WHEN IS A SETTLEMENT THE SAME SETTLEMENT?

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The Question

A thorny question which has often been difficult to resolve is "When is a settlement the same settlement for capital gains tax purposes?" The question arises most acutely where trustees exercise powers to change beneficial interests. Have they merely varied the trusts of an existing settlement or have they created a new settlement? The difference can be crucial. If they have created a new settlement, then there will have been a deemed disposal of the relevant assets, *prima facie* for a market value consideration. If they have not, there will be no such disposal. Where action is yet to be taken, it may be crucial for trustees to know how to secure the one result or the other.

The recent decision of Hoffmann J in *Swires v Renton*[2] is in my respectful opinion one of the rather more helpful judgments in this area.

Businessman or Judge?

In *Roome v Edwards* [1981] STC 96 the House of Lords considered a case where separate trustees had been appointed of a distinct fund within an existing settlement. It was held that that did not create a new settlement for capital gains tax purposes.[3] Their Lordships refused to adopt the test which is applied for the purposes of the rules against perpetuities in determining whether the perpetuity period applicable to the new trusts is that applicable to the old trusts. Lord Wilberforce laid down what I have always thought was a rather inadequate test.

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2 [1991] STC 490.

3 I have suggested in my *Comments on the Inland Revenue Trust Consultative Document* that the law be changed in this respect: see page 54 under **Different Trustees for Different Funds**, being the comment on 9.22-9.30 of the Document.

He said, at page 100:

> "Since `settlement' and `trust' are legal terms, which are also used by businessmen or laymen in a business or practical sense, I think that the question whether a particular set of facts amounts to a settlement should be approached by asking what a person, with knowledge of the legal context of the word under established doctrine and applying this knowledge in a practical common sense manner to the facts under examination, would conclude."

I have in the past criticised this approach. What is the point, I argued, of asking the businessman in the street whether the exercise, say, of a power of appointment had created a new settlement for capital gains tax purposes? Would he not say that that was a very fine point of law which Lords of Appeal in Ordinary were appointed to resolve?

Hoffmann J has by a deft, and in my view entirely justifiable, act of *legerdemain* subtly altered this test. He says, at page 499j:

> "The decision of the House of Lords in *Roome v Edwards* ... as expressed in the speech of Lord Wilberforce, shows that the question must be answered according to the view which would be taken of the transaction by a person with knowledge of trusts who uses language in a practical and common sense way. Which description would be considered more appropriate: that new trusts have been grafted on to the old settlement or that a new settlement had been created?"

In other words, Hoffmann J has changed the test from "What would a layman with practical common sense having some knowledge of the law say?" to "What would a Chancery Judge using practical common sense say?". With respect, Hoffmann J's test is infinitely preferable to Lord Wilberforce's test. He is, of course, far too bright a judge to know that he is not transmuting the test rather than just applying it. While I would rarely condone such a course of conduct, I would heartily agree that this is a case where it is totally justified.

Intention and Effect

The problem arises in an acute form where trustees exercise dispositive powers to create new trusts. The decision of the Court of Appeal in *Bond v Pickford* [1983] STC 517 lays down some useful tests. A distinction was made between powers which enable trustees to define or vary the beneficial interest but not remove the assets from the settlement to a new settlement and powers which do. These powers are referred to respectively as powers in the narrower form and powers in the wider form. In the first case, there can be no question as to the result of the exercise of the power. In the second case, however, one would have to ask whether the trustees had in fact exercised the power in such a way as to remove the assets from the settlement.

Although the tests laid down in *Bond v Pickford* are helpful, they are not, of course, conclusive. On each occasion, one has to construe the relevant power which has been exercised to determine what it *authorised* the trustees to do and then one has to go on further and construe the document exercising the power to ascertain what the trustees have *in fact* done. The big advance which *Swires v Renton* has made is in establishing that the matter is one of intention rather than effect. That is, the emphasis is on what the trustees were intending to do rather than what they have

actually done. Admittedly, that distinction is not so clear cut. Firstly, in determining the intention of the trustees one will not normally be able to look outside the terms of the deed of appointment. Secondly, what the trustees have in fact done may often be determinative of what they intended to do. The importance of the decision lies in those very many marginal cases where the power would have enabled the trustees both to create a new settlement and not to create a new settlement and where, if one looks simply to what they did, it is by no means clear whether they have in fact created a new settlement or not. In such a case, evidence of intention will be absolutely crucial.

The Moral

The result is that there is now a greater premium than ever on quality drafting. The trustees should first take advice as to which would be the more beneficial course of action, whether to create a new settlement or not. If the trustees are UK resident, it will normally be beneficial not to create a new settlement. There may, however, be exceptional cases where it would be desirable to increase the base cost now. There may well be other cases where it is crucial to have two settlements if one fund is to be held by UK resident trustees and another fund by non-UK resident trustees. Having ascertained which the better course of action is, it should now be possible for a barrister specialising in trusts and taxation matters to ensure that a power in the wider form is always exercised in the desired manner.

Limits of the Decision

Where there is a power in the narrower form, there would clearly be no choice. *Swires v Renton* does not help us to determine whether a power is a power in the narrower form or in wider form. If it is desired to create a new settlement, it will normally be necessary to take counsel's opinion. In my experience, many powers which at first glance look like powers in the narrower form turn out to be powers in the wider form when one considers them in the light of the judicial authorities on trusts.

Ex Post Facto

What does the case say about construing an instrument which has already been executed? Here, it is somewhat less helpful. There are some general comments but the specific point upon which the case was decided is rather limited. The power in question was one "to pay or apply any part or parts of the capital of the trust fund to or for the benefit of all or any one or more to the exclusion of the other or others of the specified class freed and released from the trusts concerning the same." It was decided, not surprisingly, that this was a power in the wider form. It authorised the trustees to take part or all of the assets of the trust fund out of the original settlement and resettle them on the trusts of a different settlement. But had they done so? The trusts affecting the trust fund after the deed of appointment were exhaustive. Neither the Commissioner nor Hoffmann J thought this was conclusive.

The deed was expressed to be "supplemental" to the original settlement. The Commissioner relied upon this as indicating that the deed did not intend to set up a new settlement. Hoffmann J found this factor neutral. I would respectfully agree with him.

Clause 7 of the deed of appointment provided that the administrative and other powers and provisions in clauses 7-10 of the settlement were to continue to apply to the appointed fund. The Commissioner did not think this pointed very strongly either way. The judge thought that the more natural effect of the words "shall continue to apply" is to connote the continuation of the settlement but that standing by itself that clause would not necessarily have been sufficient. I myself would have put rather more weight by these words and in the absence of any indication to the contrary would have found them sufficient to determine the question in favour of no new settlement.

At the end of the day, the decision was a very close run thing. Hoffmann J decided it upon the wording of a power conferred by the appointment on the trustees to appoint capital from the appointed fund to the Principal Beneficiary during her lifetime "freed and discharged from the trusts affecting the same under the Settlement and this deed". That, the judge reasoned, indicated that the trustees contemplated that there would be provisions of the settlement continuing to be applicable to the appointed fund. It will be readily appreciated that the indication is a relatively weak one. The taxpayer won, but by a whisker. As his Lordship admitted at the end of his judgment "Like many questions of construction, it is somewhat finely balanced but in the end my conclusion is the same as [that of the Special Commissioner] and the appeal must be dismissed." The moral is that in future all such deeds should be settled by counsel specialising in trusts and taxation matters.

Hoffmann J did express *obiter* certain views which are of a more general application. He stated:

> "The paradigm case of the creation of a new settlement would involve the segregation of particular assets, the appointment of new trustees, the creation of fresh trusts which exhaust the beneficial interest in the assets and administrative powers which make further reference to the original settlement redundant ... the absence of one or more of those features is not necessarily inconsistent with a resettlement."

This is most interesting. The segregation of particular assets as a separate fund cannot, I agree, take the matter much further. The appointment of new trustees, while perhaps being an indication of the creation of a new settlement, is certainly not conclusive. After all, it is perfectly possible to appoint separate trustees of separate funds all within one settlement. *Roome v Edwards* is a classic case.

The creation of fresh trusts which exhaust the beneficial interests in the assets would normally be a strong indication that there was an intention to create a new settlement. That was the contention for counsel for the Crown in this case. He relied upon Slade J in *Bond v Pickford* at page 525 where he said that where trustees had power in the wider form and they exercised it in such manner as to cause the trusts which currently affect the relevant assets to be wholly replaced by a new set of trusts, then the conclusion would probably be irresistible that both the purpose and effect of the transaction was to create an entirely new settlement. Hoffmann J dealt with this by saying that in referring to a new set of trusts, Slade J had in mind the whole of the trust powers and provisions of the settlement including the administrative powers. One could therefore replace the whole of the *beneficial limitations* without necessarily having a new settlement. That proposition must in my respectful opinion be right.

Hoffmann J dismissed one argument out of hand. The power which was exercised was one to pay capital "freed and released from the trusts concerning the same". Hoffmann J rejected the argument that that meant that the power could only be exercised by removing assets from the original settlement altogether. He said, sensibly enough, that "freed and released from the trusts concerning the same" can easily mean that the assets are to be released from any trust inconsistent with the appointment. There is no reason why such an appointment should necessarily involve the discharge of the assets from all the trusts powers and provisions of the settlement. Again, I respectfully agree.

Counsel for the Crown also argued that the power was very similar to the statutory power of advancement and that one could infer from the speech of Viscount Radcliffe in *Pilkington v IRC* 40 TC 416 at page 434 that he thought any use of the statutory power otherwise than by way of absolute payment would inevitably involve the creation of a new settlement. Hoffmann J rejected this argument for the very good reason that Viscount Radcliffe was dealing with an express proposal to create a fresh settlement and did not address the question whether this was the only way in which the power could be used to achieve the same result. My view is that if one analyses properly the judgment of Viscount Radcliffe one discovers that he *presupposes* that the trustees could exercise the power without creating a new settlement and that his principal concern is to reject the argument of the Revenue that the power could not be exercised so as to create a new settlement because that would offend against the principle *delegatus non potest delegare*. While my reasons are long and detailed and involve a critique of the decision, I am heartened to see that Hoffmann J apparently

takes the same view as I do myself.

A Precedent

It is not possible to produce a precedent of potential widespread application, as every case must turn upon the precise wording of the settlement and of the relevant deed exercising the power. A recital along the following lines, suitably wrapped up, would be not inappropriate:

> "Whereas the trustees are desirous of exercising the power conferred on them by clause XXX of the settlement so as to create the trusts hereinafter contained and whereas they have been advised by counsel specialising in tax and trust matters that if they hereby indicate an intention that the exercise of the power shall create a new settlement for capital gains tax purposes then such a settlement will be created whereas if they hereby indicate an intention not to create a new settlement for capital gains tax purposes then no such settlement will be created, the trustees hereby record their intention to create/not to create such a settlement."