The Personal Tax Planning Review

NICE TRY: SHAME ABOUT CONVERSION

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Introduction

The Trusts of Land and Appointment of Trustees Act 1996 as from 1st January 1997[2] introduces a new system of dealing with the co-ownership of land, the 'trust of land' regime. As part of that new regime, changes are made to the equitable doctrine of conversion, by which realty can be treated as personalty, and vice versa. Section 3 of the Act is actually headed '*Abolition* of doctrine of conversion', but this, as we shall see, is misleading.

The doctrine of conversion is simple. If realty is held on trust to sell or personalty is held on trust to purchase land, the interests of the beneficiaries in that trust property are regarded, *for certain purposes*, as if the duty to sell (or purchase) had already been performed.[3] (I say 'for certain purposes', because, as Anderson has demonstrated,[4] it was never logically applied across the whole board.) So the beneficiary under a trust for sale of realty was regarded, from the outset and even before the land was sold, as interested in the proceeds of sale, i.e. personalty, and not the realty itself.[5] It was an application of the principle that equity regards as

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2 See s.27(2) and SI 1996 No 2974.

3 See *Snell's Equity*, 28th ed 1990, 485-498.

4 (1984) 100 LQR 86.

5 *Fletcher v Ashburner* (1779) 1 Bro CC 497,499; *Re Goswell's Trusts* [1915] 2 Ch 106.

done that which ought to be done.[6] *From the beneficiary's point of view*, equity regarded the obligation as performed before it in fact had been. The thinking was that any other result would have had accidental and potentially unjust effects, as the nature of the beneficiary's interest would depend on when the market permitted sale, and when the trustees complied with their duty.[7]

Stop me if you've heard this one

Why did this matter? There were several reasons, some now lost in legal history.[8] The primary one was that a testamentary gift of realty to A and personalty to B would carry the beneficial interest of the trust for sale of realty to B, and the beneficial interest of a trust to buy land to A.[9] And the beneficiaries of an express *inter vivos* trust for sale of realty had interests in personalty, and thus enjoyed no right to reside in the property as tenants in common in equity of the land.[10] Curiously enough, the interests of beneficiaries under an *inter vivos* trust for sale *imposed by statute* did not follow this through: it was held that the beneficiary in such a case *was* interested in the land and indeed had the right to use and occupy it in specie pending sale.[11] The trust for sale in such cases was regarded as a mere conveyancing device.[12] For private international law purposes, interests under trusts for sale of land have been held to be interests *in land*, and hence immovables.[13] And in the same way, a contract for the sale of

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6 See *Lechmere v Carlisle* (1733) 3 PW 211, 215, affd (1735) Cas t Talb 80; *Guidot v Guidot* (1745) 3 Atk 254,256.

7 Maitland, *Equity*, 277.

8 See the instances given by Anderson, *op cit*, 87-88.

9 *Re Kempthorne* [1930] 1 Ch 268; *Chandler v Pocock* (1880) 15 Ch D 491, 496, affd 16 ChD 648; *Re Newman* [1930] 2 Ch 409; *Re Price* [1928] Ch 579; cf *Edwards v Hall* [1949] 1 All ER 352.

10 *Barclay v Barclay* [1970] 2 QB 677; though the decision on this point is inconsistent with earlier authorities, such as *Franks v Bollans* (1867) LR 3 Ch App 717.

11 *Bull v Bull* [1955] 1 QB 234; *Williams & Glyn's Bank Ltd v Boland* [1981] AC 487.

12 *Williams & Glyn's Bank Ltd v Boland* [1981] AC 487, 507.

13 *Re Berchtold* [1923] 1 Ch 192.

the interest of a beneficiary under a trust for sale of land needed to be evidenced in writing as a contract for the sale of an interest in land.[14]

A second reason was that the purchaser of realty from trustees for sale did not have to worry about the interests of the beneficiaries attaching to the land which he bought: he knew that they were interests in the proceeds of sale.[15] A third was that, until altered by statute in 1979,[16] the interest of a beneficiary under a trust for sale of land was not capable of being subject to a charging order,[17] unless the interests of *all* the beneficiaries were being made so subject.[18]

The Law Commission considered[19] that all of this would become redundant under their new system of 'trusts of land'. So, in their scheme of things at least, conversion (and reverse conversion) had to go. Hence the draftsman of the Act[20] headed section 3 with the words 'Abolition of conversion'. And yet, as Megarry J once said, in a quite different context, 'To yearn is not to transfer'.[21] As is

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14 *Gray v Smith* (1889) 43 Ch D 208; *Cooper v Critchley* [1955] Ch 431; cf *Re Rayleigh Weir Stadium* [1954] 1 WLR 786. Similarly for the purposes of other enactments: e.g. *Kirkland v Peatfield* [1903] 1 KB 756 *Re Hazeldine's Trusts* [1908] 1 Ch 34; *Miller v Collins* [1896] 1 Ch 573; *Stromdale and Ball Ltd v Burden* [1952] Ch 223; *Elias v Mitchell* [1972] Ch 652; see generally, Anderson, *op cit*.

15 Law of Property Act 1925 s.2; *City of London Building Society v Flegg* [1988] AC 54; cf Anderson, *op cit*, 109, who says that it was the exercise of a power by trustees that over reached the beneficiaries' interests: this is true, but beside the point, as the purchaser who dealt with trustees for sale had no need to inquire whether they had a power to sell.

16 Charging Orders Act 1979: see now *National Westminster Bank Ltd v Stockman* [1981] 1 WLR 67; *Perry v Phoenix Assurance Plc* [1988] 3 All ER 60. The 1996 Act does not affect this.

17 *Irani Finance Ltd v Singh* [1971] Ch 59, going back at least to *Thomas v Cross* (1865) 2 Dr & Sm 423.

18 *National Westminster Bank Ltd v Allan* [1971] 2 QB 718; and see *Re Cook* [1948] Ch 212.

19 See Law Com 181, para 3.6.

20 It should be made clear that the Act was not in the form of the draft Bill attached to the Law Commission's Report (No 181): Clause 21 was the relevant clause in their Bill, and was headed "Abolition of doctrine of conversion as respects trust property".

21 *Re Vandervell's Trusts (No 2)* [1974] Ch 269, 294.

well known, the side- or headnote to a statutory provision is not part of the provision itself, and has no legislative force.[22] To this section itself, then.

Now the draftsman had a choice. He or she could have *named* the doctrine, and despatched it in as many words, as the draftsman did with detinue in 1977: 'Detinue is abolished'.[23] Or he could have set out in extenso what he thought the doctrine was, *then* give it its quietus.[24] But the draftsman of this Act did neither. Instead, he or she described what were thought to be the *effects* of the doctrine, and then *reversed* those effects. As a result, the word 'conversion' nowhere appears in section 3. (Nor, for that matter, do 'doctrine' or 'abolish', or any similar words.) So, at best, the draftsman has negatived the *effects* of conversion, and has not abolished the doctrine itself.[25]

It ain't what you do...

So what? Well, let us look at the effects as stated in section 3(1):

> "Where land is held by trustees[26] subject to a trust for sale, the land is not to be regarded as personal property; and where personal property is subject to a trust for sale in order that the trustees may acquire land, the personal property is not to be regarded as land."

The first point is the meaning of the word 'land'. By section 23(2) of the 1996 Act, expressions given a meaning by the Law of Property Act 1925 have the same meaning in the 1996 Act 'unless the context otherwise requires'. By section 205(1) of the 1925 Act, land includes land of any tenure. It includes

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22 See *AG v Great Eastern Railway* (1879) 11 Ch D 449, 461; *Nixon v AG* [1930] 1 Ch 566, 593.

23 Torts (Interference with Goods Act) 1977 s.2(1).

24 e.g. Law of Property (Miscellaneous Provisions) Act 1989, s.1(1).

25 cf Shakespeare, *Macbeth* (Act 3, Sc II), "We have scotch'd the snake, not kill'd it."

26 This includes personal representatives, *unless* the death occurs before 1st January 1997: s.18(3).

leaseholds.[27] Prima facie, therefore, so it does in this Act. But leaseholds, remember, are not realty, but personalty.[28]

So what is the effect of section 3(1) on a trust for sale of *leasehold* land? By that provision the leasehold 'is not to be regarded as personal property'. Logically, therefore, it must be regarded as *realty*. Does section 3(1) *really* turn leases (when held on trust for sale) into real property? Surely not. So we are driven to the conclusion that here in section 3(1) 'the context otherwise requires', and 'land' is confined to realty.

The next point is the effect of equitable conversion on realty. It is that the interest *of the beneficiary* in the trust is not realty but personalty, i.e. the proceeds of sale.[29] No one has ever suggested that the legal estate *of the trustees* was converted to personalty as well.[30] If the question ever arose before sale whether the trustees owned realty or personalty, they could not answer that,

> 'by the force of the doctrine of conversion, we have merely interests in money, the proceeds of sale'.

The effect of conversion was limited to the interests of the beneficiaries. But section 3(1) assumes that it applied to the trustees too. It says that, for the future, '*the land* is not to be regarded as personal property'. That also (fortunately) covers the beneficiary's interest, but it gives us little confidence that the draftsman really understood what he or she was doing here.

Back to the future

This is compounded by the statement of the effect of 'reverse' conversion, i.e. that 'where personal property is subject to a trust for sale in order that the trustees may acquire land, the personal property is not to be regarded as land'. This suffers from the same curiosity, in that it looks at the interests of the trustees (which never were affected) as well as those of the beneficiary. But it goes further. It negatives the effect of reverse conversion only where there is a trust for sale '*in order that*'

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27 See *Stromdale and Ball Ltd v Burden* [1952] Ch 223.

28 See Littleton's Tenures s.740; *Forster v Hale* (1798) 3 Ves 696, affd (1800) 5 Ves 308; *Johns v Pink* [1900] 1 Ch 296.

29 See, for example, the cases cited in note 3 above.

30 cf *Re Ryland* [1903] 1 Ch 467 (rents issuing out of land held on trust for sale were *land*).

land may be bought. But, for a reverse conversion to apply, mere motive is not enough. There has to be an *obligation* placed on the trustees to apply the proceeds in the purchase of land.[31] So the draftsman has needlessly negatived the effect of reverse conversion in certain cases (motive but no obligation) where it could never have applied anyway.

Worse still to come. The specific case put in section 3(1) of a reverse conversion is the *sale* of personal property to provide money to buy land. But the common case of reverse conversion is not that. It is the case of *money* given to trustees on trust to buy land. There is no 'trust for sale' at all. But there is still reverse conversion,[32] and the interests of the beneficiaries are treated from the beginning as interests in realty and not personalty. *And section 3(1) does not touch that case at all.* So, despite the heading to the section, reverse conversion is *not* abolished, and is alive and well and living in equity textbooks.[33]

Stoppage in transitu

Subsection (2) then goes on to provide that, whatever section 3(1) means, it does not apply to a trust created by the will of a testator who died before the commencement of the Act. But subsection (3) makes clear that it *does* apply to all other trusts, whether created before or after that commencement. These transitional provisions also raise questions. One can understand why the exception for will trusts, under wills of *deceased* testators, was inserted. It could not be right to change the nature of a beneficiary's interest once it had vested. The difficulty with this patently just approach is that there is no reason in principle why it should not equally apply to inter vivos trusts created before that commencement. Why should the interests of beneficiaries under *inter vivos* trusts for sale change on commencement? No reason, of course, except that, if they did not, the Act would not affect existing inter vivos trusts for sale of land arising, for example, through the operation of the Law of Property Act 1925 sections 34 and 36. So the 1996 Act would in effect only apply for the future. Rather than accept *that* consequence, the draftsman appears to have decided to distinguish sharply

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31 *Curling v May* (1734) 3 Atk 255; *Re Newbould* (1913) 110 LT 6; *Re Twopenny's Settlement* [1924] 1 Ch 522.

32 *Re Scarth* (1879) 10 Ch D 499.

33 There are other oddities too. The Partnership Act 1890 s.22 is repealed, so partnership interests in realty are now realty instead of personalty. So options to take up partnership in a firm owning realty will become subject to the Perpetuities and Accumulations Act 1964 s.9(2) and must be exercised within 21 years.

between will trusts and *inter vivos* trusts, no doubt considering that there would not be many of the former where it much matters.

Yet there will be some cases where it does matter. Suppose that, in 1996, trustees for A and B buy 99 Acacia Avenue from A's and B's mother, and it is conveyed to them expressly on trust for A and B. By virtue of section 36 Law of Property Act 1925 there is a statutory trust for sale. On 1st January 1997 it became instead a trust of land. The trust of land regime applies to it, including sections 11 (duty on trustees to consult beneficiaries) and 12 (beneficiaries' rights of occupation). These rights only apply to beneficiaries interested *in the land*. Because it is now a trust *of land*, those rights apply. But if, instead, their mother had *died* in 1996, leaving the house by will to the same trustees for them, section 36 at that time imposed a trust for sale, and their interests, having once been converted into notional proceeds of sale, were not converted back to realty on 1st January 1997 when the Act came into force. So A and B in that case, having been entitled prior to 1st January 1997 to be consulted (under the Law of Property Act 1925 section 26(3)), and to occupy (under the caselaw), ceased on that date to be entitled *to either right*.[34] (We may note that, if, contrary to the view expressed above, 'land' in section 3(1) *did* include leaseholds, the consequence, if 99 Acacia Avenue were a leasehold property, would be to convert A's and B's interests to *realty* on 1st January 1997, so that they would be interests in *land*, and A and B *would* thereafter be entitled to the rights of consultation and occupation under sections 11 and 12!)

And the dividing line between will trusts already in force at commencement and those coming into force afterwards causes other difficulties. It means that if a testator is still alive at commencement having made a will beforehand which, to achieve the testator's wishes, depends for its effect on the doctrine of conversion, then it will no longer do what the testator wants. Is his or her solicitor negligent in not advising him or her to change the will? Does the solicitor owe a duty of care to the beneficiary who does not obtain what the testator originally wished him or her to obtain?[35]

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[34] An alternative view is that the caselaw rights of occupation persist even where the statutory right does not apply. But this would make the Act an even greater nonsense than it otherwise is.

[35] See *White v Jones* [1995] 2 AC 207.

Where to, Guv'nor?

What all this leads to, I suggest, is the conclusion that the abolition of conversion was not very well thought out. It would not have been difficult, without abolishing conversion, to provide that a beneficiary under a trust for sale of realty should be treated, for the purposes of this Act, as having an interest in land *pending sale*. Similarly with personalty held on trust to acquire land. It would have been possible to provide that a beneficiary under such a trust should be treated for the purposes of the 1996 Act as retaining an interest in personalty *pending the acquisition of the land*. That would have led to the same substantive result as that intended by the Act. It would also have conformed with reality. On a related point, it is also hard to understand why the draftsman thought it right to deal with conversion as he or she did, and yet to do nothing about the curious effects of the doctrine of ademption.[36]

Changing fundamental principles of land law has far reaching effects. It also involves significant transaction costs, because practitioners must relearn principles which they use every day. No one suggests that the legal profession is going to absorb these costs. Ultimately, one way or another, the public will have to pay for them. In view of the way in which the reform of the law of conversion has been carried out by section 3 of the 1996 Act, our clients may well be excused for thinking that law reformers, like other professions, are just another conspiracy against the laity.[37]

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36 See, for example, *Re Sweeting* [1988] 1 All ER 1016.

37 cf Shaw, *The Doctor's Dilemma*, Act I. I am grateful to Judith Ingham and Katie Bradford for helpful comments on an earlier draft, which have saved me from a number of errors, but I am responsible for those which remain.