

INHERITANCE TAX - settled property - interest in possession - testator's will gave directions to trustees permitting two married persons to live in house so long as they so wished - after the testator's death both moved into the house until the death of the survivor - whether the survivor beneficially entitled to an interest in possession - yes - whether, if so entitled, the interest in possession subsisted in the whole of the property - yes - or whether it was shared with the three residuary beneficiaries - no - appeal dismissed - IHTA 1984 ss 49(1) and 50(5)

THE SPECIAL COMMISSIONERS

CHARLES RAYMOND FAULKNER

TRUSTEE OF RUPERT CHARLES ADAMS DECEASED

Appellant

- and -

THE COMMISSIONERS OF INLAND REVENUE

Respondents

SPECIAL COMMISSIONER: DR A N BRICE

Sitting in London on 2 May 2001

The Appellant in person

Mr Peter Twiddy, Assistant Director, Capital Taxes Office,
for the Respondents

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DECISION

The appeal

1. Mr Charles Raymond Faulkner (the Appellant), as the surviving trustee of Rupert Charles Adams deceased (the testator), appeals against a Notice of Determination dated 8 February 2001 which stated:

"The Commissioners of Inland Revenue have determined:

In relation to

a) the deemed disposal on the death on 16 August 1998 of Fred Harrison ("the Deceased")

b) the will dated 9 December 1980 of Rupert Charles Adams, who died on 16 March 1981, which was proved at Nottingham District Probate Registry on 4 June 1981.

That having regard to the terms of clause 3 of the will, the Deceased's right of occupation of 1 Seacroft Square Skegness was an interest in possession in settled property within the meaning of section 49(1) of the Inheritance Tax Act 1984."

The legislation

2. Section 4 of the Inheritance Tax Act 1984 (the 1984 Act) provides that, on the death of any person, tax is charged as if, immediately before his death, he had made a transfer of value and the value transferred was equal to the value of his estate. Section 5(1) provides that a person's estate is the aggregate of all the property to which he was beneficially entitled. Part III (sections 43 to 93) of the 1984 Act contains provisions relating to settled property. Chapter II of Part III (sections 49 to 57A) contains provisions relating to interests in possession and reversionary interests. The relevant parts of section 49 provide:

"Treatment of interests in possession

49(1) A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists."

3. The relevant parts of section 50 provide;

"Interests in part, etc

50(5) Where the person referred to in section 49(1) above is not entitled to any income of the property but is entitled, jointly or in common with one or more other persons, to the use and enjoyment of the property, his interest shall be taken to subsist in such part of the property as corresponds to the proportion which the annual value of his interest bears to the aggregate of the annual values of his interest and that of those of the other or others."

4. Section 200(1)(b) of the 1984 Act provides that the persons liable for the tax on the value transferred by a chargeable transfer made on the death of any person are, so far as the tax is attributable to the value of property

which immediately before the death was comprised in a settlement, the trustees of the settlement.

The issues

5. By clause 3 of his will the testator directed that Mr Fred Harrison and his wife Mrs Annie Cuthbertson Burns Harrison or the survivor of them could live in property at 1, Seacroft Square, Skegness (the house) as long as they so wished. They both lived in the house until the survivor, Mr Harrison, died on 16 August 1998. The Inland Revenue argued that, at the date of his death, Mr Harrison had an interest in possession in settled property within the meaning of section 49(1). The Appellant argued that clause 3 of the will did not create a settlement or an interest in possession but merely gave directions to the trustees to allow Mr and Mrs Harrison a licence to occupy the house. Alternatively, the Appellant argued that, if Mr Harrison were beneficially entitled to an interest in possession in the house, then that interest was enjoyed also by the three residuary beneficiaries under the will and so Mr Harrison's interest in possession was in one-quarter only of the value of the house.

6. Accordingly, the issues for determination in the appeal were:

(1) whether Mr Harrison was, at the date of his death, beneficially entitled to an interest in possession in the house within the meaning of section 49(1); and, if so

(2) whether Mr Harrison's interest subsisted in one-quarter only of the house.

The evidence

7. The Appellant produced a small bundle of documents and the Respondents produced another small bundle which contained a statement of agreed facts.

The facts

8. From the evidence before me I find the following facts.

9. Prior to 1980 the testator and his wife, Mrs Dorothy Adams, resided in the house and Mr and Mrs Harrison resided in another property in Skegness known as Green Lodge, Gibraltar Road. Mr Harrison was a chartered accountant. The two couples were well known to each other. Neither couple had children.

10. During the 1970s the testator had a stroke and suffered physical disability but otherwise recovered. Mrs Adams became progressively senile.

11. Mrs Adams made her will on 15 December 1976 appointing the testator, Mr Harrison and a Mr Rothery to be her executors. Mrs Adams died on 17 November 1980 and her will was proved on 24 March 1981 by Mr Harrison and Mr Rothery with power reserved to the testator. At this time Mr Harrison assisted the testator with financial matters as a result of which the testator renounced all interest under the will of Mrs Adams and the estate of Mrs Adams was distributed. One quarter of the residue was distributed to Mrs Harrison.

12. The testator made a new will on 9 December 1980. By clause 1 he appointed Mr Harrison and the Appellant to be his executors and trustees. By clause 2 he bequeathed a number of legacies which are not in issue in this appeal. Clause 3 read as follows:

"3. I GIVE the following directions to my Trustees concerning my property known as 1 Seacroft Square Skegness aforesaid (referred to as "the house") and the furniture in it:

(a) The said Fred Harrison and Annie Cuthbertson Burns Harrison or the survivor of them for the time being still living may live in the house and have the use of the furniture as long as he she or they so wish

(b) Until the said Fred Harrison and Annie Cuthbertson Burns Harrison have in the opinion of my Trustees ceased to live in the house permanently neither the house nor the furniture shall be sold without their consent or the consent of such one of them as may for the time being still be living in the house and I direct that the said Fred Harrison shall be entitled to give or withhold his consent for his own benefit absolutely whether or not he is at that time a trustee of this my Will and so long as they or either of them shall continue to occupy the house and use the furniture they or such one of them as may still be occupying the house and using the furniture shall be responsible for all outgoings affecting the house including repairs and for keeping the house and furniture insured with an insurance company to be approved by my trustees against such risks as are normally covered by a householders comprehensive policy and such other risks (if any) and to a value not less than such value as my Trustees may from time to time require but my Trustees shall not be responsible for ensuring that these obligations are carried out and my Trustees shall not be bound to take or require an inventory of the furniture

(c) After the said Fred Harrison and Annie Cuthbertson Burns Harrison have both ceased to occupy the house and use the furniture then the house and furniture shall be held by my Trustees upon and subject to

the trusts affecting my residuary estate as hereinafter defined."

13. Clause 4 gave all the testator's property "not otherwise disposed of by this my Will" to his trustees on trust for sale and to hold the proceeds, after payment of the funeral and testamentary expenses, upon trust for the testator's niece Berice Slack, his nephew Charles William Adams and the Appellant (the residuary beneficiaries) in equal shares absolutely.

14. The testator died suddenly and unexpectedly on 16 March 1981. The Appellant lived 200 miles away and so Mr Harrison took the lead in the administration of the estate. On 6 May 1981 Mr Harrison wrote to the Appellant (and also to the other residuary beneficiaries) with his proposals for moving into the house. Those proposals were that Mr and Mrs Harrison would pay the cost of certain additions and improvements which they wished to carry out together with the cost of certain repairs and re-decorations. All the proposed expenditure was itemised. The letter continued;

"The value of all such expenditure to pass immediately to the estate of R C Adams, decd, subject, of course, to our own right to the beneficial occupation and use under the will during our lifetime and that of the survivor."

15. The letter concluded by asking the Appellant for his formal approval to the proposals.

16. On 21 May 1981 Mr Charles Adams wrote from Australia. Mr Adams said that he had telephoned Ms Berice Slack and had read Mr Harrison's letter to her. The letter said that both the writer and Berice were in full favour of the proposals. On 6 June 1981 the Appellant also wrote to Mr Harrison saying that he was in agreement with Mr Harrison's proposals for settling in at the house. That letter continued:

"I will aim to keep in touch with you personally, at least once a year, to see that all is well with you, and to review any of the arrangements that we may think necessary, and to make a positive check of the insurance cover for the house and contents attributable to the R C Adams estate."

17. On 4 June 1981 probate of the testator's will was granted out of the Nottingham District Probate Registry to two executors, Mr Harrison and the Appellant.

18. On 17 November 1981 Mr Harrison and the Appellant as the personal representatives of the testator assented to the vesting in themselves of the house upon the trusts

declared in the testator's will.

19. On 20 January 1982 Mr Harrison wrote to the Appellant and said that he had spent over £12,000 on alterations and decorations at the house which would enhance its value.

20. Mr and Mrs Harrison lived in the house until Mrs Harrison died. Mr Harrison remained there until he died on 16 August 1998. The house was sold in December 1998 for £87,000 and the proceeds divided between the three residuary beneficiaries. A sum was deposited with the Capital Taxes Office to cover any prospective tax liability.

The arguments for the Appellant

21. The Appellant argued that Mr and Mrs Harrison had enjoyed a licence to use the house and did not have an interest in possession. Clause 3 of the will did not give the property to the trustees but only gave directions to the trustees to permit Mr and Mrs Harrison to have rights of occupation of the house if they so desired. It was clause 4 which disposed of the property under the will. He and Mr Harrison, as the trustees of the will, had used their discretion and their authority under the will to permit the occupation by Mr and Mrs Harrison. There had been an agreement with Mr and Mrs Harrison in May 1981 relating to the expenditure and improvements under which Mr and Mrs Harrison had been given a licence and permission to use the house under certain agreed conditions. The permission had been granted under the executors' powers rather than being an entitlement under the will.

22. Alternatively the Appellant argued that, if Mr Harrison had enjoyed an interest in possession at the date of his death, it was shared with the three residuary beneficiaries. Each year the capital value of the house increased and as a result the interests of the three residuary beneficiaries also increased.

The arguments for the Respondents

23. For the Respondents Mr Twiddy argued that the house was settled property within the meaning of section 43(2)(a) of the 1984 Act as it was held in trust for persons in succession. Further, an interest in possession existed if a person had a present right to present enjoyment and he cited *Pearson v IRC* [1981] AC 753 at 775E; [1980] STC 318 at 325 and *IRC v Lloyds Private Banking Limited* [198] STC 559 at 566 a and d. After the death of the testator Mr and Mrs Harrison were not entitled to any income of the house but were entitled jointly to the use and enjoyment of it within the meaning of section 50(5). After the death of Mrs Harrison the only person entitled to the use and enjoyment of the house was Mr Harrison and at the date of his death he had the present right to the present enjoyment of the house. It was clause 3 of the will which

gave them permission to reside in the house. Clause 3(c) was significant as it provided that it was only after Mr and Mrs Harrison had ceased to occupy the house that it was to be held as part of the residuary estate. That meant that none of the three residuary beneficiaries shared the right to occupy the house. The residuary beneficiaries had vested future interests, namely present rights to future enjoyment.

Reasons for decision

24. In considering the arguments of the parties I start with the terms of the will. Clause 3(a) gives Mr and Mrs Harrison the right to live in the house as long as they wished. Clause 3(b) provides that the house could not be sold without the consent of Mr and Mrs Harrison or until they had ceased to live in the house permanently. Clause 3(c) provides that only after the survivor of Mr and Mrs Harrison had ceased to occupy the house was the house to be held on trust for the residuary beneficiaries. In my view the will does not give the trustees any dispositive power to decide whether or not Mr and Mrs Harrison should occupy the house and in what way, whether it be by way of licence or otherwise; rather it directs the trustees to permit Mr and Mrs Harrison to occupy the house if they wish to do so.

25. With that conclusion in mind I consider the authorities cited by Mr Twiddy. In *Pearson* Viscount Dilhorne referred to the following words of Lord Reid in *Gartside v IRC* [1968] AC at 607:

"In possession" must mean that your interest enables you to claim now whatever may be the subject matter of the interest. For instance, if it is the current income from a certain fund your claim may yield nothing if there is no income, but your claim is a valid claim, and if there is any income you are entitled to get it; but a right to require trustees to consider whether they will pay you something does not enable you to claim anything. If the trustees do decide to pay you something, you do not get it by reason of having the right to have your case considered; you get it only because the trustees have decided to give it to you."

26. Applying those principles to the facts of the present appeal I find that at the date of the death of the testator both Mr and Mrs Harrison had the right to claim to occupy the house jointly with each other. That right was not a right to ask the trustees to consider whether they would permit occupation. In my view, the trustees had no discretion as Mr and Mrs Harrison were entitled to occupy the house; their right did not depend on what the trustees did or did not do. That leads to the conclusion that, at the date of his death Mr Harrison had the present right to the present enjoyment of the house and he had an interest in possession.

27. In *Lloyds Private Banking* reference was made to the

drafting of a will and Lightman J at page 566 held that it was necessary to look not only at the terms of the will but also their purpose and effect. A clause in a will could be dispositive and confer a life interest, even though dressed up as a set of administrative provisions. What was decisive was the substance of the provisions and not the clothes or label they wore. In this appeal the drafting and language of the will is in terms of giving directions to the trustees but its purpose and effect was to confer on Mr and Mrs Harrison an interest in possession which, on the death of Mrs Harrison, vested solely in Mr Harrison.

28. The Appellant argued that Mr Harrison had only a licence to use the house under an agreement entered into by the correspondence of May 1981. In my view, that correspondence took place on the basis that Mr and Mrs Harrison were entitled to occupy the house under the will. Although the will provided that they had to pay for repairs, they were seeking permission to make certain improvements as well. Indeed, Mr Harrison's letter of 6 May 1981 relies specifically upon his right to the beneficial occupation under the will

29. The Appellant argued, in the alternative, that Mr Harrison's interest in possession was shared with the three residuary beneficiaries. However, during Mr Harrison's life, the three residuary beneficiaries did not have any interest in possession. They were not then able to claim any interest at all in the house. The fact that the house increased in value no doubt affected the value of their reversionary interests but they had no interests in possession.

Decision

30. My decisions on the issues for determination in the appeal are:

(1) that Mr Harrison was, at the date of his death, beneficially entitled to an interest in possession in the house within the meaning of section 49(1); and

(2) that Mr Harrison's interest subsisted in the whole of the house and not in one quarter only.

The appeal is, therefore, dismissed.

32. In accordance with section 224(5) of the 1984 Act the determination appealed against is confirmed.

DR NUALA BRICE

SPECIAL COMMISSIONER

Released: 30th May 2001

SC3041/01