TC01747

Appeal numbers TC/2009/15217

Income tax – Settlor interested trust – Trust income consisting of payments made by settlor – Whether settlor is liable to tax on trust income by virtue of s 660A Income and Corporation Taxes Act 1988 – Yes

FIRST-TIER TRIBUNAL

TAX

OLAF ROGGE
JOHN MARTIN KENT
J M KENT SETTLEMENT **Appellants**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JOHN BROOKS (TRIBUNAL JUDGE)
JO NEILL (MEMBER)

Sitting in public at 45 Bedford Square, London WC1 on 23 November 2011

Terrance Morris FCA of Lansburys International Limited for the Appellants

Matthew Slater, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. We heard the appeals of Mr Olaf Rogge (TC/2009/15217), Mr John Martin Kent (TC/2009/15221) and the J M Kent Settlement (TC/2009/15219) together, under reference TC/2009/15217, in accordance with the direction of the Tribunal released on 19 February 2010.

2. All three Appellants were represented by Mr Terence Morris of Lansburys International Limited. The Respondents ("HMRC") were represented by Mr Matthew Slater of counsel.

3. Before examining each appeal we first consider the issue that is common to all three appeals, namely whether a settlor, who has an interest in a trust, can be assessed to income tax, under s 660A(1) of the Income and Corporation Taxes Act 1988 ("ICTA"), where the income arising under the trust consists of payments made by the settlor. In short, whether payments made by a settlor can be taxed as his income.

4. Section 660A(1) ICTA provides:

> *Income arising under a settlement during the life of the settlor shall be treated as the income of the settlor and not as income of any other person unless the income arises from property in which the settlor has no interest.*

5. Mr Morris contended that on a literal reading of S 660A ICTA and on adopting a purposive approach it is impossible for a taxpayer to be taxed on his own expense and the law could not have intended such a situation to arise.

6. Mr Slater accepts that while the assertion that a taxpayer cannot be taxed on his own expense may apply in the case of the profits of a 'mutual trade' which do not attract tax under Case 1 of schedule D, (s 18 ICTA) he contends, and we accept, that the exemption from tax of the profits of a mutual trade has no wider application. *Salisbury House Estates v Fry* (1930) 15 TC 266 confirms that the different schedules of the Income Tax Acts are mutually exclusive so that any exemption from tax as trading income is not automatically extended to any other head of income. In addition the 'mutuality' principle which applies for Case 1 of schedule D is specifically excluded from rental income assessable under schedule A by virtue of s 21C ICTA.

7. In relation to the approach we should adopt to interpret and apply s 660A(1) ICTA, Mr Morris referred us to *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 where, after a review of the authorities in relation to the "Ramsay principle" by the House of Lords, it was said, at [36]:

> "Cases such as these gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As

Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35:

> "[T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

8. Mr Morris contended that when viewed "realistically" s 660A ICTA cannot apply to the circumstances of these appeals as it would result in payments made by a person being treated as his income. However, Mr Morris was unable to cite any authority in support of this construction of s 660A ICTA.

9. The only authority to which he did refer us was *Williams v Singer* [1921] 1 AC 65 which, as Mr Slater pointed out, is distinguishable on the facts from the present appeals. Unlike the cases before us, in which payments were made to trustees, *Williams v Singer* concerned the liability to tax of UK resident trustees in respect of foreign income not received by the trustees in the UK but paid directly to the beneficiary domiciled abroad and not liable to pay UK tax.

10. For HMRC, Mr Slater submitted that it was possible for a settlor to be subject to income tax on payments he had made and referred us to *Commissioners of Inland Revenue v Leiner* (1964) 41 TC 589 ("*Leiner*") and *Ang v Parrish (Inspector of Taxes)* [1980] STC 341 as authorities for such a proposition.

11. In *Leiner*, which was an appeal by Commissioners of Inland Revenue against a decision of the Special Commissioners, it was contended that the effect of s 397 of the Income Tax Act 1952 was that an annual payment of £2,040 made by Mr Leiner to the trustees of a trust established by his mother for the benefit of his son must be treated for surtax purposes as his income. Section 397 provided:

> *Where, by virtue or in consequence of any settlement to which the Chapter applies and during the life of the settlor any income is paid to or for the benefit of a child of the settlor in any year of assessment, the income shall, if at the time of the payment the child was an infant and unmarried, be treated for all purposes of this Act as the income of the settlor for that year and not the income of any other person.*

12. Plowman J who found Mr Leiner to be a settlor in relation to the £2,040 a year he paid to the trust said, at 596, "since that sum has been applied for the benefit of a child of the Respondent [Mr Leiner] in my judgment section 397 applies and this appeal succeeds."

13. *Ang v Parrish* was the appeal by a taxpayer against a decision of the General Commissioners that £2,200 which he had paid under two deeds of covenant was "income arising under a settlement" by virtue of s 454(1)(3) of the Income and Corporation Taxes Act 1970 that accordingly was "investment income" within s 32(3) of the Finance Act 1971 and fell to be included as such in the taxpayer's total income for the purposes of excess liability under s 457 of the 1970 Act. Walton J dismissing the taxpayer's appeal said, at 348-349:

> "… counsel submits that in the taxpayer's accounts with the Revenue he is entitled to show on the credit side 'Income arising under the settlement' and on the debit side 'Payments under the two deeds of covenant paid out of the income arising under the settlement per contra, thus leaving the earned income position wholly unchanged by the manoeuvres forced on him by s 457.
>
> This is a very attractive argument indeed, and it is with considerable regret that I find myself unable to give effect to it. The crucial difficulty which I feel is that there is no income arising under the settlement until sums due under the covenants have in fact been paid. In other words, there is a situation in which payment A must of necessity be made before receipt B arises. This is, of course, not the case in any manner with the kind of case in which the *Allchin* principle applies. It is not, of course, the timing as such which is important (I have no doubt that in an *Allchin* case the profits might all have been earned subsequent to the payments being made), but the logicality: the necessity that payment A be made before receipt B arises as a matter of absolute and incontrovertible necessity.
>
> As an alternative, the matter might perhaps be put in this way, namely that the section says that the income arising from the settlement is to be part of the settlor's income. If it is to be part of his income, it cannot also at the same time be appropriated to something which is going to be deducted from his income. Or, if it is, the deduction will be nugatory, as that income itself will still, according to the wording of the section, remain his income. So that the only effect of appropriating the income of the settlement to meet the sums due on the covenant would be to increase the taxpayer's total liability for income tax by the basic rate on the settlement income.

14. Having considered these authorities, we accept that *Leiner* and *Ang v Parrish* support Mr Slater's argument that it is possible for a settlor to be subject to tax on a payment that he, himself, has made and note that as decisions of the High Court both are binding on us.

15. Although not cited by the parties, guidance to statutory interpretation was given by Lawrence Collins LJ in *Harding v HMRC* [2008] STC 3499 where he said, at [51]:

> "The question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found, and the statutory provision should be given a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction answers to the statutory description: *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1, at [32], [36]. In particular, if a literal construction would lead to injustice or absurdity, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted: e.g. *Luke v IRC* [1963] AC 557, at 577; *Mangin v. Commissioner of Inland Revenue* [1971] AC 739 at 746; *Jenks v. Dickinson* [1997] STC 853. But there may be cases in which the anomaly cannot be avoided by any legitimate process of

> interpretation: e.g. *HMRC v Bank of Ireland Britain Holding Ltd* [2007] EWCA Civ 58, at [44]."

16. On a literal interpretation it would appear that s 660A(1) ICTA was intended to apply to trust income which in the case of a settlor interested trust is "*treated*" as income of the settlor and not as income of any other person. While this would not cause any difficulty in the case of income received from a third party we accept, as Mr Morris contends, that it appears to lead to an absurd conclusion when the payment to the trust was made by the settlor himself.

17. However, having considered whether the language of s. 660A(1) ICTA admits to an alternative construction which avoids the absurdity which we may then adopt in preference to the literal interpretation, we find that we are not able to do so as we are constrained by the words of s. 660A(1) ICTA itself. It would seem that the present appeals fall within those cases to which Lawrence Collins LJ referred in which the anomaly cannot be avoided by any legitimate process of interpretation.

18. We sympathise with Mr Morris when he says that this "cannot be right" and that when viewed "realistically" s 660A ICTA cannot apply to the circumstances of these appeals and recall the following passage from the Oxford Companion to Law by Professor David M Walker QC (1980) at pp 1207-8 which was quoted by Mummery LJ in *HMRC v Mayes* [2011] STC 1269 at [15]:

> … neither justice nor reason has any place in tax law, [which] … more than any other branch of municipal law … is open to the reproach of being utterly incomprehensible by the individuals affected, and even more frequently by their legal advisers.

19. We now turn to the appeals.

Olaf Rogge

20. Mr Rogge appeals against assessments to income tax of £20,246.40 for 2001-02 and £22,322.88 for 2002-03. These assessments arise out of interest paid by Mr Rogge to the trustees of the Olaf Rogge Discretionary Settlement in respect of a loan made to him by the trustees.

21. His grounds of appeal, as stated in the Notice of Appeal to the Tribunal are:

> Given the wording of section 660A Taxes Act 1988 the interest income of the offshore trust cannot be liable to income tax in the hands of Mr Rogge as he is the payer of that interest.

22. There was an agreed Statement of Facts as follows:

(1) The Olaf Rogge Discretionary Settlement ('the Settlement') was created by a Declaration of Trust ('the Trust Instrument') dated 15 August 1985 and made by D H & S Trustees (Jersey) Limited (now Abacus Trustees (Jersey) Ltd ('the Trustee').

(2) The Settlement is non UK resident; it was established under, and is governed by Jersey law. Mr Olaf Rogge is himself a UK resident non-domiciliary.

(3) Clause 5(a) of the Trust Instrument gives the Trustee a power to distribute the income or capital of the Settlement and, subject to that power, Clause 5(a) imposes a trust to accumulate the income and add the accumulations to capital.

(4) Schedule 2 to the Trust Instrument states that the beneficiaries are the Appellant [Olaf Rogge] and the Jersey Association for Youth and Friendship.

(5) On 5 February 1998, the Trustee added five persons to the class of beneficiaries of the Settlement. On 6 February 1998, the Trustee removed the Jersey Association for Youth and Friendship from the class of beneficiaries of the Settlement.

(6) The Trustee entered into a loan agreement ('the Loan Agreement') with Mr Olaf Rogge on 9 January 2001. The recitals record that the Trustee has loaned to Mr Olaf Rogge the sum of £1,000,000 (one million pounds) and Mr Olaf Rogge has agreed to acknowledge his indebtedness to the Trustee. Pursuant to the operative term of [the] Loan Agreement the loan of £1,000,000 is stated to be unsecured, free of interest and repayable on demand.

(7) The terms of the Loan Agreement were subsequently amended and the loan became subject to interest at a commercial rate. Mr Olaf Rogge paid interest to the Trustee in the sum of £50,616 in the tax year period 2001-02 and £58,309 in the tax year period 2002-03.

23. As the parties have agreed that, depending on the outcome of this appeal, they will first seek to resolve the issue between them of whether the income, including interest, arising under the Settlement is UK source income, we have not considered this issue.

Submissions

24. For Mr Rogge, Mr Morris contended a person cannot be both payer and payee for income tax purposes.

25. Mr Slater's argument, for HMRC, proceeds by the following steps:

(1) The Trustee is the party entitled to and in receipt of the interest arising under the Loan.

(2) That interest is income arising under the Settlement.

(3) It not being in dispute that Mr Rogge is a member of the class of beneficiaries, the trust is a settlor-interested trust, with the consequence that s 660A ICTA is engaged.

(4) The effect of s 660A ICTA is that Mr Rogge is liable to income tax on 'income arising under a settlement.'

Discussion and Conclusion

26. Having concluded that a settlor, who has an interest in a trust, can be assessed to income tax under s 660A ICTA where the income arising under the trust consists of payments that he has made to the trustees, it must follow that Mr Rogge's appeal cannot succeed.

27. We therefore dismiss the appeal.

J M Kent and the J M Kent Settlement

28. These appeals concern assessments and closure notices issued by HMRC in relation to rent paid to the trustees of the J M Kent Settlement by Mr and Mrs Kent who occupy property owned by the trustees as their tenants. It is common ground that the rent paid to the trustees is income arising under a settlement.

29. Mr Kent appeals against assessments (1998-99 and 2000-01) and Closure Notices (1999-00 and 2002-03 to 2006-07) on the following grounds:

> Based on section 660A [ICTA] Mr Kent cannot be liable to income tax on rental income when he pays that rental himself.

30. Mr Kent also appeals in his capacity as trustee of the J M Kent Settlement in relation to assessments (1996-97 to 2000-01) and closure notices (2003-04 to 2006-07). The following grounds of appeal are stated on the Notice of Appeal to the Tribunal:

> Given the wording of section 660A [ICTA] the rental income received by the trustees is taxable only upon Mr Kent. There is an overlap with Mr Kent's personal appeals under the same reference number as to his personal liability.

31. An agreed statement of facts in these appeals is as follows:

(1) The J M Kent Settlement ('the Settlement') was created by a deed dated 10 March 1987 ('the Deed'), between (1) John Martin Kent, as settlor; and (2) John Martin Kent and his wife Philippa Kent ('Mrs Kent'), as trustees. Except for the period 1991-1998, the Settlement has been UK resident. Mr Kent is himself UK resident.

(2) The Deed contained two schedules. The first schedule sets out, in Part I, the property of the Settlement, which, at the date of establishment, comprised 45210 ordinary shares in EPG Computer Services Ltd and, in Part II, the beneficiaries, which, at the same date, comprised of Mr Kent, his wife and 'all issue of the Settlor whether living at the date hereof or born hereafter.'

(3) Clause 1 of the Deed stated that, subject to Clause 13, the Settlement was to be administered in England.

(4) Clause 9(1) of the Deed stated that 'the Trustees shall pay the income of the Trust Fund to the Settlor during his life.' Accordingly, Mr Kent has an interest in possession in the Settlement.

(5) On 3 February 1997, the Directors of Republic International Trust Company Ltd., the trust company, then acting as the trustee of the Settlement, resolved:

(1) to purchase from Mr Kent and his wife the property at 18 Morden Road, London, SE3 0AA ('Morden Road') for the sum of £265,000; and

(2) to permit Mr Kent and his wife to remain in occupation of Morden Road as tenants at a rent of £3,000 per quarter

(6) From February 1997, Mr Kent occupied property owned by the trustees and paid rent to the trustees in respect of his and his wife's occupation of property owned by the Settlement.

(7) In approximately July 2001, the trustees sold Morden Road having previously purchased a property at 56 Dovercourt Road, London SE22 8ST ('Dovercourt Road').

(8) For the period from July 2001 to 5 April 2007, Mr Kent and his wife occupied Dovercourt Road as tenants of the trustees at a rent of £1,500 per month (£4,500 per quarter).

Legislation

32. Insofar as it applies to the present appeals, s 15(1) ICTA provides:

> *The Schedule referred to as Schedule A is as follows:–*
>
> ***1**–(1) Tax is charged under this Schedule [Schedule A] on the annual profits arising from a business carried on from the exploitation, as a source of rents and other receipts, of any estate, interest or rights in or over land in the United Kingdom.*
>
> *(2) To the extent that any transaction is entered into for the exploitation as a source of rents or receipts of any estate, interest or rights in or over land in the United Kingdom, it is to be taken to be entered into in the course of such a business.*

It is not disputed that the rent received by the trustees in these appeals is chargeable to tax under Schedule A.

33. Section 21 ICTA provides:

> *Income tax under schedule A shall be charged on and paid by the person receiving or entitled to the income in respect of which the tax is directed by the Income Tax Acts to be charged.*

34. Section 660A(1) is set out at paragraph 4, above.

Submissions

35. Mr Morris submits that s 660A ICTA treats the trust income as being that of Mr Kent and no other person for all purposes of the Income Tax Acts and contends that Mr Kent cannot be both payer and payee for income tax purposes.

36. However, as Mr Slater points out, this is not quite factually correct as the rental payments are made by Mr and Mrs Kent as tenants of the trustees. Mr Slater's argument proceeds as follows:

(1) The trustees of the Settlement are the legal owners of Doverscourt Road and are then persons receiving the rent paid to them by Mr and Mrs Kent.

(2) The income tax on the net profits should, under s 21 ICTA, initially be paid by the Trustees, as being in receipt of income (see *Reid's Trustees v Commissioners of Inland Revenue* (1929) 14 TC 512).

(3) The trustees are taxable on the total trust income with no relief for trust management expenses (see *Aiken v Macdonald's Trustees* (1894) 3 TC 306).

(4) Mr Kent, as life tenant, is according to general principles of trust law, entitled to trust income, less trust expenses (see *Commissioners of Inland Revenue v Hamilton of Dalzell (Lord)* (1926) 10 TC 406, *Murray v Commissioners of Inland Revenue* (1926) 11 TC 133, *Macfarlane v Commissioners of Inland Revenue* (1929) 14 TC 540 and *Commissioners of Inland Revenue v Dewar* (1931) 16 TC 84).

(5) Mr Kent, under s 21 ICTA, is liable to pay income tax on all the trust income, less trust management expenses, to which he is entitled and is taxable on income whether or not he receives it (see *Baker v Archer-Shee* (1927) 11 TC 749).

(6) As life tenant of a settlor-interested trust s 660A ICTA is engaged.

(7) The fact that trust income is treated as that of the settlor under s 660A(1) ICTA does not remove the charge on the trustees as s 660D(3) ICTA provides that "*nothing in this chapter shall be construed as excluding a charge on the trustee as persons by whom any income is received*."

(8) In addition to the position under trust law the effect of s 660A ICTA is that Mr Kent is liable to income tax on the trust management expenses incurred by the trustees. Section 660A ICTA refers to 'income arising under a settlement' without limiting the charge to only that income to which Mr Kent is entitled under the general law.

37. In the alternative, Mr Slater contends that s 660A ICTA provides that the whole of the trust income is taxable on the settlor as s 660A ICTA does not explicitly restrict the charge to that part of the trustees' income which does not belong to the settlor in general law. He submits that s 660A ICTA overrides the income tax treatment which would otherwise apply, where the settlor was entitled to a life interest, as it would where a non-settlor was so entitled.

38. Mr Slater submits that the overall tax effect of both his primary and alternative arguments is identical. In a settlor-interested interest in possession trust the settlor is taxable on all the trust income, either on the net income under general trust law and on the trust management expenses under s 660A ICTA; or alternatively, on the whole of the trust income under s 660A ICTA.

Discussion and Conclusions

39. We have already concluded that a settlor of a settlor interested trust can be assessed to income tax on income arising under a trust under s 660A ICTA, even though that income consists of payment he has made to the trustees. Therefore, it is clear that the argument, advanced by Mr Morris, that a person cannot be a payer and payee for income tax purposes, cannot succeed.

40. We also do not accept the submission that, as s 660A ICTA treats the rent received by the trustees as the income of the settlor and not as the income of any other person, the trustees are not chargeable to tax.

41. Although under s 660A(1) ICTA the rent received by trustees "*is treated*" as the income of the settlor and not as the income of any other person, the trustees remain the "*persons receiving*" the rent and are therefore taxable under s 21 ICTA without any entitlement to deduct trust management expenses (*Aiken v Macdonald's Trustees*). This is consistent with s 660D(3) ICTA which specifically provides that "*nothing in this chapter shall be construed as excluding a charge on the trustees by whom any income is received*."

42. If Mr Slater is correct, the effect of s 660A ICTA is that Mr Kent is also chargeable to tax on all, as opposed to the net, income of the trust which consists of the rent he and Mrs Kent have paid to the trustees. We accept, albeit with some reluctance, that as s 660A(1) ICTA refers to "*income*" as opposed to "*profit*" (as does s 15 ICTA) it must follow that he is liable to tax on all of the rent paid to the trustees without deduction of trust management expenses.

43. Although Mr Slater has advanced two routes by which we may reach this conclusion we prefer his alternative submission which relies solely on s 660A(1) ICTA. Given the absence of any restriction or qualification to the words "*income arising under a settlement*" we consider that s 660A(1) ICTA must apply to all of the income arising under a trust and not just that which would not otherwise be chargeable to tax under the law relating to trusts.

44. As such neither Mr Kent's nor the trustee's appeal can succeed and the appeals are therefore dismissed.

45. We understand (from a letter dated 13 February 2006 from HMRC to Mr Kent's accountants) that in circumstances where s 660A ICTA applies and both the settlor and trustees are chargeable to tax, that it is HMRC's practice to tax the trustees up to basic rate and the settlor at higher rate on the excess to prevent a "double" charge to tax and hope that such an approach will be taken by HMRC in the present case.

46. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN BROOKS

TRIBUNAL JUDGE
RELEASE DATE: 12 January 2012

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 15 February 2012