

## MARSHALL v KERR

### Alastair Hudson, Barrister<sup>1</sup>

*"Eeny, Meeny, Miney, Mo.  
Who settled the deed on the dead man's toe?"*

This case came before Harman J on 6th November 1991. The facts are, essentially, as follows:

Mr Brooks died in Jersey on 27th February 1977. He was domiciled and ordinarily resident there. Mr Brooks was the father of Mrs Kerr to whom he left a half share of his residuary estate absolutely. Mrs Kerr directed by an instrument of family arrangement that her fund and its income should be held on the trusts declared in the instrument. Briefly, Mrs Kerr was to have the income during her life, the trustees having the power to appoint capital to her, subject to which there was a discretionary power to benefit her children and remoter issue.

The central question is whether or not Mrs Kerr is the settlor for purposes of ss.80-85 FA 1981.<sup>2</sup> If she were not the settlor, the assessments raised on her would fall to be discharged on the basis that her father was then the settlor and he had been domiciled and resident abroad at the time of his death. What the taxpayer had to attempt to show, ultimately, was that the deeming provisions of FA 1965 s.24 should be read literally and thus counter the Revenue's suggestion that words should be read into the section to restrict its meaning.

The points of construction fell on s.24 FA 1965. Section 24(7) provides:

"On a person acquiring any asset as legatee -

- (a) no chargeable gain shall accrue to the personal representatives, and

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<sup>1</sup> Alastair S Hudson, 24 Old Buildings, Lincoln's Inn, London WC2A 3UJ  
Tel (071) 242 2744 Fax (071) 831 8095  
Assistant Managing Editor of *The Personal Tax Planning Review* published by Key Haven Publications PLC.

<sup>2</sup> It has been said, see David Harris, *Tax Journal*, 23rd January 1992, that there is no correlation between ss.80-85 Finance Act 1981 and the provisions of the CGTA. However, one need look no further than s.129 FA 1981 to see that the provisions of the former are expressly provided to be read as one with the provisions of the latter.

- (b) the legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it."

Section 24(11) provides that:

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

Section 24 was a section that governed the inter-relationship between capital gains tax and death. Originally, death was an occasion when the deceased was deemed to have disposed of his assets for a consideration equal to their market value. The deceased's personal representatives took the market value of the assets at the time of the deceased's death as their base cost. In 1971, the position was altered such that there was no capital gains tax chargeable on death. However, his personal representatives were still able to take the assets at their market value on the date of the death of the deceased. In the special instance where the personal representatives do not realise the capital gain on assets after the deceased's death, but rather vest those assets in the deceased's legatees, the personal representatives are treated as never having held the assets. Given that they will not actually have realised any gain on the assets, it was considered appropriate that the legatee be treated as though he inherited the asset directly from the deceased at the date of death.

The trustees of the settlement are, by virtue of s.24(11), to be treated as a "legatee" within the meaning of s.24(7) so that when the personal representatives vested the assets in them, the trustees were, at least for some capital gains tax purposes, to be treated as having acquired the assets at the time the personal representatives acquired them and for the same consideration. The question therefore is whether the deeming provision in s.24(7) extends for all the purposes of the Capital Gains Tax Acts or whether it is restricted to the purposes of computation. There are no express words of limitation in the section itself and therefore it would be necessary for the Revenue to justify their assertion that such limitation is to be inferred on the basis that they could demonstrate that that was the policy behind the section. If it extends to all the purposes of capital gains tax, then Mrs Kerr will not be the settlor of the settlement and, instead, it will be deemed to have been her father.

FA 1980 s.81, which imputes chargeable gains realised by non-UK resident trustees to certain beneficiaries who received capital payments from the trustees, will apply only if the settlor of the settlement was both domiciled and resident or ordinarily resident in the UK at the time when the settlement was made. Mrs Kerr was *de facto* the settlor and was at that time domiciled and resident in the UK. The taxpayer was therefore required to show that she should be deemed not to be the settlor.

### Argument before the Special Commissioner

Argument before the Special Commissioner differed markedly from that before Harman J. Before the Special Commissioner the Revenue submitted that the policy behind s.24(11) was that disposals by personal representatives were to be relieved from capital gains tax and that the section limited the relief available to the taxpayer. This restriction was to be contrasted with the wide-ranging relief in s.47 FA 1975 and s.142 IHTA 1984. Despite the recasting of s.24(11) in the 1979 consolidating legislation, the words "this section shall apply" were retained. This, the Revenue contended, meant that the relief was not to extend any further than the purposes of the particular section and was not therefore to be of general application for the purposes of capital gains tax. Section 24(7) was intended merely to ensure that the legatee's base cost was the same as that of the personal representatives but should have no further consequence.

In the absence of any case law to assist him, the learned Special Commissioner at first sought to rely on well known textbook writers, one of whom was of the opinion that this relief could be of application only to inheritance tax and not to capital gains tax generally. That is to say that in all inheritance tax cases, the taxpayer would be entitled to read the instrument of family arrangement back as though the settlement had been created by the testator. However, for capital gains tax purposes, such an inference would only be allowed for the "purposes of **this** section".

The Commissioner preferred to interpret the statute on its face. He found that the words in s.24(11) are "governed inter alia by the provisions of s.24(7)(b)". On that basis, the trustees are deemed to be a legatee of the testator's estate on the basis of the provision in s.45 FA 1965 that "'legatee' includes any person taking under a testamentary disposition or on an intestacy...whether he takes beneficially or as trustee...". That definition is clearly applicable for the purposes of s.24. Importing that definition of "legatee" into s.24(7)(b) one is left with the position that:

"the [trustee] shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it."

The Commissioner then found:

"It is therefore apparent to me that had the legislature wished to limit the effect of s.24(11) in the way contended for by the [Revenue], it could have done so by the use of appropriate words."

It is questionable whether such an abrupt dismissal of the Revenue's argument does not go a little too far. There is, it seems, a tenable reading of s.24(7) and (11) to the effect that the section is intended solely to provide a different means of calculating capital gains where it is the personal representatives who are making the disposal. However, this is a point to which I shall return.

He continued:

"As it is section 24(7)(b) operates to place the legatee (in this case the deemed legatee, namely [the trustee]) in the shoes of the testator<sup>3</sup>. Accordingly, there is not merely a no gain/ no loss situation but the acquisition is also back-dated."

As a result the Commissioner accepted the taxpayer's argument that the beneficiaries are able to rewrite the will and that the capital gains tax treatment of these *prima facie* disposals was deemed to be the same as if the testator had made those disposals himself.

### Argument in the High Court

In the High Court, consideration turned to how far the deeming effect of s.24(7)(b) should go. The Revenue's argument was somewhat different here. The primary contention they raised was as to the policy behind the section. The section was, in their contention, purely computational in its aim. On acquisition by the trustees, on the facts of this case, the argument runs, there is a relation back to the acquisition cost of the personal representatives. The first effect is that the trustees acquire the personal representatives' base cost. The second effect is a notional backdating of the trustees' date of acquisition to the date at which the personal representatives acquired the asset. The second effect in some sense facilitates the credibility of the first limb of this fiction. Thus the trustees are deemed to acquire the asset at the personal representative's base cost, at the time that the personal representatives acquired the asset.

The Revenue asked Harman J to consider what the policy behind s.24(7) was. The assertion made was that the subsection was to have only a limited purpose, that being for the computation of gains arising on death. The difficulty with this argument is that there is nothing on the face of the Act which enables us to construe such a limited purpose. The difficulty then with Harman J's decision is that he is similarly unable to explain why he is of the opinion that the deeming effect of the section is to go no further than that contended for by the Revenue.

This reading of the section has two distinct, logical precursors. The first is that the policy of the statute must be read to be that which the Revenue allege it to be. The

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<sup>3</sup> It must be the case that the Commissioner actually meant "the personal representatives" here and not "the testator".

second is that the trustees of the deceased's will must be read to be two distinct legal persons: the personal representatives and the trustees of the instrument of variation, in this instance. I shall deal with each in good order.

The taxpayer's view was that one should construe the statute first and look to the policy later. On the basis of the authorities governing the way in which a deeming provision is to be interpreted, words should not be read into the section to ascertain policy and meaning, where the section makes self-contained sense. The taxpayer argued that the deeming provisions in s.24 must apply logically, for all the purposes of that part of that statute (being the then embodiment of the capital gains tax code). Further, it was submitted that one must treat as real the consequences which must flow from that deeming.

Harman J held that:

"The purpose of these sections is simply to deal with the computation of gains and to exclude gains which would otherwise be thought to accrue to a person who made a deed of variation or other disposal by instrument. The provisions are entirely satisfied, have a clear purpose and are fully effective if they mean what they precisely say but do not carry over into any further considerations of deeming than they provide. Subsection (11) applies as if the variations were effected by the deceased so that the legatee taking them and the personal representatives assenting to their vesting and so on are all to be treated as if the deceased by his will had made the provision which is in the instrument of variation. That sufficiently takes out of the tax net and any computations any difference in value between the date of death and the date of the instrument."

The clear difficulty here is that Harman J does not explain the basis on which we are to infer that the section is to be restricted to this "clear purpose". On what basis are the provisions to be "entirely satisfied" in that by inferring this meaning in the light of those sections other words must be read in?

"The provision that the legatee shall be treated as if the personal representatives' acquisition had been his acquisition is both satisfied and adequately shown to have a purpose if one treats it as affecting dealings between the legatee and persons to whom the legatee assigns any assets and the personal representative, so there is no difficulty in the legatee's acquisition date being the date of death and the legatee's acquisition value being the value at that date."

By reading words in, one can produce a consistent result from the section. However, that does not exclude the literal interpretation of the section contended for by the taxpayer. There is no inconsistency in this interpretation which makes it any less preferable to that contended for by the Revenue. On the authorities, it is clearly the case that where there is no reason to prefer any one reading to any other, the literal interpretation of the provision is to be preferred.

There is, however, a preliminary point to be made here before looking at the authorities on "deeming provisions" and that is: if the only point of s.24(7) was to switch the positions of the legatee and the trustees to obtain a no gain / no loss disposal on the administration of the estate, why did not the draftsman use the words in para 20 Sch 7 FA 1965 to provide for exactly that? That is not what the section provides here, rather it appears to be doing something else.

The assertion that the section is purely computational in its aim is rebuttable in two ways:

1. The purpose of the statutory fiction is clear from the statute and not from what the Revenue thinks it is;
2. If the words of the section are applied rigorously in the light of that interpretation, injustice, anomalous or absurd results are inevitable.

The locus classicus of the courts' approach to questions of deeming has to be the *Metrolands*<sup>4</sup> case before Nourse J. While it was a case concerning Development Land Tax, there can be little doubt that its principles are of important, general application. Nourse J sets out the bones of the approach at page 646g-h:

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<sup>4</sup> [1981] 1 WLR at 646.

"When considering the extent to which a deeming provision should be applied, the court is entitled and bound to ascertain for what purposes and between what persons the statutory fiction is to be resorted to. It will not always be clear what those purposes are. If the application of the provision would lead to an unjust, anomalous or absurd result then, unless its application would clearly be within the purposes of the fiction, it should not be applied. If, on the other hand, its application would not lead to any such result then, unless that would clearly be outside the purposes of the fiction, it should be applied."

Clearly then, there are two strands to Nourse J's test. The first is presented second in the extract reproduced above, to the effect that a deeming provision should be given its literal meaning in all cases. The only exception to that general traverse is in the situation where such a literal reading would produce palpable anomalies. Therefore one must first read the statute literally and then examine the results for anomalies and injustices. It is only if the latter are shown to be present that the literal interpretation can be displaced.

At p.645 in his judgment, Nourse J quotes James LJ in *ex parte Walton* and his refusal to extend the purposes of a deeming provision where it would lead to injustice or absurdity, before turning in his own judgment to do just that.

An important development of this theme is approved by Nourse J when he quotes Lord Atkin giving judgment in the House of Lords in *East End Dwellings Co Ltd v Finsbury BC* [1952] 2 AC 109 at 132-133, where he says:

"If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it. One of these in this case is emancipation from the 1939 level of rents. The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs."

So we arrive at the result that our reading of the deeming provision must incorporate all the necessary results of that deeming except any such results which clearly cause injustice or are absurd.

*Murphy v Ingram* [1974] Ch 363 is the strongest case for the Revenue. It concerned the spouse provisions in the Finance Act 1965. It is clearly distinguishable on the basis that it is only of any application to the obtaining of child relief. Russell LJ at page 369f declared:

"We turn therefore to the point of the Crown's appeal. Initially the question is whether the deeming provision in section 354(1) is properly to be considered as extending its operation beyond the scope of a system dealing with the application of a charge to tax on income of a married couple while living together, by force of the words "for income tax purposes": for we apprehend that without those words it could scarcely be thought that the subsection could have any relevance to the question whether for section 212 a female child's income chargeable to tax was something to which she was

entitled in her own right."

Here a change in the law had accidentally affected something else. It was this event which was seemingly the main factor in contributing to the decision on the deeming, and therefore it can only be of minimal assistance to the Revenue. In any event it cannot rob us of our mission here, to decide on the policy underlying s.24 FA 1965.

I shall consider the alternate limbs of Nourse J's test in turn.

### **The Literal Reading Test Applied**

On the basis of these authorities and the words of the section itself it would be open to the taxpayer to argue under four following heads for the literal reading of the section for which she contended. In my opinion any one of these arguments is sufficient to find for the taxpayer.

1. Section 24 is a self-contained code dealing with the event of death and its inter-relation with capital gains tax. Section 24(1)-(10) are clearly to have application to all circumstances in which there is a question as to the inter-relationship of death and capital gains tax. Therefore there can be no reason for excluding the omni-applicability of s.24(7)(b).
2. Section 24(7)(b) provides that:

"the legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it."

This subsection must apply for all the purposes of capital gains. That being the case, all other provisions deriving their logical effect from it must be equally omni-applicable.



3. The Revenue's argument requires that words be read in to the section. Their interpretation necessitates an enlargement of s.24(7)(b) to say:

"...on any subsequent disposal by him of the asset for that purpose and that purpose alone..."

There is nothing on the face of the section to suggest such a limitation on its policy effect. On Nourse J's test, where no such reading lends itself naturally to a literal interpretation of the statute, it should not be imported.

It cannot be said that, if the policy that the legatee replaces the testator for all the purposes of the Act holds good for the purposes of inheritance tax, it can be *prima facie* invalid for the purposes of capital gains tax. Clearly it is a policy which is conceivable.

4. There is nothing in s.24(7) to explain the scope of s.24(11). The policy behind s.24(7) therefore appears to be neutral. On the basis of Nourse J's propositions (ie: if there is no discernible policy on the face of the provision, one must read the statute literally), the trustees must stand in the shoes of the personal representatives. Therefore the deeming provision replaces Mrs Kerr as the settlor of the trust which was *de facto* created by her, with the fiction that *de jure* it is created by the testator.

On the very plain words of the two subsections this must be the literal meaning. I can do no more than lay out the relevant words once more:

Section 24(7) provides that:

"On a person acquiring any asset as legatee -

- (a) no chargeable gain shall accrue to the personal representatives, and
- (b) *the legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it.*"

Section 24(11) provides that:

"If not more than two years after the death any of the dispositions of the property of which the deceased was competent to dispose...effected by will...are varied by a deed of family arrangement or similar instrument, *this section shall apply as if the variations made by the deed were effected by the deceased...*"

### Anomalies Resulting from the Revenue's Interpretation of the Section

Even if we disagree that the literal interpretation for which I contend is **not** what the section provides on such a reading, I can still rely on the second limb of Nourse J's test to show that anomalies, absurdities or injustice result from the Revenue's reading of the section and that therefore such a reading should not be adopted.

1. Imagine the situation where a husband dies leaving property to his wife, by his will. She obtains a chose in action, that is: the right to have the estate administered. She can have no right to the property under the will itself until the will trust is created. On completion of the administration of the estate, she must dispose of the chose in action, in that it no longer exists. Is the disposal of this chose in action a disposal for capital gains tax purposes? It could be argued that the chose in action has fructified into the estate. However, this interpretation is precluded by the case of *Zim Properties v Proctor*. On a straightforward capital gains tax analysis, the chose in action is a separate asset from the property in the estate. That it has been disposed of is clear by virtue of the s.20 CGTA extended definition of "disposal". Therefore s.24 FA 1965 must extend to all the purposes of capital gains tax, to deem the acquisition of the personal representatives to be the acquisition of the actual legatee, or else there would be a disposal of a chargeable asset every time an estate is administered.
2. It is clear also that the provision will apply to third parties (that is: people other than an actual legatee) and therefore extend to the general purposes of capital gains tax other than the purely computational function for which the Revenue contended.
  - (i) Under s.42 FA 1965 where a testator domiciled in the UK leaves the residue of his estate to the trustees of **non**-resident trusts, such a disposal will be caught in principle by s.42 FA 1965. However, s.24(7) deems trustees to have a base cost of next to nothing. If trustees are UK resident, s.24(7) is to be taken into account leading to an acquisition by the trustees at a low base cost. Section 24(7) must apply for all the purposes of the Capital Gains Tax Acts, including the purposes of s.42 FA 1965, or else there will be a disparity of treatment between resident and non-resident trustees. Section 24(11) must extend to those third parties also because it affects them in the same way. It is clear that in this instance the Revenue would argue that s.24(7) and (11) apply to third parties as well as the direct legatee or else enormous sums would fall out of charge to tax. To argue that it applies in one circumstance requires that it apply in all circumstances or else there will be disparity of treatment.
  - (ii) Similarly, under Sch 7 para 20 FA 1965, the husband and wife provisions, where the husband is the resident legatee, s.24(7) is invoked leading to a minimal base cost on receipt of his bequest. Therefore he is deemed to give minimal consideration for the asset. His wife could claim to be a third party on the execution of a deed of variation of the will and, on the Revenue's interpretation of the section, there would be no applicability of s.24(7) to her. Were she not included, the failure to apply s.24(7) across the board would cause enormous sums to fall out of charge to tax. The Revenue must therefore accept that the deeming extends to cover this situation. To

admit that the section does stretch this far, is to admit that it includes further classes of third parties.

The difficulty is clearly now to justify any alteration of that view on the facts of Mrs Kerr's case. If it is accepted that anomalies such as those outlined above will result from the Revenue's interpretation of the section, then, on the basis of Nourse J's test, it must be accepted that the deeming effect of the section be extended to cover these instances. Once that is accepted, it is clear that the deeming effect of the section extends beyond the purely computational application to the death provisions for which the Revenue contends.

### **The Subsidiary Argument**

There is no definition of "settlor" for capital gains tax purposes because it is presumed that you know who the settlor is. To continue the logic of there being no need for a definition of "settlor", s.24 must be given its most natural meaning to make clear what would otherwise be unclear. On these facts, the identity of the settlor is clear because, on a natural construction of the section, s.24(11) tells you.

### **Harman J's Approach**

However, Harman J had only this to say, tantalisingly, about the clear anomalies which can result from the Revenue's application of s.24:

"I accept that in those somewhat fanciful examples [adduced by the taxpayer] the results would be unexpected. I do not accept that those results are properly to be called "anomalies" let alone "absurdities". It is frequently true that taxing Acts produce results that seem surprising but that is the inevitable result of very complicated provisions having to apply to all factual circumstances. In my judgment there is nothing in counsel's examples to cause me to consider that the construction I have placed on the section must be erroneous."

For Harman J to come to the decision which he has, it must be the case that he is applying the Revenue's view of the policy of the section to his reading of it such that he can arrive at the result at which he does arrive ultimately. As I have sought to show, there are two possible readings of the policy behind the section and one must come to a decision as to which one is the more persuasive. However, what is lacking from his judgment is an explanation of the reason why he chooses to see the section as purely computational in aim. It is on the basis of this lack of clarification that I would seek to criticise the decision of Harman J primarily.

The argument is therefore twofold. In the first instance, when examining the scope of a deeming provision, one must give that provision its literal interpretation. One must not allow one's imagination to boggle at the consequences but must give it a straightforward application. On that reading of the provision in this case, the testator is deemed to be the settlor of the settlement which was, in reality, created by Mrs Kerr. The only way in which one can avoid applying this literal interpretation is if the result of that reading produces injustice, anomaly or absurdity. If one is to allege that such exist, one must explain the basis on which that conviction is held. In this instance, if the Revenue's view is upheld, the anomalies listed above are a few among those which spring to mind. Therefore, the Revenue's view must be resisted in any event.

Where one asserts that this reasoning and this policy are not correct, one must explain why one favours any alternative reading of the section. Harman J has failed to do this in his judgment. He has also failed to explain why it is that he considers the anomalies raised by the taxpayer to be "fanciful". To my mind, there is real substance in them as objections to the reading of s.24 for which he and the Revenue contend. In many senses it is equally important that he explain why he favours his interpretation as that he decide which interpretation he favours.

### **The Single Personality of the Trustees**

There is an alternative way of looking at the arrangement after the settlor's death. The trustees are to be deemed as though one continuous body of persons, by virtue of what is now s.52(1) CGTA 1979. As a result, one must be able to say that there has not been any alteration in trustees, therefore the trust has remained the same. The trust almost acquires a personality of its own in that its agents have duties, rights and obligations which remain constant despite the "real" alterations in its human personnel. All that has happened is that the terms of the will trust have been altered. The two statutory fictions work hand in hand. The actions of the legatee, the trustees

here, are to be deemed as though the actions they perform are the actions of the testator. Therefore, the beneficiaries should not be deemed to have made capital gains tax disposals of their rights under the will trust by participating in the instrument of family arrangement.

### **Conclusion**

It is, therefore, in my opinion, a shame that Harman J was not more forthcoming with his reasons for his choice of policy underpinning s.24. It is even more pitiful that he failed to lavish more attention in his judgment on the anomalies which are identifiable as a result of that reading of the section. When construing a deeming provision, "why" is as important a question as "what".