[2014] UKUT 0169 (TCC)

INHERITANCE TAX - discretionary settlement - 10-year charge – whether the proceeds of sale of scrip dividend shares to which s.249 ICTA 1988 applies are deemed to be income not only for the purposes of ICTA 1988 but also for the purposes of trust law generally and for the purposes of Inheritance Tax

PRECEDENT – whether the Upper Tribunal is bound by a prior decision of the High Court

Appeal of taxpayer dismissed

IN THE UPPER TRIBUNAL **FTC/89/2012**
TAX AND CHANCERY CHAMBER

Mr J P GILCHRIST

(as trustee of the J P Gilchrist 1993 Settlement)

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: Mr Justice David Richards

Julian Ghosh QC

Sitting in public in London on 28 and 29 October 2013

Giles Goodfellow QC, counsel, instructed by DWF LLP, for the Appellant

David Yates, counsel, instructed by the Solicitor for HM Revenue and Customs, for the Respondents

Introduction

1. The parties submitted a helpful agreed document which sets out the procedural history, the disputed issues and a statement of agreed facts, which we reproduce below at paragraphs 2-22, subject only to some slight changes.

2. The Appellant, as trustee, appeals under section 222 of the Inheritance Tax Act 1984 ("IHTA 1984") in relation to a Notice of Determination issued on 18 October 2011.

3. The effect of the Notice of Determination was to refuse a claim by the Appellant for repayment of £177,474.41 of inheritance tax plus interest from November 2004, paid in respect of a ten year charge to Inheritance Tax ("IHT") by the trustees of a settlement of which the Appellant is currently the trustee.

4. The Appellant appealed the Notice of Determination on 16 November 2011 and immediately notified his appeal to the Tribunal under IHTA 1984, section 223D.

5. On 27 November 2012, Judge Bishopp transferred the appeal to the Upper Tribunal for hearing and determination.

Outline of the Issues which are agreed and those in Dispute

6. The appeal concerns whether a 10 yearly charge under IHTA 1984, section 64 which occurred on 17 May 2003 should have been calculated on the value of assets of the JP Gilchrist 1993 Settlement ("the Settlement") including assets which represented directly or indirectly the proceeds of sales of 100,000 E ordinary shares issued by way of scrip dividend ("the Scrip Dividend Shares") to the trustees of the Settlement by a

company then called Kepacourt Limited ("Kepacourt"), now called Paccar Parts UK Limited. The part of the Trust Fund which directly or indirectly represented the Scrip Dividend Shares as at the date of 10th year anniversary (17 May 2003) is referred to as "the Scrip Dividend Proceeds".

7. If the Scrip Dividend Proceeds were at the time of the ten yearly charge date income for trust law purposes, it is agreed that their value should not have been included in calculating the value of the "relevant property" for the purposes of IHTA 1984, section 64, since "relevant property" does not include money or property which is income for trust law purposes, unless such income has been accumulated and added to capital prior to the date of the chargeable event. It is common ground that neither the Scrip Dividend Shares nor the Scrip Dividend Proceeds had been accumulated as at 17 May 2003. On this basis, the amount of the ten-year IHT charge was overstated by £177,471 and the appeal succeeds. However, if the Scrip Dividend Proceeds were capital for trust law purposes, their value was properly included and the appeal fails.

8. The income or capital status of the Scrip Dividend Proceeds at the time of the ten yearly charge in turn depends upon the effect of section 249 of the Income and Corporation Taxes Act 1988 ("ICTA 1988"), on the issue of the Scrip Dividend Shares in April 1998. It is common ground that section 249(6) applied to the issue of the Scrip Dividend Shares and that, for income tax purposes, income equal to the value of the Scrip Dividend Shares was treated as arising to the Trustees of the Settlement.

9. There are two issues in dispute between the parties.

10. The first issue (the substantive issue) turns on whether ICTA 1988 section 249(6) also had the effect of treating the Scrip Dividend Shares as income for trust law purposes;

that is whether section 249(6) deemed, at the material times, the Scrip Dividend Shares to be trust income as a matter of general trust law. The Appellant relies upon the Court of Appeal's decision in *Howell v Trippier* [2004] EWCA Civ 885; [2004] S.T.C. 1245 and the High Court decision in *Pierce v. Wood* [2009] EWHC 3225 in support of this contention. HMRC contend that *Howell v Trippier* does not decide that the actual scrip dividend shares to which ICTA 1988 section 249(6) applies should be treated as income for trust purposes and that *Pierce v Wood* was wrongly decided.

11. The second issue (the stare decisis issue) is whether, whatever our view, sitting as the Upper Tribunal, is of the current construction of section 249(6), we are bound by *Pierce v Wood* as a matter of stare decisis. The Appellant contends that the High Court decision in *Pierce v Wood* binds the Upper Tribunal. HMRC contend that the Upper Tribunal is not so bound.

12. It is common ground that, absent the application of ICTA 1988 section 249(6), the Scrip Dividend Shares issued to the Trustees in respect of the Appointed Fund were capital for trust law purposes.

Outline of Agreed Facts

13. The Settlement was made by a deed dated 17 May 1993 between (1) the Appellant as settlor and (2) Abacus Trust Company (Isle of Man) Limited. The Appellant was initially entitled to a life interest in the whole of the Trust Fund. The initial contribution to the Trust Fund was £1,200. By a deed of appointment dated 4 June 1993 the then Trustees appointed 20% of the Trust Fund ("the Appointed Fund") on discretionary trust for the benefit of other members of the Appellant's family. The Appellant and his wife were permanently excluded from obtaining any benefit from the Appointed Fund.

Following the Appointment, the Appellant made a further gift of £44,000 to the 1993 Trust, 20% of which was to be held upon the trusts of the Appointed Fund.

14. The Settlement used the gifts to contribute funds to Whitecroft Limited, a Manx incorporated company limited by guarantee in which the 1993 Trust held a membership interest. Whitecroft in turn subscribed £44,000 for ordinary shares of 10p each in Leyland Truck Manufacturing Limited, which subsequently changed its name to Kepacourt. Kepacourt became the holding company for a management buy-out of Leyland Trucks. Whitecroft owned just under 25% of issued ordinary share capital of Kepacourt.

15. In relation to the Appointed Fund, the Trustees were granted power to pay or apply the whole or any part of the income to or for the benefit of one or more of the Discretionary Objects (as defined) and to retain the income (including any income from the investment of any income) for any length of time during the Accumulation Period (which continues until 2014). During the Accumulation Period, the power of accumulation was to be exercised by resolution of the Trustees.

16. In April 1998, the Trustees entered into a scrip dividend scheme as part of an arrangement to reduce the amount of CGT likely to be payable on the sale of the issued share capital of Kepacourt to a third party purchaser. As part of that scheme, the following transactions were undertaken:

    16.1 Whitecroft sold 5,000 10p ordinary shares in Kepacourt to the Trustees; the Main Fund acquired 4,000 of such shares and the Appointed Fund the balance of 1,000 shares.

16.2 These shares along with 10,819,000 ordinary shares in Kepacourt owned by Whitecroft were converted into “C” ordinary shares of 10p each (C ordinary shares) with both funds acquiring the equivalent number of C ordinary shares as they had previously had ordinary shares in Kepacourt. The C ordinary shares carried participation right equal to approximately 25% of the participation rights in Kepacourt.

16.3 The authorised share capital of Kepacourt was increased by the creation of 100,000,000 “E” Ordinary shares of 0.0000001p each (E ordinary shares).

16.4 An interim dividend was declared on 24 April 1998 to be satisfied by a cash dividend of £1 for every 1,000 C ordinary shares with a scrip dividend alternative of 20,000 E ordinary shares for each C ordinary share. The E ordinary shares had similar participation rights to the C ordinary shares.

16.5 The Trustees opted for the scrip dividend and so became entitled to E ordinary shares by way of scrip dividend.

16.6 On 28 April 1998, the Trustees sold their shareholdings in Kepacourt (comprising 5,000 C ordinary shares and 100,000,000 E ordinary shares), along with the other shareholders, to the outside purchaser, Paccar Trucks UK Ltd. The Appointed Fund became entitled to sale proceeds of £2,945,941.58, the overwhelming proportion of which was attributable to the E ordinary shares which were sold by the Trustees. The remainder of the Settlement’s share of the sale proceeds was allocated and distributed to the Appellant as the life tenant. The Trustees had previously resolved that any scrip dividend shares which were allocated to the Main Fund would be treated as belonging to the life tenant.

17. The other Scrip Dividend Shares allocated to the Main Fund were treated as belonging to the Appellant and were subject to higher rate income tax in his hands.

18. In relation to the Scrip Dividend Shares allocated to the Appointed Fund, the Trustees treated their value as being income for income tax purposes but made their tax return for 1998/99 on the basis that such income was not subject to the rate applicable to trusts ("RAT") because the Scrip Dividend Shares and their proceeds of sale would remain trust capital and so such deemed income was not "*income which is to be accumulated or which is payable at the discretion of the trustees or any other person*" as required by ICTA 1988, section 686(2)(a).

19. Since the Trustees thought that the Scrip Dividend Shares would be treated as capital for trust law purposes, the sale proceeds were treated as capital for accounting and trust law purposes. The Trustees did not exercise any power of accumulation in relation to the Scrip Dividend Shares, their proceeds of sale, or the assets acquired with such proceeds of sale.

20. The Trustees prepared their Inheritance Tax Account for the ten-yearly charge on the assumption that the Scrip Dividend Proceeds were trust capital. The amount of the ten-yearly charge was initially calculated by HMRC on the basis that the "relevant property" had a value of £3,213,369. Consequently, the IHT was calculated to be £177,474.41 with interest on late paid IHT of £3,103.38. The Trustees paid £180,000 towards this amount on 8th November 2004 with the balance of £577.79 being paid at a later date.

21. Following the decision in *Pierce v Wood*, the Appellant formed the view that the Scrip Dividend Proceeds were income for trust law purposes and should not have been

included in the calculation of the value of relevant property for the purposes of the ten year charge. Accordingly, by letter dated 23 September 2010, a claim was made to recover the overpaid IHT. The Appellant appeals against the refusal of that claim, which refusal is contained in the Notice of Determination dated 18 October 2011.

22. The question for determination by the Tribunal is the effect of ICTA 1988, section 249(6) on the Scrip Dividend Shares for trust law and IHT purposes.

The Relevant Statutory Provisions

23. It is convenient to set out the relevant statutory provisions which were in force at the material times at this stage.

IHT Provisions: the "Relevant Property" Regime

24. The substantive issue turns on whether the Scrip Dividend Proceeds constitute "relevant property" within the meaning of the Inheritance Tax Act 1984 ("IHTA 1984"). This, in turn, governs whether the Scrip Dividend Proceeds attracted a 10 year charge under IHTA 1984, section 64.

Definition of relevant property: IHTA 1984, section 58 and SP8/86

25. IHTA 1984, section 58 defines "relevant property" and provides as follows:

> "*(1) In this Chapter "relevant property" means settled property in which no qualifying interest in possession subsists, other than –*
>
> *(a) property held for charitable purposes only, whether for a limited time or otherwise;*

> *(b)* *property to which section 71, 73, 74 or 86 below applies;*
>
> *(c)* *property held on trusts which comply with the requirements mentioned in paragraph 3(1) of Schedule 4 to this Act, and in respect of which a direction given under paragraph 1 of that Schedule has effect;*
>
> *(d)* *property which is part of or held for the purposes of a fund or scheme to which section 151 below applies;*
>
> *(e)* *property comprised in a trade or professional compensation fund; and*
>
> *(f)* *excluded property.*
>
> *(2)* *The reference in subsection (1)(d) above to property which is part of or held for the purposes of a fund or scheme does not include a reference to a benefit which, having become payable under the fund or scheme, becomes comprised in a settlement.*
>
> *(3)* *In subsection (1)(e) above "trade or professional compensation fund" means a fund which is maintained or administered by a representative association of persons carrying on a trade or profession and the only or main objects of which are compensation for or relief of losses or hardship that, through the default or alleged default of persons carrying on the trade or profession or of their agents or servants, are incurred or likely to be incurred by others.*"

Statement of Practice 8/86 ("SP8/86")

26. In the agreed Statement of Facts and Issues, it is common ground that the Scrip Dividend Proceeds were comprised in the "Appointed Fund", in relation to which no beneficiary had a qualifying interest in possession within the meaning of IHTA 1984, section 58. However, in SP 8/86, HMRC accepts that property which comprises trust income for the purposes of the general law of trusts is outside the scope of "relevant

property”, unless such income is accumulated or distributed, whether or not there is any qualifying interest in possession held by a beneficiary:

> “*This statement sets out the Board’s practice concerning the IHT/CTT treatment of income of discretionary trusts.*
>
> *The Board takes the view that –*
>
> - *undistributed and unaccumulated income should not be treated as a taxable trust asset; and*
>
> - *for the purpose of determining the rate of charge on accumulated income, the income should be treated as becoming a taxable asset of the trust on the date when the accumulation is made.*
>
> *This practice applies from 10 November 1986 to all new cases and to existing cases where the tax liability has not been settled.*”

27. “Income” in the first indent of SP 8/86 means, the parties agree, “*trust income as a matter of general trust law*”. Thus, if the Scrip Dividend Proceeds did indeed constitute trust income for the purposes of general trust law, it is common ground that the Scrip Dividend Proceeds were not “relevant property” within section 58(1). There had been no accumulation or distribution of the Scrip Dividend Shares or Scrip Dividend Proceeds prior to 17 May 2003, which is the date upon which HMRC contend that the 10 year charge arose.

Charge at Ten-Year Anniversary: IHTA 1984, section 64

28. IHTA 1984, section 64, which is the relevant charging provision in this appeal, imposes the 10 year charge and provides as follows:-

> “*Where immediately before a ten-year anniversary all or any part of the property comprised in a settlement is relevant property, tax*

shall be charged at the rate applicable under sections 66 and 67 below on the value of the property or part of that time."

Income Tax Provisions

ICTA 1988, section 249

29. The Appellant's case depends upon the effect and scope of ICTA 1988, section 249(6).

The relevant provisions of section 249 are as follows:-

"***249 Stock dividends treated as income***

(1) Subject to subsections (7) to (9) below, this section applies to any of the following share capital, that is to say -

(a) any share capital issued by a company resident in the United Kingdom in consequence of the exercise by any person of an option conferred on him to receive in respect of shares in the company (whether the last-mentioned shares were issued before or after the coming into force of this section) either a dividend in cash or additional share capital; and

(b) any bonus share capital issued by a company so resident in respect of any shares in the company of a relevant class (whether the last-mentioned shares were issued before or after the coming into force of this section).

(2) For the purposes of subsection (1)(b) above a class of shares is a relevant class if –

(a) shares of that class carry the right to receive bonus share capital in the company of the same or a different class; and

(b) that right is conferred by the terms on which shares of that class were originally issued or by those terms as subsequently extended or otherwise varied.

(3) Where a company issues any share capital in a case in which two or more persons are entitled thereto, the following provisions of this section … shall have effect as if the company had issued to each of those persons separately a part of that share capital proportionate to his interest therein on the due date of issue.

(4) Subject to the following provisions of this section, where a company issues any share capital in a case in which an individual is beneficially entitled to that share capital, that individual shall be treated as having received on the due date of issue income of an amount which, if reduced by an amount equal to income tax on that income at the lower rate for the year of assessment in which that date fell, would be equal to the appropriate amount in cash, and –

(a) the individual shall be treated as having paid income tax at the lower rate on that income or if his total income is reduced by any deductions, on so much of it as is part of his total income as so reduced;

(b) no repayment shall be made of income tax treated by virtue of paragraph (a) above as having been paid; and

(c) that income shall be treated (without prejudice to paragraph (a) above) as if it were income to which section 1A applies, but shall be treated for the purposes of sections 348 and 349(1) as not brought into charge to income tax...

(6) Where a company issues any share capital to trustees in respect of any shares in the company held by them (or by them and one or more other persons) in a case in which a dividend in cash paid to the trustees in respect of those shares would have been to any extent income to which section 686 applies, then –

(a) there shall be ascertained the amount of income which, if the case had been one in which an individual was beneficially entitled to that share capital, that individual would have been treated under subsection (4) above as having received; and

> (b) *income of that amount shall be treated as having arisen to the trustees on the due date of issue and as if it had been chargeable to income tax at the lower rate; and*
>
> (c) *paragraphs (a) to (c) of subsection (4) above shall, with the substitution of "income" for "total income" and with all other necessary modifications, apply to that income as they apply to income which an individual is treated as having received under that subsection ...*"

30. The Court of Appeal in *Howell v Trippier* summarised the effect of section 249 as follows, which summary we respectfully adopt:

> "*First, an individual who receives bonus shares in circumstances falling within section 249(1) is to be treated as having received the "appropriate amount in cash", which is defined in section 251. The appropriate amount, in a case such as this, where the market value of the bonus shares on the date of issue was substantially more than the relevant dividend, is the market value, grossed up by reference to the Schedule F ordinary rate. Secondly, such an individual is assumed to have paid income tax on that grossed-up amount, but only at the Schedule F ordinary rate. Thirdly, the individual receives a tax credit for the notional payment of Schedule F ordinary rate tax. Fourthly, that tax credit will be neither directly nor indirectly repayable. Fifthly, any liability to tax at the higher rate does not arise through the medium of section 249(4), but as a result of section 1(2)(b) which, it is common ground, is the charging section which imposes a higher rate of tax on individuals who fall within section 249(4).*" (paragraph 14).

31. Against that overview of section 249, the Court of Appeal in *Howell v Trippier* summarised the effect of section 249(6) as follows:

> "*... Section 249(6)(a) requires one to "ascertain" the amount of income which, had the bonus shares been issued to an individual, that individual would have been deemed to have received pursuant to section 249(4) and section 251. That sum would, in the present case, be the value of the bonus shares as at their date of issue, grossed up by reference to the Schedule F ordinary rate. By virtue of section 249(6)(b), that grossed-up amount is "treated*

as having arisen to the Trustees" on the date of the issue of the bonus shares." (paragraph 16).

ICTA 1988, section 251

32. ICTA 1988, section 251 supplements section 249 and provides as follows:-

"***251 Interpretation of sections 249 and 250***

(1) For the purposes of sections 249 and 250 –

(a) "bonus share capital", in relation to a company, means share capital issued by the company otherwise than wholly for new consideration or such part of any share capital so issued as is not properly referable to new consideration;

(b) "due date of issue", in relation to any share capital issued by a company, means the earliest date on which the company was required to issue that share capital;

(c) an option to receive either a dividend in cash or additional share capital is conferred on a person not only where he is required to choose one or the other, but also where he is offered the one subject to a right, however expressed, to choose the other instead, and a person's abandonment of, or failure to exercise, such a right is to be treated as an exercise of the option;

and in section 254 the definition of "security" (in subsection (1)) and subsections (5) and (11) shall not apply.

(2) In sections 249 and 250 "the appropriate amount in cash", in relation to any share capital to which section 249 applies -

(a) in a case where that share capital was issued –

(i) in consequence of the exercise of an option such as is mentioned in section 249(1)(a); or

(ii) in a quantity which is determined by or determines the amount of a dividend in cash payable in respect of share capital in the company of a different class,

and where the relevant cash dividend is not substantially greater nor substantially less than the market value of that share capital on the relevant date, means the amount of the relevant cash dividend, or in a case in which section 249(3) applies, a due proportion of that amount;

(b) in a case where paragraph (a) above does not apply, means the market value of that share capital on the relevant date or, in a case in which section 249(3) applies, a due proportion of that market value.

(3) In subsection (2) above –

"the relevant cash dividend", in a case falling within subsection (2)(a)(i) above, means the cash dividend mentioned in section 249(1)(a) or, in a case falling within subsection (2)(a)(ii) above, means the cash dividend there mentioned (subject to subsection (4) below);

"the relevant date", in the case of share capital listed in the Stock Exchange Daily Official List, means the date of first dealing and, in the case of share capital not so listed, means the due date of issue; and

"market value", in relation to any share capital in a company, means, subject to the provisions applied by subsections (5) and (6) below, the price which that share capital might reasonably be expected to fetch on a sale in the open market.

(4) Where, in a case falling within subsection (2)(a)(ii) above, the company on the occasion on which it issues the share capital in question also issues a dividend in cash ("the accompanying cash dividend") in respect of the shares in the company in respect of which that share capital is issued, "the relevant cash dividend" means the cash dividend mentioned in subsection (2)(a)(ii) above reduced by the amount of the accompanying cash dividend.

> (5) *Section 272(3) of the 1992 Act (market value of shares or securities quoted in the Stock Exchange Daily Official List) shall apply for the purposes of subsection (3) above as it applies for the purposes of that Act.*
>
> (6) *In the case of shares or securities which are not quoted on a recognised stock exchange at the time when their market value for the purposes of subsection (2) above falls to be determined, subsection (3) of section 273 of the 1992 Act shall apply with respect to the determination of their market value for those purposes as it applies with respect to a determination falling within subsection (1) of that section.*"

33. Section 251(2) defines the amount of deemed income which trustees within the scope of section 249(6) are treated as receiving. If the cash dividend and the market value (as defined) of the scrip alternative are not substantially different, the trustees are treated as receiving an amount equal to the cash dividend, even if the trustees elect for the scrip alternative. But if the cash dividend and the market value of the scrip alternative are substantially different, the trustees who elect to take the scrip dividend are treated as receiving an amount equal to the market value of the scrip alternative.

ICTA 198, sections 686 and 687

34. Before analysing the effect of s249(6), it is convenient at this stage to set out the terms of ICTA 1988, sections 686 and 687, since these provisions were important in the authorities which construed the scope and ambit of section 249. Section 686 provides as follows:

> "***686 Liability to additional rate tax of certain income of discretionary trusts***
>
> (1) *So far as income arising to trustees is income to which this section applies it shall be chargeable to income tax at the rate applicable to trusts, instead of at the basic rate or, in accordance with section 1A, at the lower rate.*

(1A) *The rate applicable to trusts, in relation to any year of assessment for which income tax is charged, shall be 34 per cent...*

(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 not, before being distributed, either –*

(i) *the income of any person other than the trustees, or*

(ii) *treated for any of the purposes of the Income Tax Acts as the income of a settlor ...*

(6) *In this section "trustees" does not include personal representatives; but where personal representatives, on or before the completion of the administration of the estate, pay to trustees any sum representing income which, if personal representatives were trustees within the meaning of this section, would be income to which this section applies, that sum shall be deemed to be paid to the trustees as income and to have borne income tax at the applicable rate.*

This subsection shall be construed as if it were contained in Part XVI."

35. Section 686(1), (1A) thus impose a rate of income tax applicable to trusts (at 34%). The rate applicable to trusts was a higher rate of income tax than the basic rate (25%) or lower rate (20%) at the material times. The rate applicable to trusts was imposed on "income" within section 686(2). The relevant head of "income" in this case is that contained in section 686(2)(a): "*income which is to be accumulated or which is payable at the discretion of the trustees or any other person ...*". It is common ground that the phrase "*income which is to be accumulated or which is payable at the discretion of*

trustees" is a synonym for trust income, that is receipts which are trust income as a matter of general trust law. As we observe below, the Court of Appeal, in *Howell v Trippier*, held that ICTA 1988, section 249(6) deemed bonus shares (or the equivalent amount of deemed income), received by the trustees in that case which shares, like the Scrip Dividend Shares in this case, were governed by section 249(1)(a) to be trust income for the purposes of section 686(2)(a) and thus subject to the rate applicable to trusts.

ICTA 1988, section 687

36. Section 687 supplements section 686 and certain provisions in section 687(3) formed part of the Appellant's submissions. Section 687 provides as follows:-

> "***687 Payments under discretionary trusts***
>
> *(1) Where in any year of assessment trustees make a payment to any person in the exercise of a discretion, whether a discretion exercisable by them or by any other person, then if the payment –*
>
> *(a) is for all the purposes of the Income Tax Acts income of the person to whom it is made (but would not be his income if it were not made to him), or*
>
> *(b) is treated for those purposes as the income of the settlor by virtue of section 660B,*
>
> *the following provisions of this section apply with respect to the payment...*
>
> *(2) The payment shall be treated as a net amount corresponding to a gross amount from which tax has been deducted at the rate applicable to trusts for the year in which the payment is made; and the sum treated as so deducted shall be treated –*

> (a) *as income tax paid by the person to whom the payment is made or, as the case may be, the settlor; and*
>
> (b) *so far as not set off under the following provisions of this section, as income tax assessable on the trustees.*
>
> (3) *The following amounts, so far as not previously allowed, shall be set against the amount assessable (apart from this subsection) on the trustees in pursuance of subsection (2)(b) above –*
>
> (a) *the amount of any tax on income arising to the trustees which (not being income the tax on which falls within paragraph (aa), (aaa) or (b) below) is charged at the rate applicable to trusts in pursuance of section 686 ...*"

37. Section 687(1), (2) subject an appointment of trust property to a beneficiary which is, in the beneficiary's hands, "income" for ICTA 1988 purposes, including trust property which is "trust income" for section 686(2)(a) purposes, to an income tax charge. If the appointment is not of "income" for ICTA 1988 purposes, there is no charge under section 687. The income tax charge under section 687(1),(2) is formally in the hands of the recipient beneficiary but the tax is assessable on the trustees. The amount charged is the value of the trust property, grossed up at the rate applicable to trusts (here, 34%). On the assumption that this income appointed to the beneficiary is paid out of trust property which has been subjected (in the trustees' hands) to income tax at the rate applicable to trusts, section 687(3)(b) gives a credit for the tax so paid by the trustees, to avoid economic double taxation.

The Substantive Issue

38. The substantive issue turns on whether ICTA 1988, section 249(6) deems the Scrip Dividend Shares (or the equivalent amount of deemed income) to be trust income for

the purposes of ICTA 1988, section 686(2)(a), or whether that deeming effect applies also for the purposes of general trust law. It is important to make it clear what we mean by the phrase "general trust law". We mean the statute and case law which governs the construction and application of settlement deeds, to ascertain the powers and duties of the trustees on the one hand and the rights of beneficiaries as against the trustees (and *inter se*) on the other. This includes, of course, the construction and application of the provisions of settlement deeds to ascertain whether trust receipts are trust income, to be applied for the benefit of income beneficiaries, or trust capital, to be applied for the benefit of capital beneficiaries. When we use the phrase "trust income" we mean, therefore, trust property which is properly applied for the benefit of income beneficiaries.

The Appellant's Submissions on the Substantive Issue

39. Mr Goodfellow QC appeared for the Appellant. His submissions on the substantive issue were very simple. It was common ground between the parties that the issue of the Scrip Dividend Shares triggered the application of ICTA 1988, section 249(6), so as to treat the Scrip Dividend Shares (or the equivalent amount of deemed income) as trust income for the purposes of ICTA 1988, section 686(2)(a). But Mr Goodfellow submitted that section 249(6) also applied to treat the Scrip Dividend Shares as trust income for the purposes of general trust law. It followed that in the absence of any accumulation or distribution by the Appellant, as trustee, the Scrip Dividend Proceeds were also trust income and thus protected by SP 8/86 from a 10 year charge under IHTA 1984, section 64. There was nothing, Mr Goodfellow submitted, in either the text of section 249(6) or in principle, which suggested otherwise. Section 249(6) therefore deems the Scrip Dividend Shares (and, in this case, in the absence of any relevant

accumulation or distribution, the Scrip Dividend Proceeds) to be trust income not only for the purposes of the charging provisions of ICTA 1988 but also for the purposes of governing the rights and obligations of the capital and income beneficiaries of all trusts *inter se* and the powers and duties of the trustees as respects the capital and income beneficiaries of all trusts, irrespective of the terms of the relevant trust deed. We observe that Mr Goodfellow's proposition that ICTA 1988, section 249(6) applies "for the purposes of general trust law" amounts to the proposition that ICTA 1988, section 249(6) is a provision of trust law as well as of tax law.

HMRC's Submissions on the Substantive issue

40. Mr Yates, who appeared for HMRC, submitted that the scope and effect of ICTA 1988, section 249(6) was confined to ICTA 1988 purposes and did not apply for the purposes of general trust law.

Decision on the Substantive Issue

41. As we have observed, it is common ground that section 249(6) was engaged on the issue of the Scrip Dividend Shares to the Appellant.

42. The construction of ICTA 1988, section 249(6) was considered by the Court of Appeal in *Howell v Trippier*. Shares (described in that case as "bonus shares") were issued and were, as in this case, subject to the application of ICTA 1988, section 249(1)(a) and section 249(6). The issue in *Howell v Trippier* was whether section 249(6) caused the shares (or the equivalent amount of deemed income) to constitute "income" for the purposes of section 686(2), and thus subject to the rate of tax applicable to trusts in section 686(1): see Neuberger LJ at [5]. It was common ground in *Howell v Trippier*,

as it is in this appeal, that the phrase "...income...to be accumulated or…payable at the discretion of the trustees..." in section 686(2)(a) was a synonym for "income for the purposes of general trust law", or "trust income". The appellant trustees in *Howell v Trippier* contended that section 249(6) applied to treat the bonus shares as "income" for the purposes of ICTA 1988 but not specifically as "trust income" for the purposes of section 686(2)(a), so that the rate applicable to trusts did not apply to the bonus shares. The Crown contended that section 249(6) applied to treat the bonus shares in that case (or the equivalent amount of deemed income) as trust income for the purposes of section 686(2)(a), notwithstanding that it was common ground that the bonus shares were trust capital under the terms of the relevant trust deed.

43. Thus the issue in question in *Howell v Tripper* was whether ICTA 1988, section 249(6) gave rise to deemed trust income, which overrode the terms of the relevant settlement, for the purposes of section 686(2)(a) (and the imposition of the rate applicable to trusts under section 686(1), (1A)).

44. Neuberger LJ observed at [6] that the terms of the relevant settlement were such that the "*bonus shares constituted capital, rather than income, in the hands of the trustees, for the purposes of trust law*" and at [22] that the bonus shares could not "*at least in the absence of a deeming or similar provision to the contrary*" fall within section 686(2)(a).

45. Neuberger LJ (who gave the only reasoned judgment, with which Dame Elizabeth Butler-Sloss P and Latham LJ agreed) stated the argument as between the trustees on the one hand and HMRC on the other as follows:

> "23. *The crucial feature of the Trustees' case is ... that section 686(2)(a) limits the ambit of section 686 to receipts in the hands*

> *of the trustees of discretionary or accumulation settlements which are to be treated as income under the relevant settlement*
>
> *24. The Revenue's argument in reply is that the issue of the Bonus Shares to the Trustees is deemed by virtue of section 249(6)(b) to be the receipt of income by the Trustees, and that one must follow through that fiction into section 686.* (emphasis added) *As a result, in the case of an accumulation or discretionary trust, such as the Settlement, where the trustees have power to accumulate, or to pay out income at their discretion, this deemed or fictional income (emphasis added), like all income receivable by the trustees "is to be accumulated or ... is payable at the discretion of the trustees". Hence, the Revenue contends, section 686 does indeed apply to charge tax at the Schedule F trust rate on the bonus shares, or, more accurately, on the notional income arising as a result of the issue of the\Bonus Shares by the operation of section 249(6)(b).*"

46. Neuberger LJ added at [51] that "*... On the Revenue's case, it is sufficient for the shares to be deemed to be income under section 249(6)(b) for the receipt to be chargeable to tax at the Schedule F trust rate pursuant to section 686, whereas on the trustees' case, there is the additional requirement that the bonus shares must, as a matter of reality, be treated as an income receipt in the hands of the trustees under trust law*" (emphasis added).

47. These passages from the judgment in *Howell v Trippier* show that Neuberger LJ identified the point at issue in *Howell v Tripper* as whether, in order for the bonus shares in that case to be deemed to be trust income for section 686(2)(a) purposes, the application of the deeming effect of section 249(6)(b) to the bonus shares was sufficient, or whether one could only, as the trustees contended, look to the terms of the settlement ("*as a matter of reality*") to determine whether the bonus shares were trust income. In other words, the question in issue in *Howell v Trippier*, which is clear from the passages we have highlighted, is whether section 249(6), through its deeming effect ("*fiction*"), made the terms of the relevant settlement, which treated the bonus shares as

trust capital, irrelevant, for the purposes of section 686(2)(a). The extent of the deeming for taxes outside the scope of ICTA 1988, or for general trust law, was not in issue.

48. The Court of Appeal held that the effect of section 249(6)(b) was indeed to treat the Scrip Dividend (or the equivalent amount of deemed income) as "trust income" within the meaning of section 686(2)(a), so that section 686(1), (1A), applied to impose the rate of tax applicable to trusts on the market value of the Scrip Dividend.

49. The Court of Appeal's decision in *Howell v Tripper* can be summarised thus: section 249(6) gave rise to "notional" or "fictional" trust income, notwithstanding the terms of the relevant settlement, for the purposes of ICTA 1988, section 686(2)(a), in the hands of the trustees in that case, which, in turn meant that the fictional trust income was subjected to the rate applicable to trusts in section under section 686(1), (1A).

50. There was some debate between Mr Goodfellow and Mr Yates as to whether the Crown, in *Howell v Trippier*, made one argument or two. Mr Goodfellow thought that the Crown had made one single argument, that the application of section 249(6)(b) to the bonus shares gave rise to notional income, quantified by reference to the "appropriate amount of cash" as defined by section 251. Mr Yates thought that the Crown had made two separate arguments: first, that section 249(6)(b) gave rise to notional income, which notional income, although triggered by the receipt of shares was thereafter simply quantified by reference to the "appropriate amount in cash" so that the actual shares received by the trustees were irrelevant and a second (separate) argument, on the other, that the receipt of the actual shares were deemed to be a receipt of notional trust income.

51. We do not think it matters whether the Crown advanced one argument or two in *Howell v Trippier*. We consider that Neuberger LJ decided the case on the basis that the receipt of the actual shares by the trustees gave rise to the receipt in their hands of notional trust income, so that the actual shares were treated as a receipt of notional trust income [32]. The question which arises in this case is whether that clothing of the actual shares as notional trust income is a fiction which applies for section 686(2)(a) purposes alone or for general trust purposes.

52. The exercise of ascertaining the scope of the deeming effect of section 249(6) requires us to consider the approach properly taken to the construction of deeming provisions generally and to apply that approach section 249(6), bearing in mind the text of section 249(6), its statutory context and its statutory purpose.

53. The proper approach to the construction of deeming provisions is well settled. We were referred to the well-known passage from the judgment of Peter Gibson J sitting in the Court of Appeal in *Marshall v Kerr* [1993] STC 360 at 366:

> *"For my part, I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that, because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so."*

This passage was approved by the House of Lords on appeal in that case: see [1995] 1 AC 148 at 164. It was cited with approval by Lord Walker of Gestingthorpe giving the

only judgment in the Supreme Court in *DCC Holdings (UK) Ltd v Revenue and Customs Commissioners* [2010] UKSC 58, [2011] 1 WLR 44. Recently, it was cited by Lewison LJ in *DV3 RS LP v Revenue and Customs Commissioners* [2013] EWCA Civ 907, [2014] 1 WLR 1136 at [13]-[15]. Lewison LJ there made clear that the fact that the court is concerned with deeming provisions does not displace the ordinary principles of statutory construction, and in particular the need to have regard to the purpose of a particular provision and to interpret its language, so far as possible, in a way which best gives effect to that purpose.

54. We were also referred to a consideration of the proper approach to deeming provisions by Robert Walker LJ in *DEG-Deutsche etc v Koshy* [2001] EWCA Civ 79. At [16], Robert Walker LJ said:

> *"Mr Thompson criticised the judge's reasoning as having overlooked the need, in applying a deeming provision (and especially one which amounts to a statutory fiction) to have regard to the legislative purpose underlying the provision. Outside the scope of that legislative purpose, there may be no reason to prefer fiction to the truth. Mr Thompson referred to the principle stated in Bennion, Statutory Interpretation 3rd ed p.736. In addition to the authorities cited in that passage there is the well-known decision of this court in Murphy v Ingram [1974] Ch 363, in which Russell LJ said (at p.370),*
>
> > *"It has been remarked on high authority that in considering "deeming" provisions in statutes it is important to have in mind what appears to be the purpose of their enactment: see, for example, Hill v East and West India Dock Co (1884) 9 App Cas 448, 454-456, and the passage quoted in Leitch v Emmott [1929] 2 KB 236, 248 from James LJ in In re Levy, Ex parte Walton (1881) 17 Ch D 746, 756."*
>
> *Bennion summarises the effect of the authorities as being that the statutory hypothesis is to be carried as far as is necessary to achieve the legislative purpose, but no further."*

At [20], Robert Walker LJ continued:

> *"The point has been fully and skilfully argued but it is in the end quite a short point. I accept the submissions put forward by Mr Thompson on behalf of DEG. The legislative purpose of the statutory fiction is to withdraw protection from the person whose certificate is revoked (as is emphasised by regulations 85 and 86) and the achievement of that purpose does not require (or permit) the fiction to be applied indiscriminately to every reference to an assisted person (such as the references in regulations 81 and 82, where it would produce absurdity)."*

55. We consider that the correct approach to deeming provisions does not permit the fiction in section 249(6) to be extended to general trust law or to other tax statutes.

56. First, to consider the text of section 249(6), interpolating the effect of the Court of Appeal's judgment in *Howell v Trippier* into the text of section 249(6)(b), section 249(6)(b) reads:

> "*(b) [Income falling to be accumulated or payable at the discretion of the trustees, as a matter of general trust law,] of [the amount equal to the appropriate amount in cash, within section 249(4), section 251]shall be treated as having arisen to the trustees on the due date of issue and as if it had been chargeable to income tax at the lower rate ...*".

The text of section 249(6), on its terms, treats shares within its scope as income arising to trustees, being trust income, for the purposes of deeming the bonus shares as having been subject to income tax at the Schedule F ordinary rate. And because the deemed income is deemed to be trust income for section 686(2)(a), the rate applicable to the trusts under section 686(1), (1A), is imposed on that deemed trust income irrespective of the terms of the relevant trust deed. Importantly, section 249(6)(a) provides that the quantum of that deemed income is "the appropriate amount in cash", as defined in ICTA 1988 section 251, which may or may not be the market value of the shares.

57. There is no suggestion, in the text of section 249(6), as construed in *Howell v Trippier*, that the deeming effect of section 249(6) extends to statutes beyond ICTA 1988 or to the area of general trust law. Nor would one expect there to be. ICTA 1988 is a taxing statute. ICTA 1988 is not a statute which governs general trust law. Mr Goodfellow's submission that section 249(6) applies for general trust law purposes is, as we have observed above, to treat section 249(6)(b) as a provision of trust law (as well as a taxing provision). There would not be any distinction between "notional" and "actual" trust income. Rather, if Mr Goodfellow's submission were correct, s249(6)(b) would convert the Scrip Dividend Shares into "actual" trust income, overriding any contrary terms of the relevant trust deed and any contrary intention on the part of the settlor. The terms of all discretionary settlements governing the identification of trust income and trust capital (and the intentions of the settlor) would be irrelevant. Such a fundamental override of the terms of a settlement deed and the intentions of the settlor by a deeming provision contained in a tax statute would require clear words in the relevant deeming provision, which are not present in section 249(6)(b).

58. Mr Goodfellow submitted that there was nothing in the text of section 249(6)(b) which expressly confined its application to matters to which ICTA 1988 applied. That is true. But we consider it misconceived to suggest that in the absence of words of confinement of the scope of a deeming provision contained in a tax statute, that deeming provision applies for all areas of law, quite apart from the particular area of tax law the taxing statute governs.

59. Where the intention is to extend the meaning of a term of art in ICTA 1988 to statutes other than ICTA 1988, it is achieved by express reference to "the Tax Acts", "the Income Tax Acts" and "the Corporation Tax Acts" (see section 831(1), (2)). These

terms encompass various collections of tax statutes. In the absence of such express extension, we would expect terms of art (and *a fortiori* deeming provisions) in ICTA 1988 to be confined to ICTA 1988. Likewise, we would expect an intention to extend terms of art or deeming provisions to different taxes, such as IHT, or, even more so, to areas of law outside the area of tax law altogether, such as that of general trust law, to be expressly stated.

60. Significant problems also arise if Mr Goodfellow is correct that section 249(6)(b) applies for general trust law purposes, beyond the scope of ICTA 1988. We note, at this stage, as did the Court of Appeal in *Howell v Trippier*, that the amount which is "*treated as having arisen to the trustees*" by reason of section 249(6) is determined by reference to the statutory notion of the "*appropriate amount in cash*" as defined in section 251. In this case, as in *Howell v Trippier*, the "appropriate amount in cash" is calculated in section 251 by reference to the market value of the shares received by the relevant trustees because the market value of the shares substantially exceeded the value of the cash dividend alternative. However, if the cash dividend had not been substantially greater or substantially less than the market value of the shares, the "appropriate amount in cash" which is treated as having arisen to the trustees under section 249(6) (and indeed to the individual to whom section 249(4) would have applied), is determined by reference to the alternative cash dividend. So, for example, if the relevant cash dividend was, say, £95 and the market value of the shares within section 249(1)(a) was, say, £100, the "appropriate amount in cash" for section 249(6) purposes, that is, the notional income arising to the trustees, would be £95. Equally, had the cash dividend been £100, and the market value of the shares been £95, the "appropriate amount in cash" (and the income treated as arising to the trustees under section 249(6)) would be £100, even though the trustees actually only received £95 in

value. Of course, this observation assumes that £5 does not constitute a “substantial” difference between the relevant cash dividend and the market value of the shares alternative (the parties did not argue with this example when we put it to each of them during the course of their respective oral submissions) but the point of principle is self-evidently good whatever the term “substantial” means in the context of defining the “appropriate amount in cash” in section 251.

61. In the example given above, in circumstances in which the cash dividend was £95 and the market value of the Scrip Dividend alternative was £100, and the trustees took the Scrip Dividend Shares, section 249(6)(b) treats the “appropriate amount in cash”, and therefore the notional trust income, as being £95 (that is £5 less than the trustees actually receive). If section 249(6)(b) applied for the purposes of general trust law, it follows, on Mr Goodfellow’s submission, that general trust law considers the trustees to have received £95 of trust income instead of £100.There is no particularly intelligible answer as to how the trustees should deal with the additional £5; presumably, as the deeming effect of section 249(6)(b) applies only to £95, the balance would be capital. That a single issue of bonus shares worth £100 to trustees should, for trust purposes, give rise to income of £95 and capital of £5 is on any basis an odd result.

62. Equally, if the cash dividend had been £100 and the market value of the Scrip Dividend alternative had been £95 and the trustees elected to take the Scrip Dividend Shares (say in the hope of future capital appreciation in the Shares, which made up for the £5 difference), the “appropriate amount in cash” and the notional trust income received by the trustees by reason of section 249(6)(b) would be £100, rather than £95, although the trustees had in fact received £95. Again, if section 249(6)(b) applied so as to treat the trustees as having received £100 of trust income as a matter of general trust law, it is

questionable how the terms of the relevant trust deed would apply to £5 which the trustees had not in fact ever received.

63. A further point, as Mr Yates for HMRC submitted, is that while the deeming effect of section 249(6)(b) will apply for income tax purposes to all trustees chargeable to income tax under ICTA 1988, the suggested deeming effect as regards general trust law would not apply to trusts governed by a foreign law, save perhaps in proceedings brought in courts in the United Kingdom.

64. The observations in the previous four paragraphs reveal clear anomalies were section 249(6) treated as a provision of trust law, giving rise to trust income for general trust law purposes.

65. As we observed above, the statutory purpose of the relevant deeming provisions must be borne in mind in applying deeming provisions, to avoid distorting the deeming provision's legislative purpose and to avoid producing anomaly or absurdity in the context of that legislative purpose.

66. The legislative purpose of section 249(6)(b) may be gleaned from Neuberger LJ's reasons for holding that section 249(6)(b) gave rise to notional income, being notional trust income, which meant that the rate applicable to trusts was levied on the appropriate amount in cash deemed to be received by the trustees in *Howell v Trippier*.

67. The Court of Appeal had three reasons for reaching its conclusion:-

(i) a contrary conclusion would lead to an over-generous tax treatment for the trustees, since otherwise the trustees would obtain a full capital gains tax base

cost for the shares and yet suffer no income tax charge at all (having been deemed to pay income tax at the lower rate) (paragraphs 42, 43, 56);

(ii) the reference in the closing words of section 249(6)(b) confirming that the notional income arising under section 249(6)(b) arose "... *as if it had been chargeable to income tax at the Schedule F ordinary rate*" reflected similar wording to section 686(1), which, in turn, implied that section 686 applied in every case in which section 249(6)(b) applied (paragraph 48, 56);

(iii) ICTA 1988, section 687(3)(b) also suggested that section 686 applied in every case to receipts to which section 249(6)(b) applied. Section 687(3)(b) gives credit for any tax paid by discretionary trustees at the rate applicable to trusts or the Schedule F trust rate, when payments are subsequently made out of income to beneficiaries and, by its terms, assumes that tax at the Schedule F trust rate will have been paid by the trustees on any sum treated under section 249(6) as income of the trustees (paragraphs 49-51, 56).

Although Neuberger LJ considered this third point to be "neutral" in its effect (paragraph 52), he nevertheless seems to have considered it to be one of the three arguments relied on by the Crown which persuaded him that section 249(6)(b) gave rise to notional trust income, where "income" was properly construed to constitute income which could be accumulated or payable at the discretion of trustees and thus fell within section 686(2)(a).

68. It is readily apparent that Neuberger LJ was addressing exclusively tax arguments as to whether section 249(6)(b) gave rise to income which was treated as trust income. And as we have observed above, he was addressing the specific question whether section

249(6)(b) gave rise to notional trust income for the purpose of ascertaining whether section 686 and the rate applicable to trusts was engaged. Thus his analysis of the nature of the deeming effect of section 249(6)(b) was confined to income tax and ICTA 1988. The reasoning of the Court of Appeal we have set out above reveals the legislative purpose of section 249(6)(b) as ensuring that in cases where a cash dividend and a share alternative are available, they are both properly taxed at the same rate of income tax (at the rate applicable to trusts, under section 686), irrespective of which alternative is taken, for otherwise the recipient trustee-taxpayers, who elected for the scrip alternative, would obtain an over-generous income tax treatment, in the light of the full acquisition cost they receive for the shares for Capital Gains Tax purposes.

69. The application of the terms of a settlement by trustees, in general trust law, is an exercise of applying trust property for the benefit of income and capital beneficiaries. This is a matter of construing the relevant settlement deed and seeking to identify the intentions of the settlor, which again is an entirely different exercise to the statutory exercise of levying an income tax charge. We cannot detect any reason for extending a provision deeming a capital receipt to be income for income tax purposes to general trust law, governing the rights and duties of beneficiaries *inter se* and the powers and duties of trustees. It would be anomalous if a tax provision such as section 249(6), in seeking to impose a particular rate of income tax on particular trust property (shares within the scope of section 249(1)), should seek to override a settlor's intentions as to what trust property is trust income, or trust capital, and to adjust the rights of income and capital beneficiaries inter se.

70. We have identified positive reasons above why section 249(6) cannot be properly treated as a provision of trust law (or, in Mr Goodfellow's formulation, a provision

which applies for general trust law purposes). The distinct legislative rationale of section 249(6), which is entirely distinct from construing and applying settlement deeds to benefit income and capital beneficiaries, means that there is no basis in principle why section 249(6) should extend its deeming effect to the terms of the settlement. We conclude, therefore, that the deeming of section 249(6)(b) should not be extended to IHTA 1984, section 58 (or SP 8/86) or for general trust law purposes.

71. Mr Goodfellow relied on section 687(3)(b) in support of his submission that section 249(6)(b) applied for general trust law purposes as well as ICTA 1988 purposes. Mr Goodfellow's submission here was that the credit afforded by section 687(3)(b) only applied if receipts deemed to be income for section 686 purposes were, in turn, appointed out as "income" (meaning trust "income"). In circumstances in which particular receipts were deemed, by virtue of section 249(6)(b), to be trust "income" for section 686 purposes but remained trust capital for general trust law purposes, that credit would not be available to the trustees if the subject-matter of those receipts were subsequently appointed out as trust capital to capital beneficiaries.

72. We do not consider that section 687(3)(b) assists the Appellant.

73. First, where the appointment did result in the beneficiary receiving "income" within the meaning of ICTA 1988, the credit afforded by section 687(3)(b) would be available, on any view, for receipts which were trust income in the hands of the trustees by reason of the terms of the relevant trust deed and subsequently appointed out as trust income. Thus there is no redundancy of the credit mechanism in section 687(3) by confining the deeming effect of section 249(6) to the purposes of section 686(2)(a), or indeed to the purposes of ICTA 1988 generally.

74. Secondly, Mr Yates, on behalf of HMRC pointed out that the credit afforded by section 687(3)(b) is available on a "pooling" basis. Credit for the income tax payable under section 686 by the trustees on any receipts by them as trust property is available on any trust property paid out as trust income to income beneficiaries. The fact that particular trust receipts taxed to income tax under section 686, if subsequently appointed out to capital beneficiaries, as trust capital, does not attract a credit under section 687(3)(b) is, said Mr Yates (and we agree), neither here nor there, since other trust property appointed out as trust income would obtain the benefit of the credit under section 687(3)(b) for tax paid by the trustees under section 686.

75. We conclude our discussion of the substantive issue by repeating our observation that the Court of Appeal, in *Howell v Trippier* confined its decision to the relationship between ICTA 1988, section 249(6)(b) and section 686(2)(a). If the Court of Appeal had considered that it was deciding that section 249(6)(b) applied for the purposes of general trust law, so that the rights and duties of beneficiaries and trustees alike were fundamentally altered (and the intentions of the settlor overridden) by a provision contained in a taxing statute, it is inconceivable that such consequences would not have been addressed by the parties in argument and by Neuberger LJ. Neuberger LJ clearly treated the trust income arising under section 249(6)(b) as "notional" trust income which would be capital under the terms of the relevant settlement deed. But as we have already observed, any distinction between "notional" and "actual" trust income is meaningless if section 249(6)(b) applied for general trust law purposes, since, in that case, the Scrip Dividend would be "actual" trust income. This confirms that, in *Howell v Trippier*, the Court of Appeal confined itself to holding that ICTA 1988, section 249(6)(b) gave rise to trust income but only for section 686(2)(a) purposes (or perhaps for ICTA 1988 purposes generally). At no stage in his judgment did Neuberger LJ

suggest that the deeming effect of section 249(6) applied in any other context, in particular to the law of trusts generally. Mr Goodfellow accepted in the course of his oral submissions that there was no discussion in *Howell v Trippier* of the implications of such a deeming effect on the part of section 249(6)(b) and that it did not appear that any submissions were made by either counsel in *Howell v Trippier* of the consequences of such a wide deeming effect. All of this confirms, in our view, that *Howell v Trippier* does not assist the Appellant on the substantive issue.

Pierce v Wood

76. Our discussion of the substantive issue and the Court of Appeal's decision in *Howell v Trippier* is not, however, the end of the matter. In *Pierce v Wood*, His Honour Judge Hodge QC, sitting in the Manchester District Registry, Chancery Division, of the High Court, expressly held at [32] that "*... the effect of the Court of Appeal's decision in Howell v Trippier is that section 249(6)(b) of the Taxes Act is to be construed as treating a scrip dividend received by trustees as income in their hands for the purposes of trust law as well as for income tax purposes.*"

77. In *Pierce v Wood*, the trustees of three discretionary settlements issued proceedings under CPR part 8, raising two main issues of principle. The first issue raised for determination by the claim form was whether, following the decision of the Court of Appeal in *Howell v Trippier,* the scrip dividend shares and their sale proceeds fell to be treated as income for trust law purposes as well as for the purposes of the legislation relating to income tax, by reason of ICTA 1988, section 249(6)(b). This is, of course, the issue before us. The defendants named in the proceedings were beneficiaries under the respective settlements and they were appointed to represent the various classes of

beneficiaries under those settlements. There was no contrary argument from the defendants, who supported the orders sought by the trustees.

78. The settlors, like Mr Gilchrist in the present case, were shareholders in Leyland Trucks Manufacturing Limited (re-named Kepacourt Limited) and they settled all or some of their shares on the trusts of the settlements. As part of the disposal of Kepacourt Limited, the trustees elected to receive scrip dividend shares, just as Mr Gilchrist as trustee in the present case so elected. As in the present case, Mr Goodfellow QC appeared as counsel for the trustees.

79. In the course of his oral submissions before us, Mr Goodfellow confirmed that the income and capital beneficiaries under the settlements in *Pierce v Wood* were in fact identical. There was not, it appears, any real issue to be determined as between the trustees and the beneficiaries. The concern was to establish that the scrip dividend shares had been received as income and to establish that, although such income had not been distributed over the period of 10 years since its receipt, it had not been accumulated and converted into capital. These were important questions because they affected the treatment of the scrip dividend shares or their proceeds of sale for IHT purposes, precisely the issue which arises in this case. Notice of the claim was given to HMRC and they were given the opportunity to be joined to the proceedings. HMRC indicated that they did not wish to be joined but they set out in a letter submissions in opposition to the trustees' position on the effect of section 249(6)(b). The letter expressed the view of HMRC that the court's ruling in that case would not set a binding precedent and reserved their rights in any future case, including their rights to issue notices of determination.

80. Judge Hodge accepted the submissions of Mr Goodfellow that the effect of the decision in *Howell v Trippier* was that scrip dividend shares were, by virtue of section 249(6)(b), income for trust purposes as well as tax purposes. At [22]-[23], the judge summarised the submissions made by HMRC in their letter and in [24]-[31] the judge set out the submissions of Mr Goodfellow on behalf of the trustees. At [32]-[34], the judge set out his summary of the salient features of the judgment of Neuberger LJ in *Howell v Trippier.* At [35], the judge expressed his conclusion that the Court of Appeal had held that the effect of section 249(6)(b) was "to treat income in the form of bonus shares as an income, rather than a capital, receipt for all purposes, and not just for the purposes of the legislation relating to income tax." He went on to state at [36] that he therefore accepted Mr Goodfellow's submission that "the scrip dividend shares, and their sale proceeds, fell to be treated as income for trust law purposes, as well as for the purposes of income tax."

81. For the reasons given earlier in this judgment, we are satisfied that the conclusion reached by Judge Hodge QC as to the effect of the decision of the Court of Appeal in *Howell v Trippier* was wrong. In coming to this conclusion, it is right to note that Judge Hodge did not have the benefit of oral submissions in opposition to the trustees' case but only written submissions in a letter from HMRC. By contrast, the case before us has been fully argued in oral and written submissions by counsel for the taxpayer and for HMRC.

82. Nonetheless, if the decision in *Pierce v Wood* is binding on us, sitting as the Upper Tribunal, we would have to follow it. The facts of that case are virtually identical to those in the present case.

Appellant's Submissions on the Stare Decisis issue

83. Mr Goodfellow's submission on the stare decisis issue was this: the High Court had supervisory jurisdiction over the Upper Tribunal. Decisions of the High Court, judicially reviewing the Upper Tribunal, bind the Upper Tribunal. It followed, said Mr Goodfellow, that the Upper Tribunal, on making substantive decisions, was bound by substantive High Court decisions as a matter of stare decisis.

HMRC's Submissions on the Stare Decisis Issue

84. Mr Yates submitted that the presence of a supervisory jurisdiction of the High Court to judicially review the Upper Tribunal did not mean that the Upper Tribunal was bound by the High Court on substantive matters. Further, in this case, the Upper Tribunal was entitled to depart from the High Court decision in *Pierce v Wood* if we were against the Appellant on the substantive issue (which is the case) and we considered the decision of the High Court to be plainly wrong (which, for the reasons set out above, we do).

High Court decisions do not bind the Upper Tier Tribunal

85. In summary, we consider the following principles to apply in relation to the question of whether the High Court binds the Upper Tribunal as a matter of stare decisis:

(i) The question whether the Upper Tribunal is bound by High Court decisions as a matter of stare decisis is a matter of Parliamentary intention, in the light of the well-recognised need for predictability and consistency of outcome.

(ii) The Upper Tribunal is not bound by decisions of the High Court, as:-

(a) the intention of Parliament, in enacting the Tribunals Courts and Enforcement Act 2007 ("TCEA 2007") and constituting the Upper Tribunal as a court of superior record makes it clear that Parliament did not intend the Upper Tribunal to be bound by the High Court as a matter of stare decisis;

(b) as a matter of principle, the need for predictability and consistency of outcome are not offended;

(c) there is a substantial line of authority that Tribunals which are constituted as superior courts of record are free to depart from High Court decisions, which line of authority has not been disturbed.

86. None of the principles we have set out above is affected by the decision of the Supreme Court in *R (Cart) v Upper Tribunal* [2012] 1 AC 663 ("*Cart*"). The question whether the High Court binds the Upper Tribunal as a matter of stare decisis is conceptually distinct from the question whether the High Court has supervisory jurisdiction, as a matter of judicial review, over unappealable decisions of the Upper Tribunal.

(a) Parliamentary Intention

87. Whether or not a particular court or tribunal is bound by another court is a matter, ultimately, of Parliamentary intention. A "superior" court binds an "inferior" court. The jurisdiction of each court or Tribunal within the United Kingdom is now found or, in the case of the High Court's inherent jurisdiction, recognised, in statute. In this case, we must consider the statutory regime enacted by TCEA 2007, in assessing whether

Parliament intended the Upper Tribunal to be properly considered as an "inferior court" to the High Court, on substantive matters, for the purposes of stare decisis.

88. TCEA 2007 established the Upper Tribunal as a "superior court of record": section 3(5). Its status as a superior court of record enables it to create precedent. As such, the Upper Tribunal is in the same position as the Employment Appeal Tribunal ("EAT"), itself a superior court of record: Employment Tribunals Act 1996, section 20(3). Furthermore, TCEA 2007 provides for appeals from the First-tier Tribunal to the Upper Tribunal and then to the Court of Appeal, in England and to the Inner House of the Court of Session, in Scotland. Neither the High Court, in England, nor the Outer House of the Court of Session in Scotland have any part to play in the appeals process for matters within the jurisdiction of the Upper Tribunal. Thus the establishment of the Upper Tribunal as a superior court of record, with the power to set precedent, together with the exclusion of the High Court and the Outer House of the Court of Session from the appeal process, strongly suggest that the Upper Tribunal is not bound by decisions of the High Court or the Outer House.

89. Neither is the need for certainty offended by the Upper Tribunal departing from High Court decisions. The legislative structure of TCEA 2007 we outline above does not have any place for the High Court in the appeals structure. There is no indication that High Court decisions have binding effect on the Upper Tribunal. Of course, the First-tier Tribunal is not a superior court of record and is bound by decisions of the High Court and the Upper Tribunal. Advisers are not placed in any difficulty in being faced with conflicting decisions of the High Court on the one hand and the Upper Tribunal on the other, any more than if there are two conflicting High Court decisions. We note that

conflicting decisions of the High Court can arise in tax as well as other matters: see, for example, *Shephard v IRC (No2)* [1993] STC 240 and *USS v IRC* [1997] STC 1.

(b) Authorities permitting Tribunals which are superior courts of record to depart from High Court decisions

90. The EAT has long considered itself to be on (at least) the same level as the High Court and capable of departing from High Court decisions in appropriate circumstances. In *Portec v Mogensen* [1976] ICR 396 at 400, Bristow J stated that

> "*In our judgment it is only decisions of the Court of Appeal and the House of Lords on matters of the law of England, and of the Court of Session Inner House and House of Lords on matters of the law of Scotland, which are binding upon us – though of course the decisions of the National Industrial Relations Court, High Court in England, and the Court of Session Outer House in Scotland, must be of great persuasive authority and we would not likely differ from principles which are there to be found.*"

91. In *Secretary of State for Justice v RB* [2010] UKUT 454, Carnwarth LJ (sitting with HH Judge Phillip Sycamore and UT Judge Rowland in the Administrative Appeals Chamber of the Upper Tribunal) observed, as regards precedent:

> "*39. There is no doubt that, when applying the law of England and Wales, the Upper Tribunal is bound by decisions of the Court of Appeal on issues of law in accordance with the ordinary rules of precedent. This follows from its status as a higher court, to which the State provides a direct right of appeal.*
>
> *40. On the other hand, for the reasons given below, it seems to us equally clear that where the Upper Tribunal is exercising a jurisdiction formerly exercised by the High Court, it need not regard itself as formally bound by the decisions of the High Court. Subject to one qualification, we think the position should be the same as with the High Court as dealing with decisions of co-ordinate jurisdiction:*

"That you will follow the decision of another judge of first instance, unless he is convinced that that judgment is wrong, as a matter of judicial comity ..."

41. *The one qualification that we would suggest to this formulation arises from the particular nature of the Upper Tribunal's jurisdiction, in line with the statement of Lady Hale in AH (Sudan) v Secretary of State [2007] UKHL 49 at paragraph 30 (repeating comments she had made in the Court of Appeal in Cooke v Secretary of State for Social Security [2001] EWCA Civ 734, [2002] 3 All ER 279). She emphasised the highly specialised character of some legislation before the tribunals, and the need for the higher courts to respect their expertise. Consistently with that approach, where such specialised issues arise before the Upper Tribunal, it may in a proper case feel less inhibited in revisiting issues decided even at High Court level, if there is good reason to do so.*

42. *For the general approach, we gain support from the Court of Appeal's decision in respect of the jurisdiction of the former Social Security Commissioners in Chief Supplementary Benefit Officer v. Leary [1985] 1 All ER 1061. Having recorded that it was "not in dispute" that judgments given by the High Court "under its supervisory jurisdiction" were binding on the Commissioners, Lawton LJ said:*

"A distinction has to be drawn in decisions of the High Court exercising its supervisory jurisdiction which are, and always have been, binding on the Commissioners and the particular jurisdiction conferred on the High Court by the Act and the statutory instrument to which we have referred. The supervisory jurisdiction of the High Court is wide and discretionary. That given to the High Court between 1st January 1978 and 24th November 1980 was much narrower and was not discretionary. The effect of the 1980 Order was to transfer the narrow jurisdiction from the High Court to the Commissioners, probably for reasons of convenience. In these circumstances, it cannot, in our judgment, have been intended that when exercising this same jurisdiction the Commissioner should be bound by earlier decisions of the High Court." (p 1064-5)

43. *The position seems to us even clearer in respect of the Upper Tribunal, which has been established by Parliament for the purpose of providing a specialist appeal jurisdiction on points of law, in many respects analogous to that of the High Court, and which is by*

> *statute made a "superior court of record" (section 3(5) of the 2007 Act). The Employment Appeal Tribunal, which is also a "superior court of record" (Employment Tribunals Act 1996 s 20(3), has for many years (apparently without question) asserted a right to depart from High Court decisions, although treating them as "of great persuasive authority" (see Portec (UK) v Mogensen [1976] 3 All ER 565).* "

92. In applying this approach, and the approach of the Court of Appeal in *Social Security Commissioners v Leary* in the passage cited by Carnwath LJ, it may be noted that the appellate jurisdiction of the Upper Tribunal in tax matters, which accounts for the great majority of its tax cases, was previously exercised by the High Court on appeal from the Special or General Commissioners. High Court Judges continue to sit regularly in the Tax and Chancery Chamber of the Upper Tribunal. Although of course conceptually possible, it would be surprising if a decision of a High Court Judge sitting in the High Court would be binding on a High Court Judge sitting in the Upper Tribunal but not if sitting in the High Court.

93. *RB* was applied in *HMRC v Noor* [2013] UKUT 071 (TCC) in which Warren J and Judge Colin Bishopp (sitting in the Tax and Chancery Chamber of the Upper Tribunal) departed from the decision of Sales J sitting in the High Court in *Oxfam v HMRC* [2010] STC 686. They held that they were not bound by his decision and should not follow it.

94. Leaving aside any effect of *Cart*, it follows that the Upper Tribunal may depart from a decision of the High Court., if the Upper Tribunal is "*convinced*" (using the language at paragraph 40 of RB) or "*satisfied*" (using the language at paragraph 47 of RB) *"... that [the High Court decision] is wrong.*" We do not consider that there is any difference between *"convinced"* and *"satisfied"* in this context.

(iv) The proposition that High Court decisions do not bind the Upper Tribunal is unaffected by *Cart*.

95. *Cart* concerned whether the Upper Tribunal was subject to the supervisory jurisdiction of the High Court, in respect of "unappealable decisions", in particular a refusal on the part of the Upper Tribunal to give permission to appeal to the Court of Appeal, and, if so, the grounds on which the Upper Tribunal's unappealable decision could be judicially reviewed. By the time *Cart* reached the Supreme Court, the Crown had conceded that the Upper Tribunal must be subject to review by the High Court in some circumstances, as the TCEA 2007 did not expressly incorporate an ouster clause.

96. The Supreme Court was concerned with framing the appropriate test for the grounds of the judicial review of "unappealable decisions" of the Upper Tribunal. The Supreme Court rejected the Court of Appeal's approach in *Cart*, which limited the grounds of judicial review by the High Court of the Upper Tribunal to circumstances where the Upper Tribunal had "exceeded its jurisdiction". Rather, the Supreme Court adopted a "second-tier appeals approach", which conferred supervisory jurisdiction on the High Court, on unappealable decisions of the Upper Tribunal, where such decisions raised an important point of principle or practice, or some other compelling reason which required permission to appeal to be granted. The rationale for this test was that, otherwise, serious questions might never be "channelled into the legal system".

97. Neither the ratio of *Cart*, nor the test adopted by the Supreme Court, nor the rationale for that test affects the observations of Carnwath LJ in *RB*, as applied in *Noor*, that, as a matter of stare decisis, the Upper Tribunal is not bound by decisions of the High Court, or the Outer House on substantive matters.

98. An express distinction was made, by Lord Brown in *Cart* at [99], between an underlying substantive decision on the one hand and supervisory jurisdiction on the other. He observed that it had never been suggested that, following a refusal of leave to appeal, the underlying decision could be judicially reviewable for error of law. Thus the existence of a supervisory jurisdiction on the part of the High Court over the Upper Tribunal does not imply that the Upper Tribunal is bound by the decisions of the High Court, as a matter of stare decisis. The ratio of *Cart*, concerning the grounds of judicial review of unappealable decisions of the Upper Tribunal by the High Court, has no application to the question of whether the Upper Tribunal is bound by decisions of the High Court in substantive matters.

99. The rationale in *Cart*, of the need for the High Court to retain supervisory jurisdiction over decisions of the Upper Tribunal (that otherwise questions of substantive law would not be "channelled into the legal system", where they could be heard by the Court of Appeal (or the Inner House)) simply does not apply to questions of law determined by the Upper Tribunal. There is a right of appeal from the Upper Tribunal to the Court of Appeal and the Inner House (based on the "second-tier appeals approach"). Thus Parliament, in enacting TCEA 2007, has ensured that substantive decisions of the Upper Tribunal may be "channelled into the legal system".

100. The authorities which make it clear that the Upper Tribunal, and the EAT, is free to depart from decisions of the High Court were not mentioned or in any way disturbed by the Supreme Court in *Cart.* There is no reason why they do not remain good law.

Conclusion

101. We therefore hold that the Upper Tribunal is not bound by previous decisions of the High Court. For the reasons earlier given, we are satisfied that the decision in *Pierce v Wood* is wrong and we are satisfied that the Court of Appeal in *Howell v Trippier* did not hold that the deeming effect of section 249(6)(b) applied for the purposes of trust law generally or indeed for any purpose outside ICTA. We hold that section 249(6)(b) does not have any effect beyond ICTA and that therefore the scrip dividend shares and their proceeds of sale were, both for general trust purposes and for the purposes of IHT, capital of the settlement.

102. The appeal is accordingly dismissed.

Hon Mr Justice David Richards

Released 11 April 2014