifically with life assurance premiums at p 454. Walker *Principles of Scottish Private Law*, 2nd edition vol 2 at p 187 contains a simple and compendious statement of what is the law of England as C expressed in *Underhill* paras (b) and (c) in the passage cited.

7.7.3 *Macdonald* v. *Irvine* (1878) 8 Ch 101 was an authority merely on the construction of a codicil. *In re Bennett* (1896) 1 Ch 778 was a special case on an unusual problem not about life policy premiums. In Smith L.Js' judgment a distinction between "outgoings", and "costs, charges and expenses" is recorded; there is an inference that annual expenses are outgoings and D chargeable against revenue, and costs, charges and expenses are capital items. *In re Sherry* [1913] 2 Ch 509 was concerned with the construction of a particular will. None of these cases establishes any general propositions about assurance.

7.8 The ordinary meaning of the words to be construed, the purpose of the enactment, and the need to produce a rational and workable scheme, all E point to the construction that any payment to a thrid party which is not either distribution or accumulation is an expense. The appeals should be allowed.

8.1 Mr. Bousher summarised his contentions as follows:

1. Life assurance premiums are not expenses of the trustees but applications of trust income akin to investment and therefore cannot be allowable deductions under s 16.

F 2. The correct way to read s 16(2)(d) is that only expenses chargeable to income under general trust law are allowable deductions. (By general trust law is intended the provisions of equity and of the Trustee Act 1925 but not the express powers in the trust instrument).

3. Consequent upon 2 if life assurance premiums are expenses, then they, investment management fees, and premiums on single premium insurance G policies, are chargeable to capital under the general law and are not allowable deductions under s 16.

Mr. Bousher accepted that if he failed on 1 and 2 he must fail on 3.

Ist Contention

8.2.1 By subs (1) additional rate tax is chargeable on income arising to trustees, provided it meets the conditions laid down in subs (2). The reference H in para (a) of subs (2) is to income arising to trustees "which is to be accumulated or which is payable at the discretion of the trustees ..."; that is not a reference to the treatment of income but to the terms of the trust instrument, i.e. if under the terms of the trust income arising is to be

accumulated, or is payable at the discretion of the trustees (whether or not the trustees have power to accumulate it), all the income arising is *prima facie* within the charge to additional rate tax. Section 16 does not impose a charge on income which has been accumulated, or on income which is not in fact distributed; the charge is on income which arises to trustees and is available for distribution. Were that income to be distributed there would not be a double charge to tax because s 17(2)(a) Finance Act 1973 ensures that the beneficiaries are treated as having received a net amount after payment of tax.

8.2.2 The income which arose to the trustees of the settlement and the trustees of the children's fund was income payable at the discretion of the trustees, but to avoid the charge being levied on the gross amount of that income para (d) provides for the deduction of expenses which have been defrayed out of income, so that the charge is on the net amount of income which arises and is available for distribution. What happens to the income thereafter is irrelevant. It is not correct to suggest that no income was payable at the discretion of the trustees until the life assurance premiums had been paid.

8.2.3 "Expenses" in para (d) is both vague and wide; it is not a term of science. In one sense all money spent is an expense, but the word would not normally be used to include a purchase of shares; that would be an investment.

8.2.4 There appears to be no inherent power for trustees to invest in life policies; they are not authorised investments; the enabling power must therefore be within the settlement, and is therefore an express power. Clause 19 contains that express power. The phrase therein "or otherwise acquire" is not one normally used in connection with expenses. Policies acquired under the clause are to form part of the trust fund; the clause is clearly conferring a power of investment. No distinction falls to be made between different types of policy; all forms of assurance policy are investment. These policies are as much part of the trust fund as the Henry Moore Album, the acquisition of which can hardly be described as an expense of the trustees. Both represent investments of available income after deduction of expenses. The purpose of acquiring the policies was to add to the capital of the Trust fund; the moneys produced under the policies will go to capital.

8.2.5 There is no authority to support this view of life policies; it is essentially a question of first impressions. Whether a life assurance policy does indeed constitute an accumulation, and whether it constitutes an unlawful accumulation, is not in issue here. The point raised in *Bassil* v. *Lister*[1] and subsequent cases can only arise if the trustees are dealing with income which could be accumulated, i.e. income net of expenses. This income, when it arose, and before the premiums were paid, was income payable at the discretion of the trustees, and within the charge under s 16. The payment of the premiums was an application of income, but it constituted investment, not an expense of the trustee.

2nd Contention

8.3.1 Section 16(2)(d) and especially the parenthesis should be read in the same way as the phrase "in the absence of any express provision in a will" in s 428(1)(a) Income & Corporation Taxes Act 1970, and s 455(b) which repeats

[1] (1851) 9 Ha 177.

A that formula. It is clear beyond doubt that those sections direct one to ignore the provisions of the settlement. The difference in wording between s 16 on the one hand and s 428 and s 455 on the other hand is irrelevant. The derivation of the latter sections stems from s 32(1)(a) and s 41(4)(d)(ii) Finance Act 1938 respectively, and the wording has remained unchanged through consolidation; it cannot be assumed that the draftsman of the 1973 Act was the same as the B draftsman of the 1938 Act, and therefore that the 1973 change in wording was deliberate. It is appropriate to look only at the wording of the 1973 Act.

8.3.2 Section 16(2)(d) should be read so that only expenses chargeable to income under the general law (including statutory provisions) are deductible; we are to assume that a particular settlement is silent as to express powers. If the parenthesis were not there, the words "which are properly chargeable to C income" might be thought to allow reference to express powers in the deed. The effect of the parenthesis is to exclude that possibility. The thrust of the passage is to ignore any express provisions of the trust. The change in tense involves two different tests, the parenthesis suggesting a notional test. The phrase "any express provisions" is unrestricted, and is not confined to powers which allow normal income expenditure to be charged to capital, but includes D powers to charge capital items against income.

8.3.3 (i) The Appellant's analysis involved treating as allowable expenses those chargeable to income under the general law, those chargeable to income under an express provision and also those expenses normally chargeable to income but actually charged to capital under an express provision of the trust instrument. The Revenue particularly takes issue with the inclusion of the last E category, but also with the second. (ii) The analysis places too much emphasis on "or", in effect removing the parentheses and making the words between them an integral part of para (d). Under a settlement with suitably widely drawn powers, trustees would be able to charge income expenditure to capital and capital expenditure to income and so reduce the s 16 charge. (iii) The Appellant's interpretation involves reading the parenthesis as ". . . any express F provisions of the trust to the contrary"; the Revenue's analysis makes it unnecessary to assume the addition of "to the contrary". The third part of the Appellant's analysis produces a system of franking income which cannot have been intended. To allow normal income expenditure charged to capital to be deductible expenses goes to the root of trust accounting, by setting capital expenditure against revenue; that makes the interpretation suspect.

G 8.3.4 As to the first canon of interpretation in *Mangin*(1), the Revenue's approach gave the words their ordinary meaning; as to the second and third, the Appellant's analysis added something to the clear meaning by implying the introduction of franking by allowing capital expenditure to be set against revenue, a sweeping change which amounts to absurdity; as to the fourth canon, s 16 extended additional rate tax to catch income held in discretionary H or accumulation trusts. The Revenue's interpretation observes all four canons, as the Appellant's does not.

3rd Contention

8.4.1 On the basis that the settlement is silent as to allocation of expenses, then the life assurance premiums (if the Revenue's first contention is rejected),

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(1) [1971] AC 739.

a single premium for a single premium insurance policy, and investment management fees, are all expenses properly chargeable to capital under general trust law and therefore not allowable deductions under s 16(2)(d). That the trustees had power to do what they did is not questioned. A

8.4.2 If it is assumed that the settlement is silent as to express powers of charging expenses, and if life assurance premiums are expenses, there is no general power to allow trustees to purchase life assurance policies. If that is right, each premium represents a payment in breach of trust and therefore it is not properly chargeable either to income or to capital, so that the premiums are never allowable under s 16(2)(d). If, however, the premiums are not expenses but investment (1st contention) the problem does not arise. Even with settled policies an express power to continue them is needed, and one must ignore all express powers in relation to expenses. B C

8.5 All three heads of expenditure are properly chargeable to capital. It is difficult to find a general principle, but expenses such as these which go towards preserving the capital of the trust fund are chargeable to capital not to income. (*Bennett*[1] *Per* Lindley L.J., at p 784, and Smith L.J., at p 787, and *In re Sherry*[2] *Per* Warrington J. at p 512). (Mr. Bousher conceded that the fact that the settlement in *Bennett* was a strict settlement was relevant; a charge against capital brings about a sharing of a load, and that is more important in a strict settlement, but the principle applies to discretionary trusts as well). D

8.6 The power given to trustees by s 19 Trustee Act 1925 to insure against fire risk reflected a change in the law introduced earlier; under the general law there had been no power to insure (*Bennett, Per* Kay L.J., at p 786). In 1896, the only power to insure was conferred by statute, and if trustees exceeded the powers conferred by what is now s 19 (i.e. if they insured against risks other than fire, or (in the case of fire risks) for more than three fourths of the value) payments were made in breach of trust and so were not properly chargeable at all. Alternatively if, because a prudent businessman would insure, trustees had an inherent power to insure, they still could not claim the benefit of s 19 to justify a charge against income, because they would have exceeded what it permits, so that either the general principle (protection of a capital asset) makes the premium a charge against capital, or the premium must be apportioned as to three-fourths against income and one-fourth against capital. E F

8.7 The appeals should be dismissed.

9. Mr. Walker made the following points in reply.

9.1 Before 1925 the tenant for life of land might have the legal estate vested in himself, without trustees. If he insured it would be at his expense, whether he insured for the value of his life interest or for the value of the whole property; if the house were destroyed by fire the tenant for life, although the remainderman had a legal interest in the site, would be entitled to the whole of the insurance moneys. Section 19 arose from that earlier situation. G

9.2 It is accepted that s 16 in reviewing the scope of income is looking to the future, but that does not assist the Revenue; if it is known that expenses will have to be paid that sum is not available to be distributed or accumulated. H

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[1] [1896] 1 Ch 778. [2] [1913] 2 Ch 508.

A In *Sherry*[1] and *Cathcart's Trustees*[2] the Court accepted that "expenses" was an appropriate designation for life assurance premiums. The Appellant accepts one necessary limitation on its interpretation, i.e. that use of income for the purchase of stocks or shares constitutes not an expense but an accumulation. The suggestion that in laying out "expenses" there would be no breach of the Thellusson Act went counter to what Lord Dilhorne said in B *Pearson*[3], when he pointed to a fundamental distinction between administrative and beneficial provisions. A capitalisation of net income may infringe the Thellusson Act; if the payment of premiums is not accumulation, they fall on the administrative side of the line.

9.3 As to the Revenue's second contention, it was not suggested that s 428 and s 455 were drafted by the same person who drafted s 16, but since C s 59(3) Finance Act 1973 requires (*inter alia*) s 16 to be construed as one with the Income Tax Acts, it must be supposed to stand as part of them, and differences in wording must be supposed to be deliberate, i.e. fully considered, and therefore require explanation.

9.4 The Appellant's interpretation made it unnecessary to read in additional words; the parenthesis could only, as a matter of sense, mean any D relevant provisions; that was not to read words in but to recognise their natural meaning. The Appellant says that it is the Revenue's interpretation that involves altering the wording of s 16(2).

9.5 There was no franking of income by incurring unnecessary expenses in order to save additional rate tax. Rather, the trustees had sought to avoid unfruitful expense.

E 10. At the time of these appeals *Piratin*[4] v. *C.I.R.* had been heard by Slade J., but the transcript of his decision, given on 11 March 1981, was not then available. Passing references to that case were made during the appeal, and we agreed to hear further argument on it if the parties thought it desirable. After the transcript was issued, the parties made further submissions in writing, which we record in paras 11 and 12. We did not find it necessary to F hold a further hearing.

11. Mr. Walker's supplementary submissions as to *Piratin* v. *C.I.R.* are as follows:

"1. The relevant parts of the judgement are the statement of facts at pp 2–4 of the transcript (especially the terms of clause 11(b) of the settlement, set out at pp 2G–3B) and the section headed "the insurance G premiums issue" at pp 14–16 of the transcript. The Judge stated the issues on this part of the case as follows (p 15A), "to determine the correctness or otherwise of [the appellant's counsel's] submission in relation to the premiums on the term policy, two questions have to be answered: (a) ["the first issue"] were they "expenses" of the trustees ...

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(1) [1913] 2 Ch 508. (2) (1883) 10 R 1205. (3) CTTL(4).
(4) 54 TC 730.

within the meaning of [Taxes Act 1970] section 445(b)? (b)["the second issue"] in the absence of any express provision in the settlement, would they have been "properly chargeable to income"? Both these questions must be answered in the affirmative if [the appellant] is to succeed on this point". A

2. The Judge's decision on these two issues of law can be summarised as follows. (1) It appears from the transcript that the Judge did not express a final view on the first issue. After setting out the contentions of both sides (p 15B–D) the Judge in effect left the first issue open and went on to consider the second issue: he said (p 15D) "even assuming that [the appellant's counsel] is right in submitting that the costs of the relevant premiums were expenses of the trustees in the relevant sense . . ." and the Judge himself referred (at p 15G) to "the expenses" as not being properly chargeable to income or capital. (2) On the second issue (dealt with at p 15G to p 15H of the transcript) the Judge held that the payment of premiums on the terms policies would not, in the absence of express provisions of the settlement, have been authorised at all; alternatively, if the payment had been proper at all, it would have been chargeable to capital, not income. B C D

3. In the present appeal the appellants do not in any way challenge the decision of Slade J. in *Piratin* v. *I.R.C.*, which they accept as binding on the Special Commissioners. However, the appellants submit that the decision is in no way contrary to their submission on the present appeal, for the following reasons. (1) If (as seems doubtful) the Judge did decide, or was inclined to decide, that the payments of premiums were not "expenses", he would have reached that decision on the special wording of clause 11(b) of the settlement concerned in that case—special wording which was no doubt included for estate duty reasons, in order to ensure that the sums assured by the term policies, if they became payable at all, would not themselves be subject to estate duty. Clause 11(b) of the settlement (which the Judge quoted at p 15B as well as at p 2G) specifically required premiums on a term policy to be paid out of income which the trustees had determined to accumulate, and in the *Piratin* case the Commissioners specifically found that the premiums were paid out of income which the trustees had already determined not to distribute (p 15B), so that the payment was necessarily part of a process of accumulation. Lord Hartington's marriage settlement did not contain any clause similar to clause 11(b) of the settlement in the *Piratin* case, and the two cases are distinguishable on that ground. (2) The Judge's decision on Taxes Act 1970 section 455(b) is also distinguishable because the wording of that statutory provision is markedly different (and as the appellants in the present case submit, deliberately different) from that of Finance Act 1973 section 16(2)(d). The Judge's decision on section 455(b) only serves, as the appellants respectfully submit, to emphasise the difference between that provision and the provision (with a parenthesis introduced by the word "or", not "and") which Parliament saw fit to enact in the Finance Act 1973 section 16." E F G H

12. Mr. Bousher's additional submissions based on the decision in *Piratin* v. *C.I.R.* are set out below: I

"It must be accepted that the judgment delivered does not specifically deal with the position of premiums in respect of whole life

(1) 54 TC 730.

A policies, but it is clear from p 14G of the transcript that like submissions as those made in relation to the premiums on term policies were made in respect of whole life policies, but Counsel for the taxpayer felt unable to press his argument in relation to the latter type of policy. It is the Crown's submission that what is said in relation to term policies applies *a fortiori* to whole life policies.

B "The first of the Crown's submissions was that the premiums in respect of whole life policies were not expenses but applications of the income of the settlement by way of investment and, in making this submission, the Crown representative submitted that there is no general power available to trustees to enable them to acquire policies of assurance. In this regard the Special Commissioners are respectfully C referred to the judgment of Slade J. at page 15E of the transcript. It follows then that the only power the Trustees of the Marquis of Hartington's Marriage Settlement to acquire the policies of assurance was that contained in Clause 19 of the Settlement. As stated at the hearing, it is the Crown's submission that this is clearly a power of investment. The second of the Crown's submissions concerned the true interpretation of D section 16(2)(d) of the Finance Act 1973. The decision in *Piratin*[1] is not relevant to this issue. "The third submission was that, assuming the premiums were expenses and assuming that the Section postulated a situation where the settlement was silent as to the allocation of expenses, then, under the general law, the premiums were properly chargeable to capital, and not to income, or alternatively were not properly chargeable E to either income or capital, but incurred in breach of trust. In support of this submission the Special Commissioners are respectfully referred to the transcript at pages 15E to 16H".

Conclusions

13. It is common ground between the parties that we are concerned purely with questions of construction.

F 14. We consider first the meaning of "expenses". The principal plank of Mr. Walker's argument was that trust income can be dealt with in three distinctive ways, by distributing it, by accumulating it, or by paying it away as expenses, and that these three possibilities cover the whole ground, without gaps and without overlapping, even though the dividing line may sometimes be difficult to discern. "Expenses", he says, is an ordinary word of wide meaning G and includes anything which is spent or paid out to persons other than beneficiaries, save only money used to purchase stocks and shares. This is an ingenious proposition but we are not persuaded that it is correct. In the first place, to give the name "expenses" to everything that is not distribution or accumulation is to beg the question. If all income is to be described as falling into one of three classes, we think that a better designation than "expenses" H for Mr. Walker's third class would be "expenditure". That leaves open the question of which items of expenditure constitute "expenses" within the meaning of s 16(2)(d).

Mr. Walker concedes that on his approach an exception would have to be made for income spent on, for example, ICI stock, but he says that this would

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(1) 54 TC 730.

in a case where the trustees had power to do so constitute an accumulation. On the approach we adumbrate, and on Mr. Walker's example, the purchase of ICI stock would merely be sub-classified as expenditure of a capital nature. A further difficulty which we see in adopting Mr. Walker's approach is that while it is, at least in some degree, an understandable approach to analysing the income of a discretionary trust, it is wholly inapt for a strict settlement where problems of accumulation do not present themselves, and problems of distribution arise only when a line has to be drawn between capital and income in relation not merely to expenditure but also to acquisitions to the trust fund (e.g. bonus shares treated by the company issuing them as paid up out of profit and loss account). Because different considerations apply in relation to the income of a strict settlement we do not think that the contrast in treatment which Mr. Walker suggests [7.3.3.] is a factor to be taken into account. We hold that the word "expenses" in s 16(2)(d) is to be read in its normal sense under the general law.

15. Mr. Walker referred to the trustee's lien for his costs and expenses on both the capital and income of the trust fund and suggested that income derived from capital is the natural source for payment of all expenses, even though ultimately an item may be debited to capital in the accounts. To the extent that income as it accrues throughout the year, is available in the form of cash, it may well be the case that it is the first resort for payment of demands upon the trustees, but that leaves open the ultimate allocation of the charge when accounts are prepared, and it is the correct allocation of the item that is the determining factor so far as the administration of the trust is concerned. The allocation in the trust accounts will depend at least in part on the express powers in the settlement. Although the settlement may give directions, as it does in respect of the life assurance premiums and the investment management fees in the present case, about whether these are to be charged against income or capital, that is not conclusive as to whether they are rightly to be regarded where liability for tax is in issue as "expenses", in contrast to expenditure, of the trustees.

16. We accept Mr. Walker's submission that the payment of life assurance premiums out of income does not of itself constitute accumulation in the technical sense. Mr. Bousher does not claim however, that the payment of the premiums in this case constitutes accumulation. He says rather that, since it is akin to investment the terms of clause 19, which (there being no statutory authority or inherent power to that end) is the sole source of the trustees' power to pay life assurance premiums out of the moneys they hold, are such that it is in essence an investment clause, any policies assured forming part of the trust fund. He offers no authority in support of this view of life policies, but says that it is a question of first impressions. Mr. Walker offered subtle arguments on the distinction to be made between costs and expenses on the one hand and outgoings on the other hand, but we do not think that the right approach is necessarily to try to enunciate a general principle within which to fit the payments here in question. Both parties conceded the difficulty of spelling out such a principle from the existing law. We think it better to look at the payments against the particular background of the settlement out of which they were made. We note that the policies to the value of £78,000 which were included in the 1969 assignment were assigned by the settlor in pursuance of his covenant, in clause 3 of the settlement, to add property to the value of £100,000 "as an addition to the capital of the Trust Fund". Clause 19 of the settlement gave the trustees power to accept those policies and to pay premiums thereon. A study of the options in document 7(a) [para 3.3.2. above] makes it clear that the value of the policy at maturity was to be directly

A related to the length of time it had been on foot, and thereby to the number of premiums paid, as indeed is to be expected. Fire insurance premiums are of a different nature. The relative cheapness of fire insurance has been mentioned in previous decisions (e.g. p 16C–F of *Piratin*[1]). In addition what is then being insured is something tangible, which remains essentially constant throughout the period of insurance, but which, insofar as it changes, is more B likely in its physical aspect to deteriorate than to appreciate. By contrast, the purpose of life assurance premiums is year by year to augment the value of the chose in action which is the policy. In paying the premiums the trustees were, to adapt the words of Walton J. in *In re Norfolk*[2] at p 62E, developing, or enhancing, the capital assets of the settlement. That is a more positive action vis-á-vis investment than paying premiums on term assurance, which was the C subject of Slade J.'s judgment in *Piratin*, as may be inferred from the passage at p 16G. In so far as that passage is to be taken as a decision on "expenses", we are not satisfied that it was reached on the special wording of clause 11(b) of the settlement there under consideration. Moreover, it seems to us that term assurance is more akin to fire insurance than to life assurance. In our view, the life assurance premiums paid by the trustees of the settlement, as well in D respect of both the policies on Lord Burlington's Life (notwithstanding that under the Standard Life policy life cover has not yet commenced), as in respect of those on Lord Hartington's life, are not to be regarded as expenses of the trustees, but are (in Mr. Bousher's words) akin to investment, and we so hold. It follows that they are not allowable deductions for the purpose of s 16(2)(d).

17. We look next at the words in parenthesis in s 16(2)(d). Section E 16(2)(d) provides for income tax to be charged at the additional rate on income arising to trustees in any year of assessment so far as it "exceeds the income applied in defraying the expenses of the trustees in that year which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)". Since the wording is different from that in s 428(1)(a) and in s 455(b) Income & Corporation Taxes Act 1970, the phrase F is to be looked at apart from those sections, and to be read in its own context. We agree with Mr. Walker that the draftsman of s 16 would have had in mind the provisions of s 428(1)(a) and s 455(b); s 16 is, as was pointed out by Mr. Walker, to be construed as one with the Income Tax Acts. We do not, therefore, in these appeals, derive any help on the construction of s 16(2)(d) from the judgment of Slade J. in *Piratin*, since he was there dealing with G s 455(b). If Mr. Walker's reading is to be accepted [para 7.6.4] it would be possible to charge against income items of expenditure properly chargeable under the general law to capital, merely because the provisions of the settlement directed that that could or should be done. In our view, the parenthesis should be read: "(or would be properly chargeable to income under the general law but for any express provisions of the trust)". On that H reading, expenditure which is properly chargeable to income under the general law is to be allowed as a deduction against income for the purposes of additional rate tax even if (which will not often be the case) the settlement permits such expenditure to be charged against capital. That situation does not arise in this appeal. In our opinion the premiums would be properly chargeable to capital under the general law, and we find support for this view in the I *Piratin* decision. Indeed, we find this a clearer case on that point for we are dealing with premiums for life assurance whereas in *Piratin* Slade J. was dealing with term assurance. On that ground also we hold that the premiums are not allowable deductions under s 16(2)(d).

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(1) 54 TC 730. (2) [1979] 1 Ch 37.

18. We infer that the employment of John Govett to manage the trust investments was decided upon by the trustees with a view if not of developing at any rate of enhancing the capital assets of the settlement. There would have been no justification for incurring the fees charged for their services, in addition to the cost of changing investments, unless that was what the trustees hoped to achieve. The fees were based on the capital value of the portfolio in their charge. It was not an expenditure that the trustees were bound to incur. We were not told when John Govett's employment began, but we know that it was terminated at the end of 1977, and that the investments were thereafter managed by stockbrokers. In *Bennett*(1) Kay L.J. defined an outgoing as "some payment which must be made in order to secure the income of the property". There was no necessity to incur John Govett's fees. We hold that they do not constitute an "expense" allowable under s 16(2)(d), because they are chargeable to capital.

19. The final head of expenditure which we have to consider is the proportion (£7) of the cost of insurance of chattels which relates to the Henry Moore Album. The album was bought as an investment, and was not part of the contents of West Lodge, although like West Lodge and its contents it forms part of Lady Hartington's fund. The £7 does not appear in the trustees' tax return for 1975–76, but has been claimed as an expense through being inadvertently included as part of a larger premium in the trustees' furnished letting computation for that year. There was little or no argument on this expenditure. It is agreed [3.1.14] that the insurance of the album included fire risk; it was a prudent and sensible expenditure on the part of the trustees. On the basis of our reasoning in para 16, but on the other side of the line, we find that the expenditure of £7 was an expense within the meaning of s 16(2)(d) and allowable against income.

20. We adjourn the hearing for one month in order that figures may be agreed between the parties. When these are notified to us we shall make a final determination.

E. Wix
R.H. Widdows } Commissioners for the Special Purposes of the Income Tax Acts

Turnstile House
94–99 High Holborn
London WC1V 6LQ
10 August 1981

The cases were heard in the Chancery Division before Vinelott J. on 22, 23 and 24 November 1982 when judgment was reserved. On 13 December 1982 judgment was given against the Crown, with costs.

D. Milne for the taxpayer J. H. R. Carver.

R. Walker Q.C. for the taxpayer D. G. Bosanquet.

C. McCall for the Crown.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Wolverton* v. *Commissioners of Inland Revenue*

(1) [1896] 1 Ch 778.

A 16 TC 467; *In re Berkeley* [1968] Ch 744; *Macfarlane* v. *Commissioners of Inland Revenue* 14 TC 532; 1929 SC 453; *In re Sherry* [1913] 2 Ch 508; *MacDonald* v. *Irving* (1878) 8 Ch 101; *Mangin* v. *Commissioners of Inland Revenue* [1971] AC 739; *Howe* v. *Lord Dartmouth* (1802) 7 Ves 137; *Roome* v. *Edwards* 54 TC 359; [1982] AC 279; *Pearson* v. *Commissioners of Inland Revenue* CTTL (4); [1980] Ch 1; CTTL (5); [1981] AC 753.

B

Vinelott J.—The issue in both these appeals is whether certain expenditure incurred by trustees is deductible in ascertaining the income of the relevant trust which is chargeable to additional rate tax under s 16 of the Finance Act 1973. Section 16(1) imposes tax at the additional rate on income arising to trustees "so far as [such income] is income to which this section C applies". Section 16(2)(*a*) provides: "This section applies to income arising to trustees in any year of assessment so far as it (*a*) is income which is to be accumulated or which is payable at the discretion of the trustees or any other person (whether or not the trustees have power to accumulate it)". Paragraph (*d*) of s 16(2) provides that the section applies to such income "so far as it . . . exceeds the income applied in defraying the expenses of the trustees in D that year which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)".

The first question (which arises in both appeals) is a pure question of construction. It can be put in this way: does para (*d*) permit the deduction of (*i*) all expenses which the trustees are authorised to incur either under the express provisions of the trust or under the general law (including any E generally applicable statutory provisions) and which under the general law as enlarged or modified by the express provisions of the trust are "properly chargeable to income" or (*ii*) only those expenses so incurred which apart from any express provision of the trust would be "properly chargeable to income"? The second question is whether particular items of expenditure were "expenses" within para (*d*) and if they were whether (if the first question is F answered in sense (*ii*)) those expenses were expenses which would have been properly chargeable to income under the general law and apart from any express provision in the relevant trust authorising the trustees to charge that expenditure to income. To explain this last question I must say something about the facts of each of these two cases.

The first of these two cases relates to a settlement (which I shall call the G. G H. Paul Settlement) made by a Mr. Geoffrey Hamilton Paul on 4 November 1964. The Appellant J. H. R. Carver was assessed to additional rate tax as a representative trustee in respect of the income arising to the trustees in the years of assessment 1974–75 and 1975–76. I do not need to refer in any detail to the provisions of the G. H. Paul Settlement. It is sufficient to say that by a Deed of Appointment dated 1 December 1964, the trustees, in exercise of a H power of appointment conferred by the Settlement, revocably appointed that the capital and income of the trust fund comprised in it should be held on trust for the settlor's son, Michael Alexander Paul, who was born on 20 November 1959, contingently on his attaining 25 or surviving a defined vesting date; and that that appointment was revoked by a further Deed of Appointment dated 26 March 1976, whereby the trust fund (other than a small sum of cash) was I reappointed on trusts under which the members of a defined appointed class (or their children taking by substitution) were given contingent interests subject to a power of revocation and reappointment which is so limited as to

ensure that the trust enjoys the protection afforded by para 15 of Sch 5 to the Finance Act 1975. During the relevant years of assessment the settlor's named son and all the members of the class presumptively entitled to share in the trust fund under the 1976 appointment were under the age of 18 and accordingly the trust fund (or, after 26 March 1976, the trust fund other than the small sum of cash appointed by the 1976 appointment) was held on trusts for maintenance and accumulation which fell within para (*a*) of s 16(2).

By a Deed of Gift dated 20 November 1972, the settlor assigned to the trustees his absolute interest in a one-third share of his father's residuary estate, the consideration for the assignment being the payment to him of the sum of £60,000. That sum was far less than the value of the interest assigned. The trustees were anxious to effect a term policy which would secure the payment of sums corresponding to those which it was calculated would be payable on the death of the settlor within seven years after the execution of the Deed of Gift. They were unable to do so for some time because the settlor had suffered a heart attack. However, he recovered sufficiently for term insurance to be practicable, and on 9 January 1975, the trustees effected a policy with the Sun Life Assurance Society assuring the payment of specified and reducing sums in the event of the death of the settlor in each of the years ending on 20 November 1976, to 1979 (both inclusive) in consideration of an annual premium of £9,223.52 payable on the commencement of the assurance, a similar premium on each of 9 January 1976, and 1977, and a premium of £1,699.50 on 9 January 1978. There was a usual endorsement on the policy declaring that the assurance would not acquire any surrender value and that no payment in excess of the total premiums paid would be made on the termination of the assurance except in accordance with the terms of the schedule thereto.

One of the contentions advanced by the Revenue before the Commissioners was that the trustees had no power under the Settlement or under the general law to effect the policy, so that the premiums could not be "expenses" properly chargeable under the trust, whether to capital or income. The Commissioners decided that the trustees did have power under clause 7 of the Settlement to effect and maintain the policy and to do so at the expense of income. Clause 7 starts with the words, "Trust monies (including any accumulations of income) may be invested or laid out"; then it specifies the ways in which trust moneys may be so invested or laid out; and then it continues with the words,

> "(including without prejudice to the generality of the foregoing powers full power to effect acquire keep up (at the expense of capital or income as the Trustees may think fit) surrender and deal in any way with assurance policies of every kind or any interest therein and to acquire improve or repair any real or leasehold property or chattels for the beneficial occupation use or enjoyment thereof by any of the Beneficiaries) as the Trustees would have if they were absolutely and beneficially entitled thereto".

The Crown have not appealed against that part of the Commissioners' decision. Mr. Milne and Mr. McCall both invited me to approach the trustee's appeal on the footing that the words in the part of clause 7 which I have cited, starting with the word "including . . ." and ending with the words "any interest therein", although they appear in the context of an investment clause in substance confer an independent power to effect and maintain at the expense of capital or income "assurance policies of every kind", and that the

A policy effected by the trustees and which is headed "Assurance policy" should be taken to have been properly so described as falling within the express terms of the power. On that footing the question I have to decide is whether the premiums were expenses falling within para (*d*).

The second case relates to a Settlement (which I shall call the Duke of Devonshire's Settlement) dated 4 April 1967, which was made by the present B Duke of Devonshire in consideration of the then intended marriage of his only son, the Marquess of Hartington. The settlor assigned certain absolute interests in other trust funds to which he was then beneficially entitled to the trustees and also covenanted with them and with his son's intended wife that if the marriage should be solemnised before 1 January 1968, and if a son of the marriage should be born and attain six months, he would within 12 months C after the birth of the first such son pay or transfer to the trustees £100,000 or property to that value. The marriage was duly solemnised before 1 January 1968, and a son, the Earl of Burlington, was born on 6 June 1969. I do not need to describe at any length the beneficial or dispositive provisions of the Settlement. It is sufficient to say that under the Settlement Lady Hartington was entitled to specified sums on her 45th and 65th birthdays (which have not D yet occurred) the trustees having power to accelerate the payment of those sums (which power they had not exercised on 18 March 1976) and that the trust fund was settled subject to that prior trust and power on trusts under which the trustees had a power of appointment in favour of a defined class of primary beneficiaries which included Lady Hartington and the issue of the marriage, and under which in default of appointment the trust fund was to be held on E trusts in favour of the children of the marriage subject to a power of accumulation.

The power of appointment was exercised by a Deed of Appointment dated 18 March 1976, whereby one fund (Lady Hartington's fund) was settled on trusts under which Lady Hartington took a life interest and the remainder of the trust fund ("the children's fund") was settled on certain trusts for the F benefit of the children of Lord Hartington who should attain 18 before or be living on a defined perpetuity date the trusts being again so framed as to fall within para 15 of Sch 5 to the Finance Act 1975. The capital sums charged by the Settlement in favour of Lady Hartington were charged primarily on Lady Hartington's fund in exoneration of the children's fund. Lord and Lady Hartington then had two children apart from Lord Burlington, both daughters G born in 1971 and 1973 respectively. Thus at all times since the Finance Act 1973, came into force the income of the trust fund or (after 18 March 1976) the children's fund has been held on trusts which fall within para (*a*) of s 16(2).

The Settlement confers very wide powers on the trustees. I should refer to three of them. Clause 19 provides:

> "The Trustees may effect purchase or otherwise acquire a policy or H policies of assurance of any kind intended to form part of the Trust Fund and pay the premiums on any policy so effected purchased or acquired (or on any policy vested in them as an addition to the Trust Fund) out of income or capital of the Trust Fund or partly out of each in such manner as the Trustees at their discretion think fit".

Under clause 21 they have power to deposit moneys, securities or title deeds I with any bank; and clause 21 provides that they may "pay out of the income or capital of the Trust Fund any charges or other expenses incurred on or in connection with any such account or deposit". Clause 23 provides that the

trustees are not to be liable for any loss or damage to any chattels subject to the trusts of the settlement but that they may "in their discretion (without being under any obligation so to do) from time to time take at the expense of the income or capital of the Trust Fund any steps that they may think proper (whether by way of insurance or otherwise) for the protection and custody of such chattels or any of them". Clause 26(b) is in the following terms: "The Trustees may at any time or times apply any income of the Trust Fund in or towards the payment or discharge of any duties taxes costs or other outgoings which but for the provisions of this clause would be payable out of or charged upon the capital of the Trust Fund".

At some time before 21 November 1969, the Duke became absolutely entitled to a large number of policies (20 in all) under which the sums assured were payable on Lord Hartington attaining 60 or on his earlier death. Those policies had been effected under the provisions of an earlier settlement in 1946 or 1947, when Lord Hartington was three or four years old. The aggregate amount of the sums assured was £212,859, the aggregate amount of the surrender values of all the policies on 21 November 1969, was £78,248 and the aggregate amount of the annual premiums was £2,740.8.4d. By an Assignment dated 21 November 1969, the Duke assigned these policies and certain investments having an aggregate market value of £21,804 (making, with the surrender values of the endowment policies, £100,052) to the trustees in satisfaction of the covenant on his part in the marriage settlement.

During the year of assessment 1970–71 the trustees effected two endowment policies on the life of Lord Burlington. In both cases the sum assured is £25,000 and is payable when Lord Burlington attains 50 or on his earlier death, though in one case only premiums paid are repayable (with interest) if he dies under 15. The annual premiums are £518.75 under one policy and £587.75 under the other. The trustees have at all times maintained the policies on the life of Lord Hartington and the policies on the life of Lord Burlington out of the income of the trust fund or (after 18 March 1976) the children's fund, of which, since 18 March 1976, the policies have formed part. The aggregate of the sums so expended in each of the fiscal years 1973–74 to 1977–78 was £3,845. That is, I understand, approximately one-fifth of the income derived from the trust fund or, after 18 March 1976, the children's fund.

The main question in the case of the Duke of Devonshire's Settlement is whether those premiums were "expenses" deductible in those years under para (*d*). During the relevant years of assessment the trustees paid a number of expenses which they charged against the income of the trust fund or, after 1976, the children's fund. The Revenue refused to allow a deduction under para (*d*) in respect of two of them. These expenses were incurred in the following circumstances. (a) Until 31 December 1977, the trustees employed a firm of investment advisers to keep under review and advise upon changes in the investments comprised in the trust fund. The Revenue refused to allow a deduction under para (*d*) for the fees paid to that firm. The Commissioners upheld the Revenue's objection. (b) In 1975 the trustees bought a freehold dwellinghouse in London with its contents and let the property furnished. They also bought from Lord Hartington a book of etchings by Henry Moore called the Sheep Album at the price of £2,000. This album was bought as an investment. It was not included in the contents let with the house. The trustees insured the contents of the house and the Sheep Album against all risks under a single comprehensive policy. The proportion of the premium attributable to the contents of the house was deductible in ascertaining the liability of the

A trustees for income tax under Case VI of Schedule D. During the year 1975–76 the premium under the policy was £36.45, the cover on the contents being £8,000 and on the Sheep Album £2,000. The proportion of the premium attributable to the Sheep Album was thus approximately £7. The Commissioners found that the apportioned part of the premium was deductible as an expense within para (*d*). The Revenue do not appeal against this part of B their decision. Since the execution of the appointment of 18 March 1976, the house and the Sheep Album have both been part of Lady Hartington's fund. The premium has of course been deducted by the trustees in ascertaining the income payable to her as life tenant.

That is all I need say about the facts of these two cases. The sums in issue (additional rate tax at 15 per cent. on the expenses claimed) are not large. C However, I understand that a large number of other cases—some hundreds in all—have been held up pending the outcome of this appeal.

Before turning to examine the terms of para (*d*) I should refer to the decision of Slade J. in *Piratin* v. *Commissioners of Inland Revenue*[1] [1981] STC 441. One question raised in that case was whether premiums paid to maintain a term policy on the settlor's life (assuring the payment on her death D within the vulnerable period under the gift *inter vivos* provision of sums equal to the estate duty prospectively payable in that event) were deductible in calculating the amount of income available to the settlor under the settlement within the meaning of s 451(2) of the Income and Corporation Taxes Act 1970. The trustees had an express power to effect and maintain a policy of this kind at the expense of income which the trustees had previously determined to E accumulate. The reason for so limiting the source of the premiums was no doubt to ensure that the proceeds of the policy would not themselves fall within the ambit of the charge to estate duty under s 38(8) of the Finance Act 1957, but would fall within the exemption provided by subs (14) of that section. Section 455(*b*) of the 1970 Act excluded from income which could be treated as available to the settlor "any expenses of the trustees of the F settlement which, in the absence of any express provision of the settlement, would properly be chargeable to income".

Slade J. pointed out that, giving these words their natural and ordinary meaning, they required all the express provisions of the settlement to be disregarded. Apart from the express power to effect and maintain the term policy the trustees would have acted in breach of trust in effecting and G maintaining it. Accordingly, the premiums paid for effecting and maintaining the policy could not be treated as properly chargeable to income or capital. Slade J. also held that even if, under s 455(*b*), it were permissible to have regard to the express power conferred by the Settlement for the purpose of ascertaining whether the expenditure in effecting and maintaining the term policy was properly incurred—that is, on the footing that the settlement had H conferred power to effect and maintain the term policy but had not stated whether the premiums were to be paid out of income or capital—the premiums would not be properly chargeable to income because in the absence of any express provision dealing with the incidence of the premiums the Court would have directed that they be borne by capital.

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(1) 54 TC 730.

Before the Commissioners both the taxpayer and the Revenue sought support from this decision for their rival interpretations of para (*d*) of s 16(2) of the 1973 Act. However, it was common ground before me that this decision does not throw any light on the interpretation of the very different language of para (*d*), to which I now turn.

Taken in isolation the words "the expenses of the trustees . . . which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)" do not appear to give rise to any difficulty. The first limb (before the words in parentheses) allows the deduction of all expenses "properly chargeable to income". Giving those words their ordinary and natural meaning they permit the deduction of all expenses which the trustees are either directed to pay out of income or which they have a discretion to pay out of income whether that direction or discretion is derived from the general law (including any statutory provision) or is derived from some provision, express or implied, of the trust. The words in parentheses then enlarge the scope of para (*d*) by permitting the deduction of expenses which under the general law the trustees would have been bound to charge or would have had a discretion to charge to income but which under some express provision of the trust they are required to charge to capital.

However, if the words "the expenses of the trustees . . . which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)" are read with the opening words "exceeds the income applied in defraying", a difficulty at once becomes apparent. Paragraph (*d*) permits the deduction of income which has actually been applied in defraying expenses. How then can the words in parentheses be read as enlarging the scope of the permitted deduction to include expenses which under the express provision of the trust were properly chargeable to capital— that is, which the trustees could not properly have paid out of income? It was this consideration which led the Commissioners who heard the appeal in the case of the G. H. Paul Settlement to conclude that on the wider construction contended for by the taxpayer the words in parentheses were "self- contradictory". The explanation advanced by Mr. Milne and Mr. Walker (which was not I think advanced before the Special Commissioners in the G. H. Paul case) is that even on the wider construction the words in parentheses are necessary to cover the case where expenses which under the express provisions of the trust are payable out of capital are paid out of income as a temporary expedient (because no moneys are available on capital account to meet them) and which apart from the express provision would have been properly payable out of income.

A similar situation in fact arose in *Stott* v. *Milne* (1884) 25 Ch 710. The main question in that case was whether the costs of certain proceedings instituted by the trustees of a testamentary trust of which the plaintiff was tenant for life for the protection of a freehold farm which was the only asset comprised in the trust had been properly incurred. The trustees had retained the costs out of income, there being no capital moneys available. In an action by the life tenant to recover the rents of the properties received by the trustees the Vice-Chancellor held that the costs of the earlier action had been properly incurred but were payable out of capital, and ordered that they be raised by sale or mortgage of the farm. He also ordered that the trustees pay the costs of the plaintiff's action personally on the ground, apparently, that they ought not to have paid the costs of the earlier actions out of income. On that point the Court of Appeal reversed the decision of the Vice-Chancellor. Lord Selborne said at page 715:

A "The right of trustees to indemnity against all costs and expenses properly incurred by them in the execution of the trust is a first charge on all the trust property, both income and *corpus*. The trustees, therefore, had a right to retain the costs out of the income until provision could be made for raising them out of the *corpus*. I am of opinion that their costs of this action ought to be raised and paid out of the estate in the same way B as the costs of the former actions."

Of course, in that case it was the Court which directed that the costs of the earlier actions should be paid out of capital; they were not payable out of capital under "any express provisions of the trust". The case for the taxpayer is that the words in parentheses are necessary to cover a case which is like *Stott* v. *Milne*[1] in that expenses which ought properly to be paid out of capital are C paid out of income in the first instance (there being no capital moneys available to meet them) and are payable out of capital only because there is an express provision of the trust directing the payment out of capital of expenses which the trustees would have been bound or entitled to charge to income if there had been no such express direction. That, it is said, gives an application to the words of para (*d*). It is pointed out that although the situation in which D the words in parentheses will apply is an unusual one it is one which in practice can easily arise and that it is not merely fanciful to suppose that the draftsman intended to deal with it. It must happen not infrequently that the only asset comprised in a trust is for instance a dwellinghouse which is let. If the trust provides that the cost of, for instance, a comprehensive insurance policy is to be met out of capital the trustees might have no alternative except to pay the E premiums out of income and to make an adjustment when the property is sold. Then part of each premium (fire insurance up to three-quarters of the value of the property) would have been payable out of income apart from the express provisions of the trust; it would under the express provisions of the trust have been chargeable to capital; it would in fact have been defrayed out of income.

Mr. McCall's main submission is that para (*d*) is fairly capable of a F different construction which avoids interpreting the words in parentheses as intended to deal with a wholly exceptional circumstance which he submits is unlikely to have been present to the mind of the draftsman. I shall return later to explain why Mr. McCall says that the case I have described was unlikely to have been present to the mind of the draftsman. He submits that the key to the interpretation of para (*d*) is to be found in the word "or" which he says is used G in its strictly disjunctive or exclusive sense. The words before and the words after the first parentheses deal with two distinct situations. The words "which are properly chargeable to income" deal with the case where the trust contains no express provision directing or authorising a particular expense to be paid out of income; the expense can be deducted if and only if under the general law the trustees either ought to pay or can properly pay that expense out of H income. The words in parentheses then deal with the case where the trust contains a provision directing or authorising a particular expense to be paid out of capital or income: the words in parentheses then require the express provisions of the trust to be disregarded in so far as they affect the incidence of the expense as between capital and income. This formulation, said Mr. McCall, was preferred by the draftsman to that contained in s 455(*b*) of the I 1970 Act because it avoids the difficulty which later emerged in *Piratin* v. *Commissioners of Inland Revenue*[2] (though that difficulty had not emerged when the Finance Act 1973, was enacted) that a provision authorising the

[1] (1884) 25 ch 710. [2] 54 TC 730.

deduction of "expenses . . . which, in the absence of any express provision . . . would be properly chargeable to income . . ." has the result that an express provision of the trust directing or authorising a particular expense to be incurred falls to be disregarded altogether. The formula used in para (*d*) permits a reference to the express provisions of the trust for the purpose of ascertaining whether the trustees acted properly in incurring the expense. All that falls to be disregarded is an express provision directing or authorising the expense to be paid out of capital. I should perhaps add that Mr. McCall accepts that the words "properly payable out of income" mean "could properly be paid out of income" and do not confine expenses deductible under para (*d*) to those which cannot properly be paid otherwise than out of income.

Mr. McCall submits that the draftsman was unlikely to have had the case I have described in mind when he included the words in parentheses for the following reason. Section 17 of the 1973 Act in broad terms deals with the incidence of additional rate tax when income is distributed to beneficiaries under a discretionary trust or power. Subsection (2) provides in effect that on a distribution of income to a beneficiary the sum paid to that beneficiary is to be grossed up by additional rate tax and basic rate tax; the additional rate tax and basic rate tax is then to be treated as tax paid by the beneficiary and so far as not set off under subs (3) as tax assessable on the trustees. Then subs (3) provides (amongst other things) that tax on income arising to trustees and charged to additional rate tax as well as basic rate tax is to be set off against the amount assessable on them under subs (2)(*b*). Mr. McCall's point is that if an expense properly chargeable to capital under the express provisions of the trust is paid out of income and the expense is allowed as a deduction under para (*d*) in that year no additional rate tax is paid in respect of the income required to meet it. If in a subsequent year of assessment the expenditure is recouped out of capital and paid to a beneficiary it must be grossed up under s 17(2). To take an example, if the expense were £55 the grossed up sum would be £100. On recoupment and distribution to a beneficiary the trustees are assessable to additional rate tax on £100. But they cannot set off additional rate tax because *ex concessis* they have not paid it on the £55 of income used to meet the expense, nor have they paid it on the capital used to recoup that expenditure.

The construction advanced by Mr. McCall does not avoid this difficulty. If an expense actually paid out of income is one which (apart from the express provisions of the trust) could properly have been charged to income but under the express provisions of the trust it is charged to capital in exoneration of income then income applied in defraying the expense is an allowable deduction in the year of assessment in which it is paid. If in a subsequent year of assessment the expense is recouped out of capital and paid to a beneficiary the same difficulty arises. The point made by Mr. McCall is that if the words in parentheses in para (*d*) were intended to deal with the case I have described then it is surprising that in drafting the ancillary provisions in s 17 the draftsman did not provide expressly for it.

I do not think that any weight can be attached to that argument. The general purpose of s 17 is clearly, first, to ensure that on a distribution of income of a trust falling within s 16 the distribution is grossed up in the hands of the beneficiary by the additional rate tax which is to be treated as deducted, secondly to make the trustees assessable for the additional rate tax attributed to the payment and, thirdly, to provide a set-off for additional rate tax actually paid in respect of the income so distributed. However, it is quite clear that s 17 does not precisely dovetail with the provisions of s 16 in the sense of making trustees assessable to additional rate tax on making a distribution only

A when and to the extent to which the additional rate tax has actually been paid on the income so distributed. For instance, if there is an increase in the rate of additional rate tax between the date when the income arises and the date when it is distributed the additional rate tax assessable on the trustees under s 17(2)(*b*) will be less than that which they can set off under s 17(3)(*a*). Mr. Walker gave another example. There are well-known cases where capital paid B to a beneficiary pursuant to a power to pay the beneficiary capital in augmentation of income is treated as income of the beneficiary for the purposes of the Income Tax Acts. Section 17(1) clearly applies to such a payment; the trustees are assessable to additional rate tax in respect of it; and they will not have paid additional rate tax under s 16 which can be set off against it.

C It seems to me that the answer to both these apparent anomalies is that the trustees have a lien on the trust fund and the income for any tax assessable on them and that if they pay the income to a beneficiary in a year when additional rate tax is payable at a rate higher than that payable in the year when the income arose to them or if they pay capital to a beneficiary which falls to be treated as income of the beneficiary they have a right independently of s 17 to D deduct additional rate tax for which they are assessable under s 17(2)(*b*) and which they cannot set off under s 17(3)(*a*). They are of course entitled to deduct and account for basic rate tax under the general provisions of the Income Tax Acts. Similarly on recouping income out of capital they must I think have the implied right to raise out of capital a sum equal to the additional rate tax on which they are assessable on the distribution of the sum E raised to recoup income.

Returning to the construction of para (*d*) advanced by Mr. McCall it seems to me that if the words before the parentheses and the words in parentheses had been intended to deal with two quite different situations as he suggests (the words before the parentheses with the case where the trust contains no express provisions dealing with the incidence of expenses properly F incurred as between income and capital and the words in parentheses with the case where the trust does contain some such express provision) it would have been more natural to have omitted the parentheses. The use of the parentheses is at least an indication that the words in parentheses were intended as subordinate to—a qualification or gloss on—the preceding words which in themselves are the primary definition of the expenses deductible under para G (*d*). Moreover, I would have expected the draftsman to have added after the word "or" something to indicate that the second limb of para (*d*) was intended to cover all cases where the trust contains an express provision directing or giving the trustees a discretion as to the way in which expenses are to be borne as between capital and income. On the other hand, I think it must be accepted that on the taxpayer's construction the words in brackets can only apply in H unusual if not exceptional circumstances. To that extent there is I think room for doubts as to the intended scope of para (*d*).

Is there anything in the wider context of the Finance Act 1973, or of the fiscal code of which it forms part which helps to resolve this difficulty? I think there is. I pointed out in *Inland Revenue Commissioners* v. *Berrill*[1] [1981] 1

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(1) 55 TC 429.

WLR 1449, that ss 16, 17 and 18 form a subsidiary part of a radical change in the tax structure effected by the Finance Acts of 1972 and 1973 whereby a high standard rate of tax coupled with a substantial earned income allowance was replaced by a lower basic rate of tax coupled with additional rate tax on investment income (defined as income which is not earned income). Apart from s 16 the new schemes would have conferred a fortuitous benefit on trust income which when it arose to the trustees did not form part of the total income of a beneficiary liable in turn to additional rate tax and higher rate tax. Looked at in the context of this statutory scheme it is I think natural to equate the income chargeable to additional rate tax under s 16 with the income that would have been chargeable to additional rate tax if it had been income of a trust to which a beneficiary was entitled as it arose. There is of course no specific provision in the 1973 Act charging additional rate tax on trust income otherwise than under s 16. None was necessary. A beneficiary entitled to the income of trust property is taxed in the same way as if he were the beneficial owner of every asset comprised in the trust property, save that a deduction can be made for expenses properly incurred by the trustees and properly charged to income (see, for instance, *Murray* v. *Commissioners of Inland Revenue* 11 TC 133). It has never been suggested and could not I think be suggested that in ascertaining the income of a life tenant a distinction is to be drawn between expenses which are charged to income pursuant to some direction or authority in the trust and those which would have been chargeable to income if the trust had been silent as to the incidence of expenses as between capital and income. It would to my mind be surprising to find that an expense which under the trust trustees are authorised to incur and charge to income but which apart from the express power to charge to income would not have been properly chargeable to income is allowable as a deduction in ascertaining the income of a life tenant for the purposes of additional rate tax but is not allowable as a deduction if the income is subject to a trust within s 16(2)(*a*).

The point can be graphically illustrated by the following example. If the fees paid to investment advisers which the Commissioners held could not be allowed as expenses within para (*d*) had been incurred in relation to Lady Hartington's fund then as I see it the fees would clearly have been deductible in ascertaining the income on which she was liable to additional rate and higher rate tax. It would to my mind be very anomalous to find that in ascertaining income of a trust within s 16(2)(*a*) such fees cannot be deducted.

Faced with this difficulty Mr. McCall submitted and was, I think, driven to submit that s 16 has a far more radical effect than anyone has yet supposed. He submitted that any trust under which the trustees have power to charge to income an expense which apart from that express provision could only have been charged to capital (that is, on the footing that the trust can be looked at to see whether the expense was properly incurred but not for the purpose of seeing whether the expense was properly charged to income) is a trust under which the income "is payable at the discretion of the trustees" within s 16(2)(*a*), the power being (like the power of accumulation in *Commissioners of Inland Revenue* v. *Berrill*[1]) a power to divert the income away from the person who would have been entitled to the income if the expense either had not been incurred or had been discharged out of capital. Mr. McCall did not press this argument so far as to suggest that a power to pay the fees of an investment adviser out of income would bring a trust within s 16(2).

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(1) 55 TC 429.

A Mr. McCall, as always, put his argument very persuasively. But after the most careful consideration I have come to the conclusion that it is impossible to construe s 16 in this way. The result if it were right would be astonishing. It is not uncommon to include in a settlement which either includes a landed estate at its inception or which contains a power to invest in the purchase of a landed estate a discretion to meet the costs of putting and maintaining the B estate in good repair out of income. Such expenditure might result in an improvement to the estate though not an improvement of the kind which would amount to an accumulation (see *Vine* v. *Raleigh* [1891] 2 Ch 13, at page 26) and be expenditure which apart from the express power would be chargeable to capital. If the fact that a power of this kind is at any given time exercisable by the trustees is sufficient to bring the trust within s 16 the trust C might move in and out of s 16 according to whether at any given time the trustees did or did not own a landed estate or possibly whether they had or had not spent money on repairs enhancing the value of the estate which they had power to charge to income. Similarly, the trust might empower the trustees to incur expenditure of the kind considered *In re Bennett* [1896] 1 Ch 778, or to charge for special services which if authorised by the Court would normally be D charged to capital (see *In re Duke of Norfolk's Settlement Trusts* [1979] 1 Ch 37 at page 62) and give the trustees a discretion to pay for such expenditure out of income. It is to my mind impossible to suppose that the legislature intended s 16 to apply to such a trust solely because the trustees had power to pay out of income expenses which apart from that express power would have been payable out of capital.

E The construction of para (*d*) advanced by Mr. McCall faces another difficulty. It is implicit in his argument that the question whether particular expenditure is of a kind which apart from any express provision of the trust would be payable out of income (in the sense that the trustees could properly pay it out of income) is one susceptible of being answered without undue difficulty by reference to general principles of trust law supplemented by F express statutory provisions (in particular s 19 of the Trustee Act 1925). In a case where the expenditure is not authorised by any provision of the trust express or implied but is incurred as reasonably incidental to the administration of the trust or pursuant to some statutory provision this assumption may be well founded. But in a case where the expenditure is authorised by some express provision of the trust and apart from that provision would not have G been properly incurred the question may be less easily answered. For instance, suppose the trustees are authorised to insure buildings against fire for their full value or to insure under a comprehensive policy valuable chattels. Is the expenditure (which in the case of the fire insurance exceeds the proportion of the value of the property which can be covered by insurance under s 19 and in the case of the comprehensive policy would not have been properly incurred H apart from the express provisions of the trust) expenditure which apart from any express provision of the trust would have fallen to be borne by income or capital? The only way of answering this question is to ask whether, if there had been no express provision of the trust and the trustees had applied to the Court for authority to incur the expenditure, the Court would have directed or authorised the expenditure to be charged to income. Applications for I authority to incur expenditure which is not authorised by the trust are normally heard in Chambers and the question whether the expenditure should be borne by capital or income often turns on the very special circumstances of the particular case. In particular, in the case where the expenditure was in maintaining a fully comprehensive policy it would be relevant to consider

whether the chattels were acquired at the request of a life tenant or were chattels of family interest which the trustees were anxious to preserve for the benefit of the remaindermen. I do not think that the legislature in enacting s 16 could have intended that the answer to the question whether expenditure incurred pursuant to some express provision of the trust is deductible under para (*d*) should depend on ascertaining whether if an application had been made to the Court to authorise it the Court would inevitably have directed that it be borne by capital or would have directed or authorised the trustees to meet it out of income.

For these reasons I think that the taxpayers' construction of para (*d*) is to be preferred even though that construction involves reading the words in parentheses as directed to a situation which is at least an unusual one. If that is right then in my judgment it must follow that the expenditure which can be deducted extends to any expenditure by trustees to meet a liability (whether incurred by them or imposed by law) which cannot be treated as being in substance either an accumulation or an application of income to or for the benefit of a beneficiary (for instance, the payment of rates on property occupied by the beneficiary)—that is, in broad terms, expenditure incurred pursuant to a power which can be classified as a power of an administrative rather than a dispositive character. In ascertaining what is the income of the trust ordinary principles of apportionment (so far as applicable) and the special statutory provisions in, for instance, ss 39(2), 47 and 66 of the Settled Land Act 1925, must be applied before the expenses are deducted; it may be that the cost of maintaining a sinking fund policy, as in *In re Gardiner* [1901] 1 Ch 697, would similarly be deducted before the income is ascertained rather than as an expense payable out of income. On that construction the premiums paid (in the case of the G. H. Paul Settlement) and the fees paid to the investment advisers and the apportioned part of the premiums for maintaining a comprehensive insurance cover over the Sheep Album (in the case of the Duke of Devonshire's Settlement) are clearly deductible under para (*d*).

Mr. McCall's narrower submission was that the payment of premiums for maintaining the policies on the life of Lord Hartington or for effecting and maintaining the policies on the life of Lord Burlington was in substance an accumulation of the income so paid. It has of course long been settled law that a trust to apply income in maintaining a life or endowment policy is not a trust for accumulation within the Thellusson Act. That was decided as long ago as 1851 by Sir George Turner, V.C., in *Basil* v. *Lister* 9 Ha 177. That decision was followed by the Court of Session in *In re Cathcart's Trustees* [1883] 10 R. 1205, and by Kay J. in *In re Vaughan* (1883) W.N. 89. It has been frequently referred to without adverse comment—see, for example, *In re Gardiner*[1] (*supra*) at page 699. The principle clearly applies to a power as well as to a trust for accumulation. I can see no reason for attributing to the word "accumulation" in para (*a*) of s 16(2) a meaning other than that which it bears in the Thellusson Act or in the statutory provisions re-enacting or amending that Act. Whether a particular application of income is an accumulation is, of course, a question of substance to be answered in the light of the particular circumstances at the time of the relevant expenditure—see, for instance, the form of order directed by the Court of Appeal in *Vine* v. *Raleigh*[2] and see *In re Rochford's* [1965] Ch 111. For instance, it is possible to imagine circumstances in which a particular application of income under clause 26(*b*) of the Duke of Devonshire's Settlement would amount to an accumulation.

(1) [1901] 1 Ch 697. (2) [1891] 2 Ch 13.

A Mr. McCall points out that *Basil* v. *Lister*[1] *In re Cathcart's Trustees*[2] and *In re Vaughan*[3] were all decided at a time when policies of life assurance were relatively unsophisticated. It is not easy today to draw a distinction between, on the one hand, an investment in units of a unit trust and, on the other, the application of income in effecting or maintaining a policy under which the sum assured is linked to the value of units of a fund of investment B held by the life assurance company and under which the assured has the right to surrender the policy for a sum similarly ascertained by reference to the value of units of the fund, more particularly when the policy is a single premium policy (such policies were, of course, popular before the tax advantages enjoyed by them were nullified by legislation). The only practical or commercial difference between a policy of this kind and an investment in a C unit trust lies in the guaranteed surrender value and in the life cover afforded by the policy (which is often modest).

I can see great force in these submissions. It may be that the application of income in effecting or maintaining policies of this kind would amount to an accumulation and that a power to apply income in effecting or maintaining policies of any kind would have to be construed as not extending to such D policies save during a period permitted by law for the accumulation of income. However, although I have been invited by Counsel to decide so far as possible all questions of principle which arise on these appeals I do not think that it would be right for me to express any opinion on this point. It is sufficient to say that in the case of the Duke of Devonshire's Settlement the policies comprised in the children's fund in my judgment fell clearly within the E principle enunciated in *Basil* v. *Lister*. In particular, the policies on the life of Lord Hartington were taken over by the trustees at a time when they had been maintained for a considerable period and the trustees were clearly entitled to take the view that it was for the benefit of all the beneficiaries interested in the capital or income of the trust fund or the children's fund that they should continue to maintain them.

F For these reasons I think these appeals should be allowed.

Appeals allowed, with costs.

The Crown's appeals were heard in the Court of Appeal, (Oliver, Purchas and Waller L.JJ.) on 25 and 26 June 1984 when judgment was reserved. On 18 July 1984 judgment was given in favour of the Crown. The Crown agreed to G pay costs.

D.C. Milne for J.H.R. Carver.

R. Walker Q.C. and *B. Green* for D.G. Bosanquet.

J. Knox Q.C. and *C. McCall* for the Crown.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Chichester Diocesan Fund and Board of Finance* H *(Inc).* v. *Simpson* [1944] A C 341; *Reg* v. *Federal Steam Navigation Co. Ltd.* [1974] 1 WLR 505; *Commissioners for Special Purposes of Income Tax* v.

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[1] 9 Ha 177. [2] (1883) 1 OR 1205. [3] (1883) W.N. 89.

Pemsel 3 TC53; [1891] AC 531; *In re Vaughan* (1883) WN 89; *Cathcart's Trustees* v. *Heneage's Trustees* (1883) 10 R. 1205; *Bourne* v. *Keane* [1919] AC 815; *Re Warden & Hotchkiss Ltd.* [1945] CH. 270; *Pearson* v. *Commissioners of Inland Revenue* CTTL(5); [1981] AC 753; *In re Gardiner* [1901] 1 CH. 697; *Re Robins* [1928] CH. 721; *Re Rochford's Settlement Trusts* [1965] CH. 111; *Vine* v. *Raleigh* [1891] 2 CH. 13. A

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Oliver L.J:—There are before the Court two appeals by the Commissioners of Inland Revenue from a judgment of Vinelott J. on 13 December 1982, by which he allowed the appeals of separate taxpayers from two decisions of the Special Commissioners upholding assessments to income tax on the taxpayers. Since both cases raised the same point, they were heard consecutively, and the learned Judge disposed of both in a single judgment C upon which separate orders were drawn up, remitting the respective cases to the Commissioners for adjustment of the assessments in accordance with the judgment delivered.

The taxpayers in each case are trustees of settlements under the trusts of which the income of the settled funds, during the relevant years of assessment, fell either to be accumulated or to be distributed to beneficiaries at the D discretion of trustees, and the point at issue in each case arises under s 16 of the Finance Act 1973. That section, in relation to income to which it applies, provides that such income shall, in addition to income tax at the basic rate, be chargeable at the additional rate provided for in s 32(1) of the Finance Act 1971, in respect of investment income surcharge.

The relevant income for purposes of the section is defined by s 16(2), and E it is upon the construction of that definition that the present appeal depends. It provides (so far as relevant) as follows:

> "This section applies to income arising to trustees in any year of assessment so far as it—(a) is income which is to be accumulated or which is payable at the discretion of the trustees or any other person (whether or not the trustees have power to accumulate it); and (b) is neither (before F being distributed) the income of any person other than the trustees nor treated for any of the purposes of the Income Tax Acts as the income of a settlor, and ... (d) *exceeds the income applied in defraying the expenses of the trustees in that year which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust).*"

The problem—and it is, we understand, one which is by no means G peculiar to these two cases—is the construction of sub-para (d) in relation to certain sums which have been expended by the trustees out of the income of the settled funds under powers contained in the settlements.

The facts of the two cases and the relevant provisions of the respective settlements have been very fully set out in the careful judgment of the learned Judge, and I do not propose to repeat them here, except to the extent that it is H necessary to do so in order to identify the particular problems which have arisen.

In the case of Carver, the settlement under which the accumulation and maintenance trusts subsisted during the relevant years contained a provision

A authorising the trustees to acquire, and keep up at the expense of capital or income as the trustees should think fit *(inter alia)*, assurance policies. That power is contained in a very wide investment clause, but it is not, as I understand it, now contended by the Revenue that the power is restricted to the acquisition and maintenance of such policies as an investment.

What occurred in this case was that in 1972 the settlor assigned to the B trustees his absolute interest in a one-third share of his father's estate, a transaction which would have given rise to an extremely heavy, though reducing, liability in the trustees for estate duty if the settlor had died within seven years. In fact, at the time, it was not possible to cover this liability by insurance because of the settlor's precarious state of health, but happily that improved and a policy was effected on 9 January 1975, with the Sun Life C Assurance Society for reducing sums in the event of the death of the settlor in each of the years 1976 to 1979. The policy was under a commencing premium of £9,223.52*p*., two further annual premiums of like amount payable on 9 January 1976 and 9 January 1977, and a final premium of £1,699.50*p*. payable on 9 January 1978. The policy had no surrender value. The first two premiums (which are the only relevant ones for the purposes of the present appeal) were D in fact paid by the trustees out of the income of the settled funds and charged to income in the accounts of the trust for the years ended 5 April 1975 and 5 April 1976, respectively. The trustees have claimed to deduct them under sub-para (d) of s 16(2), but their liability to additional rate tax for the years in question has been computed in the assessments under appeal without reference to those claimed deductions.

E The case of Bosanquet is very similar, although slightly more complicated, because the assessments cover a longer period (1973–1974 to 1977–1978 inclusive), the assessments relate to what are now two separate funds and the payments concerned include, in addition to premiums on life assurance policies, payments also of investment management fees. The question is, however, in essence the same and it is not necessary for present F purposes to dwell on these refinements. The settlement concerned is one effected by the Duke of Devonshire in 1967, and it is unnecessary to say anything more of the substantive trusts (which are fully dealt with in the learned Judge's judgment) than that they were, at the material times, trusts under which the income clearly fell within s 16(2)(*a*). It is, however, necessary to refer to two of the several very wide powers conferred on the trustees.

G Clause 19 provides:

> "The Trustees may effect purchase or otherwise acquire a policy or policies of assurance of any kind intended to form part of the Trust Fund and pay the premiums on any policy so effected purchased or acquired (or on any policy vested in them as an addition to the Trust Fund) out of income or capital of the Trust Fund or partly out of each in such manner H as the Trustees at their discretion think fit."

Similarly clause 26(*b*) provides:

> "The Trustees may at any time or times apply any income of the Trust Fund in or towards the payment or discharge of any duties taxes costs or other outgoings which but for the provisions of this clause would be payable out of or charged upon the capital of the Trust Fund."

Now as regards the insurance policies which have given rise to the question in this case, what occurred was this. Under certain earlier settlements some twenty policies of assurance had been effected assuring payment of substantial sums upon the attainment by the Duke's eldest son, Lord Hartington, of the age of 60 or his earlier death. The total sums assured were over £200,000, and by the date of the assignment referred to below they had a surrender value of some £78,248, and were under aggregate premiums of £2,740.84 until maturity. To these policies the Duke had become absolutely entitled, and on 21 November 1969, pursuant to a covenant in the settlement, the Duke assigned them, together with some investments, to the trustees as an increment to the settlement. Thereafter the trustees kept up the policies, the premiums being paid out of income. A B

For the sake of accuracy it should, perhaps, be mentioned that as a result of an appointment made in 1976 under powers contained in the settlement, that part of the fund appointed became subject to an interest in possession. That included four of the policies, so that thereafter the premiums in issue relate to only sixteen of the original twenty policies. That, however, is purely historical, and does not affect the point in issue. C

In addition, in the year 1970–1971, the trustees themselves effected two endowment policies on the life of Lord Burlington, one of the beneficiaries, each assuring payment of a sum of £25,000 upon his attaining the age of 50 or his earlier death. The annual premiums are £518.75*p*., and £587.75*p* respectively, and these too have been paid out of the trust income. D

There is one further item of income expenditure by the trustees, to which the appeal in this case relates, and that is the amount of fees paid in the years prior to 31 December 1977, to a firm of investment advisers employed by the trustees to keep the investments in the trust fund under review and advise on any changes which they considered necessary or desirable. E

Those then are the expenses with which the appeals are concerned, and I can turn back to the section. The questions raised are short ones to state, although not altogether easy to answer. First, assuming that this expenditure properly falls under the description of "expenses of the trustees", does the expression "properly chargeable to income" mean properly so chargeable under the general law in the absence of express authority in the trust instrument, or does it mean properly so chargeable under whatever authority is conferred by the particular trust instrument in addition to or in substitution for the general law? F G

To put it another way, is the section looking at particular *types* of expense to be designated as deductible in the case of *all* trusts, or is it looking as well to special provisions as to incidence which will vary from trust to trust?

Secondly, are the sums concerned "expenses" and if they are *and* "properly chargeable" bears the more restricted meaning referred to above, are they the sort of expenses which, under the general law, could properly be charged to income account? H

In each case the Special Commissioners took the view that the proper construction of the sub-paragraph was in the more restricted sense indicated above, and that the expenditure did not constitute the sort of expense which could properly be charged to income, apart from express authority in the settlement. They accordingly upheld the assessments. The learned Judge felt compelled to the contrary view, and he accordingly allowed the taxpayers' I

A appeals and remitted the cases to the Special Commissioners to make the appropriate adjustments. It is from that decision that the Crown now appeals to this Court.

Now as regards the primary question of the construction of s 16(2)(*d*), it has, I think, to be accepted that if the legislature intended to produce the result contended for by the Crown, it could have done so with complete clarity by the B use of a formula which had been employed for many years, and which is to be found in ss 428(1)(*a*) and 455(*b*) of the Income and Corporation Taxes Act 1970, both of which refer to "expenses ... which, in the absence of any express provision of the settlement, would be properly chargeable to income". The legislative intention for which the Crown contends is that for the purposes of assessing the trust income which is to be subjected to additional rate tax, C there should be deducted only those trustee expenses which under the general law would, as between life-tenant and remainderman, be properly chargeable to income, but the taxpayers contend, and indeed one cannot help observing, that if that was indeed what the draftsman of s 16 intended, he had only to say "exceeds the income applied in defraying the expenses of the trustees in that year which, in the absence of any express provisions of the trust, would be D properly chargeable to income". He did not however employ that formula, but adopted the curious device of stating what appears to be a primary class of deductible expenses and then adding an alternative in parenthesis. As the section is drafted in fact the words used, as Vinelott J. observed, give rise to little difficulty when read in isolation purely as a matter of language.

There are, on the face of it, two limbs. First there are expenses which are E "properly" (i.e. without impropriety) chargeable to income, so that all that one has to look for is whether, in charging them to income, the trustees are, having regard to the general law and the express provisions of the trust, acting properly. Secondly there are expenses which would be properly chargeable to income "but for" express provisions of the trust. Now as regards these, one is clearly directed to look for expenses which, apart from any express provisions, F would be chargeable to income under the general law. Equally, if "but for" is taken at face value, one is required to posit that the express provisions of the trust direct that they be not charged to income. That must, it is suggested, be so because as a matter of language one cannot give any sensible meaning to the expression "would ... but for" except as importing that that which "would" happen has not happened in fact, and that the reason why it has not happened G is whatever follows the words "but for". On the face of it, therefore, this limb of the subsection is dealing with expenses which are expressly charged to capital but which, were it not for that fact, would be chargeable to income under the general law.

Thus far, though there may be some difficulty in ascribing a reason for the concept, there is no real difficulty as a matter of language. But as the H learned Judge remarked, when one comes to relate these words to the opening words of the provision "exceeds the income applied in defraying" one immediately comes up against the difficulty that here is the legislature apparently assuming that expenses which have, by the express terms of the trust, been made chargeable to capital, and ought therefore not to be paid out of income, have in fact been lawfully defrayed by the trustees out of income, I for it can hardly be assumed that the legislature was contemplating the deduction of moneys paid out of income in breach of trust. At the same time, one must seek to attribute some sensible meaning to the words in parenthesis, and one must assume also that they were intended to serve some purpose which

was not already served by the first limb, which, again as a pure matter of language, gives rise to no difficulty at all. A

Thus one either has to search for some permissible secondary meaning to be attributed to the words used so as to provide a sensible and rational construction of the paragraph as a whole, or one has to accept the literal meaning and see whether there is some situation for which Parliament was seeking to legislate in which expenses expressly cast on capital could lawfully be defrayed out of income and which could, rationally, have been thought to make them expenses which ought to be deducted for the purpose of assessing additional rate tax. B

Mr. Knox for the Crown accepts straightaway that the section gives rise to difficulties however it is approached; difficulties which are not eased by the draftsman having chosen to put what appears to be a second substantive limb in parenthesis. Various suggestions have been canvassed as to how the words should be construed, but the two front-runners in the Crown's case are both variants of the theme that the word "or" is used in a strictly disjunctive sense. The first limb, it is suggested, is directed to the case where the relevant trust contains no express provisions dealing with the incidence of expenses as between capital and income. Here one is to ask only whether the expenses are expenses which would properly be chargeable to income under the general law. C D

The second limb is, it is submitted, directed to the alternative case where there are express provisions dealing with the incidence of expenses and it simply requires one to ignore those express provisions and to approach the expenses concerned on the same basis as in the first limb, the words "but for" being merely equivalent to "ignoring" or "leaving on one side". Thus limb two is, on this hypothesis, as much concerned with a case where the express trusts simply confer a discretion on the trustees as with a case where expenses otherwise chargeable to income are expressly charged to capital, or where expenses ordinarily chargeable to capital are made chargeable to income. E

There are, however, as Mr. Walker has pointed out, a number of serious objections to this approach. In the first place, there is nothing in the language used to suggest such a construction and in fact it involves, in effect, reading into the first limb some such words as "in the absence of any relevant express provisions" which then produces, in practice, exactly the same sense as the Crown's interpretation of the second limb. Secondly, the use of the parenthesis seems to suggest some subordinate class of case. But in fact most settlements do contain at least some express provisions regulating the incidence of certain expenses, and the effect of the Crown's construction therefore is in practice to elevate the subordinate limb into the primary case. Thirdly, if this was how the draftsman intended the section to operate, it is suggested that it is almost incredible that, with the example of ss 428 and 455 of the 1970 Act before him, he would have chosen so convoluted a formula. F G

An alternative approach suggested by Mr. Knox appears to come to much the same thing. One starts, he submits, with the proposition that when the section refers to "income applied in defraying expenses", it must be referring to income properly and lawfully applied in accordance with the provisions of the trust. When one comes therefore to the first limb and is directed to inquire whether the expenses (*ex hypothesi* lawfully defrayed under the express provisions of the trust) are "properly chargeable" to income, one is thrown back to the general law, for the effect of the express provisions has, as it were, already been exhausted in the inquiry whether the income has been properly (i.e. lawfully) applied under the terms of the trust. H I

A This again, Mr. Walker suggests, is open to a number of fatal objections. In the first place, there is no necessary relation between what is "lawfully applied" and what is "properly chargeable". The one looks merely to the legality of a payment factually made; the other to the proper method, under whatever provisions are applicable, of posting the payment in the books of the trust. Secondly, and more importantly, it simply construes "properly B chargeable" in the first limb as "properly chargeable in the absence of any express provisions", so that the alternative in the parenthesis now has no operation at all and becomes redundant because it has been said already. The use of a parenthetic phrase introduced by the word "or" in the sense of "or rather", or "or to be accurate", is a familiar device in every conversation but is, Mr. Walker submits, hardly what one would expect to find in a public C general statute. Thus if one is to make any sense of the second limb—and it is common ground that some meaning must be given to it—the only way that that can be done on this construction is, it is said, to jettison the first limb entirely.

Another suggestion canvassed in argument—though in fairness to Mr. Knox it should be said that it emanated not from him but from the Court—was D that sense might be given to the section as a whole if "properly chargeable" were to be construed as "uniquely chargeable" or "chargeable only to income", thus giving scope for the words in parenthesis to cover the case not covered by the first limb, where the express trusts conferred a discretion on the trustees. This, however, suffers from the objection, first, that it attributes a wholly artificial meaning to "properly", and, secondly, that it assumes that E the general law gives a single unequivocal answer to the question of whether expenses are to be charged to income or capital, whereas in fact Mr. Walker was able to refer us to a number of cases where the trustees have a discretion under the general law. Thus, on this construction, in the case where there are no express trusts, some expenses perfectly properly (in the ordinary sense of the word) chargeable to income under the general law would have to be treated F as non-deductible simply because the trustees had a discretion to charge them to capital.

In the end Mr. Knox was, I think, compelled to support the construction for which the Crown contends rather by an appeal to the supposed purpose of the section and the curious results said to flow from the taxpayers' construction, than by reference to the language which the legislature has G actually chosen to use.

On the other hand there is, as it seems to me, almost equal difficulty involved in the taxpayers' construction, for the taxpayer too is faced with the difficulty of giving a sensible meaning to the words in parenthesis. Starting from the position that the first limb of para (*d*) authorises the deduction of any expenses which are properly chargeable to income, whether on general H principles of law, or under some express provision of the trust regulating the incidence of expenses, what possible room is there then left for the alternative in the parenthesis which does not involve the contradictory conclusion that it is dealing with expenses which, by definition, are not properly chargeable to income but have nevertheless been paid out of income?

Mr. Walker has to accept that at least in this part of the paragraph the I expenses referred to are those which, under the general law, would be chargeable to income, so that to that extent his construction may be said to be open to the objection that it attributes different meanings to the properly

chargeable expenses in the two limbs of the paragraph. That is, however, something which it is submitted is inherent in the supposition which this limb of the paragraph requires to be made, namely that there is an express provision in the trust directing that they be charged to capital. The objection that that then makes nonsense of the opening words of the paragraph, which require one to assume that income has been applied (and, *ex hypothesi*, lawfully applied) in defraying these very expenses is overcome by reference to the decision of this Court in *Stott v. Milne* (1884) 25 Ch D 710, where it was held that trustees who had incurred costs in proceedings for the benefit of the estate were entitled to be indemnified out of both the corpus and income of the estate, and to retain the amount out of income until arrangements could be made for raising them out of corpus. Trustees, it is argued, may be obliged from time to time to defray out of income in hand expenses which, under the terms of the trust, are expressly thrown on capital, because there are no liquid funds of a capital nature immediately available to meet them. It may be necessary for those expenses to be met by a temporary borrowing from income until funds become available which enable the appropriate adjustment to be made. It is, the taxpayers submit, to this situation that the second limb of the paragraph is directed. The legislature, having appreciated that this situation might occur, thought it right to provide that in that case, so long as the expenses concerned were expenses which, apart from the express provision, could legitimately be charged to income, they should be treated as a deduction in calculating the additional rate tax to which the trust income is subjected.

This construction has the advantage that it involves doing no violence to the words which the legislature has chosen to use, but it is not easy to see any logical reason why, in a provision which was clearly designed to impose an additional and extraordinary tax burden on discretionary and accumulation trusts, the legislature should have thought it right to ease the tax burden of the trustees in these particular circumstances, and the notion that it should have gone out of its way to make a carefully thought-out and particular provision for a situation which can hardly have been thought of as one which was likely to arise, appears at first sight a little less than realistic.

Moreover, assuming an intention on the part of the legislature to accept a principle of relieving from additional rate tax income which has been temporarily expended in paying capital expenses, why limit the relief to expenses which, had the settlement not made them capital expenses, would have been income expenses? *Ex hypothesi* one is, on this construction, dealing with a case where income is temporarily unavailable for distribution to beneficiaries, because it has had to be applied for capital purposes, and it cannot logically make any difference whether those purposes are capital purposes because the general law designates them as such, or because the settlor has chosen to do so.

Nevertheless, it has to be accepted that this construction is linguistically a possible one, and really the only one which fits the words used on their literal meaning. The taxpayers' submission is that it is, in fact, the only way of giving effect to the language of the provision without substantially rewriting it. The difficulty about the Crown's submission, it is said, is that it necessarily involves doing not just some, but substantial violence to the language. Mr. Walker in fact suggests that it requires no less than four alterations to be made. First, he says, it involves reading into the first limb some such formula as "if the trust contains no express provisions as to incidence", and into the second limb "if the trust does contain express provisions as to incidence". Secondly, it involves reading into the second limb, after this inserted

A expression, the words "are properly chargeable to income". Thirdly, it involves adding a conjunctive "and" so as to link these words with "would be so chargeable". Fourthly, it involves reading "but for" as meaning "even in the absence of ". Finally, Mr. Walker submits that it involves ignoring the parentheses.

Persuasive as I found Mr. Walker's argument, I am not convinced that B the interpretation for which Mr. Knox contends involves quite so wholesale a reconstruction of the language of the provision. It does, however, have to be accepted that it involves, either expressly or *sub silentio*, reading the simple word "or" in the parentheses as meaning something like "or in a case where the trust expressly regulates the incidence of expenses", thus restricting the first limb of the paragraph, by implication, to cases where there is no such C express regulation.

Moreover, even so modified, the difficulty created by the words "but for" remains, and these words have to be construed as meaning "apart from", "in the absence of" or "ignoring", which is not their normal or primary sense.

Vinelott J., faced with the difficulty that the literal construction urged by D the taxpayer had necessarily to be based on the supposition that the legislature had evolved this delphic pronouncement in order to meet a case which could hardly be supposed to be a usual one, looked (and, in my judgment, rightly looked) at the wider context and legislative history of the enactment. The Finance Acts of 1972 and 1973 completed the process initiated in 1971 of effecting a radical change in the tax system of the United Kingdom. Prior to E this legislation, the salient features of the system were a high standard rate of income tax, with relief for earned income, and a surtax charged in higher incomes in the subsequent year of assessment. The object of the new legislation was to introduce a unified tax system replacing the standard rate tax with a lower basic rate broadly equivalent to the old standard rate less earned income relief. At the same time surtax was abolished and replaced with a F graduated scale of tax on higher incomes, unearned income being subjected, over a certain figure, to a surcharge of 15 per cent.

The changes are admirably and clearly summarised in the judgment of Vinelott J. in *Commissioners of Inland Revenue* v. *Berrill*[1] [1981] 1 WLR 1449 at page 1459.

The income of trustees is, as the learned Judge there pointed out, G necessarily investment income and income which, until distributed to some beneficiary so as to become part of his total income, is not subjected to higher rate tax or investment income surcharge. The primary object of the change, however, was, I infer, to simplify taxation, not to lower it, and in the case of accumulation trusts or trusts where the income is retained pending distribution at the discretion of the trustees, there would, in the absence of some H compensating additional charge, have been substantially less tax borne by the trust as a result of the changeover to the unified tax system, since trust income would now suffer only tax at the new basic rate instead of at the previous standard rate. It is this advantage that is nullified by s 16, which imposes a flat-rate charge of 45 per cent on trust income which is either distributable

(1) 55 TC 429.

under a discretionary trust, or is accumulated. When it is distributed to a beneficiary, it becomes part of his income for tax purposes, but he receives a credit for the 45 per cent. tax borne by the trustees, either paying further tax or claiming a repayment, according to his personal circumstances. This is regulated by s 17, which treats any distribution to a beneficiary as a distribution of an amount from which basic rate and additional rate tax has been deducted (i.e. as a grossed-up sum) such tax being assessable on the trustees, to whom credit is given for tax already paid by them on that income. A B

So far as the beneficiary is concerned, he is given credit for the tax paid by the trustees in assessing his tax liability on his total income, so that if his total tax liability is less than the amount paid, he is entitled to reclaim; whilst if it is more, he is liable only to pay the excess.

So far as one can look for logic in a system of taxation, one can readily see the logic, on the changeover to a unified system, of making, in an accumulation trust, an allowance against the new compensating additional rate for the normal income expenses of administration which in fact reduce the amount available for investment. Under the former regime, the income coming to the hands of the trustees suffered standard rate tax without any allowance for expenses. That, at the time of the change, was of the order of 38 per cent. If that income is now merely to be charged at the basic rate of 30 per cent., the trust obtains an uncovenanted advantage. If, on the other hand, the whole income, without deduction, is subjected to additional rate tax, the trust is penalised by being taxed at a considerably higher rate than before. C D

One can readily see that, in these circumstances, a reasonable compromise was to compensate by permitting the deduction of administration expenses for the purpose of reducing the amount assessable to additional rate tax. It is difficult, however, to see the logic of introducing a system where the yardstick for arriving at the amount of income so assessable is allowed to vary from trust to trust, according to the way in which the settlor has chosen to direct the incidence of expenses. Tax is not ordinarily to be regarded as a voluntary charge, and if one imagines the unlikely hypothesis of two accumulation settlements of identical amount administered by the same trustees who incur exactly the same expenses in each but who are subject, in one case only, to a direction to charge expenses of whatever nature to income, it is not easy to see why the legislature should sensibly have contemplated that they should be subjected to different tax burdens. E F

There were, however, two factors which influenced the learned Judge in favour of the taxpayers' construction. It is, of course, the case that in a "fixed interest" trust—the ordinary case, for instance, of a life interest to a testator's widow—the beneficiary receives by way of income only that which is available to be distributed after defraying whatever expenses of the trustees the testator or settlor has chosen to throw or to allow to be thrown upon income, and his tax liability is ascertained only on the basis of what he has actually received. If one compares that with the position of the object of a discretionary trust to whom in fact the trustees distribute the entirety of the trust income in each year, why, it is asked, should such a beneficiary be in any different position? G H

> "It would" the learned Judge observed "to my mind be surprising to find that an expense which, under the trust, trustees are authorised to incur and charge to income but which apart from the express power to charge to income would not have been properly chargeable to income is allowable as a deduction in ascertaining the income of a life tenant for the I

A purposes of additional rate tax but is not allowable as a deduction if the income is subject to a trust within s 16(2)(a)."

The other difficulty which the learned Judge saw in the Crown's construction—apart altogether from the linguistic ones—was, he observed, that it was implicit in the argument that the question whether particular expenditure is of a kind which, apart from express provision, would be B payable out of income is susceptible of an easily ascertainable answer and he instanced cases in which it might be very difficult to predict what, if the trustees found it necessary to apply to the Court for directions, the Court would direct.

Now as regards the former of these two factors, it has to be accepted that if one assumes an intention on the part of the legislature that all trusts under C which income is distributable are to be treated alike, a difference in the tax burden cast on income according to whether it is distributable mandatorily or as a matter of discretion appears as an anomaly; and Mr. Walker was able to demonstrate, by a comparison of the tax consequences in the case of a fixed interest trust and those in the case of a discretionary trust where all the income is in fact distributed, that the taxpayers' construction of s 16 produces what he D describes as a symmetry, that is to say a result in each case where the total tax burden borne by the trust income independently of the beneficiary's individual tax position is the same. That symmetry is not reflected by the Crown's construction. This is undeniable if one takes as the example the case where the whole trust income of a discretionary and accumulation trust is in fact distributed.

E But that can hardly be described as the norm and Mr. Knox criticises the learned Judge's approach because, he says, it starts from a wrong assumption that the two types of trust are intended to be treated alike. The discretionary and accumulation trust is, he submits, a different animal and one is not justified in assuming either that it was intended to be or that it should logically be subjected to the same treatment as the trust in which there is a present F interest in possession in some identified beneficiary. Discretionary trusts vary in their terms, of course. A possible form of discretionary trust which falls within s 16(2)(*a*) is one where the trustees are obliged to distribute all the income and have merely a discretion as to its division between the specified objects. Accepting that in such a case there is no immediately recognisable reason in logic why the income should be treated for tax purposes any G differently from income payable to one or more beneficiaries with identifiable interests in possession, this is not the normal case and indeed can hardly be said to be sufficiently common to warrant special treatment apart from discretionary trusts generally. In the ordinary case the trustees have a discretion whether or not to distribute and a power to accumulate income undistributed.

H Such a trust does raise quite different problems as regards taxation, for one is dealing with income which does not, in the year in which it arises, become (and, indeed may never become) part of anybody's total income for tax purposes. One is therefore dealing, by definition, with income the whole or part of which is going to be taxed only in the hands of the trustees and at the rate appropriate to the trustees and to no-one else. It is not, therefore, Mr. I Knox submits, surprising to find such trusts regulated in a different way.

Speaking for myself, I have found Mr. Knox's submissions persuasive. There seems to me to be no good reason for treating the two cases as parallels

and I do not therefore, for my part, find the differences in treatment which the Crown's construction entails to be a factor which militates against that construction. A

Nor, despite Mr. Walker's extremely persuasive submissions, have I found myself able to take the same view as the learned Judge did about the marginal cases where it may be difficult to determine what attitude "the general law" adopts. I accept of course that such cases may, and probably will arise, but that does not appear to me to be a reason for rejecting the Crown's construction if it is otherwise reasonable. In the first place, the legislature has beyond doubt adopted "the general law" (whatever the general law is and however it falls to be determined) in ss 428 and 455 of the Taxes Act 1970. Secondly, and in any event, the difficulty of determination is one which has to be faced equally on the taxpayers' construction of the words in parentheses, for it is still going to be necessary to determine whether the expenses chargeable to capital which have been paid out of income are expenses which would have been chargeable to income under the general law. If difficulty arises, it may be that it is a reason for rejecting both constructions, but I do not see it as a ground for preferring one to the other. B C

I find myself back, therefore, at the point from which the learned Judge started—that there are two possible constructions, one of which involves reading words into the section, and the other of which involves a hypothesis about the legislature's intentions which seems somewhat less than likely. It has to be accepted that on any view of the matter the section is very ineptly drawn, and that the proper construction is to a large extent a matter of impression. Few judges have greater familiarity with the taxing statutes than Vinelott J., and I differ from him only with the greatest diffidence. Nevertheless I must, in the end, follow my own inclination, and I am driven to the conclusion that the only construction which gives any rational and sensible meaning to the section is that urged by Mr. Knox. For myself, I am unable to accept the submission that the taxpayers' construction produces either a sensible or an explicable result. As a practical matter, expenses of whatever nature are simply paid out of the trustees' bank account which, at any given time, is likely to consist of a mixture of moneys from both income and capital sources. If one talks of income or capital being "applied" in payment of expenses one is, as it seems to me, looking beyond the immediate source of the money (the bank account) and having regard to the way in which, ultimately, the payment is going to be posted in the books of the trust. There are only three types of expenses which, in the books of the trust, can properly be posted to income, that is to say those which are properly so chargeable in the absence of any direction in the settlement, those which are expressly chargeable only to income under a direction in the settlement, and those as to which, under a direction in the settlement, the trustees are given a discretion regarding incidence. D E F G

On the taxpayers' construction of the section all these three possible classes have been exhaustively dealt with in the first limb of para (d), and there is admittedly no room left for the second limb to have any operation unless it can be explained by the supposition that, for some quite unexplained reason, the legislature decided that provision must be made for allowing temporary borrowings by capital from income to be deducted so long as those borrowings were made for the purpose of meeting not just expenses expressly made payable out of capital, but expenses of a type which under the general law would have qualified as income expenses. I have been quite unable to see any logical reason for ascribing so curious an intention to the legislature. Elaborate examples have been produced on both sides for the purpose of demonstrating H I

A that if such a temporary borrowing by capital is made and the amount borrowed is subsequently repaid and distributed as income, there will either in fact be no loss of tax to the Crown or that there will be some loss to the Crown. But even assuming in their favour the taxpayers' contention that there would be no loss in these circumstances, there still remains to be demonstrated any logical reason why the legislature should have contemplated this limited B deductibility in circumstances where the income is not, in fact, going to be distributed, but will be accumulated and added to capital. Moreover, I for my part find it inconceivable, even allowing for some obviously defective drafting, that if the legislature had really intended so unusual sophisticated and limited a deduction to be made, it would have adopted this obscure formula for achieving that intention.

C As against this, the Crown's construction gives a sensible meaning to both limbs. It is a meaning which produces consistency of treatment between all trusts of the nature described without allowing a fortuitous advantage to those where a settlor has chosen to alter the normal incidence of expenses; and it is a meaning which, in my judgment, more nearly fits what one would expect as the logical pattern of the legislation than that advanced by the taxpayers. D Certainly, it has to be accepted that it involves implying an unexpressed limitation on the first limb, but that does not appear to be an insuperable difficulty if one can sensibly give to the second limb the meaning which the Crown seek to attribute to it. There is no difficulty at all in seeing that it applies to trusts which contain express provisions regulating the incidence of expenses. The difficulty arises only from the use of the words "but for" and E whilst I agree that the *prima facie* sense of the parentheses, if taken in isolation, would indicate that they were dealing only with the case of income expenses expressly charged to capital, the secondary meaning of "in the absence of" or "apart from" is, in my judgment and looking at the section as a whole, a permissible one.

Accordingly, I would differ from the learned Judge on this aspect of the F case and uphold the view of the Special Commissioners.

That brings me to the second question—namely, are the expenses in issue here expenses which, under the general law, could properly be charged to income? So far as the Carver appeal is concerned, Mr. Milne concedes that the premiums with which the appeal in his case is concerned are not so chargeable. As regards the appeal in the case of the Duke of Devonshire's settlement, it G appears to me, and indeed Mr. Walker has not really argued to the contrary, that the payment of the fees of the investment advisers, which were incurred for the benefit of the fund as a whole, would be properly chargeable to capital and would not, on the Crown's construction of the section, be deductible (see *Re Bennett* (1896) 1 Ch 778).

The argument has thus centred on the position of the premiums payable H on the life policies. These, of course, were not, as in the Carver case, protection policies but were property forming part of the trust funds which came to the hands of the trustees and which required the premiums to continue to be paid if the policies were to be kept up and their full value ultimately realised. The two policies on Lord Burlington's life are on a slightly different footing since they were effected *ab initio* by the trustees, and will have to be I considered separately if the premiums on Lord Hartington's policies are deductible. If the latter are not deductible, however, then those on Lord Burlington's policies are *afortiori*.

There was a considerable argument, both before the learned Judge and before this Court, about whether the payment of these premiums constituted an accumulation and about whether the much debated decision of Turner V.C. in *Bassil v. Lister* (1851) 9 Ha 177 was rightly decided or ought now to be overruled. The initial question however is whether, in general, premiums on a life policy payable by trustees are expenses which are properly chargeable to income. If they are as a matter of generality then it will be necessary to consider whether they are, technically, "expenses" for the purposes of the section or whether they constitute accumulations. It is only in the context of the last question that *Bassil v. Lister* becomes relevant.

Mr. Walker has helpfully referred us to a number of decided cases, from which he argues that there is no well-trodden path in the general law from which it can be determined whether, in general, premiums on life policies held by trustees are chargeable to capital or income. He relies on the case of *In re Waugh* 25 W.R. 555 as an authority for charging them to income, but he would, I think, be the first to admit that the report of that case is rather less than adequate. *MacDonald v. Irvine* (1876) 8 Ch D 101, *In re Morley* [1895] 2 Ch 738 and *In re Sherry* [1913] 2 Ch 508 are all cases where such premiums were directed to come out of capital, but Mr. Walker points out that they were all cases where the question arose in the administration of a deceased's estate (where there are considerations which do not necessarily apply to an *inter vivos* settlement) and where something may have turned on the construction of the particular will or codicil. Accepting, however, that it may not be possible to derive an entirely clear picture of universal treatment of premiums from reported decisions, there does not appear to me to be any real difficulty in principle. Obviously individual trusts will vary, but the universal answer is, I should have thought, that one has to look in each case at the person or group of persons for whose benefit the policy is in fact being maintained under the relevant trust. If on such an investigation it is perfectly plain that the policy is being mantained as an investment of capital and for the benefit of capital, then I should have thought that it must inevitably follow that the premiums paid by the trustees, in the absence of express direction in the trust, would be chargeable to capital and not to income. That appears to have been the view of Slade J. in *Piratin v. Commissioners of Inland Revenue* [1] [1981] S T C 441.

In the instant case, I can see no grounds whatever upon which, apart from the express provisions of the settlement, the premiums paid by the trustees would properly be chargeable to income and I would, accordingly, restore the decision of the Special Commissioners in this respect also.

It is not necessary, therefore, for the purposes of this appeal to consider whether the premiums paid out of income do or do not strictly constitute accumulations of income. There are strong arguments for saying that they may do so in some circumstances and it may be that in some other case the views of Sir George Turner in *Bassil v. Lister* may require to be reconsidered by this Court. That, however, does not arise in the instant appeal and I say no more about it.

For the reasons which I have endeavoured to state, I would allow both appeals and restore the determination of the Special Commissioners in each case.

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[1] 54 TC 730.

A **Purchas L.J:**—I agree, although I must confess to having had some anxiety. This has arisen not from the solution for which the Crown contends as being the correct solution, but from the extent to which the Court finds itself obliged to re-write this particular provision in order to achieve that result. Moreover, we are differing from a Judge of great experience in this field. As appears from the judgment of Oliver L.J., the able arguments of Counsel for B the taxpayers and the Crown serve to underline that whatever meaning is given to s 16(2)(*d*) of the Finance Act 1973, no workable solution is obtainable in the context of the two settlements with which these appeals are concerned without considerable surgery if not positive distortion.

I need not repeat here the rival contentions already fully described by Oliver L.J. The taxpayers' contention that the "first limb" of s 16(2)(*d*) C embraces both expenses properly chargeable to income under general law and under express provisions of the trust in effect renders the words of the subsection enclosed in parenthesis otiose, save for the wholly exceptional circumstances arising in the case of *Stott v. Milne* (1884) 25 Ch D 710. Mr. Knox's submission that it is inconceivable that the draftsman of the section specifically included the words in parenthesis with that authority in mind D carries considerable force. On the other hand, the Crown's contention that the first limb of the subsection must have imported into it one or other of the phrases mentioned by Oliver L.J. requires constructive agility not to mention the fact that in this context the ordinary reading of the words in parenthesis "or would be so chargeable but for any express provisions of the trust" becomes practically meaningless if the primary meaning of the words "but E for" are used. Furthermore, it seems difficult to understand why the draftsman could not have simply phrased s 16(2)(*d*) in the terms "properly chargeable according to general law notwithstanding any express provisions of the trust to a different effect", or to have adopted a model on the lines of s 428 (1)(*a*) or s 455 (*b*) of the Income and Corporation Taxes Act 1970.

In this difficult legislative position I have also reached the conclusion that F the Court must do its best to give some positive meaning to s 16(2)(*d*) of the Act. This is particularly the case as the sense of subs (2)(*d*) is to relieve the taxpayer from the incidence of additional rate tax in certain circumstances. Mr. Knox described in attractive terms the legislative context in which additional rate tax was introduced in the conversion from standard rate of tax to basic rate between 1970 and 1973. I also agree with his submission that G assuming that Parliament wished to maintain the approximate position of the discretionary trust so as to avoid an uncovenanted bonus accruing to such trusts as a result of the conversion that this is achieved by the imposition of additional rate tax bringing up the basic rate to 45 per cent. in line with the original standard ratc at which such trusts were taxed. Against this background, in my judgment, it seems highly unlikely that Parliament H intended to place in the hands of those drafting discretionary trusts the power to write their own taxation legislation into the settlement. This in effect would be the result of accepting the taxpayers' suggested interpretation of the first limb of s 16(2)(*d*) to embrace both expenses properly chargeable to income under general law, in addition to those so chargeable under the express provisions of the settlement. With that background I find, although somewhat I hesitatingly, that the distorted construction for which Mr. Knox contends of the words within the parenthesis is acceptable.

I now turn to the question of the specific expenses which arise in the two appeals under consideration.

As the construction at which I have arrived favours the contention of the Crown, it is necessary only to consider the true nature of the outlays now reduced to premia paid on life policies in the context of the question whether they are expenses properly chargeable to income under the general law. A

I agree that it is undesirable to attempt to state an all-embracing rule as to whether or not premia paid upon life policies are chargeable to income under general law and that each case must be decided upon its particular facts. In view of the necessity to rely extensively upon what is thought to be the intention of the Act, I thought at one point that a distinction should be drawn between the cases to which we were referred and the instant case on the basis that the conflicting interests in the former were between the tenant for life and the remaindermen, whilst in the latter the interest was that of the Crown to discourage the conversion of income to capital with the consequence of a loss of tax. B C

In the former category, the solution depends upon whether it is appropriate to charge the life interest with the expense, or whether the trust as a whole should carry the burden. Such a consideration does not arise where there is no dispute between members of a class of beneficiaries under a discretionary trust. The "object" of the statutory provision is to permit some, but not necessarily all, of the income of the trust in fact spent by the trustees to escape the full incidence of tax. There is, in my judgment, considerable force in the suggestion that so long as such payments are made in the course of the proper administration of the trust and do not directly or indirectly result in an increase in the value of the settled assets, then the intention of the subsection would be achieved. This is on the assumption that the object is to prevent the enlargement of the fund as a result of tax relief granted by s 16(2)(*d*). In my view, this would extend to actions properly taken by the trustees in the discharge of their duty to preserve the value of the fund (as opposed to increasing it), whether or not as between a hypothetical tenant for life and a hypothetical class of remaindermen such an expense would more appropriately be charged to capital rather than interest. As I have said, in the case of discretionary trust, there are no life tenants or remaindermen. In these circumstances the critical factors determining whether an expense is chargeable to income or to capital account would solely be whether the expense was incurred merely to protect the fund (e.g. term insurance to protect against an untimely death and possibly fees paid to consultants to ensure prudent investment of a portfolio) or whether the expense was incurred to achieve capital accretions to the fund. D E F G

However, I have come to the conclusion that this was not the approach in fact adopted by the draftsman of the Act. His object as appears, somewhat obscurely, from s 16(2)(*d*), was to achieve a balance between those discretionary settlements under which all income is distributed, and those under which none is. In order to do this he has adopted, as a rough and arbitrary measure of compromise, the existing rules determining the manner in which expenses are to be charged as between income and capital account in the irrelevant situation as between the tenant for life and the remaindermen under the general law governing the administration of trusts. H

In these circumstances, I agree with all that Oliver L.J. has said on this question, and that the determination of the Special Commissioners should be restored. I

Waller L.J.—I have had the advantage of reading in draft the judgment of Oliver L.J. He has there set out in full the difficulties which arise from

A either of the rival constructions of para (*d*) of s 16(2) of the 1973 Act. I have been reluctant to reach different conclusions from Vinelott J., with his great experience of tax law, in what is a narrowly balanced decision.

I have, however, come to the conclusion that the construction preferred by Oliver L.J. is the one to be adopted. I also agree with him on the question of expenses.

B I agree with his judgment, and the Order which he proposes.

Appeals allowed: the Crown agreed to pay costs.

The trustees' appeals were heard in the House of Lords (Lords Fraser of Tullybelton, Diplock, Brandon of Oakbrook, Roskill and Templeman) on 16, 17 and 18 April 1985 when judgment was reserved. On 16 May 1985 judgment C was given in favour of the Crown, (Lord Diplock dissenting).

Robert Walker Q.C. and *Brian Green* for the Trustees.

John Knox Q.C. and *C. McCall* for the Crown.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Bassil* v. *Lister* (1851) 9 Ha 177; *Stott* v. *Milne* (1884) 25 Ch D 710; *In re Cathcart's Trustees* (1883) 10 Rett 1205; *Macfarlane* D v. *Commissioners of Inland Revenue* 14 TC 532; 1929 SC 453; *Murray* v. *Commissioners of Inland Revenue* 11 TC 133; *In re Duke of Norfolk's Settlement Trusts* [1979] Ch 37; *Pearson* v. *Commissioners of Inland Revenue* CTT L(5); [1981] AC 753; *Piratin* v. *Commissioners of Inland Revenue* 54 TC 730; [1981] STC 441; *In re Smith* [1913] 2 Ch 216.

E **Lord Fraser of Tullybelton**—My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Templeman, and I agree with it.

I wish to add only two comments. First, like my noble and learned friends, Lord Diplock and Lord Roskill, I express no opinion whether the Crown's concession that the premiums on the gift protection policies in the F Paul family settlement were properly classifiable as expenses was rightly made. Secondly, I do not wish to be taken as impliedly deciding that the expenses "properly chargeable" (in the sense explained by Lord Templeman) to income under s 16(2)(*d*) of the Finance Act 1973 in a Scottish trust would fall to be regulated by English trust law, if there were a relevant difference between the laws of England and Scotland.

G I would dismiss both appeals.

Lord Diplock—My Lords, it is with unaffected diffidence that I find myself constrained to differ from my noble and learned friend, Lord

Templeman, upon the true construction of s 16 of the Finance Act 1973 of which the subject-matter is the law of trusts—a field of English law with which I cannot lay claim to any special familiarity. My disagreement with the conclusion that he reached is limited to the chargeability to income tax at the additional rate of expenditure made out of income arising to trustees of trusts of the kind described in para (*a*) of s 16(2) (which for brevity I will refer to as "discretionary trusts") when that expenditure falls within the meaning of the word "expenses" as used in para (*d*) of the same subsection.

As Lord Templeman's speech embodies the conclusion reached by the majority of your Lordships and my own consists of a dissent to what is only a part of it, it would be wasteful for me to duplicate his narration of the relevant facts which give rise to the two appeals. Accordingly, my own speech has been drafted as if it were coming after his and did not, in deference to mere convention, precede it. I will, however, set out in full subs (1) and (2) of the Finance Act 1973, upon the construction of which I differ from the rest of your Lordships:

> "16. (1) So far as income arising to trustees is income to which this section applies it shall, in addition to being chargeable to income tax at the basic rate, be chargeable at the additional rate. (2) This section applies to income arising to trustees in any year of assessment so far as it—(*a*) is income which is to be accumulated or which is payable at the discretion of the trustees or any other person (whether or not the trustees have power to accumulate it); and (*b*) is neither (before being distributed) the income of any person other than the trustees nor treated for any of the purposes of the Income Tax Acts as the income of a settlor; and (*c*) is not income arising under a trust established for charitable purposes only or income from investments, deposits or other property held for the purposes of a fund or scheme established for the sole purpose of providing relevant benefits within the meaning of section 26 of the Finance Act 1970; and (*d*) exceeds the income applied in defraying the expenses of the trustees in that year which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)."

I start by observing that these appeals do not involve any tax avoidance scheme capable of attracting the new approach to the application of taxing statutes to business transactions which was initiated in *Ramsay (W.T.) Ltd.* v. *Commissioners of Inland Revenue*(1) [1982] AC 300 and developed in *Commissioners of Inland Revenue* v. *Burmah Oil Co. Ltd.*(2) [1982] STC 30 and *Furniss* v. *Dawson*(3) [1984] AC 474. On the contrary, the trust instruments with which these two conjoined appeals are concerned were perfectly normal family settlements entered into long before income tax at an additional rate upon investment income was introduced into our fiscal system. So, for the purpose of deciding the instant appeals, only the ordinary principles of construction of taxing statutes are applicable to s 16 of the Finance Act 1973. Those principles are succinctly set out in the opinion of the Privy Council delivered by Lord Donovan in *Mangin* v. *Commissioners of Inland Revenue* [1971] AC 739, 746. For ease of reference I have labelled them A to D:

> A. "First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As Turner J. says in his (albeit

(1) 54 TC 101. (2) 54 TC 200. (3) 55 TC 324.

A dissenting) judgment in *Marx* v. *Inland Revenue Commissioners* [1970] N.Z.L.R. 182, 208, moral precepts are not applicable to the interpretation of revenue statutes." B. "Secondly, '... one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used': B *per* Rowlatt J. in *Cape Brandy Syndicate* v. *Inland Revenue Commissioners*(1) [1921] 1 K.B. 64, 71, approved by Viscount Simons L.C. in *Canadian Eagle Oil Co. Ltd.* v. *The King*(2) [1946] A.C. 119, 140." C. "Thirdly, the object of the construction of a statute being to ascertain the will of the legislature it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce C such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted." D. "Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction."

Principles A and B are sufficient in themselves to solve most disputed questions of construction of provisions contained in taxing statutes. Two D conditions precedent must be satisfied before recourse may also be had to the principle C. The first of those conditions precedent is that the application of the actual language of the provision to the kind of factual circumstances with which the provision purports to deal, would lead to results so unjust or absurd that the Court is driven inexorably to the conclusion that no parliament, whatever its political complexion, could have intended to bring them about. E Parliament's long record of disparity of treatment of expenses in assessing the liability of various categories of taxpayers to taxes upon income makes the subject-matter of the words, as to whose meaning I differ from your Lordships, a weak candidate for satisfying the first condition precedent to having recourse to Lord Donovan's principle C.

The second condition precedent to having recourse to principle C is that F the actual language used in the provision to be construed admits of an interpretation that would avoid the injustice or absurdity relied upon. For my part, for reasons that I shall elaborate, I think that to give to s 16(2)(*d*) the meaning for which the Revenue contend would involve so much distortion of the ordinary meaning of the actual words the draftsman used and so substantial an interpolation of other words as to be impermissible under the G guise of judicial construction.

So too, if the problem of construction can be resolved by the application of principles A and B there is no room for resort to principle D, legislative history. The legislative history of ss 16, 17 and 18 of the Finance Act 1973 is referred to by Vinelott J. in his judgment in the instant cases [1983] 1 WLR 494, 505, and had been subjected to more detailed examination by the same H Judge in *Inland Revenue Commissioners* v. *Berrill*(3) [1981] 1 WLR 1449, 1459. Those sections form a subsidiary part of a radical change in the tax structure effected by the Finance Acts 1972 and 1973, which involved the abolition of earned income allowance and surtax and the substitution of a basic rate of income tax, lower than the former standard rate, progressive

(1) 12 TC 358. (2) 27 TC 205. (3) 55 TC 429.

higher rates on higher incomes and additional rate tax on investment income, i.e. income other than earned income. In a comparison of the way in which the expenses of trustees would be dealt with for the purpose of assessing additional rate tax under a trust falling outside s 16 because it vested a life interest in a beneficiary the payment of which the trustees had no discretion to withhold, Vinelott J. was able to discern in the application of the actual words of para (*b*) in their literal sense a legislative policy that was neither unjust nor unfair. Since, for my part, I think the meaning of the actual words in para (*d*) are in themselves too clear to justify resort to legislative history as an aid to their interpretation, the significance of Vinelott J.'s analysis is that it shows that legal minds experienced in the law of tax and trusts may form different views as to the policy which the paragraph was meant to serve.

The structure of s 16 is that the charge to income tax at the additional rate ("additional rate tax") upon some kinds of income arising to trustees is imposed by subs (1). Subsection (2) defines the characteristics of the income upon which the change to additional rate tax is so imposed. The definition of those characteristics is to be found in paras (*a*) to (*d*), and the definition contemplates that some of the income arising to trustees under a single trust instrument (other than a trust for charitable purposes or a pension fund) may possess the defined characteristics while other income arising to trustees under the same trust instrument may not. This follows from the presence in the introductory words of subs (2): "income arising to trustees in any year of assessment *so far as it*"—not, be it noted, "*which*".

So (leaving aside a statutory protective trust arising on intestacy) para (*a*) compels one to look in the first place at the express provisions of the trust instrument, and only in the absence of express provisions, to have recourse to provisions which would otherwise be implied, in order to identify what income in the year of assessment the trustees are, by the terms of that instrument, required to accumulate and also what income the trustees (or anyone else) are given by the terms of the trust instrument a discretion as to the beneficiary to whom it will be paid or a discretion whether to distribute it or treat it as an accretion to capital, or discretions to do both these things. Income arising to trustees which falls into none of these categories, unless it falls within para (*b*), is not chargeable to additional rate tax, even though it arises under the same trust instrument as income that is so chargeable. Accordingly, para (*a*) (and also para (*b*) upon which I do not find it necessary to dwell) make chargeability to additional rate tax under subs (1) dependent upon the express provisions of the trust instrument and only in the absence of express provision upon provisions which in such absence would be implied.

Paragraph (*c*) contains an exclusion from liability to additional rate tax for trustees of charitable trusts and pension funds. To my mind they throw no light upon the construction of para (*d*) to which I now come.

The introductory phrase "so far as it" in subs (2) serves a different purpose for para (*d*) from that which it served in its application to para (*a*). In relation to para (*a*) its purpose was to identify the provisions of the trust instrument whether express or in the absence of any express provision to be implied, which dealt with the application by trustees of various parts of the trust income in a particular year of assessment. In para (*d*), which starts with the word "exceeds", "so far as it" calls for the undertaking of a subtraction sum of which the minuend is the amount of income arising to the trustees in that year of assessment which possesses any of the characteristics described in paras (*a*) or (*b*), and, apart from cases which fall within the phrase in

A parenthesis with which para (*d*) ends and which I leave for consideration later, the subtrahend is income arising to trustees in the relevant year of assessment which satisfies two conditions; the first condition is that it was in fact applied to defraying the expenses of the trustees in that year and the second condition is that the expenses to which it was applied were "properly chargeable to income". This expression appears expressly in the first part of the paragraph B (which I shall refer to as "the main part") and by the words "so chargeable" is incorporated by reference in the parenthesis with which the paragraph ends.

"Expenses of the trustees" are administrative expenses incurred by them in carrying out the trusts declared by the trust instrument irrespective of whether the income out of which they are defrayed falls within any of the descriptions contained in paras (*a*) or (*b*). All administrative expenses are C covered by this phrase including those of administering a trust provision under which a life interest is vested in a beneficiary payment of which the trustees have no discretion to withhold. "Properly chargeable to income" in the second condition can, it seems to me, only mean expenses which in accordance with the law applicable to trusts the trustees are entitled under the trusts declared in the trust instrument to charge against income in the trust accounts. D To treat the expression "are properly chargeable" in the main part of para (*d*) where the verb is in the indicative mood, as commanding the reader to ignore all express provisions of the trust instrument which authorise trustees to charge all or any particular expenses to income, in my view would call for legislation; it is not possible to achieve that result by any legitimate process of construing, in the context in which they appear, the actual words the draftsman used: more E particularly, when the preceding paras (*a*) and (*b*) have already required consideration to be given to the legal effect of express provisions of the trust instrument in order to identify which of them do and which do not fall within those paragraphs.

As I suggested in the course of argument, "properly" in the context in which it appears in para (*d*) means "without committing any breach of trust". F In the majority of cases expenses which satisfy the first consideration will also satisfy the second condition. They will be actually paid out of income in a particular year of assessment and chargeable to income in the trust accounts for that year. But in the exceptional case, it may have been found expedient for expenses chargeable to capital to be paid in the first instance out of income and not recouped to income in the same year of assessment although chargeable to G capital and not to income in the trust accounts. As *Stott* v. *Milne* (1884) 25 Ch D 710 decided, this need not involve any breach of trust.

So far I have dealt only with the main part of para (*d*). I turn now to the wording of the parenthesis with which the paragraph ends. This parenthesis provides the mainstay of the Revenue's contention as to the construction of the whole paragraph—the tail that wags the dog—which was rejected by H Vinelott J. but has found favour with the Court of Appeal and with the majority of your Lordships.

First, it should be noted that the parenthesis is linked to the main part by the conjunction "or", so the words that follow that conjunction neither reduce nor explain the kinds of expenses that the main part directs shall be taken into account in calculating the subtrahend. On the contrary, they add to I them. There are several reasons why in its statutory context "or" cannot be understood in the explanatory sense of "that is to say" in which it is occasionally used colloquially.

(i) Examples of such use, so far as my experience extends, are unknown in legislative draftsmanship. A

(ii) The deliberate change from the indicative mood "are properly chargeable" to the subjunctive "would be so chargeable but for" requires the solver of the subtraction sum to scrutinise the trust instrument in order to discover whether it includes an express provision of the kind which he is to treat as if it were not present. B

(iii) Upon the literal meaning of the words, the only kind of express provision which the parenthesis requires to be treated as if it were not there is one which *prohibits* the trustees from charging to income in the trust accounts, expenses which, in the absence of such express provision, they would be either legally obliged to charge to income or would have a discretion whether to charge to capital or income. An express provision conferring upon trustees a C discretion as to the allocation as between capital and income of administrative expenses generally, or particular kinds of administrative expenses, does not fall with the actual words used by the draftsman.

(iv) The Revenue's contention that by necessary implication the parenthesis does require all express provisions of the trust instrument which confer upon trustees any discretion as to the allocation of expenses between capital to D be treated as if they did not exist, is really based upon the interpretation of the adverb "properly" which qualifies the adjectival phrase "chargeable to income" in the main part of para (*d*) and is incorporated in the parenthesis by the words "so chargeable". The expression they contend means: would be chargeable to income under the (English) law of trusts in the absence of any express provision in the trust instrument dealing with the allocation between E capital and income of the administrative expenses of the trustees. This has often disarmingly been referred to in the course of argument as "the general law" of trusts—an expression which I find wholly inappropriate to describe a law of trusts which treats as non-existent express provisions of a trust instrument with which under the law of trusts, trustees are obliged or permitted to comply. If that is what "properly" means in the main part of F para (1), then the parenthesis is wholly superfluous. The obvious way of expressing what the Revenue contends is meant by the words that appear in the main part introduced by the word "which" and also those in the parenthesis that follow, is: "in the absence of any express provision of the trust would be properly chargeable to income".

Not only is this the obvious way and free from all ambiguity, it also had G long been used in fiscal statutes and was staring the draftsman in the face, most recently in ss 428(1)(*a*) and 455(*b*) of the Income and Corporation Taxes Act 1970.

My Lords, to give that meaning to the words of para (*d*) that are introduced by "which", seems to me to involve so great a distortion of the actual words the draftsman chose to use and Parliament to approve as to fall H beyond the bounds of what it is permissible to achieve by any process of judicial construction.

I recognise that an express provision of the kind which alone the parenthesis requires to be disregarded would be uncommon. That may account for the draftsman's enclosing the words referring to it in brackets which serve no useful purpose as punctuation. I recognise too that it is not easy to discern I the parliamentary policy that underlay the making of so uncommon an express

A provision dealing with administrative expenses of trustees, the only one to be disregarded in assessing additonal rate tax on the income of discretionary trusts; but bearing in mind that the expenses referred to in para (*d*) include also expenses of administering any portion of the trust funds which by the same trust instrument is directly settled on life tenants and remaindermen upon trusts which are not the subject of any express discretion exercisable by the B trustees, I am unable to identify with precision any single coherent taxing policy as respects deduction of administrative expenses to which s 16(2)(*d*) of the Finance Act 1973 was meant to give effect.

As a proportion of the total income charged to additional rate tax in the hands of trustees by s 16, the administrative expenses of trustees are likely to be small, for I agree with my noble and learned friend, Lord Templeman, that C the premiums on endowment or life policies are not classifiable as "expenses" and, had the contrary not been conceded by the Crown, I should have thought it arguable that the premiums on gift protection policies are of a kind which, as a result of changes in the taxation system is now obsolete, were not expenses either.

For my part I would have allowed the appeal in the case of Lord D Hartington's marriage settlement so far as the fees of the financial advisers are concerned, but not the premiums on the endowment and life policies. I would allow the appeal in the case of the Paul family settlement on the Crown's concession that the premiums on the gift protection policies were properly classifiable as expenses, but without reaching any positive decision of my own whether they were or not.

E **Lord Roskill**—My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend Lord Templeman and also the dissenting speech of my noble and learned friend Lord Diplock. On the principal issues raised in these two appeals I find myself in respectful and complete agreement with the former and in equally respectful disagreement with the latter. I would, therefore, dismiss both appeals.

F But had the question been relevant I would have wished, in agreement with my noble and learned friend Lord Diplock, to reserve the question whether in the Paul family settlement case, the Crown's concession that the premiums on the gift protection policies were properly classifiable as expenses, was correctly made. I agree with the order proposed by my noble and learned friend Lord Templeman as to costs.

G **Lord Brandon of Oakbrook**—My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons which he gives I would dismiss both these appeals.

I associate myself with the reservations made by all four of your Lordships with regard to the correctness of the Crown's concession that the H premiums on the gift protection policies were properly classifiable as expenses.

Lord Templeman—My Lords, this appeal involves consideration of two problems; the trust problem of the incidence of trust expenditure as between income and capital; and the tax problem of the deductibility of expenses for the purpose of calculating income chargeable to additional rate tax by s 16 of the Finance Act 1973.

Trustees are entitled to be indemnified out of the capital and income of their trust fund against all obligations incurred by the trustees in the due performance of their duties and the due exercise of their powers. The trustees must then debit each item of expenditure either against income or against capital. The general rule is that income must bear all ordinary outgoings of a recurrent nature, such as rates and taxes, and interest on charges and incumbrances. Capital must bear all costs, charges and expenses incurred for the benefit of the whole estate.

In the present appeals, the Appellant trustees of the Paul settlement paid the annual premiums on assurance policies effected by the trustees in order to obtain policy moneys corresponding to the amount of capital transfer tax payable out of the trust fund in the event of the death of the settlor before 20 November 1979. The Appellant trustees of the Devonshire settlement paid the annual premiums on endowment policies assigned to the trustees and on other endowment policies effected by the trustees. All these premiums were paid by the Paul settlement trustees and the Devonshire settlement trustees for the benefit of the whole of their respective trust funds because the capital of the trust will be augmented by the policy moneys which will be received if and when the policies mature, and the income of the trust will be increased as and when such augmentation of capital takes place, but not before that event takes place.

In *Macdonald* v. *Irvine* (1878) 8 Ch D 101, the Court of Appeal held that premiums on life policies were a capital expense. Baggallay L.J., at page 120, said: "It would hardly be equitable to compel the plaintiff [tenant for life] to keep on foot a policy for the benefit of other persons."

In *In re Sherry* [1913] 2 Ch 508, the trust estate included an estate pur autre vie and certain policies on the life of the cestui que vie and it was held that the premiums on the policies were a capital expense. Warrington J., at page 512, said: "The life policies are reversionary interests and must be treated quite separately from the life interest of the cestui que vie. The premiums on the policies are paid for the preservation of an item of the testator's property, the benefit of which goes to capital."

It follows that the premiums on the policies held by the Paul settlement and the Devonshire settlement trustees are capital and not income expenses.

The Devonshire settlement trustees also paid annual fees to a firm of investment advisers to keep under review and to advise changes in investments comprised in the trust fund. This was a recurrent charge but not an ordinary outgoing and was incurred for the benefit of the estate as a whole because the advice of the investment advisers will affect the future value of the capital of the trust fund and the future level of income arising from that capital.

In *In re Bennett* [1896] 1 Ch 778, capital was ordered to pay the expenses of the yearly audit and inventory of a business where capital employed in the business was a capital asset of the trust. Lindley L.J. said, at page 784:

> "Why is this expense to be thrown upon the tenant for life? For whose benefit is it incurred? It is really for the benefit of the whole estate, though the practical effect of throwing it upon the whole estate will be that the tenant for life will lose the income of the sums expended. It has been suggested that such expenses are like annual outgoings. I do not think they are. By an 'outgoing' is generally meant some payment which must be made in order to secure the income of the property."

A A.L. Smith L.J. said, at page 787(1):

> "It is said that the case is like one of insurance, where the tenant for life pays the premiums; but the difference between the two cases is this, that in the case of insurance the payment is a voluntary one made by the tenant for life out of his own income without any obligation on his part to do so at all. Here the payment is one which the trustee, for the benefit of B the tenant for life as well as of the remaindermen, may properly incur in order to see whether the £15,000, of which the tenant for life receives the present income, and the persons entitled in remainder take the ultimate benefit, is safe or not. It is quite clear, in my judgment, that the expenses of these audits are costs, charges and expenses incurred for the benefit of the whole estate, and therefore ought to come out of capital and not out C of income."

Section 19 of the Trustee Act 1925 now provides that trustees may insure against fire at the expense of income for an amount not exceeding three-quarters of the full value of the trust property, and s 20 provides that money receivable by trustees or any beneficiary under a policy of insurance against loss of damage of trust property shall be capital moneys.

D *In re Bennett* [1896] 1 Ch 778 which has been accepted law for nearly 90 years affirms the trust principle that expenditure incurred for the benefit of the whole estate is a capital expense. In accordance with the authorities and in accordance with principle, the premiums paid by the Paul and Devonshire settlement trustees in respect of capital transfer tax protection and on endowment policies and the fees paid to investment advisers were capital E expenses and not income expenses.

A settlor may authorise or direct his trustees to pay income expenses out of capital or to pay capital expenses out of income. In the Paul settlement the investment clause 7 authorises the trustees to invest or layout capital and accumulation of income in any property with power: "to effect acquire keep-up (at the expense of capital or income as the trustees may think fit) F surrender and deal in any way with assurance policies of every kind . . ."

In exercise of this power, the trustees of the Paul settlement have paid the premiums on the capital transfer tax protection policies and on the endowment policies out of income.

In the Devonshire settlement, clause 19 provides that:

> "The trustees may effect purchase or otherwise acquire a policy or G policies of assurance of any kind intended to form part of the trust fund and pay the premiums on any policies so effected purchased or acquired (or any policy vested in them as an addition to the trust fund) out of income or capital of the trust fund or partly out of each in such manner as the trustees at their discretion think fit . . ."

In exercise of this power, the Devonshire trustees have paid the premiums H on the endowment policies out of income.

Clause 26(*b*) of the Devonshire settlement provides that:

> "The trustees may at any time or times apply any income of the trust fund in or towards the payment or discharge of any duties taxes costs or

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(1) [1896] 1 Ch 778.

other outgoings which but for the provisions of this clause would be payable out of or charged upon the capital of the trust fund." A

In exercise of this power, the Devonshire trustees have paid the annual fees of their investment advisers out of income, and for the purposes of this appeal, I assume without deciding that they were entitled to do so.

In the result, the premiums and fees which constitute capital expenses have nevertheless been lawfully paid out of income. Now although a settlor B may provide that capital expenses shall or may be paid out of income, the settlor cannot alter the nature of those expenses. The exercise of an express power or duty to pay capital expenses out of income, has the effect of taking income away from the income beneficiaries and bestowing it on the capital beneficiaries, so that capital is augmented. Premiums on an endowment policy remain a capital expense, although pursuant to an express power for that C purpose, the sums paid in discharge of those premiums are taken from income. If the income of a trust fund is only sufficient to pay the premiums on a ten-year endowment policy, and income is directed by the settlor to be applied in payment of those premiums, the income beneficiaries are wholly deprived of any income during the ten-year period and capital is augmented. This only means that a capital expense is paid out of income because the settlor has so D provided. Similarly, a settlor cannot alter the nature of an income expense by authorising or directing the trustees to pay that expense out of capital. A direction that rates of £1,000 per annum, payable in respect of a trust property settled on a tenant for life shall be paid out of capital, has the effect of taking £1,000 of capital away from the capital beneficiaries and bestowing that sum on the tenant for life. This only means that an income expense is paid out of E capital because the settlor has so provided.

Income tax has been judicially pronounced to be a tax on income. In arriving at the amount of income liable to income tax, Parliament may expressly provide that certain income expenses may be deducted. The legislature may go further and expressly provide that certain capital expenditure or capital allowances may be deducted for tax purposes. Fiscal F legislation of that kind does not convert capital expenditure into an income expense. If the legislature provides for capital expenditure to be deducted for income tax purposes, the legislature does not increase or reduce the income of the taxpayer but reduces the amount of the income of the taxpayer which is liable to tax.

By s 32 of the Finance Act 1971, Parliament abolished earned income G relief but provided that investment income should pay a higher rate of tax than earned income at an additional rate fixed in the first instance at 15 per cent.

By s 16 of the Finance Act 1973, income tax at the additional rate prescribed by s 32 of the Finance Act 1971 was charged on the income of accumulation and discretionary settlements in the following terms, so far as relevant: H

"16. (1) So far as income arising to trustees is income to which this section applies it shall, in addition to being chargeable to income tax at the basic rate, be chargeable at the additional rate. (2) This section applies to income arising to trustees in any year of assessment so far as it—(*a*) is income which is to be accumulated or which is payable at the discretion of the trustees or any other person (whether or not the trustees have power to I accumulate it); and ... (*d*) exceeds the income applied in defraying the

A expenses of the trustees in that year which are properly chargeable to income (or would be so chargeable but for any express provisions of the trust)."

The Paul settlement and the Devonshire settlement created accumulation and discretionary trusts. The Appellant trustees concede that s 16(2)(*a*) applies and that additional rate income tax is chargeable on the income of the B settlements under s 16(1).

In my opinion, s 16(2)(*d*) allows deduction of expenses *properly* chargeable to income, that is to say, income expenses. The words in brackets are explanatory and are placed in brackets because they are merely explanatory; they remove any possible ambiguity in the expression "properly chargeable" by emphasising that expenses which are deductible are those C which would be chargeable to income in the absence of any express provisions of the trust. The natural construction of s 16(2)(*d*) seems to me to authorise the deduction of income applied in defraying income expenses but not income applied in defraying capital expenses. This construction is consistent with trust law, consistent with income tax law and consistent also with common sense. Section 16(2)(*a*) imposed additional rate tax on the income applied in D augmenting capital pursuant to an express provision of the trust authorising the accumulation of income. Section 16(2)(*d*) cannot have been intended to exempt from additional rate tax the income applied in augmenting capital pursuant to an express provision of the trust authorising the payment of capital expenses out of income. The legislature cannot have intended to favour those pre-1973 settlements which contain power to charge capital expenditure E against income, and to penalise those pre-1973 settlements which contain no such power. The legislature cannot have intended to present settlors after 1973 with a method of accumulation which escapes the additional rate tax.

The argument to the contrary, persuasively advanced by Mr. Walker on behalf of the trustees, requires, in defiance of the rules of construction and for the purposes of diagnosis, the amputation of s 16(2)(*d*) into two limbs. F Vinelott J. was persuaded in his judgment [1983] 1 WLR 494, at page 501, that the first limb, before the words in brackets "taken in isolation" allows the deduction of income expenses and the deduction of capital expenses charged against income by virtue of an express provision of the trust. My Lords, I can find no justification for this approach which asserts that which remains to be decided, examines the first limb as though the second limb did not exist, and G construes the first limb as if it simply authorised the deduction of the expenses of the trustees defrayed out of income otherwise than in breach of trust. In order to attach some meaning to the words in brackets, Mr. Walker was driven to make the suggestion on behalf of the trustees, which is summarised in the judgment of Vinelott J. [1983] 1 WLR 494[1] at page 502 and accepted, at page 507, that:

H "the words in parentheses are necessary to cover a case which is like *Stott* v. *Milne*[2] in that expenses which ought properly to be paid out of capital are paid out of income in the first instance, there being no capital moneys available to meet them, and are payable out of capital only because there is an express provision of the trust directing the payment

(1) TC leaflet 2930. (2) (1884) 25 Ch 710.

> out of capital of expenses which the trustees would have been bound or entitled to charge to income if there had been no such express direction." A

In my opinion the suggestion is ingenious but so far fetched as to be incredible. Moreover the suggestion, is logically unacceptable because it postulates that Parliament in allowing deduction of expenses from income for tax purposes went out of its way to give effect to the provisions of trust deeds in relation to capital expenses covered by the first half of s 16(2)(*d*) but to ignore the B provisions of trust deeds in relation to income expenses covered by the words in parentheses. The simple solution is that s 16(2)(*d*) read as a whole, and in the light of s 16(2)(*a*), does not produce inequality and discrimination between different trusts but requires the express provisions of all trusts deeds to be ignored for the purpose of determining which kinds of expenses are deductible. C

Mr. Walker also relied on the fact that the expression in brackets in s 16(2)(*d*) begins with the word "or" rather than the word "and" and on the meaning which he attached to the words "but for" and to the distinction between the present indicative tense of the first part of s 16(2)(*d*) and the subjunctive tense of the expression in brackets. For my part, I was unable to deduce from these further operations of amputation any reason for altering D the thrust of the whole of the subsection which to my mind allows the deduction of expenses "properly chargeable to income" i.e. income expenses in those settlements where the settlor has made no express provision for the payment of capital expenses out of income, and only allows in other settlements deduction of those expenses which would be properly charged to income but for an express provision in the trust directing or authorising capital E expenses to be charged to income.

Finally, it was argued that ss 428 and 455 of the Income and Corporation Taxes Act 1970 reproducing provisions of an Act of 1938, achieved results similar to those for which the Revenue contend by a slightly different form of words. Section 16 of the Act of 1973 must, therefore, it is argued, produce a different result. My Lords, the Income Tax Acts are a vast patchwork begun in F the nineteenth century and doomed never to be completed. It is useless to speculate why the draftsman in 1973 used words different from those employed by the draftsman in 1938. Oversight, or some difficulty, real or imagined, may have played a part. There was every reason why the 1973 draftsman should wish to obtain the same results as the 1938 draftsman, and no reason why the 1973 draftsman should wish to obtain an opposite result. If G the 1973 draftsman had intended to produce the opposite result, he could have made his position clear. All this is only a matter for speculation. I derive no help one way or the other from the Act of 1938.

Section 16, for reasons good or bad which do not concern the courts, imposed an additional rate of income tax on the income of accumulation and discretionary settlements remaining after the deduction of expenses "properly H chargeable to income (or would be so chargeable but for any express provisions of the trust)". The section appears to me to allow the deduction of income expenses and to prevent the deduction of expenses which are only chargeable to income as a result of an express provision of the trust.

It is common ground that s 16 permits a deduction from the gross income of the trust of the grossed up amount of income expenses in order to arrive at I the gross amount liable to additional rate tax. Section 16 applies to income "chargeable to income tax at the basic rate" after deducting "the income

A applied in defraying the expenses of the trustees''. Thus, if trustees are entitled to gross dividends of £1,000 and receive after deduction at the basic rate of 30 per cent. the net sum of £700 which they apply in discharging rates, casual repairs or other outgoings which constitute income expenses amounting to £700, the trustees may deduct £1,000 from their total gross income for the purpose of computing the amount of gross income liable to tax at the B additional rate. This effect of s 16 does not assist the Appellant trustees to deduct capital expenses from gross income for the purpose of computing their liability to additional rate income tax merely because the trustees are authorised to pay those capital expenses out of income.

The Court of Appeal reversing Vinelott J. came to the same conclusion and I would dismiss these appeals.

C For the trustees the amount involved is small and for the Crown the consequences are important. The Crown have already agreed to pay the costs of the trustees up to and including the proceedings before the Court of Appeal. In the exceptional circumstances of this test case, without creating any precedent, and with acknowledgements to the fact that the Crown did not vehemently argue for their costs of the appeal to your Lordships' House, I D would suggest that there should be no order for the costs of this appeal.

Appeals dismissed.

[Solicitors:—Messrs. Sharpe Pritchard & Co. Agents for Messrs. Mills & Reeve for J.H. Carver; Messrs. Currey & Co. for D.G. Bosanquet; Solicitor of Inland Revenue.]