The Offshore & International Taxation Review

BILLINGHAM v COOPER

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The present statutory regime for taxing chargeable gains accruing to the trustees of settlements who are resident outside the United Kingdom in the hands of the beneficiaries was introduced by the Finance Act 1981. Surprisingly, perhaps, it has taken the better part of 19 years before these provisions have come before the High Court on a tax appeal. That contrasts with the previous regime for taxing such gains found originally in section 42 of the Finance Act 1965, which produced a crop of no less than five reported cases between 1980 and 1991.

The provisions of the Finance Act 1981 have now been consolidated with amendments (and further amendments since 1992) as sections 87 to 98A of the Taxation of Chargeable Gains Act 1992. The means by which chargeable gains accruing to non resident trustees are brought within the charge to capital gains tax by section 87 will be well known to all readers. Section 87(4) provides that trust gains for a year of assessment are to be treated as chargeable gains accruing in that year to beneficiaries of the settlement who receive capital payments from the trustees in that year or have received such payments in any earlier year. Subsection (4) is subject to the following provisions of the section: in particular a capital payment is to be left out of account to the extent that chargeable gains have by reason of the payment been treated as accruing to the recipient in an earlier year, and the beneficiary is not to be charged to tax on chargeable gains treated by virtue of subsection (4) as accruing to him in any year unless he is domiciled in the United Kingdom at some time in that year. Section 87(2) contains rules for the computation of the "trust gains" for the year of assessment in which the beneficiary receives capital payments. If there are no trust gains or if previous trust gains have been treated as applied in making capital payments to beneficiaries in earlier years of assessment, a "capital payment" made to a United Kingdom domiciled beneficiary will not give rise to a charge in the hands of the beneficiary unless the trustee makes subsequent gains which are not otherwise brought within the charge to capital gains tax.

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Billingham v Cooper[2] was not directly concerned with the application of section 87(2) or the provisions of section 87(6) to which I have referred. The provisions whereby gains are "matched" with capital payments received by beneficiaries after periods of delay were only considered so far as they cast light on the meaning of the provisions which the Court was called on to interpret. *Billingham v Cooper* concerned the expression "capital payment". This is defined by section 97(1) as "any payment which is not chargeable to income tax on the recipient or, in the case of the recipient who is neither resident nor ordinarily resident in the United Kingdom, any payment received otherwise than as income.[3] Subsection (1) refers merely to "payment". This, in its ordinary meaning is limited to a money payment which might or might not include a payment by way of loan. Subsection (2) therefore enlarges on the meaning of the word "payment" by including references to the transfer of an asset and "the conferring of any other benefit" and to any occasion on which settled property becomes property to which the beneficiary concerned is absolutely entitled. By subsection (4):

> "For the purposes of sections 86A to 96 the amount of a capital payment made by way of loan and of any other capital payment which is not an outright payment of money, shall be taken to be equal to the value of the benefit conferred by it".

Subsection (4) is concerned, not so much to define what is or is not a "capital payment", as to provide a proper method of computing the value of the same. But it does at least resolve any ambiguity in the meaning of the word "payment" in subsection (1). It is clear that it is intended that the expression should embrace both an "outright payment" (under which the payment becomes the property of the recipient without the obligation to repay) and a loan.

Before the decision in *Billingham v Cooper*, it was thought by many to be possible for a beneficiary under a settlement to enjoy the benefit of the gain which had accrued to the non resident trustees tax free by lending the amount of the trust gains, or what was included in the trust gains, which might otherwise be chargeable in the hands of the beneficiary receiving a capital payment, to the beneficiary on terms that

2 2000 STC 122

3 These last words underline the point that where a beneficiary receiving a capital payment is without the charge to capital gains tax, being neither resident nor ordinarily resident in the United Kingdom, the chargeable gains accruing to the non resident trustees will be attributed to the beneficiary (although not chargeable) and can thus reduce the pool of trust gains that might otherwise be chargeable on capital payments being received by beneficiaries who are resident and domiciled in the United Kingdom. Subsequent payments to United Kingdom beneficiaries may thus escape.

no interest was paid under the loan and that it was repayable on demand made by the trustees.[4] It was accepted that the making of the interest free loan, even if it did not amount to a payment of money for the purposes of section 97(1), involved the conferment of a benefit on the beneficiary receiving the loan and was, as such, to be considered a "capital payment" for these purposes. But a substantial body of opinion was of the view that the value of a benefit conferred by a loan repayable on demand (whether or not at a rate of interest) was nil. The value of the benefit had to be computed at the time the loan was made. On the making of the loan the trustees would be in a position to demand its immediate repayment. Thus the value of the benefit for the purposes of subsection (4) was at best negligible and more probably non-existent. No one, it would be argued, would regard a loan payable on demand as being of any measurable value to the beneficiary receiving the same.

Supporters of this view pointed to the provisions of section 97(1) which effectively took out of the section 87 charge a benefit consisting of a life interest in possession in the settled property since that which the life tenant would receive in the form of income would be within the charge to United Kingdom income tax or would otherwise be treated as income in his hands. The interest foregone fell into the same category.

This view of section 97 was not shared by all. The opposing view adopted the pragmatic approach of treating the benefit consisting of the interest free loan repayable on demand as being the interest which might be earned on the loan during the period in which it remained outstanding in the hands of the beneficiary. In the case of a loan which, remained outstanding year by year, what would be required is a computation of the interest otherwise receivable in each year. The amount of the "capital payment" in the form of the supposed benefit would be treated as the interest otherwise receivable in that year or, if the loan was repaid in the course of the year, during that part of the year in which the loan remained outstanding.

This opposing view has a certain specious merit. The trustees of non resident settlements, on making a loan repayable on demand, will in general have no intention whatever of demanding repayment from the beneficiary until it becomes clear that repayment is essential for some purpose of the trust: *viz* distribution to some other beneficiary, the payment of taxes or the making of an investment. A high proportion of interest free loans made by non-resident settlement trustees have been made repayable on demand in reliance on the widely held view that there is no value in such loan and therefore no capital payment, without any serious intention of exercising the right to demand repayment. Further, whilst a demand for

4 Of course, the trustees could only make such loans if suitably empowered by the settlement. But most settlements will contain adequate powers to allow this to be done.

repayment might in theory be made at any time - say within one hour of the making of the loan - such demand will, in practice, require the active participation of the trustees or (in the case of some settlements) a majority of them. The loan will remain outstanding until the trustees can collectively decide to demand repayment of the same.

The propounders of the opposing view face one major obstacle. It is the conferment of the benefit which occasions the capital payment. So it is the date on which the benefit is conferred which must be the date on which the benefit falls to be valued and not some later date. The benefit consisting of the making of the loan repayable on demand taken according to its value at the date of the making of the loan must be considered to be negligible or nil. But if one is to ignore the actual making of the loan itself and to assume some later date as the date on which the benefit is conferred, then, rhetorically, one might ask what date is to be chosen?

In *Billingham v Cooper* the Inland Revenue accepted this basic proposition. It did not seek to rely on arguments of practicality. Instead it was contended that the making of the loan was not the only occasion on which a benefit was conferred on the taxpayer in that case. A benefit was conferred on the taxpayer - and accordingly a capital payment was made - on each day on which the trustees of the settlement allowed the loan to remain outstanding. Before the Special Commissioners, the Revenue and the taxpayer had agreed that, in the event of this contention succeeding, an appropriate method of valuing the benefit so conferred was to take the interest which would have been paid in the relevant years in respect of the loans made to the beneficiary had the loan been from a commercial lender.

In *Billingham v Cooper* (and the case heard at the same time, *Edwards v Fisher*) the borrower/beneficiary was the life tenant under each of the settlements concerned. He would have been entitled therefore to the income arising from the money lent in any event. This presented the taxpayer in each case with an additional argument which was that no benefit was in fact derived from the making of the loan and not simply that the benefit derived from the making of the loan was nil.

I do not propose here to elaborate on the contentions respectively advanced by the taxpayer and the Revenue before the Commissioners and before Lloyd J. Before the Commissioners, the taxpayer's arguments succeeded. The decision of the Commissioners was reversed, substantially on the main ground argued by the Revenue. Lloyd J's reasons are set out at 2000 STC 122 at 134d:

> "In my judgment in the case of a demand loan the trustees confer a benefit on the beneficiary, the borrower, by leaving the loan outstanding for any period, even for a single day. After all, if the loan is large enough the

> beneficiary can earn a worthwhile sum on the overnight money market, let alone what he might gain from some other transaction funded by the loan. By conferring such a benefit day by day or over a longer continuous period the trustees make what section 97(2) treats as a "payment". It is a payment within section 87(1)(a) and it is therefore a capital payment as defined in section 97(1). There is no difficulty in quantifying the value of the benefit further for the purposes of section 97(4) *even though it has to be done retrospectively*. Nor is there any other difficulty in applying the statutory provisions to it, nor to repeated applications to it, nor to repeated applications of the legislation year by year while the loan remains outstanding." (Emphasis added)

Lloyd J rejected the second argument based upon the lack of any real benefit received by the life tenant borrowers for the following reasons (135a):

> "It seems to me that the legislation does not call for or permit a comparison of the position that the recipient might have been in if a different transaction had been undertaken by the trustees. There are too many different possible comparisons for that to be a tenable approach. The proper comparison is with the position of the recipient if the actual loan had not been made rather than if some other transaction had been entered into. The recipient of the actual loan, if it had not been made, would not have had the use of the money lent. It seems to me that this is particularly clear from the fact that the section is directed to attributing gains not only to beneficiaries but also among beneficiaries in circumstances in which more than one beneficiary has received a capital payment, which of course is not true of either of these cases."

What appears to have struck Lloyd J (if only by implication from his judgment) is that if he was to accept the submissions put before him on behalf of the taxpayer, there would be presented to non-resident trustees and their United Kingdom beneficiaries a ready means for avoiding the charge otherwise imposed on those beneficiaries who receive capital payments. So the Judge was led to find that a benefit is "conferred" by the mere omission of the trustees to call in the loan. For the purpose of the Judge's reasoning it would not be necessary for the trustees to take a conscious decision not to call in the loan. It is sufficient if they merely leave it outstanding. I can understand that it might be possible to contend that, in a case where the trustees met together and decided not to call in the loan, a benefit is "conferred". Such cases must be rare, *Billingham v Cooper* was not one. I prefer the view that even the conscious deliberation of the trustees of a settlement in not recalling a loan does not amount to the conferment of a benefit. Still less can I see how the simple unconscious omission to demand repayment of the loan can amount to the "conferment" of a benefit. In coming to his decision the Judge appears to have overlooked the provisions of subsection (4) of section 87, which provide for a charge on beneficiaries who "receive" capital payments "from the trustees". I fail to see how a beneficiary can receive a capital payment in the form of a benefit "from" the trustees unless the trustees at the very least have themselves made some conscious decision relating to the giving of that benefit.

But the view taken by the Judge is open to other objections not (apparently) expressly put to him. He said, in the passage cited above "there is no difficulty in quantifying the value of the benefit further for the purposes of section 97(4) even though it is to be done retrospectively." In my view there is no justification for this view. The value of the benefit has to be calculated at the date the benefit is conferred. The Judge accepted that the actual making of a loan repayable on demand did not itself amount to the conferring of anything other than a "nil" benefit at the date the loan was made. He accepted that benefits were conferred from minute to minute and hour to hour and day to day or month to month for so long as the loan remained outstanding and the benefits were conferred (he said) "by leaving the loan outstanding". But the benefit to be conferred by leaving a loan repayable on demand outstanding consists not of interest which might have been earned on the loan prior to the conferment of the benefit. The benefit represented by that interest is conferred, not as a consequence of the immediate act of leaving the loan outstanding, but of the previous acts consisting initially of the making of the loan and of the continuing past omissions to recover the same. The benefit resulting from a continuing failure to demand repayment of the loan and collect the same is the interest which is foregone in the future rather than in the past. But the benefit of a capital payment in this form falls to be valued at the date it is conferred. At *that* date the benefit of a "demand loan" (to adopt Lloyd J's terminology) has no value.

Mr Ewart, Counsel for the taxpayer in *Billingham v Cooper*, drew attention to section 160 of the Income and Corporation Taxes Act (loans to directors and "higher paid" employees) as an illustration of specific provisions which Parliament appears to have thought necessary to deal with the case where loans were made interest free or at a rate of interest less than the market rate. He might also have referred to section 41 of the Finance Act 1975[5] providing for the interest or rent foregone as a consequence of the loan of money or other property to be treated as the subject of a transfer of value for the purposes of capital transfer tax made at the end of the chargeable period or if earlier when the use of the property comes to an end. By contrast, section 97(4), in referring to a loan, appears to be directed primarily to the time of the making of the loan rather than any other period. I do not derive

[5] A provision of singularly short life span.

assistance from either of these provisions.

Lloyd J's reasons for rejecting the second of the main submissions on behalf of the taxpayer, (*viz* that the benefit is nil because, if interest had been charged it would have gone to the borrower in any event,) as put by him appears, at first blush, to be above criticism. However, the matter might have been approached in a wholly different way: the argument said to be put by the taxpayer was that the benefit was nil. That might not strictly be correct. However, the benefit has to be valued and it can only be valued by a comparison of what the taxpayer would have received had the loan not been made with what he did receive in benefit terms as a consequence of the loan being made. As the Judge points out, he does, of course, receive a benefit in the form of his ability to dispose of the money and purchase what assets he will with it. The value of the benefit is the interest he would have had to pay to a commercial lender. But, in the case of a life tenant, he has foregone the right to the income from the self same amount of money. The interest which would have otherwise been earned on that money if it had been retained by the trustees might not have been as much as would have had to have been paid to a commercial lender. But it cannot be ignored in arriving at the benefit which is actually conferred by the making of the loan concerned.

Permission to appeal was given in *Billingham v Cooper* and it is to be hoped that more light on the proper interpretation of these provisions will be found in the judgments in the Court of Appeal.

The Future

The decision in *Billingham v Cooper* (assuming it is upheld) opens the door to further lines of attack on United Kingdom beneficiaries of non-resident trusts. Take the case of trustees with undistributed trust gains who apply part of the trust funds in purchasing a residence. Their powers allow them to permit persons having interests in possession in the trust fund to reside in any residence they purchase free of rent or (perhaps) at such rent as the trustees shall determine. Trustees permit a life tenant to reside in a property rent free. On the Judge's reasoning that would involve the conferment of a benefit and the making of a capital payment since, if the taxpayer had not been permitted to occupy the property, he would not have had the use and occupation of the same. That does not appear to accord with what is intended but appears to follow from the rejection of the second argument advanced on behalf of the taxpayer in *Billingham v Cooper*. The admission of members of a class of discretionary beneficiaries to any such property by the trustees in exercise of discretions conferred on them would also operate as a conferment of a benefit for these purposes. This would be so whether the member of the class of beneficiary occupying the property had gained some security of tenure for a period of months or years or whether he had no more than a licence determinable on notice by the trustees. In each case it would be necessary to look at the position at the date the beneficiary was admitted to the property and on every subsequent occasion on which the trustees failed to exercise what powers they had to determine the licence or tenancy.

Take next the application of section 91 of the Taxation of Chargeable Gains Act (imposing an increased charge where there is delay in distributing trust gains). If the interest free loan had been made for a term of (say) six years the only capital payment would be made on the making of the loan since it is only then that any benefit is conferred. If the loan was made in the year the trust gains accrued there would be no increase to the section 87 charge. If, by contrast, the same loan was repayable on demand there will be an increase in the tax charged in each year in which the loan remained outstanding.

Billingham v Cooper, as decided in the High Court will cause other problems. Non resident trustees will frequently be found to control companies which themselves are not resident in the United Kingdom. These companies often lend money to United Kingdom resident and domiciled persons who are also beneficiaries under the settlement. These interest free loans escape the charge to tax under section 419 of the Income and Corporation Taxes Act (loans to participators in close companies) because the companies, being non resident, are not close companies. Unless the beneficiary is a director or higher paid employee,[6] he will be without the charge to tax imposed by section 160 of the Income and Corporation Taxes Act. But loans by such companies controlled by the trustees repayable on demand will now result in a charge to capital gains tax under section 87 on the United Kingdom beneficiaries receiving the same in every case where there are trust gains.[7] Of course, the non resident company has to be controlled by the trustees if a payment is to be treated as a capital payment for these purposes. But "control" can be had either by the trustees alone or by the trustees together with the settlor or a person connected with the settlor in relation to the settlement. In order to establish control there may be attributed to any person who is a participator the rights and powers of an associate (which can, in the case of trustees, include beneficiaries under the settlements). In practice it will be difficult to escape control by the trustees having shares in the company.

6 Which is unlikely in either case so as to avoid problems concerning control (and therefore residence) of the company.

7 See generally section 96(1) of the Taxation of Chargeable Gains Act.

But, just as *Billingham v Cooper* closes some doors, so other doors may yet be opened to the trustees. If the making of an interest free loan repayable on demand amounts to the conferring of a benefit and accordingly to the making of a capital payment or series of capital payments for so long as the loan is outstanding, the trustees could, make loans to beneficiaries of the settlement who are either not resident in the United Kingdom or, if resident in the United Kingdom not domiciled in the United Kingdom. Those beneficiaries receiving such capital payments will be treated as if trust gains had accrued to them but they escape the charge to capital gains tax either because they are not resident or not domiciled in the United Kingdom. The balance of the fund (that is, that part not representing trust gains) could thereafter be distributed to the United Kingdom beneficiaries free of tax. Alternatively, the trustees could make such an interest free loan repayable on demand to a United Kingdom charity to whom the chargeable trust gains could then be attributed prior to distribution to the United Kingdom beneficiaries.