A HISTORY OF THE ANTI-AVOIDANCE LEGISLATION APPLYING TO SETTLEMENTS FOR INCOME TAX PURPOSES

VOLUME 1

A thesis submitted for the degree of

Doctor of Philosophy

in the University of Glasgow

by

David Paul Stopforth FCCA FTII

Department of Taxation
Faculty of Law and Financial Studies

September 1988

ACKNOWLEDGMENTS

Much of the material upon which this study is based is held in the Public Records Office and I am indebted to the staff for their help and guidance in using the records under their care. For the period after 1956 most of the study is based on material held by the Office of the Parliamentary Counsel whose staff must be thanked for the speed and efficiency with which they attended to my requests and provided copies of correspondence. The financial assistance given by The Scottish Chartered Accountants Trust for Education to enable me to visit the Public Records Office and the Office of the Parliamentary Counsel was most welcome.

I am grateful to Eleanor Bruce and to all the secretaries in the Department of Accountancy and Business Law at the University of Stirling (Pat Norman, Jill Bruce, Elissa Elings, Elizabeth Sloss) who cheerfully assisted with the typing of this thesis. My thanks are also due to the many members of that Department who took an interest in what I was doing and gave me encouragement through the more difficult stages.

Finally, I wish to thank my supervisor, Professor Mervyn Lewis, for his guidance and assistance. Although the final version of the thesis has benefited from his constructive criticism of earlier drafts, any shortcomings which remain are my fault alone.

TABLE OF CONTENTS

A HISTORY OF THE ANTI-AVOIDANCE LEGISLATION APPLYING TO SETTLEMENTS FOR INCOME TAX PURPOSES

ABSTRACT

The main purpose of this study is to examine the growth and spread of income tax avoidance through the use of settlements and to analyse the background to the introduction of appropriate anti-avoidance legislation. Though there is much material available to explain the meaning of this legislation there is little to explain why it was introduced, what it was aimed at and why it took the form it did. This research fills that gap and in the process throws light on the nature of the relationships between the Inland Revenue, Parliamentary Counsel, the Chancellor of the Exchequer and Parliament. It also shows the influences each have in the policy-making and legislative processes. Although the focus is on settlements, some of the observations apply to avoidance generally and explain the development of the Revenue's attitude to it.

The research shows that the use of settlements for income tax avoidance was taking place at least as early as 1851 and became more worthwhile once graduation and super-tax were introduced. The real attraction to such avoidance came with the large and rapid increases in tax rates during the First World War. Anti-avoidance legislation, broadly in line with the recommendations of the 1920 Royal Commission, was introduced in 1922 but soon proved almost worthless. In 1927

a clause to prevent all tax relief for charitable covenants was, under pressure, withdrawn. Avoidance spread from the wealthy to the less wealthy until in 1936 its cost, in terms of revenue lost, had become unacceptably high, and legislation to prevent its most common form, (children's settlements) was brought in. Taxpayers adopted variations on a similar theme and following a threat of retrospective legislation most of the blatant forms of avoidance were blocked in 1938. This new legislation was a great success, though there were a few problem areas for the Revenue which were highlighted by cases coming before the courts. Any loopholes so discovered were quickly closed off. Restrictions on other classes of settlement were put forward by the Revenue to the new Labour Governments elected in 1945 and 1964, and many of their suggestions were taken up. Some of the changes to the legislation since 1977 have been relaxations to the provisions to alleviate their harsh manner of operation in certain restricted circumstances.

The main source materials for the research were the voluminous records of the Inland Revenue and the Treasury available in the Public Records Office,together with the files concerning the drafting of the legislation held in the Office of the Parliamentary Counsel. Subsidiary sources were parliamentary debates and papers and contemporary journal articles, books and press comment.

The analysis has been taken up to April 5, 1988.

CHAPTER 1

INTRODUCTION

SCOPE AND PURPOSE OF THE STUDY

The sections which make up Part XVI of the Income and Corporation Taxes Act 1970, (ICTA 1970), and those other sections of that Act which operate by reference to it, are a set of anti-avoidance provisions introduced piecemeal from 1922 onwards in response to the development of specific methods of avoidance involving settlements. They do not have relevance only to trusts, because in most cases they are drawn widely enough to encompass dispositions, covenants, agreements and arrangements in which a trust is merely incidental, and even cases in which there is no trust at all. The provisions also extend to settlements made abroad and to sources of income not situated in the UK.

Some indication of the importance of Part XVI could be obtained if the number of new settlements coming under review by the Revenue each year and the number of technical challenges made under those provisions were known. Unfortunately, the Inland Revenue were unable to produce such statistics without very considerable cost, but they were able to provide the following figures relating to non-charitable covenants.

New Deeds Of Covenant*

Year To 30 September	Deeds To Minors	Deeds To Adults
1981	16,000	60,000
1982	21,000	84,000
1983	36,000	85,000
1984	37,000	87,000
1985	46,000	90,000
1986	53,000	100,000
1987	49,000	100,000

*Estimated to the nearest 1000

Source: Extracted from letter to the writer from Inland Revenue Claims Branch dated July 28, 1988.

The number of technical challenges made against these covenants in the year ended September 30, 1986, was just over 6,000 with an estimated tax saving of £4.7m. The equivalent figures for the following year were 5000 and £2.6m.[1] The only year for which an analysis of these technical challenges to covenants could be provided by the Revenue was for the year ended September 30, 1983, in which 64.45% related to section 434, 10.68% to section 437, 0.42% to sections 445 and 450, and 24.45% related to other causes, (mainly failure to seal).[2]

Incomplete though the above information is, it does show how attractive this form of avoidance seems to be, and how dangerous Part

XVl still is for those who are reckless enough to ignore its terms, or so badly advised that they fail to manoeuvre round the obstacles it creates to the successful use of settlements for income tax avoidance.

The purpose of the research is to examine the historical development of this form of avoidance and of the corresponding anti-avoidance provisions in order to determine the aims of the legislation and to explain the circumstances which led to the introduction and refinement of each of its parts. It attempts to show why the provisions took the form they did and to give an insight into the attitudes, thought processes and events which shaped them. Through the fairly narrow perspective of the income tax settlement provisions will be seen the factors which stimulated avoidance, its spread amongst taxpayers, and the Revenue and Government reaction to it.

The development of an institutional structure by the Revenue to detect avoidance will be shown, as will the active role they played in bringing forward proposals for anti-avoidance legislation and in influencing its underlying policy, form and detail. There has been no coherent policy governing the nature of the legislation but rather the policies and principles have been developed by the Inland Revenue as new problems have arisen. The Inland Revenue have sometimes, (particularly in the earlier years), had to wait a long time for the opportune moment to put forward their suggestions, and although they seem to have a keen sense of knowing minister's minds, public attitudes and the political acceptability of their proposals, it is often the cost to the Exchequer of the particular form of avoidance which has been the major spur to legislation. In more recent years the Revenue seem to have met no resistance to their suggestions for almost immediate action to deal with any flaws discovered in the existing legislation.

The passivity of most Chancellors might cause surprise as many give the impression of mere "rubber stamping" of detailed and persuasive arguments put forward by the Inland Revenue whose considerable power is based upon their technical and tactical expertise. There have however, been rare but important occasions when Chancellors have prevented the Revenue from getting what they wanted. Furthermore, although the influence of Parliament on the anti-avoidance legislation has been minimal, some non-government amendments have resulted in changes to the proposals and an indirect influence has always been exerted through the restraint and moderation caused by fears of excessive parliamentary criticism. Even when the eventual legislation has been satisfactory to the Inland Revenue it has often, particularly in the case of the earlier provisions, failed to achieve its objective, and such failures have been reflected in the increased sophistication of later legislation. The Inland Revenue has been characterised in the thesis as an entity which displays such human characteristics as learning from its mistakes, having a memory and its own culture and values. It has matured as its experience of tax avoidance methods has increased.

Analysis of the "travaux preparatories", though not permitted as an aid to the interpretation of the statute, gives a useful but limited view into the minds of those who created the legislative text. This can give reassurance as to its meaning, but unfortunately although "the assiduous academic commentator can act in this way, (subject to the problem of access to confidential official records), the practical lawyer cannot".[3] The emphasis has therefore not been upon using background materials as aids to interpretation, but more as aids to understanding the legislative process, the influences upon it and the relationships between those involved in formulating the legislation. By so doing, a more rounded explanation of the objectives of the provisions can be given.

CONTRIBUTION

The thesis contributes to knowledge in a variety of ways. It shows the aims of the settlement legislation and the reasons for the refinements which have been made over the years. It accounts for the development of the Inland Revenue's attitude to avoidance in general through the microcosm of its experience of the settlement anti-avoidance provisions. It shows what great power the Revenue can have in the policy-making and legislative process and the factors conducive to their obtaining that power. The insights given into the workings of the "corporate mind" of the Inland Revenue are important in helping to judge the way it will react in future situations, and given its influence on tax legislation, provide considerable explanation for the eventual shape of that legislation. Some aspects of the detailed account of the process of producing tax legislation and of the behaviour and tactics of the administration may prove useful to those who wish to influence that legislation.

METHOD OF APPROACH AND LIMITATIONS

The main approach used was to analyse archival data, particularly that available in the Public Record Office and the Office of the Parliamentary Counsel, together with reports of parliamentary debates and papers presented to Parliament. These primary sources were used in combination with reports of tax cases and with journal articles and press commentary to gain a full picture of the state of the relevant income tax law immediately before the introduction of each new anti-avoidance provision, the nature and extent of the avoidance being used, public and professional awareness of it, and the reaction of the administration to its discovery. By bringing these materials together in one place the thesis presents a systematic study of the process by which one part of the anti-avoidance legislation has evolved from the time the various "abuses" and faults of the existing system were detected by the Inland Revenue and examines how well that legislation has met its objectives. The legislation and case law is only explained as part of the process of achieving the main purpose of the research and a familiarity with the relevant law is assumed.

A major limitation of the research is that the thirty year closure rule prevented the examination of files in the Public Record Office after 1957, and that the department's discretionary power to impose a 50 year, 75 year and even 100 year closure has been frequently used by the Inland Revenue.[4] It seems likely however, that in general, extended closures have been used mainly for files involving personal details rather than for those relating to policy matters, and that therefore possibly little of major importance has been missed, but some of the class descriptions of closed files did indicate that they might have been relevant.

Fortunately, and rather surprisingly, it was found that the Office of the Parlimamentary Counsel was prepared to grant access to their files right up to May 1979. The writer's experience of earlier years shows that much of the material on the closed post-1957 Inland Revenue and Treasury files will be on the Parliamentary Counsel files, and that the latter files will thus give sufficient details to be able to deal with later years adequately. However, it is probable that there is considerable preparatory material on the closed files concerning the need for legislation, statistics and options considered, and it must therefore be borne in mind that all analysis and commentary relating to 1958 onwards (Chapters 9 to 11) has been subject to this constraint.

REVIEW OF RELATED RESEARCH

There are four main classes of research related to the subject matter of this thesis; that which deals with the history of income tax; that which deals with tax avoidance generally; that which specifically deals with the settlement provisions; and that which deals with the formulation of tax policy. Although all four have in varying degrees been useful, their approach can be distinguished from that used in this study.

The general works on the history of income tax[5] concentrate on the overall development of the income tax system through an analysis of the strategy of the various Budgets, the reaction to them, and the political and economic climate in which they were introduced. In doing so they, and the more specific papers which focus on one Budget or one Chancellor,[6] make more than passing comment about the development of anti-avoidance legislation, but can hardly go into the details of any specific provision. They are essentially dealing with matters on a "macro" level, and because of this they rarely refer to those detailed papers in the Public Record Office or the Office of Parliamentary Counsel which had to be examined in order to carry out research at the "micro" level required for this thesis. Nevertheless, they provide an essential background and context within which this study is set, and are based upon some of the same source materials.

Research concerning tax avoidance as a whole is of two types, historical and legalistic. To provide a detailed history of income tax avoidance would be a gargantuan task, and although nobody has yet undertaken it, a valiant attempt to give a popularised account of the subject was made by Oliver Stanley.[7] Settlements were, however, largely dealt with by giving brief accounts of the major (and simpler) tax cases.[8] The legalistic research considers the merits of the different approaches available for dealing with tax avoidance and often proceeds on the basis of a comparison between countries.[9] It also concerns itself with judicial attitudes to avoidance.[10] Neither of these aspects of legalistic research has been examined in this thesis.

The third class of research is that which provides an analysis of the statute and case law concerning settlements, and in some cases goes on to provide advice on how to skirt round these provisions and gives appropriate wording for the drafting of deeds.[11] Such an approach does not involve an attempt to explain why the provisions were brought into effect and as this thesis does not provide a detailed account of the operation of the sections or an analysis of the case law, (except where it explains some later anti-avoidance provision), the two approaches are fundamentally different.

Perhaps the most relevant class of research to that in this study deals with the tax policy-making environment and the way in which tax policy is formed.[12] As Robinson and Sandford[13] point out "we have little idea how our tax system came to be as it is - whether as a result of economic forces, political ideology, bureaucratic power, or other influences". Their analysis attempts to deal with this through an examination of the introduction of new taxes and shows that politicians set the goals for these taxes and that the civil servant's role was largely to flesh out their proposals and in doing so they did not perform "innovative and imaginative functions".[14]

This study shows an entirely different aspect of policy-making. It does not deal with new taxes but with specific anti-avoidance provisions, and shows the Inland Revenue not only taking the initiative for introducing the legislation but also proposing the policy and working out the detailed procedural rules. It indicates that at the more "micro" and less political level, the policy-making process is quite unlike that found for the introduction of new taxes. The methodology used by Robinson and Sandford was to analyse a wide variety of documentary evidence relating to new taxes introduced between 1964 and 1976 and to interview many of those who were directly involved, but they could not examine the Inland Revenue or Treasury files due to the thirty year closure rule.

The primary materials upon which this study is based have not been used for this purpose before, and therefore there is no directly relevant prior research literature to review.

ORGANISATION OF THE STUDY

Chapters 2 to 11 present an analysis of the subject matter over almost 190 years in broadly chronological order with each chapter focusing on a period whose length has been determined according to the introduction of some important aspect of the legislation. The analysis stops at April 5, 1988 and references to the current legislation are therefore to the Income and Corporation Taxes Act 1970 (ICTA 1970). Copies of the relevant clauses and schedules of the Finance Bills prior to 1970 are provided in the appendices in volume 2 together with copies of the sections eventually enacted.

Chapter 2 sets the scene for the introduction in 1922 of the first efforts at the anti-avoidance provisions, by analysing the early evidence of the use of settlements and the changes in the tax system which may have encouraged their spread. It gives some indication of how the Inland Revenue's attitude towards avoidance changed between the time income tax was introduced and the time they gave evidence to the 1920 Royal Commission on Taxation. It shows how the introduction of graduation and super-tax followed by the rapid rise in tax rates during the First World War and a hardening attitude to evaders caused a major stimulus to widespread avoidance.

The following chapter shows how, after a curious delay, a slightly modified version of the Royal Commission's proposals regarding settlements were put to the Chancellor, agreed to, clothed in statutory language and put before MP's, many of whom clearly had little understanding of the complex and detailed provisions they were being asked to consider.

Chapter 4 examines the way in which the 1922 provisions were within a few years easily circumvented and how a Cabinet Committee was formed to consider the whole problem of tax avoidance. The implementation of the Committee's recommendation to remove all tax relief for payments under charitable covenant proved to be so contentious that the proposed legislation was withdrawn. Nothing further was done to modify the 1922 provisions and the professional journals and eventually the newspapers spread detailed information on how to get round them so that by 1936 this form of avoidance was widespread and costly to the Exchequer.

The process by which the Inland Revenue built up statistics of the extent of the problem, (at least in respect of settlements on children), and persuaded the Chancellor of the need for action and battled unsuccessfully to get their own way is the subject of Chapter 5.

Chapter 6 shows how despite the Chancellor's threat of introducing retrospective legislation to block such schemes, avoidance methods hardly used in 1936 spread rapidly through the medium of journals and newspapers so that by 1938 further legislation became necessary. New provisions were introduced to deal with revocable settlements, (now S445-446 ICTA 1970), settlements in which the settlor retained an interest, (now S447 ICTA 1970), annual payments to trustees which were not distributed by them, (now S450 ICTA 1970), and capital sums paid to the settlor in cases where income had been accumulated in the settlement, (now S451 ICTA 1970) and these, together with their supplementary provisions, make up a major and important part of the whole code. The process leading to this legislation contained some extraordinary elements, with the Chancellor receiving advice from a barrister concerning how this form of avoidance could be stopped once and for all, the draft Budget statement being circulated amongst some of the Chancellor's trusted friends, various individuals attempting to draft appropriate legislation, and the Parliamentary draftsman having great difficulties in producing a satisfactory form of words for section 451.

The following chapter demonstrates how the rather unsophisticated level of professional advice and the changed public attitudes to avoidance contributed towards the success of the 1936 and 1938 legislation in preventing the avoidance at which it was aimed. However, a potentially dangerous loophole in connection with settlements involving joint settlors was discovered as a result of the case of Herbert v. CIR[15] but it was closed with retrospective effect on rather flimsy grounds of principle by means of declaratory provisions which are now in sections 436, 442 and 452 of ICTA 1970.

The eighth chapter shows that despite the continuing success of the original provisions, the Inland Revenue were quick to put forward two further radical restrictions relating to certain classes of settlement when the new Labour Government was elected in 1945. Though the Government accepted both proposals without resistance, and the attack on the Duke of Westminster class of avoidance received no direct criticism, the removal of surtax relief for payments under charitable covenants was of an altogether different character. Even though it could hardly be classed as tax avoidance it was presented as such, and this caused considerable resentment and contentious argument in Parliament. The proposal emerged unscathed and obtained statutory effect in what is now section 458 ICTA 1970.

Although the period 1946 to 1958 involved a much reduced level of legislative and case law activity relating to settlements, Chapter 9 indicates that there were nevertheless two highly significant events. Firstly, the consolidation in 1952 created a defect which was not discovered until five years later, and secondly, the Revenue's loss of the case of Saunders v. CIR in 1957[16] was the first major failure of the 1938 provisions. The Revenue reacted to these dangers with great speed, and though they had some difficulty in obtaining exactly what they wanted, their perseverance resulted in them not only getting their own way, but also in the introduction of further anti-avoidance legislation, (now section 448 ICTA 1970), before any known cases of avoidance had arisen. The chapter also illustrates how it can be politically acceptable to make minor changes to related legislation at the same time as major changes elsewhere, even though there is no direct interdependence between them and the minor alterations would not otherwise have obtained parliamentary time.

Chapter 10 deals with the eight years to 1966, a period in which a recurrent theme was the changes to the settlement provisions consequent upon alteration to the tax legislation in other areas and in which the settlements legislation was first applied to another tax by being forced in an unsatisfactory manner to encompass short term gains. Even with a Labour Government committed to attacking "notorious avoidance and evasion devices",[17] the Inland Revenue's major review of tax avoidance through settlements in late 1964, merely resulted in the removal of surtax relief for virtually all covenants and income transfers the following year, leaving their other suggestions to be introduced in modified form a few years later, or to be ignored. The harsh provisions dealing with covenants and income transfers created anomalies and difficulties which were serious enough to result in retrospective relaxations being introduced in 1966.

One of the salient features of the penultimate chapter is the continuation of the process of making adjustments to the settlement provisions and applying them to other areas whenever new legislation, like restrictions on relief for interest paid, was introduced. However, the short-lived aggregation of children's income with that of its parent introduced by the Finance Act 1968, and the permanent repeal of relief under section 228 of the Income Tax Act 1952, were responses to arguments put forward by the Revenue in the 1964 review mentioned above. The Labour Government's weakness in 1977 led them to be persuaded by the Liberals to introduce relaxations to the settlement provisions in their application to maintenance funds for historic buildings and these relaxations were later extended by the Conservatives. A loophole pointed out by the draftsman in 1965 was eventually exploited in the early 1970's by the reverse annuity scheme, which, once discovered by the Inland Revenue, was quickly stopped by the Finance Act 1977. It was not until 1980, when a flaw was found in section 451 ICTA 1970, that the Revenue came forward with a consultative paper concerning its modification, despite the considerable judicial criticism of the section's draconian manner of operation many years earlier.[18]

The final chapter draws conclusions from the detailed research and attempts to analyse and explain trends, to draw together the connecting factors and to make explicit the patterns which have emerged from the study. An indication of the usefulness of what has been done is given, and finally some brief suggestions for further related research are provided.

CHAPTER 2

1799-1920: FACTORS LEADING TO THE USE OF SETTLEMENTS FOR AVOIDANCE AND TO EVENTUAL ANTI-AVOIDANCE MEASURES

INTRODUCTION

The potential for tax avoidance using settlements has been available right from the very introduction of income tax and the evidence shows that it was not long before the loophole was exploited. The Inland Revenue initially had a very relaxed attitude to such avoidance and were far more concerned about the fact that evasion was widespread and difficult to detect. Avoidance was probably thought of by many taxpayers as being unnecessary when evasion was simple, relatively risk-free and achieved their aims.

A major stimulus to tax avoidance came in the early part of this century when the Revenue obtained greater powers to assist them to detect evasion and the penalties imposed became more severe. When this was combined with the imposition of graduation, super-tax, and sudden and very large increases in tax rates, many taxpayers appear to have been drawn into tax avoidance, and professional expertise began to develop to assist them.

By the end of the First World War, the Revenue's attitude to avoidance had hardened considerably and the damning evidence on the use of settlements which they presented to the 1920 Royal Commission resulted in recommendations for anti-avoidance legislation.

EARLY EVIDENCE OF THE USE OF SETTLEMENTS FOR AVOIDANCE: 1799-1903

The Potential Attraction

Although the income tax introduced in 1799 was charged at the rate of 10%, various outgoings, like annual interest and annuities, were deducted in computing the total income upon which that charge was made. These deductions in combination with the fact that incomes under £60 where exempt, and graduated rates of tax were applied up to £200 before the full 10% was charged, meant that the system contained a defect because it would have been possible to avoid tax by creating settlements. These could take such simple forms as the transfer of assets to others within the family or the granting of annuities to them.[1] The ease with which the tax was evaded[2] would possibly have led many people to merely evade rather than avoid it, but nevertheless the fundamental flaw upon which much tax avoidance was later based was inherent in the income tax system right from the start.

The greatly modified income tax introduced in 1803 was much more difficult to evade because it was based on the principle of taxation at source. This may have led taxpayers to actively seek out means of avoidance, and settlements would certainly have been very effective for this purpose, due to the exemption of incomes under £60 and the abatements applying up to £150. Initially the full rate of tax was only 5%, but with avoidance being so easily achieved it was probably still considered worthwhile. In 1805/06 the full tax rate was increased to 6¼% and in the following year to 10%; a rate which applied until the abolition of the tax in 1815.

Evasion had apparently become so widespread, and so many persons had been declaring their income to be just under the £60 exemption limit, that it was decided, in 1806/07 to reduce that limit to £50 so that those who had made returns at just under the £60 limit in the previous year would find difficulty in showing a sufficient reduction in their income to obtain exemption.[3] The total income tax yield for 1806/07 was double that for the previous year, and even after allowing for the increased rate of tax and reduced exemption limit, it is clear that a considerable number of evaders had effectively been caught. It is very likely that these new payers of income tax, finding evasion a little more difficult, became all the more attracted to avoidance.[4]

In 1842 income tax was reimposed by an Act which was largely a reprint of the Act of 1806,[5] but with the limit of exemption for individuals raised to £150 and the tax rate fixed at seven pence in the pound.[6] By present day standards one might think that with such a low rate of tax avoidance might not have been considered worthwhile, but it must be taken into account that once total income reached £150 the whole of it became liable to tax, and therefore at the margin avoidance had a considerable attraction.

<u>Evidence Put to the Select Committees of 1851 and 1852</u>

Evidence taken before the Select Committee on Income and Property Tax in June and July 1851[7] indicates that there was indeed a considerable amount of avoidance taking place.[8] Although the committee spent more time discussing evasion, (in the strict sense), than avoidance the few references there are to methods of avoidance often relate to settlements. The creation of a charge on income by means of an annuity was apparently very common, as was the transfer of property to children and relatives, other than the wife,[9] as can be seen from the following exchanges in the in the Minutes of Evidence to the Select Committee.

> Question 226 Mr. Henley.(A member of the committee)
> "How do you distinguish between what you have termed an evasion and a fraud?"
>
> Charles Pressly.(A Commissioner of Inland Reveue)
> "I made use of the word avoidance; a man having £160 a year may charge his estate with an annuity of £20 a year to his child; I do not call that an evasion of the duty at all; I think it is perfectly legitimate; I think he avoids the payment of the duty."
>
> Question 2387 Mr. Henley
> "Have you any other cases about Schedule A?"
>
> Mr. J. Hyde.(A Surveyor of Taxes)
> "I have only ways and manners in which parties get off; some in one way and some in another by contrivances, what we call avoidance; these two cases are under Schedule D; one is that of a clerk to rather an important gentleman, whose salary was £150 a year, and he publicly asked his master to reduce it below, to get off the list; that is a common case now."
>
> Question 2388. Mr. Henley.
> "What is the other case?
> Mr. J. Hyde.
> Another is a case of an annuitant selling a sixpence out of the £150 to get it off."

One of the special Commissioners (Mr. Hyde) gave a good example of the kind of avoidance which was taking place:-

> "... a farmer who is the owner and occupier of a farm at £140 per annum ... would be assessed at £4/1/8d under Schedule A for the value and at £2/-/10d for the occupation, under Schedule D. His son, ... was employed upon the farm; he ostensibly makes the son his tenant, by which means the father can claim the £140 for the value of the farm, and the son can claim under Schedule D as the occupier at £140. The exemption runs up to £300 a year .... I believe that was done in Derbyshire to a great extent, and in other parts of the country, after the first year. This is what I would describe perhaps as a legal avoidance; it is not a fraud; it is merely the management."[10]

Hyde told the Committee that this kind of avoidance occurred quite frequently, and argued that taxpayers freely admitted to doing so because they thought such avoidance to be fair and reasonable.[11] The Committee explored the possibility that such transactions were not bona fide because they were fraudulent, but the Revenue explained that there were no means of disproving that such transactions were bona fide.[12]

The Revenue officials thought that avoidance by bringing income under the £150 exemption limit had increased considerably since income tax was first imposed.[13] When asked whether taxpayers had begun to look upon the tax as permanent rather than temporary and therefore considered it more worth their while to make avoidance arrangements[14] the Revenue did not directly reply, but merely drew attention to the fact that more people were making small repayment claims than had previously done so because they had not taken the trouble of making a claim when they thought that the tax was only temporary.[15] This reflects a change in the behaviour of taxpayers which is likely to have been more fundamental than a changed attitude to repayment claims. Once they considered income tax as a permanent feature of their financial affairs many more taxpayers probably began to create settlements to avoid it and it is possible that this was partly responsible for the increase in repayment claims.

The 1851 Select Committee merely made a one page holding report and suggested that a further committee should be appointed. The following year their suggestion was taken up, but the 1852 Committee spent most of its time considering alternative forms of taxation rather than the detailed operation of the existing system, and there is no mention of income tax avoidance in the Minutes of Evidence.[16] However, the Comptroller of Legacy Duties did indicate that there had been a considerable increase in the number of deeds of gift of personal property, and particularly stock, which was often put into joint names.[17] By this means not only was legacy duty being avoided, but in many cases probably income tax as well.

Although there is little direct evidence of avoidance besides that provided by the Revenue, there were certainly many people whose circumstances would have made avoidance very attractive. The Head of the Statistical Branch of the General Register Office advised the Committee that there were 341,000 individuals with incomes of £150 per annum or more in 1848. Of these, 105,000 had incomes in the range £150-£200 per annum[18] and the temptation for them to use avoidance to bring their income below the £150 exemption limit must have been quite strong.

The Effects of Permanancy And Rate Fluctuations

The Income Tax Act of 1853 made major changes to the system but made it clear that the tax was intended to expire on April 5, 1860. It is suggested that this was a long enough period to cause individuals to go to the trouble of taking avoidance measures; especially when it is considered that there was a reduction in the exemption limit from £150 to £100. Reduced rates of tax were applied where the income fell between £100 and £150 and for 1853/54 the lower rate was five pence while the higher rate was seven pence. It was intended that these rates would be reduced over the seven year period for which the tax was imposed but on the declaration of war with Russia it became necessary to double them with effect from 1854/55. A further increase took place in 1855/56 taking the lower rate to eleven and one half pence and the upper rate to one shilling and four pence; rates which also applied in the following year. One shilling and four pence was the highest income tax rate ever reached until the outbreak of war in 1914.

The doubling of the rate of tax in 1854/55 and the further increase in 1855/56 may well have been the stimulus for a considerable extension in the use of simple avoidance techniques but there is no direct evidence of this.[19] The relatively high tax rates were, however, short-lived, and by 1857/58 they were reduced again to their pre-war levels.

Although another Select Committee on Income and Property Tax was appointed in 1861[20] with the same terms of reference as the previous two, it concentrated its attention on some fairly radical proposals for modifications to income tax put forward by the Committee Chairman and did not consider avoidance. However, Inland Revenue officials did indicate that they believed that evasion of income tax was rife, but because of lack of information powers, extremely difficult to prevent.[21] Once again, the Committee made no proposals for amendment of income tax[22] and a long period of stability in the income tax system was to follow.

In the fifty years from 1859 to 1909 tax rates varied between two pence and one shilling and three pence in the pound "as poverty or plethora dictated"[23] so that until the Finance Act of 1909-10 introduced super-tax together with a slight element of progression in the tax rates, the pay-off from avoidance would have been very small. Additionally, in 1863, the lower rate of tax on small incomes was replaced by a system of abatements where incomes exceeded the limit for exemption and this would have further decreased the attraction of avoiding tax where the exempt limit was marginally exceeded. However, evasion continued, according to the Inland Revenue, to be "very considerable".[24]

Although there had been expectations of the abolition of income tax (and in fact a promise of its abolition to the Electorate of 1874) by 1876 "even that modest ambition was abandoned"[25] and with income tax looking like a permanent tax, many individuals probably began to consider taking permanent measures to avoid it.

Evidence From The Revenue's Internal Files

In the period from 1851 to 1904 there is a dearth of internal Inland Revenue documents concerning tax avoidance,[26] though fragmentary evidence of the use of settlements is available in some of the Public Record Office files. This lack of materials may indicate the relative rareness of such forms of avoidance and some support for this is given in a memorandum by the Board of Inland Revenue to the Cabinet Tax Evasion Committee in 1926 when the Cabinet was informed that,

> "the incentive to legal avoidance may almost be said to have begun with the high rate of taxation imposed during the war. It has been practiced since that time probably to a steadily increasing extent."[27]

Despite what the Board reported there is some evidence concerning the use of settlements prior to the 1914 War in the Revenue's "Precedent Books" which set out brief details of certain technical cases which had been considered by specialists at Head Office. The book for the period 1892-1910[28] contains the following separate entries:-

> "Minors - claim made by father, no trust and no absolutely definite statement as to nature of interest or amount expended. Mr. Stoodley [Secretary for Stamps and Taxes to the Board of Inland Revenue] considered that there was no doubt as to money being minor's own and accepted the view that all the income was expended. The claim ultimately passed."

> "Minor children - income arising from shares transferred to their names and shares purchased in their names (Scotland). The solicitor's opinion on the facts of this case is that delivery of the property to the children has been proved. Claim accordingly admitted under Board's Order 3rd October 1886."

The decision in the latter case was taken in 1896[29] but it is clear that questions had arisen in the past concerning the effectiveness or otherwise of transfers of income to children and that the Board had laid down guidelines in 1886 as to how such cases were to be treated.

The other evidence is all rather negative.[30] Although a file giving details of precedents and practice notes for 1903[31] contains no references to any relevant matters and neither do the files containing the Solicitor's opinions and reports for the years 1906-1908 inclusive,[32] at least this is some evidence of the relative lack of importance of settlements at that time.

Miscellaneous Evidence

The relatively unsophisticated nature of the tax advice given by professionals can be seen from the correspondence and articles in their journals for the latter part of the nineteenth century.[33] No doubt this ensured the restrained nature of avoidance in this period and that information concerning successful avoidance schemes spread only very slowly through the professions.

The Revenue estimated that the number of UK taxpayers was fairly steady at between one million and 1.3 million between 1840 and 1882.[34] By 1883 the number had reached 1.5 million, but by 1901 five million people were estimated to be liable to income tax.[35] This dramatic increase in the number of taxpayers over a very short period of time may well have stimulated an interest in tax avoidance for those who came within the tax net for the first time.

Transfers of income to charities in order that they could reclaim the tax deducted eventually came to be considered as a major problem by the Revenue, but there is little evidence of such transfers prior to the First World War. Even if such transfers did take place their effect must have been rather insignificant because according to a Special Commissioner who gave evidence to the Hume Committee in 1851, only £24,960 was repaid in total to the 3,334 charities making claims.[36] Evidence from after the First World War refers back to the pre war period and gives support for the view that transfers of income to charities was not common.[37]

Any loss of tax arising through settlements was apparently not of major concern to the Inland Revenue, because if it had been, they would almost certainly have found some cases worthy of fighting in the courts on the grounds that the income transfer was ineffective. The Tax Cases contain no evidence of such an attitude being taken until the case of CIR v Wilson[38] in 1927, and although reported cases may only represent the tip of an iceberg, the scarcity of references to such avoidance devices in the files at the Public Record Office does seem to indicate that the number of cases in which the Revenue considered litigation but decided not to go ahead was probably negligible.

SIGNIFICANT CHANGES IN THE SYSTEM AND IN THE TAX RATES

Although there was little to provoke widespread income tax avoidance in the latter half of the nineteenth century, by the end of the First World

War changes had taken place which produced a major stimulus for taxpayers to find ways to reduce their liability. These changes took place in two stages; firstly, by structural alterations in the ten years before the war, and secondly by major increases in tax rates during the war.

Re-appraisals Lead To Important Changes To The Tax System

The first important step towards change was the appointment in 1904 of the Departmental Committee on Income Tax[39] which enquired into the desirability of alterations in the income tax system under various headings, including the prevention of fraud and evasion.[40] Although the terms of reference refer to fraud and evasion the Minutes of Evidence[41] show that the Committee treated avoidance as a form of evasion.[42]

Detailed examples of classes of avoidance were provided in a memorandum submitted by Sir Thomas Hewitt, a King's Counsel[43] who had been Clerk and Counsel to the Commissioners of Taxes for the City of London for a period of over 22 years. He described the methods used to avoid tax as forms of legal evasion.

> "Other numerous cases of evasion are those effected with the assistance given by the decided cases under the Income Tax Acts, and the careful evasion, after careful study by the taxpayer of the Acts and decided cases, of the fair incidence of the tax on profits which ought properly be charged."[44]

There is no mention in the Report or the Minutes of Evidence of the avoidance of tax by settlements, but it is clear that Sir T. Hewitt believed that all forms of avoidance were extending considerably. "I know it is so. I can speak absolutely and positively."[45] On being asked whether non-liability following tax avoidance was recognised by the Inland Revenue he replied:-

"We have been trying hard to see that it is not recognised, because it is so grossly unfair. The Inland Revenue should be looked upon as representing the other taxpayers, and its interest is to protect those who pay the taxes against frauds or evasions by those who do not. It is in that relationship that the Inland Revenue has taken up the cudgels and have said that these persons to all intents and purposes are liable."[46]

This is perhaps the first clear sign of the Inland Revenue's antipathy towards avoidance and their determination to challenge its effectiveness and is in stark contrast to the neutral attitude of the officials giving evidence to the Select Committee in 1851, who seemed to believe that avoidance was merely the sensible arrangement of a persons affairs.[47] Perhaps the best illustration of the changed attitude is the response of Hewitt to the question of whether the law was in a satisfactory condition.[48]

"I consider that strong measures should be taken to put down all trickery to evade what is the plain duty of every man having the protection of the government".

Hewitt told the Committee that the avoidance he had described to them had arisen within the previous 5 years. He could offer no explanation for its growth, but rather surprisingly, stated that he did not believe that increases in the rate of income tax had been the main cause of it.[49] Given the evidence on the behavioural effects of rate increases on repayment claims (see below) his views are a little suspect.

Settlements could at this time only be used to benefit from further exemptions or abatements which would not otherwise be utilized by members of a person's family or others. With income tax being deducted at source, repayment claims would have beeen necessary in cases where income had been transferred to another person for avoidance purposes. In 1904, total repayment was available where the income did not exceed £160, while abatement was available where income did not exceed £700. The virtual doubling of the rate of income tax from eight pence in 1900, to one shilling and threepence in 1902, was accompanied by very large increases in the numbers of claims to repayment. The total number of repayments made in the year to April 5, 1904, was 435,000, (of which over 70% related to exemption claims by individuals, while only 1% related to charities),[50] an increase of just over 100% in four years.[51]

It might be thought that this rapid growth in repayment claims was related to transfers of income to avoid the increasing rates of tax, but this was not the explanation given to the Committee by the Inland Revenue. The Principal of the Income Tax Repayment Department at Somerset House thought that the chief cause of the increase in the number of claims was that those who had considered it hardly worth their while making claims when the tax rate was eight pence did think it worthwhile to claim when the rate was increased.[52] He did concede that there were other causes, citing the increase in population and changes in the distribution of wealth, but did not specifically refer to settlements.[53]

Given a background of rapidly increasing tax rates and a climate in which some forms of tax avoidance were beginning to grow and spread, it seems likely that the exploitation of the exemption and abatement limits would begin to take place, and this may have contributed to the changes in the distribution of wealth mentioned above. However, obtaining a tax repayment was neither a simple nor a speedy matter,[54] and the claimant would often be troubled with various queries before repayment would be made. These factors must have weighed against creating settlements to avoid small amounts of tax.

To some degree there is probably a relationship between avoidance and the extent to which evasion is possible with little risk of detection. As the probabililty of detection of evasion, as perceived by the evader, is increased, more evaders will probably replace their illegal activities by avoidance. In 1905 there apparently was "abundant evidence to show that, in the sphere in which self-assessment is still requisite, there is a substantial amount of fraud and evasion"[55] Revenue officials apparently had evidence showing "that grossly insufficient returns, or no returns at all, are made over long periods of years with impunity, the probability of detection being slight until some event occurs to bring the true facts to light ...."[56] The Revenue thought that their powers to obtain information in order to detect evasion were totally insufficient and that even if an evader was caught the penalty powers and period for which recovery could be made were "far from adequate".[57] It was believed that "many persons or their advisers, and their number is increasing rapidly, are aware of the very limited powers of the department, and therefore refuse to make restitution."[58] The evader was therefore in a very strong position in that the risk of detection was slight and even if detected, the penalty was relatively insignificant. As the Committee record "even in cases of persistent and deliberate evasions of duty, continued it may be, over a long series of years, only a small portion of the evaded duty can be legally recovered and only very insignificant penalties can be inflicted when the fraud is finally detected."[59] The Committee recommended the extension of the time limit for recovering back duty from one year, to three years after the end of the year assessment involved, and that the maximum penalty should be treble the duty for the whole period involved rather than for the one year to which penalties could at that time be applied. Furthermore, they recommended an extension to the Revenue's information powers concerning income from employment.[60]

The Committee's suggestions relating to evasion were implemented in 1907 and heralded the beginning of a major shift in the manner in which evaders were detected and dealt with. This may have driven many erstwhile evaders into avoidance.

The pace of change was gathering speed and a Select Committee was set up in 1906 to enquire and report "upon the practicability of graduating the income tax and differentiating between permanent and precarious incomes".[61] This Committee had a major influence on the radical changes which occurred over the following few years because it concluded that graduation by way of a superimposed tax (super-tax) was practicable if it was confined to larger incomes and that differentiation between earned and unearned income was feasible by charging a lower rate on earned income.

Differentiation was introduced in the Finance Act 1907[62] but a return of total income was required in order to claim the benefit of the lower rate of tax on earned income.

Graduation was introduced by the Budget of 1909 with the imposition of a super-tax on individuals with incomes over £5,000. The rate of tax was sixpence in the pound on the income in excess of £3,000, but as it was estimated that there were only 12,500 taxpayers with income in excess of £5,000,[63] few people were expected to be affected. The same Budget increased the income tax rate on incomes exceeding £3,000 to one shilling and two pence but there were no other major changes in income tax or super-tax, except for certain super-tax loopholes being closed, until the last Finance Act before the outbreak of war in 1914. That Finance Act reduced the exemption limit for super-tax to £3,000 and introduced a graduated scale of super-tax up to a maximum of one shilling and fourpence on incomes exceeding eight thousand pounds. It also switched income tax to a graduated scale; from ninepence on earned income of £1,000 or less, to one shilling and two pence on earned income exceeding £2,500 with the rate on unearned income being fixed at one shilling and two pence. The maximum rate of tax was therefore approximately thirteen percent on unearned incomes exceeding £8,000; a level at which the shoe began to pinch.

Even with these tax rates, as Lloyd George pointed out, although avoidance was possible, much of it "was not worthwhile".[64] as the inconvenience of tax avoidance was in many cases not justified by the small tax savings obtained; a point emphasised in 1911 in perhaps the first published article entirely devoted to the subject of avoidance.[65] However, none of the seven examples of methods of avoidance in the article involved any form of settlement. Although readers were reminded to satisfy themselves as to the honesty as well as the legality of avoidance schemes, and to remember "that what is legal is not necessarily honourable,"[66] within a few years, questions of honour would have been overshadowed by the very considerable increases in tax rates and the consequent attractions of tax avoidance.

Rate Increases Magnify the Attraction of Avoidance

By the introduction of a super-tax and the attack on evasion, the seeds of widespread avoidance were sown, but it was not until the major increases in tax rates were imposed in order to assist in the financing of the First World War that avoidance grew and blossomed. Between 1913-14 and 1918-19, the standard rate of income tax increased from 1s.2d to 6 shillings,[67] and the rate of super-tax increased from a flat 6d in the pound to a top rate of 6 shillings in the pound on incomes above £30,000 per annum.[68]

Other factors were also at work. The lowering of the income tax exemption limit from £160 per annum to £130 per annum in 1915 when combined with the rapidly rising level of wages, brought into assessment a greatly increased number of individuals[69] There was more than a three-fold increase in the number of individuals charged to income tax over the period 1913-14 to 1919-20.[70] The reduction in the limit below which super-tax was not payable from £5,000 in 1913-14 to £2,000 by 1921/22 led to an increase in the numbers liable to super-tax from 14,000 to 93,000 while the super-tax charged over this period increased over twentyfold[71]

The effect these income tax and super-tax changes had upon various classes of individual can be seen from Appendix A5. The unmarried individual whose sole income was from investments and who was liable to super-tax in 1920-21 (income exceeding £2,000) had on the assumption of no change in his income, suffered an increase in tax of between 450 and 700 percent, and the married individual with three children and whose income was all earned and who was liable to super-tax had suffered broadly equivalent increases. It seems unlikely that the relatively well-off individual who received the major part of his income from investments would have been able to maintain his real income with a rapid price inflation and a major portion of any increased profits available to pay his dividends being eroded by excess profits duty or the munitions levy. With a shrinking disposable income due to taxation and the real value of that income being eroded by inflation those individuals with investments must surely have felt a considerable burden and may well have attempted to maximise the family income through the creation of settlements.[72]

There had also been a dramatic shift in the relative burden of taxation towards the more wealthy. In 1912 the indirect taxes produced 42% of all revenue and direct taxes 53%, but by 1918 indirect taxes produced only 18%, with direct taxes accounting for82%[73] Increases in the indirect taxes were relatively insignificant and could hardly be said to have borne harshly upon anything other than the very smallest of incomes.[74] Larger incomes clearly bore the brunt of the increased total tax burden and it was this that lead to claims that they were "already inequitably overtaxed"[75]

A further push towards avoidance was provided by the manner in which graduation of the income tax rates operated prior to the Finance Act of 1916. Once the income exceeded the limit for any particular lower rate of tax, the next rate was applied to the whole of the income. A similar situation could arise where an individual ceased to be entitled to an exemption or abatement or became entitled to a reduced exemption or abatement on account of his income exceeding a certain limit. Section 32 of the Finance Act 1916 rectified this position by introducing a marginal relief but prior to this such a gross inequity occurred that those adversely affected would probably have been strongly inclined to take any necessary action to avoid the inequity.

Between 1914 and 1919 the rate of estate duty more than doubled on estates with a value in excess of £350,000, but the duty was easily avoided by making gifts inter vivos provided they were made more than 3 years before death. With an effective rate of duty of 23% on an estate of £200,000 and 30% on £1,000,000 and, as high as 40% on £2,000,000, the combined effect of income tax, super-tax and the potential estate duty probably created a powerful force towards the spreading of assets within the family.

Although excess profits duty and the complementary munitions levy were not easily avoidable, they may, because of their very high rates,[76] have caused businessmen to do whatever they could to reduce the income tax and super-tax liabilities on their other income. It is reasonable to assume that efforts to find ways of avoiding excess profits duty had a knock-on effect upon income tax avoidance.

Over the period 1914 to 1920 various changes to the income tax system were made which were aimed at mitigating the high nominal rates of tax particularly for those with low incomes. However, there were some changes which increased liability or reduced the scope for avoidance. The child allowance, which had been re-introduced in 1909, was doubled in 1914 and was again increased in 1915 so that its value became the tax on £25. No allowance was given if the total income of the taxpayer in 1915/16 exceeded £500.[77] There was no scaling down of the child allowance where the child had income in its own right and therefore transfers of income to children could be made without any adverse effect upon the parent's tax liability, and each child would be able to utilise its own personal allowances and lower rates of tax.[78]

The Finance Act 1918 introduced the Married Man's Allowance and the Housekeeper and Dependent Relative allowances, but they were unavailable to those with incomes in excess of £800.[79] The married man with children and with no super-tax liability, suffered a much less severe increase in his tax liability, and may have been less inclined towards avoidance.[80]

The Finance Act 1920 removed the income restrictions on these allowances and provided that all allowances should be given as reductions from gross income (except for super-tax purposes) thereby giving relief at the marginal rate.

For the payer of super-tax, not only had the rate of tax increased and the threshold of income decreased with no personal allowances being given, but the Finance Act 1916 had removed the right to deduct life assurance premiums in calculating the income liable. More sophisticated means of avoidance would therefore have had to be used.

Up until 1911, where income was accumulated during the period of minority of a child with a contingent interest, then when the minor came into possession of the property, he could claim repayment of income tax on the income accumulated over the whole period of minority, provided that he was entitled to exemption or abatement for each of the tax years involved.[81] In 1911 the Inland Revenue changed their view on this and were refusing to make repayments on the grounds that such accumulated income could not be regarded as the income of any individual and that in fact it had become capital.[82] The effect of this change of practice must have been to strongly discourage the creation of such trusts and to encourage transfers under which the child had an immediate entitlement to income. However, as the original position was reinstated by Section 14 of the Finance Act 1917 the accumulation settlement probably came back into vogue.

The position at the end of 1919 was well described by Sir Josiah Stamp.

> "Taxation is now rapidly developing from a merely unpleasant incident into a dominating feature of daily life, and those features which hitherto have been of little interest, because they have been too small to matter, now become of great importance; the blemishes which were insignificant may now be intolerable simply because in the magnitude of the burden they have become sufficiently magnified or intensified to be within the range of ordinary human feeling."[83]

CLOSING IN UPON WIDESPREAD EVASION

Those dissatisfied by the level of taxation could either pay up and complain, attempt to evade it, or take steps to avoid it. The evidence discussed below indicates that evasion was widespread but it also shows that the Inland Revenue were becoming better at detecting evaders and that some of those who were caught were receiving well publicised jail sentences.

The Minutes of Evidence of the 1920 Royal Commission on Income Tax[84] indicate that the Inland Revenue were still attempting to "taint" avoidance by referring to it as part of evasion.

> "Evasion may result from at least four causes (a) fraud (b) wilful withholding or misstatement of material facts (c) ignorance or carelessness and (d) legal avoidance."[85]

The Revenue's explanation of the main reasons for systematic evasion were as follows:

(a) the absence of any serious social disgrace attaching to successful evasion.

(b) the absence of adequate powers of investigation;

(c) a feeling of injustice engendered by the belief that income tax contained many anomalies needing correction;

(d) a widespread impression that other taxpayers were evading their just liability; and

(e) the high rates of tax.[86]

If these were reasons for evasion (in the strict sense) then they were all the more strongly reasons for avoidance.

It is always difficult to accurately estimate the extent of evasion but the evidence submitted to the Royal Commission suggests a broadly held belief that evasion was both widespread and considerable.[87] Evasion of super-tax was a relatively low risk matter prior to the Finance Act 1922 because the Revenue had no power to obtain any detailed information on how an individual's total income was made up.

The Revenue presented statistics to the Royal Commission which showed the total amounts of unassessed income tax, including compounded penalties, recovered in England and Wales.

Year ended 31st March 1914	£229,000
Year ended 31st March 1915	£260,000
Year ended 31st March 1916	£415,000
Year ended 31st March 1917	£929,000
Year ended 31st March 1918	£1,227,000
Year ended 31st March 1919	£1,216,000 [88]

Revenue officials did point out that the rapid increase in the rates of tax explained a considerable part of the increase in the amounts of back duty recovered, but thought it probable that the actual amount of income concealed in the year ended 31st March 1919 was not less that two or three times the corresponding amount for the year ended 31st of March 1914.[89]

The view that evasion was widespread and considerable was not merely one held by the Inland Revenue. Evidence submitted to the Royal Commission on behalf of the London Chamber of Commerce indicates their belief that large amounts of tax were lost through evasion[90] but no concrete evidence was provided.[91] Contemporary authors on taxation also believed that evasion was rampant. A typical statement is that by Sir Josiah Stamp:-

> "On the whole I am inclined to think that the general sentiment of tax honesty in this country was rapidly improving prior to the war. But the fever of profit making and the high rates of taxation brought about a bad relapse, and it has recently been estimated that the loss in income tax and excess profits duty in the last few years has amounted to one hundred million sterling."[92]

In the light of all the evidence the Royal Commission concluded that it was beyond question that serious evasion of income tax existed.

> "Although a taxpayer is obliged by law to make a return...in many cases a return is in the nature of things capable of only a partial or imperfect check, and when this is known or suspected by a taxpayer he is tempted to speculate on the chance of escaping detection if the return is inaccurate. He may not always be guilty of fraud; he may be culpably careless; he may decide every doubtful point in his own favour by deliberately refraining from inquiry; he may cultivate a profitable ignorance or a negligence that is not free from guile."[93]

The Committee believed there was so much tax evasion already discovered "with the imperfect means now at the disposal of the authorities" that there must have been much tax evasion which had not been discovered.[94] They thought that the greatly increased rates of tax and the imposition of the excess profits duty had exposed the taxpayer to much more serious temptation.[95] It is difficult to comment upon the statements of the Royal Commission because evidence was put before them on the subject which was "undesirable to describe in detail" but which "fully convinced us that there is a serious loss of revenue caused by fraud, negligence and ignorance."[96]

The extent of super-tax evasion (as opposed to income tax evasion), was not so fully discussed in the Minutes of Evidence or in the report of the Royal Commission. The absence of sufficient powers to detect evasion and the lack of any internal system to enable evaders to be caught, when coupled with the shortage of trained staff due to the war, probably resulted in a very low risk of a super-tax evader being detected.[97]

The Royal Commission were "perfectly convinced that with the present rates of tax, the hands of the authorities must be strengthened in the difficult task of discovering inaccuracies"[98] and believed that the powers of investigation of the Inland Revenue were extremely limited "and there can be no doubt at all that the knowledge of this limitation is taken advantage of by the unscrupulous".[99]

As might be expected during a period of war, the public's attitude towards evasion became highly critical. "The Accountant" for this period contains regular references to prosecutions for tax evasion and the correspondence columns leave little doubt as to the adverse public attitude to evaders.[1] The Royal Commission commented that the views expressed by witnesses unconnected with the Revenue on the necessity of measures to catch and deter evaders "were even more vigorous and far reaching than those put forward by witnesses who represented the Revenue," and that there was a growing feeling among the community against evaders so that the public would accept a more stringent administration.[2]

It was during the war years that the Inland Revenue began the regular prosecution of tax evaders. They thought that successful prosecutions, and particularly imprisonments, had radically altered the public attitude towards evasion and that taxpayers were no longer proud of the fact that they had defrauded the Revenue.[3]

The journals of the period show plentiful examples of criminal prosecutions. In 1914, the first prosecution of a chartered accountant by the Board of Inland Revenue (for furnishing false accounts) is fully reported in "The Accountant".[4] This must have had a considerable effect upon the attitude of accountants towards clients whom they suspected of evasion and may even have encouraged them to put forward means of avoidance to such clients.[5] In August 1919 "The Accountant" carried a report that the 'Daily Mail' contained a reference to the formation of a special body of Surveyors for the purposes of investigating evasion. The war against evaders had begun in earnest.

PROFESSIONAL EXPERTISE STARTS TO DEVELOP

From around 1910 onwards, the professional journals show that there was a greatly increased interest in taxation. More and more technical questions were dealt with by the journals and "The Accountant" even set up a regular column "in view of the increasing importance of income tax...and the expanding individual practices in the matter caused by the taxpayer realising the advantages of professional assistance in a subject of such intricacy...."[6] This column quickly established itself as a major source of advice to accountants and many of the queries they raised concerned the efficacy of simple tax avoidance schemes. The sophistication and know-how of accountants on tax matters increased rapidly, and so much so that by August 1922 the following note appeared in the Accountant.

> "In view of the increasing complexity of the problems submitted to us we have still further strengthened the advisory committee by whom such problems are considered. The organisation now placed at the disposal of our readers is an expensive one, and it involves a rearrangement of our scale of fees."[7]

The standard of professional advice on tax matters seems to have improved dramatically before the end of the war and simple tax avoidance schemes were being discussed in the journals.[8] With tax rates having increased so much and with evasion having become both unacceptable and risky, tax avoidance was the main escape route. The professions dealing with tax matters began to adopt a frame of mind which did not just accept tax liabilities as inevitable, but which actively searched out methods of tax minimisation. This could be said to be the period in which the tax avoidance industry was born.

The first evidence in "The Accountant" of the use of settlements for tax avoidance appears in a letter at the end of 1913.[9]

> "A had income from investments of over £7,000 per annum. To avoid paying income tax he transfers in proper form to his children paying the full stamp duty on the considerations, sufficient capital to reduce income below £5,000. Dividends received by the children from the shares in their names are handed by them to their father. A has been advised that these payments by his children are in the nature of gifts and are not part of his income, and that his income for super-tax is less than £5,000 per annum. It is true that the payment of the dividends by the children is a voluntary act and could not be enforced by the father. Are you of the opinion that the super-tax returns would be correctly rendered excluding the dividends received from the children?"

The journal's "legal contributor" provided the following published reply.

> "If the payment by the children to the father is really a voluntary contribution which they may withdraw at any time and which they are under no obligation to make, I agree that super-tax is not payable. If, however, on the true facts of the case it is either payable as a charge on the property of the person paying the same by virtue of any deed or otherwise or as a reservation thereout or as a personal debt or obligation by virtue of any contract within Section 1 and 2 of the Act of 1842, the tax would be payable."[10]

The airing of such problems and the authoritative answers obtained must have given confidence to tax advisers so that such practices would become more widespread. Further queries of a similar nature arose occasionally over the following few years and the details of such queries are shown in Appendix A6.

Queries began to appear concerning disputes with the Inland Revenue over the amounts of wages and salaries paid to sons and daughters employed by parents in their business.[11] There is no clear evidence on the point, but it may well be that such wages and salaries were merely another form of settlement because of their being in excess of the amounts justified by the amount of work done. The Inland Revenue resisted such excessive payments and the advice given to querists supported the Inland Revenue's view.

<u>THE COLWYN COMMITTEE CONSIDERS SETTLEMENTS AND MAKES RECOMMENDATIONS</u>

Only three people gave evidence to the Royal Commission concerning avoidance through the use of settlements; Mr G F Howe, the Presiding Special Commissioner, Mr W Allen on behalf of the Middle Classes Union, and Mr E R Harrison, Assistant Secretary to the Board of Inland Revenue. All three witnesses were of the view that this form of avoidance was common. Mr Howe advised the commission that he had "seen enormous sums escaping taxation that ought to have borne taxation...."[12]

Mr Allen had no concrete evidence that this form of avoidance was taking place but was adamant that he knew it was being done on a considerable scale.[13] According to Mr Harrison

..."A good deal of use is made at the present time (of) the settlement of income, the creation of trusts and charges, and the transfer of securities to or for the benefit of members of the family of the individual whose liability is affected. The same methods may also be adopted by persons... not liable to super-tax [but] liable ...at one of the higher of the graduated rates [of income tax]. The evil is however most marked and the loss of revenue is most serious in connection with incomes which exceed the limit of exemption for super-tax."[14]

He had no doubts that it was the high tax rates which had caused people to take action to reduce their personal liability and believed that the tendency to avoidance would continue and, unless checked, would materially reduce the yield of tax.[15]

Each of the three witnesses gave examples of the methods used to avoid liability.

"Some striking cases have occurred. A father by a revocable deed settles a sum of money in trust for his children. The annual income is to be paid to him for maintenance and education of the children, for whom, as father, he would in any case be responsible. There is no check upon him as to how he expends the income, nor as to whether he expends it all; he is responsible to no-one, and may himself be trustee. Before the date, if any, at which the estate would vest in the beneficiaries the deed can be revoked. The settlor runs no risks as he can put an end to the whole arrangement whenever he likes, and in the meantime escapes payment of income tax and super-tax."[16]

Mr Allen had an example of a rather different form.

"A father has an income of £15,000 a year. Assume he has four children. He charges £1,000 a year on the estate for each of the two sons and £500 a year for the two daughters, the charges to remain in force until each child reaches the age of 21. The income tax and super-tax he would have to pay on the £3,000 amounts to £1,575. Under the arrangement each son would pay ... £187.10s a year and each daugher ... £75 a year. The total taxation for the children would thus be £527. The loss to the State through what is really a fictitious transaction amounts to £1,050 per annum."[17]

Mr Harrison gave a similar but more extreme example.

> "A had originally an income of £15,000 a year. The amount of super-tax payable for 1918/19 on an income of £15,000 would be £2312. If A has alienated or charged this income so that only £3,000 now remains to him whilst £2,000 represents the income of each of his six children A will pay only £62 in super-tax and his children will be totally exempt."[18]

The Inland Revenue were apparently not concerned about cases where individuals had paid voluntary allowances to poor relatives and then converted such allowances to a compulsory form in order to reduce tax liabilities. Mr Harrison believed that in such circumstances "no objection can properly be raised"[19]

The attitude towards transfers to children was quite different. Mr Howe believed it to be an "evil" which ought to be remedied and suggested that even accumulated income should be deemed to be the settlor's.[20] Mr. Harrison expressed great hostility to this form of avoidance but accepted that nothing could be done under the then current law to attack such schemes. The main problem was that the parent "gets out of an expense which other parents have to bear without obtaining any allowance for super-tax purposes"[21]

Each of the three witnesses had views as to how in practice such avoidance could be stopped. Mr Howe thought that any revocable deed should have no effect on the settlor's liability and that irrevocable parental settlements on any child for whom they were responsible should not diminish the parent's liability to taxation. In the latter case he thought it irrelevant whether the income was accumulated or not[22] Under examination, the question was posed as to whether Mr Howe thought that even in a case where the settlor could not in any way touch the income, it should nevertheless be treated as his. He believed that in all cases, if the benefit was for one of his own children who was an infant, then the income should be treated as the settlors,[23] and that even if the parent had other means to support the child and did so from such other sources, it should make no difference.[24] Lord Colwyn did not appear to think that the argument was sound in regard to an irrevocable deed but Mr Howe was unmoved in his views.[25]

Mr Allen thought that the way round this problem was to introduce into the income tax code analogous provisions to those applying to avoidance of excess profits duty by artificial or fictitious transactions. Lord Colwyn gave this proposal short shrift, pointing out that it would be dangerous to give permission for even the most trustworthy and impartial officials to decide whether a transaction is fictitious or not.

> "It is rather a dangerous power, is it not, that the law should come in and practically upset modes of settlement which are otherwise recognised by the law.... Is it not practically saying to A, B, C and D 'you shall not, except under very severe penalties, make this or that use of your property, even for your own children'?.... Answer: Personally I do not think it is. I think if a transaction is merely entered into for the sake of avoiding tax, as these transactions are, it is perfectly legitimate for the State to say 'we will not recognise a transaction of that kind'".[26]

It is perhaps surprising to see a representative of the middle classes putting forward proposals which would have given the Inland Revenue such wide power and discretion. However, the Royal Commission clearly rejected the idea and it was not discussed again or mentioned in their Report. It may be that the experience of the operation of the general anti-avoidance provision for excess profits duty which required that a person should not "enter into any fictitious or artificial transaction or carry out any fictitious or artificial operation" (S44(3) F.A.(No.2) 1915) indicated that the granting of such powers created as many problems as it attempted to solve, and what was needed here was a set of more objective tests.

The views put forward by the Inland Revenue as to how this avoidance could be prevented were fairly practical and well thought out. They rejected the idea of any type of motive test,[27] but wanted to be empowered to disregard any alienation, transfer or charge on income which was:-

> "(a) made in favour or for the benefit of an unmarried infant child of the settlor;
>
> (b) variable or revocable by the settlor - to the extent that it is possible for such variation or revocation to be exercised in favour or for the benefit of the settlor, or his wife or an unmarried infant child."[28]

They desired that any income so transferred should be treated as the income of the transferor and not of the transferee. This was not a novel idea at the time because, in the United States, provisions were already in force by virtue of which "the income of a revocable trust must be included in the gross income of the grantor."[29]

The principle which the Inland Revenue had in mind was that there must be a genuine alienation which actually deprived the settlor of the income of the estate from which it arose.

> "...if the settlor retains any power over that income we should be entitled to tax it. If he really finally divests himself of the income...I think we could do nothing. I think if he finally deprives himself of his income...we are bound to accept the consequence. He has lost the income and we must lose the tax."[30]

It was this principle which underpinned much of the later legislation on settlements, though action was often not forthcoming until revenue lost became relatively high. Under examination Mr Harrison explained that it would be impractical to have an enquiry into the motives of a parent who had made a settlement on a minor child,[31] and unnecessary to interfere with irrevocable settlements in favour of sons or daughters who were not under-age because liability to maintain the child would have ceased.[32]

The Royal Commission discussed the question of retrospection of any anti-avoidance provisions in two senses. Firstly, in the sense of altering tax liabilities for periods prior to the date of introduction of the anti-avoidance legislation, and secondly, altering for future years the tax effects of settlements entered into prior to the date the legislation was introduced. Mr. Howe was adamant that any legislation should operate on settlements created prior to the change in the law and the alteration in the treatment of life insurance premiums for super-tax purposes was pointed to as a precedent for doing this.[33] Mr Harrison was also of the view that future years should be affected but that "we should not rake up past year's super-tax."[34] Some members of the Commission were not happy with the idea of future years being affected in this way[35] and the report of the Royal Commission avoids the issue. It contains only one paragraph on the subject of settlements.

"There are plain indications that super-tax is being avoided also by the alienation of income by means of deeds under which income is applied for the education or maintainance of the infant children of the super-tax payer. These deeds often contain a clause giving the settlor power to revoke all or any of the trusts declared by the deed. As the parent is in any case obliged to maintain his infant children it would seem unreasonable that he should be able to avoid super-tax on part of his income in this way. We recommend that in all cases of revocable deeds the income so alienated should be regarded for super-tax purposes as the income of the settlor and that in cases of irrevocable deeds the income of a trust fund settled by a parent for the benefit of his unmarried infant children, with or without other beneficiaries, should be treated as the income of the parent to the extent to which it is actually paid to or for the benefit of the unmarried infant children."[36]

It should be noted that the deeming process envisaged by the Commission was for super-tax purposes only and that nothing was said about income tax. Thus it seems they were not too concerned by the income tax avoidance which was taking place through the use of the exemption and abatements. Furthermore, no mention was made of dispositions for short periods which were to form a fundamental part of the eventual anti-avoidance provisions in 1922.[37] It is also noticeable that the recommendations of Mr Howe concerning income accumulated in childrens' settlements was not taken up by the Commission and they recommended that the deeming process only be applied to income actually paid to or for the benefit of unmarried infant children. Within a few years of the introduction of the first anti-avoidance provisions to deal with settlements, the transfer of income to charities had become a major issue. It is interesting to note that neither the Minutes of Evidence nor the Report of the Royal Commission mentioned anything about this problem, though evidence was presented on the income of charities and the amount of money repaid to them.[38] According to the Revenue there were only a few cases of people transferring income to charity in a manner which reduced their personal tax liability.[39] The Royal Commission merely suggested that the term "charity" should be explicitly redefined by Parliament but did not express any view on which activities should be excluded[40]

An investigation of the tax system by a Royal Commission had been promised shortly before the outbreak of the First World War but was delayed by the war and by the belief that the work would be made much easier after the consolidation of the legislation. Had it not been for these factors, the anti-avoidance provisions concerning settlements would probably have been introduced a few years earlier than they were. As it was, the understaffing of the Inland Revenue which had existed prior to 1914 was made worse by new legislation, the millions of new taxpayers and the fact that the war had taken the greater part of the trained clerical staff.[41] The Department was hardly in a position to research the avoidance that was going on, let alone think through and implement the appropriate anti-avoidance provisions, until after the war.

CONCLUSION

The basic flaw upon which avoidance through the use of settlements was based was inherent in the income tax system from the start but was hardly exploited until high tax rates were imposed. Although, initially, the Revenue were apparently unconcerned by this class of avoidance, once it became costly through fairly common use and it looked likely that it would spread, because it was being regularly discussed in the professional journals, their attitude began to change.

The 1920 Royal Commission was sympathetic to the Revenue's views on settlements and the principles upon which anti-avoidance legislation should be based. It is surprising therefore that their recommendations were not put into effect earlier than 1922.

CHAPTER 3

1920-1922: THE FIRST ATTACK ON SETTLEMENTS

INTRODUCTION

The legislation introduced by section 20 of the Finance Act of 1922 was aimed at revocable dispositions, short-term dispositions and certain dispositions by parents in favour of their children. Although recommendations had been made on this subject by a Royal Commission some two years earlier, there was a curious pause before any action was taken, and even then the subject seems to have arisen almost by chance following the Chancellor's questioning of the Revenue about evasion.

Once the inertia had been overcome, the proposals for dealing with the problem were broadly formulated upon the Royal Commission's recommendations but with the Revenue generally getting their own way in respect of certain changes of principle and differences of opinion on the drafting.

With the weight of a Royal Commission to back them up, it was difficult for MP's to argue that the proposals were unnecessary and there was therefore little resistance to the general principles though there was considerable debate about the precise details, especially in respect of parental settlements on their children.

DELAYS IN IMPLEMENTING THE ROYAL COMMISSION'S RECOMMENDATIONS

Although the Royal Commission reported on March 11, 1920 it was just over two years before its recommendations (in a modified form) were put into effect. It is interesting to consider the possible causes of the delay. Obviously it would have been difficult, if not impossible, to rush through the appropriate legislation for inclusion in the Finance Act of 1920 but there was plenty of time to introduce the provisions in the Finance Bill of 1921.[1]

One possible explanation for the delay could be the burden put upon the Inland Revenue by the major reforms introduced in the Finance Act of 1920[2] combined with the continuation of excess profits duty and the introduction of corporation profits tax. All this must have considerably stretched the resources available at all levels within the Inland Revenue and perhaps the minds of the most senior members of the department were too fully occupied with implementation problems to be concerned about settlements.

Another possible explanation for the delay relates to introduction in 1920 of the modified form of child allowance such that no allowance was to be given if the child's income in its own right was greater than £40.[3] It might have been thought that the loss of child allowance resulting from large income-transfers to children was sufficient penalty for those who had already made such transfers and would discourage anything other than small transfers in other cases. This may have been seen as a holding operation before the whole question of anti-avoidance provisions could be fully reviewed and implemented. However, the Finance Act 1921 contained few major changes and it is perhaps surprising that time was not found to bring forward detailed anti-avoidance provisions in that year.

THE REVENUE PERSUADE THE CHANCELLOR TO LET THEM HAVE THEIR WAY

Those files which are not closed to public in the Public Record Office are peculiarly silent on the matter of tax avoidance in 1920 and 1921 and the first reference to the provisions which eventually became Section 20 of the Finance Act 1922 are in a note of interview with the Chancellor of the Exchequer on August 29, 1921.[4] The Chancellor (Sir Robert Horne) had raised the question of income tax evasion and wanted to know the meaning of the frequent parliamentary references to this by Mr William Graham. Although it was explained to him that those references were mainly to the securing of additional powers and the imposition of additional penalties, the Chancellor "thought that the time was not opportune for legislation in that sense"[5] but he did "desire to have detailed proposals placed before him in time for the next Budget in regard to the stoppage of avoidance of super-tax by legal devices"[6] It appears therefore that the initial prompting for this legislation came from the Chancellor rather than, as was usually the case for later refinements to the legislation, the Inland Revenue. The raising of the point appears to have been almost fortuitous and as a result of a question from the Chancellor on something entirely different. It is possible that the Inland Revenue or the Treasury siezed upon the opportunity to raise this related though entirely different matter with the Chancellor, though why they did not do so earlier is not known.

The Treasury files for 1922 indicate that considerable efforts were being made to search for a new form of taxation in order to raise revenue[7], and it may well be therefore, that the Chancellor saw the blocking up of loopholes as a more politically acceptable basis for raising revenue than the introduction of any new tax.

Payers of super-tax were experiencing difficulty in meeting their tax liabilities and the fact that many companies were reducing or even not paying dividends was causing further financial embarrassment to the wealthier classes.[8] Such pressure may have led to a growth in the use of avoidance techniques and the Revenue's realisation of this may have heightened the urgency for anti-avoidance legislation.

The matter of tax avoidance was not raised with the Chancellor again until the Budget Conference on January 23, 1922.[9] However it was not until March 1, 1922 that the Chairman of the Board of Inland Revenue wrote to the Chancellor to illustrate how settlements were being used, and to put forward suggestions for modification to the preventive legislation recommended by the Royal Commission.[10]

The Revenue informed the Chancellor of the large loss of revenue which resulted from "devices adopted by an increasing number of taxpayers in order legally to avoid their true liability to income tax and especially to super-tax,"[11] but admitted that the problem of preventing it was "in its technical aspects a very complex one".[12] They believed that the legislation would prove very contentious and suggested that it should be confined to catching "the most glaring and indefensible cases, leaving their extension and elaboration for future years when public opinion may be more ripe."[13]

The attempt to persuade the Chancellor of the need for action was buttressed by telling him that this problem was not in any way confined to the UK but had parallels in other countries, several of which were endeavouring to find solutions, and by the rather dubious statement that the indisputable intention of the law was that the tax avoided should have been paid.[14] The latter argument was quite commonly used in support of anti-avoidance legislation even though it would appear that it was more true to say that the legislature had never considered the problem and could not in any real sense have had any such intention.

The Revenue asserted that "the practice of avoiding the true liabilities...by means of the creation of trusts etc. is markedly on the increase and with the present high rates of taxation the incentive to follow this form of activity is very great."[15]
Hypothetical cases to illustrate the methods of avoidance being used were set out for the Chancellor's benefit and show :-

1. a parental settlement in favour of his children where the children have a vested interest in the property and income;
2. a parental settlement in favour of his children where there is a partial accumulation of income;
3. a wealthy batchelor creating a revocable trust or covenant in favour of impecunious relatives or friends;
4. a trust or covenant for needy friends and relatives which is not revocable but which is limited to a fixed period of time; and
5. a disposition for a short period in favour of a charity.[16]

The Revenue praised the Royal Commission to the Chancellor for dealing with revocable deeds separately from other deeds because "there can be no real hardship in treating as a settlor's income for income tax and super-tax purposes, income of which a settlor can resume complete and unfettered enjoyment at any moment."[17] The Royal Commission had in fact only mentioned super-tax but the Revenue apparently were able to gloss over this without being noticed. They also forcefully made the crucial point that it was essential to have a wide definition of revocability.[18]

The recommendations of the Royal Commission were ambiguous on the question of whether the deeming provisions should only apply to revocable deeds in favour of the settlor's unmarried children, but the Revenue argued that such a limitation would "leave untouched a large amount of the whole field"[19] and urged that "if a practicable method...to deal...effectively with this growing problem of evasion" was to be found, then all revocable deeds would have to be dealt with.[20] In no other part of the paper to the Chancellor is the word evasion used as a synonym for avoidance and it may have been inserted deliberately to help tip the balance of the argument in the Revenue's favour. If so, it succeeded.

As regards irrevocable deeds in favour of unmarried infant children it was admitted that there were considerable difficulties in deciding the best approach to the solution of what was a technical and awkward problem because the proposals of the Royal Commission could easily have been circumvented by the interposition of a "dummy settlor".[21] The Board of Inland Revenue had already considered this objection to be so weighty[22] that they originally intended to recommend that in all cases, (whether the income came from funds provided by the parents or anybody else), the income of unmarried infant children should be deemed to be the income of parents for all purposes but decided that it would be too difficult to justify such a novel approach, especially when it was not one of the proposals of the Royal Commission.[23] It was recommended therefore, that the Royal Commission's proposals should be implemented with safeguards against the interposition of "dummy settlors" though the need for aggregation of such childrens' income was not ruled out if future experience showed it to be necessary.[24]

There were no recommendations by the Royal Commission concerning irrevocable deeds for limited periods but it was pointed out to the Chancellor "that an inevitable result of dealing with revocable deeds...will be that the people concerned will... attain their ends by the creation of trusts irrevocable for a short period of time."[25] It was thus absolutely essential that dispositions for short periods should not be effective for income tax and super-tax purposes, and the Revenue suggested that if the period of disposition did not exceed six years then the income should be deemed to be the settlors.[26]

The Revenue put various other matters to the Chancellor concerning settlements which had either not been considered by the Royal Commission or which had not been subject to a recommendation by them. Firstly, they argued that the time might come when action would be necessary in regard to discretionary trusts but hesitated to recommend legislation at that time because it was thought to be too contentious and it did not have the support of recommendations of the Royal Commission to back it up.[27] There were two other problem areas which the Board suggested should be considered at a future date; temporary charitable trusts where the capital would revert to the settlor's estate upon his death, and accumulation of income within irrevocable trusts (whether for children or others).[28]

The Chancellor's reaction to the Inland Revenue's arguments is not known but the final form of the legislation so closely follows the proposals of the Board of Inland Revenue that he must have found them totally acceptable. However, it seems that he was wary about reliance upon the hypothetical cases which had been put to him in support of the Revenue's views, because on May 2, 1922, the day after presenting his Budget Speech, he requested details of actual cases.[29] The response was made on the same day and consisted of four examples of revocable dispositions and three of irrevocable dispositions.[30]

The only points of interest arising out of these cases concern the dates on which the dispositions were made, (two of them were made in 1918 and the others show no dates), and the attitude the Revenue adopted towards them. Legal opinions had been obtained, and in each case the advice was against contesting the matter.[31] In one of them, claims to repayment on behalf of minors had been refused and the District Commissioners of Income Tax had confirmed this refusal on appeal. However, a stated case was demanded and was submitted to the Solicitor of Inland Revenue and to counsel who both advised that "it was useless for the Crown to resist the appeal."[32] Obviously the Inland Revenue had tried very hard to prevent avoidance using the existing law but apparently with no success.

One of the cases put to the Chancellor shows the first time that any of the papers examined specifically mention the use of charitable covenants. A number of charities were inviting their subscribers to enter into deeds for a short period, (usually two or three years), and legal opinions obtained by the Revenue indicated that it was impossible either to successfully resist the claim that such payments were deductible in computing the donor's total income or the entitlement of the charity's claim to repayment.[33]

The Chancellor's request for actual examples of the problem appears to have been an afterthought because he had already made his Budget Speech promising action and a considerable amount of drafting had already taken place. The procedures by virtue of which the Inland Revenue's proposals were to travel on their bumpy way towards legislation were therefore already well advanced.

DRAFTING

Once the Chancellor of the Exchequer had been persuaded of the necessity for legislation and had agreed its broad nature, the next stage was for the Inland Revenue to agree the details of the budget resolution and clause with Parliamentary Counsel. The draftsman was therefore sent a copy of all the background information that had been provided to the Chancellor and draft clauses which the Revenue had prepared.[34]

Parliamentary Counsel's primary concern appears to have been the putting together of the Budget resolutions, (as these would be required on Budget Day), and in the space of six days three drafts of it were prepared, with the fourth and final version not being printed until Budget Day itself. It is clear from the first version that the draftsman thought that the provisions were only to apply to trusts,[35] but the next version corrected this by referring to dispositions and disponors, instead of merely trusts and settlors.[36] It was not until the second draft that provision was made for the recovery by the disponor of additional tax payable by him as a result of the income being deemed to be his, and not even in the final version was there any reference to the fact that the disponor would not be allowed to benefit from any additional tax repaid to him as a result of the deeming process. The overall impression gained from all this is that Parliamentary Counsel was working under intense pressure and that the whole subject was rather ill thought-out.

The first three drafts of the Finance Bill contained no references to the proposed settlement legislation, and the fourth draft[37] had a version which in many respects was a long way from that finally adopted. The Revenue's own draft[38] was, in matters of substance, much nearer to the final legislation than Parliamentary Counsel's first version; though it was rather more long-winded because it had three independent clauses dealing with three different sets of circumstances.

The Revenue clause concerning revocable dispositions contained an exception for cases where revocation required the consent of some person other than the disponor or the spouse of the disponor, but the draftsman did not have such a let-out in his first version. The eventual legislation shows the Revenue's dominance on this and contained the relevant let-out, but with the benefit of hindsight it is clear that there was merit in the draftsman's version because within a few years the Revenue found that the let-out was being used in a manner which made the whole provision on revocable dispositions virtually ineffectual.[39]

Both the Revenue's and Parliamentary Counsel's first drafts referred to revocable dispositions by individuals but the Bill presented to Parliament applied the provisions to such dispositions by any person. Although this change clearly made the provisions more widely drawn, it is not clear in what circumstances they would apply to anyone other than an individual unless a company were to make a revocable settlement.

Considerable differences of opinion also existed between the Revenue and the draftsman on the provisions for dispositions for short periods. Again the draftsman widened their scope by making them apply to any person and not merely to individuals. Although the Revenue version specifically referred to the fact that the deeming process was only to apply if the individual was still living, the draftsman thought this unnecessary, because income could not be treated as belonging to someone who was not alive. The Revenue view eventually prevailed.[40] The Revenue also made it clear that dispositions for valuable consideration were not to be caught,[41] and it is therefore strange that the draftsman ignored this until drawing up the final version of the Bill.

There were few differences between the two sides about the draft clause on dispositions for the benefit of unmarried, infant children of the disponor. The draftsman did, however, remove considerable verbiage from the Revenue's draft, widened its scope, and removed references to the deeming process only applying if the disponor was still living.[42]

FROM BUDGET TO SECOND READING

The Budget statement made only the following short reference to tax avoidance.

> "I wish....to direct....attention....to certain instances of legal avoidance of income tax and super-tax which have recently become so prevalent as to produce....startling inequalities in the incidence of taxation as between different taxpayers. I think it is fairly generally known that many people, by creating temporary or revocable trusts, have succeeded in avoiding their due share of tax and super-tax. ....I think most people will recognise that it is not fair that those that are clever enough to find ways to do these things should benefit at the expense of others."[43]

The Budget resolution on settlements was in three main parts dealing with:

(a) revocable dispositions;

(b) dispositions for short periods; and

(c) dispositions for the benefit of unmarried infant children of the disponor.[44]

Some members had a fair idea of what the resolution was aimed at but, perhaps not surprisingly, there were serious errors of detail in their understanding.

> "I should like to ask what this resolution means. It is very involved, and on the face of it it may mean nothing...."[45]

There was general support from all sides on the parts of the resolution dealing with revocable dispositions and dispositions for short periods.

> "As far as paragraphs (a) and (b) are concerned I am inclined to think the Chancellor of the Exchequer is right, for there a man says 'I will give my property to somebody until such time as I take it back'".[46]

It was the proposals on parental settlements on their children which was least well understood and to which great exception was taken. One member freely admitted that he did not understand the relevant part of the resolution and considered it unintelligible to the ordinary layman and incomprehensible to the majority of the House.[47] The Financial Secretary to the Treasury duly explained the paragraph with a heavy reliance upon the notes provided to him by the Inland Revenue but caused some controversy with the following statement.

> "Supposing he makes an irrevocable trust for ten years for the purpose of maintaining the child. Why should it cease to be looked upon as his income any more than the income that goes in the working class household and is spent on the daily food of the child? That surely is evasion to which the practical common sense of all would object."[48]

Some members were quick to argue that there was no evasion as no law was being infringed and it is clear from the ensuing debate that the present-day distinction between evasion and avoidance was not at all clear in the minds of Members of Parliament in 1922.[49]

The precise extent of operation of the children's settlement proposals was poorly understood, even by the Financial Secretary, who, when asked whether they would catch the case of a disponor who still wished to retain some control and inserted a provision for the trust to end on the happening of some event, indicated that it was a matter which needed consideration.[50] It is suspected that he was really just unsure about what his briefing notes meant. Criticism was levelled at the proposals because they would make a parent tend to keep his wealth in his own hands, and also because there were a large number of settlements in which, because a man could not tell how his children would turn out or what his own circumstances might be in the future, the power was retained for the father to revoke the settlement with the consent of the trustee on special grounds.[51]

Strong disapproval was expressed of the apparent retrospective nature of the resolution.

> "[The] settlement may have been made years ago, and I want to know whether it is the intention of the Chancellor of the Exchequer to make this entirely retrospective. I wholly object to retrospective legislation. What has been done has been lawfully done under the existing law. ...When the settlement has been made years ago I suggest that this clause would hit it, and that would not be just."[52]

No response was given to this objection at this stage, but the matter was fully debated later.

At the second reading stage there was very little debate on the settlements clause, (clause 13), but Mr. Dennis Herbert expressed his thanks to the Chancellor for the alterations of principle which had been made since the Budget resolution.[53] He was referring to two modifications which were to be made; firstly, only revocable dispositions which did not require the consent of any other person were to be caught, and secondly, children's settlements were to be caught even if they had been made in some indirect manner by the parent. The second change was a clear tightening up of the provisions and was unlikely to have stimulated Mr Herbert to express his gratitude, and the first did not go any way towards meeting the case originally raised by him. What he had wanted was for children's settlements which included a power to revoke with the consent of a third party to be treated as for the life of the child and therefore outside the provisions. The proposed modification only related to the effect of consent on revocable settlements but Herbert clearly thought that he had won a concession. The Inland Revenue must have known that they had not met his point, because in the case of Wiggins V. Watson,[54] where a father had power to revoke a settlement on his child with the consent of one of five other persons, they contended that, because of this power, the disposition was for a period less than the life of the child, and that unless that contention was agreed, the Court would be defeating the obvious intention of the legislature.[55] The Inland Revenue lost the case at all stages up to and including the House of Lords, and presumably, therefore, thought the matter most important and capable of being won. One of the reasons the case was lost was that the inclusion of the reference to consent in the part of the section dealing with revocable dispositions excluded its relevance in determining whether a settlement was for the life of the child. Therefore, Mr. Herbert had won a victory, but the Inland Revenue did not know it until some ten years later!

Mr Herbert had suggestions for further modifications to the provisions relating to children. Firstly, he proposed that determination of the interest of the child on bankruptcy or alienation should not be construed as producing a disposition for less that the life of the child. Secondly, he suggested that where the disposition was to cease on the death of the disponor, it should not be treated as a disposition for a period less than the life of the child.

> "...many a man is trying to make provision for his children, not out of capital which he already owns, but out of money which he is making, because he has no other means of providing for them. ... it would be quite impracticable for him to saddle his estate and executors with the burden of making those payments after his death."[56]

Both of his suggestions were eventually taken up.

As might be expected at the second reading, the major subjects of debate tended to be more a matter of political point scoring than a detailed analysis or critique, but neither the Chancellor nor any Treasury Minister made any comment at all on the clause, though it did arouse a considerable amount of interest outside Parliament.[57]

AN ANALYSIS OF CLAUSE 13 AND ITS PROGRESS THROUGH THE COMMITTEE AND REPORT STAGES

The Board of Inland Revenue explained the purpose of the clause to ministers in the following way.

> "It is designed to counteract the growing loss of revenue arising from dispositions made by taxpayers under which income spent by them on their children and in other ways is legally alienated so as no longer to be returnable in their statement of total income.... The object which is sought by this legal alienation is to cause income, which in reality is the income of one individual, to become in strict law the income of two or more individuals, and by this means to reduce the effective rate at which income tax and super-tax is charged upon it."[58]

The substance of the clause was contained in the three paragraphs of sub-clause 1 and each of them is examined in turn below. (A copy of the clause is in Appendix B together with a copy of the eventual legislation)

Revocable Dispositions

Paragraph (a) of sub-clause 1 dealt with dispositions in which the disponer had reserved to himself a full power of revocation so that he could resume the legal possession of the income. It was to operate on any disposition no matter when it was made, provided that beneficial enjoyment of the income could be obtained by the disponor after April 5, 1922. However, where the disponor could not obtain the beneficial enjoyment of the income without first obtaining the consent of someone, other than his spouse, the provisions did not apply.[59]

A considerable number of amendments to paragraph (a) were put down at both the committee and report stages.

The first amendment to be considered was an attempt to restrict the clause to cases where the disponor actually obtained the beneficial enjoyment of the income, rather than to cases where he merely had power to do so. It was meant to provide a let-out for cases where "a man has put aside a certain sum of money to maintain an imbecile relative,"[60] or "leaves a sum to be used for the purpose of setting up some institution."[61] However, as the Board of Inland Revenue explained to ministers, the amendment would have defeated the whole purpose of paragraph (a), because if a person actually obtained the beneficial enjoyment of income it would already automatically be included in his total income without the deeming process envisaged by the clause.[62] The Board therefore advised that the amendment would be nugatory, and as it did not raise any question there was nothing to debate.[63]

Because the clause, as drafted, applied to anyone who was able to obtain for himself the beneficial enjoyment of the income, whether or not he had made the disposition, an amendment was put down in an attempt to ensure that it would only apply to the disponor.[64] The unfairness of the existing draft was that where A conferred on B an unlimited power of appointment over property or income which until such appointment was to go to C, there would be some difficulty in arguing that the income should be treated as belonging to B if he refrained from exercising his power of appointment, had never in fact enjoyed the income, and perhaps would never enjoy it. The anomaly was illustrated in the following way:-

> "The father of a family may have a close friend who dies and leaves a sum of money, the income of which is to be paid to that father's children unless and until the father should see fit to deprive them of the income and take it for himself."[65]

The Attorney-General agreed that this amendment was not inconsistent with the general scope of the clause, but pointed out that, as drafted, it would open up a loophole, because the disponor could grant an unlimited power of appointment to his or her spouse when alienating income for the benefit of a third party, with the result that the spouse with the power of appointment would not be caught, (as he or she was not the disponor), while the disponor would escape as well, (as he or she did not have any power of appointment). Such a case would clearly have been within the mischief at which the clause was aimed.[66] The Chancellor introduced appropriate amendments at the report stage to meet the point but without creating a loophole.[67]

The provisions were to apply to the income arising for the whole of the tax year 1922/23, but due to a misunderstanding as to their manner of operation an amendment was suggested such that they would only operate from Royal Assent.[68] The proposer of the amendment appears to have thought that the deeming process was to be applied to pre-April 6, 1922 settlements, even after any right of revocation was given up, but on being assured by the Attorney-General (on the Revenue's advice) that this was not the case, he withdrew his amendment.[69]

<u>Dispositions for Short Periods</u>

Paragraph (b) of sub-clause 1, was an essential provision to work in conjunction with paragraph (a), because the inevitable result of dealing only with revocable dispositions would have been to invite the avoidance of taxation by means of irrevocable dispositions operating for short periods. The Board of Inland Revenue suggested that a six year period was the minimum that would effectively safe-guard against short-term dispositions, and advised that any much longer period might be difficult to justify, though experience would perhaps make an extension necessary.[70] An amendment which would have increased the six year period to one of not less than the life of the person for whose benefit the disposition had been made, was on Revenue advice, ruled out of order.[71] The provisions were restricted to dispositions made after May 1, 1922, because the Revenue thought it would be unfair and might cause hardship if transactions made before any intimation had been given of the changes in the law were detrimentally affected.[72] However, an amendment was proposed under which any disposition, no matter when it was made, would have been caught. As the Revenue pointed out to ministers, such an amendment would have extended the charge beyond the scope of the corresponding budget resolution and was therefore out of order.[73]

A short-term disposition was not to be caught if it was made for valuable and sufficient consideration, but as Mr Dennis Herbert, (a prominent solicitor), did not know the meaning of "sufficient consideration" and was not aware that it had any recognised legal meaning, he put down an amendment to ensure that the let-out applied if the consideration was merely valuable.[74] The Revenue argued that without the words "and sufficient" it would be possible to escape the provisions by giving some purely nominal consideration.[75] Parliamentary concern was expressed as to who was to judge the sufficiency of any consideration and it was hoped that taxpayers would not be "at the mercy of an official".[76] Although the Solicitor-General promised to reconsider the matter,[77] more effective words apparently could not be found.

There were two further amendments put down relating to paragraph (b) which on the face of things were very different but whose underlying purpose was very similar. The first was an attempt to have paragraph (b) removed entirely, while the other sought to exclude charitable dispositions from its scope. The first amendment was also motivated by a desire to protect charities and the background to the debate on it gives an interesting insight into the Government's attitudes towards the support of charities.

In the ministerial briefing notes, the Board of Inland Revenue forcefully made the point that claims for tax deductions for contributions to charitable objects had been repeatedly put forward and had been uniformly resisted.[78] They pointed out that the whole subject had been dealt with during the passage of the Finance Bill 1920, where the Chancellor had said:-

> "I could not possibly accept...any concessions in this respect in regard either to income tax or super-tax. The proposal has been made again and again to my predecessors, and one and all, whatever their political complexion, they have repulsed it with a unanimity which is truly wonderful. I find myself in the same position of unalterable opposition to it. The richer the man the greater the proportion of his so-called subscription which is found by the State. The poorer the man the greater the proportion of his so-called subscription which is found by himself. That cannot be right."[79]

The Inland Revenue also reminded ministers that with relief through the tax system the selection of the institution to be benefited and the amount of the State's contribution would be determined by the individual taxpayer, and that as the practice was growing among charities of inviting subscribers to pledge themselves by means of a short-term convenant, the cost to the Exchequer could increase rapidly.[80]

Sir Robert Horne took on board the views of his predecessors and of the Inland Revenue and made out an effective case against any concession for charities in the debate on the amendment.[81] His opposition came from Lord Robert Cecil who believed that the injury done to charities would be out of all proportion to the "few thousand pounds" benefit to the State.[82] He believed the provisions would cause great discouragement at a time when it was difficult to get money for any charity and asked that the position be reconsidered.[83] When the Chancellor agreed to do this the amendment was dropped, but none of the relevant files[84] indicate that any reconsideration actually took place, and nothing was said about it at the report stage.

Dispositions by Parents on Their Minor, Unmarried Children

The Revenue indicated to ministers that in their view "avoidance of tax is commonest and easiest [in cases] of dispositions by parents in favour of their unmarried infant children,"[85] and argued that it was necessary to introduce provisions going beyond paragraphs (a) and (b) in cases of this type.[86] Ministers apparently agreed, and under paragraph (c) the whole income under a parental disposition was to be deemed the parent's if and so long as the child was an infant and unmarried. The effect was to exclude the income from being taken into account in any repayment claim on behalf of the child. Because of the one major let-out which was to apply when the income was payable to or for the benefit of the child for a period not less than its life, out-and-out dispositions were not caught.[87]

Of the three provisions, paragraph (c) was by far the most controversial. There were five amendments put down for consideration at the committee stage, and of these three of them were dressed up in a different form and presented for reconsideration at the report stage. The Chancellor put forward the official version of four of them at the report stage so that, although, in all, thirteen amendments were put down, the position was not quite as contentious as a cursory inspection of the number of amendments tabled might indicate.

By far the most contentious matter was the retrospective application of the paragraph to dispositions made before the commencement of the

Act.[88] An amendment was considered at the committee stage which attempted to limit its application to dispositions made after the commencement of the Act and because the Revenue provided very little guidance as to the principles underlying their intentions and gave no indication of any arguments to help counter any claims of retrospection, ministers were left with a difficult task in justifying the position.

It would appear that the Board completely underestimated the strength of feeling about this retrospective element of the clause, as those criticising it were quite fierce in arguing that dispositions made before the Act were perfectly legal and resulted in no adverse tax consequences.[89] They pointed out that "great judges have said over and over again that the subject is entitled to avoid - not to evade - taxation if he can."[90] Some appeared to have total misconceptions about the Bill, thinking that it would go over years in which liabilities had been settled, or make such settlements illegal, but those who made these points later admitted that they did not mean precisely what they had said. Clearly this was a case of exaggeration in an attempt to support a case; but it got nowhere.[91]

In defence of the provisions, the Chancellor argued that it would have been absurd to have a situation where one set of citizens who set aside funds prior to the Act would escape, while others who had not been clever enough to have thought of this device soon enough would not.[92] The Solicitor-General put the matter rather well.

"...if this criticism were accepted and the amendment adopted, the result would be that those parents who knew perfectly well what they were about, and that it was their duty to maintain their children and wanted simply and solely to escape their proper burden and put it on to other people's shoulders, would get off, while everyone doing it in the future would be hit."[93]

He also pointed out that it was open to the disponor to get out of the clause by extending the existing settlement to the whole life of the child by a supplementary deed.[94] The overall principle involved here seemed to be that:-

"Every parent...who has put income out of his power should be treated in the same way as any other parent who maintains his children by the same expenditure of money, paying it out of his pocket instead of through a trustee. Insofar as that is justifiable, no question whatever of retrospective legislation arises because it is simply the expression of a view of what is right and proper in the way of taxation of individual members of the community."[95]

Despite the support for the government from those who could not see that the proposal was in any way retrospective,[96] and from those who found it disturbing that "large numbers of people [had] for four or five years avoided... tax by deliberately creating trusts,"[97] the Solicitor-General promised to reconsider the matter to see whether there were any grounds for the apprehension which others had expressed.[98] Even with such a promise, an amendment was put down at the report stage in terms broadly similar to that at the committee stage, but the Government had already decided to modify the paragraph so that it only applied to dispositions made after April 5, 1914.[99] This date was chosen because it coincided with the first appreciable increase in the rate of super-tax and it was believed that by operating the paragraph from that date the gaps through which tax had been slipping away would be stopped.[1] The proposers of the amendment saw that the Government's concession would be of very little value but it was agreed to with little complaint.[2]

Mr Dennis Herbert tabled a committee stage amendment intended to secure a let-out where, although the disposition was not for the whole life of the child, it was for the whole life of the disponor. The wording of the amendment did not actually achieve this, but the Board of Inland Revenue's notes to ministers indicate that they understood the spirit of it and that they did not think it unreasonable.[3] They reminded ministers that an out-and-out disposition by a parent was not affected by Clause 13, and argued that a disposition operating for the parent's life would be so similar a case as to make it difficult to argue that such a disposition should not be similarly treated.[4] The Solicitor General was thus persuaded of the merits of the amendment and he agreed to give it favourable consideration[5]. An appropriate modification was later inserted.[6]

Mr Herbert also expressed concern that a disposition might not be for the life of a child if there was some provision for its "termination on bankruptcy, insolvency, alienation or other like event or matter," and brought forward an amendment to provide an exception for such events[7]. The Board's notes on this indicate that they believed that where a disposition was made defeasible on the bankruptcy or insolvency of the child or upon the alienation of his interest, it would nonetheless be for the life of the child, and indicated that the clause was drafted with this intention and would be interpreted by the Revenue in that sense.[8] They did however object to the final words "or other like event or matter" as these were so extremely wide that even the <u>ejusdem generis</u> rule might have been insufficient to limit their scope adequately.[9] Although the amendment was not even raised for discussion and the Inland Revenue believed it unnecessary, the Chancellor of the Exchequer inserted a proviso to paragraph (c) to remove any doubts as to the position where the child's interest was defeasible in the event of bankruptcy or the alienating or mortgaging of the income.[10] The proviso was clearly aimed at the protective trust rather than dispositions which could come to an end, as can be seen from the fact that, on such an event, the income had to become payable to some other person if the proviso was to apply. This proviso was to form the model for future settlements legislation.

The only other amendment to be accepted in principle at the committee stage was that the deeming process should not apply where capital was required to be held on trust absolutely for the child at the end of any period less than the life of that child.[11] The Revenue thought that the amendment was obscure but believed it was aimed at the case where the parent settled, say, £20,000, the income from which was applicable for the benefit of the child until he reached the age of 21, at which time £10,000 of capital became the child's absolutely.[12] If this was its meaning, the Revenue thought it unnecessary, because the income from one half of the capital in the illustration would be payable for a period less than the life of the child and would be caught, while the other half would not, as the interest of the child in that half would be for his life.[13] Even though the Revenue thought that the amendment was unnecessary, (assuming it meant what they thought), and suggested to ministers that it should be rejected because of its obscurity,[14] the Solicitor-General agreed it in principle subject to drafting considerations and it was accepted at the committee stage.[15] However, at the report stage the Chancellor put down a clarifying amendment to indicate with rather more precision the actual facts of the class of case at which the provision was directed.[16]

Despite the fact that the remaining amendments put down for consideration were not actually made, they are interesting for the insights the responses of the Revenue and ministers give to the intention behind the legislation.

One suggestion was that a disposition should not be caught merely because it could be terminated with the consent of some person other than the parent.[17] This would of course have provided an easy means of escape from the provisions by using a friendly trustee with whose consent the disposition could be terminated, and would have defeated the whole object of the clause. In their response to the amendment the Inland Revenue were dismissive of the suggestion but indicated their concern over another unrelated matter.[18] Their worry was that one person might provide funds to another who would then at some later time create a settlement on the original donor's child, and whilst they believed that the provision was wide enough to catch this situation

> "...legal ingenuity is multiform, manifold and menacing and there is often an element of uncertainty in the decisions of the courts. It may happen, therefore, that at some later stage it will become necessary to seek some tightening of these provisions in order to ensure their effective working."[19]

A further suggestion was made by some MP's who thought it was not within the intention of the provisions to catch cases where the parent, although having made a disposition for less than the life of the child, had nevertheless irrevocably disposed of income in such a manner that it could never become payable to or applicable for the parent's benefit.[20] It is perfectly clear from the cases used to illustrate their point that the anti-avoidance provisions would have had no affect on the particular circumstances which they had in mind because the child was over the age of majority. Nobody pointed this out. After some explanations of the clause as it stood, which were heavily reliant upon the notes provided by the Board of Inland Revenue, the Chancellor promised to review the situation.[21] It seems that few MP's really understood the scope of these provisions and were worrying unnecessarily.

A second attempt was made to introduce a similar amendment at the report stage but this time the Solicitor-General appears to have agreed with the Revenue's advice.

> "Even if he wished to make an out-and-out gift over to some stranger when the child's interest ceased, there is no reason whatever why, during that child's minority, he, the parent, should not continue to bear tax upon income which he has himself provided for the maintenance etc., for the child during its minority, i.e. whilst it is the natural and proper duty of the parent to provide for his child."[22]

A further illustration of how complex these provisions must have seemed can be seen from an amendment which, although intended to narrow down their scope, would, if it had been accepted, actually have had the opposite effect. A memorandum by the mover of the amendment to the Solicitor-General explained that it was designed to meet the case of a settlement in favour of a number of children where the power was reserved for the settlor to appoint the fund in different shares between different children.[23] The Solicitor-General explained that this had been very carefully considered and it had been concluded that the section would not apply, and that the amendment as drafted would have created unintended traps.[24]

Another point which worried some MP's[25] was the position where a parent created a trust for the benefit of his children under which the trustees were to apply the income for the benefit of all or any of the children as they thought fit, with a power to appoint capital to one or more of those children, or to their husband or wife or their issue.[26] It was feared that in such a case it would be sought to claim that the trust income was payable for a period less than the life of the child. The Board's advice to ministers indicates that these fears were groundless because regard would be had to the position of each child and it would be impossible to contend successfuly that as regards any one of the children the disposition was for a period less than his life.[27] This matter was considered by the Solicitor-General and Parliamentary Counsel as well as the Revenue in order to be sure that the case postulated was entirely outside the scope of the clause.[28]

Although support for the clause came from Colonel Wedgewood, the Vice-Chairman of the Labour Party, who saw it as a means by which the child "will be able to marry as it thinks fit,... to quarrel with its parents and to adopt a different line of business to the one the parent desires it to follow,"[29] he put down a most curious amendment which was inconsistent with all that he had said.[30] He wanted to leave out clause 13 altogether! The Revenue could not see why he should "rush into the arena in support of the avoidance of income tax and super-tax... especially when it is borne in mind that the legal devices by means of which this avoidance is effected are not easily available to the poorer classes of taxpayers."[31] The only explanation the Revenue could think of for Colonel Wedgewood's amendment was that by the removal of clause 13 he would show his approval of the distribution of property even though as they pointed out, taxpayers would remain perfectly at liberty to dispose of their property as they thought fit and the clause would not affect out-and-out dispositions of property.[32] We shall probably never know his reasons because the amendment was not debated

Recovery Rights, Definitions and Supplementary Provisions

It was realised that it would be inequitable to leave the disponor to bear any additional tax which might be charged by virtue of these anti-avoidance provisions, and it was therefore provided that he should be entitled to recover that tax from the trustee or other person to whom the income was payable,[33] unless it related to a revocable disposition.[34] The right of recovery related to both additional income tax and additional super-tax, and in order to provide evidence of the amount of that tax the disponor could require the Commissioners concerned[35] to provide him with a certificate specifying the income and the tax charged.

In calculating the additional tax payable as a result of the deeming process, the income caught by the anti-avoidance provisions was to be treated as the highest part of the income.[36] However, the problem of what was to be done when several items of income had to be treated as the highest part of the income was not addressed, and it is assumed that in practice the several items would have been aggregated and that the tax attributable to that aggregate apportioned amongst the several items of income according to their respective amounts.

It was foreseen that in some cases the deeming process might cause the disponor to become entitled to a greater repayment than he would otherwise have obtained. On the other hand the person to whom the income was actually payable could be deprived of any repayment in respect of that income. Sub-clause 3 therefore provided that where a person received a repayment which was greater than he would have had but for the deeming process, the excess repayment would have to paid over to the actual recipient of the income.

It is probably rare now to have circumstances in which this situation would arise,[37] but in 1922 no child allowance was given if the child had income of more than £40. Therefore, by deeming the child not to have the settlement income the child allowance might again be available to the parent. The child on the other hand would not get any repayment in connection with the income deemed to be the parent's and therefore would be worse off. Sub-clause 3 corrected such a situation and even provided that in cases where there had been more than one disposition, the total excess repayment was to be apportioned "as the case may require".

Although there is no reference to repayments of super-tax in sub-clause 3, it is believed that this was deliberate, because the deeming process could not result in any additional allowance or relief for super-tax purposes and therefore no additional repayment could arise.[38]

Sub-clause 5 provided some definitions. A child included a step-child or an illegitmate child, and a disposition included a trust, covenant, agreement or arrangement. It is clear from the fact that the term "disposition" included an agreement or arrangement that the Inland

Revenue were aware of the fact that disponors might try to make their dispositions by complex and tortuous means.[39] Judging by some of the cases which were to follow many years later, it was quite correct to make the meaning of "dispositions" as wide as possible, although perhaps some uncertainty was created by doing so.

CONCLUSION

The need for anti-avoidance provisions to attack settlements seems to have been accepted without anything like an exact knowledge of the extent of the problem. The Revenue did not present any statistical information to the 1920 Royal Commission or to the Chancellor concerning the value of assets transferred or the amount of income involved. The need for action was proved to the Chancellor by showing him a few hypothetical examples and by asserting that they were unacceptable and by telling him that the number of cases was already large and was likely to grow rapidly. It seems that the Inland Revenue saw the potential difficulties of not being able to provide hard evidence of the extent of avoidance, because by 1936, when the first major overhaul of the settlement provisions took place, detailed statistics were available of the number of cases, the amounts of income involved and their effect in tax terms.[40]

The legislation eventually introduced in 1922 was largely modelled upon the recommendations of the 1920 Royal Commission and those recommendations very much represented the views put forward by the Inland Revenue. Influence on tax legislation appears to be closely linked with influence on the Royal Commission, and this point was certainly not lost on the Revenue.

Conversion of the Royal Commission's suggestions into a set of clearly defined rules caused considerable difficulty, particularly as they represented one of the first efforts at specifically targeted income tax anti-avoidance provisions. The Revenue had little to go on and it is not surprising therefore that many refinements took place between the first draft and the passing of the Act.

No clear evidence could be found as to why the Revenue did not attempt to introduce a short, widely-drawn, generalised rule, but it is likely that such an approach did not find favour with them due to the problems they had had with such an approach in the Excess Profits Duty provisions attacking artificial or fictitious transactions. Furthermore, the possibility of using widely drawn legislation was discussed by the Royal Commission and firmly rejected, though without giving substantial reasons.[41]

The only part of the 1922 legislation on settlements which remains in any recognisable form today is that which deals with dispositions for short periods.[42] The other provisions of the section were very rapidly to prove almost worthless, but were not recast until 1936 and 1938, by which time they had been virtually ineffective for ten or more years. It should not however be thought that the parts which were repealed were of no value because the Revenue's desire to use familiar methods and shun the untried and untested, led to the use of elements which were effective as precedents for future legislation. The shape of a considerable amount of the current settlement legislation owes much to the Revenue's experience of its first attack on settlements.

CHAPTER 4

1922-1936: THE FAILURE OF SECTION 20 FINANCE ACT 1922 AND THE DISCOVERY OF OTHER MEANS OF AVOIDANCE USING SETTLEMENTS

INTRODUCTION

Section 20 of the Finance Act 1922 quickly proved to be a flimsy barrier to the tax avoider, and although the mechanism by which knowledge of avoidance techniques was passed on was only embryonic, by 1927 the Inland Revenue considered the provisions to be a failure. Even though a detailed account of its shortcomings was presented to a Cabinet Committee examining tax avoidance, the Committee decided to take no action except in relation to charitable covenants, but their proposals flopped even before reaching the statute book.

The publicity surrounding the Revenue's loss of important cases in the courts seriously damaged any residual effectiveness section 20 might have retained through ignorance of the methods of avoiding it. Not only did knowledge of such avoidance schemes spread, but new methods not contemplated when the section was drafted began to take root. The Board of Inland Revenue had the foresight to investigate thoroughly all known methods of avoidance and put together their proposals for tackling them, even going so far as to draft appropriate clauses. When the time came for action, they were well prepared.

THE CABINET REVIEW OF TAX AVOIDANCE

The journals of the time show little to indicate it, but by 1927 section 20 of the Finance Act 1922 had, for those who were well advised, become virtually ineffective. Evidence of this failure can be found in a memorandum by the Board of Inland Revenue to the 1926 Cabinet Tax Evasion Committee.[1]

The Inland Revenue had begun to notice the disparities in treatment of individuals whose ability to pay was apparently identical but who, because of their legal status or the manner in which they carried out their transactions, actually paid considerably different amounts of tax. Their first paper to the Committee put the matter in the following way:

> "Legal avoidance (or legal evasion) may perhaps more properly be said to begin when a taxpayer makes some artificial or unnatural disposition of his property or his income of such a nature that its object may be derived to be, and its effect is, greatly to reduce the burden of taxation upon him without materially altering his power of enjoyment of the property or income so treated."[2]

The paper went on to outline the main forms of avoidance known to the Revenue at that time, and pointed out that although the settlement provisions had at first proved quite effective, lawyers were beginning to find ways of avoiding them, and amending legislation would soon become necessary.[3] It was to be nine years before anything was done.

A second and much more detailed paper was presented to the Committee, (now re-named the Cabinet Revision Committee), setting out the general defects in Section 20 of the Finance Act 1922.[4]

> "It was to be expected that the ingenuity of lawyers would in the course of time find means of reducing this section to impotence, and that time has now arrived. That is to say while the section now deters many people, all those who are skilfully advised walk round it without any difficulty."[5]

Details of the three main loopholes in the section were explained. The first consisted of "the most formidable engine of destruction"[6] and involved a provision in the deed that if the disponor revoked it he should be free of any liability under it upon payment of a small penalty. Treasury Counsel had advised that there was no chance of successfully contending that such a deed was revocable.[7] It was therefore outside the scope of the anti-avoidance provisions and the small penalty payable was outweighed by the potential tax savings. The Revenue appear to have accepted this advice and took no case before the courts on the point.

The second loophole was thought to be almost as serious as the first,[8] and arose from the let-out which was provided where consent was required to the revocation. An extremely simple method of getting within the escape clause was to name in the deed a series of intimate friends and to provide that with the consent, and only with the consent, of one of those persons, the disponor could revoke the disposition and resume beneficial enjoyment of the income. If the first friend refused to give consent then the settlor would ask the next, and so on until he found one who would.[9]

A third though less serious problem concerned short-term dispositions.

The Board believed that the words "which cannot exceed six years" ought to be altered to "which is less than six years".[10] It would appear that what the Inland Revenue had in mind was the adoption of a "wait and see approach" so that if a disposition which could exceed six years did not in the event exceed six years, it would be caught. This would presumably have meant that prior years assessments would be reopened, but the practical problems of implementing such a system were not examined in the paper. This is the only time this matter appears to have been raised by the Revenue and the existing provisions remain with us to this day.

A further defect in the section had only recently come to light at the time of writing the paper.[11] Although it was under consideration by the Law Officers, the Revenue believed that the need for legislation on the point had not been established and did not provide details to the Committee or give any indication of its nature.

A clear attempt was made by the Inland Revenue to persuade the Cabinet that modification of the law was essential in respect of the three main problem areas mentioned above.

> "Having regard to the helplessness of the Revenue in the face of the devices and the loophole mentioned it is for consideration whether amendments of section 20 to deal with these points should be introduced in the forthcoming Finance Bill in conjunction with the other provisions against legal avoidance now under consideration."[12]

However, at a meeting on March 8, 1927, the Board of Inland Revenue explained the nature of the forms of avoidance and the remedies being contemplated, and the Committee decided, apparently without giving reasons, that it was unnecessary to legislate at that time, but agreed that the development of such practices should be carefully monitored.[13]

AN ATTEMPT TO REMOVE THE TAX ADVANTAGES OF CHARITABLE COVENANTS

The treatment of covenants in favour of charities was the subject of a separate paper to the Cabinet Tax Revision Committee[14] and in this case the Board's plea for modifications to the law got as far as the committee stage of the Finance Bill. The Board submitted evidence concerning charitable covenants even though at that time their cost to the Exchequer was relatively minor because they knew that the Chancellor intended introducing a further relief for charities by exempting certain trading profits which had been shown to be taxable in the 1926 case of Brighton College v Marriott.[15] They estimated that it would cost £100,000 per annum to provide this further exemption and explained to the Committee that this could be recovered by removing the relief for charitable covenants. The use of such covenants was described as a "small anomaly" which had recently arisen and which ought to be corrected because it was "a practice [which was] growing very fast...and might ultimately cost ... not far short of £1,000,000 per annum".[16] It was pointed out that charities had been exploiting more and more widely what the Revenue described as "an ingenious scheme" but which was in fact merely a charitable covenant.[17] Some indication of the persuasiveness of the Revenue's paper can be seen from the following extract.

> "They are more or less sham deeds; although expressed to be irrevocable they are really revocable, because in the event of a subscriber failing to maintain his payments the charity would certainly not commit the folly of suing him under the deed; any such action would obviously destroy the market once and for all time. In fact the Board of Inland Revenue have been ingenuously

> asked by one of these charities whether there will be any danger of it being legally obliged to take action to enforce fulfilment of the covenant. ...These schemes are being widely advertised and...are on the whole more attractive to the less scrupulous taxpayer to the detriment of his more scrupulous fellow."[18]

The Revenue were able to produce evidence that they were not the only ones who were unhappy with the situation. A lawyer from Glasgow had written to the Chancellor in January 1926 because "I think it my duty to send...a circular which is being issued by the Glasgow Charity Organisation"[19] The circular set out the details of how to make use of covenants which the lawyer criticised as "unfair to those who do not believe in the State endowment of religion and object to have (sic) their income tax increased"[20]

One of the banks[21] was offering to act as a trustee on behalf of its customers, receiving annuities for seven years and distributing the money to such charitable bodies as the customer might select.[22] It had issued a form of draft deed which specified that it was not to be liable for any omission or neglect to enforce the covenant, which, as the Board pointed out to the Committee, meant that in effect the arrangement was voluntary and revocable.[23]

The Revenue put forward what they believed to be six cogent reasons for taking serious exception to the use of charitable covenants.[24]

(a) There was no general relief for money spent or saved in some desirable fashion.

(b) Such covenants led to larger subscriptions.

(c) There was no justification for substantial and irregular additions to the cost of the charity exemption.

(d) Such covenants were mainly of benefit to the rich "as the poor have little or no tax to evade". (sic)

(e) They were attractive to the less scrupulous taxpayer.

(f) They were being used in connection with capital gifts to charities by spreading large lump sums over a period in excess of six years.

Although the case for introducing legislation to remove the tax relief for the payer had been made to look fairly strong, the Revenue warned that:

> "...the legislation would no doubt arouse strong opposition...and past history has always proved that there are always serious difficulties in the way of carrying through an amendment of taxation law designed in any way to restrict or interfere with the privileges enjoyed by charities."[25]

The Revenue suggested that the way to proceed was for any disposition of income to be treated as the disponor's, unless it was in favour of and for the use of an individual.[26] There was thus no intention to interfere with covenants in favour of needy relatives or friends. No case was made out as to why covenants to individuals should be treated any differently and this leads one to suspect that charitable covenants were being attacked on cost grounds rather than on principle.

The Minutes of the Cabinet Committee[27] indicate that the Board met with no opposition to their proposals. A potted version of the Board's arguments and proposals was included in the Committee's report[28] which was put before the full Cabinet on March 23, 1927. After questions on certain technical aspects of the subject had been answered by the Chairman of the Board,[29] the proposals concerning charitable deeds of covenant were approved, subject to the proviso that the measures taken to block the avoidance should apply only to future covenants.[30] Despite the support it had at the highest levels, the Board's prophecy of serious difficulties was correct.

Winston Churchill described the matter in his Financial Statement as "a small amendment, without retrospective consequences" and in the same breath gave details of his proposal to exempt "the profits of public schools and other similar trading profits of charities".[31] The exemption was presumably intended to smooth the passage of what he described as the "small amendment" but which was in fact the complete removal of both super-tax relief and income tax relief on charitable covenants.

A very detailed explanation of the mischief aimed at and why it was to be stopped was given by the Financial Secretary to the Treasury in the Ways and Means report stage debates.[32] Because all the government cards were put on the table, by the time the clause came to be debated in committee[33] powerful counter-arguments had been formulated by the charity lobby. They pointed to some of the classes of charity which would be seriously injured - "The Voluntary Hospitals, The Great Educational Societies, The Universities, The National Libraries, The Cancer Campaign."[34] Those charities which did not have such a wide measure of public support were not, of course, mentioned. Example after example was given of the good works being done and the way in which the system had greatly encouraged charitable gifts. The cost to the Exchequer was ignored. Mr Philip Snowden, on behalf of the Opposition, even suggested that "in withdrawing this clause the Chancellor of the

Exchequer is losing nothing at all"35. One of the arguments used against covenants was the fact that "if there were default in the payment...the charity would never take the defaulter to court; it would obviously spoil their market for subscriptions,"[36] but the lobbyists were able to point out that "there is actually at present a case before the court to compel a subscriber to carry out the agreement he has made".[37] It is a matter for speculation as to whether this situation had not been set up in order to destroy one of the main planks of the Government's argument.

The interpretation of the clause caused some confusion in the legal profession, and four questions about it were raised by Messrs Hasties in a letter published in The Times.[38] These questions were brought up at an interview with the Financial Secretary by a leading member of the legal profession[39] and answers were provided only after they had been cleared by Parliamentary Counsel.[40]

Some of the journals also indicate the unpopularity of the proposals. The general attitude was that "...many people will think that the Chancellor might have found some less meritorious object of attack."[41]

Perhaps the most persuasive arguments were put by the charities themselves. A special written plea was submitted by Lord Knutsford on behalf of hospitals, and although Churchill was "not very keen about this" he refused to make any special exception.[42] Further representations were made on behalf of the Universities[43] and St. Thomas' Hospital London,[44] but the Revenue drafted letters firmly refusing to compromise on the proposals on the grounds of cost to the

Exchequer, and these were approved and issued.

Eventually however, the Financial Secretary agreed to meet a deputation representing hospitals, universities, religious organisations and general welfare organisations,[45] and was subjected to a detailed account of the damage the proposals would cause and the areas in which they would cause increased claims upon the State. It was even argued that the provisions concerning short-term dispositions in the 1922 Act had been inserted in order to encourage charitable covenants. Even more surprisingly, the Financial Secretary described the provisions as a concession which was never intended to be applicable to charities.[46]

Although the Financial Secretary was much impressed by the claims that charitable covenants were never defaulted on and that charities did not fail to enforce them,[47] he pointed out that the evidence he had from the Revenue told a different story.[48]

The Financial Secretary had been instructed by the Chancellor "not to give a very definite reply ... because he [was] really considering the whole matter"[49] and had not been authorised "to hold out any very definite hope that he would materially alter the proposal which ... [had been] very carefully considered before anything was said about it at all."[50] However, a promise was made to pass on the representations of the deputation to the Chancellor.

Faced with this opposition the Chancellor withdrew the clause. However, he thought that "in logic and in equity ... the case for this clause stands quite unassailed" but he acknowledged the fact that "sentiment plays its part ...and the practical considerations ...that, but for these benefactions, there are charitable institutions of many kinds which otherwise would be drawing very near to [making] a demand upon the State"[51] had led him to retreat.

This unsuccessful attack had left behind it a full public exposure of the precise details of the scheme and its advantages to the payers and the charities. It had also indirectly provided a form of government approval to the use of the scheme, and both of these factors no doubt encouraged the further rapid growth in the use of the charitable covenant.

THE IMPORTANT NON-FOREIGN-ELEMENT REPORTED CASES AND THEIR IMPLICATIONS

Although there were no cases coming before the courts on the interpretation of section 20 of the Finance Act 1922 until 1928, the Revenue had already taken cases where they believed there was some technical defect in the transfer of income such that it was ineffective under general principles without the need to resort to the anti-avoidance provisions. The first such case was C I R v Allan[52] in which the Revenue were successful, but in Linton v Chapman[53] the Revenue's contention that there had been no effective donation was rejected by the Court of Session.[54] These cases show that the Revenue were determined not to let people get away with reductions in their tax liabilities too easily, particularly where there was the possibility that all the strict formalities had not been complied with.

The first case to come before the courts concerning section 20 was Gillies v CIR[55] in which the appellant had bound himself to pay an annuity for three years to his adult, married son. He claimed that the annuity should be allowed as a deduction from his income, and contended that because the annuity was payable for a period less than the life of the child it was covered by, (but not caught by), paragraph (c) of sub-section 1, and that this took it outwith the scope of the more general provisions of paragraphs (a) and (b). Not surprisingly, it was held that there were no grounds for the suggestion that paragraphs (a), (b) and (c) were mutually exclusive. The annuity was therefore caught by paragraph (b) because it was payable for a period which could not exceed six years.

In May 1930, the case of CIR v The Trustees of The Hostel of St. Luke[56] came before the High Court. It concerned income received by a charity under a deed of covenant dated February 3, 1927 which required the covenantor to pay during the term of seven years from April 6, 1926, an annual sum, the first of which was backdated to December 31, 1926, with subsequent payments on December 31, each year. The question arose as to whether or not payments under this covenant were for a period which could not exceed six years. The Inland Revenue obviously saw this case as involving an important matter of principle and had agreed beforehand that they would bear all costs irrespective of the outcome. In a unanimous judgement the Court of Appeal held that in calculating the six year period one had to look at the due dates of the payments which were to be made,[57] and the Revenue were therefore successful with their contention that there could be no backdating of a deed to escape the provisions applying to short-term dispositions.

The next case to reach the courts was that of Wiggins v. Watson[58] and its loss gave considerably publicity to a serious flaw in the provisions. In March 1930, the settlor, by deed, covenanted to pay trustees during the joint lives of himself and his son, an annuity, to be held in trust for the son with power to the trustees during the son's minority to apply the annuity for the son's education, maintenance and benefit. The deed contained a power of revocation exercisable by the settlor with the consent of any one of five specified persons. Clearly the case was not caught as a revocable disposition because consent of a person other than the disponor or the disponor's wife was required, and neither could it be argued that the disposition could not exceed six years. The Inland Revenue therefore had to rely upon the contention that, by reason of the power of revocation, the annuity was applicable for the benefit of the child for some period less than its life. Although the General Commissioners agreed with this contention, all the courts up to and including the House of Lords held without dissent that it was incorrect because the mere fact that there was a power of revocation did not mean that the interest was for a period less than the life of the child. The legal reasoning behind this was that the interest, while it lasted and was not set aside, was for the life of the child.[59] There can be no doubt that this decision virtually destroyed the effectiveness of the children's settlement provisions, because the mere insertion of a power of revocation with the consent of others, (excluding the wife or husband of the disponor), would take any disposition capable of exceeding six years outside the section.

Although the House of Lords decision probably even further encouraged the creation of settlements of this type,[60] it was just over three years before action was taken to recast the rules. Today such a gaping hole in an anti-avoidance provision would probably be blocked within days by a ministerial statement followed by legislation effective from the date of the statement.

A case with considerable similarities to Watson v. Wiggins was the 1932 case of Levitt v. CIR[61] in which the appellant transferred certain shares to trustees to apply the income for the maintenance, education and upbringing of his children until the youngest attained the age of 21, and then to divide the capital among the survivors. The deed contained a provision that a child marrying a person not of the Jewish faith, without the consent of its parents, should forfeit any interest in the trust estate. The Inspector of Taxes objected to a claim to repayment on the ground that by reason of the provision of forfeiture, income was payable to or applicable for the benefit of the children for some period less than their lives, and therefore was deemed to be the father's under Section 20 (c) of the Finance Act 1922.

It was held by the Court of Session that the Revenue's contentions were correct because the matter was contingent. This view was supported by reference to the second proviso to paragraph (c) which it was argued set out exhaustively the only circumstances in which a disposition which was defeasible should nevertheless be treated as being for a period not less than the life of the child. Lord Sands did think it a little anomalous that an improbable contingency should cause the deeming provisions to apply but believed that if it were possible to condone the contingency in the Levitt case, then contingencies which were much less remote might also claim to be ignored.[62]

A case very similar to Levitt was the subject of correspondence in The

Accountant Tax Supplement in July 1930. Apparently a considerable number of deeds had been drawn up with events similar to that in Levitt v CIR which would cause the child to lose his interest in the trust. Clearly as the correspondent pointed out "many learned counsel who have drawn up these settlements have badly blundered."[63]

The difficulties of reconciling the Watson and Levitt cases caused problems for the Income Tax Codification Committee. They concluded that codification of the decision in Watson's case was not desirable because this class of case depended upon very fine distinctions and intricate questions of law, such as the difference between limited and defeasible interests, and they realised that the result might depend on slight variations in the wording of any particular instrument.[64]

In December 1932 the High Court heard the case of CIR v Clarkson-Webb[65] in which the respondent had covenanted with his brother on May 28, 1929, to pay an annual sum of £350 to be held by his brother upon trust for his nephew, the infant son of the brother. On the face of things the terms of the covenant were outside the scope of Section 20, but by a deed executed on the same date, the respondent's brother had covenanted to pay the respondent the annual sum of £350 upon trust for the respondent's own son. It was admitted by the respondent that he would not have made the disposition had it not been for the fact that his brother made a reciprocal disposition. Although the Special Commissioners allowed the appeal on the grounds that the respondent had not made the disposition directly or indirectly for the benefit of his child, Mr Justice Findlay could not agree. He thought that the respondent's disposition was part of one transaction, and that by making the provision for the benefit of his nephew he was directly procuring the making of a provision of precisely the same amount for the benefit of his own son, and that therefore the two deeds had to be looked at together. Subsequent settlement legislation makes specific reference to reciprocal arrangements in defining the settlor,[66] but Part I of Chapter XVI still relies on Clarkson-Webb to achieve the same effect.

The Clarkson-Webb case was one in which the Inland Revenue clearly had a good chance of success but in others their chances were, at best, very poor. Such a case is CIR v Firth,[67] in which the respondent convenanted to pay an annuity to a widow for her life but:

> "provided always that I may cease to pay the aforesaid three monthly sum on first obtaining the written consent of [the appellant's accountant] or of some person appointed by me other than a wife of mine."

This pushed the limit of the consent let-out for revocable dispositions to its absolute limit, because the respondent could go first to one person and then to another until he found somebody who would consent to the cessation of his liability under the deed. The Attorney General argued that this was a means whereby the efficacy of the section could be destroyed but it was held that nevertheless, the let-out applied to such a case and that it was not permissible to go into the question of whether, if it had occurred to anybody that this plan would be adopted, the whole section would have been differently framed.

The Revenue had mentioned this loophole in their paper to the Cabinet Tax Evasion Committee in February 1927, and made no suggestion that it was other than perfectly effective in getting round what they believed to be the intent of the section. It is surprising therefore that they decided to take a case some six years later, especially as a full copy of the deed was in the stated case, available for anyone to copy and use in the certain knowledge of obtaining the tax advantage involved. It seems to have been sheer folly for the Revenue to have taken this case and it is difficult to think of a reasonable explanation for having done so.

A further serious blow was dealt to the Inland Revenue by the decision in CIR v. The Duke of Westminister,[68] where a deed of covenant not caught by section 20 was used to substitute deductible charges on income for non-deductible payments to an agent and household employees. Although the case does not directly concern section 20, it illustrates the kind of modification required to that section to prevent such blatant cases of tax avoidance. It was just over eleven years before anything was done to deal with this scheme and its repercussions are still regularly discussed even now.

<u>THE IMPLICATIONS OF FAILING TO TAKE ACCOUNT OF THE FOREIGN ELEMENT</u>

In June 1932 judgement was given by the High Court in the case of Ormonde v. Brown[69] in which the appellant had in 1922 assigned certain foreign property to an American trustee to pay the net income to herself and her husband in equal shares during their joint lives. The settlor retained a power of revocation and modification but relinquished it until January 1, 1929. At this point she revoked the trust and by a separate deed transferred the trust estate to an American trust company, declaring trusts which provided for the payment of annuities to each of three persons named in the deed as a charge on the whole fund and for the payment to the appellant and her husband of the annual sum of £6,000 each. Again, however, she retained a power of revocation and modification, but if its exercise would infringe the rights of the annuitants it was only exercisable with their written consent.

The appellant was only liable under Schedule D case V on a remittance basis because the source of income was the trust.[70] The Revenue contended however that by the exercise of the power of revocation the appellant could, without the consent of any other person, obtain for herself the beneficial enjoyment of the whole income arising from the assets comprising the trust funds except the sums required to meet the irrevocable annuities. Because of this they argued that the appellant was assessable in respect of the whole income arising from the trust funds less the amount of the irrevocable annuities.

Although the Special Commissioners agreed with the Revenue's contentions, in the High Court it was held that section 20 was not a charging section and that therefore the words "any income" at the beginning of the section only referred to income which was already within the charge to UK tax.[71]

Under the rules then applicable to case V of Schedule D, income arising from stocks, shares or let property outside the UK was computed on an arising basis, whereas income from other sources outside the UK was charged on a remittance basis. Therefore, in order to shift income from an arising basis to a remittance basis it was only necessary to transfer the assets to a trust governed by the law of a State in which the income from the trust investments did not belong either legally or equitably to any of the beneficiaries. Under such a trust the identity of the various sources of income would be lost after receipt by the trustee, and the source of income to the beneficiary would be the trust itself. By such means, foreign income could be sheltered from UK income tax and surtax even though the trust was revocable by the settlor without anyone's consent. Ormonde v Brown therefore showed up yet another serious loophole for public view.

The Inland Revenue were dissatisfied with the decision in Ormonde v. Brown and admitted in the High Court in the case of Perry v. Astor[72] that they had taken that case to test the decision in Ormonde. Astor had become absolutely entitled to certain American stocks and shares on attaining the age of 21 in August 1928, but in September 1929 he transferred them to an American corporation as trustee. Under the trusts the balance of income after paying taxes and expenses was payable to Astor during his life in such amounts and at such dates as he might from time to time direct. He also retained a power of revocation. Although the Revenue agreed that the settlement was governed by the law of New York State and that Astor was not entitled to the specific income arising from the stocks and shares but only to a right in equity to enforce performance of the trust, they assessed the income arising under case V of Schedule D on the grounds that the trust was revocable without consent. Not surprisingly, the Special Commissioners decided that the case was governed by Ormonde v. Brown and allowed the appeal. In the High Court both sides merely agreed that the case should be bound by the decision in Ormonde v. Brown. However, the Inland Revenue seem to have thought that Perry v. Astor was more favourable for them than Ormonde v. Brown as no consent was required to the revocation, and they therefore took the case further. The Court of Appeal was unanimous in its view that Ormonde v. Brown was wrongly decided and that the deeming process envisaged by section 20 could be applied to Astor.

The Revenue's victory was short-lived because in March 1935 a four to one decision was given against them by the House of Lords who held that Ormonde v. Brown was rightly decided and that the words "any income" were to be construed to mean any income chargeable with tax under the British Finance Act of the year. Therefore, as the income was the foreign income of a non-resident, (the trustee), it was not chargeable and the deeming process of section 20 could not be applied to it.[73]

Thus, by March 1935, the tax shelter spotlighted by the Ormonde case had received further publicity, and the backing of the decision of the House of Lords meant that this method of avoidance could be used with certainty of success. Not only did these two cases raise the possibility of avoidance but also they drew the Revenue's attention to complex problems concerning the application of the settlement provisions to cases containing a foreign element.

There is no evidence in the preparatory papers leading to the introduction of section 20 of the Finance Act 1922 that any foreign aspects of the application of the legislation were even considered.

As Lord Macmillan pointed out in Perry v Astor, "the possible extra-territorial effects of the section were obviously not thought out and the task which the legislature has omitted to perform is imposed upon your lordships of reconciling the resulting conflict".[74] He thought that the conflict and anomalies arising in cases with a foreign element had come about because the anti-avoidance provisions had been introduced without sufficient regard to the basic scheme upon which the taxes originally rested.[75]

The anomalies referred to by Lord Macmillan arose from the Revenue's insistence that the words "any income" were to be read without any qualification, territorial or otherwise. He illustrated with four examples the anomalies which would arise if this view were correct.[76]

(1) The income arising under a revocable disposition to an American trustee of American stocks and shares by an American resident under which the income was payable to a UK resident would be deemed for UK tax purposes to be the income of the settlor and not the income of the person resident in this country.

(2) An American resident who made a disposition there under which income of American stocks and shares was payable to a UK resident for a period of five years would have that income deemed to be his and the UK resident would have no income from that source.

(3) If a UK resident made a revocable settlement of the income from foreign assets on another UK resident and then later the settlor ceased to be a UK resident, on the Revenue's contention the income would still be deemed to be the

settlors, with the result that neither the settlor nor the beneficiary would pay any tax, even though the whole of the income might be received and enjoyed by the beneficiary in the UK.[77]

(4) The rights of recovery of tax paid by the disponor against an American citizen in respect of American stocks and shares was thought to be a remarkable result following from the Crown's contention. The requirement under section 20, sub-section 3, to make additional payments to such an American beneficiary was thought to be quite unreasonable unless the settlor could succeed in recovering from that beneficiary any tax paid in this country under the terms of sub-section 2.

Lord Macmillan attempted to reconcile the conflict between the existing scheme of income tax and section 20 in the following way.

> "The reconciliation is, I suggest, to be effected by reading section 20 as designed to effect the notional amalgamation of two existing incomes both charged to income tax by the existing law. If the words "any income" are construed as they reasonably may be, to mean any income chargeable with tax under the British Finance Act of the year, the difficulties of the Crown's interpretation to a large extent disappear. For the income of the American trustee, being the income of a foreign non-resident, is not brought into charge, while the income so far as received by the resident in this country is ... brought into charge under its appropriate head."[78]

Lord Macmillan, it should be noted, only indicated that the difficulties arising would "to a large extent disappear"; he neither explained to what extent they would disappear, nor examined the anomalies and difficulties which would arise from his own interpretation of the words "any income". The Inland Revenue were left with these problems and by July 1935 had begun a detailed investigation into precisely how they would be able to interpret Astor v. Perry in such a manner as to produce a sensible and coherent way of dealing with cases involving a foreign element.[79]

The Revenue seem to have been forced to consider these problems because of a claim by a taxpayer that section 20 was of benefit to her and should be applied.[80] The facts of the case were that she had made a revocable UK settlement of UK assets in 1915, when she was UK resident, but had in the meantime become resident in the Irish Free State. She therefore claimed that as section 20 deemed the income of the trust to be hers, and she was a resident of the Irish Free State, she was entitled to exemption from UK tax and a repayment was due. After a painstaking analysis of the principles which could be derived from Astor v Perry her claim was refused.[81]

The core of the Revenue's analysis was based upon the precise meaning of "any income chargeable with UK tax" and showed the ambiguity of the word "chargeable" in this context.[82] It could refer to any one of four situations:

(a) the person is in receipt of income arising from a UK source and

  (i) is resident in the UK, or

  (ii) is not resident in the UK, or

(b) the person is resident in the UK and is in receipt of income,

  (i) arising in the UK, or

  (ii) arising outside the UK.

It was then shown that in the first anomaly raised by Lord Macmillan, (see above), the disponor in relation to the American stocks and shares was entirely outside the four classes of chargeability. In his third example the disponor was originally in the position shown by (b)(ii) above, but then on becoming non-resident fell outside the four classes of chargeability. At this stage, therefore, Lord Macmillan was concentrating on the position of the disponor only, but later, when he proceeded to apply the principle that he laid down, he referred to an "amalgamation of two existing incomes both charged to income tax by the existing law". The condition required before amalgamation could take place was therefore that there should be two existing incomes both charged to income tax by the existing law. Thus, it was argued that he must have been referring to the disponor and the person actually receiving the income. The Revenue accepted that they would have to look at the income after transfer by the disposition, with all the circumstances then prevailing, and ask whether that income might be deemed to be the income of the disponor.[83] They realised that if they were not able to look through a trust, and the trust investments produced UK income, that income would be derived by a UK beneficiary from a foreign possession to which remittance basis would apply.

The next stage in their analysis examined the residence position of the disponor and recipient. Initially one member of the Board thought that both persons had to be resident in the UK for the deeming provisions to apply, but in the end he agreed that the only limitation implied by Lord Macmillan was that the disponor himself should be resident in the UK. Such an interpretation avoided what the Board believed to be absurd situations[84] and avoided the inexpediency and impracticability of imposing taxes on non-residents. There does appear to be in all of this an element of the Board deciding which position would be best for them and then finding the logically defensible way of getting there.

The Irish resident claimant was not therefore entitled to repayment of the UK tax deducted from the income of her revocable trust. It was not merely grounds of non residence that scuppered her claim but also the Board's view that such income failed the chargeability test because, although it was chargeable on general principles, the effect of the Irish Free State resident's exemption was to make it non-chargeable and therefore not susceptible to the deeming process.

Correspondence passed between the office of the Revenue Commissioners in Dublin and the Board of Inland Revenue on this case because the Irish Revenue Authorities did not agree with the Board's view and said that they would have operated section 20 in a converse case.[85] When the Board of Inland Revenue pointed out to the Irish Revenue Authorities that their revenue was not affected and there was no necessity to pursue agreement, the matter seems to have been dropped.[86]

The Inland Revenue had learned their lesson from all this and future modifications to the settlement legislation contained specific provisions to deal with any foreign elements which might arise.[87]

DISSEMINATION OF INFORMATION CONCERNING AVOIDANCE

There was little response in the journals to the introduction of section 20 of the Finance Act 1922 and although a detailed article on the subject was promised in "The Accountant",[88] it never materialised.

The August 19, 1922 issue of "The Accountant" indicates that new conditions were to be applied to tax queries because of their increasing complexity. The Advisory Committee by whom such problems were considered was increased, as were the fees for dealing with such cases. They decided to classify cases into half-guinea cases, guinea cases, special cases involving a fee exceeding one guinea and special cases in which Counsel's opinion was required. It is likely that problems relating to this relatively new legislation would have fallen into the more expensive class and were not suitable for publication.

While there were many general queries concerning trusts, particularly arising out of repayment claims relating to relief for income accumulated during minority, there was only one query in the period up to December 1926 which specifically concerned section 20 of the Finance Act 1922.[89] Up to that time there was nothing in the technical journals concerning how to avoid the operation of the section even though at the beginning of 1926:

> "Recognising the value to accountants of the latest taxation news The Accountant has progressively increased the amount of space devoted to this subject and it is now felt that the time has arrived for a supplement [The Accountant Tax Supplement] dealing exclusively with taxation matters."[90]

Despite the fact that the means existed for the passing of information on technical matters of taxation, it was a few years before detailed articles on tax avoidance began to appear.

Although according to the Inland Revenue, section 20 was virtually ineffective by 1927, the journals of the time do not reflect this and it was probably only the best-advised taxpayers with large incomes who were actually side-stepping the provisions. It is clear from some of the queries in the journals in the few years after 1927 that many advisers were only vaguely aware of the effect of section 20 and hardly had an understanding of its detail let alone the ability to advise on its avoidance.

In its first two years there were no articles on avoidance in The Accountant Tax Supplement and no queries about section 20. In 1928 although some readers were writing in with simple tax planning ideas none related to section 20, and articles mentioned nothing of tax planning. Interest in the subject of avoidance seems to have been sparked by a series of eight articles based upon lectures entitled "The Legal Avoidance of Income Tax and Supertax by Individuals and Companies".[91] The first article explained that avoidance had been recognised as perfectly acceptable by the highest legal authorities and then proceeded to explain schemes for avoidance "which are a matter of everyday practice by accountants who are brought into sustained contact with taxation".[92] It went on to show how a covenant could be used to provide an overall tax advantage where it was payable to a dependent relative or other person with a low income.[93] Another scheme discussed the advantages of a covenant to an infant child of the covenantor, but stated that it was necessary to provide an absolute covenant by the settlor for himself and his executors to pay the annuity during the whole life of the child. The explanation given for this "whole life" requirement was the impossibility of escaping section 20 by having an annuity during the joint lives of parent and child because the covenant might not then be for the life of the child. This was clearly incorrect as a let-out existed for such cases.[94]

The publication of the above article resulted in correspondence involving variations on the theme and questions as to whether they would be successful,[95] but the two queries on the subject in 1929 reflect a poor understanding of the scope of the section.[96]

The Accountant Tax Supplement for 1930 reflects the greatest number of queries concerning section 20 in the period to 1936. There were six such queries and though some of them began to reflect slightly more sophisticated methods of avoidance, for the most part they represented simple transfers where the enquirer was worried that in some way or another the Inland Revenue might be able to mount an attack under section 20. An interesting answer was provided in August 1930 in response to the question as to whether or not a client who did not carry on any trade profession or vocation could obtain a deduction in any way for the cost of employing a secretary. Although one of the answers indicates that the expenditure "can be likened to the payment of wages of domestic servants, gardeners etc. on account of which no deduction is allowed for taxation purposes",[97] the other is far more inventive. It suggested that in order to obtain a deduction in an indirect way the client could, by deed, grant annuities to the secretary for at least seven years so that the salary would be converted to an annual payment and could be deducted as a charge on income. This is precisely the kind of arrangement used by the Duke of

Westminster,[98] and it indicates that this manner of avoidance may have become quite widely known amongst tax experts long before the Duke of Westminster case first came before the courts in March 1934.

Over the following few years the queries raised became more complex and the avoidance schemes more refined. Covenants of a fixed proportion of the payer's income were suggested as well as the voluntary repayment to a parent of the income arising under parental dispositions in favour of their children. The journals began to be used as a forum for the exchange of the experiences that practitioners were having with the Inland Revenue and by this means began to clarify Revenue practices and provide information on Commissioner's decisions.

Despite the detailed articles on the use of covenants and other dispositions and the thorough explanations of the relevant case law, some practitioners obviously were not convinced that the provisions of section 20 could be so easily avoided, and the queries and correspondence therefore continued.[99] However, it is clear from the journals that, by 1933, knowledge of the loopholes in section 20 was fairly wide-spread amongst tax practitioners, even though for some there was a great deal of uncertainty concerning the exact procedure to be followed.

By late 1934, the Inland Revenue were so concerned about the spread of this kind of avoidance that they monitored the journals; perhaps to get early warning of what was going on.[1] They were aware of the series of articles in The Law Journal in December 1934[2] explaining in detail the operation of Section 20 of the Finance Act 1922 and the case law which had shown how it could be easily circumvented. Their concern must have increased on seeing that when The Financial News of January 2, 1935 carried an article[3] explaining the main methods of avoidance, great interest was generated, and three further articles were published[4] going into all aspects of the matter, including drafting a deed to attract the lowest possible amount of stamp duty.

By April of 1935 discussion of this means of avoidance had spilled over into the newspapers. For example short articles appeared in the Evening Standard giving sufficient information to whet the appetite of any person inclined to take avoidance measures.[5]

Shortly after the Duke of Westminster case had been decided in the House of Lords, the Financial News ran a detailed article[6] explaining exactly what had happened and how the decision could be used by others. It was suggested that "...there is no reason why the scheme may not be adopted in other cases as well e.g. to payments to clubs and other annual subscriptions, the provision of board and lodging, the rendering of annual services by independent contractors, such as laundering, car maintenance and so on."[7]

As well as articles, newspapers and journals carried advertisements by charities encouraging the public to subscribe by covenant, pointing to the tax advantages of doing so, and offering advice on educational trusts to reduce the burden of school fees.[8] The professional journals and newspapers of the time thus kept the general public in touch with the current means of avoidance. No doubt the professional adviser would have had little difficulty in drafting appropriate deeds and was probably under considerable pressure to do so from clients who knew from the publicity that considerable savings of tax were available.

By no means all public opinion was in favour of tax avoidance and some dissenting voices could be heard after the publication of the Finance Bill 1935. The Law Times of June 8, 1935, expressed surprise that the Finance Bill contained no provisions to stop up the loopholes, while The Daily Telegraph of July 12, 1935 carried a letter expressing disappointment with the attitude of the Chancellor to income tax avoidance.[9]

OTHER FACTORS ENCOURAGING TAX AVOIDANCE

In the period from 1922 to 1936 there were changes in legislation and in the mode of operation of the Inland Revenue which considerably improved their chances of detecting evaders. The first stage in this process was the power given under section 22 of the Finance Act 1922 to enable the Special Commissioners to obtain detailed particulars of the sources of income and deductions claimed in super-tax returns. The Finance Act 1923 introduced an extension to the penalty provisions and an increase in their severity[10] and extended the time limit for making an assessment to six years after the end of the year of assessment.[11] In 1925 procedures were put into effect for the intensive examination of all super-tax returns over a four year cycle and this proved to be most effective in detecting evasion.[12] Other procedures were set up to detect individuals who were liable to super-tax but who had not made returns.[13] As the odds became stacked against the evader it is highly probable that both the evaders who were detected and those who were not began to shift their attention to methods of avoidance.

The Finance Act 1927 considerably tightened up the anti-avoidance provisions concerning undistributed income of close companies[14] and may have caused a further push towards the use of avoidance techniques involving settlements.

In the slump of 1931 the second Finance Act for that year both increased the rate of tax by six pence, to five shillings in the pound, and made considerable reductions in the personal reliefs. Furthermore, the rates of surtax were increased by an addition of ten percent to the rates at each point in the scale. Such sudden and relatively drastic increases in the total tax payable must surely have given a new fillip to avoidance, and the ratchet effect would have ensured that subsequent reductions in tax rates would not result in the reduction of avoidance to the pre-tax increase levels.

THE BOARD'S COMMITTEE ON AVOIDANCE[15]

Although in March 1927 the Cabinet Revision Committee had decided not to bring forward legislation to close the loopholes in section 20 of the Finance Act 1922, it did ask the Board of Inland Revenue to keep the progress of the practice under review.[16] It is clear that the Board took this request seriously because it upgraded its systems for measuring the extent of avoidance and monitoring the development of the methods in use. The Intelligence Division of the Special Commissioners Office, (dealing with surtax), and the Research Division, (dealing with "millionaire cases"),[17] kept records of the classes of avoidance they came across and the amounts of tax involved. Claims Branch had kept records of the numbers of minor's claims since at least 1923, but was instructed to keep more detailed records so that

> "If the duty lost becomes substantial some efforts will .... be made to stop the leakage; it is difficult to approach ministers unless we give them some idea of the yield of any proposal."[18]

By October 1933 the Board was so concerned about avoidance that it set up a committee to investigate the problem and various papers were put to it by the Intelligence Division, the Research Division and other branches which had knowledge of the methods and extent of avoidance.[19] Details were provided of the avoidance practices of millionaires as known to the Revenue in 1930.[20] The main forms of avoidance considered by the committee had all been used by millionaires at least three years earlier and what seems to have happened over time was that the practices spread to lower income groups.

The following general classification of the methods of avoidance was prepared together with estimates of the amounts of income upon which tax was avoided and the tax lost for 1931/32.

Classes of Avoidance and Estimated Amounts Involved in 1931/32

Type of Avoidance	Income[1] on which Tax was Avoided by the Largest 490 Incomes	Surtax Avoided in Other Cases
	(Research Div.)	(Intelligence Div.)
	£	£
Private holding companies, British	1,300,993	144,000
Private holding companies, abroad	1,103,517	144,000
Trusts for accumulation	844,859	92,000
Settlement on minors	154,019	98,000
Settlements on adults	276,765	13,000
Settlements on charities	597,864	10,000
Out and Out gifts of capital or annuities	478,898	20,000
Miscellaneous	62,395	-
	£4,819,310[2]	£521,000

Note 1 This column deals with income alienated, but the other is in tax terms. The amounts in each column are independent so that income in the first column is not reflected in tax in the other, and vice versa.

Note 2 This total represented almost 11% of the total income (including income upon which tax was avoided) in the 490 cases involved.

Source: Derived from reports to the Board's Tax Avoidance Committee (PRO File IR40/4576).

The Committee's report indicates that avoidance through the formation of British settlements and trusts had grown very rapidly, most particularly in the form of settlements in favour of minor children and charities, though many other classes of settlement and trust were also being used.[21] The approach of the committee was not to consider what modifications to the original provisions were required, but to try to develop new proposals to deal with each problem area.

Parental Settlements for the Benefit of Their Minor Unmarried Children. The main evidence of this form of avoidance was submitted by the Research Division of the Special Commissioners Office which gave examples of some of the extremely large cases they had come across.[22] For example, Lord Dulverton had settled shares on trustees for the benefit of his minor children and the value of the investments in 1933 was three and a half million pounds while the income upon which surtax had been lost was two hundred and twelve thousand pounds.[23] In their view the purpose of these trusts was "evasion of surtax and death duties",[24] and they pointed out that there was little to prevent the settlor destroying the trust deed once it had served its purpose. There was seldom evidence of a separate bank account or actual payment of the trust income to or for the benefit of the beneficiary.[25] They commonly came across cases where the settlor would borrow large sums from the trustees, at interest, thereby creating an annual charge which would further reduce his income.[26]

The evidence of Claims Branch showed that they had kept records of the total numbers of claims in respect of minors submitted for each year since 1922 but that until March 1928 they did not separate out claims where there had been a parental transfer of income.[27] The statistics up to March 1928 are shown in Appendix C2 and indicate only a relatively small increase in the number of such claims over the period, with almost half of the increase taking place in the year to March 31, 1928.[28] For the year ending March 31, 1929 and following years details were kept of new cases submitted involving settlements by parents and settlements by other persons on minor children, and a detailed analysis of such cases is given in Appendix C3.

The Revenue estimated the loss of income tax at £387,000 and of surtax at £163,000,[27] but pointed out that the surtax figure was probably grossly underestimated because it did not include cases where trusts had been set up primarily to accumulate income in which the ultimate beneficiaries were the minor children of the settlor.[30] Some such accumulation settlements were very large and one case involved a loss of surtax of more than £80,000 per annum.[31]

Despite the fact that the bulk of the settlements purported to be irrevocable, the Revenue believed that there were many cases where payments were not continued after the child attained majority because he would not be aware of the existence of the settlement and the parents would either destroy the deed or simply ignore it.[32] A further source of irritation to the Revenue were cases where investments alleged to have been given to the children absolutely had been re-transferred to the parent when the child attained majority, but the Board had already decided that no action could be taken to refuse relief during minority.[33] The Committee agreed that nothing could usefully be done to meet either of these cases.[34]

After discussing the possibility of treating the whole family as the unit for taxation and whether a distinction could be drawn between cases where capital was transferred irrevocably and cases where only income was transferred, the Committee finally agreed that three alternative "remedies" were practicable:[35]

(a) as a comprehensive remedy, all deeds by parents in favour of minor children, (whether transferring income or capital and whether revocable or not), could be ignored for tax purposes and the income treated as the parent's; or

(b) if the first measure was considered too drastic, a halfway house would be to treat as valid all settlements where the capital was transferred irrevocably; or

(c) if neither of the above remedies were acceptable, it would be possible to make a deduction of the child's income in calculating the amount of the parent's child allowance.

The Committee proposed that the age of majority for these purposes should be 21, though one member had argued that the age of 18 would be justified for cases in which settlements were made to provide for expensive university education, because of the lack of surtax relief for such expenditure.[36]

Detailed draft legislation to deal with all forms of settlement by parents on their children was appended to the Committee's report and included what was described as a comprehensive proposal and an alternate proposal limited to dispositions involving settlements with a power of revocation.[37] It was pointed out however, that if the latter proposal was enacted it would only affect about 20% of the settlements and would be unlikely to discourage further large-scale adoption of irrevocable settlements on children.[38] The legislation eventually introduced was a watered down version of the comprehensive proposals. (See Chapter 5).

Settlements on Adult Children

A memorandum prepared for the Committee indicated that the majority of settlements on adult children were made by surtax payers and resulted in a loss of surtax estimated at £214,000 per annum.[39] One case in particular was highlighted.[40] The settlor had covenanted to pay trustees £200 per month which was to be paid at their discretion to him or his wife, adult children or remoter issue, but he had retained the power to displace or appoint trustees and to revoke the settlement with the trustee's consent. A payment had been made by the trustees to a son, and he in turn had made a voluntary payment of the same amount to the settlor. The settlor had thus obtained a deduction for surtax purposes in respect of the payments to the trustees while the voluntary payment from the son could not be included as part of the settlor's income for surtax purposes. It was thought that such devices were probably exceptional at that time but that there was a risk that they might be resorted to to a greater extent if any attempt were made to attack settlements on minor children.[41]

The committee decided that no major changes would be recommended to the existing provision regarding settlements on adults.[42] However, it was suggested that cases where the beneficiary voluntarily handed back the whole or part of the settlement income to the settlor should be dealt with by means of a general clause on artificial transactions.[43]

Cases where the beneficiary was kept in ignorance of the trust were described as being "semi-fradulent" and they argued that to deal with this problem and to assist generally in the enforcement of the provisions concerning trusts, the Special Commissioners should be given powers to obtain particulars of any trust or disposition from both the taxpayer and, where necessary, the beneficiary.[44]

The general principle adopted by the committee was that dispositions in favour of adult children, relatives and third parties (other than charities) should be recognised as transferring the income for taxation purposes provided:-

(a) there was no power under which the settlor could obtain directly or indirectly the beneficial enjoyment of the income either for himself, any child of his under 21, or any charity; and

(b) the transaction was a genuine one, so that for instance the settlor was not getting back some consideration in capital or other non-taxable form.[45]

The fact that the period of any disposition only had to be capable of exceeding six years was thought to be unsatisfactory and the following alternative periods were suggested:-

(a) the joint lives of the donor and donee; or

(b) until either of them marries; or

(c) a definite minimum period of years.[46]

Dispositions In Favour Of Charities.

Many taxpayers, particularly wealthy ones, were adopting the seven year deed as a means of paying subscriptions to charities, and by September 29 1929 there were a total of 8,000 such deeds in force, providing for annual payments of £830,000.[47] Over the next few years the rate of growth in the use of charitable covenants accelerated so that the numbers of new deeds recorded by the Revenue were:

Year to September 1930 5,000

Year to September 1931 7,222

Year to September 1932 9,545

Year to September 1933 7,963

Four months to January 1934 2,675.[48]

The total income payable to charities under these deeds was put at not less than £2,000,000 per annum[49] with one case alone involving £240,000 per annum,[50] and over one thousand new deeds in one year relating to one charity.[51] In 1933, the total amount of tax lost as a result of these deeds was estimated "almost certainly [to] exceed one million pounds,"[52] out of an overall benefit to charities of their exemption estimated at twelve and a half million pounds.

By 1934 it had become a common practice for hospitals and other charities to have printed agreements for seven year periods available for subscribers together with a full explanation of the benefits of doing so.[53] The National Council of Social Service had taken the matter further. It had devised and publicly advertised a scheme under which subscribers could obtain exemption on their ordinary annual gifts, provided that they covenanted to pay a fixed sum, not to a specified charity, but to the Council, for seven years.[54] The distribution of that sum to charities was then made by the Council at the subscriber's direction. The scheme was very popular, with the Council receiving some £200,000 a year in subscriptions.[55]

The committee believed that the need to prevent the loss of revenue through the use of such deeds was "based partly on principle, but rests mainly on the fact of its cost to the State,"[56] and admitted that there was little in principle to distinguish payments to a charity from payments to a poor relative.[57] They proposed that if it were decided to restrict the loss of revenue by differentiating between settlements in favour of charities and those in favour of individuals, the remedy would lie in one of two methods.[58] Firstly, the original proposals put forward in 1927 could be reintroduced so that income payable by an individual to a charity would be treated as his and not that of the charity. Alternatively, they suggested that any income payable by an individual to a charity should be deemed to be his for the purpose of surtax without interfering with the income tax relief. Neither of the above proposals were to apply to income arising from capital of which the donor had absolutely divested himself of all interest in favour of the charity.[59]

Other proposals put forward to limit the loss of revenue included continuing to treat the individual in the same way but not permitting the charity to claim repayment of income tax deducted at source, and attempting a redefinition of charities for tax purposes.[60] Neither of these proposals found favour with the committee and the proposal not to repay income tax was considered to be a minor tinkering with the charity exemption by refusing relief on only one relatively small item of their income.[61]

A further concern was the non-enforcement of settlements by charities and it was considered that this should be dealt with by drafting a general clause against artificial transactions. Such a clause was never prepared.

Revocable Dispositions

The committee suggested that it was desirable to make the revocable settlement provisions effective again following the decision in the Firth case.[62] They proposed that an amendment should be made to the original provisions so that any income the beneficial enjoyment of which a person was able to regain in any way, with or without the consent of any other person, should be deemed to be his income for tax purposes.[63]

Accumulation Settlements

The first indication of the Revenue's concern about tax avoidance through accumulation of income in settlements was in a note in January 1931 on avoidance by millionaires.[64] Although its use was not at that time common it was expected to increase.[65] Some taxpayers had settled funds upon trustees to accumulate the income for a number of years and then pay it back with the capital to the settlor who then received the whole sum in a non-taxable form. While the income was accumulating the settlor usually had a power to borrow funds from the trustees so that his yearly net disposable income could be increased by the amount of surtax avoided.[66] Three examples were given of cases the Revenue had come across up to 1931.[67]

Further evidence collected over the following two years indicated that the tax lost was very considerable indeed.[68] In the largest four cases the sum total of the settled funds was £5,355,000 and the amount of income upon which surtax had been avoided had amounted to over £600,000.[69] The trustees in these cases were usually the settlor and his wife, with perhaps one other person, but in the case of Lord Londonderry the settlor was the sole trustee. In these and similar cases there was usually a provision that when the accumulations reached a certain amount a portion of them should be payable to the settlor in the form of capital. For example when the accumulations of the Duke of Hamilton's trust reached £100,000 he was eligible to receive £50,000 as capital. In other cases the accumulations were devoted to paying off mortgages and other charges upon the property which had been transferred to the trustees.[70] The trust deeds in such cases generally permitted the trustees to make loans to the settlor and Revenue officials complained of the fact that they had no means of finding out whether the settlor had borrowed money from the trustees, even though that borrowing would not have caused a tax charge.[71]

A memorandum prepared for the Committee in September 1933 indicated that the largest case was that of Lord Dulverton who had settled shares on trustees consisting of himself, his wife and an employee of the Imperial Tobacco Company. The investments, as swollen by accumulations of income, had a value at that time of three and a half million pounds, and the income on which surtax had been lost for 1931/32 was £212,000.[72]

A further form of accumulation trust was designed to enable indirect surtax relief to be obtained for life assurance premiums. If the settlor had paid such premiums himself he would only have been eligible for income tax relief, but by settling on trustees an annuity equivalent to the insurance premiums, (or investments which would produce a sum sufficient to pay those premiums), surtax relief could effectively be obtained. This formed a relatively cheap way of accumulating a large fund in an insurance policy which could eventually pass for the benefit of the family and it had been used by some particularly prominent people including Sir Victor Warrender, M.P., Sir James Leigh-Wood, Sir Godfrey Baring and Lord Bradford, with one of the trustees in the latter case being a former Attorney-General.[73]

A variation on this theme was found in the case of Captain Remington-Wilson who had settled money on trustees which was paid to a private company in exchange for shares. The company had paid all of that money back to the settlor in exchange for an annuity and then applied the annuity to the payment of premiums on a life assurance policy. This is perhaps the first example of the reverse-annuity scheme which Ronald Plummer and the Rossminster Group were to make famous some forty years later and which led to special anti-avoidance provisions in 1977.

At the second meeting of the committee, in October 1933, the problem was first considered and it was decided that insofar as the trust income was distributed and in whatever form, whether as a loan or as capital, it should be deemed to be the income of the recipient for tax purposes, but spread back over the years of accumulation without time limit. It was further decided that it would be impracticable to charge undistributed trust income year by year as there was frequently no person to whom it could be allocated due to the discretionary nature of the trust and the fact that certain beneficiaries might be unborn at that time.

By the eleventh meeting the original proposal was dropped and replaced by one under which, if the settlor, his wife or child were one of the potential beneficiaries, the income accumulated would be treated for surtax purposes as though it arose to the settlor himself. This treatment was to be applied in all cases where trustees had power to make loans to the settlor, or where by any means he might receive money from the trust.

The subsidiary problem of dealing with settlements under which income was accumulated but which were not caught under the proposals above were also considered. Three possible remedial measures were put forward:

(a) that all income accumulated should be treated as the settlor's as long as he was alive; or

(b) that the income should be allocated for surtax purposes equally between all the living potential beneficiaries, even though they had not at that time any title to the income and might never receive it; or

(c) that no charge should be made while income was accumulating for contingent interests, but that when any contingency arose and income was actually distributed, surtax should be charged for past years without time limit on the beneficiary in respect of the accumulated income received.

By the fifteenth meeting the committee had changed their minds again and decided that:

(a) a living settlor should be charged on accumulated income if he, his wife, or his minor child was a potential beneficiary, or if he had a power of revocation in favour of himself, his wife, or his minor child, but limited to the amount of the potential benefit so that it might not necessarily cover the whole of the income; and

(b) no change was to be made to the existing treatment of cases to which (a) above did not apply.[74]

Various incidental matters were also decided upon; the settlor should be given the right of recovery of any extra tax from the trustees; foreign trusts should be treated in the same way as UK trusts; and the Special Commissioners should be given powers to demand information concerning such trusts from the trustees and the settlor.

The committee's report indicates that the decisions taken at their fifteenth meeting were final, and set out detailed proposals for legislation based on the principles they had formulated.[75] They justified their proposals on the grounds that the position in such trusts was in essence substantially the same as if the settlor either made a definite disposition in favour of himself or his family, or, having made a disposition in favour of some other person, retained for himself a power of revocation.[76] It was 1938 before any of these proposals were adopted. (See Chapter 6).

Avoidance Of The Settlement Provisions By Means Of A Company

This method of avoidance had apparently been devised by Messrs. Spicer and Peglar and involved the disponor setting up a limited company in which he held the ordinary shares carrying the voting control while the persons to whom income was to be transferred held participating preferred ordinary shares carrying the right to a non-cumulative dividend of such amount as might be declared by the company in general meeting.[77] The next stage was for the disponor to arrange for the company to buy investments or an annuity from him out of the amount he subscribed for his shares. Then, through his voting control, he could in effect transfer whatever sum he chose as dividends to his intended beneficiaries, the holders of the participating preferred ordinary shares. Because those shares were not entitled to any surplus on a winding up, his capital could be returned to him intact whenever he liked by the dissolution of the company.

One case had been taken before the Special Commissioners[78] where the annuity version of the scheme had been used and it was decided that the annuity must be allowed as a deduction in calculating the payer's surtax liability. The Board did not contest that decision even though they were aware of four other occasions on which Spicer and Peglar clients had used the scheme, including one in which Lady Louis Mountbatten was paying an annuity of £100,000, part of which was then being transferred to her children through the company.79

The committee believed that this type of scheme should be dealt with by introducing provisions which would empower the Special Commissioners to disregard the transfer of property entirely and charge both parties as if the transfer had never taken place.80 Such provisions were never to be introduced, but the Revenue eventually found that, contrary to the opinions they obtained from their own solicitor, a company could be part of an arrangement involving a settlement, and this type of scheme could be successfully attacked.81

Miscellaneous Devices

By September 1933 there were a number of cases involving persons employing servants and other personal attendants who had drawn up deeds under which those employees were entitled to receive an annuity instead of their ordinary salary or wages.82 At that time the appeal in the case of the Duke of Westminster had only recently gone through the Special Commissioners and the Inland Revenue were not confident that they would win the case in the High Court.83

Another scheme involved an individual covenanting to pay an annuity to a company, (usually on some technical grounds not a close company), and receiving in return either redeemable debentures or a lump sum payable in instalments spread over a number of years.84 The annuity ranked as a deduction in computing the person's income for surtax, while the debentures or the instalments constituted capital receipts and were not liable to surtax. Variations of this device involved the transfer of the person's interest in mining rents and royalties to a company in consideration of redeemable debentures. The remedy suggested in these cases was that only the excess of the aggregate of the annual payments over the amount of the capital sum received or receivable should be deductable as a charge.[85] The reverse annuity scheme which was to cause a massive potential loss of revenue in the 1970's (see Chapter 11) was a development of the device considered by the Committee.

CONCLUSION

The settlement provisions of the Finance Act 1922 were a failure because they had been inadequately thought out and failed to take account of the hostile analysis they would receive from tax specialists. However, they retained their prophylactic effect on a large proportion of taxpayers for a long time merely because knowledge of the tax avoidance methods was so slow to spread. The Revenue no doubt learned a great deal from this early experience and exercised much greater caution with later settlement anti-avoidance legislation.

The fact that tax avoidance was considered in detail by the Cabinet shows that it was thought to be a serious problem, yet one can only guess at the reason for their failure to recommend legislation to block the settlement loopholes. It is probable that the tax cost was not sufficient to be of concern and that the more widespread, well known and costly avoidance through close companies took precedence. Their decision to attack charitable covenants was a serious political misjudgement serving only to advertise the very scheme they were trying to stop.

It was not until the early 1930's that the mechanisms for spreading detailed knowledge about methods of avoidance of section 20 really got to work, but only when interest in the matter had reached fever pitch, with regular detailed newspaper articles and advertisements of avoidance schemes, was action contemplated. The cause of this long delay is not clear, but had the nettle been grasped earlier there could have been far fewer people who, having tasted the drug of tax avoidance, found themselves hooked!

The Income Tax Codification Committee appointed in October 1927 and reporting in April 1936,[86] reviewed section 20 of the Finance Act 1922 and concluded that it was unsatisfactory in many respects and plainly inadequate to fulfil its apparent intention. They suggested that the matter was worthy of the attention of Parliament.[87]

CHAPTER 5

1936: THE SECOND ATTACK: PARENTAL TRANSFERS OF INCOME TO THEIR CHILDREN

INTRODUCTION

Despite the Inland Revenue collecting evidence showing how avoidance through settlements by parents on their minor children had become widespread, they were unable to obtain approval for legislative action until the avoidance had become wholesale and flagrant and its growth rate had begun to almost double each year. By the time action was taken, so many people were using this form of avoidance that dealing with it was politically problematical and the Chancellor was very wary about the advice he received from the Revenue as to how it should be attacked. Preliminary detailed tactical and presentational planning did not prevent considerable criticism of the proposed legislation from all sides, even though many MP's, (including lawyers), admitted they found it almost unintelligible.

THE INLAND REVENUE BUILD UP THEIR CASE

Although in April 1929 the Board did not contemplate taking any action in connection with the increasing number of repayment claims which related to parental transfers of income to children,[1] by May 1930, a little more concern was being shown and discussions took place on how best to analyse the claims to produce useful statistics[2]. It was eventually decided to classify children's incomes in order to show the number of cases in which the parent's child allowance was being preserved, those in which the maximum relief at the standard rate was being secured, and those in which the apparent object was obtaining the maximum possible tax relief.[3] Statistics based upon this exercise are shown in Appendix C3.

In October 1930, a bank employee called the Inland Revenue and claimed that he knew of cases where deeds had been drawn up providing for considerable payments to children that were not intended to be acted on and would be destroyed before the child reached the age of majority.[4] This claim was brought to the attention of very senior Inland Revenue officials, and was thought merely to confirm what they had suspected for some time. They considered the whole question of fraudulent deeds and concluded that all dispositions in favour of children should be deemed inoperative for tax purposes during their minority, except where the disposition was on death.[5] The problem of mala fides was raised again by Claims Branch in their report on the statistics for the year ending March 31 1931. They suggested that District Inspectors should be asked to submit any case in which the beneficiary ceased to receive settlement income or in which a settlor omitted an annuity from his declarations of income and advised the Revenue that payments had ceased. These submissions were expected to lead to investigations into "irregular revocations"[6], but it seems that the suggestion was not taken up.

In April 1931, Claims Branch were unable to offer any definite explanation for the increase in dispositions but:

> "Observation has revealed that several firms of solicitors and accountants have at last realised that easy money is to be obtained by acting as trustees, ... and are clearly bringing to the notice of their clients the possibility of settlements in favour of children. As existing clients are likely to acquaint their immediate friends, it is perhaps not too much to expect a

> mushroom growth of this form of avoidance, particularly when any revival in industry results in bigger income tax liability for an increasing number of people. The fact that a well known firm of Scottish legal advisers, who issue a roneoed form of settlement, have in the last twelve months put in a number of such settlements for residents this side of the border must be due mainly to recommendation and is indicative of the mushroom growth suggested above."[7]

By July of 1931 the Claims Branch reports indicated that the "professional trusteeships" referred to in the report three months earlier had continued to spread, and in the two months to June 30, 1931 ninety cases had been observed, embracing seven firms. It was thought that:

> "The rapid expansion of the last three months was due in no small measure to the fact that prohibiting legislation in this year's Finance Bill was anticipated in the professions".[8]

No evidence could be found to indicate that such legislation was being seriously contemplated at the time.

In October 1931, estimates were made by the Revenue of the loss of tax arising from deeds of settlement on minor children, not only by their parents but also by others[9]. They calculated the loss at £587,000 per annum, but this figure was revised following the Finance (No. 2) Act of 1931, to £429,000. These calculations seem to have underestimated the true position because the Board had, in August 1931, made an order under[10] which, pending the decision in Wiggins v Watson,[11] Inspectors were to reject any deed containing a limited power of revocation, and when that case was lost the 230 cases which had been rejected and excluded from the estimates would have considerably swelled the figure.

The total loss of tax had become so great that in the eyes of a Claims

Branch Official:

> "We now have evidence of a scale of legal evasion large enough to warrant immediate consideration of legislative action. In considering what forms such action should take we must not lose sight of the ingenuity which has been displayed in defeating the object of the existing legislation. No mere tinkering will stop this leak, and for my part I can see little prospect of success short of [making] all dispositions in favour of children (any children, not merely children of the disponor) inoperative for income and surtax during minority - including dispositions of capital". [12]

Despite such a strong plea, there is no evidence of any attempt to draft legislation or to consider the form it could take or to address the problems which might arise out of it, until the Board set up its tax avoidance committee in late 1933. (See later).

Meanwhile the avoidance continued to grow rapidly, and in April 1934 Claims Branch reported that certain agents were submitting deeds in large numbers as a result of advertisements in the daily press and personal recommendation.

> "...they...comb effectively through various large staffs of employees. One agency is for example "working" the dockyards, Royal Marines and other naval establishments." [13]

Still nothing was done, but in 1933/34 and following years, records were kept of the total income involved in parental dispositions (see Appendix C3) and other dispositions (see Appendix D1) in favour of minors.

By May 1934, Claims Branch were so concerned that they put forward a memorandum to the Chief Inspector setting out the amendments which they thought necessary to make section 20 of the Finance Act 1922 effective. They told him that if it was too late to take action in the Finance Bill of 1934, or if the figures were not thought to be sufficiently alarming to persuade Parliament of the need for change, they would be happy to make an interim report at December 31, so that the position could be considered in good time for the next year's Bill.[14]

The Secretary of Taxes submitted the Claims Branch memorandum to the Chief Inspector and observed that the "procedure represents a substantial and cumulative waste of national effort and administrative time."[15] He suggested that a formal request should be made to the Board to set in motion the procedure to obtain appropriate amendments to the Finance Act 1922 provisions. The Chief Inspector's reply merely pointed out that the Chancellor had already told the House that there would be no preventative legislation in the 1934 Finance Bill.[16]

No evidence could be found to indicate why anti-avoidance provisions were not introduced in the Finance Bill 1935. The interim report to December 1934 volunteered by Claims Branch does not appear to have been prepared and by the time the statistics for the year ending March 1935 were submitted on April 15 1935, they were perhaps a little too late to influence the content of the Finance Bill of that year, even though they showed the epidemic proportions which avoidance had taken on.

In the year to March 31 1935, the number of claims submitted in respect of settlements by parents was over two and half times the figure for the previous year.[17] Claims Branch reported that April 1935 had commenced with the receipt of an unprecedented number of deeds, and indicated that there was a marked increase in the number of agencies which were thriving almost exclusively on settlements by parents.[18] Some agencies, and in particular those run by qualified accountants, "are advising clients to make dispositions which are out of all reasonable proportion to income".[19] Banks were apparently a little more conservative and "are usually careful to emphasise that they pay regard to the grantor's income in advising upon the amount of the disposition."[20] However, accountants were "as usual setting the pace [such that] it will only be a matter of time before every agency advises its clients to make covenants for the maximum sum on which repayment can be claimed."[21]

The Chief Inspector was updated on the current situation on April 30 1935, and was told that the number of new settlements was likely to double in 1935/36 if no action was taken. He referred the matter to the Board, and by November 1935 the Chairman was writing to the Chancellor of the Exchequer "to press upon you the urgency of taking some step to check the evil".[22]

PERSUADING MINISTERS AND DECIDING POLICY AND STRATEGY

The Board of Inland Revenue were worried about all forms of avoidance but decided to put forward a case for anti-avoidance legislation in only three areas; transfers of assets abroad, settlements in favour of minor children, and close companies.

The Revenue's case in respect of parental settlements on minors was extremely persuasive, though the language used was often very emotive. It did not involve a reasoned argument on a theoretical basis, but a wide variety of possible justifications for taking action.[23] Three of the arguments were related to the likely growth in the problem and were based on the fact that;

(a) propoganda, (this was the word used by the Chairman of the Board) in favour of avoidance had been considerably assisted by comments of the House of Lords in the Duke of Westminster case; and

(b) touting for business was taking place by the issue of circulars worded in such a way as to reduce any pangs of conscience felt by potential clients; and

(c) the first book dealing purely with methods of tax avoidance had been recently published.[24]

The other supporting arguments were more political and pointed out that:

(a) the situation had considerable possibilities for public scandal; and

(b) it would be politically advisable to deal with avoidance in the earlier rather than the later years of a Parliament.

Sir Warren Fisher, (The Permanent Secretary to the Treasury), had mentioned to the Revenue that he thought the whole subject of taxation should be examined by a select committee of the House of Commons. Although the Inland Revenue could see this would have the advantage of facilitating the passage of anti-avoidance provisions through Parliament, they advised the Chancellor against it because of the difficulty of preventing the committee extracting evidence from them concerning not only the details of different types of avoidance but also the particulars of individual cases[25]. They believed that there would be a grave risk that such evidence might be exploited by the unscrupulous to create scandal and pointed out that examination by a select committee

> "might well prove extremely embarrassing and lead to recommendations on certain aspects of evasion which you might feel involved questions of policy which it is for you alone to decide."[26]

All this, when added to the delay which would take place between the setting up of the committee, its report, and the eventual introduction of any remedial legislation, led the Chancellor to reject Fisher's suggestion.

The Chairman of the Board explained to the Chancellor the "largely artificial... tax dodging" methods by which parents were avoiding tax by the creation of settlements on their minor children and argued that there was little "moral justification" for this because of a parent's obligation to maintain his children during their minority[27]. Statistics showing the growth in the number of these settlements were put before the Chancellor together with copies of some of the leaflets being used by the "touts". Interestingly, at this initial stage, (November 1935) the Chairman of the Board suggested that it was not necessary to deal with cases where a parent transferred capital outright to minor children, and that it was only covenanted payments which called for remedial action.[28] By January 1936, his view had changed and he was arguing that all settlements on minor children should be caught.[29]

The Chairman got no direct reply to his paper, but heard indirectly from the Treasury that the Chancellor had asked them for their views "on the horrible topic of legal avoidance"after they had discussed it with Sir Warren Fisher.[30] The Treasury were anxious to obtain legislation because "apart from anything else the growing loss of money is serious with the increasing burdens with which the Exchequer is faced."[31] They were much impressed by the Revenue's statistics concerning the rapid growth in the number of deeds and by the disparity that this had caused between the liability of individuals whose circumstances were otherwise identical.[32] They estimated that if everyone entered into these arrangements the tax lost would be fifty million pounds per annum[33] but the Revenue calculated that twenty million pounds per annum was the maximum.[34]

The Treasury was most unhappy about the situation which would arise if a large number of people did not enter into such arrangements "either because they have not heard of the trick or because they dislike it"[35] and thought it at least arguable that the State should level things up either by removing the tax advantages or by explaining it on Income Tax Returns so that everyone would be treated alike.[36]

The Treasury made a suggestion to which the Inland Revenue took great exception. It was that:

> ... "the sting could be taken out of the proposal if it were possible to accompany it by another proposal giving a relief, equal in amount to the present loss of duty, to taxpayers with young children. The Revenue would then save in the future all the successive cumulative losses that would otherwise arise through the perpetuation of this anomaly."[37]

The Revenue argued that as Parliament had decided that £50 was the proper allowance for a child, any anti-avoidance provisions should be introduced "without any corresponding sop in compensation"[38] and that any increase in child allowance might well lead to the criticism that other allowances were inadequate.[39] The question of "a sop" was to become one argument which the Revenue were eventually to lose.

The Treasury realised that any legislation on this matter would probably prove to be "in the parliamentary sense, extrememly troublesome".[40] Although the details of their advice to the Chancellor are not known, he took the papers concerning tax avoidance away with him over Christmas and had by the New Year decided that he would like to deal with the main forms of avoidance together in the forthcoming Budget to "get the matter over, rather than have a series of difficult debates in successive years".[41]. His instructions were that the proposals should be considered with the utmost care, particularly from the point of view of the criticism which would be directed against them from lawyers and the business world.[42] He expected the arguments for anti-avoidance legislation to be well supported by illustrations and he therefore delegated responsibility for the matter to the Financial Secretary to the Treasury, who was to study the whole area with the support of the Inland Revenue and report back.[43]

The process of giving a detailed briefing to the Financial Secretary, Mr W S Morrison, began at an interview between him and three members of the Board on January 6, 1936.[44] Morrison thought that avoidance through children's settlements was quite different from other forms of avoidance because it was practised to a considerable extent by the middle class taxpayer, who would contend that he was justified in adopting the device because of the comparatively heavy burden of taxation on the family man.[45] He therefore insisted that despite the Revenue's distaste, proper consideration be given to increasing child allowance, and requested alternative costed proposals so that he could make an appropriate recommendation to the Chancellor.[46]

At this first meeting the Inland Revenue modified the original proposals they had put to the Chancellor and urged that it was essential for the provisions to catch settlements of capital as well as transfers of income.[47] They pointed out that if the provisions were restricted to cases where income was transferred, they would be seen as being aimed at the professional man and not the well-off capitalist.[48] Morrison did not disagree but asked for a note on the point.[49]

The Revenue took eleven days to reply to the Financial Secretary, which, in the context of preparatory work for forthcoming legislation, was an extremely long time. It is probable that they greatly regretted their original blunder in suggesting that capital settlements should be outside the anti-avoidance provisions and were therefore being careful to make a watertight case to show why such settlements should be caught. The major points they made in their paper on this matter are set out below.[50]

(1) There were difficulties in finding any reason for drawing a distinction between capital settlements and income settlements.

(2) Difficulties could be expected in Parliament because the distinction would be represented as one between the middle classes and the wealthy classes.

(3) The family was the normal unit of society and ideally should be the unit for taxation and although there were practical difficulties in adopting such a general rule, it was possible to go some way towards it by aggregating with the parents' income any income of their children which was derived from them.

(4) In the same way that protection of tax revenue required the income of a husband and wife to be aggregated, those same considerations applied to income arising from children's settlements.[51]

(5) If capital settlements were not included, it would be construed as Parliament's recognition of the propriety of reducing tax liabilities by such transfers of capital, and would therefore act as an incentive to further avoidance.

The Revenue were also unhappy with the idea of increasing child allowance as compensation for the proposed anti-avoidance provisions, and although the Financial Secretary did not ask for any comments on this, they could not resist putting forward detailed arguments against it. Firstly, they pointed out that "when similar legislation was passed in 1922 it was not found necessary to give any sop to compensate for the new liability".[52] Secondly, they suggested that the anti-avoidance provisions would not come as a surprise, because the professionals engaged in income tax work had long been expecting remedial legislation.[53] Thirdly, they reminded him that the Chancellor had, in the previous two years, received many letters of complaint concerning the injustice caused to the honest taxpayer by those who were "involved in artificial arrangements".[54] Finally, it was urged that the legislation could be shown to be so necessary in the interests of tax revenue and of justice that it should obtain parliamentary consent without any quid pro quo.[55]

Clearly, the Revenue were not going to give in without a fight, but grudgingly accepted that "if there must be a sugaring of the pill" the child allowance should be increased from £50 to £60, at an annual cost of two million pounds in a full year.[56] Even at this point they could not resist a side-swipe at the suggested course of action by pointing out that the benefit would be much greater for those with small incomes, while for the person liable to surtax the increase would provide "little sugaring for the pill he has to face", because of the much larger settlements involved.[57]

Even by April 1936, the Revenue appear not to have given up hope, as the Chairman's comments in response to a request by the Treasury "for a note on the nature of this sop to be given to make the children's evasion clause more palatable," show.[58]

> "In principle it is quite unsound that the Chancellor should not be able to retrieve losses from such evasion without giving up something in return .... However, on the present occasion the Chancellor may well think that the operation he has to perform necessitates some kind of anaesthetic. The trouble is that, so far as I can see, he can only have one kind of anaesthetic, in a large number of cases it will really be unnecessary, while in others it will do nothing effective to counter the pain and shock of the operation."[59]

Before making his report to the Chancellor, the Financial Secretary requested one further piece of information. He wanted an estimate of the number of settlements in five years time if no action was taken, and the annual loss which they would cause, assuming that the most recent rate of increase was maintained [60]. The answer was that there would be a quarter of a million settlements and an annual loss of revenue of eight million pounds.[61]

On February 11, 1936, the Financial Secretary advised the Chancellor that there were two main reasons for immediate anti-avoidance legislation; firstly, the longer the delay the greater would be the number and strength of the interests adversely affected; and secondly, "the conjunction of such legislation with the necessity for repairing deficiencies in our armaments appears favourable".[62] He had noticed that the material being circulated by "tax dodging agencies" had been combined with judicial pronouncements to create among those affected "a moral standard different from that which governs the memoranda of the Board,"[63] and warned of the serious parliamentary opposition which this implied. He expected that most people would be reluctant to defend avoidance openly, and that the opposition would therefore take the form of wrecking amendments.[64]

He advised the Chancellor that two things ought to be remembered about children's settlements:

(a) taxpayer's with small incomes did not generally attach the same degree of moral obliquity to the matter as the Board; and

(b) there were unconscious associations aroused by references to children and the family which tended to make people gloss over the ethical features of anything done for their benefit.[65]

Nevertheless, the principle upon which this form of avoidance was to be attacked was the injustice of having two men with the same incomes and the same burdens paying different amounts of tax.

Having provided the Chancellor with details of the loss to the Exchequer caused by this form of avoidance and the estimated loss in five years time if nothing were done, the Financial Secretary then put forward his views on minimising the political problems. He believed that the overall problem was to present the matter in a way which would ensure that the taxpayer saw the anti-avoidance provisions as defensible on the grounds of fairness and did not view them as "a mere tightening of the screw."[65] It appears to have been his idea to suggest that the presentation should be from the point of view of the taxation of the family unit, so that it could be argued that the income of minor children was in reality the family income insofar as it was obtained from the parents. This approach would enable ministers to symphathise with the financial struggles of parents bringing up children and to point out that no increased taxation on them was intended but that on the contrary, the intention was lighten their total burden, but "lightened by Parliament, fairly and equally all round, and not as at present unequally and unfairly by the activities of tax dodging experts."[67] To buy this escape route he suggested that the child allowance be increased by £10 which, at a cost of two million pounds in a full year, was slightly less than the annual loss of tax from the use of such avoidance.

The Financial Secretary was obviously much impressed by the Revenue's arguments concerning equality of treatment between capital settlements and income settlements and relied heavily on them in proposing to the Chancellor that capital settlements should be brought within the proposed anti-avoidance provision.

DRAFTING

Even though the Financial Secretary did not submit his suggestions to the Chancellor until February 11, 1936, the Board had, irrespective of the lack of authority from the Chancellor, written to Parliamentary

Counsel some two weeks earlier with a suggested draft clause.[68] The short covering letter merely explained the background to the need for legislation and that it was intended to cover,

(a) dispositions of income;

(b) outright capital transfers; and

(c) cases where income was accumulated for the benefit of the child.[69]

The Revenue's draft clause was worded to achieve these aims and also included provision for recovery rights for the settlor and a requirement that he should pay over to the settlement any extra repayment he obtained as a result of the deeming process.

The Chancellor's reaction to the paper from the Financial Secretary is not known, but by March 4, 1936, Parliamentary Counsel had prepared his first draft of the legislation and it would appear therefore that the Chancellor had agreed to go ahead.[70] A long memorandum from Parliamentary Counsel to the Inland Revenue gave a detailed account of why there were differences between his draft and theirs.[71] Largely they arose from the draftsman's use of terminology from the Codification Bill which was to be published before the Finance Bill. Realising that any departures from the model drafting of the Codification Committee would have to be explained, he thought it better to follow their wording, even though it referred to section 20 of the Finance Act 1922 and much of this was to be repealed in the forthcoming Bill.

The draft clause prepared by the Revenue contained a let-out where the income did not exceed £5. The provision was retained in Parliamentary Counsel's first draft which required the income arising in a settlement to be examined each year to see whether it exceeded the £5 limit when divided by the number of children affected. It was realised that difficulties would arise where income varied from year to year because of changes in rates of interest or dividends, or where in the case of a settlement on several children, one or more of them died, thereby increasing the income payable for the benefit of the others. There is a handwritten note alongside these provisions indicating that they were only to be put in at the committee stage. It is intriguing to see that there was a clear intention to include such a mitigation but that it was to be held back and presented as a concession so that the Government would appear to be open to reasonable suggestions. Sure enough, the National Savings Committee made representations and the provisions were re-inserted as a "concession" at the report stage.

Parliamentary Counsel's first draft contained information powers which were so widely drawn that even he himself found it necessary to comment on them.

> "I hope to goodness the Special Commissioners don't pitch on me. I am a trustee of a dozen or more ordinary marriage settlements, which, though they are in no sense tax dodging, will be hit... and to comply with this sub-section will take me several days work."[72]

A considerable narrowing down of these information powers was eventually made at the committee stage.

Although the Revenue's original draft did not deal with adopted children, this point was taken up with them by the draftsman and it was agreed that he should include any adopted children, whether or not they were adopted under the Adoption of Children Act 1926, or the

Adoption of Children (Scotland) Act 1930. A problem was foreseen if a child was adopted without an adoption order and then the real parents regained custody, because it would have been anomalous for income settled on such a child to continue to be treated as the settlor's after the child had returned to his real parents. Parliamentary Counsel's original draft could have been interpreted in such a way as to catch such a situation, but the draftsman thought it would only apply for the period of adoption. Although he thought it arguable that the deeming process would continue to apply even though the child subsequently ceased to be adopted, nothing was done to clarify the point. There was also some difficulty over the meaning of adoption, but the draftman suggested that if by chance it did not include a child adopted without a formal order, it probably would not matter, and it would hardly be worth putting the point beyond doubt. The Inland Revenue seem to have agreed.[73]

The Revenue's original draft contained the following:

> "... any income which, by virtue or in consequence of any transfer of assets made by any person, is or may become payable to or applicable for the benefit of a child of that person."[74]

The draftsman pointed out that if transfers to any person were included, then no outright transfer by a parent with a minor child could escape the operation of the clause because the income derived from the assets could, if the donee chose, be payable to the child of the donor. He did not think that anything would be lost by confining the clause to transfers to children because if assets were transferred to some other person on the understanding that any income arising should be applied for the benefit of the transferor's children, that transaction would be an arrangement and accordingly would be caught as a settlement. Parliamentary Counsel's first draft therefore excluded transfers of assets from the provisions but his second draft did not, and there is nothing to indicate why he changed his mind.

The informalities of the relationship between Parliamentary Counsel and the Inland Revenue at this time is reflected by the inclusion of a personal question at the end of one of the draftsman's letters.[75] He asked the Revenue how the clause would apply to one of his own cases in which the settlor had settled his house and property on his son and the trustees had leased it back to the settlor. The draftsman was unsure if the settlor would be taxed on the rent which he paid the trustees as well as under the old Schedule A. It is perhaps a little surprising to see the draftsman of the legislation asking the Inland Revenue how it would operate, but it does illustrate that the Revenue were no mere junior partners in the drafting process.[76]

On March 19, 1936, a copy of the draft clause was sent by the Inland Revenue to the Financial Secretary to the Treasury along with a detailed note of its manner of operation and further points requiring consideration.[77] The opportunity was taken, yet again, to explain in detail the need for and justification of the clause and the principles upon which it could be defended. Three pages were devoted to going over the same ground, thus creating the impression that the Revenue believed that unless they repeated themselves, the politicians would forget or not understand what was involved.

Even at this stage the Chancellor had not made a final decision to go ahead with legislation,[78] so the Financial Secretary's instructions to the Revenue had been to draft a clause "on wide lines".[79] In their response to him they pointed out that if the Chancellor chose to go ahead, a decision would be required on the following matters:

(a) whether the provisions should apply to irrevocable capital settlements

(b) whether the age of majority should be 21;

(c) whether any exemptions were to apply; and

(d) whether to include any compensatory increase in child allowance.[80]

In their paper to the Financial Secretary the Revenue warned that there would almost certainly be vigorous attempts to draw a distinction between income settlements and capital settlements, and yet again, most forcibly put forward their arguments for not making such a distinction. After explaining the manner of operation of each sub-clause the question of how to deal with alleged cases of hardship was examined. The Revenue thought that, initially, no exceptions should be admitted, but indicated to the Financial Secretary some of the possible lines of attack which might be used in support of let-outs.[81] These included:

(a) children with small savings derived from parents;

(b) a father paying maintenance for a child where the parents were divorced;

(c) a child working away from home where the father had provided income or capital for the child's maintenance; and

(d) illegitimate children not living at home with the father.

The Revenue put forward no suggestions for dealing with such cases or for resisting arguments concerning the hardships they involved.

Parliamentary Counsel's third draft on March 20, 1936[82] took account of the Revenue's insistence on the insertion of words making it clear that the section would only apply where the settlor was alive. Their concern was that if, on his death-bed, a settlor made a settlement on his minor child, it might be possible that the income arising under the settlement would be the deceased's and not the child's. This seems to be an extraordinary proposition, but the Inland Revenue were sufficiently concerned about it to take the possibility seriously, and unlike in 1922 when the draftsman had argued that there was no problem, this time the Revenue met with no resistance.

Following further discussions between both sides, a fourth draft was produced[83] which included two significant changes. Firstly, it provided that no repayment could arise when a child obtained an absolute interest in income which had been accumulated for its benefit if that income had already been deemed to be the settlor's. Secondly, an insertion was made into the definition of income so that it included "any income whatsoever, whether or not it would have been chargeable to income tax under any provision of the Income Tax Acts apart from the provisions of this section." The purpose of this definition was to over-ride the decision in Perry v Astor.[84] This subject had caused disagreement between the Revenue and the draftman but in the end the draftsman inserted his own wording on the grounds that it was very close to that used in Lord Macmillan's judgement.[85] This approach did not find favour with the Inland Revenue, who thought it was so wide that it might have caught receipts like capital gains chargeable under the United States Income Tax Law but which would never be chargeable under the UK Income Tax Acts. The draftsman admitted his error and modified the definition to fit the Revenue's requirements.[86]

Parliamentary Counsel prepared a draft resolution for the Ways and Means Committee, setting out in some detail the way in which the eventual clause would apply,[87] but the Revenue were unhappy with this and instructed that the resolution should be as non-committal as possible.[88] Although he followed these instructions, the draftman made it clear that he had objections to doing so, not only because it was very unusual and unsupportable by precedent,[89] but also because there was a risk that the authorities of the House might rule that such a general wording did not cover some point which it was particularly desired to include at some later stage. He believed that the resolution was so wide that it would cause considerable alarm. The underlying cause of this problem was the Chancellor's indecision on what classes of settlement were to be caught.

In early April the Financial Secretary raised with the Revenue the question of whether irrevocable settlements of capital were to be caught. While he saw no difficulty if income was paid to or for the benefit of a minor child, he foresaw trouble in getting proposals for deeming accumulated income to be the parent's through the House of Commons.[90] Within twenty-four hours, the Revenue sent the Financial Secretary a seven page paper providing full arguments as to why it was essential for such accumulated income to be caught.[91]

Not safisfied with these efforts to get their own way, the Chairman of the Board wrote to the Chancellor's Private Secretary under the pretext of explaining why the notes on the Budget resolution were so long.[92] After symphathising with the Chancellor's doubts in attacking irrevocable capital settlements in which income was accumulated and the settlor was excluded from benefit, (and yet still had to maintain and educate his child), he put forward the following five grounds for treating such settlements on the same footing as others.[93]

(1) The essence of the proposals was to provide that shifting of resources within the family should not diminish tax liability. "If the accumulated income referred to is to be excluded we are starting with a big hole in the net."[94]

(2) If irrevocable accumulation settlements were not treated in the same way as others, it would, in effect, be an admission that a particular form of saving carried a tax exemption while, in general, tax law did not recognise saving as diminishing tax liability.

(3) The loss would be serious, (three quarters of a million pounds in a full year), and it would grow.

(4) "The device is readily available to the rich surtax payer. It is in fact where the big money is. We have information of cases in which very large sums are involved. If the easier doors of evasion ... are closed there will certainly be increased resort to this method of egress."[95]

(5) One could never be certain that once the settlement had served its purpose the capital would not pass back to the parent.

THE BUDGET STATEMENT, RESOLUTION AND DEBATES

On April 21, 1936, the Chancellor presented his Budget Statement and in introducing the various proposed anti-avoidance provisions described them as "certain minor changes in the legislation."[96] He admitted it was natural that the higher the tax rate was raised the greater was the inducement to avoid it, but "the burden at the present time is high enough to attract the attention of ingenious minds, and discoveries and inventions have now proceeded to such a point that it is necessary to ask Parliament to intervene."[97] Although he said he did not have time to describe in detail the various ways in which avoidance was taking place, he had not in fact decided the precise extent of the legislation he intended to introduce, and therefore had to be suitably vague.

However, he had decided that income settlements were to be dealt with and gave a fairly full account of how they operated and how they had grown. Detailed extracts were read out from the documents which were being "issued wholesale all over the country."[98] A particularly blatant example was of course provided, which explained that "you would meet the technical requirements if you drew a cheque payable to Deed of Covenant or Bearer, and paid it into your own bank account as if it were a dividend warrant" and concluded by saying "your friends will thank you for an introduction to our scheme and I should be happy to send you a cheque for ten shillings and sixpence in respect of any new client introduced and accepted by us."[99]

The Chancellor went on to paint the picture of a householder in the suburbs receiving such a document and reading it with growing delight as he found that he could substantially reduce his liability to tax, and then remembering that he should do unto others as he should be done by, and in an act of neighbourly kindness, passing the document over the fence. Within a short time there would not have been a householder in the neighbourhood who would not be introduced to this philanthropic agent who had come to the assistance of the British taxpayer. It was also explained that various insurance agents were hawking schemes of this kind in the following terms:-

> "We are going to save you money, and the only condition which I wish to make is that you regard this as confidential and apply every penny of the savings for the benefit of yourself, wife and children on a policy with my company. This will be the only gain I will receive, and as this is my profession I depend upon your word not to divulge the scheme to any other insurance representative."[1]

While the Chancellor was careful not to say that every transaction under which a man parted with some of his income for the benefit of his child was done for avoidance purposes, he opined that everybody would agree that all parents ought to be treated alike. He therefore proposed that "the legislation will take the form of saying that the income of an infant and unmarried child which is in any way derived from the parent shall be aggregated for all purposes of income tax law with the income of the parent."[2] The reference to income which was in any way derived from the parent was to cause the Chancellor problems later, as it implied that the legislation was going to be as widely drawn as possible. This may have been a misjudgement because he was apparently very uncertain at this time what the precise width of the anti-avoidance legislation was going to be but it is more likely that he made the statement deliberately in order to test the water and see what kind of reaction he got, while still leaving sufficient time to make appropriate modifications to the Bill before it was published.

The Board of Inland Revenue provided ministers with eighteen pages of detailed notes on the Budget resolution concerning settlements on children, which itself only ran to seventy-one words[3]. The notes provided little new information but pressed home the old arguments in slightly different words. One new point put forward was that if no attempt was made to stop this method of tax avoidance, it would emphasise the inequality of the tax burden between those who had made use of the loophole and those who had not, and it would encourage the view that it was acceptable for taxpayers to avoid, by any colourable means, the tax liabilities which Parliament had intended them to bear[4]. The Board thought that in the long run this might prejudice the willingness of the general body of taxpayers to pay, and it would then have serious knock-on effects for the administration of the tax system.[5]

Not surprisingly, the Board took the opportunity in the notes to impress upon ministers yet again, all the reasons for taking action against irrevocable accumulation settlements, even though they had already been fully rehearsed in the paper to the Financial Secretary. However, one entirely new aspect of the problem concerned the distinction between income spent on a child and income accumulated for him.[6] It was realised that payments from a trust might represent capital rather than income, and that a payment in any given year might exceed both the income of that year and the accumulated income of previous years. To deal with this the Board thought that all payments after 1935/36 should be deemed to be income to the extent of the income arising to the trust after 1935/36, and that the amount deemed to be income would have to be spread over more than one year if it exceeded the income arising in the year of payment.[7]

Despite their hopes of persuading the Chancellor otherwise, the Board had begun to think about the details of the legislation they would find acceptable if he were to decide that irrevocable capital accumulation settlements were not to be caught. They therefore made the point in their notes that with such a let-out there would have to be "an absolute standard of irrevocability that would not permit of any discretion by the settlor or by any other person."[8] The Revenue told the Chancellor to expect demands for exceptions where the deed merely contained a clause permitting revocation to prevent the capital being squandered if the child turned out to be a spendthrift, or to prevent it being diverted into "channels repugnant to the parent."[9] They warned that if any revocation power was permitted "it would open the door once again to the tax dodger who could easily appoint tame trustees whom he could rely on to agree to revocation whenever the parent desired."[10]

The Times of April 23, 1936, carried an article by their parliamentary correspondent suggesting that the Budget resolution could be circumvented by mutual arrangements between A and B under which A provided for B's children and B provided for A's children, or by A transferring assets to B to make a settlement on A's children. The Inland Revenue wrote to the Treasury the following day stating that the article gave the Chancellor and his advisers little credit for imagination, and pointed out that the provisions under which CIR v Clarkson-Webb[11] was decided against the taxpayer were reproduced in the draft clause[12]. It was suggested that if the point was raised in the House, the reply should be that such an obvious device would not be overlooked.[13]

There was a rapid response to the Chancellor's statement that the anti-avoidance provisions would apply to any income which was "in any way derived from the parent". The day after the Budget speech[14] Major Hills asked the Chancellor to think again about where the lines should be drawn, because although he agreed that income settlements ought to be caught, he thought irrevocable capital settlements were on a different footing[15]. The latter settlements were described as "educational trusts", and an attempt was made to evoke sympathy for them by showing that they were only used to satisfy the need to ensure that a child received a decent education[16]. Concern was also expressed that the Chancellor's words would catch cases in which the parent took out an education policy with an insurance company[17] but confirmation was later given that such policies would not be caught.

The Budget resolution made clear that it applied to settlements made both before and after the date of the resolution, and this, combined with the Chancellor's statement concerning its scope, drew considerable fire from his own party at the Ways and Means Report Stage. Though many Conservative members expressed themselves to be generally in favour of the intention of the resolution, there were some, like Mr Alan Herbert, who were openly against it on the grounds that the "old virtues of thrift, of looking after one's family and of preparing for the future were admirable."[18] Mr Herbert believed that these settlements started from a fundamentally good instinct and openly admitted that he had entered into an income settlement for the benefit of his children.

Almost all the Conservatives speaking in the debate made strong pleas for the special treatment of irrevocable trusts. Their arguments took the following forms:[19]

(1) Their use had been prevalent long before the current high rates of tax came into operation.

(2) They were merely a prudent insurance to guarantee the child's future, whatever might happen to the settlor.

(3) They had all suffered their fair share of tax by payment of stamp duty at one per cent.

(4) The proposed provisions would charge income not being spent for the child's education.[20]

(5) If any change were to be made it should not affect what people had done perfectly legally and honestly and paid stamp duty for the privilege of so doing.

(6) The result of such settlements was that parents were able to send their child to a much more expensive school than would otherwise have been the case, and if they now had to pay extra tax the child might have to be moved to a cheaper school with resultant damage to his education.

It was however realised by some, that making a distinction between capital settlements and income settlements could be seen as putting the less wealthy into an unfavourable position and could be "a matter of great injustice to the middle classes."[21]

The question of the age of majority was also contentious. Twenty-one was thought to be far too high because it was quite common for an unmarried child under that age to leave home, and yet the parent would still be charged on income he could never use.[22]

The provisions seem to have caused considerable uncertainty in some Member's minds, and some were not clear whether the Chancellor intended to annul these trusts.[23] It was suggested that if he did, the stamp duty should be returned, and that if he did not, the law governing trusts should be altered to allow trustees to invest in more speculative stocks than were permitted under their trust deeds.[24] Such variations in investment powers were said to be necessary because people would have arranged their budgets only to find themselves taxed in a way they had not expected.[25] This missed the whole point, because there was to be a right of recovery of additional tax paid by the settlor from the trustees or recipient of the income.

Perhaps not surprisingly, but rather embarrassingly from the point of view of the Chancellor, his proposals were fully supported by the Labour Party which saw them as only "a tentative beginning",[26] and argued that there were a large number of other irrevocable trusts which could have been attacked before this more legitimate form. The Duke of Westminster case was used as an illustration of the kind of situation they found most objectionable but more general concern was expressed that wealthy taxpayers would be able to escape these new provisions.

In his replies, the Chancellor made it clear that he recognised there might be cases falling within the terms of the resolution which he would not wish to touch, and emphasised that the House should not assume that every conceivable case would be covered by the clauses of the Bill.[27] He told the House that he wanted to hear what Members had to say on the subject, because they might be able to identify cases of hardship which ought to be taken into account.[28] He admitted, however, that he was unconvinced that a proper distinction could be drawn between revocable and irrevocable trusts, but promised to consider all the points made in the debate in the drafting of the relevant clauses.[29]

THE CHANCELLOR FINALLY DECIDES UPON THE SCOPE OF THE PROVISIONS

Even by early May, the Chancellor of the Exchequer was undecided as to precisely what policy should be adopted towards settlements in the Finance Bill and asked the Chairman of the Board of Inland Revenue to provide him with a paper detailing the implications of each of the following three proposals.[30]

(1) To provide an exclusion for existing irrevocable parental settlements, but to apply the anti-avoidance provisions to all such future settlements and to existing revocable settlements, irrespective of whether the income was spent or accumulated.

(2) To provide an exclusion for a limited amount of income of existing irrevocable parental settlements so that income in excess of the amount required for maintenance would be deemed to be intended to be used for the parent's own purposes and would be charged on him.

(3) To provide a complete let-out for income accumulated in irrevocable parental settlements so that only income applied during the minority of the child would be deemed to be the parent's.

The Chairman dealt with the first proposal by providing statistics concerning revocable and irrevocable settlements, but with no records available for capital settlements in favour of minor children, he could only estimate that there were a maximum of ten thousand such settlements, and guessed that in most of them the income was to be accumulated.[31] He expected the proposal to halve the two and a half million pound gain estimated to accrue from the Revenue's own suggested approach.[32] Although he could see no practical difficulties with the proposal, (provided there were no exceptions and there was a straightforward test of irrevocability), he could find no merit in its principles.[33]

During the debates, one of the reasons put forward for special treatment of irrevocable settlements was that parents would have entered into commitments on the strength of the existing tax treatment, and it would be unfair to alter their position.[34] The Chairman doubted whether this was a reasonable argument because in most cases the amount of tax at stake was not a material factor.[35] He also pointed out that this kind of argument could be put forward whenever there was any increase in the income tax rates, because increased liability could equally be attacked on the grounds that the taxpayer had ordered his life in such a fashion that he could not afford to pay the higher liability imposed.[36] Such claims were therefore absurd.

The Revenue believed it would be anomalous to have different treatment applied to taxpayers who were otherwise in the same circumstances, merely because one had made an irrevocable settlement before the Budget and the other after, especially as these settlements were mere "tax dodging devices". Because the literature of the agencies pushing these schemes often stated that although the law might be altered the gain up to the date of change would make the use of the scheme worthwhile, the Revenue were able to argue that such a change was anticipated, the benefits were not expected to continue, and it was unnecessary to provide a dispensation for existing settlements.[37]

A further reason given for not distinguishing between existing and new settlements was that to do so would set a precedent for the future, and it might encourage similar dispensations being sought for other anti-avoidance provisions in the Finance Bill.[38]

The Chairman thought the second proposal would be practicable if there was a specified figure, rather than a sum which varied according to the amount of settlement income or parent's income.[39] He suggested a figure of £200-£300 a year, but estimated that this would result in hardly any additional tax being raised.[40]

The third proposal was one which, except for the inclusion of irrevocable income settlements, had been fully explored in previous papers. On this new point the Revenue argued that where a parent made a settlement of capital he was settling an accumulation of income on which he had already paid tax, but where the settlement involved annual payments by the parent they would be allowed as deductions for surtax purposes and would escape tax.[41] They urged that there should be no breach of the general principle that a man ought to pay tax on his income before any deductions to provide for his family, and that therefore the settlor's income should not be reduced by an annuity payable to a children's settlement.[42]

The Chairman did not repeat the arguments against giving special treatment to such settlements, but merely referred the Chancellor to the Revenue's previous reports. However, he did point out the rapid growth in the number of accumulation trusts for adults,(by parents on children and between husband and wife), where income was being stored up free of surtax, and warned that it might prejudice effective action on this problem in a future year if the statute set down a precedent by exempting from surtax income accumulated for a minor child.[43]

Within two days of receiving the Chairman's report, the Chancellor had almost made up his mind.

> "After full consideration and discussion I am of the opinion that the arguments here adduced against the exemption of irrevocable trusts existing before the Bill, although formidable, do not outweigh the arguments in its favour. As a variant, however, I should be ready to consider a provision that the exemption should be limited in time, e.g. to five years, which would clear those whose children were already committed to the "expensive school". I propose to exempt the accumulative irrevocable trusts, both past and future, but agree that in the case of income trusts the income should be counted in for surtax."[44]

The following day, the Chairman of the Board provided a paper for the Chancellor concerning the feasibility of a five year exemption period for existing irrevocable settlements[45] and, not surprisingly, was very much in favour of it. He could foresee no difficulties in administering it and thought it would lessen any feeling of inequality between taxpayers who had entered into such settlements in the past and those who might enter into them in the future.[46]

Time was by now running very short, and by the afternoon of May 5, the Chancellor had at last made his final decisions and the Board had written to Parliamentary Counsel setting out the details.[47] It had been decided:

(a) to exclude all irrevocable settlements, whether of income or of capital, made on or before Budget Day;

(b) in the case of irrevocable settlements made after Budget Day to exclude income arising to the trustees which under the terms of the settlement was to be accumulated for the benefit of the child on attaining majority or on marriage, but to charge any income paid to or for the benefit of the child;

(c) in the case of any future irrevocable annual payment settlement, to allow no deduction in computing the payer's total income; and

(d) in the case of future outright transfers of assets, to charge the income arising from those assets as the parent's income during the minority of the child.

The Inland Revenue suggested to the draftsman that the first task would be to develop a definition of irrevocability, and said that the Chancellor had agreed that the definition must be such as would exclude any personal discretion[48]. They had foreseen difficulties in drawing a distinction between income payments and capital payments and suggested that any payment made by the trustees to the parent should be regarded as income insofar as the trustees had received income sufficient to cover the payment.[49]

Parliamentary Counsel had at last got instructions in something like final form and within twenty-four hours was reluctantly sending the Revenue his re-draft "which I am quite sure is nowhere near right."[50] Over the following six days, three further re-drafts were made, with the final one being ready on May 12. The changes made on each draft were relatively minor and, probably due to the fact that there was great urgency in finalising the clause, they were explained over the telephone or at meetings and there is nothing on the files to explain why they were necessary.[51]

REACTION TO THE PUBLICATION OF THE BILL

By May 14 the Bill had been published and the Chancellor began to receive the first in a stream of critical letters, most of which concerned the definition of an irrevocable settlement.[52] The Revenue had already warned that this was likely to attract the greatest attention, because if the settlement could pass as being irrevocable it would have complete exemption if made before the Budget, and partial exemption, to the extent of accumulated income, if made after the Budget. The Revenue provided the Chancellor with a review of all the criticisms, and suggested that the governing principle in considering them was that an irrevocable settlement had to be one in which the settlor could not obtain any sum for his own benefit at any time or in any contingency.[53]

In a letter to "The Times" which was also sent to ministers,[54] a barrister criticised the definition of irrevocability because it only set out particular instances where a settlement was deemed not to be irrevocable and he wanted it worded in such a way that if the deeming provisions did not apply, the settlement would be treated as irrevocable. As drafted the definition only intended to show the particular circumstances under which an irrevocable settlement would be treated as revocable, and as it was designed to catch any settlement which by its very terms provided for revocation by the settlor, the barrister's suggestion for modification was not entertained.[55]

Some correspondents had mentioned cases where the settlor had power to direct the trustees to re-allocate the income in new proportions. The Revenue received legal advice that such a power would not of itself turn what would otherwise have been an irrevocable settlement into a revocable settlement, but that where the settlor had a power of revocation and re-settlement, it would be caught.[56]

Irrevocable status was denied to any settlement which provided for total or partial indemnification or exoneration of any person in the event of his failing to enforce the settlement. This was criticised by some correspondents as being much too wide as it would have caught innocent and common form indemnifications of trustees. The Lord Advocate of Scotland told the Financial Secretary that Scottish settlements usually contained an indemnification provision which merely reflected the provision in the Trusts (Scotland) Act 1921, which applied to all settlements.[57] As the purpose of the provision was to deal with cases where the settlor undertook to make an annual payment and then used the indemnification route to enable him to cease payment, the Revenue agreed to a re-casting so that it only caught cases where indemnification was given to trustees in the event of their failing to enforce any obligation on the settlor under the settlement.[58]

The Attorney-General drew attention to the fact that many settlements provided for suspension or determination of the settlement in the event of bankruptcy of any of the children, and suggested that it might be desirable to provide that such a provision would not make the settlement revocable.[59] The Inland Revenue saw no objection to this but thought it was not desirable to move an official amendment at the committee stage and the Chancellor agreed with them.[60]

A major firm of solicitors suggested that because a parent's payments of maintenance under a court order would be outside the clause, maintenance payments made under an agreement should be similarly treated.[61] The Inland Revenue advised the Chancellor that "though this may be equitable I think you will agree that it is not a matter on which you should move and that its consideration can be left over till it is raised by way of amendment."[62] Again, he agreed with this tactical proposal,[63] but when an amendment was put down the Board resisted it and it was rejected. A ridiculous and unjustifiable distinction between court orders and maintenance agreements was thus allowed to creep into the tax system.

Within ten days of publication of the Bill, the Revenue discovered that one of the agencies promoting children's deeds was issuing circulars suggesting that pre-Budget revocable deeds could be made irrevocable by a supplemental deed and thereby come within the let-out for pre-Budget irrevocable settlements.[64] The circular explained the reasons for taking such action, included a suitable form of wording, and also pointed out that a deed made before April 22, 1936 could be lodged for stamping at any time up to May 21, 1936. The Revenue interpreted this latter point as a suggestion that deeds entered into after the Budget might be ante-dated and stated their intention to take steps to discover such fraud.[65] Parliamentary Counsel was instructed to draft amendments to strengthen the provisions to ensure that pre-Budget revocable settlements could not be amended so as to pass as irrevocable settlements.[66]

SECOND READING

At the second reading, the Labour Party's attack was led by Mr Benson, who believed "lack of resilience of the public revenue ... [was] unquestionably the result of the vast amount of evasion that is taking place."[67] He wanted to know why settlements not involving children had not been dealt with, and instanced revocable settlements, seven year covenants, and annuities to pay wages as being just as in need of attention. He was convinced the Chancellor was approaching the problem from the wrong end and suggested introducing legislation to invalidate any trust for tax purposes and then making limited exceptions. A vigorous attack was mounted against the Chancellor's decision to exempt pre-Budget irrevocable settlements because the Opposition could not be seen how it "was ... any less immoral three months ago to create an irrevocable trust for the purpose of dodging income tax and surtax than it is today."[68] Benson believed such a distinction was invidious, but the Financial Secretary thought it justified where a settlement was truly irrevocable because of the harshness of taxing a settlor who could not get his money back in the same way as one who could.[69]

The Chancellor explained that although he was not dealing with every class of avoidance known to occur, those which were most costly and commonly used would be caught.[70] The other types of settlement which Benson had described did not, according to the Chancellor, involve considerable loss of tax but he promised to deal with them if they did become costly. It seems that cost dominated principle where tax avoidance was concerned.[71]

The only criticism from Conservative Members was the extreme complexity of the clause, which in parts was said to be almost incomprehensible. The Chancellor admitted that the anti-avoidance aspects of the Finance Bill were more technical and complicated than any for which he had been responsible, but contended that the variety of avoidance and the necessity to make the provisions watertight made plain, simple language impossible.[72] He invited any Member who was unconvinced to try using simpler language, but indicated that his own frequent experiments to do so had always shown that there was a good reason for every word.[73]

AN ANALYSIS OF THE SETTLEMENT PROVISION IN THE BILL

A copy of the settlement provision of the Finance Bill as originally introduced is in Appendix D2, and the following material explains its manner of operation in detail.

General Review

The clause can be analysed according to its effect on revocable settlements, irrevocable settlements made on or after April 22, 1936, and irrevocable settlements made before that date.

All income of revocable settlements by parents on their children, whether made before or after the Budget, was to be treated as the parent's so long as the child was both an infant and unmarried and the settlor was alive. This rule was to apply to both income and capital settlements if they were revocable in any circumstances whatever, whether with or without the consent of any other person. By 1936, these settlements were the most popular, but all their income tax and surtax benefits were to be terminated.

For irrevocable settlements made on or after April 22, 1936, a distinction was made between income accumulated and income spent on the maintenance of the child. Sums applied for maintenance were to be treated during the child's minority as the income of the parent, but income accumulated was not. However, annual payments by a parent to such a settlement were to be treated as the parent's income even if they were accumulated by the trustees.

Irrevocable settlements made before April 22, 1936, were to be entirely outside the scope of the clause, whether the income was distributed or accumulated. The reason for this was that parents might in good faith have entered into commitments, particularly for education of the child, based upon the tax advantages derived from such settlements, and it would have been harsh to have removed those advantages while leaving them bound by the irrevocable nature of the settlement. However, a new much more stringent definition of irrevocability was to be applied.

Sub-Section 1

This provided that if any income was paid from a parental settlement to or for the benefit of a minor unmarried child of the settlor it was deemed to be the parent's. Although this apparently applied to all settlements, pre-Budget irrevocable settlements were excluded by virtue of sub-section 9.

Sub-Section 2

This sub-section provided that income accumulated under the settlement was deemed to be paid for the benefit of the child, and consequently caught by sub-section 1, unless the settlement was irrevocable, in which case sub-section 3, provided a let-out. Revocable settlements in which accumulated income was not required to be allocated to any particular child, or in which some children might be infants and others might not or in which some persons other than the settlor's children were beneficiaries, were dealt with by special provisions,[74] which deemed the accumulated income to be divided equally between beneficiaries who were children of the settlor. For example, if the parent created a revocable settlement for the benefit of his five children with the income to be accumulated until the youngest was twenty-one and then distributed between the children at the discretion of the trustees, then if at the commencement of a particular tax year three of the children were over twenty-one and two were under twenty-one and unmarried, two-fifths of the income would be deemed to have been paid for the benefit of the two minor children, and would consequently be treated as caught under sub-section 1.

Sub-Section 3

Under this sub-section, with one exception, accumulated income of irrevocable settlements made on or after April 22, 1936, was not to be treated as the parent's. The exception applied to accumulations consisting of, or representing directly or indirectly, annual payments made by the parent. The words "directly or indirectly" were designed to prevent devices being used to transform what were really income settlements into capital settlements. For example, if B transferred one thousand pounds to trustees to be accumulated for his minor child, and then borrowed that sum from the trustees at interest, that interest would be deductible in computing his total income, but because of these provisions it would also be treated as his, thus negating the deduction from his total income. (The Revenue had come across a case where this device had been used and the agreed interest rate had been one hundred per cent per annum.) If a company was interposed between the trustees and the parent, this too would be caught. For example, if a parent transferred capital to a settlement and the trustees used those funds to subscribe for shares in a company which then lent the money to the parent at interest and used the interest to pay dividends for accumulation by the trustees, those dividends would indirectly represent the interest paid by the parent and would be treated as his income.

An important second aspect of this sub-section was that all sums paid under irrevocable settlements were to be deemed to be payments of income for the purposes of sub-section 1 in so far as there was income available to cover them. By this means, capital sums were to be treated as income to the extent that they could have been paid out of income.

Sub Section 4

Any additional tax payable by the parent as a result of the deeming process was recoverable under this sub-section from the trustees or other person to whom the income was paid. Conversely, where the parent received a greater repayment than he would have if the income had not been deemed to be his, that excess repayment had to be paid over to the trustees or other person receiving the income.

Sub Section 5

Where income was accumulated under the provisions of a will or settlement for the benefit of some person contingent on his attaining some specified age or marrying, that person could, when the contingency occurred, claim the income tax reliefs to which he would have been entitled had his income year by year included the amounts accumulated. Where that income had already been deemed to be that of the settlor, this sub-section prevented any such claim.

Sub Section 6

Any particulars which the Special Commissioners thought were necessary for the purposes of the section were obtainable under sub-section 6. The Revenue would normally have obtained all the information necessary for operating the provisions from the evidence in support of repayment claims, but as they needed to determine what income had been spent and what had been accumulated they needed additional statutory powers.

Sub-Section 7

To ensure that the term "irrevocable settlement" only applied to those which were completely irrevocable, a settlement was to be deemed to be revocable if any of paragraphs (a), (b) or (c) applied. Paragraph (a) made sure that the settlor had parted with the capital and income completely, and prevented the device of inserting some special provision under which funds would be returned on the happening of some highly likely contingency, such as the death of an aged relative. Paragraph (b) stopped settlements which could be revoked with the consent of some other person being regarded as irrevocable, and was based upon the Revenue's experience of avoidance of the provisions of section 20 of the Finance Act 1922. Paragraph (c) excluded settlements which could be terminated on payment of a nominal penalty and was thought to be particularly relevant to annuities paid under covenant.

Sub-Section 8

This provided definitions for the clause. The definition of a child was the same as that used in section 20 of the Finance Act 1922, but with the inclusion of adopted children. The definition of a "settlement" was the same as that for a 'disposition' in the Finance Act 1922, but with the added words "transfer of assets" which were inserted to make it clear that an outright gift of capital would be caught. The term "settlor" was introduced for the first time, and although reciprocal arrangements and the indirect provision of funds were covered by the approach used in the Finance Act 1922,[75] the Chancellor met his promise to include a more explicit form of words.

A definition of income was necessary to overcome the problem created by Perry v Astor[76] in which a restricted interpretation had been applied. To ensure that income was not deemed to belong to a person who was not chargeable to U.K. tax, (foreign income), or who, if chargeable, could not be forced to pay, (U.K. source income), the clause was to apply only so long as the settlor was resident in the U.K. At that time, foreign income of a foreign trust was not chargeable if it was not remitted to the U.K., and therefore, to escape the clause, a taxpayer in the U.K. would have been able to transfer foreign securities to a foreign trust for the benefit of his child. However, this device was blocked by extending the definition of income to include any income which would have been chargeable if it had been received in the U.K.

Sub-Section 9

This not only provided a let-out for pre-Budget irrevocable settlements but also made it clear that the clause applied to a settlement wherever it is made or entered into.

Sub-Section 10

The Finance Act 1922 provisions relating to settlements on children were not to apply to settlements within sub-section 9 but were to remain in operation for revocable settlements made before April 27, 1936.

THE COMMITTEE STAGE

Consideration of the settlement provisions at the committee stage was a long and drawn-out affair in which twenty-four of the forty-five amendments put down were moved. Those which were not moved were either covered by some other amendment or involved a misunderstanding of the effect of the provisions or an attempt to introduce some modification totally inconsistent with them. Only the more interesting amendments discussed in the House are examined here.

Many Members thought there was an element of retrospection in the clause and therefore moved an amendment to ensure that this could not happen. The Board's notes indicate that they were unsure of the reason for the amendment and thought it possible that it was designed to exclude any charge on income for the two weeks of the tax year which had expired at the time of the Budget.[77] The debate shows that they were wrong and that the concern was over the first year for which the clause was to apply. Once it was confirmed to be 1936/37, the amendment was negatived.[78]

The deeming provision were only to apply if the child was an infant and unmarried at the commencement of the tax year, but an amendment was put down under which the age of the child at the time of payment would be the determining factor. The Board's notes indicate that in the first year of the child's life, (unless it was born on 6th April), the provisions would not apply because the child was not an infant and unmarried at the commencement of that year, as it did not in fact exist at that time[79]. Correspondingly, the clause would apply for the whole year in which the child attained the age of 21, because on April 6 of that year the child would have been an infant and unmarried. The Revenue realised they would gain in the year of majority but lose in the year of birth and advised ministers that although the amendment was theoretically sound, it was objectionable on practical grounds because it would involve an apportionment in the first and last years[80]. Although the amendment was negatived the discussion of the matter in the House lead to such wide exploitation of the loophole in the year of the child's birth that in 1958 the legislation was changed so that the determining factor was the age of the child at the time of the payment. Thus, some twenty-two years later, the amendment was accepted![81]

On Revenue advice the Chancellor introduced amendments to ensure that pre-Budget revocable settlements could not be amended so as to obtain the dispensation available for pre-Budget irrevocable settlements, and to alter sub-section 3 so that if a revocable settlement was converted to an irrevocable settlement, income accumulated prior to the alteration was still liable to the deeming process. Double counting of the same income, (once due to revocability and again due to paying out accumulated income after the settlement had become irrevocable), was achieved by providing that accumulations of income prior to the settlement becoming irrevocable were not counted as available for making payments to beneficiaries.

An attempt to treat irrevocable annual payment settlements in the same way as irrevocable capital settlements and exclude them from sub-section 3, led to an interesting debate on the rationale for their different treatment. Supporters of the amendment believed it unfair that someone only having earned income was treated more severely than one fortunate enough to have capital. After explaining that only the annual payment was to be treated as the settlor's and not the income derived from its investment by the trustees, the Attorney-General defended the proposals for annual payments out of earnings, on the grounds that they should not be given more advantageous treatment than settlements of capital sums built up out of after-tax income.[82] He was challenged on this because it contained the basic flaw that not all capital had been built up out of after-tax income; some was inherited wealth and wealth accumulated by capital accretion. The Attorney-General clearly had relied too heavily upon the notes provided by the Board of Inland Revenue without considering their veracity. Mr Benson, for the Opposition, pointed out that once a capital settlement had been made, the settlor would no longer be taxable on the accumulated income, and that this produced "a differentiation against the man who can't afford to make a capital settlement and in favour of the man who can."[83] He was right, and although various Labour Members reinforced the point, no response was made and the dicrimination between capital and income settlements was allowed to stand.

An amendment to restrict the information powers so that only a settlor or trustee of the settlement, (rather than any person), could be required to supply information was resisted by the Board. They believed it would make the sub-section too narrow by making it impossible to obtain information from a bank, solicitor, accountant or other professional person, even though they had "of course no intention of making use of the information provision in this way."[84] The clause was, according to one Conservative Member, "an unwarrantable interference with liberty ... which may lead to grave abuses."[85] Labour Members, however, were against any restriction of its scope because "the only thing that an inspector of taxes can find out is income, and if everybody declared their income, as they ought to do, there is no reason why an inspector of taxes should not have every facility afforded to him."[86] As the Revenue were not averse to some restriction on their powers the Attorney-General agreed to consider whether they were unnecessarily wide.

The debates on the definition of irrevocability centred on various provisions found in existing irrevocable settlements which though there for good reasons, would have resulted in them being treated as revocable for tax purposes.[87] Many settlements were determinable on the bankruptcy of any of the children who were beneficiaries, and as the Revenue agreed it was unreasonable to treat such settlements as revocable,[88] a let-out was provided on the basis that such a provision did not give the parent power to revoke the settlement.

Both an attempt to make the provisions only apply if the parent was eligible for child allowance and an alternative amendment to reduce the period of infancy to 16 years, with an extension beyond that time if the parent was eligible for child allowance, failed.[89] The Board advised ministers that to accept either suggestion would prejudice the parent whose child's education continued beyond the age of 16. They dismissed this as "topsy-turvy discrimination"[90] and ignored the anomalies which the amendments would have removed for cases in which a minor child had left home and was earning his own living.

An amendment to exclude maintenance payments to a child whether under a separation agreement or court order was rejected.[91] The Board seem to have been content that a court order was not a settlement, but objected to separation agreements resulting in more favourable tax treatment after separation or divorce than before it, and insisted they should be caught.[92] Their main argument was that the parent was providing for the expense of maintaining his offspring out of his income, and the citizen who had not separated or divorced might well be aggrieved if he found himself worse off than those who had[93]. Although this objection applied equally to court orders, the Attorney-General seems either not to have noticed or not to have thought it important, and after his speech relying heavily upon the notes provided by the Board the amendment was negatived without further discussion.

An important part of the debate concerned the let-out for pre-Budget irrevocable settlements which had been inserted even though the Chancellor had originally described it as indefensible during the debate on the Budget resolution. This was latched onto by Mr Benson who believed that the change of mind was a result of "back-stairs influence by honourable gentlemen behind the Chancellor."[94] He protested that the exemption of such trusts was unjustified because:

(a) they were confined to the extremely wealthy;
(b) they had been established mainly for tax motives, (and for those that had not it would cause no hardship to deem the income to be the settlor's); and
(c) their irrevocable form was largely a question of luck, in many cases depending upon which agency he used.

The Chancellor dismissed these objections on the grounds that these trusts were quite lawfully made and the settlor would be bound by undertakings or engagements which, because of the irrevocability of the trust, he could not escape. It was stressed that the exception only applied to settlements meeting the new more stringent tests of irrevocability, and that therefore as many of them contained offending provisions which effectively made them revocable, they would be caught.

At the conclusion of the committee stage debate a number of Members grumbled about the difficulties they had had in understanding the clause. Three typical comments were as follows.

> "Several honourable members learned in the law have complained of the drafting of this clause. I, as an ordinary layman, have found it extremely difficult to understand, and I imagine that there are many others in the committee who, like me, do not know exactly what we are doing or what the effect of this clause is."[95]

> "... The real proof of the unintelligibility of the clause was found in the debate last night ... in which practically every speech was read, although the standing orders say that they should not be read. Those speeches included all those made from the Treasury Bench, because neither ministers nor members could make speeches on this subject without lavishly prepared briefs."[96]

> "It is the most complicated clause that I have ever had to deal with. I have had to deal with settlements of various kinds for the past forty-five years, and I have taken this clause home and tried to read it and understand it but I have entirely failed. I sent it to the very best counsel at the Bar and have received several letters from them to say that it is totally unintelligible. There has been a Committee of the Law Society studying it. This morning I spoke to a leading member of the Committee and I was told that they are thoroughly puzzled by it."[97]

The Financial Secretary to the Treasury answered this criticism by explaining that although clarity was desirable, certainty of meaning through the use of highly technical language was essential to safeguard against litigation, and this had to be offset against any disadvantage arising from loss of clarity to the lay mind.[98]

THE REPORT STAGE AND THIRD READING

Foreseeing that the difficulty of understanding this clause would be exacerbated by the large number of Government amendments, the Revenue had suggested to the Chancellor that some be held over to the report stage. The Chancellor agreed, but as promises had been made in committee to reconsider certain matters, the amendments were numerous and there was a further flurry of activity to enable all the points to be considered and appropriate amendments drafted.

At the committee stage concern was expressed that educational policies would be caught[99] because they contained provisions under which, if the child died before attaining school age, the premiums or a part of them would be returned to the insurer.[1] The Board drafted a letter to the Financial Secretary explaining that such policies were not caught because there was no settlement and the annual payments made by the insurance company would be direct to the parent with no obligation to apply them for the child's benefit.[2] The draft was reviewed by Parliamentary Counsel, who advised that although such policies might be settlements, they would not be caught because the payments under the policy were not to or for the benefit of the child.[3] No special let-out was therefore required.

As explained earlier, the original draft clause included a £5 de minimus limit which was removed from later drafts so that a political advantage could be obtained by waiting for the point to be raised and then appearing generous by giving a concession. It was not until early June 1936 that the National Savings Committee realised the implications of the clause and wrote to the Treasury to argue that it "appears to go beyond the intention at which it is aimed, and in doing so is likely to act as a deterrent to thrift on the part of the millions of small investors with whom we deal."[4] The Inland Revenue suggested a £5 exemption so that a total deposit of £200 in the Post Office or the Trustee Savings Bank would not be caught. The draftsman was requested to prepare an appropriate amendment but despite having done so in the earlier draft, he now had great difficulty, as the following extract shows.

> "I am afraid that I have been completely defeated by your proposal ... There must be some way of giving effect to this proposal without enabling a settlor to evade the clause by making a large number of £5 settlements, but I have not succeeded in finding it. As a matter of drafting it is extraordinarily difficult."[5]

Within a few days the draftsman had "at last got it right"[6] and produced the let-out which still exists today.[7]

Further evidence of the draftsman's difficulties are provided by his comments on certain other amendments.[8] In drafting one let-out he admitted that "it needs a more extensive aquaintance with settlements than I possess to say whether it is too wide or not wide enough."[9]

On June 23, the Chairman of the Board wrote to the Chancellor with the Revenue's views on matters arising out of the committee stage.[10] Not only did he deal with points on which a review had been promised, but also with certain others, in an attempt to remove any lingering doubts the Chancellor might have had as to their merits.

Although there were many amendments at the report stage, the major concern was with the tests of irrevocability. Committee stage comments about the possibility of settlements being treated as revocable if trustees had a discretionary power to hand over funds to the child on marriage or on attaining majority or a later age, led to an amendment to exclude such cases from the deemed revocability provisions.[11]

Criticism which had been levelled at the provisions relating to indemnification of trustees resulted in a review of the whole question of indemnification and exoneration and a decision that the inclusion of such provisions would not make settlements revocable if they were otherwise irrevocable. The only evidence of the reason for this change of mind is in the report stage debates where it was explained that in Scotland practically every deed contained a provision for total or partial exoneration of the trustees.[12] The Opposition warned[13] that this modification would create a loophole for trustees to pay accumulated income of a capital settlement to the parent as a gift because even though they would be violating the terms of the trust, they would be exonerated. The clause would not catch payments to the parent because they would not have been applied for the benefit of the children. The contrary view was that because such a trust would not be valid, the loophole would not exist,[14] but as was pointed out, such a case would not come before the courts until the beneficiary was of age and capable of suing, and in all probability the parent would be able to rely upon the goodwill of his child in not suing him. Unfortunately further discussion of this point did not take place.

Another relaxation of the deemed revocability rules was introduced to exclude cases where funds might revert to the parent in the event of the bankruptcy of the child or his assignment of, or execution of a charge on, the income. A similar dispensation existed in the 1922 provisions under which it had been the practice of the Revenue since the Trustee Act 1925 "to pass without question the mere inclusion in a settlement of a protective trust clause, on the ground that it is covered by the provisions relating to bankruptcy, assignment or execution of a charge."[15] The Attorney-General thought this practice was not strictly correct because section 33 of Trustee Act covered an attempted as well as an actual assignment or execution of a charge. For this reason special measures were included in the tax legislation to deal with protective trusts, because without them certain acts or events would determine the settlement and the income would then be held on discretionary trust for the benefit of a variety of persons. As the parents would be included among the objects of the the trustees' discretion, the settlement would from the very beginning be treated as revocable, and hence a let-out was required.

The Revenue were concerned that if every protective trust was excluded the settlor could insert a clause which would in effect make the settlement revocable by specifying some particular event which would be treated as a divesting event. They therefore proposed that any let-out should be strictly confined to those events specified in the Trustee Act which would result in the beneficiary losing title to income, and this was agreed by the Chancellor. The only risk attaching to such a provision was that a parent might obtain revocation of a settlement by persuading the child to attempt to perform an act which caused divestment, for example by causing the child to apply for an advance of money on the security of an assignment of his rights under the settlement. The Revenue were not unduly concerned about this possibility and thought that although "it is not easy to prophesy what the tax dodger will do, and experience has shown that he is capable of doing many strange things, we doubt very much whether there is any danger in the present connection."[16] As the income would be paid to the child prior to the attempt at divestment it would be deemed to be the parent's anyway, and therefore the connivance at divestment would be of little purpose because the income would then usually be actually received by the parent.

With one exception all Government amendments at the report stage were passed without difficulty. Although the Chancellor had intended to restrict the Revenue's information powers, Sir Stafford Cripps persuaded him that it would be undesirable to do so[17] because information concerning payments made from the settlement could be relevant and would not have been obtainable under the Chancellor's restricted provisions.[18] The amendment was withdrawn and no such restrictions were introduced.

A further concession on the deemed revocability rules consisted of a let-out for settlements on children containing a power for trustees, after the death of the settlor, to apply part of the children's income to make up the income of the widow to a specified sum. Although this relaxation was not expected to affect many settlements, the Financial Secretary accepted there were undoubtedly some in which hardship would otherwise be involved. The supporting argument for this amendment was based upon existing settlements, but as Sir Stafford Cripps was quick to point out, it would also have affected future settlements and might have represented a loophole.[19] The amendment was also criticised because it would apply to income payable to a widower after the death of the widow; a case in which the need for an exception was not so strong. These objections were dismissed on the grounds that such cases were very unusual anyway but the amendment was accepted with a promise to "keep our eye on any sinister purposes for which it might be used."[20]

As drafted, the clause treated a settlement as revocable if it provided for a penalty to be paid by any person on failing to comply with its terms. The Government, thinking the words "any person" were too wide, wanted to subsitute "the settlor" but the Opposition believed that it would be simple to avoid such an amended provision by specifying that the penalty should be paid by the settlor or some other person on his behalf. When the Attorney-General explained that future settlements of income would be caught anyway and that the amendment would only affect existing income settlements, all known cases of which contained a provision for payment of any penalty by the settlor, the amendment was agreed to.[21]

At the third reading warnings of their future attitude towards tax avoidance were given both by the Financial Secretary and the Chancellor

> "I give warning that the people who indulge in practices of that kind must not consider that because this time we have not passed retrospective legislation we shall be debarred from doing so in any future legislation."[22]

Although criticism was levelled at the Government for failing to deal with other forms of avoidance, the Chancellor was adamant that all known serious forms of tax avoidance had been dealt with. Those which had not been touched by the Finance Bill of 1936 were said not to have been sufficiently extensive or subversive to require legislation. It was, according to the Chancellor, all a matter of degree, but before very long he was to find that other forms of avoidance involving settlements had grown to such a level that they could no longer be ignored.

CONCLUSION

There is no clear evidence of the reason for such a long delay in introducing anti-avoidance legislation once the Revenue had statistics showing its extent and growth, and information about the manner in which it was spreading. There was almost five years between the first clear call for action by Claims Branch and the introduction of legislation, and it appears that it was not until the tax being lost became very considerable that ministers could be persuaded to act.

Rather unusually, the legislation eventually introduced did not fully reflect what the Revenue had wanted, but this was not through any lack of effort to get their own way. Having managed to convince the Financial Secretary that irrevocable capital settlements should be caught, they found the Chancellor much more cautious. The Revenue used every available opportunity to press their point of view on him, and when the main argument was lost they had various fall-back positions. None of them however were accepted by the rather timid Chancellor, who even agreed to increase child allowance to smooth the passage of the anti-avoidance provisions.

Neville Chamberlain seems to have been so concerned about the political acceptability of the legislation that he used a deliberately vague and ambiguous Budget Statement to draw fire from potential opponents so that he could assess the potential difficulties which lay ahead. Because he had not decided the precise extent of the proposals, he was able to use the information so obtained to enable him to formulate the policy of the legislation. This was a method not seen again in determining later settlement legislation, where principles seem to have retained their dominance over political expediency.

The delay in introducing these provisions was certainly a major factor contributing to the political difficulty of taking action, because as time went by the numbers of people who would be adversely affected increased in an almost geometric progression. It was this delay which probably resulted in the Revenue not getting the legislation they wanted, and realisation of this may have encouraged them to apply pressure earlier on the ministers responsible for future anti-avoidance legislation. It was only twelve months later that the Revenue brought to the Chancellor's attention the growing problems arising from those areas which had been left untouched by the 1936 legislation. However, as can be seen from Appendix D4, the 1936 provisions were a great success in preventing the avoidance at which they were aimed.

CHAPTER 6

1936-1938: THREATS PROVE INEFFECTIVE AND WIDE-RANGING LEGISLATION IS INTRODUCED

INTRODUCTION

Even though in 1936 the Chancellor had stated that all known serious forms of avoidance had been dealt with, and had threatened that in future avoidance might be attacked retrospectively,[1] by 1937 it had grown to such an extent that his successor, (Sir John Simon), decided to take further action. Ironically, it was probably the success of the children's settlement provisions of the Finance Act 1936 [2] which stimulated growth in the use of various forms of accumulation settlement as an alternative means of sheltering income from surtax, and led to the need for additional anti-avoidance measures.

The problem of how to deal with such settlements was not new to the Inland Revenue, as they had fully explored it when the whole question of tax avoidance was scrutinised by the Board's Tax Avoidance Committee in late 1933 and early 1934.[3] This investigation had involved consideration of the various avoidance methods known to the Revenue and the possible ways of dealing with them, and had even gone so far as to put forward draft clauses. When, therefore, the Revenue were asked to devise anti-avoidance proposals, it was merely necessary for them to refer to the Committee's recommendations. There is therefore great similarity between some of the clauses introduced in the Finance Bill 1938 and those of the Committee some four years earlier.

The settlement provisions introduced by the Finance Act 1938 now make up a considerable portion of Part XVI I.C.T.A. 1970, (sections 445, 446, 447, 450 and 451), and are still largely in the same form as originally enacted. (Section 451 has been subject to the greatest modification but the basic approach remains unaltered).

THE CHANCELLOR'S WARNING

During the third reading of the Finance Bill 1937, the Chancellor issued a stern warning to the effect that if tax avoiders continued exploiting loopholes he would have to introduce retrospective legislation.[4] The stimulus which led to this threat was the following letter from a practising barrister.[5]

2 Hare Court
Temple
EC4
24 June 1937

Dear Simon,

Here is a copy of the deed about which I spoke to you at Bradfield. Under this it is possible to save everybody surtax on a ten shilling stamp and by a very simple operation.

I am sorry I did not send it to you before. I am going to worry you with a memorandum on a general clause designed to prevent all sham transactions. I am waiting for the text of the German clause, which is designed to achieve a similar object.

Yours sincerely

John Foster

The Chancellor's handwritten note on the letter indicates how seriously he considered the matter.

> "I should like Sir E Forber[6] to see this. I am told it is going on all over the place. (Chancellor's underlining). Is a new clause in this year's Finance Bill out of the question? 29 June 1937."[7]

On July 3, the Daily Herald carried an article which not only explained in some detail how settlements could be used to avoid surtax, but also said that the Chancellor was "understood to be considering more drastic methods than any yet devised for preventing evasion of surtax."[8]

The Chancellor believed that the problem had become "the more serious as the Daily Herald had advertised how it is done!"[9] By this time it had been explained to him that it was too late to legislate in the Finance Act of 1937, so instead, he asked for a carefully framed warning to be prepared in such a way as to justify retrospective legislation.[10]

A copy of the relevant correspondence and offending deed was passed to Forber, the Chairman of the Board of Inland Revenue, and on July 13, 1937 he wrote a long memorandum to the Chancellor explaining why the deed was not caught by the existing provisions, the general nature of the remedial legislation required, the method of achieving retrospection for surtax purposes and the form of warning which might be suitable.[11]

The Revenue estimated that the loss of tax arising from the use of accumulation settlements amounted to half a million pounds a year. As might be expected, Forber suggested action going slightly beyond that required to prevent the avoidance covered by the specific deed under consideration and the matters mentioned in the Daily Herald article. However, it would have been unwise for him to disregard other related loopholes, because these would probably have been rapidly exploited if they were left open and would have required further legislation at some later date.

Forber suggested that the way to proceed was to introduce legislation in the Finance Act of 1938 and make it applicable to surtax becoming due in 1938/39. As that surtax would be based upon the income of 1937/38, the legislation would apply to settlements made during that year and the desired retrospection would be achieved. He advised against making the legislation apply to any year earlier than 1937/38.[12]

The Revenue provided a detailed form of words to the Chancellor for use at the third reading of the Bill and the actual words he used[13] were almost identical to those provided.[14] Given the fact that the third reading took place only three days after the memorandum from the Chairman of the Board of Inland Revenue, it is perhaps not surprising that the Chancellor chose to use the suggested wording but it shows his willingness to go along with the Revenue's advice and his agreement to action being taken.

While the Chancellor's statement did not make it plain that there definitely would be retrospective legislation and people may well have continued to enter into such arrangements in the hope that the threat would not materialise, the die was cast.

Reporting the Chancellor's warning, "Taxation" [15] lamented the threat of retrospective legislation which "must be regarded by all reasonable taxpayers as un-British" but agreed that it was the duty of the

Chancellor to close up all material loopholes.

In the event, retrospective anti-avoidance legislation was introduced in the following Finance Bill, and it would appear that the only reason that it was not brought in in 1937 was that the matter was not brought to the Chancellor's attention in time. It is rather surprising that the Inland Revenue themselves did not raise the problem with the Chancellor as they appear to have been aware of such avoidance. Perhaps the explanation is that they were not aware of its extent.

SUGGESTIONS FOR A BLANKET ANTI-AVOIDANCE PROVISION

Although the Chancellor had decided to introduce anti-avoidance provisions in the next Finance Bill, the exact form of the legislation had not been decided and the possibility of widely drawn general anti-avoidance provisions had apparently not been ruled out. The barrister, Foster, wrote again to the Chancellor on July 26, 1937, enclosing his suggestions for the "complete prevention of tax avoidance"[16] together with a translation of the relevant German law designed to block all tax avoidance.[17]

Foster also enclosed specific suggestions for dealing with accumulation settlements, but these were at best half-baked and amounted to no more than an extension to all settlements of the tests of irrevocability which applied to children's settlements. However, his proposals concerning a general anti-avoidance provision were far more radical.

He argued that the existing method of dealing with tax avoidance resulted in legislation which was always several moves behind the tax avoider, and thought that it was bound to contain many gaps through which ingenious lawyers and accountants would be able to find a way. In his view, it was ridiculous that large numbers of accountants and lawyers spent their time and exercised their ingenuity in devising methods by which one body of taxpayers could throw the burden of taxation on to the remainder, and suggested that all forms of tax avoidance could be made impossible by framing a general clause enabling all sham or artificial transactions to be disregarded for tax purposes. Such a provision was to catch all schemes designed for the main purpose of avoiding taxation.

The practicability of this proposal was questionable, and he admitted that the copy of the German legislation which he provided was "not suitable for an English statute."[18] The only precedent he could find for legislation of a similar character related to an order of The Ministry of Food, in 1917, designed to prevent persons from evading the law as to the maximum prices of potatoes by fictitious or artificial transactions.[19] There is however, a very considerable difference between a piece of legislation designed to operate over a limited class of transactions and one which would range over all the possible transactions which would come within the scope of taxation. Foster did not address the difficulties which would have arisen from an attempt to operate a general anti-avoidance provision. While he suggested that it would be necessary to provide a right of appeal on the question of intent to avoid tax, the difficulties of determining a person's intent were entirely glossed over.

Foster's suggestion appears to have received no consideration by any of the officials involved. There are no marginal comments alongside anything he wrote[20] and there is no mention of his suggestions in any of the papers concerning tax avoidance in contemporary or later files. By this time, British anti-avoidance legislation had generally taken the form of specifically targeted provisions designed to be as objective as possible. Clearly, the Inland Revenue was geared up to this way of dealing with tax avoidance, and neither the administration nor its political masters seem to have been interested in any other approach. The anti-avoidance provisions introduced in 1938 therefore continued to follow the narrow, targeted approach and Foster's influence was restricted to hastening that legislation.[21]

OBTAINING THE CHANCELLOR'S AGREEMENT TO THE ANTI-AVOIDANCE PROVISIONS

Although Foster's proposal for a general clause to block all avoidance transactions had apparently been rejected, the nature of the further provisions to prevent avoidance through the use of settlements had still to be determined, and this required the Chancellor's authority. A lengthy memorandum was sent to him by the Board on February 11, 1938,[22] setting out their suggestions for dealing with what they believed to be the most serious form of avoidance existing at that time.[23] After giving an overall review of the income tax and surtax treatment of trust income, the Board argued that four further anti-avoidance provisions relating to settlements were necessary. All four of their suggestions are analysed under the various headings below. Only two of them were accepted by the Chancellor.

Settlor Retaining An Interest and Revocable Settlements.

The Revenue believed that revocable settlements led to the most serious form of avoidance.[24] The problem arose from the fact that although the loophole highlighted by Watson v Wiggins[25] had been blocked in relation to parental settlements on their children by the Finance Act 1936, surtax avoiders merely modified the device by making their settlements on other beneficiaries.[26] As a modification of this there were many cases where the trustee had power to make loans to the settlor and his annual payments were being lent back by the trustees so that he never really lost the use and enjoyment of the funds but nevertheless obtained a reduction of his liability to surtax. There was apparently considerable growth in this type of avoidance after 1936.[27].

The principle upon which the Revenue thought that action should be based was that where an individual had not parted with his wealth beyond recall, he should be treated as still being in possession of it. The remedy they suggested was for the tests of irrevocability to be brought into line with those for children's settlements laid down in section 21(8) of the Finance Act 1936.[28] The effect of the change would be that no annual payments under a revocable settlement would be allowed as charges in computing the settlor's income, and any income arising to the trustees would be income of the settlor, whether or not that income was accumulated or paid out to a beneficiary. In effect the revocable trust was to be ignored and the settlor was to be treated as having the funds in his possession.

The Inland Revenue did point out to the Chancellor that their suggested remedy would affect some settlements which had been entered into for reasons other than avoidance of tax, but thought that it would be impossible to provide an exception for such cases because any exception would require an inquiry into the settlor's motives. The Chancellor agreed that no exception should be provided [29] and authorised the drafting of legislation in accordance with the Revenue's proposals.[30]

The detailed arguments put to the Chancellor concerning the need for these provisions were entirely couched in terms of revocable settlements but the covering note referred to their application to cases in which the settlor "can secure for himself or his wife the enjoyment of any of the funds of the settlement."[31] With a little effort it can be concluded from the Revenue's reference to the application of the definition of revocability from the children's settlement provisions that settlements in which the settlor retained an interest would be caught, but it is perhaps surprising that they did not make this more clear. The Inland Revenue were either careless or devious in not bringing the precise details of their proposals to the Chancellor's attention and in advising him that they did "not anticipate that you will find any difficulty in accepting this particular proposal."[32] The apparent reason for their belief was that the Chancellor had given a warning on this matter in the debates on the third reading of the Finance Bill 1937. However, the only class of avoidance which had been brought to his attention at that time concerned settlements revocable with consent, and not irrevocable settlements under which the settlor retained an interest. Within a few days of receiving the Revenue's paper the Chancellor gave his approval for the drafting of legislation in accordance with their proposals.

Shortly after authorising the drafting the Chancellor had second thoughts and sought further clarification, as the following letter from Gregg of the Board of Inland Revenue to Parliamentary Counsel indicates.

> "I was summoned suddenly for an audience with the Chancellor at 6 p.m. and was cross-examined by him for over an hour on what we proposed to do as regards surtax on trusts. I shall have to write him a note tomorrow outlining our proposals in the light of our conversation and I want to have a word with you in the morning if you are free before writing the note.
>
> He criticised the application to all trusts of a condition similar to Section 21(8)(a) (irrevocability definition of Act of 1936) on the ground that in an ordinary marriage settlement the bride's father would in its terms provide for the funds of the settlement to revert to the settlor in the event of the death of the married couple without issue. I advised him that marriage settlements would not be caught and that if necessary we could exclude settlements for valuable consideration whereupon he challenged me as to the danger inherent of speaking of "valuable consideration"!
>
> Yours in haste (and very muddled in mind)
> C J Gregg" [33]

The Chancellor was also unhappy with the Revenue's proposal that all the income arising under a settlement in which there was a mere possibility of reversion of the funds to the settlor was to be treated as the settlor's income. Modifications were therefore made so that it was only accumulated income which could be so treated.[34] The Chancellor thus played a very significant part in determining the final form of what is now section 447 ICTA 1970, and this is probably in no small measure because he was, as a former practising barrister, able to understand the legal details of the complex problems being put before him.

Irrevocable Capital Settlements

For a considerable time[35] the Revenue had been aware of the possibility of surtax avoidance through the creation of irrevocable capital settlements under which income was accumulated, and they therefore took this opportunity to bring the matter to the attention of the Chancellor. The accumulated income escaped surtax because it did not belong to any individual during the period of accumulation, and usually no surtax was payable when it was distributed because it was then a capital receipt in the hands of the beneficiary. An additional Revenue grievance was that if, under the provisions of any will or settlement, income was accumulated for the benefit of any person contingently on his attaining some specified age or marrying, then relief from income tax at the standard rate to which that person would have been entitled if the income had been deemed to be his throughout the period of accumulation could be claimed on the happening of the contingency.[36]

> "The Revenue is thus in the extraordinary position that such a person may come forward on the contingency happening and claim relief from income tax for all the years, irrespective of time limit, during which the income has been accumulated, but though the income is treated as his for relief from the standard rate, the individual in question cannot be charged to surtax in respect of the same income if its magnitude was such as to render him liable to surtax."[37]

The Revenue admitted to the Chancellor that it would be very difficult to defend on principle any proposal for the accumulated income to be treated as the settlor's, even if the settlor could recover any additional surtax from the trust.[38] Even in the case of children's settlements, where there were fairly strong grounds for treating the income as that of the parent, an exception had been provided for accumulated income, and thus other settlements were all the more strongly entitled to such an exception. It seems that the provision of a let-out for the accumulated income of children's settlements made it impossible for the Revenue to argue that the settlor should be charged on accumulated income in other settlements. It was necessary for them to find some other more acceptable principle which could be applied on a logical basis and which would enable them to obtain surtax on the accumulated income.

They therefore argued that a sound principle would be to charge the beneficiary when accumulated income was paid out for his benefit. A tax charge at that time could be justified on the grounds that it could then be shown that the accumulations were ultimately for his benefit. The remedy they suggested was that accumulated income paid to the beneficiary should be apportioned over the years in which it had been accumulated and assessed on him for those years.[39]

The Revenue advised the Chancellor that of the four proposals this one would evoke the most criticism and opposition.[40] The weaknesses were that assessments might be made for years which were otherwise out of date, and that it could be argued that advantage was being taken of the situation for one class of settlement to create a charge on another class which was generally bona fide and not usually a device for tax avoidance. A memorandum to Parliamentary Counsel indicates that the Revenue thought it unlikely that the Chancellor would accept these proposals.[41]

Given the Revenue's openness about the political difficulties of obtaining legislation on the subject, it is not suprising that the

Attorney-General told the Revenue of his opposition to their proposals.[42] As the Chancellor also disliked them, the Revenue decided to drop the matter.[43] The problem was raised again by the Revenue in 1965 but they still could find no convincing grounds upon which a tax charge on the accumulated income could be based, and no action was taken.[44] The imposition of additional rate tax on certain accumulated income by section 16 of the Finance Act 1973 may well be seen by the Inland Revenue as a compromise solution.

Irrevocable Annual Payment Settlements

The Revenue thought that the treatment of income accumulated in irrevocable annual payment settlements was anomalous.[45] The trust was seen as, in effect, a kind of savings box into which the settlor was paying an annual sum to be used for some future purpose. The principle they thought was being infringed was that annual savings by individuals out of their income should not be allowed as deductions in computing income.[46] A precedent for this existed in the childrens' settlement provisions of the Finance Act 1936.[47] They therefore suggested to the Chancellor that annual payments should not be allowed as deductions from total income in computing surtax liability if they were being accumulated in the hands of the trustees.[48]

The importance of such a provision arose from the fact that any surtax payer, (not just those with capital), could adopt this method of reducing his surtax liability provided he was prepared to earmark an annual sum irrevocably for beneficiaries other than his minor children. The Revenue thought that the potential exposure of surtax to this form of avoidance was extremely great and their proposals accordingly met with little resistance from the Chancellor.[49] The

Attorney-General was "rather against the annual payment proposal"[50] but he appears to have changed his mind, and a draft clause was prepared.

Settlor Having a Dispositive Power Under an Irrevocable Settlement.

A further cause of concern to the Inland Revenue were cases in which the settlor had totally parted with his funds, but had reserved the power to direct the trustees to use the funds for the benefit of such beneficiaries, other than himself and his wife, as he might select. It was apparently common to find that the settlor had stipulated that the trustees were to accumulate the income during his life and dispose of the funds in accordance with his will.[51]

The Revenue argued that in such cases the income so accumulated should be regarded as the settlor's because the trust was being used by him as a surtax free savings box.[52] Although initially neither the Chancellor nor the Attorney-General objected to this proposal, later, the Chancellor apparently decided that no action was to be taken.[53] The Revenue seem to have accepted that this battle was lost and the matter does not appear to have been raised again on any later reviews of the relevant legislation.

Tax Lost Through This Avoidance

The Inland Revenue estimated that the loss of tax resulting from all four of the devices above was not less than one and half million pounds per annum, of which between half a million and three quarters of a million pounds related to settlements which were revocable with consent and the balance related to irrevocable settlements.[54] No details were provided to the Chancellor concerning the growth in the incidence of these classes of avoidance or the number of cases which would be caught by the Revenue's proposals.[55]

Capital Sums Paid to the Settlor

Despite the fact that the above proposals concerning settlements taken together with those in three other unrelated areas, were said by the Inland Revenue to complete their programme concerning tax avoidance,[56] events made it necessary for them to hastily bring forward one further measure concerning settlements.

The Revenue were aware in 1934 that trustees were sometimes making loans to the settlor out of accumulated income but it only occurred occasionally.[57] It was probably because of the rarity of such loans that no proposals were put forward to the Chancellor in the Revenue's original submission. However, their attitude was changed by the appearance of an article in "The Spectator" on March 4, 1938 entitled "The Art of Tax Dodging" which drew attention to the use of loans to the settlor as a device for tax avoidance.

The Revenue realised that if their suggestions regarding irrevocable annual payment settlements were enacted, then although the loan device would not work in connection with such settlements, irrevocable capital settlements would remain untouched. Therefore on March 8, 1938 they put forward a proposal to the Chancellor that in the case of any irrevocable settlement, loans made to the settlor were to be deemed to be the settlor's income insofar as there was accumulated income to cover the loan.[58] They were "not blind to the fact that this is a pretty stiff proposition, but we feel that we must advance it for the consideration of the Chancellor, so that he may appreciate, not only the method of avoidance afforded by loans but the drastic character of any remedy designed to check it."[59]

There is nothing to indicate that the Chancellor found any difficulty in accepting the Revenue's proposed remedy, even though they themselves thought it to be so severe. The lack of any detailed paper from the Revenue to argue the case for the introduction of their proposals may well have been a major contribution to the legislation being illogical and faulty and consequently the subject of scathing judicial criticism.[60]

THE LORD CHANCELLOR'S DRAFT

In the field of taxation it is most unusual for the Lord Chancellor to attempt to influence the detailed form of the legislation. However, he drafted a clause to prevent surtax avoidance by means of trusts and submitted them along with accompanying notes to the Chancellor of the Exchequer, who on April 1, passed them on to the Board of Inland Revenue.[61] They prepared detailed notes for Parliamentary Counsel, indicating where the draft went beyond what was required, and the major areas it left untouched. The main faults they found were as follows:-

1. The Chancellor of the Exchequer had decided to deal only with accumulated income of irrevocable settlements, yet the Lord Chancellor's draft went wider than this and caught income arising.
2. The draft would have caught irrevocable accumulation settlements

for the benefit of minor children, but it had already been decided that these should be left untouched.

3. He had not dealt with the problem of revocable settlements except for those which could benefit the settlor's family.
4. The Lord Chancellor had referred to the need to include measures to deal with the effect of the Archer-Shee v Garland case.[62] This was totally unnecessary as the provisions of Section 18 of the Finance Act 1936 relating to transfers of assets abroad already caught the creation of trusts abroad.

All in all the Lord Chancellor's suggestions were largely beside the point, if not totally irrelevant, and they had no effect whatever on the final shape of the legislation.

The Revenue's notes were passed to Parliamentary Counsel with the following covering note:-

> "Here is the retort courteous to Maugham, [the Lord Chancellor] which you may amend as you will."[63]

The precise form of words used in any communication with the Lord Chancellor is not available from the files examined but there does not appear to have been any further direct intervention by him.

THE CHANCELLOR TAKES ADVICE ON HIS BUDGET SPEECH

The Chancellor took the unusual step[64] of circulating extracts of his draft budget speech to various people for their comments, including the Lord Chancellor, Josiah Stamp and a Kings Counsel named A.M. Latter. It was to Latter that he turned for advice on the proposals concerning settlements, and on April 14, 1938, he sent him a copy of the relevant part of his draft speech.[65]

Latter went carefully through the draft making pencilled alterations before returning it to the Chancellor. Virtually every one of his suggestions was accepted.[66] Latter also provided the Chancellor with detailed notes on the difficulties he could foresee with the implementation of some of the proposals. He quite obviously had a thorough grasp of the subject, and each of his comments was given serious consideration by the draftsman. However, Latter was not provided with a copy of the draft clauses and therefore some of his suggestions merely reflected the lack of detail in the Chancellor's proposed statement. He was, like the Revenue, in favour of charging surtax on accumulations of income in capital settlements, but the Chancellor had already decided that that was an area which he would not touch "at any rate at present."[67]

The importance of this extraordinary, informal consultation process is that the Chancellor seems to have believed that there were advantages in having trusted outside advisers to consider the complex problems with which he was trying to grapple. The process helped to ensure that all aspects of these problems had been fully considered and no doubt resulted in some improvements, if not in the legislation itself, at least in the Chancellor's understanding of what his civil servants were asking him to approve. The only criticism is that he did not take the matter further and allow consultation on the draft legislation so that it could be altered before it became encumbered by parliamentary procedures. Perhaps the provisions governing loans to settlors would not have been subjected to such severe criticism, (see Chapter 11), had the consultation been extended.

DRAFTING, PARLIAMENTARY DISCUSSION AND ANALYSIS OF THE PROVISIONS

The drafting process began on March 11, 1938, when Parliamentary Counsel sent his first draft to the Inland Revenue for comment. Because of MP's previous complaints about the incomprehensibility of legislation of this type, all the machinery provisions were inserted in a separate schedule so that there was no referential legislation.68

There were four major provisions concerning settlements in the Finance Bill 1938, and all of them are still in operation in largely the same form as originally enacted.

1) Clause 32 (1) and (2),(the equivalent of what is now ICTA 1970 section 445 and 446 respectively), dealt with revocable income settlements and revocable capital settlements.

2) Clause 32 (3), (the predecessor of ICTA 1970 section 447), dealt with settlements where the settlor retained an interest.

3) Clause 33, (the predecessor of what is now ICTA 1970 section 450), dealt with the disallowance of deductions from total income in respect of annual payments by the settlor where those annual payments were not distributed by the recipient trustees.

4) Clause 34, (the equivalent of what is now ICTA 1970 section 451), dealt with capital sums paid to the settlor where there was accumulated income in the settlement.[69]

Various supplementary provisions were included to deal with such matters as definitions, rights of recovery for the settlor and let-outs for certain situations under which the settlor might with good reason obtain a benefit from the settled property.

Much of the groundwork in connection with basic definitions and the tests of irrevocability had been covered in the Finance Act of 1936 and this may explain why there were far fewer amendments put down and far less parliamentary debate than there had been on the less extensive childrens' settlement provisions in 1936.

Each of the clauses were drafted, discussed with the Inland Revenue and put through the Parliamentary procedure at the same time, but they have been dealt with separately below for the sake of clarity. A copy of each clause, as introduced, is in Appendix E2 and a copy of the legislation is in Appendix E3.

Clause 32

This clause dealt with two distinct but related classes of case. Firstly it applied to settlements which were wholly or partly revocable under any circumstances whatsoever, and secondly to settlements which contained provisions under which there was a possibility of funds reverting to the settlor or his spouse.

In the case of revocable settlements, sub-section 1, (which dealt with annual payment settlements), and sub-section 2, (which dealt with capital settlements), provided that all the income, irrespective of distribution, was to be treated as the settlor's. However, no such deeming was to apply where any power of revocation could not be exercised within six years of the time the first annual payment was made, (income settlements), or the time property first became comprised in the settlement, (capital settlements).[70]

Where the settlement was such that funds could revert to the settlor or his spouse, sub-section 3 specified that any undistributed income was to be treated as the settlor's.[71] However, certain cases were excluded from the deeming process by the proviso to sub-section 4.

The remainder of the clause dealt with certain incidental provisions and specified that the whole clause was to take effect for surtax purposes from 1937/38 and for standard rate purposes from 1938/39. By this means the retrospection threatened by the Chancellor in 1937 was achieved.

There were few problems with the drafting of sub sections 1 and 2. This was probably due to the fact that the basic proposition was simple - if there was any power of revocation under which the settlor could obtain the benefit of the funds settled, then the income was to be deemed to be his. There were to be no exceptions and so there were no difficulties with "line drawing".[72] However, the review of possible further loopholes which might arise from the introduction of these provisions was extremely thorough and seem to indicate a far more cynical view than had been taken in 1922 of the extreme measures which might be adopted to avoid tax.

One area where opinion was divided was the question of whether the settlor should be deemed to have retained an interest in income for the purposes of sub-section 3 where income or assets could become payable to his or her widow or widower. In the end it was decided to exclude such a situation from the provisions[73] and it is surprising therefore that in the case of Vestey's Executors and Vestey v. CIR in 1939[74] the Revenue should have argued that the word "wife" included the settlor's widow for these purposes. The House of Lords decided that it did not.

Another question which exercised the minds of the Revenue and the draftsman was whether sub-section 3 should apply to protective trusts. The children's settlement provisions had provided a let-out for such trusts, but the difference in this case was that there was a "considerable possibility that the creation of a protective trust will make it possible that the settlor may be one of those persons who may have income paid to him ...."[75] The Revenue were concerned because protective trusts were a very common feature of settlements and objections would be raised unless some special exemption was allowed. Without an exemption a settlor, with no intention other than that of providing an advantage to a beneficiary, might find that in certain events settlement income would be treated as his.[76] If, however, an exemption was granted, then it would have been possible for a settlor to select some beneficiary over whom he had sufficient influence to enable him to induce that beneficiary to bring the protective trust into operation. The result of this would be that the settlor might be one of the persons in whose favour that trust could be operated.[77] The draftsman's view of protective trusts was that so long as the first trust, (the trust mentioned in section 33(1)(i) of the Trustee Act 1925) subsisted, the income held on that trust would have to be distributed, and it could not therefore be caught by sub-section 3 of the clause. However, once the first trust had failed, he believed that the income would then to be caught by the clause and that therefore it was unnecessary to provide a let-out for protective trusts.[78] This view seemed to attain general acceptance without further discussion and hence there was no exception for protective trusts in sub-section 4.

Parliamentary Counsel was concerned about the position where a married settlor had made a settlement under which, on the death of the wife, part of the income was to be paid to the husband and the remainder was to be applied for the benefit of the children, because in such a case the let-out in sub-section 4 paragraph (c) would not apply. Although the draftsman argued that such cases should be excluded from the provisions, the Inland Revenue disagreed and as the draftsman did not press the point, no change was made.[79]

The question of marriage settlements attracted the attention of the Scottish Law Officers, because under Scots Law, by virtue of the doctrine of radical right, the funds comprised in any marriage settlement would fall to be held for behoof of the spouse from whom they were derived in the event of failure of the matrimonial purpose through, for example, death or divorce. Although they advised the draftsman that sub-clause (3) would apply to every marriage settlement, the problem was not specially provided for in the legislation.[80]

Discussions on the drafting thus resulted in few changes and the Parliamentary process was almost entirely concerned with the retrospective effect of the clause.[81] The combined effect of the two provisos to sub-section 7 was to ensure that for surtax purposes the income was deemed to be the settlor's for 1937/38, but that nevertheless, it was still treated as the beneficiary's for the purposes of relief from standard rate tax. By this means the retrospective effect of the clause was limited to surtax. This element of retrospectivity only applied to clause 32 and not to the other clauses affecting settlements.

The MP, Sir William Brass, was so perturbed by the restrospection that he arranged to meet the Chancellor, who discussed the matter with him and asked him to confer with the Board of Inland Revenue.[82] According to their notes of the meeting with him[83] on June 15, Brass had himself entered into four settlements in 1937 to provide for needy relatives,[84] and they all included a power of revocation with the consent of certain specified persons. The kinds of argument used by Brass are recorded in the Revenue's notes.

> "He was very vehement in protesting against the unfairness of denying him a deduction in respect of the annual payments for surtax purposes.... As the law stood when he entered into these agreements he was entitled to a deduction. He was not a tax dodger and the Chancellor's speech about tax dodging last year was not addresssed to him and so on."[85]

Brass quoted the Chancellor as agreeing with him that it was not fair that in his circumstances he should be caught, but admitted that he had been challenged as to how deserving cases could be differentiated from others.[86] He had already thought out a solution to this difficulty by the time he approached the Revenue. His remedy was to insert a proviso to sub-section 1 to the effect that if any deed contained a power of revocation and the settlement was amended in 1938/39 so as to become completely irrevocable, the provisions would not apply in computing surtax liability for 1937/38.[87] The Revenue's notes indicate that Brass's suggestion was of the kind they would have recommended to the Chancellor had he thought it necessary to protect certain bona fide classes of revocable settlement.[88]

By June 13, 1938, the Chancellor had received only five written representations of protest concerning clause 32.[89] The Revenue appear to have been surprised[90] that only three of them related to the effect of the clause on deeds in favour of charities, because a letter in "The Times" from Lord Queensberry on May 27, had drawn attention to the fact that many charitable deeds would be affected. At first, the Revenue were against giving in to such pressure, arguing that revocable covenants were really voluntary payments and were in effect free gifts made from year to year.[91] They drafted replies for the Chancellor based on this view, but advised him not to issue them until he had seen how things developed at the Committee Stage.[92]

Immediately after the meeting with Brass, the Revenue's attitude altered, as the following extract shows.

"A lot can be said in support of the Brass proposal for we must admit that where a taxpayer binds himself to pay the annuity for seven years certain, the annuity qualifies as a deduction in computing his total income and it is difficult to disallow a deduction for last year on the grounds that the settlement was then revocable if the taxpayer is prepared this year to make it irrevocable so that it will certainly be paid for seven years including last year."[93]

The Revenue pointed out to the draftsman that it would be "a perfectly complete answer in the House ... to say that if the deed is made irrevocable it will be treated so for the year 1937/38."[94] Thus when Brass put down his amendment for consideration at the committee stage there was no impediment to accepting it. He proposed that if the settlor released any power of revocation in an annual payment settlement within three months of the Finance Bill becoming law then sub-section 1 would not apply. Two other amendments were put down of a similar character to that of Brass; one extended the let-out to sub-section 2 as well as sub-section 1; the other provided that if by December 31 1938, any power of revocation or any provisions under which funds might revert to the settlor were cancelled then clause 32 should not apply at all. The Revenue indicated to ministers that there was a good deal to be said in favour of some concession on the lines of all of the proposed amendments, but advised that if a concession was to be made it should be introduced at the report stage because of the technical deficiencies of the current amendments.

Only Brass's amendment was debated in any detail, and in moving it he illustrated the problem by reference to "four settlements that have been made by a friend of mine."[95] He argued his case persuasively and created the feeling that entirely reasonable and charitable settlors would be caught through being unaware of the Chancellor's warning in 1937.

> "All my life I have been told that ignorance of the law ... is no excuse, but now I am being told that ignorance of the Chancellor's speech is no excuse. I think that that is going rather too far."[81]

He had obviously researched previous parliamentary commentary concerning retrospective tax legislation, and was able to refer to an attack on such retrospection made in 1922 by the current Minister for the Coordination of Defence.[97] This enabled him rather pointedly to suggest to the Chancellor that he should discuss the matter with his fellow Cabinet member.[98]

There was considerable support in the House for Brass's amendment, and while all those speaking in favour of it expressed their abhorrance of avoidance, they suggested that there were many bona fide cases which ought to be given the opportunity to escape from the clause. In particular, it was agreed that many charitable covenants would be caught, and that in most cases people would be prepared to make amendments to remove the offending powers.[99] Various other hard cases were put forward[1] but Mr Benson, who had been highly critical of the restricted scope of the 1936 provisions, believed that the examples used showed how hard cases would make bad law, because the retrospective effect of the clause would only be confined to surtax, and the hard cases would not have involved a significant surtax liability. In his view, the provision of a let-out would apply to many settlements which had been "definitely evasive in their object".[2]

In reply, the Chancellor of the Exchequer defended his action in issuing the warning in 1937, and expressed the view that it had greatly limited the use of such schemes. He did, however, agree that there were undoubtedly cases which would be caught which were "perfectly understandable, straightforward and honourable,"[3] but he thought it impossible to draw a workable distinction between the meritorious case and other settlements. He suggested that the practical way of dealing with this problem was to say to settlors:

> "If you do not use this power of revocation and if you are prepared now to turn your settlement into a really irrevocable settlement, these are such indications of your real intention to get within the spirit of the provisions of the law, that you ought not to be retrospectively hit."[4]

However, in those cases where the powers of revocation had been used already to get money back into the settlor's hands, the Chancellor believed that they "ought to be shown [no] mercy, because it was not a genuine and straightforward settlement."[5] He had, in effect, decided that he would prefer to avoid doing an injustice to people who had acted bona fide than make them suffer because others had not, and he therefore promised to introduce an amendment on report.

At the report stage, a carefully guarded let-out from retrospection was introduced which became Part II of Schedule 3 to the Finance Act 1938. Paragraph 1 provided that annual payment settlements made before the Budget date were to be excepted if any of the following conditions were satisfied:

(a) the settlor had released his power of revocation within three months from the date of the passing of the Act and had not received any consideration in respect of that release; or

(b) annual payments were made for a continuous period of seven years; or

(c) the settlement had been revoked within three months of passing the Act, and a new irrevocable settlement had been put in its place.

Capital settlements were dealt with by paragraph 2 in a similar way to annual payment settlements, but in both cases a further condition was imposed by paragraph 3 such that the let-out would not apply if, since April 5, 1937, the settlor had received any capital sum, either from the trustees of the settlement or any company connected with it. This stipulation was included to ensure that nobody who had made use of the avoidance methods struck at by clause 34 could claim that retrospection did not apply.

Mr Benson, for the Opposition, argued that the Chancellor was giving in to back-bench pressure in providing a considerable and unwarranted concession. He was fiercely critical of providing a let-out for a seven year settlement of income which had a revocation clause, because in his opinion "it is merely an annual gift cast in the form of a settlement ... [so that] you can set it against your income for tax purposes."[6]

All the non-government amendments put down for consideration at the committee stage concerning matters other than retrospection were not moved. One of the amendments was to the effect that any settlement made for valuable consideration, or as part of family arrangements, or by a person under the age of 25, should be excluded from the clause. The Revenue could not understand why the settlor's age should be relevant and thought that the relaxation in favour of marriage settlements in sub-section 4 covered all the classes of settlement entered into for valuable consideration which were worthy of special treatment. They pointed out to ministers that a concession in favour of settlements on members of the settlor's family would make the whole clause virtually useless. Another amendment attempted to exclude any resulting trust arising by reason of the failure of the trusts of the settlement. A modified version of this amendment was put down at the report stage but was dismissed on the grounds that it would have created a very large loophole, because the settlor would be able to make a settlement giving a contingent interest to an aged beneficiary and provide that the income was to be accumulated for a period of years, and so be practically certain that the beneficiary would die within the period for accumulation and that the whole undistributed income would revert to him under the resulting trust without any surtax liability.[7] The only government amendment involved a minor drafting point.

At the report stage an attempt was made to substitute an age limit of 30 instead of 25 for the let-out for funds reverting to the settlor on the death of the beneficiary under a specified age. The mover of the amendment contended that there were a very great number of settlements in which an age of 30 was laid down. However, the Board of Inland Revenue had advised ministers that such settlements were quite exceptional and that usually where income was being accumulated for minor children, the age limit would be fixed at 25 or some lower age. The Solicitor-General resisted the amendment on these grounds and argued that the drawing of the line at the age of 25 was very reasonable.[8]

Representations had been made to the Chancellor to the effect that paragraph (d) of sub-section 4 did not go far enough, in that it did not provide an exception where the beneficiary, on obtaining the age of 25, would not obtain any title to the accumulated income, but would only have a life interest in future income.[9] The Chancellor had agreed that this type of case should be excepted, and a government amendment was put down at the report stage to add a further proviso to sub-section 4 letting out any case in which income was being accumulated for a beneficiary under the age of 25, irrespective of his interest on attaining that age.

Overall, therefore, there were three amendments made to clause 32, and the only major relaxation obtained was the introduction of transitional provisions under which settlements could be modified so that the settlor would not be caught by the retrospective surtax element of the clause.

Clause 33

The aim of this clause was to prevent a surtax deduction being allowed for annual payments made by a settlor to the trustees of an irrevocable settlement to the extent that those annual payments were accumulated by the trustees.[10] It was thought that there was no logical reason why the settlor should not obtain a deduction for annual payments to trustees which were paid out year by year to a beneficiary, because had the settlor made these payments direct to the beneficiary under a deed creating a charge on his income for a term exceeding six years, he would have obtained a deduction for surtax purposes. Thus, the clause only prevented annual payments being stored up surtax free in a trust, and was an application of the principle that no deduction should be allowed for savings in computing total income.

The conversion of these aims into a draft clause seems to have caused very little problem for Parliamentary Counsel. After only his second attempt, the Inland Revenue were able to agree the clause subject to one final modification to ensure that annual payments made to foreign companies would be caught.[11]

Sub-section 1 contained the basic deeming provision for undistributed income, but in order to prevent any double charge, it excluded any income which was treated as the settlor's under clause 32 from being counted as his again under clause 33.

Sub-section 2 provided that annual payments made by a settlor to a company connected with the settlement were to be treated as made to the trustees so that such payments would also be ineligible for deduction from income for surtax purposes. It was necessary to have such an extension to the basic provisions in order to catch arrangements under which the settlor interposed a company, (or a chain of companies), between himself and the trustees, and made annual payments to the company in return for an allotment of shares which were then transferred to the settlement so that the annual payments could be accumulated and eventually paid out as capital to the trustees on the liquidation of the company.[12]

The Board's notes for ministers concerning sub-section 3 indicate that it was designed to ensure that the subsequent distribution of accumulated annual payments which had already been treated as the settlor's income would be counted as part of the beneficiary's income.[13]

Sub-section 4 ensured that the clause only applied to post-Budget settlements and existing settlements made irrevocable after the Budget date, while sub-section 5 treated a husband and wife as one person.[14]

In their briefing of ministers for the parliamentary discussion of the clause, the Revenue warned of possible criticism on the grounds that it hit the salary earner as opposed to the person who could make an irrevocable settlement of capital.[15] Their suggested answer to any such criticism was that a person who was able to put aside a capital sum had built up that sum out of his taxed income.[16] The over-simplification of such an argument had been pointed out in the debates concerning a similar provision made in the 1936 Act in connection with settlements on minor children,[17] but in the event, this time the point was not raised.

There was little parliamentary debate on the clause, and the only amendment put down was at the committee stage where Mr Benson for the Opposition attempted to extend its operation so that it would apply to all settlements no matter when they were made. The Revenue advised ministers to resist this amendment on the grounds that the settlor had no power to terminate the settlement and it would therefore have been harsh to have imposed an additional tax liability on him.[18] Furthermore, they believed that settlements within clause 33 were quite different from those under which the taxpayer still retained a power to enjoy the income, because in cases solely within clause 33 the settlor had parted completely with the annual payment.[19] Mr Benson's amendment was really untenable and he withdrew it without fuss on realising that he had misinterpreted its object in thinking it was designed to strengthen a clause of the 1936 Act dealing with accumulation trusts for the benefit of children.[20]

Clause 34

The drafting of clause 34 was a much more hurried and less well thought out affair than the drafting of the other clauses, because it was not until March 1938 that the Revenue decided that the avoidance at which the clause was aimed ought to be blocked in the Finance Bill of that year. It was only press articles drawing attention to the various devices in the few months prior to the Budget that led the Inland Revenue to make a late request to the Chancellor for legislative action. The type of avoidance at which the clause was aimed showed a sudden potential for rapid increase, and although its simplest form had been known of by the Inland Revenue for a number of years, some extremely complex arrangements were discovered by them during the course of the drafting process.[21]

The basic feature of the avoidance was that accumulated income was used to make non-taxable payments to the settlor. Usually, in simple cases, loans were made to the settlor which created a debt on his part, but the beneficiary of the trust to which the amount was owed would often be a member of the settlor's family and also a beneficiary under his will. Normally therefore, the repayment of the loan would make no difference to the beneficiary as he would receive the repaid loan from the trustees but with the amount received from the estate being correspondingly reduced. In effect the scheme enabled the settlor to enjoy the income of the settlement during his life without having a surtax liability in respect of it.

There were two main variants on the theme of direct loans to the settlor. Firstly, there were cases where the settlor transferred securities to a company for a consideration which for a short time was unpaid (say £100,000) and then settled a small sum (say £100) on trust with the income to be accumulated during the settlor's lifetime. The next step would be for the settlor to make a loan (say £99,900) to the trustees, who would use it, together with the amount settled, to subscribe for shares in the company to which the securities were originally transferred. By this means the company acquired the sum necessary to pay the settlor for the securities he had transferred to it. The company would subsequently pay dividends to the trustees corresponding to the income from the securities it had acquired from the settlor, and the trustees would use those dividends to repay the settlor's loan. As a variation on this scheme, cases had been found where the securities were transferred for an inflated consideration which the loan to the trustees covered. The effect of this variation was to extend the period over which the settlor would receive the income of the trust in repayment of his loan.

The second device took the form of the settlor selling assets to the trustees at a figure greatly in excess of their real value under an agreement by which the purchase price would be paid by instalments over a number of years. In effect this created an artificial loan to the extent of the excessive consideration and that loan was repaid by the trustees out of the income of the settlement.

These more complex schemes had only come to the attention of the Inland Revenue shortly before the drafting of the Finance Bill clauses began. The Parliamentary Counsel file contains a copy of a deed dated April 7, 1936, which a covering note indicates had "been supplied to us"[22] These methods of avoidance had therefore started at least a couple of years earlier without the Revenue realising it, and it appears that there was someone outside the Inland Revenue who passed the deed to them in order to bring the matter to their attention. The terms of the deed of interest in the present context were that the trustees were given power to borrow money and to repay it out of capital or income, and that any money borrowed was to become part of the trust funds without the trustees having any personal liability in respect of it. It was these basic features of the deed which made it possible for the settlor to exploit the settlement to obtain a tax advantage.

The person analysing the deed[23] believed that:

> "legislation upon the lines of attacking loans by the settlor to the trustee of the settlement, or companies which then pass on those loans to the trustees of the settlement, does not seem to me to go to the root of the matter. Further, such legislation would be exceedingly complicated ...."[24]

The writer of the note believed that the essential feature of all the offending transactions lay in the fact that the terms of the settlement provided for the trustees to borrow money and repay it out of income, and he suggested that there was no proper reason for trustees to do this. On these grounds he argued that legislation should be drafted which merely attacked settlements which contained the offending powers. This method was thought to avoid the complications of defining the relationship of the settlor to the settlement, and the settlor to any company which lent money to the trustees. Two clauses based upon this manner of attack were prepared[25] but unfortunately do not appear on any of the files examined. What is clear, however, is that they must have been thought totally inappropriate as there is no further reference to them.

Because of the very late stage at which it was decided to include provisions to catch capital sums paid out of accumulated income, the Inland Revenue had hardly given any thought to the detail of the required legislation by the time the draftsman sent them his first draft on March 11, 1938. That draft merely referred to the lending of money to the settlor by the trustees and would not have caught the more complex schemes. The Revenue's response was to suggest a complete revision which bore little relationship to the original but which was wide enough to catch loans made indirectly and loans through companies. The basic provisions of the Revenue's draft did bear some relationship to the eventual legislation but did not require the grossing up of the sums paid to the settlor and did not deal with the position where the capital sums paid exceed the accumulated income. A computational example was provided to the draftsman indicating what the Revenue was seeking to charge in cases where the capital sum exceeded the accumulated income, but this approach confused the draftsman who was looking for words in the draft legislation which achieved the objectives shown in the computational example. No such words were there because the Revenue wanted him to draft the appropriate words. The draftsman readily admitted that he did not understand the following example provided by the Revenue.

Example Provided by the Revenue to the Draftsman

	Loan		Accumulated Income
Year 1	1,000		500
		charge 500	
Year 2	Nil		500
		charge 500	
Year 3	Nil		500
		charge Nil	
Year 4	1,500		500
		charge 1,000	

Source:- Parliamentary Counsel Finance Bill 1938 File, P4041

Parliamentary Counsel's main criticism of the Revenue's draft centred on the definition of accumulated income as being income arising under a settlement to which no person was beneficially entitled. He argued that almost always someone would be beneficially entitled because even if one person was beneficially entitled subject to a contingency, he and the person who would take in default of the contingency might together constitute the persons who were entitled to that income. Clearly the legislation had to approach the problem by reference to undistributed income arising under the settlement.

Parliamentary Counsel's next draft was very largely a development of his original, but it did take into account the representations of the Inland Revenue by extending the provisions to catch loans made by a company to the settlor where the trustees of the settlement were members of the company. This latter proposal was too wide and the next draft limited it to companies whose income had been apportioned to the trustees under the close company legislation in the same tax year as the capital payment to the settlor.[26] The fourth draft extended the clause to catch repayments of loans as well as the making of loans, but still only caught indirect arrangements through close companies where income had actually been apportioned to the company. It was not until the fifth draft that the provisions were altered so that the company merely had to be a close company connected with the settlement to bring indirect arrangements within the clause.

As each further draft was prepared so the Inland Revenue realised that there were other matters which had to be dealt with and refinements to be made. For example, the income available had to be reduced by the tax on that income, and the capital sum had to be grossed up; the provisions had to be extended to include foreign companies; and income already caught by the other settlement anti-avoidance provisions had to be excluded. Even at the end of April the draftsman was still having great difficulties as the following extract shows.

> "I [have] tried to find some formula for equating the income arising under the settlements with the loans. I am afraid that I not only found this very complicated but utterly beyond my mathematical powers. Would you mind taking this case and trying to invent some formula which will fit it?"[27]

Not only did the draftsman have difficulties putting together this clause but the Inland Revenue lacked time to think it through fully. Various last minute amendments were made[28] and doubts expressed,[29] and the whole drafting process creates an impression of pressure of time, confusion and lack of background research. It is perhaps not surprising therefore that the legislation resulting from this process was subjected to severe judicial criticism. (See chapter 11.) The whole episode is a prime example of the dangers of introducing complex anti-avoidance provisions without adequate planning and time for considering all the details.

Sub-section 1 specified that any capital sum paid to the settlor was to be treated as his income for the tax year in which it was paid, to the extent that it fell within the amount of income available at the end of that year. Where the capital sum exceeded the income available then, up to the amount of the income available at the end of the following year, the excess was to be treated as his income for that following year, and so on for succeeding years until all of the capital payment had been treated as the settlor's income. Although this was the stated intent of sub-section 1 according to the Board of Inland Revenue's notes on clause 34, [30] subsequent judicial comment indicates that it did not achieve its objective.[31]

The amount of the undistributed income at the end of a tax year was defined in sub-section 2 as the aggregate amount of any undistributed income of that and any previous year, less certain deductions. Those deductions were set out in paragraphs (a) to (e) and represented income which had already been deemed to be the settlor's under the clause; income deemed to be the settlor's already under clauses 32 and 33; and the amount of tax at the standard rate on the undistributed income, (after deduction of income which had been taken into account under clause 32 and 33). The basic idea, therefore, was to ensure that there was no duplication of charge on the same income.

The more complex methods of avoidance were caught by sub-section 3. This provided that any capital sum paid to the settlor by a company or other corporate body connected with the settlement was to be treated as having been paid by the trustees so that it would fall within sub-section 1. Thus, sub-section 3 caught the situation where the settlor transferred investments to a company in return for an allotment of shares, and then settled those shares on trustees, while the company paid no dividends and used its income to pay a capital sum, (usually a loan), to the settlor.[32]

The amount which was to be treated as the settlor's income was, by virtue of sub-section 4, the gross equivalent of the amount to which the deeming process was applied. Grossing up was needed in order to take account of the fact that the trustees would be making the capital payment out of taxed income.

The clause was to apply to all existing and future settlements, whether made in the UK or abroad, but only in respect of capital sums paid after April 5, 1938 out of income accumulated after that date.

Not only was a loan or repayment of a loan to be caught, but also any other sum which was not treated as income in the hands of the recipient and which was not paid for full consideration in money or money's worth. The reference to full consideration was aimed at artificial arrangements for the payment of inflated amounts for over-valued assets and was not intended to catch genuine situations where the settlor sold investments to the trustees at their market value. Any capital sum paid to the settlor in the exceptional circumstances specified in the proviso to clause 32(4), (bankruptcy of a beneficiary, death of the parties to a marriage settlement or death of a beneficiary under the age of 25), was not deemed to be income.

A husband and wife were to be treated as one, so that, for example, if the settlement was made by the husband, any capital sum received by his wife would be caught. It was thought that such treatment would prevent any artificial arrangements betweeen husband and wife which might otherwise escape the clause.

At the committee stage there were only three amendments put down, and at the report stage there were none. The amendment put down by Mr Spens to provide a let-out for settlements made prior to the Finance Act which were for valuable consideration, or part of a family arrangement or involving a person under the age of 25, was not moved, and similar comments apply to it as applied to the analogous amendment put down under clause 32. [33]

The sole Government amendment related to a modification to sub-section 2(a) so that not all capital sums paid would reduce undistributed income, only capital sums paid to the settlor. The reason for this change was that without it the trustees could pay capital sums to other persons, and such sums would have reduced the amount of undistributed income available to be deemed the settlor's.[34]

The only amendment debated concerned an attempt to exclude from the clause any loan to the settlor where he had mortgaged or charged property as security. It was proposed that this exclusion should be up to an amount not exceeding two thirds of the value of the mortgaged property. The intention was to exclude genuine loans for which adequate security had been given, but as the Board of Inland Revenue pointed out, this would have defeated the main object of the clause, because a person wishing to avoid tax would be willing to provide such security for a loan if he could thereby ensure that clause 34 would not apply and that he could enjoy the accumulated income without a surtax liability.[35] . The Attorney-General explained that the need for the clause was

> "that certain people have set up machinery under which the income goes in at one slot and the same amount of money comes out below, but when it comes out below, they say it is a capital payment, whereas they deduct from their total income return what they have put into the slot above."[36]

Whilst he was sympathetic with the view that it would be unfair to exclude genuine loan transactions, he did not think that the amendment, as drawn, would achieve that end, and the Inland Revenue advised him that "there is really no means of distinguishing the genuine loan from the loan obtained as part of a tax avoidance scheme."[37] The Attorney-General was careful to point out that anyone who genuinely desired to raise money would have to be careful not to raise it from the trustees of a settlement in which income had not been fully distributed. As the Revenue said, "it is really no part of the function of trustees to be providing loans for the settlor, and there is no particular hardship if, in future, the settlor ... has to look elsewhere for his loan."[38]

Clause 35

The main purposes of clause 35 were to set out the relationship between the new and the existing settlement provisions; to introduce machinery provisions; and to define various words and phrases. The terms "settlement" and "settlor" had already been defined in the Finance Act 1936, and the draftsman was able to utilise the same definitions, with the exclusion of the words "transfer of assets" which appeared in the earlier Act. There were, however, a considerable number of matters which required new definitions but none of them excited any parliamentary comment.

Although each of the clauses were applicable to any settlement wherever it was made, a territorial limitation was set by clause 35(4), paragraph (a)(i) of which defined income arising under a settlement to include any income chargeable to tax and any income which would have been so chargeable had it been received in the UK by a person domiciled, resident or ordinarily resident there. Such a wide definition was necessary in order to get around the difficulties created by Perry v Astor, [39] (see chapter 4), which had shown that a taxpayer in the UK could transfer foreign securities to a revocable foreign trust without the 1922 anti-avoidance provisions applying because those provisions only caught income already liable to UK tax before the application of the deeming process. Other than the inclusion of the word "domicile," there is no difference between the definition of income in section 21 (9)(d) of the Finance Act 1936 and the 1938 provisions. However, an extension of the meaning of "income arising" was applied by paragraph (a)(ii) so that it included any income of a body corporate which could be apportioned to the trustees under the close company apportionment provisions.[40] This enabled apportioned income to be treated as undistributed income for the purposes of the various settlement clauses of the Finance Bill. The Revenue were aware of a large number of cases in which the close company apportionment provisions were being avoided by the transfer of assets to a company in return for an allotment of shares which were immediately settled on trust for beneficiaries having only a contingent interest, and in which the settled funds would revert for the benefit of the settlor or his spouse in the future.[41] Any apportionment to the trustees in such a case was to no avail as the trustees were not liable to surtax. The extended meaning of income arising was an indirect attack on income being accumulated in a close company. An amendment to the definition was made at the committee stage so that income which could be apportioned direct to a beneficiary could be counted as income apportioned to the trustees, and hence subjected to the deeming process and treated as the settlor's. The need for this arose from the decision in the case of Drew & Sons Ltd., v C.I.R.,[42] in which it was held that apportionment could be made direct to a beneficiary having a life interest in shares in a close company.

A limitation was placed on the meaning of "income arising" by the final part of paragraph (a). It was designed to exclude income of a year in which the settlor, on the assumption that he was actually entitled to the income, would not be chargeable to tax because of his domicile, residence or ordinary residence status. Thus, where he was not resident and would not have been chargeable in respect of dividends from foreign securities, or where he was not ordinarily resident and would not have been chargeable in respect of interest on UK government securities, those classes of income would be excluded in calculating the amount deemed to be his under the settlement provisions.

The rules for determining how much income had not been distributed were laid down by sub-section 4(d). This permitted three classes of deduction from the income arising:

(a) any sum paid which formed taxable income in the hands of the recipient;[43] and

(b) expenses properly chargeable to income, (e.g. management and administration expenses); and

(c) in the case of charitable trustees, any amount exempted from income tax because of its application for charitable purposes.

Government amendments were put down at the committee stage to ensure that deductions could not be taken into account more than once. The Revenue's concern was that trustees might pay a salary to a clerk which would be taken into account under (a) above, and which would also constitute an expense of the trustees falling within deductions of class (b). In a similar fashion, trustees of a charity might have made payments which fell within class (a) or (b), and in the absence of the amendment they could also be deductible as part of the income in respect of which tax exemption was available under class (c).

The only other new concept was that of a body corporate connected with a settlement. A wide definition ensured that a body corporate was connected with a settlement not only if an apportionment was made to the trustees, but also if an apportionment could have been had the income not been distributed or had the corporate body been incorporated in the UK.[44]

CONCLUSION

The new Chancellor appears to have been bolder and more knowledgeable than his predecessor, and this, in combination with a more aggressive and cynical Inland Revenue, seems to have resulted in a much more speedy reaction to the problem than the more hesitant approach to the 1936 provisions. The Chancellor's legal training no doubt was of great assistance in ensuring that the clauses he brought forward achieved precisely what he wanted, but did not prevent serious anomalies slipping into the provisions applying to loans to settlors.

Parliamentary influence on the legislation was very slight and this was probably in part due to its extreme complexity. Although the Chancellor and the Law Officers were congratulated for having "given us extraordinarily limpid and lucid explanations of the different clauses ... they were in a favourable position ... for no matter what they said nobody was in a position to contradict them."[45]

The 1938 legislation, together with the Finance Act 1936 provisions, forms the basis of a major part of the current anti-avoidance rules concerning settlements. Most of the subsequent changes merely blocked loopholes discovered in the existing legislation or made relatively minor additions to the existing code. Many of the provisions which were to be introduced at a later date merely attacked avoidance methods which were known of in 1938 but which were not thought to be sufficiently important by the Conservative government to require legislation. The changes needed to prevent these methods of avoidance had to await future Labour Governments.[46]

CHAPTER 7

1938-43: THE NEW LEGISLATION HITS ITS TARGETS AND A POSSIBLE LOOPHOLE IS RETROSPECTIVELY BLOCKED

INTRODUCTION

By 1938 most of the major legislation dealing with avoidance through the use of settlements was in place, but initially the general level of awareness and understanding of it seems to have been low.

The period is notable in two main respects. Firstly, for the considerable success the Revenue had in settlement cases brought before the Courts, and secondly, for the apparent change of attitude towards tax avoidance brought about by the increased level of patriotism during the war.

Although the cases the Revenue lost before the courts mainly involved relatively unimportant matters, the case of Herbert v CIR[1] created sufficient doubt as to the efficacy of the settlement provisions in cases involving joint settlors to justify the Revenue in requesting and obtaining immediate legislation to close any potential loophole. Schedule 6 of the Finance Act of 1943 contained the appropriate provisions, and although these were expressed to be merely declaratory of the existing law, they were retrospective in their effect. The Revenue were aware of one case involving a considerable amount of tax in which it would have been possible to argue that the joint settlor loophole applied, and it is probably for this reason that corrective legislation was introduced with a speed not previously seen in connection with the settlement legislation.

DIFFICULTIES IN COMMUNICATING THE CHANGES

In 1938 a circular was issued to all surtax payers drawing attention to the settlement provisions of the Finance Act 1938 with the aim of helping taxpayers and their advisers to understand how they were affected.[2] Despite this, and despite the fact that many of the professional journals were carrying lengthy articles explaining the general operation of the new rules and advising that adjustments should be made to revocable settlements to bring them within the let-out of Schedule 3 Part II of the Finance Act 1938, the query columns of the journal "Taxation" indicate that many advisers were either unaware of, or totally misunderstood, the provisions concerning children's settlements in the Finance Act 1936, and had hardly begun to understand the complexities of the 1938 provisions.[3] The editor of "Taxation" may have realised the existence of this gap in the knowledge of his readers because the journal contains many articles on the subject and detailed explanations of the basics of the legislation whenever a relevant case was decided, even though that case had already been fully explained in the "Current Taxation Cases" column.[4]

With this apparent lack of understanding of the provisions, it is very likely that there was no widespread avoidance of them. Because of their complexity, it was only the highly skilled tax specialist who might successfully attempt to find loopholes.

THE SUCCESS OF THE PROVISIONS

The statistics in Appendix D4 indicate the great success of the provisions attacking transfers of income by parents to their minor children, and the number of claims refused gives an indication of how poorly understood they were. The writer was unable to find such direct evidence of the success of the Finance Act 1938 provisions, but indirect evidence of their effectiveness is provided by answers to parliamentary questions. In 1940, in reply to a question concerning how many people were avoiding tax by making revocable settlements[5], Captain Crookshank, the Financial Secretary to the Treasury, stated that he was not in a position to provide statistics as to the operation of the changes of the law in either the Finance Acts of 1936 or 1938, but he was "advised that they have proved generally to be effective in checking avoidance of tax by way of settlements of income."[6]

General satisfaction with the state of the anti-avoidance provisions concerning income tax and surtax was expressed by the Chancellor of the Exchequer, Sir Kingsley Wood, in moving the second reading of the Finance Bill of 1941. Clause 26 of that Bill introduced extremely wide powers enabling the Revenue to set aside any transaction or transactions whose object was to reduce liability to excess profits tax. Consideration had been given as to whether to take similar powers to deal with avoidance of income tax and surtax, but it had been decided that

> "on the whole ... these tax avoidance provisions ... have fulfilled their object, and as at present advised I do not consider it necessary to arm myself with general powers comparable to those I am proposing in the case of excess profits tax."[7]

The Chancellor made it clear that he intended keeping the matter under constant review and that if it was found that wide general powers were required he would not hesitate to introduce them with retrospective effect.[8]

THE EFFECT OF THE WAR ON ATTITUDES TO AVOIDANCE

The outbreak of war in 1939 appears to have marked the beginning of a considerable change in attitude of the public to tax avoidance. In a leading article in "Taxation" of April 16, 1938, full support was given for what was described as the legal avoidance of taxation. The leading article in the same journal of January 14, 1939, was headed "Avoidance: The Ethical Aspect" and again gave support to tax avoidance. It ended:

> "One is ... sometimes forced to the conclusion that the sins of the taxpayer in exercising any careful scheme of avoidance are no greater than those of the State which permits and enforces the rigidity of the law ...."[9]

Avoidance was seen as "perfectly legitimate in any State which recognises private ownership".[10]

By March 1941, the tone of the journal had completely changed and readers were being advised that it was "the duty of every citizen to pay the full measure of all taxation according to the circumstances in which it finds him when it is imposed."[11] There was apparently thought to be no justification in attempting to avoid liability as the "legal liability of the taxpayer has given place to the moral liability; a moral liability which is without parallel in the history of taxation."[12]. Throughout the war years the journal is virtually devoid of references to methods of tax avoidance.[13]

Not all the technical journals were taking this view. "Taxation Practitioner" expressed entirely the opposite opinion. It argued that no one needed to have any compunction in advising their clients of any legal way to reduce their tax liability, because resources retained in a business would more effectively serve the national interests by remaining within the business than being diverted to the Exchequer.[14] A short article appeared in "Taxation" which expressed amazement at such a view being put forward by "the official organ of the Institute of Taxation "[15].

The subject was returned to in the leading article in "Taxation" of February 17, 1943. This time it was made clear that the views being expressed concerning tax avoidance only applied for the duration of the war and "when, at last this nightmare of war has passed we may revert to our former opinion ...."[16]

Correspondence was published in "Taxation" both for and against the points of view which the journal had put forward in its leading articles.[17] Some of the correspondents were totally against the idea of accountants acting as a moral conscience on behalf of their clients. They believed that it was the responsibility of the Chancellor with his legal advisers, to put their intentions into words, and there was no duty on the part of a tax consultant to hold the balance between his client and the State on any ethical grounds.

The debate was also taking place in some of the newspapers, and the leading article in "The Times" of February 12, 1943 [18] argued that under war conditions it was the duty of every citizen to recognise his moral obligation to pay the full measure of taxation due. Lord Quickswood responded by expressing the view that it was a good thing that "human ingenuity can always find a way by which the minority can escape from tyrannical imposts."[19] (The standard rate of income tax had increased from a pre-war level of 5s 6d, to 10s, and the top rate of surtax from 8s 3d to 9s 6d, with a reduction in the income level above which the maximum was paid from £50,000 to £20,000.)

Notwithstanding the differences of opinion and the increased attractions of tax avoidance due to the severe increases in tax rates,[20] it is likely that anti-avoidance legislation was not put to a severe test during the war years, because many tax advisers would not have canvassed tax avoidance schemes, and many taxpayers would not have taken up such schemes even if they had been told of their existence. However, despite the change of attitude and the generally satisfactory way in which the legislation was thought to be operating, the Inland Revenue remained vigilant for new methods of avoidance involving settlements and not only did Claims Branch and the Research Division remain active in their review of unusual cases,[21] but also they began investigating cases in which they suspected that the settlement would not be implemented. (See Appendix F1)

SIGNIFICANT COURT DECISIONS OF 1938-1943

In the period from April 1938 to the end of March 1943, 23 cases were heard in the courts concerning the settlement provisions, and the Inland Revenue were successful in all but the following 5 of them: Chamberlain v CIR, (1943), 25 TC 326; Whigham v CIR, (1941), 24 TC 41; CIR v Fitte, (1943) 25 TC 345; Mauray v CIR, (1943), 26 TC 96; and

Herbert v CIR, (1943), 25 TC 93. Two of the cases which the Revenue lost, (Mauray v CIR and Whigham v CIR), were of little long term importance to them as they concerned parts of the 1922 settlement legislation which had been superseded by wider provisions in 1936, and the Fitte case was "a pure question of construction of very special deeds".[22] The Revenue's failure to win Herbert v CIR in 1943 identified the first weakness in the new settlement legislation, and it was removed immediately by the introduction of corrective provisions in the Finance Act of 1943. The Revenue lost the Chamberlain case because they attempted to push the principle which formed the basis of their success in Copeman v Coleman, too far, (see later).

The first case to come before the courts in the period 1938-1943 was CIR v Warden,[23] in which the Revenue successfully argued that if trustees had the power to cancel the obligations arising under a settlement without the consent of the settlor or the beneficiaries, then that settlement was not irrevocable within the meaning of the 1936 legislation. Therefore, notwithstanding the fact that the settlement was made prior to April 22, 1936, the income arising under the settlement was deemed to be the settlor's and no repayment could be made to the minor child in respect of that income. At the time of taking the case the Inland Revenue were aware of five others concerning the same point.[24]

If the Revenue had lost the Warden case it would have been a very simple matter to sidestep the irrevocability requirements of the Finance Act 1936 provisions, and in a major respect they would have been virtually useless. The Revenue won all of the many cases they took on the question of irrevocability in the period 1938 to 1943, except CIR v Prince-Smith[25] which, though lost on the irrevocability point, was won on the point that the income was not payable for a period which could exceed six years. There were, however, other cases which were not brought before the courts in which the Revenue gave up any claim that the settlement was not irrevocable. An example of this kind of case is in Appendix F2.

The Inland Revenue were successful in all the reported cases in the period 1938 to 1943 dealing with the childrens settlement provisions of the Finance Act 1936. However, again there is evidence which indicates that, in one instance at least, (see Appendix F3), the Revenue eventually accepted the taxpayer's contentions even though they had won the case before the Special Commissioners.

Perhaps one of the most important victories for the Inland Revenue was the decision in Copeman v Coleman.[26] This involved the allotment of a preference share to each of two minor children by a company which was controlled by their parents. It was held that the allotment of shares was a settlement, and that the settlor was the father because he had indirectly provided the funds for the settlement.

Prior to this case the Revenue were very uncertain of the extent to which the settlement provisions could be applied to arrangements which did not involve any trust,[27] as well as to cases where trusts existed but the arrangements also included transactions involving companies.[28] The doubt in cases involving companies was whether the income and funds of the company formed part of the settlement. The Solicitor of Inland Revenue had advised the Board on July 23, 1937, that a case involving trusts and transactions with a company would not be caught as a settlement by the Finance Act 1936 provisions.[29] The Revenue also had counsel's opinion that for the purposes of section 38 (2) and (3) of the Finance Act 1938 there had to be a trust before it was possible to argue that there was a settlement, and that furthermore it was not possible to look outside the trust for any power of revocation or determination.

Despite these opinions, the Board decided to attempt to apply the settlement provisions to such cases and their success in Copeman v Coleman opened the door to a considerable new territory of complex, convoluted arrangements which could be caught. Other similar cases were brought before the courts and in each of them the Revenue was successful.[30] At this time, it must have seemed to the Revenue that they had acquired a new and devastating weapon, as almost anything the taxpayer did could be part of an arrangement and therefore a settlement. The only restriction imposed by Copeman v Coleman was that the settlement provisions did not apply to bona fide commercial arrangements.

The favourable outcome in Copeman v Coleman led to a review of previous decisions in which the Revenue had decided that no action was possible under the settlement provisions. Although the number of such cases was not thought to be very large, the duty at stake was thought to be substantial.[31] There were problems of identification, but it was decided that as most of the cases had been the work of Messrs

Spicer and Pegler, the Special Commissioners Office might be able to provide a list of them.[32] It is not known whether they could.

The Board's solicitor was asked to reconsider a case in which he had previously advised that the Revenue stood little chance of success. He indicated that there was now "sufficient chance of success to justify the Board in attacking the scheme." (See Appendix F4) It is clear from his analysis that two similar cases had been taken before the Special Commissioners[33] who though agreeing that the arrangements amounted to settlements, had decided that there was no power to revoke them and that they were therefore not caught. Neither of these cases actually reached the courts, but the case of Chamberlain v CIR,[34] in which the facts were similar, was brought before the Special Commissioners on November 19, 1940. The Revenue won the case at each stage until, in the House of Lords, it was decided that the arrangements forming the settlement did not go so far as to include the assets of a company connected to a trust where those assets had been provided to the company by the settlor in return for full consideration. The Revenue were probably not too concerned over the loss of the Chamberlain case, because in the other cases of a similar nature they had a very much stronger argument due to the fact that the settlors had transferred assets to companies at a considerable undervalue. These cases did not reach the courts, and it seems likely that following the Chamberlain decision, the taxpayers gave up their fight despite their success before the Special Commissioners.

The case of Lord Herbert v CIR was decided on January 26, 1943[35] and led to an almost immediate change in the relevant legislation.

The facts of the case were that the appellant's grandfather had settled certain landed estates and investments on his son, Lord Pembroke, as tenant for life with the remainder to his grandson, the appellant. Some year's later, a further settlement was made of the property in the first settlement consisting of a part of the settled landed estates. The settlors of the second settlement were therefore both the tenant for life and the remainderman. The appointment of the property from the first settlement to the second settlement was revocable, and if it were revoked it was possible that Lord Pembroke and Lord Herbert might become entitled to the property. On these grounds the Revenue assessed Lord Herbert, as the settlor, in respect of the settlement income under the provisions of Section 38(2) of the Finance Act 1938. These assessments were confirmed by the Special Commissioners on appeal.

In the King's Bench Division, the Crown contended that where there were joint settlors there was an option on the Crown to assess one settlor to the exclusion of the other. Mr Justice Macnaghten refused to accept that contention.

The Crown also contended that where there were two or more settlors, the assessment could be made upon the settlor to whom income would have belonged if the settlement had not been made. In his judgement, Mr Justice Macnaghten explained that this argument did not assist the Crown, because if the settlement had not been made Lord Pembroke, as tenant for life, would have been entitled to the income, but the assessment was on Lord Herbert, the remainderman. It was decided that "no assessment under the Finance Act 1938, can be made upon Lord Herbert during the lifetime of his father ... " The legal reasoning for the decision was therefore that because the remainderman had no interest in the income arising from the property during his father's lifetime, he was not a settlor in respect of that income.

The Solicitor-General advised the Revenue that the court appeared to be impressed by the argument that the section 38 liability should follow the original destination of the settlement income, although it did not decide the point.[36] On this basis he advised that an assessment could be made on Lord Pembroke with a good prospect of success because it was Lord Pembroke who brought the life interest into the settlement.[37]

On the face of things this was not an important case for the Inland Revenue as they were still apparently able to assess the person who would have received the income had the settlement not been made. However, a line of argument was used which shook their confidence in the effectiveness of all the settlement anti-avoidance provisions in cases where there were joint settlors.

The cause of concern was that where the settlement provisions applied, the legislation required that the income "shall be treated as the income of the settlor ... and not as the income of any other person." If there were two settlors, A and B, it could be argued that the settlement provisions could not apply to either of them, because if settlor A were assessed, he could say that B was a settlor and the income must be regarded as the income of B and nobody else, and if settlor B were assessed he could use a similar argument to escape liability. Mr Justice Macnaghten did not expressly approve or reject this contention as it was not necessary to do so to arrive at a conclusion in the Herbert case. However, as the Board advised ministers:

> "Publicity has been given to the contention that cases where there are two or more settlors are outside the legislation and that contention may be raised in some other case where ... it is vital to the decision."[38]

THE BACKGROUND TO THE DECISION TO LEGISLATE - THE VESTEY CASE

Despite the views which were being expressed in the journals of the time,[39] the Inland Revenue were fairly confident that Mr Justice Macnaghten's decision in Herbert v CIR was not authority for the proposition that the settlement provisions did not apply to cases where there were two or more settlors, and they had legal opinions in support of this.[40] Those opinions also stated that the decision was consistent with the view that in the case of a joint settlement of capital, the property or income to be looked at in relation to each particular settlor was the property which that settlor brought into the settlement, or the income arising from that property. Similarly, in the case of income settlements, the income to be looked at in relation to each settlor was the income which he provided for the settlement.[41]

On March 23, 1943, the Chairman of the Board informed the Attorney-General of the background to the Herbert case and the legal opinions they had received in respect of the effect of decision.[42] It was explained that ordinarily, because of the advice they had received, the Board would have left the question of joint settlors to be decided by the courts, and would have maintained their view that the sections did apply to joint settlors. However, the Chairman was very concerned with "the bearing of the joint settlor point on a very important case which has been decided by the Special Commissioners in our favour and will find its way to the courts - the Vestey case ...."[43]

This case was concerned with the settlement referred to in the Union Cold Storage Company v Adamson,[44] and involved a settlement under which the Vestey brothers had settled upon non-resident trustees the rent from property they had leased to the company. Since 1921 the fund had been built up out of the accumulation of rent received by the trustees. The Revenue had taken Counsel's opinion on whether they should mount an attack under the provisions of the Finance Act 1938 on the grounds that because the Vestey brothers could determine the lease of their property to the company at six months notice, the settlement was revocable.[45] "After repeated and prolonged consideration of the question" Counsel had concluded that the anti-avoidance provisions could be invoked.[46] The amount of duty for the years 1937/38 to 1941/42 was expected to be in the order of four million pounds, and the Revenue wished to ensure that there should be no chance of the Vesteys being successful in claiming that the joint settlor loophole applied.[47] The Revenue believed, however, that on the joint settlor point, the Vestey case was as strong a case in their favour as was likely to exist, because the property in the settlement was largely segregated into two separate funds. Nevertheless, they feared the possibility of losing the case and advised the Attorney-General that if the courts eventually decided that the joint settlor point did provide a let-out, legislation would be necessary. The Board argued that:

> "Such legislation ought to be retrospective - the Inland Revenue has always taken the view that this section applies to joint settlors - but it will be contrary to precedent to revoke by retrospective legislation the decision of the House of Lords in a particular case of this kind."[48]

Realising that it would not be possible to introduce retrospective legislation to directly overcome the effects of an adverse decision, the Revenue's proposed solution to this problem was ingenious. They suggested to the Attorney-General that legislation should be introduced which was expressed to be merely declaratory of the existing law and therefore retrospective, and justified this on the grounds that there had been no decision of either the Special Commissioners or the courts against the Inland Revenue on the joint settlor point. As the Chairman of the Board put it:

> "The Vesteys have not yet got a vested interest in possible imperfections of existing legislation."[49]

This proposal does appear to be retrospective legislation by another name. It seems to be splitting hairs to say that the Vestey brothers did not have an interest in any loopholes in the existing legislation. In effect, what the Revenue were saying was that they believed that there never was a loophole, but if there was, and anyone had made use of it, then the loophole could be stopped up after it had been used, and the legislation would be applied as if the loophole had never existed. This is an extraordinary line of reasoning but it seems to have been accepted by the Attorney-General.[50]

The Board also argued that there was a need for legislation to clarify the point irrespective of the Vestey case. They did not wish to leave the point open to anyone who had sufficient money at stake to take a case before the courts, because if the decision was unfavourable to the Revenue, it would have required corrective legislation. It was admitted however that,

> "If it were not for the Vestey millions... it would probably have been thought proper to let events take their course."[51]

A rough outline of the form of the required legislation was put to the Attorney-General and he was asked to authorise detailed drafting. At this stage the Chancellor had not been informed of the position because the Chairman of the Board believed that he would almost certainly merely ask the Attorney-General for his opinion before authorising the drafting of a clause.[52] The Attorney-General discussed the matter with the Solicitor-General and they concluded that appropriate legislation should be introduced,[53] but they were so concerned about its exact form that they retained an interest in its drafting.

Even before the Chancellor had been made aware of the problem, Parliamentary Counsel had written to the Public Bill Office to explain the need for the proposed legislation, and had enclosed a copy of a draft budget resolution. He asked whether there was any possibility of the point being successfully taken that the resolution was too vague, even though he did not think it any more vague than other anti-avoidance resolutions he had been involved with.[54] The confidence with which it was assumed that the Chancellor would give authority for the legislation is worthy of note, as is the apparent intentional vagueness of the Budget resolution.

On March 30, 1943, the Board asked the Chancellor for authority to request Parliamentary Counsel to draft an appropriate clause. The following day this authority was given.[55]

DRAFTING OF THE PROVISIONS

Because of the need to be able to show that the clause was merely a declaration of the existing law, the Attorney-General and Solicitor-General were closely involved in its preparation. Some comfort must have been provided to them by Parliamentary Counsel's first draft which was sent with a covering note indicating that in his opinion

> "It is at any rate almost (Parliamentary Counsel's underlining) decent to say that [the clause] merely declares the existing law."[56]

However, although the Revenue advised that the way cases involving joint settlors were dealt with in practice was precisely that provided for in the draft legislation, there has to be some doubt about this in view of the fact that they failed to do so in the cases of Lord Herbert and Prince-Smith (below).

What started off as a short, straightforward clause prepared by the Inland Revenue, ended up as a fairly lengthy three-part schedule to the Finance Act of 1943. It seems that the reason for this was that the original legislation had been introduced in a piecemeal fashion, and contained slight differences in wording, such that it was simpler and clearer to have separate provisions relating to joint settlors for each of the three Finance Acts dealing with settlements.[57]

By 1943, the Inland Revenue appear to have had a very jaundiced view of the extremes to which taxpayers would go to avoid taxation. They scrutinised the drafts produced by Parliamentary Counsel extremely closely, and made numerous suggestions, some of which covered very unlikely situations. Even though the Revenue's Head Office was at the time operating from a hotel in Llandundo, there does not seem to have been any reduction in their standard of examination of draft clauses. Complex matters were dealt with by long telexes supported by the occasional visit to London for discussions with the draftsman.

By April 22, 1943, after a few disagreements between the Revenue and Parliamentary Counsel, the final draft of the clause was ready. Although it was sent to the Attorney-General with an apology for its increased complexity, the Inland Revenue nevertheless told him that this would in no way increase his difficulties in defending it as one which only declared existing law.[58] It was clear that the Attorney-General was most concerned in case anyone would be able to find a basis upon which to argue that some change in the law was being introduced. The Solicitor-General seems to have been equally concerned and drew to the attention of the Revenue and the draftsman[59] the case of CIR v Prince-Smith[60] which had been decided three months earlier. He pointed out that it was an instance of a case involving joint settlors where the courts had operated the existing provisions without finding any difficulty. His concern was that the new clause might produce a result inconsistent with the decision in Prince-Smith, and therefore would not merely be declaring existing law, but altering it.

The Prince-Smith case concerned a settlement of £2,500 by a grandfather on his grandchildren. That £2,500 was used to buy 50,000 £1 ordinary shares in a company controlled by the childrens' father. Those shares were then converted to preference shares with particularly valuable income and capital rights for a five year period. It was held that the father was a settlor in relation to the wide arrangement which included the special resolution of the company converting the ordinary shares to preference shares. Under that arrangement very large dividends were paid to the trustees. The point that the grandfather was also a settlor was not raised before the courts, and the whole income was treated as that of the father. The cause of concern to the Solicitor-General was that there was no apportionment of the income between the father and the grandfather. Both the Revenue and the draftsman investigated the problem created by this case and came to different conclusions.

The draftsman believed that when the draft Part III of the sixth schedule to the Finance Bill 1943 was applied to the facts of the Prince-Smith case, a double charge on the same income would arise; once on the father and once on the grandfather. Under paragraph 2(a) of Part III, the income on the preference shares represented income from property which the grandfather had directly or indirectly provided. Under paragraph 2(d), the income was provided directly or indirectly by the father, because it could not have been paid but for the resolution passed at the extraordinary general meeting, and as virtually the whole share capital belonged to the father prior to that meeting, he had effectively ensured that a resolution beneficial to the settlement had been passed. Paragraph 1 of Part III made it clear that the liability of the father and the grandfather were to be ascertained as if the other were not a party to the disposition, and therefore, according to the draftsman, there was "a perfectly clear double charge".[61] He could see no obvious way out of this problem, because an apportionment would have been inconsistent with the decision in Prince-Smith, and yet a provision which enabled the Revenue to charge whichever person they liked would have been inconsistent with the decision in Herbert.[62]

The Inland Revenue's view was that there were two settlors; the grandfather who had brought in £2,500; and the father who had brought in an interest in the company equal to the value of 50,000 preference shares, with their special dividend and winding-up rights, less the £2,500 paid for those shares. They believed that there was a joint capital settlement and that an apportionment under paragraph 2(c) of Part III of Schedule 6 would be required to apportion the income between the father and grandfather. Because of the special income and capital rights of the preference shares, the Revenue thought that only a very small proportion of the income ought to be attributed to the £2,500 provided by the grandfather. They submitted that the Prince-Smith case, although not involving any apportionment, did not invalidate the apportionment required by Part III of the draft Schedule because it would have made little difference to the ultimate result if an apportionment had been made. As they pointed out, "in complicated matters there is always a tendency for small points to be overlooked."[63]

The draftsman was unconvinced by the Revenue's argument and found difficulty in seeing how the shares on which the dividend was paid represented property provided by the father. He maintained that those shares represented capital provided by the grandfather, but that the income was nevertheless provided by the father, and that therefore double assessment would apply. He drafted a letter for the Attorney-General to explain the point,[64] but passed it to the Inland Revenue who managed to persuade him to make modifications which gave greater emphasis to their point of view.[65] The Revenue argued that the main flaw in the draftsman's argument was that, in an extreme case, where the grandfather had settled, say, one shilling on his grandchildren, and the father sold shares worth a million pounds to the trustees for a shilling those shares would represent the grandfather's shilling and would not be, or not represent, property provided by the father. Although they found it "almost impossible to swallow this",[66] they seem to have missed the draftsman's point; he believed that the whole income would be assessable on both settlors.

The problem was resolved by the Solicitor-General who felt "no difficulty about the Prince-Smith case,"[67] and believed the Revenue's view was correct.

PARLIAMENTARY DISCUSSION

The presentation of the matter in Parliament was very low key, and made no reference to the fact that the pending Vestey case was the main reason for introduction of the proposed legislation. There was no mention of the proposals in the Budget speech, and the only discussion that took place was at the Ways and Means Report Stage where the Attorney-General gave a short account of the difficulties created by the Herbert case and gave an assurance that the clause was designed to make it clear that tax would not be charged twice on the same income.[68] There was no comment on the clause at any other stage in the parliamentary process. No evidence could be found of the Vestey family making any representations to MP's concerning the effect this legislation might have on the case which they were taking before the courts. If they had done so, perhaps a rather more suspicious attitude might have been taken in Parliament.

ANALYSIS OF SCHEDULE 6 TO THE FINANCE ACT 1943

As there is no difference between the Bill and the Act, the discussion below is in terms of the Act, and only a copy of the Act is provided in Appendix F5.

The general principle of the legislation was to declare that where there were two or more settlors each was to be treated as though he had made a separate settlement of the property or income which he brought into the settlement, and that regard would only be had to that property or income in determining his liability to tax. The change was to have retrospective effect, because it was supposed to be merely declaring what the law had always been thought to mean.

Schedule 6, Part I (now I.C.T.A. 1970, Section 452)

This part of the schedule applied the joint settlor rules to the settlement provisions of the Finance Act 1938. The general principle was that where there were two or more settlors, each settlor should be dealt with as though he had made a separate settlement of the property or income which he had provided. Paragraph 1 therefore ensured that the Finance Act 1938 provisions applied to each settlor as if he were the only settlor, and paragraph 2 required that those provisions were to be applied only to property or income originating from that settlor.

The term "property originating from the settlor" was defined in sub-paragraphs 1 and 3 of paragraph 5, and ensured that the property attributed to a particular settlor would include only:

(a) the original property provided directly or indirectly by that settlor, including any property provided by another person in pursuance of reciprocal arrangements;[69]

(b) property representing the property referred to in (a);[70] and

(c) the proportion of any property which represented both the original property provided by one settlor and some other property.[71] Similar definitions were applied by paragraph 5(2) and 5(3)(a) to the term "income originating from the settlor."

Paragraph 3 provided for the situation where there were outgoings from a settlement which were to be taken into account in calculating the undistributed income but the settlement made no provision for the allocation of those outgoings between the income originating from different settlors. In such a case, outgoings were to be apportioned according to the income derived from the different settlors.

Schedule 6, Part II (now I.C.T.A. 1970, Section 442)

The general principles of operation of Part II were the same as those which applied to Part I. The intention behind the legislation was to split out the property or income arising from the different settlors, so that each could be treated according to whether or not the childrens' settlement provisions applied to the property or income settled by him. The definitions of the terms "property originating from a settlor" and "income originating from a settlor" were the same as those applying for Part I, except that apportioned income of a close company was to be omitted from the definition of "income originating from a settlor" because such apportioned income was not caught by the Finance Act 1936 provisions.

Schedule 6, Part III (now I.C.T.A. 1970, Section 436)

This only applied to dispositions of income, and provided a fairly straightforward separation of the income derived from each settlor and the property or income directly or indirectly derived from that income.

CONCLUSION

The statistics concerning parental settlements on children give an indication of the effectiveness of the 1936 provisions, and the case law shows that both the 1936 and the 1938 settlement legislation was proving to be very robust. However, these were early days, and poor understanding of the legislation, combined with the war and the changed public attitudes to avoidance, probably resulted in the provisions not being severely tested. It was fortunate that the legislation was in place before the war caused drastic increases in tax rates and reductions in personal allowances, as otherwise many more people would have been tempted as they were in the First World War, to enter into settlements to avoid the increased burden.

The Revenue's speedy reaction to the appearance of a mere potential loophole is indicative of their degree of concern over tax avoidance. The relatively simple concept of apportionment of income between joint settlors was extremely difficult to put into effect due to the complexity of, and slight differences in wording between, the underlying legislation of 1922, 1936 and 1938, and this problem was compounded by the Revenue's fear of creating further opportunities for avoidance. Even at the final drafting stage there were major differences of opinion between Parliamentary Counsel and the Revenue as to the interpretation of the proposed legislation. Although this disagreement was settled by the Solicitor-General siding with the Revenue, it did not auger well for the clarity of the legislation when the draftsman took a view of its interpretation which differed in such a material way from those who were to implement it.

Although the existing settlement provisions were a great success during this period, there were certain forms of avoidance through settlements which had to await the changed political climate after the war before they could be tackled.

CHAPTER 8

1944-46: THE REVENUE'S SUCCESS CONTINUES AND THE DUKE OF WESTMINSTER SCHEME AND CHARITABLE COVENANTS ARE ATTACKED

INTRODUCTION

In the two years to the end of March 1946, the Revenue's success with the legislation continued, and although they lost two cases,[1] as they both related to deeds executed prior to the Finance Act 1936, they were of little long term relevance. The Revenue therefore probably considered the legislation to be most satisfactory, especially as they had won the important case of Jenkins v CIR,[2] which showed that a settlor retained an interest in a settlement where he had made a loan to it which was being repaid out of dividends on shares acquired with the loan, and they had had success in four other cases[3].

Notwithstanding the satisfactory manner in which the legislation was operating, the change of Government after the war provided the Revenue with an opportunity to obtain two further provisions attacking settlements, because members of the new Government had, when in opposition, regularly argued that there was a need to close-up these further loopholes.[4] Modifications were thought to be necessary in two areas. Firstly, to prevent the use of the method of avoidance used in the Duke of Westminster case,[5] and secondly to check the explosive growth in the cost to the Exchequer of charitable deeds of covenant. Legislation was introduced which prevented surtax relief on the relevant classes of settlement whilst retaining income tax relief, but as it only applied to settlements made on or after April 10, 1946, the

Exchequer was left exposed to the effects of not having taken earlier action.

The approach of the legislation was to specify that all income arising under a settlement was to be treated as that of the settlor unless one of four let-outs applied, or the income was already deemed to be his. It was impossible for charitable covenants to come within any of the four let-outs, although where a settlor was prepared to divest himself absolutely of property in favour of a charity, for example by creating a charitable trust, the income arising would not be caught.[6] The new provisions did not strike at covenants to relatives or other individuals, unless they were employees. The reason for dealing with charitable covenants but not covenants to individuals was solely based upon the relatively low cost of the latter to the Exchequer.[7]

<u>THE ATTACK ON THE AVOIDANCE HIGHLIGHTED IN THE DUKE OF WESTMINSTER CASE</u>

The Duke had paid his employees, and an architect he had regularly engaged, by means of covenants, and by this means had converted salaries, wages and fees from a non-tax-deductible form to a tax-deductible form. The decision in favour of the Duke in this case was said to have caused "a great deal of indignation among the staff of the Board of Inland Revenue."[8] Although the matter had been discussed by the Board's Tax Avoidance Committee in 1933,[9] no attempt was made by the Revenue to persuade any Chancellor to introduce appropriate anti-avoidance legislation. Although the annuities in the Duke of Westminster case were more than £20,000 per annum, and the Report of the Board's Tax Avoidance Committee indicates that there were a number of similar cases, [10] it is unlikely that the total amount of tax lost was very significant, as normally only the extremely wealthy would have been able to use the scheme.

From the time that the facts of the Duke of Westminister case came into the public domain to the time that the loophole was blocked, there were various parliamentary criticisms of the lack of Government action.[11] Because the method of avoidance had been fully explained in both Parliament and the professional journals, it is likely that it had been taken up by all those who had the inclination and circumstances to take advantage of it.

Although there was very little parliamentary discussion of the proposed legislation to prevent this means of avoidance,[12] concern was expressed that the many people who covenanted pensions to their former servants might be caught.[13] Parliamentary Counsel's first draft[14] specified that only a covenant to an individual "in the service of the settlor" was to be caught, and these words were carried right through to the Finance Act. Clearly, there was no intention to catch pensions paid under covenant as the payee was not then "in service". This was never explained to Parliament, but the notes for ministers by the Board of Inland Revenue pointed out that such pensions would not be affected,[15] and presumably those who had expressed concern were told privately of this exclusion.

The only parliamentary criticism of the exclusion came from Mr James Callaghan who argued that there was no reason why the State should assist in the payment of pensions by wealthy landlords to their previous employees.[16] It is interesting to note that nineteen years later, in Mr Callaghan's first Budget as Chancellor of the Exchequer, he introduced settlement provisions much more restrictive than those of the Finance Act 1946 and caught, amongst other things, covenanted pensions to previous employees.[17]

Mr Callaghan made an effort to explain to the House what the Duke of Westminster had done and why he thought it reprehensible. However, his speech was interrupted incessantly on points of order concerning his description of the avoidance as "a ramp" and "a racket," and also on the technicality that as the Duke of Westminster was a member of the House of Lords, no member was entitled, according to Erskine May, to make a statement which reflected on his personal honour.[18] Even though Mr Callaghan was only making use of information available from the reported case, points of order were raised as to whether it was proper for him to use information which he had obtained by virtue of having been an employee of the Inland Revenue.[19] The debate certainly seems to indicate that friends of the Duke of Westminster, or those sympathetic to what he had done, were determined to try to muzzle Mr Callaghan. Eventually, however, he was allowed, albeit in a piecemeal fashion, to paint a rather unpleasant picture of the kind of avoidance which had been allowed to go on by previous Governments.

At the committee stage there were no amendments put down concerning this particular aspect of the clause, although a question was raised as to whether the provisions could be dodged by making the covenanted payment in favour of the wife of the employee, agent or solicitor involved. The Solicitor-General merely pointed out that the payment would have to be to the wife for her own use in order to escape the provisions.[20] Apparently, he thought that if a payment was made to the wife of an employee, agent or solicitor of the settlor, the Revenue would be able to show that it was not for her own use, unless there were special circumstances.

COVENANTS TO CHARITIES BY INDIVIDUALS

The Inland Revenue had waited a long time for a further opportunity to attempt to introduce legislation to restrict the tax relief for payers of charitable covenants. The bid to do so in 1927 had failed,[21] and even though the whole question of covenants to charities had been fully investigated by the Board's Tax Avoidance Committee and a full report had been given to the Chancellor in 1934, no further action had been taken.[22] The eventual impetus for the introduction of legislation was mainly the excessive cost to the Exchequer of permitting the deduction of such covenanted payments from the income of the payer.[23]

The income tax loss to the Exchequer was related to the standard rate of tax, and although this had been in the range 20% to 25% between 1927/28 and 1935/36, each year thereafter saw an increase, until finally in 1941/42 the rate reached 50% and remained there until 1946/47. As a by-product of the increased tax rates the net cost of a covenant had become less and tax repayments to charities had increased.[24] Surtax rates had also increased significantly, so that by 1939/40, a person with an income of £25,000 who covenanted to pay £1,000 per annum to a charity, could do so at a net cost of £25 to himself and £975 to the Exchequer. Such a minimal net cost had encouraged one individual to enter into charitable covenants under which he was obliged to pay a total of £275,000 per annum and according to the Revenue there were plenty of examples of covenants for tens of thousands of pounds per annum.[25]

As can be seen from the table below, the reduced net cost of making a charitable covenant seems to have greatly encouraged their use.

Number Of Operative Deeds In Favour Of Charities

Year Ended September 30th	Number of Deeds	New Deeds
1929	8,000	Not available[1]
1930	Not available[2]	5,000
1931	" "	7,222
1932	" "	9,545
1933	" "	7,963
1934	35,000	Not available
1935	55,000	" "
1936 to 1941	Not available	" "
1942	158,000	" "
1943	185,000	" "
1944	221,654	60,000
1945	259,331	67,000

Note 1 – The figures are not available from the files examined by the writer but probably were known to the Inland Revenue at the time.
Source: Derived From PRO File IR63/172.

By the early 1940s, new deeds were being created at more than double the rate at which old deeds were expiring, and by 1943 the cost to the Exchequer had again attracted the attention of the Chancellor. During the discussion of the Finance Bill 1943, the Chancellor had said that he would have to consider whether the privileges attaching to charitable covenants could be justified.[26] On subsequent consideration of the matter he decided

> "that the time was not opportune for action which would have a prejudicial effect on war charities and hospitals in particular, [because the] Red Cross, etc. made extensive use of the seven-year deed to get funds and it was not considered politic to make any alteration of the law that might dry up the sources of supply during the war."[27]

However, once the war was over the time was ripe to consider imposing restrictions on the loss of tax arising through the use of charitable covenants.

In early 1946 the new Labour Chancellor, (Mr Dalton), received letters from members of the public explaining the nature of the relief for charitable covenants and calling into question its justification.[28] The Board were able to confirm to him that the letters were "substantially correct,"[29] and siezed the opportunity to review the history of and costs associated with this relief. They then suggested that "the full-blooded remedy is to withdraw both the income tax relief to the charity and the surtax relief to the payer"[30] but they did point out that "there would be opposition by the charities, and the House of Commons has always a tender heart for charities."[31] As an alternative a "more limited remedy" was described which "would probably ... stop the present abnormal growth."[32] This involved merely denying surtax relief to the payer so that "he will not be so ready to enter such deeds as when he may have to provide only so little as six pence in the pound."[33] The Chancellor's handwritten note on the Revenue's submission states that his "inclination is to ... stop relief of surtax though not of income tax,"[34] and he gave instructions[35] for a clause to be drafted.

The Revenue also pointed out to the Chancellor that there was evidence to show that there was some artificiality in the case of certain covenants to charities, in that although they were irrevocable, the charity would normally not enforce payment.[36] They said that they had sometimes even been asked by charities whether there was any legal obligation to take action to enforce payment.[37] In some cases charities had gone so far as to give the subscriber an undertaking that there would be no legal action in the event of non payment.[38] The Chancellor apparently decided that nothing was to be done to deal with such cases.

The discussions between the Revenue and Parliamentary Counsel concerning the drafting of the required clause went very smoothly indeed, but considering that this was a matter which had been under review for many years, the Revenue produced a rather poor draft clause as the starting point.[39] Parliamentary Counsel's first draft was very close to the final form in the Finance Act, and only required minor modifications to take into account various afterthoughts on the part of the Inland Revenue. They suggested that a definition was required of the words "divested himself absolutely by the settlement"[40] and suggested that the analogous provisions in section 38(4) of the Finance Act 1938 could be used with appropriate modifications. The latter provisions caught settlements in which the wife or husband of the settlor could benefit, and it is surprising therefore that the Finance Act 1946 provisions did not also deal with this, thus leaving a possible loophole. No explanation appears on the files for this omission. However, the further tightening up of the provisions in 1965[41] removed the lacuna in the previous legislation, though it is not known to what extent it had been used.

It is probable that the drafting process passed very smoothly because there was a considerable body of settlement legislation on which the new provisions could be hung. For instance, the various definitions were available, as were the provisions concerning joint settlors and recovery by the settlor of any additional tax resulting from the deeming process.

Although the section was represented to Parliament as being aimed at covenanted payments to charities, it was drawn in much wider terms. This was necessary for two reasons. Firstly, if only annual payments had been dealt with, the Revenue realised that

> "the experts in tax avoidance could at once have recourse to a disposition of capital for a limited period, and could thus escape the mischief of the new legislation."[42]

A further reason the section did not specifically mention charities was that tax efficient subscriptions were being made by means of covenants to non-charitable bodies, and these were also to be stopped.[43] It clearly would have been unjustifiable to allow a surtax deduction for covenanted payments to non-charitable institutions while denying it for such payments to charitable institutions.

Despite the considerable and well orchestrated parliamentary opposition to these provisions, the fact that they were intended to remove only surtax relief in respect of future settlements helped greatly in the presentation of the Government's case, because there would be no immediate fall in the covenanted income of charities, and therefore no immediate hardship.

A great deal of debate on the matter took place when the Budget resolutions were being considered but, unlike in 1927, little information was provided by the Solicitor-General until all those opposing the resolution had had their say. Tactically this was a good move, because some of those speaking against, had, due to lack of information, inadvertently lent support to the resolution. For example, it was said that, "if the Treasury is losing £1,000,000 a year it will be something to worry about, but we are not told how much money is being lost."[44] At a later stage the Solicitor-General was able to show that the figure of tax lost was in fact £1,250,000, and thereby seriously damaged the Opposition's arguments.[45]

The case put in favour of the resolution was based on the following: total cost to the Exchequer; the net cost of a covenant after surtax relief; the rate of growth in the use of covenants; and the fact that in many cases the Treasury was the main contributor while "others get the honours".[46]

The counter-arguments were at this stage very weak, merely pointing to the assured income that covenants provided to charities and the fact that if relief was acceptable for covenants payable to needy individuals, (in certain circumstances), then it should be acceptable for those to worthy charities.[47]

Limited support for the resolution came from all sides, but there were those who thought that income tax relief should be removed as well.[48] The Chancellor himself indicated that this was merely the first stage in the removal of relief for he advised the House that "we begin by stopping it in respect of surtax"[49] though he did not wish to push the matter too far "at this stage".[50] It may well be for this reason that he chose not to attack settlements for the support of relatives and dependents that were not already caught.

Considerable anger seems to have been generated through the description, (by the Chancellor and others), of such charitable settlements as being "a bit of a ramp".[51] Many Members could see nothing wrong with making use of charitable covenants and made forceful statements to that effect.

> "Before the Government dry up the springs of charity, let them bear in mind what has happened. Were those gifts immoral in their direction? Were they devoted to some vile purpose or contrary to the best interest of the State? Did they do any evil in any direction at any time? Were they covenants that any honest citizen could have said were undesirable? If the answers to those questions is "No" then His Majesty's Government are taking a step which will stop the outpourings of human charity."[52]

Before the Finance Bill reached its committee stage, Mr Keeling had asked two questions on the subject, both designed to elicit further information about the total annual surtax cost to the Exchequer of charitable covenants.[53] He had also put down an amendment to exclude covenants to the National Trust and to charities from the new proposals.[54] The questions and the amendment enabled the Revenue to consider carefully the arguments which Mr Keeling would be likely to use and to provide a brief for the Chancellor setting out the detailed counter-arguments.[55]

Mr Keeling was a member of the Executive Committee of the National Trust, and the Revenue expected him to make special pleas on its behalf if the wider proposal to exclude all charities was rejected. The Board advised ministers that there was no ground for treating covenanted payments to the National Trust in any different way than such payments to any other charity. However, it was pointed out that the National Trust derived income from capital endowment funds for the maintenance of particular properties and that the Revenue had always taken the view that income from such a fund was applied solely for the purposes of the National Trust itself, and not for the benefit of the person who transferred the property, even though that person might continue to occupy the property under a lease granted by the Trust.[56] They therefore suggested that an assurance might be given to Mr Keeling that sub-section (1)(d), which provided a let-out in respect of income from property which the settlor had divested himself of absolutely, would be treated as satisfied in the above circumstances. However, Mr Keeling did not specifically raise the point in debate and may well have received a private explanation.

In outline, the main arguments used at the committee stage by those opposing the clause were as follows:

(a) The average annual income of surtax payers was four an a half thousand pounds and therefore the actual net cost of a covenant to most of them was a significant amount.[57]

(b) A net cost to contributors of one million pounds was not negligible.[58]

(c) It was anomalous that the relief was available for a covenant to, say, an orphan grandchild, yet it was not available for such payments to an orphanage.[59]

(d) The clause would result in a reduction in the income of charities "and the incidence of this blow would be very uneven"[60]

As regards the last argument, evidence was given to the effect that the National Council of Social Services handled £20,000 of new covenants in April and May of 1945 as compared to £5,000 in the equivalent period of 1946. It was argued that the proposals would provide a powerful discouragement to such settlements being made or renewed.[61]

The Solicitor-General was not really able to produce satisfactory answers to these contentions and the matter really boiled down to a question of the large loss of tax "which the Treasury cannot afford."[62] A distinction was made between convenants to individuals and charitable covenants on the basis that the former were very few as compared to the latter.[63]

Once it became clear that the Government were not prepared to concede completely, it was suggested that what was needed was "some re-definition of charities"[64] or a set of "clearly defined charitable objects"[65] in respect of which relief would be available. Another suggestion involved putting some overall limit on the amount which would qualify for relief.

Under pressure, the Chancellor agreed "to give thought to arguments which have been advanced from the other side ... but with no kind of commitment to agree to any modification at all."[66] It was clear that the Chancellor's position was strong, as Churchill, who instigated the 1927 attempt to remove relief altogether, was now the Leader of the Opposition, and Mr Dalton was able to point to Churchill's unsuccessful attempt and to the fact that "Conservative predecessors of mine (a reference to Sir Kingsley Wood in 1943), have shared my view that this is an arrangement which cannot be defended."[67]

The Chancellor's promise to review the position came to nought. The Board advised him that the suggestion regarding re-definition of charities "should be dismissed as simply impractible" and that "the allowance of a proportion of the income would mean in effect the continuance of the present system under which the Exchequer bears the cost."[68]

A last ditch attempt was made to draw the teeth of the clause at the report stage, but the amendment put down by Mr Keeling has a handwritten note on it:- "Out of order - Solicitor-General"[69]

The provisions were enacted in section 28 of the Finance Act 1946 in exactly the same form as they appeared in the clause introduced in the Finance Bill. (A copy of section 28 is in Appendix G1)

The Revenue had expected that the abnormal growth in covenants would be stopped by the new provisions and the cost to the Exchequer held steady.[70] Neither of these expectations were to be realised, although for the following two years the number of new deeds did reduce slightly. Thereafter, for every year up to 1953 there was an increase in the number of new deeds. Statistics for the period 1946-1954 are in Appendix G2.[71]

CONCLUSION

The avoidance and loss of tax aimed at by section 28 of the Finance Act 1946 had been known about by the Revenue for many years and was well understood by tax practitioners, if not by the general public. The "Duke of Westminster loophole" could quite easily have been remedied over ten years earlier, but even though the scheme was almost impossible to justify the Governments of the period up to 1946 seemed to have lacked the political will to act. The question of tax relief for charitable covenants was far more contentious because it was of a completely different character and was at best at the very fringe of avoidance.

The timing of the removal of surtax relief was almost perfect as the war had just finished and there could therefore be no special pleading by the war charities. Furthermore, the public attitude during the war had shifted against tax avoidance and that attitude probably lingered on for at least a few years thereafter.

It is clear that the Chancellor of the Exchequer considered that the action he had taken was only a first stage and, although he did not specify what further measures were required, it is almost certain that he was considering the removal of income tax relief on covenanted payments. Such a change was never to be made, but the Finance Act of 1965 considerably restricted the situations in which surtax relief could be obtained on covenanted payments to individuals. For the period from 1946 to 1965, however, income tax relief and surtax relief were available for covenanted payments to relatives, (other than minor children of the payer), and to former employees. It was the Finance Act of 1965 which removed surtax relief for such cases.

CHAPTER 9

1946 - 1958: FURTHER REFINEMENTS LEAD TO THE MATURE STAGE OF THE LEGISLATION

INTRODUCTION

In contrast with the period from 1938 to 1946, the period from 1946 to 1958 saw far fewer cases concerning settlements being taken through the courts and a far higher proportion being lost by the Revenue. Although some of the cases which they lost were on highly specific and narrow points which were unlikely to recur and which did not show up any significant loopholes, two decisions of the House of Lords in 1957 resulted in a very swift reaction by the Revenue in order to obtain remedial legislation. In the first case, CIR v Countess of Kenmare[1], although the Inland Revenue were successful, judicial comments were made which suggested that there was a fault on the consolidation of section 38(7) of the Finance Act 1938 into the Income Tax Act 1952. The second case, Saunders v CIR,[2] showed up a gaping hole in the revocable settlement provisions of section 404 of the Income Tax Act 1952.[3]

Corrective legislation was introduced in the Finance Bill of 1958, and at a very late stage in the parliamentary process the opportunity was taken to introduce two minor changes to the provisions concerning settlements on children,[4] and a brand new provision in anticipation of possible avoidance through settlements giving a discretionary power for the benefit of the settlor or his spouse.[5]

THE 1952 CONSOLIDATION CREATES A DEFECT

Despite the fact that consolidation is normally only meant to repeal and re-enact the existing statute law in an improved form and without amendments of substance[6], certain modifications were made to the legislation concerning settlements in the process of consolidation which remained undiscovered for five years and which were thought to involve substantive changes. Declaratory legislation therefore had to be introduced in the Finance Act of 1958 so that the relevant sections of the consolidated legislation could be treated as if they had not contained the offending alterations[7]. (A copy of the settlement provisions of Income Tax Act 1952 is in Appendix H1)

An examination of the details of the consolidation process and the discovery and correction of the fault it brought about, provides an excellent example of the difficulty and dangers of consolidation - particularly where piecemeal and complex anti-avoidance provisions are involved.

The process leading to consolidation began in the Spring of 1949,[8] and took almost three years to complete. After six months "trying to get a Consolidation Bill on its feet,"[9] Parliamentary Counsel wrote a five page memorandum explaining why he believed "the idea of consolidating [the Income Tax Acts] is misconceived and should be abandoned."[10] There were many strands to his argument but one of the main ones was that it would be impossible to give anyone an assurance that the consolidation did not amend the law. He believed it to be "obvious that no honest draftsman could give any such assurance in anything but the most qualified form"[11] and that "the only conclusion

... would be that the Bill altered the law to a quite unpredictable extent."[12] In his view consolidation tended "to degenerate quickly into a shameful, demoralising attempt to cover every doubt, and avoid every difficulty ..."[13]

It could be argued that the draftsman's attitude merely reflected the fact that he did not relish the thought of carrying out the work, but it is fairly clear that the opinions he expressed were honestly and strongly held, as the following quotation shows:

> "... I have reached the above conclusions with some regret. To help to clear up the income tax mess has been one of my ambitions, and consolidation seemed to offer by far the best hope of actually achieving something toward this end. But if I am right in thinking that consolidation is impracticable and that, if it were practicable it would be worse than useless, it surely follows that it ought not to be proceeded with merely because the alternative plans for reform appear unpromising."[14]

The draftsman's memorandum does not indicate to whom it was addressed, but there is nothing on the files to indicate that his words fell on anything but deaf ears and that the consolidation process continued totally unaffected.

The Inland Revenue formed a committee[15] which was charged with responsibility for considering the draft clauses. After some fifty specialists from the Inland Revenue had pored over the details, various minor amendments in wording and punctuation were made. The Special Commissioners Office made observations on the settlement provisions, and their suggestions were incorporated into the Bill which was published in March 1951 as a Command Paper.[16] In accordance with normal practice, it was referred to a joint committee of both Houses who examined the clauses with the assistance of the draftsman and Inland Revenue experts in order to satisfy themselves that the Bill was merely a consolidation and did not alter the law.[17]

Despite such a great effort to ensure that no changes in the law were made, substantive changes slipped through. In their original form section 404 and 405 of the Income Tax Act 1952 did not contain the words "wherever made", whereas the provision from which those sections were derived - Finance Act 1938 section 38 (7) - clearly stated that they "shall apply in relation to any settlement, wherever made ...." The draftsman's warning of the unpredictable consequences of consolidation had become a reality.

The point was not discovered until the case of Countess of Kenmare v CIR[18] came before the courts. The appellant, who was neither resident nor ordinarily resident in the U.K., had made a settlement in 1947 governed by the laws of Bermuda, under which the trust funds were invested in the U.K. It was contended by the Revenue that, due to certain provisions of the trust which enabled the trustees, at their discretion, to declare that part of the trust funds should be held for the settlor in trust for her benefit absolutely, the settlement was revocable or determinable and caught by section 38 (2) of the Finance Act 1938. The House of Lords decided that the case was caught, and in arriving at that conclusion they attached some importance to the words "wherever made" in sub-section (7) of Section 38.[19] It was this that seems to have prompted the Inland Revenue to look for the corresponding words in the consolidated Act, and, on discovering that they did not exist, to discuss with Parliamentary Counsel the problems that this omission might cause.[20]

The Inland Revenue consulted their records concerning the consolidation but were unable to find any explanation for the exclusion.[21] They thought it possible that because so much of sub-section (7) was transitional, the officials involved might have assumed that the whole of it was transitional and failed to reproduce the one small part which was not.[22]

The Revenue's concern was that although there was a presumption that consolidation was not intended to alter the law, as it had already been recognised that the 1918 consolidation might have effected some change,[23] the presumption was easily rebuttable. Such a rebuttal could have been mounted on the grounds that although section 404 and 405 did not contain the words "wherever made" section 407(4) and 408(7), which were in the same chapter of the Act, did. Further support for the argument could be based on the fact that section 397(2), which was in a different chapter of the Act, also contained those words. In view of these differences in wording the Revenue sought a legal opinion as to whether a court might be persuaded that a settlement made abroad was outside sections 404 and 405. The opinion was that the risk of the court being so persuaded would be "rather substantial."[24] On this basis the Board decided that they could not ignore the problem[25] and suggested to the draftsman that what was required was a declaratory clause to make it clear that the sections were to apply to settlements wherever they were made.

The draftsman did not think it prudent to include such a provision. He believed that the language used in sections 404 and 405 was all-embracing and that there was no reason in the sections themselves to suggest that the words "any settlement" or "a settlement" meant anything other than that, and would apply to any settlement, no matter where it was made.[26] He argued that it would be the taxpayer who would be contending that the plain language of sections 404 and 405 must be given less than its full effect. Although he could see that the inclusion of the words "wherever made" in section 408 (7) would be useful ammunition for the taxpayer, he noticed that the Revenue had some defence in the shape of section 407 (4) which did refer to settlements "wherever made," and in doing so also directly referred to settlements on which section 404 operated.[27] The draftsman was much impressed by this reference back to section 404 in section 407 (4), and considered the risk of problems arising out of the Kenmare case to be far less serious than the Revenue had made out.[28] The Revenue for their part dismissed the draftsman's argument on the grounds that the courts would be able to find that the reference to "wherever made" only related to settlements made prior to 1936.[29]

Parliamentary Counsel speculated as to why the previous draftsman had omitted the words "wherever made" from the relevant sections. He pointed out that section 415 also contained no such reference and yet felt sure that the section ought to apply to a settlement made while on holiday abroad just as much as to one made before departure abroad or on return.[30] The definition of a "settlement" which applied for the purposes of section 28 of the 1946 Finance Act, (from which section 415 was derived), was based upon the definitions in the Finance Act 1938, but the words "wherever made" did not appear in the definition section of the 1938 Act either. Because of the history of this section Parliamentary Counsel believed that the draftsman of the 1952 Act might not have thought it justified to incorporate the phrase into section 415 and also may have thought that if he used it in section 404 or 405 he would be reinforcing any doubt there might be as to the scope of section 415.

> "I think it would have been natural for him to have left the phrase out of the earlier sections in Chapter III of Part XVIII but to have started using it when he first had, because of the time factor, to repeat the peg to which it was attached in the previous Act."[31]

The draftsman therefore urged that if anything was to be done with sections 404 and 405 it would be necessary to deal also with sections 415, 392 and 393; none of which contained the words "wherever made."

The Revenue were not persuaded by Parliamentary Counsel's speculation as to why the draftsman of the 1952 Act chose to exclude the words, and believed that it would be possible for a court to guess with some plausibility about the motive which could have made Parliament wish to change the law by excluding certain settlements from sections 404 and 405.[32] They thought it could be argued that:

(a) the section 407 settlor was morally within the jurisdiction since he was claiming a deduction from total income for the annual payments to the trustees;

(b) the section 408 settlor was an understandable target since he was at least getting his hands on the trustee's money; but

(c) the section 404 or section 405 settlor, who may have had no connection with this country when he made his settlement was being taxed in respect of a mere potentiality, since the power might never be exercised or the retained interest might never fructify,[33] and therefore some territorial limitation should be imposed.

The Revenue's concern was that such arguments could be used against them to show why the words "wherever made" appeared in sections 407 and 408 but not in sections 404 or 405.[34]

The Revenue were also unimpressed with the draftman's arguments based upon the history of the sections.[35] They believed that given the distinct chapters of Part XVIII represented additions to the Taxes Acts at widely different dates, the contrasts which appeared within a single chapter were much more weighty than the contrast between more remote provisions.[36] They thought that because section 415 was within Chapter IV and was consolidated without any change of wording, there would be a strong presumption that its meaning was unchanged and that it would not be affected by "a mere domestic tidying up inside Chapter III."[37] They argued that in practice, because the real targets of section 415 were charitable settlements, relief for which was restricted to bodies and trusts subject to the jurisdiction of the U.K. courts,[38] they were not greatly concerned about foreign elements in relation to the section.[39]

A further danger foreseen by Parliamentary Counsel[40] was that following the insertion of the missing words, it would be possible to argue that "expressio unius, exclusio alterius," and that therefore, by implication, other foreign matters besides the place of making the settlement would no longer be regarded as irrelevant - as they had been in the Kenmare case. The Revenue were not convinced by this, [41] believing that the intention to cut down the effect of a House of Lords decision would normally manifest itself in some much more direct way. They thought that the courts would still regard the Kenmare decision as good law in spite of the insertion of the words "wherever made".[42] It does seem that the draftsman's arguments on this point were rather too refined.

At this stage the Parliamentary Counsel dealing with the Finance Bill was changed, but his replacement also had misgivings about the Revenue's views. He particularly did not agree that the insertion of the words could be made with no risk of throwing doubt on other sections.[43] He had in mind the observations of Lord Evershed and Hodson L J in Camille and Henry Dreyfus Foundation Inc. v CIR[44] which had showed what might happen if nothing was said about the effect on other sections. Furthermore, he was not satisfied that much comfort could be obtained from the fact that the words of section 415 were identical with those of section 28 of the Finance Act 1946, as this was of little help unless the meaning had been explored in a decided case - which it had not.[45]

The Revenue's assertion that they were not concerned with foreign matters in connection with covenants to charities did not impress the draftsman, who pointed out that although they were not concerned at that moment they might well be "once it has become fashionable for settlors, when entering into covenants with charities to do so on a holiday in France or Switzerland."[46]

The new draftsman also raised a fresh argument based upon the effect a declaratory clause might have on the behaviour of tax specialists.[47]

He thought that it was safe to assume that, on seeing a case reported in 1957, the professionals would not be drawn into making a comparison between the 1952 Act and its predecessors in order to try to discover possible discrepancies. They would, he thought, be more likely to take for granted that as section 38 of the 1938 Act was now section 404 and 405 of the 1952 Act, the Kenmare case would also apply for the purposes of the 1952 Act, and argued that if the declaratory clause was inserted it would be more likely to attract attention to the wording of section 415, and such attention might cause problems.[48]

The Revenue's response was merely to send the draftsman a photo-copy of an article in "Taxation" of December 28, 1957[49] "which shows that something has already happened to stimulate a move to a comparison between the 1952 Act and its forerunners in this particular respect."[50]

There is no further correspondence concerning the above differences of opinion on the files of Parliamentary Counsel, and it appears that the points of disagreement were probably resolved at a meeting.

Interestingly, even up to this stage, no authority from ministers had been obtained for the inclusion of a clause, but this formality was complied with on March 16, 1958. By March 21, 1958, Parliamentary Counsel had prepared a draft of the required Budget resolution authorising with retrospective effect the insertion of the correction requested by the Revenue.[51] Clearly, by this time the Inland Revenue had won the argument. They did not, however, like the reference to retrospection as they thought it might convey an impression that ministers had something much fiercer in mind than their actual proposals.[52] A milder form of words was suggested and the draftsman made an appropriate amendment.[53] The clause passed through Parliament with only the briefest of explanation and debate.[54] The provisions became section 21(5) of the Finance Act 1958 and this is shown in Appendix H2.

SIGNIFICANT COURT DECISIONS OF THE PERIOD

In the period from April 1946 to March 1958, 16 cases were heard which in one way or another concerned the income tax settlement provisions. The Inland Revenue eventually won 9 of them; a far lower success rate than they had experienced between 1938 and 1946. Many cases that the Revenue won were ones in which there were few principles, or involved an awkward or ill-advised taxpayer who had little chance of success,[55] while others were based upon rather narrow and special facts and did not result in the development of any new major points of principle which they could apply to other cases on a wholesale basis.[56]

Besides the Vestey case, whose importance to the Revenue to a considerable extent lay in the many millions of pounds of tax involved, (see chapter 7), there were two cases the Revenue lost which involved points of principle of great significance because of the tax avoidance possibilities they highlighted.

The first such case, Potts' Executors v CIR,[57] involved section 40 of the Finance Act 1938 - sums paid to settlors otherwise then as income.[58] A settlement had been made by Potts on his infant grandchildren, and the funds of the settlement had been used to purchase shares in a company controlled by him. All the income of the settlement was accumulated. Potts had a current account with the company which was credited with his remuneration and debited with various items, including payments of his own surtax liability, charitable donations and payments direct to him. Although the account had been in credit for many years, when it became overdrawn the Revenue assessed Potts on the basis that section 40 caught payments by the company to third parties on his instructions as well as direct payments to him. It was held that the section did not apply to payments by a connected company to persons other than the settlor or persons accountable to him, and that therefore payments of Potts' surtax liabilities and charitable donations did not result in a tax charge on him. Although this decision made it relatively straightforward to avoid the connected company aspects of the section, it was not until 1981 that legislation was introduced to reverse its effect.[59] The reason for the delay appears to centre on the severe judicial criticism of the section in the Potts case and later cases; a matter fully discussed in Chapter 11.

The second significant loss by the Revenue was in Saunders v CIR.[60] Its consequences were extremely serious because it showed just how easy it was to circumvent the revocable settlements provisions of section 38 (2) of the Finance Act 1938. The case involved a settlor who had set up a settlement with £100 and added a further £25,000 a fortnight later. Under the settlement, with the settlor's permission, the trustees had discretion to pay capital to members of a specified class, (which included the settlor's wife), provided that the trust funds immediately after the exercise of their discretion should not be less than £100. The question was whether or not this involved a power to revoke or otherwise determine the settlement or any provision thereof. If it did then any income arising under the settlement would be treated as the settlor's.

By a majority of three to two, the House of Lords held, on July 25, 1957, that the settlement was not caught, because no provision of the settlement would be entirely brought to an end by the exercise of the power to pay over the trust capital. There would always be £100 within the trust, and every part of the trust would remain in operation, though affecting only a reduced fund. Furthermore, the word "revoke" was held not to include partial revocation, and the word "determine" was held not to include partial determination. A major part of the settlement legislation had been rendered virtually useless and clearly a swift response by the Revenue was essential.

LEGISLATION TO REVERSE THE EFFECT OF THE SAUNDERS CASE

Difficulties With The Chancellor

It is interesting to note that the Revenue believed that the Saunders case showed up the first major failure of the 1938 legislation.[61] They had apparently been considering one or two other defects for some years but had found that those faults did not readily lend themselves to exploitation and had not been exploited on a substantial scale up to that time.[62] There is, however, no indication on the files of what those other weaknesses were, and it was only the Saunders defect which was brought to the attention of the Chancellor and corrected.

By early December, 1957, the Board were writing to the Chancellor, (Mr Thorneycroft), to alert him to the Saunders problem. He was urged to take action in the forthcoming Finance Bill because:

> "The device ... was a very simple one which can easily be adopted by anyone making a similar settlement and it is essential that it should be dealt with as soon as possible before it is widely exploited."[63]

After explaining the background to the provisions of the Finance Act 1938 and the broad basis of the Saunders decision, the Revenue pointed out to the Chancellor that two of the majority opinions in the House of Lords had expressly referred to the fact that Mr Saunder's settlement was a plain and obvious attempt to evade the 1938 provisions.[64] The Revenue argued that the original legislation was meant to catch such a case and that, without corrective legislation, the Saunder's device would be imitated on a large scale and "the legislation directed against tax avoidance by means of settlements would become largely a dead letter."[65] This rather overstated the case as it would only have been the revocable settlement provisions which would have been rendered virtually impotent.

It was explained to Mr Thorneycroft that what was required was not only a provision to deal with the capital settlement cases such as Saunders, but also one to deal with annual payment settlements, because a similar device could be used for them. Perhaps in order to make the proposed legislation more attractive to the Chancellor, the Revenue advised him that the required legislation would probably not be lengthy. In the event, it[66] ran to just over 800 words!

The date upon which the legislation was to become effective, and whether it was to catch settlements made prior to that date, were questions upon which the Revenue had great difficulty in persuading the Chancellor to take their view. They believed that there were some grounds for proposing full retrospection, because in the 1938 Budget Speech, the Chancellor, (Sir John Simon), had given a warning that he intended to keep a close watch on the subject, and if necessary, to introduce further anti-avoidance provisions with retrospective effect.[67] However, because, as far as the Revenue were aware, there had been few cases of imitation of the Saunder's settlement, and because of the time which had elapsed since the warning given in 1938, they suggested to the Chancellor that he might "consider it ... sufficient if the legislation first operated for the taxes actually imposed by the 1958 Finance Bill ..."[68] The Revenue believed it to be obvious that the provisions should apply to all settlements no matter when they were made, but on the advice of the Financial Secretary (Enoch Powell) the Chancellor decided that although the legislation proposed by the Revenue should be introduced, it should only apply to settlements made after publication of the Finance Bill.[69]

The Inland Revenue were unhappy with this decision and luckily for them, on January 6, 1958, shortly after making their decision, Mr Thorneycroft and Mr Powell resigned. The Revenue had apparently prepared a further detailed submission for Mr Thorneycroft in an attempt to persuade him to change his mind, and although the memorandum is headed "drafted for submission to Mr Thorneycroft", in view of the fact that it was not sent until January 10, 1958, it is suspected that the Revenue were merely grasping an opportunity for reconsideration following the change of Chancellor but did not want it to look as if that were the case.[70]

The major points made in the memorandum were as follows:[71]

1. No sympathy should be given to those affected by the proposals because they were involved in a form of deliberate avoidance which was clearly contrary to the intention of the original legislation.
2. The settlor would be able to obtain reimbursement from the trustees for any additional tax he had to pay.
3. The provisions directed against revocable settlements had always applied to both existing and future settlements.[72]
4. The avoidance in Saunders involved the very section in relation to which Sir John Simon (as Chancellor) had issued the warning concerning the introduction of further anti-avoidance legislation with retrospective effect.
5. If the legislation were only to apply to future settlements, it would encourage tax avoidance because it would engender the belief that any new scheme taken up prior to the introduction of anti-avoidance legislation would be able to retain its tax advantages indefinitely.
6. Because income tax and surtax were annual taxes it was fundamental that they could be altered from year to year with nobody claiming a vested right to the continuance in his favour of any particular feature.

Although quite clearly the Revenue were fighting very hard to get their own way, they were prepared to put forward a compromise solution involving a let-out for those settlements in which the offending provisions were removed within three months of the passing of the Finance Act.[73] If the Revenue had put forward this suggestion in the first place it is likely that Mr. Thorneycroft would have agreed to their proposals, but it seems that they misjudged the attitude of ministers to tax avoidance, perhaps believing that they abhorred it as much as the Revenue did.

The result of this further submission was that the new Financial Secretary agreed with the Revenue's compromise solution but suggested that the legislation should be introduced with no such let-out, "keeping the locus poenitentiae up the Chancellor's sleeve as a possible concession for a later stage."[74] The Paymaster-General thought it imperative to include the let-out from the outset but the Chancellor was initially undecided.[75] By the middle of February 1958, the Chancellor had accepted the Revenue's compromise solution concerning which settlements were to be caught and had agreed to include a let-out for settlements which had the offending provisions removed not later than three months after Royal Assent.[76]

Drafting

Rather unusually, the drafting instructions did not include the Revenue's attempt at a draft clause, but only described what the legislation was to achieve. This was done by reference to capital settlements of the Saunders type but it was also explained that it was necessary to have similar provisions to prevent the device being used where the settlement only involved an annual payment. As an example of this, the Revenue instanced a covenant to make an annual payment of £100 which could be reduced to £1 if the trustees saw fit to so direct. They had not in fact seen any such cases but wanted to "run no risks for the future".[77]

Lord Reid had made a reference in the Saunders case to innocent situations which ought to be excluded from the scope of the revocable settlement provisions.[78] The Revenue had attempted to guess what these were but could not think of any examples for the draftsman.[79]

However, they believed that in all probability Lord Reid was thinking not of cases where there was a power of partial revocation, but of cases where there was some event upon which the settlor would obtain a benefit.[80] Such cases were caught by section 405 of the Income Tax Act 1952 and the appropriate let-outs for innocent events were provided for in sub-section 2 of that section. The Revenue believed that there were no innocent cases within section 404 and the draftsman appears to have agreed with them.[81]

The drafting of the commencement provisions caused disagreement between the Revenue and Parliamentary Counsel. The Revenue wanted them to be based upon the analogous provisions of the Finance Act 1938[82] but the draftsman preferred a shorter and more direct approach[83] and also put forward a highly esoteric argument that the corresponding provisions in the 1938 Act should not be used as they would result in no standard rate tax being charged on any of the settlement income.[84] The Revenue told him that they had never seen a case in which that argument had been used and were nervous to adopt the shortened form of words "because the idea that income is at one and the same time beneficially A's income for surtax and B's income for standard rate purposes is so bizarre that it seems safer to spell it out step by step in some detail."[85] Their concern really seems to have been that any break from the accustomed pattern set in the 1936 and 1938 provisions might have invited troublesome contentions by taxpayers.

The draftsman had originally proposed that the commencement provision merely said that for the purposes of surtax the clause was to have effect for 1957/58 and subsequent years.[86] Because of the Revenue's uncertainty as to effect of this bare formula[87] he agreed to elaborate it, but pointed out that section 14 of the 1957 Act had made it impossible to base the commencement provisions on the corresponding provisions in the 1938 Act.[88] The 1957 Act had modified personal reliefs for surtax purposes so that they were related to the standard rate of tax, and because of this, the draftsman believed that the use of the formula in the Finance Act 1938, which also referred to granting relief from tax at the standard rate, would cause complications and confusion. It was this point which seems to have clinched the argument for the draftsman and a slightly expanded version of his short formula approach was eventually enacted.[89]

The final draft of the clause was completed on April 2, 1958, in good time for the parliamentary process which began on April 15.

Representations And Parliamentary Discussion

The Budget statement gave a short explanation of the facts and decision in the Saunders case and expressed disapproval of the strategem used.[90] The Chancellor said that he wished to restore the law to what was originally intended, but promised that any pre-Budget settlements would be excluded from the new provisions if they were "made truly irrevocable within three months after the Royal Assent to the Finance Bill."[91]

At the second reading, the Financial Secretary said that he had nothing to add to the explanation which had already been given in the Budget Speech and there was no discussion whatever of the clause.[92]

Before the committee stage began, the Revenue had received representations from the Law Society, the Accountancy bodies[93] and the Inns of Court Conservative and Unionist Society, (ICCUS), all of which had expressed the view that the clause went too far.[94] The Law Society and the Accountants made the point that divorce and separation agreements often contained provisions under which the husband had power to reduce his annual payments if his income fell below a certain level, or on the remarriage of the divorced wife. Such powers were caught by the clause but the Revenue believed it was difficult to do anything about this class of case without undermining the whole structure of the provisions.[95] They thought that for such settlements made in the future, conveyancers would be able to devise a form of words which would provide automatic consequences in certain events such that the same results would be achieved in practice as were achieved by covenants involving a power to reduce the annual payments.[96] They did, however, agree that there was a case for an additional let-out to be provided for pre-Budget divorce and separation agreements, without requiring the parties to remove the offending power. They suggested this extension of the let-out to the Chancellor, even though the matter was not raised in the committee stage debate. The basis of their generous attitude was that they believed that such agreements were more genuinely at arms length than other family settlements.[97] An appropriate insertion was drafted and introduced at the report stage by the Solicitor-General, who commented that such agreements were remote from tax avoidance because they were only designed to protect the husband from paying excessive maintenance following a reduction in his income.[98]

The I.C.C.U.S. raised the problem of covenants in favour of relatives in which the covenantor was bound to pay an annuity for any year in which his income exceeded a specified amount. The Revenue did not believe that such a case would be caught and took the matter no further, but the point was raised at the committee stage.[99] The concern was that it was in a man's power to diminish his income by not earning as much as in the previous year and therefore the amount payable under the covenant could be reduced to nil. The Solicitor-General was honest enough to admit that he had never considered the point and although he thought that it would not be caught, he promised to review the matter.[1] There is no evidence of such reconsideration on the files of Parliamentary Counsel.

Besides the Solicitor-General, there were only three members who spoke on any matters of substance at the committee stage. Mr Diamond, who was not a lawyer, made only a political attack on the intention to provide a let-out for those who had avoided tax in the past,[2] but in reply the Solicitor-General forcefully made the point that some of the settlements were made for perfectly innocent reasons, even though the bulk of them were tinged with tax avoidance. The main answer to Mr. Diamond's criticism was that:

> "... The person who has brought about this kind of tax avoidance can purge himself of that altogether, and it seems reasonable to allow him to do that."[3]

The Solicitor-General was also able to point to the precedent of Part 2 of Schedule III to the Finance Act 1938 for providing such a let-out.[4]

Both of the other two members who spoke on the clause were lawyers. Even so, one of them, (Major Hicks Beach), was so obscure in his explanation of what he believed to be faults in the let-out section that the Revenue suggested to the Solicitor-General that he should be asked for some elucidation of his views so that they could be given proper consideration.[5] (Major Hicks Beach appears to have been making the point that in certain circumstances an application to the court would have been required if a power was being released to the possible detriment of a beneficiary under the settlement and that the time limit of three months was insufficient for such cases.[6] This was a point explained more clearly by another Member and is discussed below.)

The other lawyer, Mr Fletcher-Cooke, made three main points concerning the conditions of the let-out and all of them had already been made to the Financial Secretary in a memorandum from the ICCUS.[7] The first was that the time limit for taking advantage of the let-out would expire at the end of October 1958 and this was too short if the offending power was vested in trustees, because they would have to apply to the court for approval and the court did not sit in August and September.[8] The Solicitor-General retorted that in effect there was six months notice of the requirement to "properly purge" such settlements of the offending power, but promised to review the matter.[9]

As regards approval from the courts, the Solicitor-General believed that in the ordinary case, if the beneficiary gave consent, there would be no difficulty.[10] The Inland Revenue investigated this matter further and obtained legal advice to the effect that where the settlor, (and his wife, if she was concerned), was of full age and capacity then he, (or they), could consent to a trustee releasing a power exercisable in their favour without recourse to the court.[11] Where such circumstances did not exist, an application to the court would be necessary,[12] and the Revenue therefore recommended to ministers that the time limit should be extended to April 5, 1959, with an over-riding power to the Commissioners of Inland Revenue to extend that time limit in cases where it would be too short.[13]

The Government was apparently in favour of the Revenue's suggestion and an appropriate amendment was put through at the report stage.[14] The Solicitor-General explained that the discretionary power to extend the time limit beyond April 5, 1959 was intended to be used only in cases where the parties had taken all reasonable steps to secure the extinction of the power by that date and their failure to do so was due to circumstances beyond their control.[15] As the extension was to cover delay in obtaining the courts' approval, it was explained that there was to be no extension of the time limit in cases where a person was merely unaware of the conditions of the let-out.[16]

Conservative members seem to have been reasonably satisfied with the extension of the time limit and thought that it made the let-out workable, "whereas, as originally drawn ... the kindest thing one could say ... was that it must have been drawn by someone who had never been in practice."[17] The Opposition noticed that the time limit had been extended by six months beyond that requested by the movers of the original amendment and asked the Government to reconsider the matter and insert a six month time limit.[18] The Solicitor-General argued that there would have to be a considerable amount of searching through the files in solicitors' offices to find out which of the settlements required "purging" and that as this would take some time to do, there should be no such reduction in the time limit.[19]

The second point made by Mr Fletcher-Cooke was that where the wife was a minor or either spouse was of unsound mind, or where the offending power was exercisable in favour of a future wife, then that power could not be released or disclaimed.[20] The Solicitor-General expressed no view on this point, but the Revenue advised the Chancellor that in view of the jurisdiction which was to be vested in the court by the Variation of Trusts Bill, (which was then going through the House of Lords), it was unnecessary to make any provision in the Finance Bill, as these classes of case would be brought within the jurisdiction of the court.[21] The Revenue were also advised that no difficulty would arise in Scotland in such cases.[22]

The I.C.C.U.S. had made representations in connection with a similar class of case where the offending power was vested in a person under a disability or in a person who was not yet ascertainable.[23] Again the Revenue believed that such cases would be covered by the Variation of Trusts Bill but were advised that in Scotland such cases might cause difficulty in the case of a power vested in a person not yet ascertainable.[24] However, as no representations had been made concerning the position in Scotland, the Revenue thought it "unnecessary to go out of our way to legislate for such an exceptional case."[25]

The Inland Revenue recommended that no action should be taken on any of these matters[26] and that recommendation appears to have been accepted by ministers without comment. The problem was not raised again at any other stage in the parliamentary process.

Mr Fletcher-Cooke's third point was that because the doctrines of equity might cause the court to insist upon some consideration, the requirement that neither the settlor nor the wife or husband of the settlor should receive or be entitled to any consideration for the release or disclaimer was too harsh.[27] He therefore argued that nominal consideration should be permitted to prevent settlements being caught between the tax provisions, which required no consideration, and the courts, which did.[28]

The Solicitor-General explained that the background to the requirement was to prevent abuse of the let-out by receiving funds from the settlement under the guise of consideration for the release or disclaimer.[29] This was, in effect, part of the mischief against which the clause as a whole was aimed but he promised to consider the matter again.[30]

The Inland Revenue obtained advice to the effect that if the courts required consideration it must be "real consideration"[31]. They argued that normally there would be sufficient benefit to satisfy the courts, because the settlement would be freed from the provisions of the clause which would have otherwise imposed a tax liability on the settlor who in turn would have recovered that tax from the trustees at the expense of the persons entitled to the income under the settlement. On this basis, and on the grounds that they saw any relaxation of the condition barring consideration to be dangerous, they recommended that no action should be taken, and their advice appears to have been accepted without comment.[32] The close scrutiny which the Inland Revenue gave to the let-out in order to examine the problems raised by Mr Fletcher-Cooke, resulted in them realising that as drafted, it left a loophole.[33] It would have been possible for the power to be exercised to some extent in favour of a settlor or a settlor's wife within the prescribed time limit and for it to be released thereafter insofar as it was not exercised. For example, using the facts of the Saunders case, it would have been possible to pay £24,000 to the settlor's wife and then subsequently give up the offending power and still be within the let-out. As the Solicitor-General explained to the House:

> "... [It] did not deal with the kind of villain who might choose before the expiry of that time limit to exercise the power in favour of the settlor."[34]

At first, the Inland Revenue suggested that the remedy would be to provide that the escape clause would not be available if the offending power had been exercised in 1957/58 or a later year.[35] However, after the Financial Secretary had agreed to this proposal, the Inland Revenue realised that there could be criticism of such a remedy because it could deprive settlements of the let-out due to some action taken before Budget Day. The Revenue were concerned that their proposal would raise the question of retrospection but nevertheless put forward two rather weak justifications of their proposals based upon the Chancellor's Budget speech and comments of the Solicitor-General in committee.[36] Fearing any claim of retrospection, ministers required the let-out to be amended so that it would only apply if the power had been exercised before April 16, 1958.[37] The provisions became section 21 of the Finance Act 1958 and this is reproduced in Appendix H2.

DISCRETIONARY POWER FOR THE BENEFIT OF THE SETTLOR OR SPOUSE

The examination of the revocable settlement provisions made the Revenue realise that their proposal to deal with the Saunders mischief did not go far enough in two respects.[38] Firstly, it did not cover the case of a capital settlement where no part of the capital could revert to the settlor or his wife during the settlor's lifetime, but he or his wife were members of a discretionary class who could be entitled to the income. In such a case the trustees might decide that virtually the whole income for a year should be paid to him or his wife to the exclusion of the other members of the class. For example, a capital settlement could be made under which the income was to be divided annually between X and the settlor's wife in such proportions as the trustee thought fit, but so that X would always receive at least £1. In such a case, X would receive virtually no income unless the trustees decided to let him have it. The settlement would, in effect, be virtually revocable in relation to income because it could pass back to the settlor's wife in any year in which the trustees decided to pay income to her. Such a settlement was within one of the general principles of the anti-avoidance legislation - i.e. that a settlor should be charged on income unless he had effectively alienated it in advance - yet it would not have been caught by the then existing anti-avoidance provisions.

The second class of case involved settlements taking the form of a covenant to pay an annual sum for seven years to a trustee upon trust to pay the income annually to X, or the settlor's wife, as the trustee may from time to time decide. Again, in this case, there would be no effective alienation of income until it was actually decided to pay that income to X, and yet such a case would not be caught by the then current anti-avoidance provisions.

Even though the Revenue knew of no such cases of avoidance, the Chancellor's private secretary (Mr Maude) was approached on June 13, 1958 so that authority could be obtained to introduce an additional resolution and new clause.

The Revenue had been criticised by Parliament in the past for always being at least a step behind those involved with tax avoidance, [39] and therefore when proposals were put forward to block loopholes even before they had been used, ministers were probably grateful for the opportunity to appear to be in control of the situation. The Revenue thus obtained their authority for drafting, apparently with no questions asked. As the Solicitor-General said at the time of introducing the new clause:-

> "... the Revenue ... is trying to get a move ahead - and it seems a wise thing that that should be done."[40]

By June 19, 1958, the Inland Revenue had sent what they described as "a spoof draft"[41] to Parliamentary Counsel with additional notes explaining that what they wanted was:

(a) a clause to apply to discretionary powers to repay income to the settlor or his spouse;

(b) the application of the clause to any income arising while there was an existing or potential power, but not to income arising after the date of extinction of the power;

(c) an appropriate limitation on the deeming process where the power only extended to a fixed amount or a proportion or part of the income;

(d) a let-out for powers which could not be exercised within a six year period modelled upon the provisos to section 404(1) and (2) I.T.A. 1952;[42] and

(e) the application of the joint settlor provisions, information powers, and intepretation provisions in sections 409-411 of I.T.A. 1952.[43]

The draftsman expressed concern that there was an element of overlap between the proposed legislation and the existing rules,[44] (especially those concerning revocable settlements and settlements where the settlor retained an interest), but got round this problem by confining the new provision to income which could not be treated as the settlor's under any other section.

After a couple of drafts and meetings to discuss them, their final form was agreed, but ministers still had to decide the starting date and the form of any transitional let-out for cases where any offending power was removed within a reasonable time of the passing of the Finance Act. The Revenue recommended, and ministers accepted, that the starting date should be the date of the additional resolution required to introduce the clause, and that the transitional let-out should be based upon exactly the same principles as the let-out for the tightening up of the revocable settlement provisions.[45] In order to prevent any justifiable claim of retrospection it was agreed that the let-out was to apply for settlements made before the Government's intentions were made known, provided the power had not been exercised after that time.[46]

The new clause was debated in the House on July 15, 1958 with virtually no time for anyone outside the Government to give it any consideration whatever. The Solicitor-General gave a brief explanation of the kind of cases it was aimed at and pointed out that although it was drawn in very wide terms, any overlap with other provisions had been avoided.[47] The provisions are shown in Appendix H3.

Although the Opposition were curious as to why anti-avoidance provisions were being introduced so late in the consideration of the Finance Bill,[48] no explanation was given. This made them anxious about the effectiveness of checks on tax avoidance, and gave them "the feeling that it is a sporadic exercise" which was "a hit and miss effort according to whether there is a Finance Bill in the second half of the year, or whether the committee stage ... lasts long enough for the Chancellor to be advised of additional provisions which should be included ...."[49]

SETTLEMENTS ON CHILDREN

In May 1958, Sir William Trower wrote to the Financial Secretary to request that a relaxation be made to the children's settlement provisions.[50] The Chancellor decided to reject this request because the matter was not urgent and it would have needed an additional resolution and clause for a Finance Bill which was already long enough.[51] That decision had not been communicated to the correspondent when it was realised that an additional resolution and clause would be required anyway to deal with settlements involving a discretionary power for the benefit of the settlor or his spouse.[52] The Inland Revenue therefore approached the Chancellor to suggest that, in view of the need for an additional resolution, a modification to the children's settlement provisions should be dealt with at the same time.[53] The Chancellor agreed and authorised a modification to proviso (ii) to section 399 I.T.A. 1952 so that the effect of paragraph (b) of that section would be confined to cases where, on the determination of the settlement a benefit could pass to the settlor or his spouse.[54]

The problem which was being tackled was that a settlement of capital would be treated as being revocable if it contained a power to appoint or advance capital during the lifetime of the child to persons other than the child and the child's spouse and issue, even though the settlor and the settlor's spouse were specifically debarred from any benefit. These deemed revocability provisions were more restrictive than the equivalent provisions in Chapter III of the I.T.A. 1952 dealing with revocable settlements generally. As the Solicitor-General explained on introducing the amendment, there had been a tendency to increase the class of beneficiaries in whose favour the trustees might appoint capital or income, and there were provisions which conveyancers would like to include in settlements which would be caught by the existing provisions even though there was not the remotest possibility of either the settlor or the settlor's wife benefiting.[55]

The provisions were therefore altered so that a settlement was not deemed to be revocable if it could be determined in such a manner that no benefit could pass to the settlor or the wife or husband of the settlor during the life of the child.[56] As a result, some settlements which were previously treated as revocable became irrevocable as from April 6, 1958, and it became possible to include a wide class of potential beneficiaries who could receive funds on the discretionary termination of a children's settlement.

A further modification to the childrens' settlement provisions was made as a result of representations made to the Chancellor by Mr S Hammersley, an ex-M.P.[57] He had been caught under the rule that income was treated as that of the parent "if at the commencement of that year the child was an infant and unmarried,"[58] because a child of his had married before the age of 21 and he had settled income on her in the year of marriage. Quite correctly, the Revenue had assessed him on the grounds that at the commencement of the year of marriage the child was both an infant and unmarried. He was most upset by this and attended an interview at Somerset House on June 11, 1958 at which he suggested that the Revenue should themselves propose an amendment to correct the anomaly.[59] They refused, because in their opinion Parliament would not concern itself with a grievance which affected so few people and which was in the main of a technical character.[60]

Hammersely was not satisfied. He sent a copy of his notes of the interview with a covering letter suggesting how "this injustice can be remedied" to all members of the House of Commons.[61] He also wrote to the Chancellor requesting an appropriate simple amendment.[62]

Fortuitously, the timing of his request was almost perfect because the Revenue were considering the relaxation concerning revocability of childrens' settlements referred to above. They advised ministers that there was some justification for his suggestion and that it was at least equal in merit to the representation concerning revocability.[63]

The Revenue pointed out to ministers that there was another side to the problem. Tax was being lost because of the appreciable number of deeds for the year of a child's birth which escaped the settlement provisions in that year because the child was not even born at the commencement of that year. They admitted, on the other hand, that occasionally taxpayers' advisers did overlook the statutory provisions in the year in which a child attained the age of 21 or married, and that in such cases the settlor often had a sense of grievance.[64]

Although an amendment had been put down during the passage of the Finance Bill of 1936 to the effect that the legislation would only apply if the child was under 21 and unmarried at the time of payment, it had been rejected because of Revenue advice concerning the practical difficulties of apportioning the income. They were honest enough to acknowledge that their original view in 1936 was mistaken, and advised ministers that it would have been better if that amendment had been made.[65]

Given this background, it is not surprising that ministers accepted the proposed change. The provisions were therefore altered so that they only applied if the child was an infant and unmarried at the time of the payment. This prevented the legislation starting to apply too late, and going on for too long. With the anomalies arising out of the previous rule removed, the Revenue were relieved of the annoying task of making repayments for newly born children arising from parental settlements and of the embarrassing task of explaining the ridiculous manner in which the rule applied to marriage settlements.

Special considerations applied to cases where a settlement on a newly born child was made after April 5, 1958 but before the Government's intention became publicly known. It was thought fair that the settlor of such a settlement ought to be treated in the manner he expected when the settlement was made. Therefore, an exception was made[66] so that the old provisions applied in respect of payments made in 1958/59 to a child born after April 6, 1958 under a settlement made before July 9 of that year. The legislation is reproduced in Appendix H4.

CONCLUSION

In the twelve years to 1958, the settlements legislation stood up at least tolerably well, and it was only towards the end of the period that case law began to show up faults. The Revenue's reaction to the discovery of these faults was extremely fast. They immediately initiated the introduction of corrective legislation on all matters for which the political climate for change was right. Although the judicial criticism in the Pott's case was probably an embarrassment to them, the harsh way in which the legislation could be operated was to the Revenue's advantage, and this could explain why no attempt was made to have the loophole the case highlighted, blocked. However, generally the Revenue appear to have got pretty much the legislation they wanted, though not without a few battles on the way.

Once ministers agreed to go ahead and block actual loopholes it was to be expected that the Revenue would take the opportunity to review the legislation for any other weaknesses which had come to light, but they went further than that and actually introduced provisions to cover defects which had not to their knowledge been exploited. This resulted in various provisions being brought in as afterthoughts, and although it perhaps did not create a good impression in Parliament, they probably thought it better to carry in minor modifications on the coat-tails of essential changes rather than having to fight to get those minor alterations included in the "Budget Starters" for later years.

It is probably fair to say that, with the exception of the provisions relating to loans to settlors, the legislation on settlements after the 1958 amendments contained virtually everything the Revenue thought was necessary; or at least what they thought would be politically acceptable at that time. This view is supportable on the grounds that after 1958 there were few alterations or additions to the settlement legislation which were not merely the result of new policies following changes of Government, or changes to other parts of the tax system.

CHAPTER 10

1958-1966: INTERACTION, EXTENSION, REVIEW AND ADDITIONAL PROVISIONS

INTRODUCTION

During the period 1958 to 1966, five Acts made modifications to or extended the application of the settlement provisions, but it was the 1965 and 1966 Finance Acts which made the most significant alterations and these were a result of the change of Government in October 1964.[1]

Up to 1965, some of the changes were only made because the settlement provisions were part of a whole framework, and when any part of that framework underwent major change, modifications were sometimes necessary to the settlement provisions to make them interact with other parts of the Tax Acts in an effective and logical fashion. These modifications were generally extremely easy to make.

Rather different and more difficult problems arose when alterations or additions were being made in some area of tax law having nothing to do with settlements, but parts of the settlement provisions were thought to be useful for anti-avoidance purposes in that other area. In such cases rather than designing new anti-avoidance provisions to meet the new problem precisely, the settlement provisions were extended to it and made to fit the need by a Procrustean device. Although this kept the volume of legislation down and avoided the difficulties of achieving a completely self contained and coherent system, the results were less than perfect. The extension of some of the settlement provisions to short-term capital gains illustrate this well.

The Inland Revenue must have been greatly satisfied with the results of the thirteen cases concerning the settlement legislation which went before the courts in the period from April 1958 to March 1966. They only lost three and none of those three involved any serious loss of tax or brought to light any major opportunities for tax avoidance. On the other hand, some of the cases they won were important because they emphasised the considerable width of the definition of a settlement for these purposes[2] and showed the formidable power of section 408 I.T.A. 1952 to catch capital sums paid to the settlor.[3] Thus the case law of the period indicates that there was little need for the Inland Revenue to suggest any changes to the legislation. This view is supported by a memorandum they sent to the Chancellor on February 15, 1965[4], which, although putting forward some very radical proposals for policy changes, expressed little dissatisfaction with the working of the existing provisions and largely just reviewed the matters which deliberately had not been dealt with by prior Governments. The Chancellor decided that the only point requiring immediate action was the tightening up of the rules relating to covenants to individuals, and this was done in the Finance Act 1965. However, these provisions were so tightly drawn that the Government eventually accepted representations concerning the need for relaxations, and these were introduced by the Finance Act of 1966 with retrospective effect.

INTERACTIVE CHANGES TO THE SETTLEMENT PROVISIONS

During the period 1958 to 1966 it was fairly common for changes in tax legislation outside the area of settlements to have a knock-on effect which required the settlement legislation to be altered so that it interacted with the other legislation properly.

Penalties for Failure to Provide Information

In February 1960, it was decided in the case of CIR v Hinchy[5] that the penalty chargeable on a taxpayer who had omitted a small amount of bank interest from his return was equal to three times the total tax chargeable for the year involved, and not merely three times the tax on the omitted income. The resulting penalty was just over thirty times the amount of tax on the omitted income and was therefore completely out of proportion to the offence. The injustice this highlighted led to a complete review of all penalty provisions, including those concerning failure to give information.[6]

As regards settlements, the existing provisions of section 402 and 410 I.T.A. 1952 specified that where there was a failure to provide information the penalty would be £50, plus £50 per day for every day that the failure continued after judgement had been given. This must have been considered rather too harsh and was, like many other penalties for failure to produce information[7], reduced to £50, plus £10 a day for every day the failure continued after declaration by the court or Commissioners before whom the penalty proceedings were taken.

Information Powers Of The Revenue And Recovery Rights Of The Settlor

The Income Tax Management Act of 1964, (ITMA 1964), removed all jurisdiction concerning administrative functions other than appeals from the General and Special Commissioners to Inspectors and the Board of Inland Revenue.[8]

The information powers under the settlement provisions had, prior to 1964, involved the General or Special Commissioners in issuing a written notice to any party to a settlement requiring them to provide such particulars as were thought necessary.[9] This power was transferred for the purpose of charging tax at the standard rate, to the Inspector, and for the purposes of charging surtax, to the Board.

Under section 410 (2) I.T.A. 1952, if the General or Special Commissioners were not satisfied with the information provided by a party to a settlement, they could in certain cases make an estimate of the amount of income chargeable on the settlor.[10] The whole of that section was repealed by schedule 6 of ITMA 1964, presumably on the grounds that it had become unnecessary on the introduction of the general power of the Inspector or the Board to make estimated assessments under section 5 ITMA 1964.

Normally the settlement legislation gave the settlor power to recover any additional tax payable by him as a result of settlement income being deemed to be his from the trustee, (and certain other persons). He could require the General or Special Commissioners[11] to provide him with a certificate specifying the amount of that additional tax.[12] As this function was not related to appeals it was transferred, in the case of income tax, to the Inspector, and in the case of surtax, to the Board.[13]

Closely Controlled Companies

As the Chancellor pointed out in his 1965 Budget Statement,[14] his proposed revisions to the corporate tax system would create a greater temptation to retain profits, because by doing so income tax as well as surtax would be avoided. It was therefore thought essential to extend the existing close company provisions to cover income tax as well as surtax and the opportunity was taken at the same time to tighten them up.[15] The complete recasting of the close company provisions by the Finance Act 1965 meant that references to the previous close company legislation in the settlement provisions[16] had to be modified. This gave the Revenue the opportunity to attempt to widen the scope of the settlement provisions under the guise of changes to the close company provisions. Under the existing settlement legislation any amount apportioned from a close company to the trustees of, or a beneficiary under, the settlement, was to be counted as part of the income arising and could therefore be treated as the settlor's,[17] but this only applied to revocable and other settlements in which the settlor retained an interest.[18] The Inland Revenue therefore requested the draftsman to extend the inclusion of apportioned income to the other provisions concerning settlements.[19] However, he did not "really know what [they] were asking for"[20] and thought that whatever it was it would involve a charge to tax and would fall outside the corporation tax resolution.[21]

The Revenue admitted their instructions were "rather cryptic"[22] but explained that a problem arose where income was apportioned to trustees of a childrens' settlement because the apportioned amount could not be treated as the settlor's. There were two kinds of case which caused them concern; settlements which were revocable under the tests of the childrens' settlement provisions but not under the other settlement provisions; and irrevocable capital settlements under which capital payments were made to the child. In the former case the apportioned income could not be treated as the settlors, while in the latter case the income apportioned to the trustees could not be counted as income available for the capital payment under S398(2) and (6)[23]

Realising that his proposals were totally unjustified, the Revenue official dealing with this matter advised the draftsman that achieving the change was more difficult than he had at first thought and that as "... there are very few cases, and we may have to have a frontal attack on [childrens settlements] next year,[24] I would now say drop [it] unless it can be simply done."[25] In reply the draftsman said that such an amendment would be "near the edge of what one can treat as consequential on the new code for dividends"[26] and that as it was really a substantive amendment "it is a bit dishonest to tuck it away in the schedule."[27] The draftsman seems to have shamed the Revenue into dropping the matter, and as the "frontal attack" on children's settlements never materialised, they still retain what the Revenue see as being an unjustifiable, though relatively unimportant, anomaly.

The revision of the close company provisions made it necessary to modify the definition of a body corporate connected with a settlement.[28] The opportunity was taken to tighten up the definition so that it caught corporate bodies which would have been close had they been resident in the U.K. rather than, as was provided in the original definition, merely those which would have been close had they been incorporated in the U.K.

Given the incidental nature of the above changes it is not surprising that they produced no parliamentary discussion even though various minor Government amendments were made to the provisions at the committee stage.[29]

EXTENSION OF THE APPLICATION OF THE SETTLEMENT PROVISIONS

Short-Term Capital Gains

There was no parliamentary discussion of why it was thought necessary to apply the settlement provisions to short-term capital gains, and the files of Parliamentary Counsel provide no clues, though they do indicate that the decision to apply the provisions was an afterthought. However, the need to deem such gains to have been made by the settlor is fairly obvious when it is considered what avoidance would have been possible if this had not been done.30

Devising rules to enable the settlement provisions to be applied to short-term capital gains in a manner which was workable, logical and not open to avoidance, was found to be problematical. A major difficulty was that under the short-term gains provisions it was not the gain made on a particular date that was treated as income, but only the aggregate balance of gains and losses in the year of assessment.[31] Such aggregation would have been unacceptable for settlements. For instance, if a father had transferred an asset to his minor son who subsequently made a gain on it but who also had short-term losses in the same year on assets not derived from the parent, it was necessary to ensure that each separate gain was deemed to be income so that the short-term losses could not be set off, and so that only gains which related to settlements caught by the anti-avoidance provisions would be deemed to be the income of the settlor.[32] A further difficulty arose from the need to catch cases where a person whose residence status made him non-chargeable made gains on assets which had been provided to him by a settlor who would have been chargeable.[33]

The draftsman thought that the best way to deal with these problems was to deem each gain not merely to be income, but to be income arising under a settlement, so that the settlement provisions themselves would be left to operate on each separate gain.[34] However,for revocable settlements and settlements in which the settlor retained an interest[35] it was thought that there were special features which permitted the netting-off of gains and losses.[36]

The draftsman was aware that his solution did not deal with cases where assets were transferred to trustees who used them to make gains by a succession of transactions, but he thought that it was possible to argue that tracing applied so that all the gains which were derived from the original transfer by the settlor would be caught.[37] Furthermore, he knew that he had not resolved the special difficulties which would arise if the proceeds of sale of the original assets provided by the settlor were mingled with other property and subsequent gains were made.[38] Another complication not dealt with was the manner of operation of the provisions where they applied to only a part of the gain so that the balance of gain was available for the set-off of losses of the trustees.[39] The draftsman had grave doubts "whether we could really make these [settlement provisions] fit case VII at all comfortably, without having something very like a new code."[40] It was decided however, to make do with the existing code.

The application of the settlement provisions to short-term capital gains was achieved by means of two separate and slightly different deeming provisions; one for childrens' settlements and the other for revocable and other settlements in which the settlor retained an interest.[41] (See Appendix I1)

Different rules applied to children's settlements according to whether the property was held by trustees or had been transferred outright,[42] but in both cases gains were to be treated as profits from a trade of dealing in the assets and were to be segregated from the settlor's own short-term gains.[43]

For property held by trustees of a children's settlement, (other than bare trustees),[44] the net short-term gains after deduction of short-term losses could be deemed to be the settlor's but where the result was a net loss it was merely carried forward against the trustee's subsequent short-term gains.[45] Any net gains capitalised by the trustees were to be brought into account in determining the amount of income available for distribution under section 398 (2) I.T.A. 1952[46] so that they could be treated as distributed if a payment was made to the child, (or for his benefit), in excess of the income received by the trustees in the year of that payment. If the majority of trustees were resident and/or ordinarily resident in the U.K. and the trust was administered in the U.K., standard rate was charged on them and not on the settlor.[47]

By providing that profits on assets which had been gifted outright by a parent to his minor child were treated as the child's trading profits, it was ensured that any short-term gains or losses realised by the child on other assets were not counted as the settlor's, but it also meant that short-term losses realised by the child on assets transferred by the parent were not attributed to the parent.

The rules applying to revocable settlements and other settlements in which the settlor retained an interest were similar to those for childrens settlements, but the net gain for the year of assessment was deemed to be income arising, which, together with any close company gains apportioned to the trustees of, (or beneficiaries under), the settlement, could be treated as the settlor's. Net losses were not attributed to the settlor but merely carried forward, and the settlor was not permitted to set off his own losses against the trustee's gains.[48]

Because section 407 I.T.A. 1952 was not applied to short-term gains, if the trustees distributed all annual payments received from the settlor but retained short-term gains as capital, the settlor's surtax deduction for the annual payments was not scaled down under that section.[49]

For income tax purposes, settlement income did not include income which would not have been chargeable on the settlor, (because of his residence status), if he had actually received it. In a similar fashion, a non-resident and non-ordinarily-resident settlor was not chargeable to surtax on the short-term gains of trustees resident in the United Kingdom. However those trustees remained liable at the standard rate on such short-term gains if the majority of them were resident and ordinarily resident in the U.K. or the trust was administered in the U.K.[50].

Capital Gains of Non-Resident Trusts

At the time of introducing capital gains tax it was realised that because only persons resident or ordinarily resident in the U.K. were to be liable, it would be extremely simple to avoid tax on future gains merely by transferring assets to trustees resident abroad.

With such avoidance possibilities it was essential to have provisions to attribute gains of trustees of non-resident settlements to U.K. resident beneficiaries. However, it was decided that this was only to be done where the settlor was domiciled and either resident or ordinarily resident in the U.K. at the time the gain was made, or at the time the settlement was made. After considerable criticism[51] and amendment, the provisions designed to achieve this purpose became section 42 of the Finance Act 1965, with the terms "settlement" and "settlor" having the same meanings as those in the income tax settlement provisions,[52] and the term "settled property" construed in accordance with those definitions. Despite the considerable parliamentary discussion of the section,[53] nobody questioned the need for such extremely wide definitions.

As the definition of a settlement goes much wider than merely a trust, it might be thought that the deeming provisions of section 42 would apply to outright gifts and other dispositions and arrangements not involving trusts. If this were the case, it would be possible for gains made by a non-resident person who was not a trustee to be attributed to a resident person. However, section 42 only applied "as respects chargeable gains accruing to the trustees,"[54] and it is thought that it could therefore not have applied to dispositions, covenants, arrangements and agreements which did not involve trusts. Thus, there must have been some other reason for including the wide definition of a settlement and a settlor. It is suggested that it was necessary for at least two reasons. Firstly, it would have prevented a person successfully claiming that he was not a settlor of indirect arrangements under which he provided funds for the purposes of a settlement which was apparently made by another person who was neither domiciled, resident or ordinarily resident in the U.K. at the time of making the settlement, and who was unlikely ever to acquire that status. Secondly, it would have caught reciprocal arrangements under which a person with no connection with the U.K. made a settlement on U.K. beneficiaries whilst at the same time a corresponding settlement with non-resident trustees was made by a U.K. resident in favour of non-resident beneficiaries.

Obviously, for the Revenue to be able to find out about the existence of reciprocal arrangements and indirect settlements, they needed considerable information powers and they were given the same powers as those under the income tax settlement provisions.[55] Thus, any party to a settlement could be required to provide such particulars as the Inspector thought necessary for the purposes of ascertaining the underlying facts. However, the legislation did not specify who was required to give details of the trustees' chargeable gains. This must have created difficulties for the Revenue, but on the recasting of their powers by the Taxes Management Act 1970, they were given the right to require any person who was interested in settled property to which section 42 applied to provide details of chargeable gains which had accrued to the trustees of the settlement.[56] At the same time, it was decided to replace the existing information powers[57] with powers to require particulars from any person interested in the settled property.[58]

In 1981, when the existing provisions governing capital gains of non-resident trusts were replaced by more equitable provisions designed to achieve the same purpose,[59] the same wide meanings of settlor and settlement were not used. Although the reason for this is not known, it is possible that indirect settlements and reciprocal arrangements were entered into before the loophole was closed with effect from April 6, 1984,[60] and it can only be assumed that the original omission was an oversight.

A REVIEW OF POLICY

Background

When a Labour Government was elected in October 1964 with a mandate to "block up the notorious avoidance and evasion devices that have made a mockery of so much of our tax system,"[61] the Inland Revenue were quick to put forward suggestions for meeting its promises.

Many of the provisions introduced to prevent avoidance through the use of settlements had been compromise measures by Chancellors who, on political grounds, did not feel able to prevent completely the tax advantages accruing to certain types of arrangement. One such compromise was that irrevocable settlements on children by their parents were totally unaffected provided no income or capital was paid to or for the benefit of the children during their minority. Similarly, the attack on covenants in 1946 had not touched covenants in favour of individuals provided they were for a period which could exceed six years, were irrevocable, and were not for the benefit of a minor, unmarried child of the covenantor or for the benefit of the covenantor's agent, solicitor or servant.

Mr James Callaghan, the new Chancellor appointed in October 1964, was an ex-member of staff of the Inland Revenue and had been highly critical of avoidance through the use of settlements in the debates on the Finance Bill of 1946.[62] Having the ear of a sympathetic Chancellor, the Revenue prepared a lengthy paper setting out all the areas in which the avoidance possibilities still open to taxpayers by using settlements could be blocked.[63] The memorandum was in two parts; one dealing with deeds of covenant and the other with settlements of capital.

Settlements Of Income

The Revenue pointed out to the Chancellor that under a deed of covenant in favour of an individual, if the covenantor was liable to the top rate of surtax and the beneficiary's income was kept below the tax threshold, the payer could provide the recipient with an income at a net cost of two shillings and three pence per pound of gross income covenanted.[64] The existing anti-avoidance provisions relating to covenanted payments were explained and the Chancellor was reminded that they were a mere compromise adopted in 1946 and criticised by him at that time.[65]

The Revenue, though admitting they had no precise figures for the number of deeds in favour of individuals, estimated that there were 160,000, about half of which were in favour of minor children by persons other than their parents.[66] The total income transferred was estimated to be £40m a year and the reduction in tax liabilities £17m a year, of which £11m represented surtax relief and £6m the income tax repaid to beneficiaries.[67]

In contrast, the figures for charitable covenants were thought to be accurate because their claims were handled centrally.[68] The Chancellor was informed that in the year to September 30, 1964 there were one and a third million charitable deeds in force transferring a total income of £24m and for which income tax of just over £9m was repaid.[69]

Various counter-measures were discussed in the paper. An extreme possibility was the withdrawal of recognition of deeds of covenant for tax purposes but this, the Revenue advised the Chancellor, would arouse considerable opposition.[70] Those charities which derived substantial income from covenants, and those individuals, particularly the elderly, who benefited under covenants from their children, as well as those who would find that the cost of maintaining their relatives was increased due to the removal of tax relief would all complain bitterly.

A less radical proposal was the extension of the non-recognition for tax purposes of covenants in favour of minor children so that it applied to covenants by grandparents and others, as well as by parents. This suggestion was thought to be possible to implement but difficult to justify, because there would be no common law obligation on the covenantor to maintain the child and the income would be available to meet family expenditure, so that it would be more sensible to treat it as the parent's.[71] Such aggregation of some of a child's income was thought logically to lead to the aggregation of all of it, but as this would have involved a considerable recasting of the tax system, the Revenue did not recommend either aggregation or non-recognition of covenants in favour of children.[72]

What the Revenue recommended was a middle course, bringing all covenants into line with the treatment of charitable covenants so that no surtax relief was available to the payer.[73] They thought such an approach was justifiable on the grounds that the relief for covenanted payments belonged to the system of flat rate tax that prevailed before the introduction of super-tax.[74] The net cost to a top rate surtax payer would, if the Revenue's proposals were introduced, have increased from two shillings and threepence for each pound of income covenanted, to twelve shillings and threepence. However, the benefit was still significant enough for the Revenue to "think that a surtax disallowance would [not] be a mortal blow to individual covenants."[75]

A further type of covenant the Revenue believed ought to be dealt with was what they described as "discretionary covenants,"[76] under which an annual sum was paid to trustees to be applied at their discretion to any number of named persons or members of a defined class. Such covenants had been used to stretch one of the let-outs provided in the 1946 provisions[77] to a limit the Revenue found objectionable because they were "no more than isolated gifts of benevolence, with no necessary element of continuity."[78] They estimated that there were a few thousand such covenants under which individuals could benefit and that they involved income of approximately two million pounds and a tax loss of between three-quarters of a million and one million pounds per annum.[79] The Radcliffe Committee[80] had recommended that these covenants should no longer be recognised for tax purposes and the Revenue urged that the recommendation be adopted.[81] What the Revenue really objected to was the ability to switch income year by year among the beneficiaries in the most tax efficient manner.

The Chancellor was warned that if a general disallowance was applied to discretionary covenants, there would be some solely for charitable purposes which would be caught.[82] The Revenue also pointed out that the removal of income tax relief and the denial of repayments to the charities eventually receiving income through the discretionary trustees would be difficult to justify if covenants payable direct to charities were unaffected. They suggested to the Chancellor that he might propose in his Budget Speech to withdraw tax recognition from all discretionary covenants and then see what pressure developed for the exclusion of discretionary charitable covenants.[83] This was advice which understandably the Chancellor did not take.

While dealing with covenanted payments, the Revenue could not resist inserting a short paragraph to describe "a small gap in the parent/child tax provisions which would be worth stopping up if other action is being taken in the field of transfers of income."[84] The gap referred to was the treatment of payments direct to a child under a court order under which the parent obtained a deduction from his income. Considerable tax savings were often possible because such payments counted as the child's income. The Revenue could see no reason why the mere fact that a marriage had broken down enabled one of the parties to obtain tax relief for payments to a minor unmarried child, and suggested that such payments should be treated as the income of the parent for all tax purposes.[85] Although they proposed that such a change should be limited to court orders entered into after the change in the law,[86] the Chancellor apparently thought the matter too politically sensitive to touch.[87]

Capital Settlements

What the Inland Revenue found distasteful about settlements of capital was the ability to store up income free of surtax for the eventual benefit of the settlor's family or for distribution to persons who paid only a low rate of tax.[88] They recommended action in three main areas; discretionary trusts, children's accumulation trusts, and other accumulation trusts.[89]

Firstly, for capital settlements under which income could be applied at the discretion of the trustees or someone else "for the benefit of a mixed bag of beneficiaries,"[90] the Revenue submitted that there was every justification for treating the income as the settlor's because there was no alienation of it to a particular beneficiary or beneficiaries for a period of years.[91] They suggested such settlements could be dealt with in the same way as discretionary covenants, so that all income arising would be treated for both income tax and surtax purposes as the settlor's, but their proposals met the same fate as those for discretionary covenants.

The second area in which the Revenue thought there was a need for action was accumulation settlements for the benefit of minor children of the settlor. Although parents who made such settlements were only taking advantage of an opportunity which was deliberately left open in 1936, by 1965 there were "some very large settlements [escaping] surtax ... under these provisions."[92] The problem was exacerbated by the unit trust movement which had "recently begun to encourage less wealthy parents to set up settlements of units for their young children [with] income ... accumulated and paid over as capital when the children reach majority."[93] It was estimated early in 1965, that there were ten thousand unit trust settlements and that they involved over three million pounds of capital. The Revenue expected the number of settlements and the capital involved to increase steadily as new settlements were created and as further units were added to existing settlements under regular savings schemes.[94]

The annual loss of surtax due to these childrens' accumulation settlements was estimated at eight and a half million pounds[95] and a further one and a half million pounds of income tax was being reclaimed by the children under the provisions of section 228 I.T.A. 1952 when the accumulated income was eventually paid over to them.[96]

The Revenue attempted to persuade the Chancellor to take action not only on the grounds of tax lost but also upon principle. It was contended that because covenanted payments by a parent in favour of a minor child were caught, it was unfair to taxpayers who had no capital resources that a parent who did could create an irrevocable capital settlement under which accumulated income would not suffer surtax.[97] This was exactly the opposite of the argument they had suggested to ministers in 1936 to help them justify to Parliament their decision not to bring such capital settlements within the children's settlement provisions.[98]

The Revenue's suggested solution was for accumulated income in parental settlements created after Budget Day to be treated as the parent's so long as the child was under 21 and unmarried.[99] Again, the Chancellor apparently had no enthusiasm for their proposals and this class of settlement is still generally left untouched by the anti-avoidance provisions.

In order to deal with accumulation settlements other than those by parents on their children, three lines of attack were put forward by the Revenue, but even they thought them impracticable. The first was to deem the income to have been paid to potential beneficiaries and to charge them.[1] The Revenue thought this administratively unworkable, as the beneficiaries might be numerous, and difficult to justify, as their title to income might depend on various contingencies so that they might ultimately receive nothing.[2] The second suggestion involved simply taxing the undistributed income as the settlor's. The Revenue warned that this would be difficult to support because it was completely out of line with the policy of existing legislation where the settlor had specifically debarred himself from any future benefit.[3] The third possibility was to treat the accumulated income as subject to surtax and apply all the normal surtax rules.[4] Their reservations on this were that it was too complicated and too easy to avoid without some provision for aggregating all settlements made by the same settlor.[5]

Given the Inland Revenue's lack of conviction on the need for and practicability of their proposals, it is not surprising that the Chancellor decided to leave well alone. However, with the introduction of a much reduced basic rate of tax in 1973, the opportunity was taken to apply a surcharge, (additional rate tax), to accumulations of income.[6]

The Outcome

With a delay of almost a month before getting the Chancellor's response, the Revenue were probably hopeful for major changes, but when they obtained it they must have been disappointed that he had agreed to take action on so little of what they had proposed.[7] The

Chancellor decided merely to extend the disallowance of surtax relief to those classes of covenant for which relief had not been withdrawn already by earlier legislation. This was only to apply to covenants made after April 6, 1965.

MAJOR NEW PROVISIONS IN THE FINANCE ACT 1965

Initial Drafting

The Chancellor's decision to disallow surtax relief applied not only to deeds of covenant but also to "similar payments of all kinds".[8] As the existing let-outs in respect of such covenants and payments[9] operated as listed exceptions to a general prohibition, the Revenue suggested to the draftsman that to meet the Chancellor's objectives only required those exceptions to be removed. By doing so they believed that section 407 (1) and (2) of I.T.A. 1952 would be made unnecessary.[10] However, they wanted to maintain the principle of section 407 (3) I.T.A. 1952 so that if any annual payments were accumulated by trustees, an equivalent restriction would be made on any income tax repayment should those accumulations be distributed in a later year.

Parliamentary Counsel duly drafted a clause and resolution which precisely met the instructions,[11] but on seeing it the Revenue "took fright"[12] because to achieve the equivalent of section 407 (3) I.T.A. 1952 involved taking up "an astonishing amount of space".[13] They had second thoughts and decided to achieve their objectives by merely leaving the whole of section 407 in operation, even though it would be overlapped almost totally by the new provisions.[14]

Examination of the first draft led the Revenue to discover a weakness in the existing provisions[15] preventing surtax relief on income settlements. Under section 415 I.T.A. 1952 a let-out applied so that income would not be deemed the settlor's if it arose from property of which he had divested himself absolutely. However, he was not deemed to have so divested himself if the property, or any income from it, could under any circumstances become payable to him or applicable for his benefit. The rather obvious flaw was that the settlor's spouse could benefit, yet the let-out would still apply. This loophole was to be blocked and the draftsman introduced appropriate words for direct insertion into section 415.[16]

Clause 12 of the Finance Bill 1965 indicated that there were to be changes to section 415 to ensure all forms of income settlement, without exception, were to be caught.[17] (See Appendix I2) Sub-section 1 disallowed the deduction of any annual payments whatsoever in computing the payer's total income for surtax purposes. It also treated the income arising under a settlement of capital as the settlor's for surtax purposes unless he had, in effect, given the capital away completely, and sub-section 2 extended that treatment to settlements in which the capital or income might become payable to the settlor's spouse. Sub-section 3 made clear that these changes only applied to settlements made after April 6, 1965.

As introduced the proposed legislation contained no exceptions, and it was this which led to considerable criticism and the eventual introduction of let-outs for certain classes of deserving case. At first, the Chancellor, adamant that no exceptions should be provided, made it clear in his Budget Statement that the provisions were to apply "to all payments under covenant," because they resulted "in too much of their bounty being provided at the Exchequer's expense".[18] Although at the ways and means stage there was no comment on these proposals, this was compensated for at the second reading by a debate which although running to thirty columns of the official report, consisted only of emotional appeals about the hardship which would be created.

<u>Committee Stage Amendments And Debates</u>

Five amendments were put down for consideration at the committee stage and each of them was an attempt to obtain some relaxation.

One amendment[19] was designed to ensure that only covenants to minor children receiving full-time instruction at a school or university would be caught, and that any annual payments to other individuals would still be eligible for surtax relief. This appears to have been an attempt by Conservative MPs to limit the clause to the class of case thought to be particularly unacceptable to the Labour Party. The Board cautioned ministers that although the amendment would preserve relief for some, such as elderly relatives, for whom sympathy might be felt, it would also apply even if the sole purpose was to avoid tax by spreading income more evenly between members of a family.[20] They therefore advised that it should be resisted.[21]

During the debates the Chancellor was criticised for penalising those who accepted their family responsibilities and their obligations to "faithful retainers".[22] Other examples were given[23] of cases likely to evoke sympathy, but all these pleas were to no avail because the Government were "not persuaded that because there is a moral obligation towards old servants or elderly parents, this implies that such a moral obligation must be financed as to income tax and surtax by the State."[24]

A proposed exception for covenanted payments to a parent[25] was so badly drafted that it would have applied to payments to anyone's parent, no matter who made the covenant. The clear intention was for it to apply only to the parent of the covenantor, but even if it were so limited, the Board insisted that it was nevertheless unacceptable because it was not invariably the case that a covenant in favour of an aged parent was more deserving of sympathy than a covenant for another relation, for example, an orphan nephew or an old poverty stricken aunt.[26] They believed that the only practical approach was to disallow all such payments and ministers apparently agreed.[27]

The other three amendments were similar in character and to some extent overlapped.[28] The first was an attempt to exclude settlements made for valuable and sufficient consideration. The Revenue were not clear what the proposers of the amendment had in mind, but thought it likely that their concern was with:

a) payments by a husband to a divorced or separated wife;
b) payments by a professional firm to a retired partner or his dependents; and
c) payments made for the purchase of a business where the purchaser could not pay the price in one sum.[29]

The Law Society had made representations regarding the need for an exception for cases within classes (a) and (b), and other professional bodies had made similar representations regarding class (c).[30] The argument they put forward for the continuance of surtax relief was that there was no element of bounty.

Although the Inland Revenue believed it possible to argue with some force that there was no reason for the Exchequer to contribute to the cost of buying out a retiring partner, they nevertheless told ministers that such cases were on a completely different footing from other covenants.[31] Ministers were advised that there was some doubt about whether or not the absence of bounty in these cases would mean that they were not settlements and would fall outside the scope of the new clause.[32] As there was no clear-cut authority on this, the Revenue suggested that if ministers were sympathetic to the principle, legislation would be required to put the point beyond doubt, and that it would not be sufficient to merely make a parliamentary statement.[33]

It seems that the Revenue were not averse to this amendment and may even have slightly favoured it and so gave ministers no grounds upon which it could be resisted. However, as drawn, it could not be accepted as it might have left the door open to avoidance "by disguising acts of bounty as made for some intangible consideration."[34]

The Revenue were also sympathetic towards that part of the amendment aimed at providing an exclusion for payments by a husband to a divorced or separated wife.[35] The rationale for their sympathy was that if the new rule was applied to a separation agreement, it could be avoided merely by obtaining a court order by consent because such an order would not be a settlement.[36] There was obviously sense in having the same treatment where the substance of the transaction was the same but the form differed. Why such good sense did not prevail on the introduction of the children's settlement provisions in 1936, (see chapter 5), is not known.

A second amendment in this group was intended to preserve surtax relief for the partners of a firm making annual payments to a retired partner, or the widow or widower of a retired partner.[37] Its terms were such that relief only applied if the payments had an aggregate value reasonably comparable to the benefits normally provided by statutory superannuation schemes and the retired partner was over the age of 50 in 1956. The age requirement was inserted to limit the provision to partners who were too old to derive much advantage from the introduction in 1956 of tax relief for pension arrangements by the self-employed. The Revenue saw no objection to this amendment.[38]

The final amendment was aimed at retaining surtax relief for annual payments representing the full purchase price for a business or professional practice,[39] and was subsumed under the more general amendment concerning valuable and sufficient consideration. The Revenue were supportive of some form of let-out on the grounds that such transactions were matters of ordinary commerce with no element of bounty.[40]

The committee stage debates were restricted to the treatment of annuities to retired partners. The picture was painted of young men entering into partnership without a capital sum available for investment whilst older men seeking to retire from partnership had had little chance of earning sufficient to provide enough for retirement.[41] Because of this, the custom was said to have grown up that an incoming partner would make a personal covenant in favour of an outgoing partner.[42] It was contended that it was perfectly fair that where a man had spent his life building up a practice and handed it over to a successor, he should be entitled to some reimbursement for the effort he had made.[43]

The Financial Secretary undertook to review the whole subject with a view to bringing forward more suitable amendments on report.[44] He also advised the House that there were possible problems in connection with payments for the purchase of a business and payments by a husband to a divorced or separated wife, and he promised to review these two areas as well.[45]

Persuading The Government To Provide Exclusions

During the committee stage debates, Mr John Osborne's offer to supply the Financial Secretary with further information concerning the use of covenants on the formation and dissolution of partnerships[46] was gratefully accepted "to help with our study of this matter".[47] Osborne's information came from a wide variety of sources. His letter to the Financial Secretary on June 16, 1965 indicated that he had been approached on the subject by the Institute of Chartered Accountants, the Law Society[48] and various individuals,[49] and that he had a copy of correspondence between Lord Nathan and Sir Alexander Johnstone (The Chairman of the Board of Inland Revenue) relating to the matter.

Perhaps the most useful facts he had were in a letter to Mr William Clark, MP, from the Association of Certified Accountants.[50]

The Association had carried out an investigation into the proportion of their practising members who, in 1963, were making payments to former partners or their widows. The survey had indicated that ten per cent of firms having two or three partners made such payments, while the figure for those with four to nine partners was twenty per cent. As the survey had not covered the largest partnerships, on becoming aware of the proposals in the Finance Bill the Association made enquiries of four of the largest accountancy firms and found that three of them had such arrangements.[51] There was therefore a clear correlation between the size of the firm and the payment of annuities to retired partners or their widows.

Various firms had written to Osborne urging some form of let-out for commercial arrangements, and he had himself privately consulted Thomson, McClintock & Co. who had advised him that:

> "It is only the ability to pay annuities or pensions to retiring partners that enables a healthy movement within partnerships to be maintained and the average age kept at the reasonably low level which modern conditions appear to require."[52]

The Inland Revenue were apparently perfectly satisfied that there was a need to provide let-outs for commercial arrangements and had advised ministers of this in their guidance notes on the committee stage amendments.[53] In spite of the Revenue's recommendation that ministers should bring forward their own amendments on report, Government uncertainty appears to have held up any action until well over a month after the recommendations were made. Osborne's letter, reflecting as it did the wide variety of interests which would be adversely affected, eventually seems to have tipped the balance and persuaded ministers to act. It was backed up by a persuasive and supportive commentary on its contents from the Chairman of the Board of Inland Revenue,[54] who also reminded the Financial Secretary that a very good case could be made for providing a let-out for covenants by a husband to a divorced or separated wife.[55]

Drafting Of The Exclusions

Given the importance of the exclusions and the time pressures on drafting, it is surprising that it was not until June 30 that ministers gave approval for the Revenue's recommendations.[56] Perhaps the Finance Bill of 1965 had tried to do too much and ministers just could not cope with the large volume of detail. Whatever the cause, it was totally unsatisfactory for the drafting of complex amendments to be compressed into the six remaining days before the report stage on July 7.

The instructions to draft made the following points concerning the let-outs:

a) they were not to apply to payments which were really instalments of a capital sum;[57]
b) they were to apply to an annuity payable in part or full consideration for the sale of an entire business, even if it did not represent the whole value of the business where there had been an initial lump sum payment;
c) only an annuity payable to the vendor, or if he was dead, his widow or dependents was to be let out;

d) only an annuity in consideration for the whole or part of the annuitant's share of the partnership assets and payable by a continuing partner under the partnership deed or some later instrument, was to be let-out, and only then if it was payable to the retired partner, or if he was dead, to his widow or dependents; and

e) as an assignment of an annuity would itself fall to be considered as a settlement, there was no need to restrict the let-outs to unassignable annuities.[58]

The day after receiving these instructions, Parliamentary Counsel sent a draft of the required amendments to the Inland Revenue for their consideration.[59] Within a few hours the Revenue had responded and the draftsman had issued a revised version[60] which, although acceptable to the Inland Revenue, he had reservations about.

His concern was with the Revenue view of the way section 415 I.T.A. 1952 applied to cases involving valuable and sufficient consideration.[61] The Revenue had obtained a legal opinion to the effect that a covenant made at arm's length for valuable and sufficient consideration was not a settlement, and therefore arguably not caught by section 415 anyway.[62] It was thus possible that the let-outs being proposed were not necessary, but to remove any uncertainty the Revenue thought it best to insert them.[63] They thought that after their introduction it would still be open to the taxpayer to contend that, even if the let-outs did not apply, the section could not operate on a covenant for valuable and sufficient consideration.[64] Although they were "not much worried by this," they resisted the insertion of a specific reference to valuable and sufficient consideration in section 415 because it might have drawn attention to the point.[65]

The draftsman doubted that the insertion of the let-outs would have no effect on the argument that valuable and sufficient consideration automatically took a covenant outside section 415.[66] His reasoning was that if covenants made for valuable and sufficient consideration were already automatically outside section 415, then none of the let-outs would have been necessary. Therefore the insertion of the let-outs would imply that all such covenants must have originally been caught and that Parliament was now providing certain limited exceptions.[67] The importance of this went beyond section 415, because it defined a settlement by reference to chapter III of part XVIII I.T.A. 1952, and the same implication regarding valuable and sufficient consideration would therefore be carried across into that chapter. Although the draftsman would have preferred to spell out that arrangements for valuable and sufficient consideration were not settlements at all, he accepted that it was too late to obtain clearance for doing so.[68]

Parliamentary Counsel discovered a further problem when he realised that section 392 I.T.A. 1952, which also applied to covenants, contained a specific exclusion for cases in which there was valuable and sufficient consideration. He believed it anomalous that a covenant for valuable and sufficient consideration would be outside section 392 and yet be caught by section 415 unless covered by the express exclusions which were being introduced.[69] The Revenue still resisted the insertion of words into section 415 making clear that it had no application to arrangements for valuable and sufficient consideration, and this is not surprising given that this might have highlighted let-outs for cases which the Revenue thought not worthy of exemption.

It is interesting to note that in considering the current equivalent of section 415 (section 457 ICTA 1970) the House of Lords decided, in the case of IRC v Plummer,[70] that the word "settlement" only applied to transactions which included an element of bounty. It would appear therefore that both of the draftsman's concerns were unfounded, and it is most unfortunate that they distracted attention from considering the inherent flaws in the exemptions which were being made.

The Report Stage

Despite the report stage being only six days after the drafting of the amendments, so that there was little time for outsiders to consider their implications, Mr Osborne did manage to raise some sensible questions of interpretation. Because he did not understand how valuable and sufficient consideration could be involved in dealings with widows and dependants of former partners, he wanted to know whether covenants to meet a moral obligation to pay them an annuity would be caught.[71] The Financial Secretary made it clear that no let-out would apply to annual payments made ex-gratia or for less than full consideration, but that payments to the widow would not be caught if she was provided for in the original agreement.[72] However, if there was no stipulation at the time of retirement that the covenant should inure for the benefit of the widow, any annuity payable after the death of the retired partner would be an act of bounty and would not fall within the let-out.[73] Though this seemed rather harsh, the Financial

Secretary accepted Revenue advice that it was impossible to make a concession without undermining the whole clause.[74]

Although various other questions were asked by Mr. Osborne which were not satisfactorily answered,[75] one of them became an important issue in the Finance Bill 1966. It involved the situation where partners A, B and C had an arrangement to pay an annuity to the widow or dependants of any one of them and then, through a series of changes of partnership, the position was reached where partners X, Y and Z actually paid such an annuity. As it was unclear whether the payments by X, Y and Z would be caught, Osborne wanted the Financial Secretary to explain the position, but being quite out of his depth he asked to be allowed to study the matter carefully so that he could reply "with more accuracy than I think I could now."[76]

It is unknown whether the Financial Secretary provided answers to Mr Osborne, but what is clear is that the minimal research and consultation and the rushed approach resulted in section 12 of the Finance Act 1965 being a hopelessly inadequate set of provisions which had to be virtually re-written in the Finance Bill of 1966. This is perhaps one of the best examples of how the hurried introduction of complex provisions without proper consultation often results in poor legislation. (Section 12 is reproduced in Appendix I3)

CORRECTION OF THE ANOMALIES CREATED BY THE FINANCE ACT 1965

Though section 12 of the Finance Act 1965 created serious anomalies and difficulties, particularly for professional partnerships, representations by the Law Society and the Institute of Chartered

Accountants[77] led to retrospective adjustments to it in the Finance Act 1966. (The provisions of the Bill are in Appendix I4 and the Act in Appendix I5.) The process leading to the amendments began with a meeting at which a joint deputation from the Law Society and the Institute of Chartered Accountants[78] protested to the Revenue that the let-outs for maintenance payments, payments to ex-partners, and payments to former owners of a business in section 12(3) of the Finance Act 1965 were too narrow.[79] The Revenue advised the Chancellor that although none of these areas was by itself of major importance, taken together they justified making amendments because a valid case had been made out for each of them.[80]

The Law Society had also contended that surtax relief should be given to new partners taking over their share of voluntary annuities to previous partners which had been entered into prior to April 7, 1965. The Financial Secretary accepted the Revenue's view that this was insupportable because the whole purpose of the section was to disallow relief for voluntary annuities,[81] and agreed that the amendments should be limited to maintenance payments and certain payments to ex-partners and former owners of business.[82]

Payments To Spouses In Cases Of Voluntary Separation

The let-out in section 12(3) of the Finance Act 1965 for settlements made by one party to a marriage on the other after a divorce or annulment or while they were separated under a court order or separation agreement did not, according to the Law Society, cover the common practice of entering into a maintenance agreement without an agreement to separate.[83] With no separation agreement, the maintenance payments would be caught by section 12.

Because under the law at that time, the existence of an agreement to separate was a bar to desertion as a ground for divorce, there was frequently only an agreement to pay maintenance so that the right to a divorce on the grounds of desertion after a period of three years was preserved. Most of these maintenance agreements were for a relatively short time, but in cases where neither spouse bothered to obtain a divorce some of them continued for a long period.[84]

The combined effect of the existing tax law and divorce law was to encourage a husband not to make provision for his wife so that she was forced to obtain a court order under which he obtained surtax relief. It was clearly unreasonable to treat cases where no formal separation agreement had been made on a different footing to others, but the Financial Secretary was concerned that any correction of the anamoly could be open to the accusation "of giving a tax encouragement to the matrimonial offence of desertion."[85] The Inland Revenue were therefore instructed to contact the Home Office and the Lord Chancellor's Department to see whether they had any objections. When none were raised,[86] the drafting of appropriate amendments went ahead.

The only alteration required was the insertion of the words "in such circumstances that the separation is likely to be permanent." These words were exactly those used in the Income Tax Act 1952 to specify the circumstances in which spouses were to be treated as separate persons for income tax purposes[87]. The amendment therefore put the treatment of the maintenance on the same basis as the treatment of the individuals for income tax. It passed through Parliament without comment.

Payments To Ex-Partners For A Fixed Term Of Years

The Institute of Chartered Accountants and The Law Society informed the Revenue that it was not unusual for partnership agreements to require covenanted payments to be made to ex-partners for a fixed term of years rather than for life, so that the retired partner obtained a "pension" for a guaranteed term without saddling the partnership with a liability for an indefinite period.[88] If the ex-partner died before the fixed term expired the payments would continue, and the person to benefit from them would depend upon the terms of the deceased's will. Where the right to the payments passed to the ex-partner's widow or dependants, the conditions of section 12 of the Finance Act 1965 would be satisfied and surtax relief would continue. But if his estate was left to some other person, such as a charity, a friend or distant relative, then no surtax relief would be due. It was thought unfair that surtax relief for the continuing partners depended upon the terms of the deceased partner's will.[89]

Although the Inland Revenue agreed with these contentions and recommended that appropriate modifications be made to meet the case,[90] the Financial Secretary asked them "to consider a ten year limit for fixed term payments to qualify for the surtax deduction."[91] He was not very precise about what he wanted and although the instructions to Parliamentary Counsel[92] refer to a ten year period running from the date of death of the partner, this was later altered to run from the date of retirement.[93]

The first draft of the clause referred to payments made, (no matter when they were due), in the ten year period following the partner's retirement,[94] but the Revenue quickly picked up on the point that this restriction could easily be avoided by making payments in advance just before the ten years expired.[95] An amendment was made so that only payments falling due within the ten year period would qualify for surtax relief.[96] The provisions became section 23(4) of the Finance Act 1966 without any parliamentary comment.

Other Payments To Ex-Partners And To Former Owners Of Businesses

Under section 12 (3) of the Finance Act 1965, annual payments by a partner under a partnership agreement, or by any person in connection with his acquisition of a business or part of a business, were deductible for surtax purposes, provided they were incurred for full consideration, and that the recipient was a former member of the partnership, or the former proprietor of the business, or was a widow or dependant of such a person. Various problems arose from these highly restrictive rules.

If annual payments were made to an ex-partner under a partnership agreement, then to obtain relief section 12 required them to be made "by a member of a partnership" to "a member of the partnership."[97] The Institute of Chartered Accountants had taken Counsel's opinion on this requirement and provided a copy to the Inland Revenue.[98] Counsel advised that where partner D joined a partnership of B and C after the retirement of a former partner A, then D was never a member of the partnership of which A was a member. Therefore, any undertaking by D to pay part of A's annuity could not be eligible for relief. The Solicitor of Inland Revenue had already advised the Board in similar terms,[99] and they accepted that this was a shortcoming of section 12.[1]

The basis of the problem was that although commercially many partnerships were treated as a continuing entity even though the partners changed over time, that treatment was not in accordance with partnership law because every time a partner was admitted or retired there was a new partnership. In the example above, the continuing partners B and C could obtain relief for their payments to A under the old partnership agreement, because payments were allowable for surtax purposes if they were made to a retired partner by a continuing partner who was a member of the partnership existing at the time of the retirement of the former partner.[2] A person who became a partner after another partner's retirement, (as D did in the above example), would never have been a member of the same partnership as the retired partner, so his share of the payments to that retired partner would not be eligible for surtax relief.

The Revenue thought it would be possible to get round this difficulty by framing partnership agreements in such a way as to fix the liability to make the payments on those persons who had been in partnership with the retired partner and making appropriate adjustments of the division of profits to take this into account.[3] However, they advised the Chancellor that this would make the drafting of partnership agreements excessively complicated and would not provide a solution where the retired partner outlived all the members of the partnership at the time of his retirement.[4] The Accountants and the Law Society had suggested to the Revenue that the appropriate way to deal with this problem would be to give surtax relief for covenanted payments to a former partner by partners who had joined the partnership after his retirement as well as by those who were members of it at the time of the retirement.[5] The Revenue agreed with their suggestion but decided to investigate the consequences of changes of partnership more thoroughly.

Their investigation showed up two other flaws in section 12(3) of the Finance Act 1965. Firstly, there was an anomaly if a business previously carried on by a partnership ultimately came to be carried on by one surviving partner, because he would then not be a member of a partnership as required by the section and would not obtain relief for his payments to his former partners. Secondly, another anomaly arose where the business of a sole proprietor had been acquired by a partnership in consideration of an annuity and then the partners changed but the annuity continued, because no relief would be available to a person who was not a partner at the time the business was acquired as he would not be making the annual payments "in connection with the acquisition by him of the ... business."[6]

Both of these anomalies and the problem which had been discussed with the professional bodies were put to the Chancellor,[7] and as the Financial Secretary advised him that they were "a logical and reasonable extension of what we conceded last year,"[8] he agreed to the introduction of appropriate legislation.

The drafting of the modifications caused considerable difficulty due to the Revenue's insistence on ensuring that they went no further than was absolutely necessary to remove the three defects identified.[9] However, as the drafting process continued, more and more anomalies were discovered and each was corrected.[10]

The Budget Statement made only the most bare reference to the relaxations which were proposed.[11] Although there were no Government amendments at the committee stage, the Opposition put one down intended to remove the requirement for full consideration if the covenant was merely a renewal of one which qualified for relief but which had expired.[12] The Inland Revenue had been careful that the Budget resolution specifically mentioned that the relaxations were only to apply to payments for full consideration.[13] This ensured that any attempt to extend the relaxations to payments containing an element of bounty would be out of order because it would switch the surtax liability to the recipient.[14] Even though the Opposition amendment was out of order, Mrs Thatcher made a number of points on the Stand Part Debate which explained why it was thought to be necessary.[15]

She gave two examples of situations in which it was thought reasonable to give relief even though the liability was not incurred for full consideration. The first was where a retired partner had a right to an annuity from the partnership which was about to expire but which would be renewed. The second was where a partnership renewed an annuity to the widow of a retired partner under a covenant which had expired.[16] The Government's response was that such cases did not arise from bona fide business arrangements and were purely matters of bounty.[17] Mrs Thatcher was quick to point out that entering into arrangements for bona fide business reasons was quite different from incurring a liability for full consideration. She submitted that there were good business reasons for a partnership, particularly in a small town, to look after former partners and widows of former partners, because of the possible bad reputation which a failure to do so would create.[18] The Board had advised ministers that even though full consideration was difficult to define precisely, it would clearly exclude artificial partnerships used to obtain a surtax deduction for annual payments to, say, members of an individual's family.[19] It was almost certainly concern over such possible abuses which led the Government to resist the withdrawal of the requirement for full consideration.

Another objection raised by Mrs Thatcher was that because a number of annuitants had commuted their right to income from the partnership in return for a capital sum by assigning that right to a financial institution, the partners were prevented from obtaining surtax relief. Because this was something beyond the payer's control, she believed a further relaxation should be introduced.[20] The Chief Secretary to the Treasury promised to look at the point, but without any undertaking to introduce an amendment to meet it.[21]

The Revenue investigated the matter and found that it was the subject of only one representation by the professional bodies to the Chancellor.[22] Furthermore, they were unable to find any case in which such a commutation had actually occurred[23] and reasoned that such commutations would be infrequent because the financial institutions would be unwilling to buy annuities of uncertain duration which depended upon the credit-worthiness of the firm making payment and its continued prosperity.[24] They argued that if there were such cases they deserved no special treatment because they were "an attempt to get the best of both worlds"[25] as surtax relief would be available to the payer while the retired partner would obtain a capital sum not liable to tax.[26] The Revenue thought that if partners wanted to protect themselves from any possible disallowance of their payments for surtax purposes, they would merely have to provide in the covenant that the annuity was not assignable. It was these arguments which appear to have persuaded ministers that no action was necessary, and the matter was dropped.

At the report stage, the Opposition made a further attempt to introduce a relaxation for bounteous covenants renewed after April 6, 1965, but again their amendment was out of order. The only Government amendment involved a technical alteration to correct a minor drafting error which the Revenue had noticed too late for the committee stage.[27] The relevant provisions became section 23(1), (2), (3) and (6) of the Finance Act 1966.

Sub-section 1 effectively involved no change from the 1965 provisions. It provided surtax relief for payments made under a partnership agreement and for full consideration to a former partner, (or if he was dead, to his widow or dependants), by someone who had been in partnership with him.

Sub-section 2 dealt with annual payments made in connection with the acquisition by an individual of a business or a part of a business. Paragraph (a) gave surtax relief for annual payments made by an individual or a member of a partnership in connection with the acquisition of a business. It also included the case where an annuity was payable for a specified share in a partnership. Paragraph (b) enabled incoming partners to claim surtax relief for their share of annuities payable for full consideration to partners who had left the business before they entered it. It also allowed relief for cases where a business originally sold by a sole trader was still being paid for by means of annual payments from the successors of the partnership which bought him out.

Sub-section 3 set a limit to the amount of surtax relief an incoming partner would obtain for his share of the annual payments which the existing partnership was already under a liability to pay. However it did not affect the relief where the new partner simply purchased an outgoing partner's share of the business on an arm's length basis.

Sub-section 6 specified what was meant by a "preceding partnership". This definition was required for the purposes of sub-section (2)(b) because incoming partners were only entitled to surtax relief for annual payments to retired partners of a preceding partnership. In order to qualify as a preceding partnership there had to be a continuity of the business, or part of it, between the current partnership and its predecessor. Also, on each change of partnership there had to be one or more partners who were members of both the old and the new partnership.

MINOR ALTERATIONS BY THE FINANCE ACT 1980 AND LATER FINANCE ACTS

By consolidation in ICTA 1970, the 1965 and 1966 provisions were merged into one section[28] to which two amendments were made by the Finance Act 1980. Firstly, a limited form of relief was inserted for additional annual payments made to a former member, or a widow or dependant or a deceased former member, of a partnership. Relief was made available for those additional payments provided they did not take the total of such annual payments beyond the amount of partnership retirement annuity which could be treated as earned income.[29] Secondly, a new let-out was inserted which effectively introduced relief at higher rates for covenanted payments to charities up to a limit of £3,000 per annum.[30] The limits on relief were increased from £3,000 to £5,000 and then to £10,000, and eventually an unlimited relief was introduced by section 32 (1) of the Finance Act 1986. That Act also introduced new sub-sections 1B and 1C which were consequential upon the provisions designed to prevent abuse of the exemption of the income of charities.

CONCLUSION

Although the application of the settlement legislation to short-term gains was the first time it had been used to any extent outside income tax, all the other changes up to 1964 were relatively unimportant. However, with the election of a Labour Government committed to attacking avoidance, the Revenue would have been foolish not to have grasped the opportunity provided by the changed political climate to put forward radical proposals for extending the scope of the settlement provisions. It is noticeable that the suggestions all favoured the Revenue and that no mention was made to the Chancellor of the draconian provisions concerning loans to settlors and the severe judicial criticism of them.[31]

Even the new Government, pledged to reform, would only take on board part of the Revenue's proposals, and in their hurry, ill thought-out legislation was introduced which had to be re-cast the following year.

It is fair to say that by 1966 the settlement legislation had virtually reached its high-watermark and that bar the provisions introduced in 1977 to deal with reverse annuities, virtually all the changes after 1966 were either incidental to new legislation in other areas or specific relaxations made as a matter of policy.

CHAPTER 11

1966-1988: PARTY POLITICS, CIRCULAR SCHEMES, REVENUE SELF-INTEREST AND STABILITY

INTRODUCTION

Many of the alterations to the settlement provisions in the period from 1966 to 1988 resulted from changes in tax legislation in other areas. Thus, aggregation of a child's income with that of the parent, disallowance of interest paid as a deduction for income tax purposes, and the introduction of capital transfer tax relief for maintenance funds for historic buildings, all led to modifications to the settlement provisions.

However, there were additions and alterations which were a direct result, not of changes in other areas of tax law, but of specific problems perceived by the Inland Revenue. The reverse annuity provisions of the Finance Act 1977 were a response to an expectation by the Revenue that they would lose the case of CIR v Plummer,[1] and the changes to section 451 ICTA 1970 anticipated their loss of an important point in the case of Piratin v CIR [2].

Although the Revenue's fears about the Piratin case turned out to be justified, they only lost four other settlement cases during the period and won eleven. Two of their losses turned on narrow and specific points which were unlikely to recur because they were based upon the particular wording of the trust deeds.[3] Another was Bulmer v CIR[4] which, although it was an important case, involved a wholly commercial transaction with no apparent tax avoidance motive and did not therefore enable the Revenue to argue that corrective legislation was necessary. However, the principle formulated in that case was heavily relied upon in the highly artificial reverse annuity schemes under which annuities were created in consideration of a non-taxable capital sum and of which the Plummer case was an example. The most recent case lost by the Revenue was IRC v Levy[5] in which they unsuccessfully contended that interest free loans to a company in which 99% of the shares were owned by the lender, involved an element of bounty and formed part of a settlement.

AGGREGATION OF CHILDREN'S INVESTMENT INCOME WITH PARENTAL INCOME

The Background to Aggregation and Its General Manner of Operation

The legislation which required the investment income of unmarried infants who were not regularly working to be aggregated with the income of their parents was introduced by section 15 and schedule 8 of the Finance Act 1968, and came into operation on April 6, 1969. Certain modifications were made by the Finance Act 1969, but they and the 1968 provisions were short-lived and were repealed by the Finance Act 1971 with effect from April 6, 1972.[6]

The majority of the Radcliffe Rcyal Commission on Taxation (reporting in 1954) were against aggregation,[7] but a minority recommended that because a family constituted a common spending unit, the child's income should be aggregated.[8] One of the minority was Professor Nicholas Kaldor who, by 1968, had become an economic adviser to the Government and was receiving copies of policy papers concerning taxation.[9]

In February 1965 the Inland Revenue had provided a lengthy paper to the Chancellor explaining their discontent with the tax treatment of non-parental covenants to minors and payments under court order for minor unmarried children of a divorced or separated parent. They had also expressed dissatisfaction that no surtax was chargeable on income accumulated under irrevocable settlements of capital by parents on their minor unmarried children.[10] The aggregation provisions in the Finance Act 1968 neatly dealt with all these grievances except for accumulated income. But the Chancellor promised to take action on that in the Finance Act 1969.[11]

What prompted the decision to bring in aggregation is not evident from Parliamentary Counsel's files. However, the Inland Revenue provided a memorandum to the Chancellor on December 22, 1967 setting out the then current system, the views expressed in the Royal Commission's Report and the detailed provisions necessary to achieve aggregation.[12] There was a two month delay before the Chancellor gave the go-ahead. The legislation was to achieve the following:

a) aggregation of all investment income and capital gains[13] of minor unmarried children who were not in full-time employment with that of the parent or other person having custody of the child; and
b) withdrawal of the £5 exemption for income arising from parent/child settlements.[14]

Because of the need to make enquiries about untaxed income of minor children in order to collect the tax on it through PAYE, the legislation was not to be operative until 1969/70.

The Revenue persuaded the Chancellor that it was essential to deal with accumulation settlements to prevent taxpayers escaping the aggregation provisions by merely creating such settlements on children, but it was decided to defer action for a year. However, the Revenue thought it advisable for the Chancellor to make some statement of intent in his Budget Speech and suggested a suitable form of words[15] which he used verbatim.

> "The picture will not be complete, however, until we have dealt with certain associated questions, such as the use of settlements to accumulate income. I give notice now that in next year's Budget I will attend to these details so that the legislation as a whole can come into effect from 6 April, 1969."[16]

Although a note provided for ministers made it clear that the legislation would deal with all accumulation settlements for children, and not just those made by parents or those created after the 1968 Budget Statement,[17] the provisions eventually introduced did not range so widely. (See later.)

<u>The Application of Aggregation to Settlements</u>

The aggregation provisions were to apply to all the child's unearned income. For settlements, this meant that income received from covenants and income receivable from trusts (no matter who made them) was to be treated as the parents'.[18] Furthermore, income payable to some other person but treated for tax purposes as income of the child, for example, because the child had made a revocable settlement, was also aggregated.[19]

Any aggregated income was to be liable to both income tax and surtax, or to income tax alone, or to surtax alone, according to what the treatment would have been had it not been aggregated.[20] Usually this meant that both income tax and surtax would have been chargeable, but where a child's income under a deed of covenant was already deemed to be the payer's for surtax purposes, it could only be treated as the child's for income tax purposes,[21] and therefore only income tax would be charged on the parent.

Any parent who paid additional tax as a result of aggregation had the right to recover it from the child, but if all or part of that additional tax was attributable to undistributed trust income there was a right of recovery, exercisable against the trustees, out of that income.[22]

Resistance to the Settlement Aspects of Aggregation

The Royal Commission Minority that had recommended aggregation had suggested that a child's investment income up to £25 should be exempted from aggregation, believing that this would save work.[23] The Revenue view on this was that it would create more work by making it necessary to obtain details of the investment income of all children in order to apply the de minimus exemption[24] where a child's investment income did not exceed £25. As they thought a £25 limit would probably encourage grandparents and others to covenant to children up that limit and so impose an additional burden of dealing with repayment claims, they strongly disfavoured the suggestion.[25]

It was decided on practical grounds that there should be no de minimus exemption for aggregation purposes,[26] and it followed that the

£5 de minimus exemption for parent/child settlements would have to be removed. Had this not been done, the settlement provisions would have deemed up to £5 to be the child's, and then the aggregation provisions would have deemed it to be the parent's. This would have made the £5 exemption pointless and the Revenue suggested that as there was "no sound reason for a de minimus exemption [and] practical considerations are against it" the exempt income limit for settlements should be removed.[27]

Once the Bill was published a representative of the National Savings Committee wrote to the Chancellor asking for a £5 de minimus exemption on the grounds that even before aggregation had been proposed, the Committee had received protests concerning the way in which the tax treatment of income accruing on investments in children's names acted as a deterrent to saving by parents and others on their behalf.[28] The Chancellor accepted that without some small exemption the provisions would cause irritation and have adverse repercussions out of proportion to the revenue involved, so that when the point was raised during the committee stage debate, the Chief Secretary to the Treasury promised to look into the matter "with a certain amount of sympathy".[29]

An amendment was introduced to provide an exemption where the child's total investment income, including income from a parental settlement, did not exceed £5. Thus, settlement cases previously excepted under the old £5 exemption limit applying to parental settlements were thereafter caught if the child had other investment income taking the total over £5.

There were two exceptions to aggregation; one provided by the Finance Act 1968, the other by the Finance Act 1969.[30] The 1969 amendment enabled the Opposition to attempt to introduce an amendment of their own to increase the de minimus limit to £50. In the course of debate various hard cases were put forward in support of such a change.[31] However, as the Revenue had advised ministers that such an amendment would merely encourage covenants in favour of children up to the £50 limit and that this would cost in the region of twelve and a half million pounds per annum,[32] the Government decided against it.[33]

Accumulation Trusts

The Chancellor's promise in his Budget Statement of 1968 to deal with accumulation trusts turned out to be a damp squib. It only resulted in the repeal of section 228 I.T.A. 1952, under which claims to repayment of income tax could be made on account of personal reliefs once the beneficiary reached a specified age or married.

The Chancellor would probably have liked to have extended the aggregation provisions to any income accumulated to which the infant was contingently entitled, but was almost certainly advised that this posed great difficulties, not least of which was the problem of cases where the beneficiary turned out not to get a vested right. The only feasible alteration in the law was probably the repeal of section 228. With investment income being aggregated it would have been absurd not to have repealed this section, because the whole basis of it was to go back over the years during which the income arose and allow the child's unused personal reliefs against the income accumulated for his benefit in those years.

The inability to find a logical and justifiable way to tax the income of accumulation settlements left open the tax advantages of the transfer of assets into an irrevocable children's accumulation trust. Although the children would not obtain an income tax repayment on the income arising, the trustees would only pay income tax on it, and the settlor could thereby shelter family wealth from surtax.

The Repeal of Aggregation

During the debates on the 1968 Finance Bill there were assurances from the Conservatives that they would repeal aggregation at the earliest opportunity.[34] The matter was considered important enough to take a place in the 1970 Conservative Manifesto which promised to "repeal the Labour changes which have imposed new penalties on children's income."[35]

In the September following the formation of a Conservative Government in June 1970, the Inland Revenue briefed the Chancellor on the precise extent of the repeal of aggregation.[36] They put on record their view that aggregation had provided a useful restriction on tax avoidance involving minor children, but assumed "that you will regard yourself as committed to the complete repeal of these provisions."[37] The Revenue urged that to avoid the work involved in a post-Budget recoding in 1971, the repeal should be made effective from 1972/73. Another possibility was for an announcement to be made in October 1970 that the legislation would be repealed in the Finance Act of 1971 so that the coding for 1971/72 could be carried out on that assumption. The Chancellor chose the deferral of the repeal.

Although the additional revenue arising from aggregation had been estimated in 1968 at between twenty and twenty-five million pounds per annum, the cost of repeal was estimated at between fifteen million and twenty million pounds per annum.[38] The Revenue warned that this cost might well increase "as greater public attention is focused on the possibility of tax savings by settlements, covenants etc. for the benefit of children."[39]

In 1969, during the debates on the repeal of section 228 I.T.A. 1952, a Conservative spokesman had been strongly critical but the official Opposition amendment seeking its retention had been negatived.[40] The Inland Revenue therefore took an early opportunity to try to persuade the Chancellor that section 228 should not be reintroduced by pointing to its illogicality.[41] Because the Revenue believed that a completely logical approach would require "some pretty complicated legislation and might produce a lot of mainly unproductive work,"[42] the Chancellor was advised that the best practical course was to leave section 228 as inoperative for income arising after 1968/69.[43] This advice appears to have been taken without any resistance.

Another problematical area for the Revenue was the reintroduction of the £5 per annum de minimus exemption into the children's settlement provisions. In the Finance Bill debates in 1968 and 1969, Conservative Members had suggested fairly significant increases in the exemption limit. However, the Revenue advised the Chancellor that they were most reluctant to recommend any increase because of its cost, both in terms of revenue lost and additional work on repayment claims.[44] The available papers indicate no Government dissent from the Revenue's view and the £5 limit was therefore reintroduced in exactly the same form as before its repeal by the Finance Act of 1968.[45]

REDUCTION IN THE AGE OF MAJORITY

As the Government accepted the recommendation of the Latey Committee[46] to reduce the age of majority to 18, section 16 of the Finance Act 1969 was introduced to make the appropriate modifications throughout the tax legislation. However, there was one exception. A conditional reduction in the age limit was to apply to parent/child settlements so that income could still be deemed to be the parent's after the child was 18, if he or she was under 21 and was not working regularly.

Although questions of fiscal policy were outside the Latey Committee's terms of reference, such questions were not beyond their comment, and they had recommended that "infancy should cease for fiscal purposes at 18,"[47] even for parent/child settlements.[48] A Conservative member therefore put down an amendment aimed at ensuring that the parent/child settlement provisions would only apply where the child was under 18 and unmarried. The Chancellor did not accept that such a change would be justified, because a person between the ages of 18 and 21 who was not working regularly would normally be dependent upon their parents, and that fact was recognised by the parent's right to child allowance if the child was undergoing full-time education.[49] The Revenue reminded the Chancellor that the basic objective of the settlement legislation was to stop avoidance, and cautioned him that the cost of the amendment would probably be very substantial because it would be exploited by parents with children over 18 at school or university through covenanted payments and capital settlements in their favour.[50]

In the committee stage debates the singling out of parent/child settlements was described by the Opposition as "the mean and niggling exception to the broad general rule ...",[51] but the Government refused to alter its policy. When the new Conservative Government of 1970 wanted to remove the "niggling exceptions" the Revenue argued on cost grounds that no modification should be made. They were at first unable to quantify the potential loss of tax but warned that it could easily be substantial in view of the number of young people continuing their education after the age of 18.[52]

Neither the Chief Secretary nor the Financial Secretary agreed with the Revenue's view that the childrens' settlement provision should not cease to run automatically when the child reached 18, but initially the Chancellor was undecided.[53] In early March of 1971, after the Revenue had found it necessary to remind him that a decision was necessary,[54] he requested an estimate of its cost.[55] Although the Revenue had to speculate on this, as there was no way of knowing how many parents would take advantage of the proposed change, they thought two factors might restrain the tax loss.[56] Firstly, they assumed that the regulations concerning student grants would be changed so that a student's income from a settlement, would also be treated as his for grant purposes and reduce any advantage from the change in the tax rules. Secondly, they believed that the reduction in the parent's child allowance once the child's income exceeded £115, would tend to limit the number and value of parental transfers.[57] Despite the uncertainty the Revenue gauged that the cost would be in the order of one million pounds a year and that there would be twenty-five extra clerks required to deal with the resultant repayment claims.[58] Within a few days of receiving the Revenue's estimates the Chancellor decided to go ahead and remove the conditions attaching to the age limit of 18.[59]

The only noteworthy point in the drafting process is that it illustrates the need to draft tax legislation with the Scottish legal system in mind. The Revenue had suggested the use of a reference to "an infant" rather than to a child who has not attained the age of 18, but a few weeks later there was a change of mind and the draftsman was advised that it would be better to refer to the age of 18 as otherwise "we would have to translate for Scotland in terms of minority and pupilarity."[60] It is not uncommon for "Scottish amendments" to be inserted as an afterthought.

The provisions formed part of clause 10 of the Finance Act 1971 which also repealed aggregation. At the committee stage, the Liberal Party put down an amendment proposing the complete deletion of the clause.[61] This was an almost complete reversal of its previous attitude, as during the 1968 debates Mr Richard Wainwright had supported amendments designed either to wreck or to draw the teeth of the aggregation provisions.[62] After a long debate by a committee of the whole House the clause was agreed to without any modification.[63]

THE EFFECT OF RESTRICTIONS ON RELIEF FOR INTEREST PAID

When the Finance Act 1969 introduced severe restrictions on relief for interest paid,[64] the Inland Revenue realised that beneficiaries of a trust could nevertheless effectively obtain relief for surtax purposes on interest paid by the trustees.[65] For example, where the gross income of the trust was £1,000, and interest with a gross equivalent of £100 was paid by the trustees, only £900 would be income of the life tenant. Thus, because the administrative expenses of the trustees were a deduction in arriving at the income attributable to the life tenant, the result was the loss of surtax on the gross equivalent of any interest paid by the trustees.[66]

The Revenue thought it would be unacceptably severe to impose a surtax charge on beneficiaries in respect of income paid out as interest, because they had not received it. However, they thought it acceptable that if the income of a settlement was treated as the settlor's then interest paid by the trustees ought to be treated in the same way.[67] It was explained to the Chancellor that without such a rule it would be open to an individual who wished to borrow to acquire investments to set up a trust for this purpose and thereby gain a tax advantage.[68]

There was no need for special provisions for trusts in which income could not be treated as the settlors, and it was unnecessary to deal with settlements caught by those anti-avoidance provisions which treated income arising as the settlors, because non-qualifying interest paid would not be deductible in calculating the income arising.[69] Initially, the Revenue only wanted anti-avoidance provisions for those sections of the settlement code which operated by reference to the undistributed income of the settlement,[70] but later decided they wanted an analogous provision to deal with children's settlements.[71] There is nothing on the files of Parliamentary Counsel to indicate that the Revenue met any opposition in getting what they wanted.

The provisions concerning interest paid by settlements in which undistributed income, or part of it, was treated as the settlor's, were introduced by paragraphs 9 and 10 of schedule 13 to the Finance Act 1969, whose general manner of operation was to increase the amount of income treated as undistributed. This was done by excluding interest payments from the deductions permitted in calculating undistributed income. If income arising in a tax year had been paid out, other than as interest, to a person who had to count that sum as his income, any interest paid by the trustees was apportioned rateably between income paid out and income retained. To ensure that the treatment of interest paid by trustees was no more disadvantageous than for individuals, the provisions did not apply where that interest qualified for tax relief.

If interest was paid by the trustees to the settlor or the wife or husband of the settlor, there would have been a double charge to tax; once on the income actually received, and again on the amount of interest treated as undistributed income. An exception was therefore provided to prevent such a double charge. However, in other cases, the disallowance of interest in calculating the undistributed income was not to affect the tax liability of the person actually receiving that interest.[72]

An interesting insight given by the drafting instructions is the Revenue's request that no mention be made of the application of the provisions to capital sums paid to the settlor,[73] even though they were to apply to such cases. The reason for this was that "neither this Bill nor its predecessor pays any attention to the scathing criticisms of section 408 made by the House of Lords in CIR v Bates."[74] It seems that the Revenue wanted to reduce the risk of parliamentary criticism which might have led to amendment of the rules governing capital payments to the settlor. As it was, there was virtually no parliamentary discussion of the provisions.[75]

The approach in the case of children's settlements was the converse of that explained above, because it was not accumulated income which was attributed to the settlor from such settlements, but income paid out. It was provided therefore, that if all the income arising was paid out, any interest paid by the trustees was to be deemed to have been income paid to or for the benefit of a child of the settlor, and was, as a consequence, treated as the settlor's. However, where only part of the income arising was distributed, only a proportionate part of the interest paid was deemed to have been paid out for the benefit of the child and treated as the settlor's. The necessity for special rules for children's settlements appears to have been realised rather late by the Inland Revenue, as it was April 23, 1969 before they asked the draftsman to put together a clause.[76] The only explanation they gave him for needing the provisions was that "the trustees could distribute the whole income for the benefit of minor children and increase the amounts so distributed by borrowing to buy securities."[77] It is not at all clear what was meant by this, as it would be unusual for the return on an investment to exceed the interest payable on the loan. It is thought that the Revenue were probably worried that a settlor who intended to borrow to make an investment and who would obtain no relief for the interest payable, might persuade the trustees of a children's settlement, of which he was the settlor, to make the borrowings and receive the income from the investment. If the income was to be paid out anyway, and so treated as the settlor's, it would have been reduced by the interest payable, and therefore, effectively, the settlor would obtain surtax relief on the interest paid by the trustees. Under the anti-avoidance provisions, if the total income was paid out to the child, then not only that income, but also the interest paid by the trustees, would be treated as the settlor's. However, the rationale for these provisions is much less clear than that for undistributed income.

The drafting of the legislation followed very closely the provisions applying to undistributed income, and the same let-outs applied for interest which was eligible for tax relief and payments of interest to the settlor or his spouse. Similarly, the provisions were not to affect the liability of the person actually in receipt of the interest. There was little debate on these proposals in Parliament.[78]

With the virtual removal of the restrictions on relief for interest paid in the Finance Act 1972, the corresponding provisions relating to interest paid by trustees became unnecessary and were repealed,[79] but with the reintroduction of those restrictions by the Finance Act 1974, they were reinstated in exactly the same form and without any discussion whatsoever.[80]

MAINTENANCE FUNDS FOR HISTORIC BUILDINGS

Striking A Bargain - The Lib/Lab Pact

The Finance Act 1976, introduced measures which enabled the owner of a historic house to set up a trust fund for its maintenance without creating a capital transfer tax (CTT) charge either when the trust was set up, or subsequently.[81] The result was that the fund was sheltered from the CTT which would have arisen if it had been kept in the family's ownership. A capital gains roll-over relief was also introduced for the disposal of the assets to the maintenance fund.[82] A fundamental aspect of both these reliefs was that the fund should be irrevocably dedicated to the maintenance of the house, but subject to the possibility of an ultimate gift over for national purposes or to a heritage charity. The fund could therefore never revert to the settlor or his family.

The conditions for relief were so stringent that in the first twelve months of their operation, no maintenance funds were set up.[83] In an attempt to make them more attractive, two new clauses were put down for consideration during the passage of the Finance Bill 1977; one by Conservative back-benchers, and the other by the Liberals.

The Conservative's clause[84] was designed to relax the conditions for relief to enable capital to pass back tax free to the settlor, or subject to a CTT charge, to other beneficiaries. This was based upon the general line being adopted by the heritage lobby and the

Conservative's that the maintenance fund exemption would be insufficiently attractive unless capital could eventually pass back to the settlor or his descendents. The Inland Revenue warned the Chief Secretary to the Treasury that if such a concession was granted, maintenance funds could be used "as a money box in which the family's wealth can accumulate for relatively low CTT charges."[85] They also opined that there would be nothing to stop people having no connection with the historic building setting up a maintenance fund "so the potential range of abuse is substantial."[86] They made it perfectly clear that this new clause should be firmly resisted.[87]

The Liberal's clause was designed to limit the tax rate on income of a maintenance fund to the basic rate plus the investment income surcharge, but made no attempt to alter the conditions for qualification as a maintenance fund.[88] Calls for a similar form of relief had been made in the debates on the Finance Bill 1976,[89] but at that time ministers accepted the advice of the Inland Revenue and were unwilling to provide any relaxation of the income tax charge.[90] However, the Lib/Lab Pact had made the political situation in 1977 different, and although the Revenue thought that under normal circumstances it would be undesirable to accept the new clause, except where the owner or occupier of the house was not the settlor, they realised that the then current parliamentary situation made it imprudent to reject it.[91] They therefore suggested that a concession could be granted to the Liberals "as the price of the Liberals voting with the Government in resisting the Capital Transfer Tax new clause and any other proposal for CTT relaxation in this field."[92] They thought that the most sensible course of action would be to raise the matter with Mr Pardoe, the Liberal spokesman, in advance, and attached a draft of a letter[93] which the Chief Secretary[94] issued, without amendment, the following day.[95]

In the meantime, the Liberal Party had been considering an additional new clause, similar in effect to that of the Conservatives, to allow the capital to pass back to the settlor and his family.[96] Because of this Mr Pardoe did not reply for over two weeks and indicated that he would have been prepared to come to some agreement but for the changed situation.[97] He suggested a meeting to help come to a final decision. A meeting was arranged and the Liberals agreed not to pursue their CTT clause or to support the Conservative new clause in return for the Government's promise to concede the income tax point.[98]

The following day the three new clauses were discussed together, and in accordance with their pact the Liberals did not press their CTT clause;[99] a fact that did not go unnoticed and which was scornfully criticised by the Conservatives.[1] As the Government's side of the bargain, the Minister of State expressed sympathy with the income tax proposal and promised to bring forward a new clause at the report stage. The following day the Policy Division of the Inland Revenue wrote to Parliamentary Counsel with instructions to draft an appropriate clause.[2]

Drafting The 1977 Provisions

The Liberal's new clause was aimed at giving the trustees of a maintenance fund the power to elect, within two years of the end of the year of assessment, that the income should only be charged at the basic and additional rates. The Government, though forced to agree to this, was advised that various technical amendments were required.[3]

The drafting instructions were extraordinarily complex and to assist the draftsman with his task the Revenue explained how the existing provisions operated, what had to be achieved and how they thought it could be done.

The income tax treatment of a maintenance fund prior to the passing of the Finance Act 1977 depended upon whether the owner or occupier of the historic building was also the settlor or the settlor's spouse. If so, the whole of the income arising under the trust would, according to the Revenue[4], be treated as the settlor's[5] on the grounds that he had retained an interest, or that there was some discretionary power for his benefit, or that he had not divested himself absolutely of the property, and the trustees would not be liable to additional rate tax[6]. In cases where the owner or occupier was not the settlor, the Revenue's view[7] was that at least some of the payments for the maintenance of the house were likely to be taxable as the income of the owner or occupier on the principles enunciated in the case of Lady Miller v CIR,[8] and that the trustees would be liable to additional rate tax.

The Revenue pointed out that because income arising to trustees of a discretionary trust is their income and the exercise of their discretion creates a new source of income, it would be necessary to deal separately with income arising and with distributions of that income. The objective of the new provisions was to set a ceiling for the income tax liability on the trust income at the sum of the basic and additional rate. To achieve this, the Revenue suggested it was necessary to provide that if an election was made income arising would be treated as that of the trustees and not of any other person, and that distributions of income would not be counted as income of the recipient.[9] Thus, where an election was made for any particular year, neither the income arising nor any income distributed in that year was to be charged on any individual.

The Revenue realised that there would be a difficulty with their proposal in years for which no election was made but distributions were made. Those distributions would have to be linked with the income of particular years and where identification was with income which had been subject to an election, that election would have been pointless if the eventual distribution caused a tax charge on the individual. The Revenue therefore suggested to the draftsman that a distribution in a non-election year should be identified first with the income arising in that year and then with the income of the next preceding year and so on, but only insofar as that income was not already subject to an election or had not already been counted as distributed.[10] The aim of this was to ensure that over the life of the trust the income of election years could never be charged as income of any individual. If, however, the payments exceeded the income available for identification, that excess was to be treated as paid out of capital.[11] The draftsman was also asked to ensure that where income of a settlement was treated as the settlor's it was not taxed again when it was distributed.

Given the complexity of what was required, it is not surprising that the Revenue were not satisfied[12] with the draftsman's first attempt[13] and that considerable correspondence took place between them before an acceptable form of words could be found.[14] In the process, various other difficulties and concerns were discussed.

A difficult drafting problem involved the potential application of section 451 ICTA 1970 to capital payments by the trustees. If undistributed income[15] included income for an election year and was caught by section 451 when trustees made a capital distribution,[16] this would have invalidated the effect of the election. Therefore an appropriate let-out was inserted to exclude the operation of section 451 in such circumstances.

The Revenue's instructions to Parliamentary Counsel,[17] show that they were concerned that the Opposition might succeed in introducing their new clause relaxing the qualifying conditions for CTT maintenance funds.[18] They therefore asked the draftsman to ensure there was no possibility of obtaining income tax relief unless the stringent requirements of the existing conditions were met, as they were "particularly against ... this income tax relief being given as well as CTT relief."[19]

Initially, the Revenue suggested that any repayment supplement arising because of an election should be calculated as if the repayment related to the tax year in which the election was made.[20] However, as the Select Committee on the Ombudsman had been "taking an interest in repayment supplement",[21] the Revenue decided to drop their original proposals for fear that they might cause an embarrassing full-scale debate on the subject.[22]

The 1977 Parliamentary Debates

The long debate on these provisions consisted mainly of political rather than technical points.[23] Matters discussed included the possibility of the State taking over heritage properties, the relationship between such properties and tourism, and the high tax rates which created the need for special rules. One technical point concerned the effect of the rule against perpetuities which specified that a fund could not continue for more than eighty years.[24] This, it was argued, was a deterrent to the creation of a maintenance fund, because once the eighty years had expired it would have to pass to a museum or other body for the public benefit, or to a qualifying charity. The Government accepted that the rule did create a problem and promised to look into it.[25] Parliamentary Counsel thought that it would not be possible to legislate in a Finance Bill to disapply the rule because the connection with taxation was too remote,[26] but as, ultimately, it depended upon a decision of the Speaker acting on the advice of his officials, he offered to consult those officials if the Revenue wished.[27] The Revenue, however, thought it "not worth troubling the Speaker's officials on this at the present stage and we very much doubt whether it ever will be."[28] The matter thus seems to have been quietly dropped.

Further Relaxations In 1980 With Stringent Anti-Avoidance Rules

Despite the objections of the Inland Revenue to the idea of property in a maintenance fund being withdrawn for non-heritage purposes, once a Conservative Government was returned to power the provisions were modified to permit such withdrawals.[29] As a by-product the problem concerning the perpetuity rule was solved.

The Revenue had warned in 1977 that there would be considerable scope for abuse if the settlor or his family were allowed to receive capital from a maintenance fund. Their argument that in effect there would then be little difference between a maintenance fund and a normal discretionary trust with the settlor as a potential beneficiary[30] persuaded ministers that any relaxations should be guarded by stringent anti-avoidance rules to prevent abuse. Because of this the provisions were fairly complex.[31]

The fundamental principle of the relaxation was that as long as there was no withdrawal of property for non-heritage purposes, the fund would continue to benefit from the existing income tax relief.[32] But to prevent avoidance, if such a withdrawal took place there was to be an income tax charge on any income which had not been applied to heritage purposes. The charge therefore arose whenever income or capital was applied during the life of the settlement to a non-heritage purpose, or was passed to any person, other than an approved heritage beneficiary, on the termination of the settlement.[33]

An additional qualifying condition was prescribed for maintenance funds so that during the first six years there could be no application of capital or income for any non-heritage purpose.[34] If trustees infringed that condition there was to be an occasion of charge to income tax.[35]

If an income tax charge arose the trustees were to be charged at 30% on the total income, (after deduction of trustees' expenses), arising from the time the settlement was created, (or from the last occasion of charge), but only to the extent that that income had not been applied to maintenance or other approved heritage purposes.[36] However, any income arising in a year of assessment for which no election had been made under section 38 of the Finance Act 1977 was excluded from the charge.[37]

The notes for ministers indicate that the objective was to make a charge whenever property was withdrawn from a maintenance fund for non-heritage purposes, such that there would be no more and no less income tax payable than there would have been if that property had not been put into the fund in the first place.[38] Therefore the only income which was to be charged was that which had not been applied for maintenance or other heritage purposes at the time of the charge. The Board explained that in a case where the fund was of an appropriate size for the property concerned, its income would normally be applied for heritage purposes more or less fully over the life of the fund.[39]

Furthermore, as the trustees would be able to control the manner and timing of the application of the income, and also the timing of any chargeable event, they would be able to arrange matters so that when a charge arose, all, or nearly all of the income, would have been applied to heritage purposes.[40]

Balancing equity with administrative simplicity to arrive at an appropriate tax rate was a difficult matter, and various options were put to ministers by the Revenue. One approach was to charge tax at rates reflecting the differences between the settlor's personal tax rates and the trust's tax rates over the whole period to which the charge related.[41] A simpler method was to assume that the income which had not been applied for heritage purposes was that for the most recent years and that the tax charge should reflect the difference between personal rates and trust rates of tax for those years.[42] In the end administrative simplicity dominated any questions of equity and it was decided, on the assumption that most individuals who set up maintenance funds would be higher rate taxpayers, that a 30% rate should be applied to reflect the difference between the highest personal tax rate of 75% and the 45% chargeable on the trust.[43] No direct linkage was created between the maintenance fund rate and the personal and trust rates of income tax. Therefore whenever the differential between the top rate and the trust rate of income tax is reduced it would be reasonable to reduce the 30% rate applicable to maintenance funds. Such a reduction has not been made.

A further anti-avoidance aspect of the provisions was designed to prevent the possibility of abuse where a non-heritage beneficiary with a reversionary interest under the settlement sold that interest to a heritage charity. In such a case no tax would have been chargeable when the interest devolved on the heritage charity, so that in effect the non-heritage beneficiary would have obtained value from the maintenance fund without triggering an income tax charge. A similar transaction could have been used to avoid the ban on the extraction of property other than for heritage purposes during the initial six year period. Section 52(5) of the Finance Act 1980 prevented such forms of avoidance by providing that tax would be chargeable if property devolved on a heritage body or charity and that body or charity had acquired an interest under the settlement for money or money's worth other than from another such body or charity.

1982 - Minor Anomalies Are Corrected

Three further changes to the income tax rules affecting maintenance funds were made by the Finance Act 1982. Firstly, section 61 dealt with the possibility of a double charge arising on the same income in cases where the settlor was carrying on the trade of showing the property to the public but had also obtained reimbursement from the fund trustees of expenditure on maintenance of that property. If no election was made under the Finance Act 1977 provisions, the total income of the fund was treated as the settlor's, but as the reimbursement of the maintenance expenses would result in a disallowance of those expenses for the purposes of calculating the trading profit or loss, an effective double charge arose. This had not been foreseen, but once it was discovered it was corrected by ensuring that the reimbursement was excluded from the trading results. The second change enabled part of a settlement to benefit from the income tax provisions where the Treasury only approved part of it for heritage purposes. Each part was to be treated as if it were a separate settlement for the purposes of both Part XVI ICTA 1970 and the income tax provisions applying to maintenance funds.[44] The third modification introduced a new power under which the Treasury could withdraw approval from maintenance funds[45] and cause an income tax charge to arise calculated according to the normal rules applying to such funds.[46]

ANNUAL PAYMENTS FOR NON-TAXABLE CONSIDERATION

The Scheme, Its Discovery By The Revenue, And Proposals To Block It

An area of weakness in the settlement provisions was highlighted in 1966 when the case of Bulmer v CIR[47] showed their non-application to commercial transactions involving no element of bounty. Parliamentary Counsel had warned of this in the discussions relating to the drafting of the 1965 provisions preventing surtax relief for annual payments to individuals,[48] but at that time the Inland Revenue were not unduly concerned.[49] This weakness was, however, to form the basis of a tax avoidance scheme which involved the Revenue in the potential loss of many millions of pounds.

The scheme appears to have started in the early 1970's,[50] but it was not until the end of 1976 that the Revenue began taking steps towards the introduction of preventative legislation. By this time they had lost before the Special Commissioners in Plummer v IRC[51], which involved the scheme, and although they were challenging all 330 cases which had come to their notice they had "little confidence that we shall succeed in all cases."[52] It seems that they expected the decisions in the courts to go against them and thought it necessary to insure against this by obtaining legislation to frustrate the device for the future.

The process leading to the introduction of legislation to annul the scheme began with a paper by the Revenue to the Chief Secretary to the Treasury explaining the details of what was happening and what counter-action was necessary.[53] At that time the Revenue thought the scheme was only being used by individuals but, as they were later to find out, it had been exploited by companies too, and in one case the company expected to avoid a very considerable tax liability.[54]

There were two main variations of the scheme; the type illustrated by Plummer v IRC, and the variant involving an insurance company buying and selling annuities. The Plummer scheme is well known and the details are not discussed here though the illustration provided to the Chief Secretary to the Treasury is given in Appendix J1. The variant scheme involving an insurance company was illustrated by the following example.

> "An individual sells an annuity of (say) £15,000 net for 5 years to an insurance company for £65,000 and at the same time buys from it an annuity for £15,687 gross for 5 years for £66,500. Using bridging finance, each instalment payable by the invidual is met by the sum due to him from the company. As this annuity contains a high capital element, the company deducts only a small amount of tax from the income element, so that the individual receives (say) £15,000 net. The capital element in the life annuity received is exempt from tax, and it is contended that payments to the company are deductible in computing the annuitant's liability to higher rate tax and investment income surcharge. The company too hopes to make a net gain at the expense of the Revenue from its purchase of the annuity, by claiming credit for the income tax deducted from the annuity it receives."[55]

As far as the Revenue were aware, the schemes were operated mainly by minor insurance companies, a small number of charities and certain investment companies.[56]

In December 1977 the estimated loss of tax resulting from the use of these schemes was two million pounds a year, but because of the expectation that this loss would increase sharply if the courts gave a decision adverse to the Revenue, it was recommended that the Finance Bill 1977 should contain provisions to remove the scheme's tax advantages from both the payer and the payee.[57] The Revenue suggested that this could be achieved by denying the payer of the annuity the right to deduct basic rate tax, so ensuring that the payee would not be able to claim repayment or credit, and by not allowing the payer a deduction for the annuity in computing his total income.[58]

A tricky question was whether the legislation should apply only to future arrangements, or should be more severe and apply to all future payments no matter when the arrangement was made. The Revenue warned ministers that the latter alternative could be attacked as being retrospective and to expect any attack to refer to the fact that the 1946 legislation concerning covenants to charities and the 1965 legislation concerning covenants to individuals, only applied to such covenants made after Budget Day.[59] The defence, the Revenue suggested, was that these were not valid precedents because there was nothing artificial about the covenants, the covenantors derived no personal benefit, and they did not enter into them solely to reduce their tax liability.[60] More in point were the precedents of section 38 of the Finance Act 1976, (involving interest payments where the sole or main benefit accruing was the tax relief), and section 81 of the Conservative Government's Finance Act of 1972, (withholding future relief in respect of transactions involving premiums on leases already entered into), both of which applied to future payments irrespective of the date of the agreement under which the obligation arose.[61]

In 1976, the anti-avoidance legislation on interest paid had been prefaced by an advance warning in the form of an arranged parliamentary question, and the legislation had been operative from the date of the answer to that question. This was done because the "legislation was concerned with very large sums and the matter had to be dealt with urgently."[62] The Revenue believed that the tax at stake in the current schemes was much less, and recommended that the provisions should only apply to payments due after Budget Day.[63] Later discoveries of the extent of the avoidance may have led them to regret that recommendation.

Drafting

Two days after receiving the Revenue's briefing the Chief Secretary to the Treasury gave authority for them to go ahead with legislation[64] but it was not until six weeks later[65] that Parliamentary Counsel was instructed. The reason for this delay was that the Revenue found the subject to be "very tricky stuff"[66] and Policy Division had found it necessary to discuss the subject fully with their technical and legal colleagues.

A detailed note explaining the problem was sent to Parliamentary Counsel, but the particular draftsman involved was already well aware of it, as the covering note to the drafting instructions indicates.

> "You may well smile on reading these instructions. I see that you drafted section 12 of the Finance Act 1965 and in the course of the correspondence raised the questions which have now come home to roost."[67]

The Revenue thought that modification of the definition of a settlement so that it would encompass bona fide commercial transactions was not the best means of attack, believing it to be "better to legislate outside the scope of Part XVI and ... kill the particular schemes ....'[68] Any changes to the definition of a settlement could have had totally unpredictable consequences and may have brought wholly commercial transactions, with no taint of tax avoidance, within the scope of Part XVI. The draftsman was therefore instructed to produce highly targeted provisions giving specific exceptions for royalties, payments within section 457(1) (a), (b) or (c) ICTA 1970, and for cases where a limited interest under a trust was given up in return for annual payments by the reversioner. However he was to ensure that the legislation applied to transactions entered into by trustees and by companies who were not engaged in "a genuine business of granting annuities."[69]

The drafting instructions clearly stated that the legislation should apply to payments made after Budget Day, yet the recommendation approved by the Chief Secretary to the Treasury was that it should only apply to payments due after Budget Day. There is no evidence that the Revenue obtained approval for this subtle alteration which clearly was advantageous to them.[70]

The first draft of the clause only caught an annuity if none of the consideration for it was required to be brought into account for income tax or corporation tax purposes.[71] The draftsman had missed the rather fundamental point that it was necessary to include cases where only part of the consideration was not so liable, as otherwise purchased life annuities would escape. The appropriate insertion was therefore made.

The Inland Revenue thought the proposed budget resolution did not make it clear that the provisions were to apply to payments after Budget Day and that consequently tax would no longer be deductible,[72] and were concerned in case a person making such a payment would not know this until the Finance Bill was published. Parliamentary Counsel was not unduly troubled by this point because he expected the Budget Statement to contain a brief description of the proposal; particularly as it was effective from Budget Day.[73] Eventually, the Inland Revenue satisfied themselves that no action was needed because they realised that people making payments affected by the provisions would be entitled to deduct tax, (or required to deduct tax in cases where section 53 ICTA 1970 applied), until Royal Assent, and then the payer and payee would have to make the appropriate adjustments between themselves.[74]

Normally the Inland Revenue respond to Parliamentary Counsel's drafts within a matter of a few days, but in this case it was over five weeks before any reply was made because there were "an exceptionally large number of people here ... interested in this clause."[75] Even after such lengthy consideration their suggestions involved only fairly minor points designed to achieve the objective of treading "a narrow path between on the one hand innocent transactions and on the other leaving gaps in the legislation."[76]

<u>A Private Informant And A Public Exposure</u>

The proposed clause was apparently finalised when the Chairman of the

Board received an anonymous letter enclosing information concerning a further related scheme of avoidance in sufficient detail for the Revenue to ascertain that the proposed legislation did not catch it. (A copy of the letter and the details of the scheme are provided in Appendix J2). The lacuna in the draft clause was that it only applied to payments subject to the deduction of tax under section 52 (1) or section 53 (1)(a) of ICTA 1970 and would not therefore have caught payments under a group income election.[77] The remedy was to modify the proposed legislation so that it applied to any annuity or other annual payment charged with tax under case III of schedule D. By this means, the deduction of tax at source became irrelevant.

The Inland Revenue did not know which companies were involved in this new scheme but on May 22, 1977 the "Business News" section of the "Sunday Times" reported an unusual footnote to the accounts of George Wimpey & Co. It indicated that as a result of transactions which had taken place during the year ending 31st December, 1976, the directors hoped to obtain a reduction in the company's tax liability equivalent to most of the charge for taxation in that year's accounts.[78] By the following week, a "Sunday Times" journalist had obtained the details underlying the mysterious comments in the Wimpey accounts.[79] For a fee of £2.8 million, London Mercantile Corporation, (controlled by the tax avoidance expert Godfrey Bradman), and Rossminster Group Holdings, (which was connected with Roy Tucker and Ronald Plummer), had devised a scheme to enable Wimpey to avoid tax of £18.2 million. The details of the scheme were exactly the same as those provided to the Inland Revenue by the anonymous correspondent some two months earlier.

At the company's annual meeting on June 13, 1977, the chairman explained that the reason for entering into the scheme was to wipe out the exceptional tax liability that the company would have otherwise incurred as a result of a change of its basis of valuing stock and work in progress consequent upon the introduction of SSAP 9.[80]

Because the clause blocking the scheme was to be debated at the committee stage of the Finance Bill shortly after these articles were published, the Revenue armed the Chief Secretary to the Treasury with a detailed analysis of the implications of the Wimpey case which in the event he did not need.[81] Embarrassingly, the payment had been made prior to Budget Day, and the new provisions would not apply, but the Revenue intended to examine the transactions carefully to try to establish grounds under the existing law for challenging the effect of them in the courts.[82]

The Revenue raised the possibility of retrospective legislation to deal with this case with the Chief Secretary to the Treasury, but advised him that this had always been offensive to both Parliament and to the general tenor of responsible opinion.[83] Although there had been purely retrospective legislation in the past, it had mainly concerned declarations of the law, or had merely re-established a practice which had been upset by a decision of the court. They therefore suggested that it would be "quite unprecedented for the Government to come forward this year - out of the blue - with a proposal that the annuity provision ... should have effect in relation to payments made in say 1976",[84] even though there would "be a general sense of outrage at the apparent enormity of what Wimpey's (and no doubt others) have set out to achieve ...."[85] Even though they thought it was "a new dimension to tax avoidance that a major public company should be prepared to embark on such a scheme,"[86] they advised ministers that this could only be used as an aid to rebutting any argument that the provisions ought not to apply to arrangements entered into before Budget Day and not to support full scale retrospection.[87] Instead, they recommended that a minister should make a statement designed to scare off potential customers from those marketing tax avoidance schemes.[88] They suggested that this problem was not a Party matter, because it involved a deliberate side-stepping of what Parliament had intended, and that therefore ministers might be able to say that Parliament would "find itself driven to measures which are themselves unpalatable, including ... retrospective legislation."[89] Although the Chief Secretary agreed with the Revenue,[90] no statement of the type requested was made.[91]

The Committee And Report Stages

On the publication of the Finance Bill, the Solicitor of Inland Revenue for Scotland noticed that the provisions referred to an interest in "settled property"; a term which has no meaning in Scots Law. He therefore brought this to the attention of the Lord Advocate who suggested the insertion of a special Scottish provision referring to property held in trust.[92] It is surprising that such an obvious defect was not noticed earlier, but it seems that the usual process of sending draft clauses to the Board's Scottish solicitor does not seem to have been followed.

Besides the "Scottish amendment", there were seven others put down for discussion at the committee stage. The Revenue advised ministers that only one of them merited a promise of further consideration and that the rest should be rejected.[93]

The meritorious amendment concerned the let-out which had been provided for the holder of a life interest who surrendered that interest to the person next entitled in consideration of an annuity, and was designed to extend the let-out so that it would apply to a surrender to any person having a subsequent interest.[94] The Revenue believed that the proposers of the amendment had in mind the kind of case where property was settled on A for life and then to his wife B for life and then to their son absolutely so that A and B could surrender their life interests in consideration of their son paying them an annuity for their joint lives and for the life of the survivor.[95] If this was all that was involved they thought that the proposal was probably acceptable but "in the murky atmosphere of tax avoidance, [we] come across cases where the arrangements are very artificial, such as an interest in settled property which lasts only for a few days."[96] In fact the Revenue could not think of a single example under which the amendment could be used for avoidance purposes and an appropriate amendment was therefore inserted at the report stage.

The other six amendments were "designed to explore the dark places of the clause."[97] They achieved their purpose by forcing the ministers to confirm that the provisions applied to:

(a) an annuity payable to an individual, even where that annuity was brought into account in computing total income;[98]

(b) an annuity in consideration of the purchase of an asset;[99] and

(c) annual payments to non-residents.[1]

They also confirmed that the legislation did not apply to payments under a court order or to patent royalties.[2]

One of the probing amendments eventually resulted in an additional let-out. The example used in support of the amendment was of a tenant for life who did not have sufficient capital to improve his property.[3] In such a case one way he could raise capital would be to assign his interest in the trust, but an alternative would be to covenant to pay an annuity to an institution in return for a capital sum, with that annuity being charged upon his interest under the trust. The minister promised to consider this type of case,[4] and the Inland Revenue advised him that as the provisions did not apply to the assignment of an interest, there was a case for providing a let-out where an annuity charged on that interest was created.[5] The only reservation the Inland Revenue had was that such a let-out would apply to annuities charged on property in reversion which was not at that time producing an income.[6] However, according to their information there was only one company which had purchased annuities charged on reversionary interests and it had only done so in a few cases.[7] In view of this and the fact that the exception was to be restricted to pre-Budget Day contracts, they were happy to provide a let-out for such cases, as well as those involving annuities charged on interests producing income.[8] An appropriate amendment was drafted and inserted on report.

The provisions have not been altered since their introduction, and as there have been no reported cases this may give some indication of Revenue satisfaction with them.

REVISION OF SECTION 451 ICTA 1970

Section 451 had received criticism by the House of Lords on three occasions in the 30 years before major modifications were made by the Finance Act 1981.

The first criticism was in 1951 in the case of Potts' Executors v IRC,[9] which held that payments were not paid indirectly to the settlor unless they were made into the hands of someone accountable to him. Although this showed up a loophole in the provisions, it did not seem to concern the House of Lords, because the section was so "capable of involving straight-forward transactions to such a considerable extent that a decision which may encourage the substitution of something better need not be a matter for regret."[10]

In the case of IRC v De Vigier,[11] the settlor's wife advanced money to the trustees to enable them to take up a rights issue in respect of shares forming part of the settled property. The House of Lords was unanimous in their decision that the section applied to this loan but commented that "the pit dug by the legislature [is] wide enough to catch the unwary innocent."[12]

The most detailed criticism of the section came in 1966 in IRC v Bates,[13] where the settlor was a director of a company connected with the settlement and his current account with the company was overdrawn for most of the year, but at the end of the company's accounting period it was credited with his salary and dividends to bring it into credit. It was nevertheless held that section 451 applied and that the settlor was chargeable, not only to surtax, but to income tax as well. It was also pointed out that income available could be counted more than once where the capital payment was not fully identified with undistributed income up to the year of payment a consequence described by Russell L.J. as "monstrous" and which was not, according to Lord Reid, applied by the Inland Revenue in that manner.[14] He went on to say that "the draftsman has chosen such a complicated method that he has obviously failed to realise the absurd results to which it leads in all but the simplest cases - and I think in almost every case where the trust income has to be accumulated."[15]

It is perhaps surprising that the Inland Revenue made no effort to obtain legislation to close the loophole shown up by the Potts case, but it may well be that they were satisfied to allow the defect to exist provided they continued to have the advantage of such severe legislation. It seems they were anxious not to modify the legislation, because on the introduction of the provisions restricting relief for interest paid, the draftsman was specifically instructed to avoid any reference to section 451, and by this means it was hoped that attention would not be drawn to the section so that it would not attract the kind of adverse parliamentary comment which might have led to modifications being forced upon the Revenue by ministers.[16]

As might be expected, the Inland Revenue waited until it suited them before suggesting changes to the legislation. In January 1980, the case of Piratin v CIR[17] came before the Special Commissioners. One aspect of the case concerned the application of section 451 to a situation where the settlor had deposited money with a body corporate connected with the settlement which had transferred it, at the request of the settlor, to another company, by drawing a cheque in favour of that company and handing it to the settlor. At the end of February 1980, the Special Commissioners decided the point in favour of the Crown on the grounds that the Potts case could be distinguished, but said they thought the question was "nicely balanced".[18] Within the Revenue this comment probably created a lack of confidence that they would win before the courts and may have been the stimulus to long overdue action.

In September 1980 a consultative paper[19] was issued suggesting various changes aimed at dealing with the judicial criticisms of the section made by the House of Lords and with various other anomalies and difficulties which the Revenue thought worthy of correction. Although it was presented as being largely a series of relaxations, it did propose modifications to close the Potts loophole.

As it turned out, when the judgement of the High Court in the Piratin case was handed down on March 11 1981, the Inland Revenue were unsuccessful on the section 451 point, but the judgement indicated that if the words "for the benefit of" had been included in section 451 (1) then the relevant payments would have been caught. These words were therefore inserted by the Finance Act 1981.[20]

One minor irritation to the Revenue related to the loss in 1948 of the case of Howard de Walden v CIR,[21] in which it had been held that "the flow of apportioned income along any particular channel is to be stopped by the appearance of a foreign corporate body in that channel."[22] Although it was only in rare cases that this prevented the Revenue from counting income as available for payment to the settlor, the opportunity was taken in section 44 of the Finance Act 1981 to remove this problem, by requiring apportionment of income through a company which would have been close had it been resident in the U.K. At the same time, the definition of a body corporate connected with a settlement was extended so that it included any body controlled by a company which was connected with the settlement.[23]

Even after the process of consultation and the subsequent modifications by the Finance Act 1981, section 451 still contained two minor errors which had to be corrected by section 63 of the Finance Act 1982, but at last a more reasonable regime for the taxation of loans to settlors had been introduced.

MINOR MODIFICATIONS AND INTERACTIONS

During the period, a variety of minor modifications have had to be introduced to bring the settlements legislation into line with alterations which were being made elsewhere. The provisions concerning settlements, although apparently forming a self-contained code, do have to be made to dovetail with other parts of the tax legislation.[24]

Another consequence of having a set of anti-avoidance provisions which are not totally isolated from the rest of the legislation is that every time new anti-avoidance legislation is brought in it is necessary to consider the interaction between those new provisions and the settlement provisions. Furthermore, it is sometimes necessary to determine which set of provisions is to have priority.[25]

CONCLUSION

This period is marked by party political differences concerning tax policy which began to show in the settlements legislation. The tightening up process the Labour Government had begun in 1965 was continued, but the controversial aggregation of children's income and the restriction on relief for interest paid was removed by the Conservative Government of 1970-74, leaving only the permanent elimination of section 228 I.T.A. 1952 relief as a Labour legacy.

In 1974, when the new Labour Chancellor re-introduced the interest paid restrictions and decided not to bring back aggregation, it looked like a period of stability had come to the settlement provisions, but for two reasons this was not to be. Firstly, the weakness of the Labour Government which led it into making pacts with the Liberals caused the relief for settlors of heritage property maintenance funds to be rather unwillingly thrust upon them and even more unwillingly upon the Revenue. Secondly, a potentially devastating tax avoidance scheme was discovered which the settlement provisions seemed powerless to stop. It became essential, therefore, to introduce immediate preventative legislation, but it took an anonymous tip-off for the Revenue to realise that their initial proposals were not widely drawn enough, and a tax counsel of the calibre of Peter Rees M.P. to make them realise that their final proposals were unnecessarily severe.

Stability still had not come even after these changes, because self-interest, and apparently little else, motivated the Revenue to obtain major modifications to the provisions dealing with loans to settlors in 1981. Since then the legislation has remained virtually unaltered, though complexity has been compounded by complexity as new anti-avoidance provisions latch on to the settlement provisions and apply them by reference.

CHAPTER 12

SUMMARY AND CONCLUSIONS

OVERVIEW

The following sections of this chapter summarise the study from different perspectives and begin by examining matters specific to settlements and then proceed to wider issues. Conclusions are also drawn from the different perspectives at two different levels; those specific to settlements, and those which are more general in their scope. Before dealing with the more detailed analysis, a very broad review of the main findings is given.

The income tax system contained inherent flaws in having exemption for low incomes, personal reliefs and different treatment for income and capital receipts which although all very necessary, led to their exploitation for tax avoidance purposes through the use of settlements. The attractions of such avoidance were increased by the introduction of graduation and super-tax, and by the large and rapid increase in tax rates which occurred during the First World War. The avoidance spread from the wealthy to the less wealthy over a fairly long period of time and was blocked in a piecemeal fashion by legislation aimed at the specific areas involved (often only when the cost to the Exchequer became too high to let it continue). The first efforts at anti-avoidance legislation were a failure, largely because of the great flexibility of trusts. Eventually effective means of attack were found by the Inland Revenue and were introduced with little parliamentary scrutiny due to lack of understanding of the details and complexities by the ministers and other M.P.'s involved.

AIMS OF THE LEGISLATION AND CAUSES OF THE CHANGES TO IT

There is no single informing theme to the legislation and little of it has been directly influenced by political ideology. The only time any party has had a public stance towards tax avoidance was in 1964, when the Labour Party manifesto stated that they would deal with notorious tax avoidance schemes. But this was mere rhetoric and was not based on clearly thought out detailed proposals. Ministers lack time to go into details and the Party Research Departments cannot help as they are too involved with more politically sensitive areas and do not normally have the expertise anyway.

It has generally been left to the Inland Revenue to develop the appropriate underlying policies of the settlement legislation and this seems to have been done in stages. It started with the principle that a settlor (or spouse) should not be able to benefit from the settled property, and neither should a person legally supportable by him. The next stage was the principle that the Exchequer should not contribute to the cost of employing individuals for whom no other tax allowance was available, (as in the Duke of Westminster case). Eventually the legislation was based upon little of principle but almost entirely upon the cost to the Exchequer if action was not taken, (as for charitable deeds of covenant).

The stimuli leading the Revenue to request changes to the legislation have been varied. In 1922 it was the extensive use of avoidance which a Royal Commission had recommended ought to be stopped. In 1936 and 1946 it was widespread use of particular methods of avoidance, (children's settlements and charitable covenants), which had become too costly. A further stimulus was the Revenue's loss of important tax cases which had shown up weaknesses in the existing system. In the 1920's and early 1930's nothing was done to close up such loopholes; thereafter reaction was extremely fast. Finally, changes of Government have of course been occasions for the Revenue to put forward more radical proposals for tightening up the rules.

Little pressure for change has come directly from the public, though shifts in public attitudes to avoidance, particularly during periods of war, have created a climate in which change became politically acceptable. Although there is evidence of public pressure preventing the introduction of legislation in 1927 to remove tax relief on charitable covenants, by 1946 public opinion seems to have been divided and there was much support for such action. The only clear evidence of public pressure leading to change was in 1977 when the heritage lobby was able to exploit the weakness of the Government to obtain relaxations in the application of the settlement provisions to maintenance funds.

Despite a disastrous start, the legislation has stood up very well in achieving its objectives. Few cases have been lost by the Revenue before the courts and little evidence was found of Revenue dissatisfaction with it. The study shows that the aims of this legislation have been very largely left to the Inland Revenue to work out and that they have usually been successful in obtaining appropriate legislation and changes whenever they have thought it necessary.

REASONS FOR THE COMPLEXITY OF THE LEGISLATION

Undoubtedly the complexity of this anti-avoidance legislation explains why some settlements are still caught and why it received so much adverse parliamentary comment on its introduction. But did these provisions need to be so complex?

Once the 1920 Royal Commission rejected the argument for broad general anti-avoidance legislation in favour of specific highly targeted rules, the approach which the 1922 provisions had to take was set. This approach led to overt complexity and little Revenue discretion rather than the hidden difficulties and wide discretion applying to more general rules.

Experience of the failure of the 1922 provisions led the Revenue to take great care that the 1936 provisions did not suffer the same fate. By then they had discovered just how flexible trusts could be, and how if every bolt hole was not blocked taxpayers would make arrangements to squeeze into them. When in 1936 the battle was won on one front, the taxpayer made an attack on another, and again in 1938 complicated legislation seems to have been the only way to fight back. By the time provisions were included to deal with the foreign element and joint settlors and to rectify the effect of the more important skirmishes which the Revenue had lost, the legislation was already intricate. But when it was altered to fit in with restrictions in other areas of tax law, (for example on relief for interest paid), and to provide concessions for certain deserving cases, (for example partnership annuities and maintenance funds), it became truly labyrinthine. Thus, when legislation is designed to deal with such malleable transactions, close all unintended loopholes and yet provide closely guarded let-outs, it is inevitable that it is complex. However, because the Revenue generally get their own way on anti-avoidance legislation, it can sometimes be excessively widely drawn and of uncertain scope and effect, thus condemning tax advisers to spend long hours grappling with the provisions, often only to discover that they do not apply.

We have come to the present position through what has been called "incrementalism",[1] under which overall policy has been developed by building layer on layer to patch up existing provisions without any fundamental review. As there is overlap between some of the sections making up Part XVI ICTA 1970, perhaps a complete review, say by The Law Commission, would lead to something more logical and comprehensible, but in the writer's opinion given the reasons for its complexity, this is doubtful It is also unlikely that such a proposal would find favour with the Inland Revenue who are probably satisfied with a system which has been tried and tested and which has a considerable body of case law to back it up. The inevitable conclusion is that complexity is necessary and that any hopes for simplification are unrealistic.

DEVELOPMENT OF THE INLAND REVENUE'S ATTITUDE TO AVOIDANCE

From the introduction of income tax to the present day, the Inland Revenue have moved from having a very relaxed attitude to income tax avoidance to their current aggressive stance. This study in no way deals with the whole subject of tax avoidance, but even the limited area of settlements provides considerable explanation for the Revenue's altered frame of mind.

The change seems to have commenced when, following the introduction of super-tax, professional expertise started to become more sophisticated and know-how on tax avoidance began to spread through the medium of the professional journals. As the number of taxpayers increased and the amount of tax they were avoiding rose, the Revenue saw that they had a duty to monitor the problem. Once a specialist office began dealing with the affairs of all the wealthiest taxpayers the basis of an intelligence gathering system was created and the Revenue were able to determine the avoidance methods used by those who had the most to gain and were probably the best advised.

The almost total failure of their first efforts at settlement anti-avoidance provisions within a few years of their introduction led to a realisation of the lengths to which taxpayers would go to avoid tax and encouraged the Revenue to adopt a more jaundiced view of the problem. As the use of children's settlements grew and spread widely through the taxpaying community and further schemes were developed despite the Chancellor's warning of restrospective legislation, the Inland Revenue's attitude hardened. They found that many taxpayers would unashamedly exploit schemes to avoid tax and that if any loophole was left open it would be used. It was vital for legislation to cover every escape route and if any were missed it was essential to act swiftly to close them. Time after time their early experiences were reinforced by further examples of what they considered to be abuse, and these experiences were passed down through each new generation of tax officials, (through the files and by word of mouth), and became reflected in the Revenue's culture. It is probable that the new recruit will quickly learn that wide-ranging anti-avoidance provisions are essential; for to believe otherwise is heresy.

The study shows that given the Revenue's experience of avoidance their attitude is understandable. Although it is an attitude which pervades their thinking and influences the way they interpret information and make decisions, it would be unjustifiable to criticise them for this, for it is no mere paranoia, it reflects the world as it is.

INSIGHTS INTO POLICY-MAKING AND THE LEGISLATIVE PROCESS

Little material is available concerning the process by which the policy and detailed proposals upon which legislation will be based are determined, or on the relationship between ministers, civil servants and outside interests in this pre-drafting stage.[2] In an idealised form the process would involve identifying the problem, determining alternative strategies and predicting their consequences, deciding which to put into effect and reviewing its operation in practice.[3] This study has thrown some light on the nature of this process in practice and the relationships between those involved in it, but its conclusions may not be of general application outside the particular type of legislation examined.

Identifying the problem and taking the initiative for legislation has usually been left to the Inland Revenue without any prompting from ministers. However, the changes in 1946 and 1965 were responses by the administration to newly installed Labour Governments known to be sympathetic to more stringent anti-avoidance provisions, but in neither case did ministers apparently request proposals. Recognition of the need to act therefore seems to lie with the Revenue officials and largely reflects their values and their opinions concerning tax avoidance.

Putting forward alternative strategies and their likely consequences is not something the Revenue often seem to do, though if asked, as in 1936, they can show ministers that alternatives are available. Internal Revenue committees, such as the Board's Tax Avoidance Committee, do consider alternatives and think them through fully.

Proposals put to ministers therefore reflect a considerable internal debate in the Revenue, and as it is unlikely that any outsiders have been consulted, they are probably those which are best for the Inland Revenue. The tendency towards the "well-reasoned one possible solution" approach seems to have become the norm in recent years, but it could be argued that this is because the existing settlement legislation constrains the form of any new legislation so that only one solution is possible unless the earlier legislation is to be revised as well.

The decision to go ahead with legislation clearly lies with the minister, but there is little evidence of questioning the advice given unless political dangers can be foreseen in what is being proposed.

Given how busy ministers are[4], it is not surprising that they are only presented with one proposal and that they rarely quibble over details.[5] The Revenue's briefings are generally (and probably of necessity) fairly long, detailed and well argued,[6] thus making it difficult for anyone but a tax expert to dispute.

> "If a minister accepts his officials' advice and he is challenged, he at least knows he can go back and get all the supporting evidence he wants. But if he strikes out in a direction of his own choosing, he can all too easily find himself alone and lost."[7]

Despite the general position, there have been instances where the Revenue's advice has been wholly or partly rejected by ministers; most notably in 1936 when the Chancellor decided to increase child allowance to take the sting out of the Revenue's proposals and refused to deal with accumulated income in irrevocable capital settlements on children. The latter problem was intractable, and although it was raised by them again in 1938 and 1965, on both occasions nothing was done.

When an attempt is made to reject or modify the Revenue's proposals, they normally do not give up easily unless there would be practical difficulties with implementation. A particularly interesting phenomenon is the weakness of a new minister and the opportunity this gives the Revenue to put forward arguments they would not have used with his more experienced predecessor, and more importantly, to re-open matters which have already been decided upon.[8] The most blatant example of this occurred in 1958 when, following the resignation of the Chancellor and the Financial Secretary, the Revenue resurrected the minister's decision that their proposals should not apply to existing settlements but only to settlements made after publication of the Finance Bill. The original decision was reversed by the new Chancellor.

Once agreement has been given for legislation to be drafted it is rare for ministers to take any interest in the detailed rules, and it is this that gives the Revenue considerable influence. In exceptional cases, for example where there is a risk of political embarrassment, such as a provision with retrospective effect being passed off as a declaratory provision (as in 1943), ministers retain an interest in the detail. Where no such interest is retained, it could be argued that ministers examine the details later, particularly when they are taking the resulting clauses of the Bill through the committee stage, but by this time the die is cast and changes are embarrassing.

Public pressure only occasionally seems to have had any direct impact on the settlement legislation, as for example when the Chancellor began receiving letters complaining of the tax relief for charitable covenants. However, the Revenue's proposals to some extent are probably somewhat restrained by their perception of public attitudes. Because many representations are channelled through the Inland Revenue, they have the opportunity to comment on them and play down any unacceptable points before ministers get any ideas.

Once the legislation is in place there is little evidence that ministers are informed of or take an interest in its successes or failures, or in any difficulties it creates for taxpayers and their advisers. However, this review process is carried out by the Inland Revenue, and they have, since 1938, been quick to bring deficiencies to the attention of the Chancellor for immediate corrective action.

It can be concluded that the Inland Revenue normally identify where problems lie and determine the policy, the principles and the details for dealing with them, and it is very difficult for ministers to take an active part in the process. The Inland Revenue therefore usually get the legislation they want.

There is in all this an implied criticism of the existing system of creating legislation on complex anti-avoidance matters, and this requires some suggestions for its improvement. Many suggestions concerning the improvement of the overall process have however already been thoroughly explored by others elsewhere,[9] and those general suggestions are equally relevant to complex anti-avoidance provisions.

TACTICS AND STRATEGY

It is not enough for the Revenue and the Government to have proposals; there must be planning to ensure they reach the statute book. There are two aspects to this. Firstly, the Revenue have developed methods which help to make certain that their proposals are accepted. The way in which they can exploit the inexperience of a new minister has already been described, but other methods have also been demonstrated in earlier chapters. In 1922 and 1936 they were not averse to using spurious arguments to back up their suggestions. Later, they wisely began to keep detailed statistics supporting their claims that the this class of avoidance had become so serious that action was essential. They have, however, never shied away from providing estimates which can have been no more than inspired (and possibly exaggerated) guesses when new forms of avoidance had been discovered and statistical information was lacking. The care with which any reference to section 451 ICTA was side-stepped, because it might have drawn attention to judicial criticism of its drafting, is worthy of note. In the main however, the Revenue have been able to rely on their expertise and information, and the ministers' lack of it, to obtain acceptance of their proposals.

The second aspect is that Governments prefer to deploy tactics to ensure a quick and smooth parliamentary passage for their proposals, and require a strategy for presenting them in the best light, with any warts well camouflaged. The Inland Revenue assist in this task by making appropriate suggestions and pointing out likely areas of difficulty. The presentation of the declaratory provisions concerning joint settlors in 1943, and the retrospective removal in 1958 of the fault in the 1952 consolidation, are two illustrations of how true intentions and full implications can be covered up.

Perhaps the most insidious strategy is that referred to in the seemingly innocuous words of Lord Morrison of Lambeth who, in describing the legislative process, stated that "sometimes ministers may prefer to save up concessions until Parliament is dealing with the matter".[10] The settlement legislation illustrates that in practice this means that although the Revenue and ministers may have already agreed some minor let-out, the Bill as presented to Parliament excludes it. The Government can then give in to pressure from their own back-bench, or even from the Opposition when it is argued that some relaxation is essential. The sham of negotiation and "seeing reason" probably creates an atmosphere in which other, perhaps more contentious matters, obtain an easier passage. This strategy was used for the £5 exemption limit for children's settlements in 1936. However, it backfired because nobody raised the point in debate, and a Government amendment had to be introduced following late representations by the National Savings Committee. These plannned "concessions" create an illusion of power for those who have gained them and only go undetected because of the extreme secrecy surrounding the advice given to ministers.

It can be seen that not only have the Revenue covertly steered ministers towards the provisions the Revenue desired, but also they assisted them in manipulating the parliamentary process to their mutual advantage.

THE ROLE OF PARLIAMENT

Parliament's power in matters of complex anti-avoidance provisions is extremely limited; it rarely produces significant changes. Richard Crossman[11] expressed the view in his diaries that there is no effective parliamentary control of ministers, and stated that he (and others) never bothered to understand the actual clauses because "both sides worked off written briefs to an astonishing extent". [12] By comparing those briefs with the debates one can see that this assertion is generally true, at least for the settlement provisions.

Furthermore, he argued that the Opposition was usually so badly briefed that it could not sustain any real criticism.[13] Again the history of the settlement legislation supports this view. Real mastery of the subject of debate lies with Inland Revenue officials, shielded by the minister from direct parliamentary scrutiny, yet holding a powerful grip on proceedings through the secret advice they give him.

The detailed examination of the parliamentary process leading to the settlement legislation confirms Griffiths' findings that it is rare for Government back-bench amendments to be accepted and even more unlikely for Opposition amendments to succeed.[14] Some amendments are merely attempts to discover the intentions of the legislation or the meaning of some particular part of it or to obtain assurances concerning its mode of operation, and therefore the raw figures of those which fail can be misleading. One must weigh the impact of Parliament by the importance as well as the number of amendments which have been accepted. Not only have the numbers been insignificant but they have all concerned relatively minor matters rather than important points of principle. This should not be interpreted as meaning that Parliament has had no influence on this anti-avoidance legislation; it has had influence , but it has been minimal. Sometimes, ministers, though rejecting on Revenue advice the actual wording of an amendment, have promised to consider the principles on which it was based and have inserted their own amendments at the report stage to meet the point. Nevertheless, most Government amendments appear to have little relationship to parliamentary criticism but more to fine tuning of the provisions following further consideration by the Revenue or the draftsman.

If the effectiveness of the parliamentary process is measured by the number and importance of the changes it causes, then as far as the settlement legislation is concerned, its achievements are probably far outweighed by the time and effort involved. Hostile parliamentary scrutiny of the settlement proposals was far more the case in 1922, 1936 and 1938 than thereafter, and the impression is that it dwindled through lack of debating time and the increased length and complexity of Finance Bills. Perhaps Parliament's greatest success was in 1927 when the proposal to remove all tax relief on charitable covenants was dropped, but even this was only achieved with considerable behind the scenes lobbying.

Parliament does however have an indirect influence. The proposals put before it have already been tempered to take into account expected parliamentary criticisms and in some cases, (notably in 1936), the policy of the legislation is not finalised until the reaction to a deliberately widely-drawn and vague Budget statement and resolution has been received. Given the practical difficulties of having consultations with interested parties concerning proposed anti-avoidance measures, it is perhaps not surprising that this "testing the water" approach has sometimes been used.

The lack of information available to M.P.'s concerning the detailed background to the anti-avoidance provisions contributes to the limitation of Parliament's influence. Ministers are provided with a comprehensive, persuasive, but perhaps rather one-sided argument, and their own lack of time and expertise makes it very difficult for them to understand the details, let alone dispute the Revenue's proposals. Non-Government amendments are treated to the same thorough and damaging Revenue treatment so that almost all pass to the minister fated to fail by the advice "resist", and supported by the detailed arguments to do so. Modifications are perhaps therefore most likely to be obtained through direct approaches to ministers. Individuals and pressure groups who have been able to do this have been very successful in bringing about changes. Those who wish to influence legislation must counter the Revenue's powerful position by ensuring that their arguments are fully thought through, capable of implementation and contain appropriate responses to any Revenue objections. Given the relatively short time in which to do this, it is not surprising that the Revenue have the upper hand.

THE POWER OF THE INLAND REVENUE OVER THE LEGISLATIVE PROCESS

Although some aspects of the Inland Revenue's influence are mentioned in other parts of the conclusion, it is desirable to bring the whole subject together in one place. It is stressed that explanation of the Revenue's power is only an incidental by-product of this study.

Power has been defined by Weber as "the possibility of imposing one's will upon the behaviour of other persons".[15] The Revenue's power arises from their ability to persuade a minister to believe what they tell him, to accept their authority on the subject and to have confidence and trust in them. Their power is hidden rather than overt, but sometimes shows itself in the way ministerial approval is treated as a mere formality.

There have been a variety of factors conducive to the Revenue obtaining the settlement legislation they wanted. Perhaps the most important of these was the growth of specialist knowledge and expertise in the Department. Advice was given with the authority of the accumulated experience not just of present staff, but of the Revenue itself, as reflected in its files. The continuity through records of past successes, difficulties and failures, when combined with the inclination to look for precedents, ensured that departmental attitudes were passed on from one generation of officials to the next, and continued to evolve through experience. Much of the Revenue's power therefore comes from the information available to them. The lack of access to such information by anyone else enables the Revenue to put whatever gloss on the facts is necessary to help achieve their purposes, and even if there is no deliberate distortion there will be a hidden bias. Perhaps the position is best summed up by the statement "ministers may have the will, but the mandarins have the files".[16] Two further circumstances which contribute to the Revenue's power are ministerial dependency and reliance on them, and the advantage of direct access to ministers; an advantage not easily available to counterveiling forces.

The above factors largely concern attributes of the Revenue but there are others relating to attributes of ministers which also work in the Revenue's favour. The lack of training in the subject and poor understanding of its details, when combined with the relatively short time normally spent in any particular post, makes it difficult for a minister to question official advice effectively . It is not even possible for him to have access to papers from the prior administration to help him gain a better understanding of previous thinking on a subject, and access to departmental files is also denied.[17] When his other duties are combined with the wide range of issues he has to get to grips with in any Finance Bill and the limited time in which this has to be done, it is not surprising that the Revenue have very considerable power on matters so complex and politically non-controversial as most of the settlement anti-avoidance legislation has been. Perhaps it is true that "the biggest pressure group comprises those administering a department".[18]

The potential for the Inland Revenue to develop power is a natural consequence of the detailed process of government and it has increased as anti-avoidance legislation has become more complex and Finance Bills more lengthy. It is assisted by limited direct access of outsiders to ministers and by the way the Revenue neutralise as far as possible any unacceptable views which do get through. The ability to have the last word is a useful weapon and it is always used.

The main limitation on the Revenue's power is that the political climate restricts major policy changes. For example, it was not until Labour Governments were elected in 1945 and 1964 that the Revenue put forward radical proposals for further restrictions on the use of settlements for tax avoidance. There is therefore some relationship between public attitudes to avoidance, the power of the Inland Revenue and the anti-avoidance legislation imposed, but it is only slight.

Given this state of affairs, how can "outsiders", like professional bodies, exert an effective influence? Although they can submit persuasive representations concerning non-political matters such as practical problems arising from implementation, apparent omissions, vague terms, drafting errors and syntactic ambiguity, such representations cannot receive the fullest enquiry and discussion because of the limited time available between publication of the Bill and completion of its parliamentary processing. This study shows that at the time of the Budget statement a draft of the relevant clauses has almost always been prepared. Therefore, further time could be made available for discussion by releasing copies of the draft clauses to the professional bodies directly concerned with taxation before publication of the Bill. Another weakness of the present arrangements is that the different professional accountancy bodies and the representative bodies of lawyers and tax specialists generally make their submissions to the Chancellor separately. Far more weight would be attached to a joint representation from all such bodies and this would require a cross-professional technical committee properly funded and supported to act as a "heavyweight" to help counterbalance the Revenue's powerful position.

USEFULNESS OF THIS RESEARCH

An attempt is made here to show who could benefit from this research, and what disciplines, organisations and groups may find some value in what has been done.

Perhaps the research will be of most value to pressure groups and particularly to the professional bodies representing tax specialists. The latter make representations to the Chancellor at various stages in the legislative process, including pre-budget representations and post Finance Bill comments, as well as putting suggestions forward regarding the correction of anomalies discovered by their members. A better understanding of the legislative process and the influence and attitudes of the Inland Revenue may help in formulating more effective representations. To a considerable extent it is the Inland Revenue and not ministers that must be persuaded of the need for change and it is essential therefore to examine suggestions from their point of view with proper regard for difficulties of implementation and the possibility of creating opportunities for avoidance or further anomalies. Possible objections must be thought through and answered so that the Revenue cannot easily dismiss proposals as impracticable. The insight given into the past behaviour and thinking of the Inland Revenue may help in predicting how it will react in the future.

Parts of the study will interest political scientists and political economists as they illustrate the policy-making process, the influences upon it and the weakness of Parliament, and they also provide evidence strongly supportive of the Whitehall model of the constitution. Certain aspects of the research are relevant to those interested in public administration, the power of organisations in general and the civil service in particular. The historian's focus will not only be on the above matters but also on the materials available for this type of research, the explanation for the development of the settlement legislation, and the parts played by the various parties to obtain it.

For those studying the detail of the settlement legislation it may aid understanding if its purpose is known, even though that purpose may not be used as an aid to interpretation by the courts.

SUGGESTIONS FOR FURTHER RESEARCH

Though it has answered some questions, the findings of this study have been limited by the restriction of the subject matter to settlements. It would be useful to have a complete picture of the background to all the major anti-avoidance legislation, and particularly to the close company provisions because they were originally introduced at the same time as the settlement legislation, usually altered at the same time, and served a parallel purpose in preventing avoidance through close companies.

This study only examines the culture, ideology and power of the Inland Revenue from the limited perspective of the settlement legislation, and does so as a secondary matter. A specific and wider study would lead to a better understanding of the Revenue's attitudes and behaviour.

BIBLIOGRAPHY

UNPUBLISHED SOURCES

Only the main class references are given here. Detailed references to the sources used within each class are found in the text and footnotes.

PUBLIC RECORDS OFFICE FILES

INLAND REVENUE (CLASS IR)

	Class Reference
Tax Abstracts And Statistics 1845/1912	IR 16
Minutes 1799/1951	IR 31
Stamps & Taxes Division Registered Files 1808-1979	IR 40
Budget & Finance Bill Papers 1869-1950	IR 63
Statistics & Intelligence Division Correspondence & Papers	IR 64
Private Office Papers	IR 73
Private Office Papers	IR 74
Private Office Papers	IR 75
Establishment Division Registered Files 1894-1950	IR 81
Miscellaneous	IR 83
Royal Commission 1919-20	IR 85
Office Of Special Commissioners	IR 86
Solicitor's Opinions & Reports	IR 99
Special Commissioner's Instructions	IR 112
Director of Statistics Budget Papers 1919-34	IR 113

Note: Each class usually contains hundreds (or in some cases thousands) of files.

TREASURY (CLASS T)

Chancellor Of The Exchequer's Office, Budget & Finance Bill Papers 1859-1951	T171
Hopkins Papers 1914-1942	T175

REGISTRY OF FRIENDLY SOCIETIES (CLASS N.S.C.)

National Savings Committee. NSC 18
Intelligence Matters And Liaison
On Savings Matters

FILES OF THE OFFICE OF THE PARLIAMENTARY COUNSEL

The files for each Finance Bill involving the introduction of or amendment to the settlement legislation was examined.

NATIONAL LIBRARY OF SCOTLAND

Evidence Submitted To The Radcliffe Commission on Taxation (Ref. CRG 19)

NEWSPAPERS, JOURNALS ETC.

The Accountant
The Accountant Tax Supplement
The Evening Standard
The Financial News
Hansard (Budget Debates And Questions on Tax Avoidance)
The Law Journal
Taxation
Taxation Practitioner
The Times

PARLIAMENTARY PAPERS

In Order Of Issue:

The Hume Committee's Report, 1852 (354) ix.

The Minutes of Evidence Of The Hume Committee, 1852 (510)

The Hubbard Committee's Report, 1861 (503) vii

The Ritchie Committee's Report (1905) Cd. 2575

The Minutes of Evidence Of The Ritchie Committee Cd. 2576

The Dilke Committee's Report (1906) (365) (ix) 659

The Colwyn Committee's Report (1920) Cmd. 615

The Minutes of Evidence Of The Colwyn Committee Cmd. 288

Report Of The Committee On National Debt And Taxation Cmd. 2800

The Income Tax Codification Committee Cmd. 5131

The Radcliffe Committee Reports Cmd. 9105 and 9474

The Latey Committee Report Cmnd. 3342

ARTICLES

BURGESS, R. "The Settlor And Section 447", British Tax Review 1971, No. 5, p.278.

FERRIER, I. "Sir Robert Horne And The Pharaohs of Somerset House", British Tax Review, 1982, No. 6, p.375.

HOWE, Sir Geoffrey, "The Reform Of Tax Machinery", British Tax Review, 1977, No. 2.

SULLIVAN, L. "£18.2 Million Of Wimpey Tax", The Sunday Times, May 29, 1977.

SABINE, B.E.V. "The Six Budgets Of Neville Chamberlain 1932-1937", British Tax Review, 1981, No. 4, p.223.

SPICER, E.E. "Some Remarks On Income Tax And Super-Tax And Its Legal Evasion", The Accountant, January 21, 1911.

STOPFORTH, D. "Charitable Covenants By Individuals - The History Of The Background To Their Tax Treatment And Their Costs To The Exchequer", British Tax Review, 1986, p.101.

STOPFORTH, D. "Sowing Some Of The Seeds Of The Present Anti-Evasion System - The 1920's", British Tax Review, 1985, p.28.

TILEY, J. "General Anti-Avoidance Provisions", Fiscal Studies, Vol. 4, No. 1, March 1983, p.24.

TILEY, J. "Judicial Anti-Avoidance Doctrines", British Tax Review, 1987, p.180, p.220, p.433 and 1988, p.63 and p.108.

BOOKS

BARNETT, J. Inside The Treasury, (London : Andre Deutch, 1982)

BENNION, F. Statute Law, 2nd ed. (London : Oyez Longman Publishing Ltd., 1973)

BIRCH, A.H. The British System of Government, (London : George Allen & Unwin, 1980)

ENGLEFELD, D. Whitehall and Westminster, (Harlow : Longman, 1985)

GALBRAITH, J.K. The Anatomy of Power, (London : Corgi, 1985)

GRIFFITH, J.A.G. Parliamentary Scrutiny of Government Bills, (London : George Allen & Unwin, 1974)

JOHNSTONE, D. A Tax Shall Be Charged, (London : HMSO, 1975)

KELLNER, P. and Lord CROWTHER-HUNT, The Civil Servants, (London : Macdonald, 1980)

MALLET and GEORGE, British Budgets, 2nd series 1913-1921 (Glasgow : The University Press, 1929)

NORTON, P. The Commons In Perspective, (Oxford : Martin Robertson, 1981)

PETERS, B.G. The Politics Of Bureacracy, (London : Longman, 1978)

POTTER, D.C., MONROE, H.H. Tax Planning With Precedents, (London : Sweet & Maxwell, 3rd ed. 1959)

ROBINSON, A., SANDFORD, C. Tax Policy-Making In The United Kingdom, (London : Heinemann, 1983)

SABINE, B.E.V. A History Of Income Tax, (London : George Allen & Unwin, 1966)

SMITH, B. Policy Making In British Government, (London : Martin Robertson & Co., Ltd. 1976)

STAMP, Sir J. The Princples of Taxation, (London : Macmillan & Co. 1921)

STANLEY, O. Taxology, (London : Weidenfeld & Nicholson, 1972)

VENABLES, R. Tax Planning Through Trusts, (London : Butterworths, 1983)

ZANDER, M. The Law Making Process, (London : Weidenfeld & Nicholson, 1980)

A HISTORY OF THE ANTI-AVOIDANCE LEGISLATION APPLYING TO SETTLEMENTS FOR INCOME TAX PURPOSES

VOLUME 2

A thesis submitted for the degree of

Doctor of Philosophy

in the University of Glasgow

by

David Paul Stopforth FCCA FTII

Department of Taxation
Faculty of Law and Financial Studies

September 1988

TABLE OF CONTENTS

VOLUME II

CHAPTER 1 - FOOTNOTES

1. Letter to the writer from Inland Revenue Claims Branch dated July 28, 1988. These figures do not include investigations into tax evasion, where for instance payments are not made or are only partially made, but apparently do include failures to seal the covenant and other technical failures to comply with the general law.

2. Ibid.

3. Francis Bennion, Statute Law, 2nd ed. (London : Oyez Longman Publishing Ltd., 1973), p.101.

4. The law specifies that subject to certain minor exceptions, any file in the Public Record Office is not available until the 1st of January following the end of 30 years after the date of the last document on that file. The department involved has the power to extend the 30 year period and this power has been used by the Inland Revenue to a considerable extent so that many of their records have 50 year, 75 year and even 100 year closures. The Departmental Records Officer has authority, under Section 5(4) of the Public Records Act, to allow access to files within the closure period. The writer therefore made a written request for access to relevant files or parts of files for the purposes of this thesis, with a promise to give a written undertaking not to disclose any information of a personal nature which might be so obtained and sent a copy of the letter to the Public Records Office. Although, in response to a direct request from the Public Records Office, the Inland Revenue did review the closure of one class of files which had had a blanket closure of 75 years applied (Class I.R. 40) and opened up a considerable number of them (approximately 1,200 out of about 3,000) access to other classes of files, some of which were likely to contain extremely relevant material, was refused.

5. Such as BEV Sabine, A History of Income Tax; Mallet and George, British Budgets.

6. Such as BEV Sabine, Lloyd George's Budget of 1909, British Tax Review 1975, No 2, p114; BEV Sabine, The Six Budgets of Neville Chamberlain 1932-1937, British Tax Review 1981 No4, p223; Ian Ferrier, Sir Robert Horne And The Pharaohs Of Somerset House, British Tax Review 1982, No 6, p375.

7. Oliver Stanley, Taxology, (London, Weidenfeld and Nicolson, 1972)

8. Ibid, Chapter 5, "Spread It Round The Family".

9. See for example John Tiley, General Anti-Avoidance Provisions, Fiscal Studies, Vol 4, No.1, March 1983, p24.

10. See for example John Tiley, Judicial Anti-Avoidance Doctrines, British Tax Review 1987 p180, 220, 433, 1988 p63, 108.

11. See for example M K Robson, An Analysis of The Structure of The Income Taxation Of Trusts, Thesis for LLM, Faculty of Law, Glasgow University, October 1988. R Venables, Tax Planning Through Trusts, London, Butterworths 1983. R Burgess, The Settlor And Section 447, British Tax Review 1971, No5, p278. Potter and Monroe, Tax Planning with Precedents, London, Sweet & Maxwell 1987.

12. Brittan, S. Steering The Economy, Harmondsworth, Penguin 1971; Johnstone, D, A Tax Shall Be Charged, London H.M.S.O. 1975; Robinson A. and Sandford C., Tax Policy-Making In The United Kingdom, London, Heineman 1983.

13. Tax Policy-Making In The United Kingdom, Introduction p.vii.

14. Ibid. p106.

15. (1943) 25 TC 93.

16. (1957) 37 TC 416.

17. 1964 Labour Party Manifesto.

18. Potts' Executors v IRC, (1951) 32TC 211; IRC v De Vigier, (1964) 42 TC 24; IRC v Bates, (1966) 44TC 225.

CHAPTER 2 - FOOTNOTES

1. Avoidance of the Assessed Taxes had been common - B.E.V. Sabine, A History of Taxation, p27 - and there is a strong likelihood that the propensity for avoidance was carried over to the income tax.

2. Ibid. p38.

3. Guide to the Property Tax Act, 1806, referred to in Simon's Income Tax Vol I 1964-65 p74.

4. There is however no direct evidence of such avoidance.

5. One of the more important changes was the extension of the exemption of charities from tax under Schedule A to include exemption of income within Schedule D. For other changes see B.E.V. Sabine, Great Budgets III, British Tax Review 1971 No. 1 p50.

6. All references to pence are to the currency prior to decimalisation.

7. The Hume Committee. 1852 (354)ix.

8. When examining documents prior to the 1930's it is essential to realise that the relatively clear distinction now made between evasion and avoidance was not then made and it was common for officials to refer to evasion when clearly they meant, what we would now call, avoidance. It is interesting to note that the officials giving evidence to the Select Committee in 1851 did use the term avoidance and used it in the sense which is now current. Subsequent documents show a blurring of the distinction and one wonders whether this may have been deliberate policy on the part of officials in order to make avoidance appear to be less acceptable by tainting it with the illegality of evasion.

9. The income of the wife was deemed to be that of the husband.

10. Minutes of Evidence, answer to question 1455.

11. Ibid. Question 1456.

12. Ibid. Mr E. Hyde, Mr F. Tarleton, Mr C. Levien, questions 1457-1459.

13. Ibid. Question 1467.

14. Question 1468, Mr. Ricardo to Mr. Hyde.

15. Ibid.

16. 1852 (510).

17. Ibid. Mr. Trevor Question 4825.

18. Appendix 10 to the Minutes of Evidence of the 1852 Committee.

19. Changes in the amount of tax actually charged is a poor indicator of the extent of avoidance, but the tax charged for 1854/55 is almost exactly half that charged on the doubling of the tax rate in the following tax year. Similarly, the increase in tax charged in 1855/56 compared with that of the previous year is almost exactly directly proportional to the increase in the tax rate between those two years. This proves very little but it does give some evidence that tax avoidance was not taking place on a massively increased scale due to the increases in the tax rates.

20. The Hubbard Committee, 1861 (503)vii.

21. See for example the evidence of Charles Pressly at questions 24-35. No comments were made about avoidance. It is fairly clear that those giving evidence were referring to evasion in the strict sense, and there were no references to avoidance or anything which would now be called avoidance but which at that time may have been loosely classified under the heading of evasion.

22. The Report of the Committee only runs to just over one page.

23. Buxton, Vol. II p.48.

24. For example see the Board's Report 1860 page 21 and 25, and 1862 page 29, and 1867 page 24, and 1868 page 23.

25. Sabine, A History of Income Tax, Page 112.

26. There is little mention of avoidance in general in the reports of the Board of Inland Revenue and no reference at all to avoidance using settlements.

27. PRO File T171/265.

28. PRO File IR 83/61.

29. Papers 16399/96T.

30. The precedent book covering the period 1906-1920 - PRO file IR83/62 - is closed until 1996 and no other direct evidence could be traced at the Public Record Office to give an indication of the kind of problem cases which may have come to light in that period.

31. PRO File IR74/253.

32. PRO File IR99/124-126.

33. "The Accountant" for instance only began in 1884 and in its earlier years there are few detailed articles on taxation and virtually no discussion whatever of tax avoidance. The leading article in "The Accountant" of August 13, 1892, refers to the lack of attention to the subject of taxation among accountants and argues that "the increased attention to the subject at the recent examinations is most welcome but took many candidates entirely by surprise."

34. PRO File IR74/108.

35. Ibid. This estimate should be treated with some suspicion given the figures in Appendix A3.

36. Report of Minutes of Evidence 1852 (354) IX Questions 564 and 592. A large proportion of this £24,960 would almost certainly have related to tax deducted at source from the investment income of endowed charities rather than repayments relating to covenanted income.

37. A memorandum on PRO File IR75/69, submitted to the 1926 Charity Committee - apparently an internal departmental committee - states, "it is clear ... that the practice of entering into these deeds is only in its infancy" - Page 408. Furthermore, evidence - Board of Inland Revenue Memorandum No. 3 - submitted to the 1955 Royal Commission on The Taxation of Profits and Income CMD 9474 - states that charitable covenants first came into prominence after the First World War, though this was probably only the received wisdom of the Department, based upon the 1926 materials.

38. (1927) 13 TC 789.

39. The Ritchie Committee - reporting in 1905. Cd 2575.

40. The other areas investigated were the treatment of income from copyrights, patent rights and terminable annuities; depreciation of assets; the computation of profits under schedule D on the average basis; the recovery by taxpayers of overpayments and the treatment of Co-operative Societies.

41. Cd 2576.

42. Ibid. Paragraphs 20 and 24.

43. Ibid. Appendix No. 8.

44. Ibid. There are two types of avoidance to which he took great exception; non-residents who relied upon the technicalities of Granger v Gough so that they were not trading in the UK, and companies which transferred their residence abroad.

45. Ibid. Question 1108.

46. Ibid. Question 1109.

47. See Charles Pressly and others quoted earlier in the chapter.

48. Cd. 2576 question 1111.

49. Ibid. Questions 1112-1113.

50. Cd. 2575 para 114 and 119.

51. Ibid. para 119.

52. Cd. 2576, question 486.

53. Ibid.

54. The Committee considered that the claim forms which were then in use were very difficult to understand and likely to be completed incorrectly - Ibid, question 444 to 486.

55. Cd. 2575 para 17.

56. Cd. 2576 Appendix 1, page 1.

57. Ibid.

58. Ibid. p2.

59. Cd. 2575, para 31.

60. Ibid. Para 38-41.

61. The Dilke Committee (365)(1X)659.

62. Earned incomes not exceeding £2,000 were charged at nine pence in the pound while the standard rate of one shilling was charged on unearned income.

63. Ibid. Question 41.

64. Hansard, July 16, 1914 Mr Lloyd-George

65. "Some Remarks on Income Tax and Super-tax and Its Legal Evasion." E.E. Spicer, F.C.A. The Accountant, January 21, 1911. The article was based upon a paper presented to the London Chartered Accountants Students Society on November 2, 1910.

66. Ibid. p117.

67. The rate of 6 shillings was retained until the end of 1921-22.

68. Details of the rates involved are set out in Appendix A1 and A2.

69. Mallet and George, British Budgets, 2nd series, 1913-1921, (Glasgow, The University Press) p326.

70. See Appendix A3.

71. See Appendix A4.

72. If settlements were being created on a large scale one would have expected a large increase in the number of repayments being made. The number of exemptions granted in respect of small incomes did in fact almost double between 1910 and 1919 but interpretation of these figures is made difficult by changes in exemption limits, tax rates, income levels and population.

73. Report of the Royal Commission on the Income Tax Cmd. 615 Reservation IV by J. Walker Clark.

74. For details of indirect tax see the Report of the Committee on National Debt and Taxation Cmd. 2800 p93-95.

75. Cmd. 615, Reservation IV para 6, Mr. J. Walker Clark.

76. Initially the rate set by F.A.(No.2) 1915 was 50% but this was to 60% the following year and to 80% the year after that, but was reduced to 40% by the Finance Act 1919. Considerable amounts of duty were collected so that by 1917 it accounted for over 36% of the total tax revenue. Avoidance was prevented by providing that no person could "enter into any fictitious or artificial transaction or carry out any fictitious or artificial operation." S44(3) F.A.(No. 2) 1915.

77. The Finance Act of 1916 extended the limit of the parents' income to £700 and this was increased to £800 by the Finance Act 1918 and where the total income exceeded £800 but did not exceed £1,000 an allowance was granted for each child except the first two. The Finance Act of 1919 increased the amount of allowance in respect of the first child to the tax on £40.

78. Restrictions on child allowance based upon the child's income were not introduced until much later.

79. Except the child allowance where the limit was increased to £1,000.

80. Between the years 1913-14 and 1919-20 a batchelor with an income of £520 per annum suffered a 420% increase in his tax liability whereas over the same period a married man with seven children suffered a 215% increase of tax liability.

81. Murray and Carter's Guide to Income Tax Practice, 5th ed. p.378.

82. The Accountant, 1911, p650 and p683.

83. Lectures delivered to public audiences under the Newmarch Foundation of the University College, London, published in book form as The Principles of Taxation by Sir Josiah Stamp, Macmillan & Co., 1921.

84. Cmd. 288.

85. Evidence-in-Chief of E Stanford-London, Deputy Chief Inspector of Taxes, ibid paragraph 12376.

86. Ibid. Para. 12381.

87. It must be remembered, however, that at this time the majority of all income was subject to deduction of income tax at source and income tax evasion to that extent was made more difficult. It was still possible, however, to make false claims to exemption or abatement by non-declaration of the full income.

88. Cmd. 288, para 12387, Mr. E. Stanford - London. His evidence went on to say that these amounts were paid over specifically for the years given and that there were considerable sums in addition, which were added to the current assessments and not recorded and which would materially swell the totals.

89. Ibid.

90. Ibid. Paragraph 5811 and 6008 to 6010.

91. The comment of one of the witnesses for The London Chamber of Commerce sums up the arguments used by many other witnesses on this matter. "All I can say is that from my personal experience I know that revenue is lost." Ibid paragraph 6010.

92. Sir Josiah Stamp, The Principles of Taxation at page 107. He complained of the difficulties the Revenue have in this matter in the following way.

"For the taxpayer is no none too reasonable in the matter. In one breath he is loud in his complaints as to the amount of evasion and the way in which the Revenue allows itself to be cheated and in the next he hotly resents some personal question addressed to him on his own tax returns, failing to recognise that he himself cannot escape the tests provided for carrying out his own policy."

93. Cmd. 615, paragraph 625.

94. Ibid. Para 626.

95. Ibid. Para 627.

96. Ibid. Paragraph 628.

97. See "Sowing Some of the Seeds of the Present Anti-Evasion System - The 1920s" David Stopforth, British Tax Review, 1985, p.28.

98. Cmd. 615 para 633.

99. Ibid. Under Section 44 (1) of the Finance (No. 2) Act 1915 the Board of Inland Revenue had power, for excess profits duty purposes to require production of such accounts and other particulars as they considered necessary to arrive at the true liability and believed that a considerable amount of evasion had come to light through the use of this power (Minutes of Evidence para. 12473). Taxpayers were also making voluntary disclosures in order to get a higher pre-war standard for excess profits duty purposes but Revenue officials were certain that far more had been recovered through special investigations than through voluntary disclosures (paragraph 12479 Mr. Stanford, London).

1. A letter dated 23rd of November, 1915 in "The Accountant" bears the title "Income Tax Shirkers" and refers to evasion by non-disclosure of income taken from a business which an employee of an accountant had come across when carrying out an audit. The view of the writer sums up very well the attitudes of other correspondents on this subject.

> "Now this man is a foreigner and it is really hard, especially at a time like this, to see Englishmen pouring out their blood and money like water while such a man is defrauding the government of pounds."

2. Cmd. 615, para. 644. Most of the recommendations of the 1905 departmental Committee to inquire into fraud and evasion were put into effect within a short time of its report and the Perjury Act of 1911 further strengethened the hand of the Inland Revenue. (This did not apply to Scotland or Ireland.) The main form of non-criminal proceedings was the imposition of a treble penalty of the duty on any tax evaded but this could only be imposed for the three years of assessment in date at the time of imposing the penalty. Thus what the Inland Revenue were entitled to obtain was three years of evaded tax and a penalty of up to three times the evaded tax for those three years. It is clear from the evidence presented that the Revenue would investigate years which were out-of-date in order to find the amount of tax evaded and would adjust the penalty in order to obtain, as far as possible, at least the amount of tax evaded in the out-of-date years. (See Minutes of Evidence, para. 12509-12513).

3. Cmd. 288 para.12381.

4. Vol. II, p89, July 18, 1914.

5. By 1919 "The Accountant" was reporting a considerable number of prosecutions based upon articles drawn from local newspapers. The Revenue were obviously making an example of people up and down the country in order to obtain the maximum publicity and the maximum deterrent.

6. The Accountant, 6th June, 1914.

7. The Accountant, 19th August, 1922, p.252.

8. For example, The Accountant, February 19, 1916, March 24, 1917 and November 3, 1917.

9. The Accountant, 1913, vol.2, p.741.

10. Ibid. p777.

11. For example, The Accountant, November 26, 1921.

12. Cmd. 288, para. 13590 Mr. G.F. Howe.

13. Ibid. Para. 14117.

14. Ibid. Para. 14408.

15. Ibid. Para. 14414.

16. Ibid. Para. 13442 Mr. Howe.

17. Ibid. Para. 14033 Mr. Allen.

18. Ibid. Mr. Harrison, para. 14412. Although the journals and the evidence given to the Colwyn Committee contain references to the fact that settlements were being created there is little other indication of this. Neither the Association of Tax Surveying Officers nor the Association of Tax Clerks submitted any statements to the 1920 Royal Commission on the subject. Even the evidence submitted in November 1919 concerning thirty-five contentious appeal hearings dealt with by the Commissioners for the City of London (Cmd. 288, Appendix 34) indicates that none of the appeals concerned any dispute relating to settlements. This goes some way to prove that the Inland Revenue were not seriously disputing any of the settlement cases that they had come across up to that time.

19. Ibid. para 14415.

20. He prefaced his written evidence on the matter with the heading "Settlements with Intention to Evade Taxation" Ibid, para. 13443. Mr Allen merely described these transactions as fictitious but was otherwise uncritical. He was trying to persuade the Royal Commission that a husband and wife should be taxed separately and the matter of tax avoidance was only an incidental aspect of his argument in that he believed that stopping such avoidance would produce the additional revenue which the separate taxation would cause to be lost.

21. Ibid. Para. 14531, Mr Harrison.

22. Ibid. Para. 13692.

23. Ibid. Para.13751.

24. Ibid. Para. 13756.

25. Ibid. Para. 13759.

26. Ibid. Para. 14118, Mr. Allen.

27. Ibid. Para. 14417.

28. Ibid. Para. 14419.

29. Regulations No.45, revised article 341 of the Revenue Act 1914.

30. Cmd. 288, para. 14490.

31. Ibid. Para. 14492-3.

32. Ibid. Paras 14528 and 14535.

33. Ibid. Para. 13590-13595.

34. Ibid. Paras 14509.

35. "A parent who does such a thing at the present time is acting strictly in accordance with the law, and deserves, therefore, some consideration on that ground...." Ibid, para. 14150.

"You want to upset a perfectly legitimate transaction, and you go so far as to upset cases that have been done in the past and upon which further settlements in family arrangements depend." Ibid, para. 14536.

36. Cmd. 615, para. 576.

37. This matter was not discussed or mentioned in the Minutes of Evidence and apparently no- one had thought of the likelihood that, if revocable settlements were to be made ineffective, people would just enter into short-term dispositions.

38. Cmd. 288, Appendix 14.

39. Ibid. Para. 14579. Mr. Harrison.

40. Cmd. 615, para. 307.

41. Cmd. 288, para. 4068, Mr. R.V.N. Hopkins, Commissioner of Inland Revenue.

CHAPTER 3 - FOOTNOTES

1. The Inland Revenue's Finance Bill files for that year (PRO File IR113/7) mention nothing of this subject so it was apparently not a case of an abortive attempt to introduce legislation.

2. The changes made in that year included the introduction of earned income relief; a modification to the way in which personal allowances were to be given; (i.e. as deductions from income before charging tax), the introduction of a wife's earned income allowance, modification to graduation and exemption limits; changes to double taxation relief; a reduction in the lower income limit for super-tax purposes and a modification to child allowance such that it was given irrespective of the level of parents' income.

3. There was no reduction in the child allowance where the income was £40 or under.

4. The Treasury's 1922 Budget Taxation Proposals, Volume I PRO File T171/203p2

5. Ibid. p3.

6. Ibid.

7. Betting tax, bicycle tax, taxation of foreign visitors and imported commercial motor vehicles, turnover tax, merchant sales tax and auction sales tax were all being considered. PRO File T171/203.

8. Treasury memoranda on the 1922 Budget. PRO File T171/205.

9. PRO File IR63/101 p55, para 1.

10. Ibid. p55-70.

11. Ibid.

12. Ibid.

13. Ibid. They suggested that the easiest occasion on which to make further attacks on avoidance would be when the rate of income tax was being reduced.

14. Ibid. para 8.

15 Ibid. para. 3.

16. Attachment to paper on PRO File IR63/101 p55. Each illustration shows the total tax received by the Revenue being reduced by approximately by one-third, as a result of the income-splitting technique being used.

17. Ibid. para 24.

18. Ibid. para 25.

19. Ibid. para 26.

20. Ibid.

21. Ibid. para 28.

22. The problem perceived was probably that it would be extremely difficult to set up a system to detect cases where "dummy settlors" had been used.

23. PRO File IR63/101, p55, para 29.

24. If the more radical proposal of aggregation had been adopted it would probably have prevented much of the avoidance which was to follow.

25. PRO File IR63/101, p55, para 31.

26. Ibid. para 33.

27. This is an example of how crucial the recommendation of a Royal Commission can be in easing the passage of sensitive legislation.

28. Another Revenue proposal was carried in on the back of these anti-avoidance provisions. Prior to 1922, persons liable to super-tax were not required to give a detailed analysis of their sources of income and it was contended that "if the result of this legislation is to be effectively administered it will be necessary that this omission ...be rectified." (PRO File IR63/101, p55, para 58.) It is not clear that this contention is justified and in fact the major use to which the information obtained from detailed super-tax returns was put (following the powers introduced in Finance Act 1922) was the detection of evasion by the omission of income. (Sowing Some of the Seeds of the Present Anti-Evasion System - The 1920s, David Stopforth, British Tax Review, 1985, p.28.)

29. PRO File IR63/101, p196.

30. Ibid.

31. Ibid.

32. PRO File IR63/101, p198.

33. Ibid. p199.

34. Parliamentary Counsel Finance Bill 1922 File, Vol. 2, p187. The office of the Parliamentary Counsel's files for recent Finance Bills contain the detailed correspondence underlying all the changes which took place between the initial draft clauses and the production of the final legislation and provides a detailed analysis of the reason for each change and a clear idea of precisely what the Revenue wanted to achieve. However, it is not until the late 1920s that this detailed correspondence begins to appear on the files. The explanation given for this by the Civil

34. (cont'd)
Servant in charge of administration of the Office of Parliamentary Counsel was that, in those days, the drafting of legislation was not a full-time job and the counsel involved usually considered the instructions as part of their personal papers.

35. Ibid. Vol. 1, p199. The draft is headed up "Income under Revocable and Certain Other Trusts to be treated as Income of Settlor".

36. Ibid. p189.

37. Ibid. p35. May 13, 1922.

38. Ibid. Vol. 2, p187.

39. See next Chapter.

40. The words "if living" were inserted at the committee stage even though the Revenue pointed out to ministers that the words were superfluous because of the impossibility of treating income as that of a deceased person. PRO File IR63/102 p118. However, as the amendment made no difference, the Solicitor-General agreed to it, thus giving the appearance of being helpful and subject to persuasion. In 1936, the Revenue were far more cautious and required the words "if living" to be included in the children's settlement provisions.

41. Parliamentary Counsel Finance Bill, Vol. 2, p86.

42. Ibid. Vol 1 p35.

43. Hansard, May 1, 1922, col. 1033, Sir R. Horne.

44. Detailed notes on all resolutions are provided by the Board of Inland Revenue to the ministers involved.

45. Hansard, May 8, 1922, col. 1953, Sir F. Banbury.

46. Ibid. col. 1958, Major Hills.

47. Ibid. col. 1954, Sir F. Banbury.

48. Ibid. col. 1955, Mr H Young.

49. A further example of this can be seen at the second reading where one member was "very glad to see that at last the Chancellor of the Exchequer is dealing with the very important question of evasion." He was "glad to see that the question of recoverable (sic) trusts is going to be dealt with." Ibid, column 1832, Mr. G. Locker-Lampson.

50. Ibid. col. 1956, Mr. H. Young.

51. Ibid. col. 1958-1959, Major Hills, Mr. D. Herbert.

52. Ibid. col. 1957, Mr. Hohler.

53. Hansard, May 29, 1922, col. 1830, Mr. Dennis Herbert.

54. (1933) 17TC 728.

55. This argument was mentioned by Lord Justice Romer in the Court of Appeal at page 739.

56. Hansard, May 29, 1922, col 1830 - 1831 Mr. Dennis Herbert.

57. "The Accountant" ran a series of articles giving a detailed account of the Finance Bill and the first one dealt with Clause 13 because of its "importance and novelty". (The Accountant, June 10, 1922, p. 823 "The Clauses Explained" by Raymond W Needham). This is one of the first examples of a detailed article on a specific narrow area of legislation which provide both discussion and examples to illustrate its operation.

58. PRO File IR63/102, p. 41.

59. Because liability to super-tax was computed by reference to the statutory income for income tax purposes of the preceding year, the super-tax liability of a disponor caught by these provisions would not be affected until 1923/24. The same delay applied to the other two deeming provisions of sub-clause 1.

60. Hansard, June 20, 1922, col. 1200, Mr. Barnes.

61. Ibid.

62. PRO File IR63/102 p.104.

63. Ibid.

64. Ibid. p105.

65. Hansard, June 20, 1922, col.1201 Mr. Dennis Herbert.

66. Hansard, June 20, 1922, col. 1201, Sir Leslie Scott.

67. The words "by virtue or in consequence of a disposition made directly or indirectly by himself" were inserted into paragraph (a) while the loophole so created was blocked by the insertion of a proviso to the effect that the husband and wife were to be considered as one person. (See paragraph (ii) of the first proviso to section 20, sub-section 1 of the Finance Act 1922. A further amendment at the report stage clarified the position where the consent of the husband or wife of the person having power to obtain beneficial enjoyment, of the income was required in order to obtain that beneficial enjoyment by the removal of the reference to the husband and wife from paragraph (a) and its insertion into the first proviso to sub-clause 1. The effect was to make it clear that when spouses were separated, either by agreement or a court order, the wife or husband could for the purposes of paragraph (a), be counted as a person whose consent would suffice to keep the income outside the deeming provisions of that paragraph.

68. Hansard, July 13, 1922, col. 1498, Mr. Dennis Herbert.

69. The clause, as drafted, would only have caught the income up to the date of giving up the power of revocation and because thereafter the settlor could not obtain the beneficial enjoyment of it, it could not be counted as his.

70. PRO File IR63/102 p42.

71. Ibid. p112.

72. Ibid. p108. Paragraph (c) was not limited in its operation to dispositions made after May 1, 1922, and this element of retrospection was to be a matter of considerable contention.

73. Ibid.

74. Hansard, June 20, 1922, col. 1204, Mr. Dennis Herbert.

75. Ibid. col. 1205, Sir L. Scott.

76. Ibid. Mr. Inskip. In fact it would of course have been a matter for the appeal Commissioners.

77. Ibid. Sir L. Scott.

78. PRO File IR63/102, p110-111. The examples used were the new clauses and amendments during the progress of the Finance Bill 1920 and 1921.

79. Hansard, July 16, 1920, col. 2812, Mr. Chamberlain.

80. PRO File IR63/102 p111.

81. Hansard, June 20, 1922 cols. 1202-1204.

82. Ibid. col. 1204, Lord Robert Cecil.

83. Ibid. Reconsideration of the problem by the Cabinet Tax Evasion Committee in 1927 led to an attempt to completely remove all tax relief on charitable covenants. (See Chapter 4).

84. Inland Revenue and Treasury files at the P.R.O. and Parliamentary Counsel files.

85. PRO File IR63/102, p42.

86. Ibid.

87. No estimates of the numbers or value of cases which would not be caught are in the relevant papers.

88. The debate on retrospection ran to almost ten columns of Hansard and represented almost one-third of the discussion on the whole of the clause. Hansard, June 20, 1922, cols. 1206-1215.

89. Ibid.

90. Hansard, June 20, 1922, col. 1208, Mr. Inskip.

91. An example of the admission of exaggeration is as follows:-

"When I said illegal I did not mean in the sense ordinarily accepted that it was illegal. What I meant was that the man would not be able to avoid the payment of income tax." Hansard, June 20, 1922, col. 1211, Sir F. Banbury.

92. Ibid. col. 1207, Sir R. Horne.

93. Hansard, June 20, 1922, col. 1214, Sir L. Scott.

94. Ibid. col. 1213, Sir L. Scott.

95. Ibid. col. 1214, Sir L. Scott.

96. Ibid. col. 1210, Sir Owen Phillips.

97. Ibid. col. 1211, Mr. Holmes.

98. Ibid. col. 1213 and 1215, Sir L. Scott.

99. PRO File, IR63/102, p418.

1. Ibid.

2. Hansard, July 13, 1922, cols 1411-1412, Mr. A.M. Samuel, Mr. Betterton.

3. PRO File IR63/102, p114.

4. Ibid.

5. Hansard, June 20, 1922, col. 1215.

6. The Chancellor's version of the amendment was inserted at the end of the first paragraph of the second proviso to sub-section 1 of section 20 of the Finance Act 1922 and ensured that paragraph (c) did not apply to any case where income was payable to the child during the whole life of the parent.

7. PRO File IR63/102 p115-116.

8. Ibid.

9. Ibid.

10. The proviso appeared in paragraph 2 of the second proviso to sub-section 1 of section 20 of the Finance Act 1922.

11. Hansard, June 20, 1922 col. 1219 Mr. Inskip.

12. PRO File IR63/102 p119.

13. Ibid.

14. Ibid.

15. Hansard, June 20, 1922, col. 1220.

16. The amendment became the first part of para 1 of the second proviso to sub-section 1 of section 20 of the Finance Act 1922.

17. PRO File IR63/102 p115.

18. Ibid.

19. Ibid. p116. The tightening of the provision did become necessary but not because of the use of 'dummy settlors.'

20. Hansard, June 20, 1922 cols 1216-1219. Mr. Inskip, Sir F. Banbury, Mr. Rawlinson, Mr. D. Herbert.

21. Ibid. col. 1219, Sir R. Horne.

22. PRO File IR63/102 p.422.

23. Ibid. p448, from Mr. Dennis Herbert.

24. Hansard, July 13, 1922 col. 1413, Sir. L. Scott.

25. Lt.-Col. Spender Clay, Lt. Col. Sir Samuel Hoare, Major Hills.

26. Ibid. cols.1408-1410, Mr. Dennis Herbert.

27. PRO File IR63/102 p426.

28. Ibid.

29. Hansard, June 20, 1922, col. 1212, Colonel Wedgewood.

30. Ibid. p120.

31. Ibid.

32. Ibid.

33. Section 20(2) F.A. 1922.

34. It was thought that there was no necessity to have this power of recovery in connection with revocable dispositions because the disponor in such a case had the remedy of revocation if he did not like the consequences of the deeming process. Recovery rights are now provided for such dispositions - see S499 I.C.T.A. 1970.

35. General Commissioners for income tax and Special Commissioners for super-tax.

36. Sub-section 4.

37. Loss relief might be an example.

38. This point seems to have been misunderstood by the 1936 Income Tax Codification Committee because they suggested that surtax repayments should be brought within the scope of these provisions - Cmd. 5131 p298.

39. The terms "settlement" and "settlor" were not used in the legislation and did not appear until 1936 following a recommendation by the Income Tax Codification Committee.

40. See Chapter 5.

41. Cmd.288. Minutes of Evidence para 14118.

42. Taxes Act 1970 Section 434-435. Section 436 was not introduced until later.

CHAPTER 4 - FOOTNOTES

1. This was formed on December 14, 1926. (Cabinet 64 (26) conclusion 3).

2. PRO File T171/265 p37. Memorandum by the Board of Inland Revenue to the Tax Evasion Committee.

3. Ibid. p38.

4. PRO File T171/265 p142-144.

5. Ibid. p143.

6. Ibid.

7. Ibid.

8. Ibid.

9. The Revenue later took a test-case on this; CIR v Firth, see later.

10. PRO File T171/265 p144.

11. February 25, 1927.

12. PRO File T171/265 p.144.

13. Ibid. p170.

14. Ibid. p93-98.

15. (1926) 10 TC 228.

16. PRO File T171/265 p94.

17. Ibid. p95.

18. Ibid. p96-97.

19. Ibid. p99.

20. Ibid.

21. It was not named.

22. Ibid. p97.

23. Ibid.

24. Ibid. p97-98.

25. Ibid. p98.

26. Ibid.

27. Conclusion of the fourth meeting March 8, 1927. Ibid. p166.

28. CP88(27) March 14, 1927.

29. Details of what these technical questions were do not appear in the Cabinet papers.

30. CAB18(27).

31. Hansard, April 11, 1927 col. 85-86, Mr Winston Churchill.

32. Hansard, April 28, 1927, col. 1126-1129 Mr McNeill. The details provided by the Revenue to ministers on the Budget resolution are virtually the same as those in the paper provided to the Cabinet committee, and the Board's notes on the relevant clause in the Finance Bill (Finance Bill 1927, Clause 19) are virtually a repetition of the same material.

33. Hansard, June 30, 1927, cols 736-741.

34. Ibid.

35. Ibid.

36. Hansard, April 28, 1927, col. 1228, Mr McNeill.

37. Hansard, June 30th, 1927, col. 738, Major Birchall.

38. The Times, May 25, 1927.

39. Sir Henry Buckingham.

40. There is no mention on the files of Parliamentary Counsel for 1927 of anything concerning these provisions. The explanation for this provided by the current administrative head of the Office of Parliamentary Counsel is that no details are kept on such files concerning material which did not reach the statute books so that on a change of Government the new Government cannot look back to find details of proposed changes of its predecessors which were never put into effect. Support for this explanation can be found in Kellner and Crowther-Hunt, The Civil Servants, (London, MacDonald) p284.

41. The Finance Bill, Raymond Needham. The Accountant Tax Supplement, 1927, p.271.

42. PRO File IR40/3293; letter May 22 1927 and reply May 26 1927.

43. J. B. Baillie, the Vice Chancellor of Leeds University wrote to the Treasury on April 22, 1927. Ibid.

44. Sir Arthur Stanley wrote to the Treasury on April 29, 1927. Ibid.

45. May 19, 1927.

46. PRO File IR40/3923 p24. Clearly this was turning the whole thing on its head as it was in no way a concession but a restrictive anti-avoidance provision.

47. Ibid. p25.

48. Ibid.

49. Ibid. p22.

50. Ibid.

51. Hansard, June 30, 1929 col. 740, Mr Churchill.

52. (1923-25), 9 TC 234.

53. (1927) 13 TC 448.

54. It is is interesting to note that the Lord President (Clyde) pointed out that:-

"The idea of making the transfer may very probably have occurred to him in connection with ... the consideration that if a family estate is divided among the members of the family so as to split up the family income into a number of smaller separate incomes, some, if not all, of those smaller incomes may be entitled to the advantages which the Income Tax Acts provide for incomes of moderate amount."

55. (1928) 14 TC 329.

56. (1930) 15 TC 682.

57. In this case the first due date could not be before February 3, 1927. The period was therefore three days short of five years eleven months.

58. (1932-33) 17 TC 728.

59. Support for this view was obtained by contrasting paragraph (a) with paragraph (c), because paragraph (a) dealt completely and fully with all cases where the disponor had power of retaking possession of income by means of a power of revocation or a power of appointment that he could exercise in his own favour.

60. In 1931 a Board's Order was made concerning deeds containing a power of revocation in an attempt to reduce their use - PRO File IR40/6084, Memorandum October 26, 1931. The exact terms of this order are not known, but it may well have been to the effect that Watson v Wiggins type of cases should be treated as caught. If so, the floodgates were only temporarily closed. In the year to March 31, 1931 only 13% of children's settlements were revocable but in the following six months the proportion had increased to almost 26%. (PRO File IR 40/6084).

61. (1932) 17 TC 719.

62. 17 TC at p726.

63. The Accountant Tax Supplement July 19, 1930 p 293.

64. PRO File IR75/9 p587.

65. (1932) 17 TC 451

66. S454(3), S444(2) and S459 ICTA 1970.

67. (1933) 17 TC 603.

68. (1935), 19 TC 490.

69. (1932) 17 TC 333.

70. The trust was governed by law similar to that of the State of New York, and therefore Garland v. Archer-Shee applied (15 TC 693).

71. It was also held, that having regard to the whole of the documents, the consent of the trustee was certainly required, and that of the annuitants was probably required, before the appellant could obtain the beneficial enjoyment of the income, and that therefore the power of revocation could not have been within section 20.

72. (1935) 19 TC 255.

73. The case of Duncan's Executors v. Adamson, (19 TC 255), involved facts almost identical to Perry v. Astor except that the property was situated in India and the trustees were resident there. It came before the High Court after the Astor case, but before it had reached the House of Lords, and the decision therefore went against the taxpayer. However, it was decided in his favour when it came before the House of Lords at the same time as the Astor case.

74. 19 TC at p288.

75. 19 TC at p287, quoting Lord Tomlin in Neumann v CIR, 18 TC 322 at p358.

76. 19 TC at p286-287.

77. Lord Macmillan considered that this was perhaps the most anomalous case.

78. 19 TC at p290.

79. The details of this investigation are in PRO File IR40/6461.

80. Ibid. Papers T16686/27/35.

81. Ibid.

82. Ibid.

83. Ibid.

84. An example of the absurdity is the case where disponor A, resident abroad, grants under revocable deed to B, resident in the UK, income from British securities and at the same time B grants to A equivalent income from foreign securities. In that case B's disposition in favour of A is within Perry v. Astor and no deeming could take place. However, the deeming process could apply to the UK income received by B so that it would be deemed to be received by A who is non-resident. The net result would therefore be that B, although he was resident in the United Kingdom, might enjoy an income of say £50,000 a year without a surtax liability. The possibility of attacking such a scheme on the grounds that it was a reciprocal arrangement was not discussed. The way round the problem was seen to be to apply section 20 only where the disponor was resident in the UK.

85. Ibid. Letter March 3, 1936.

86. Ibid. Letter April 6, 1936.

87. The Board's interpretation of Perry v. Astor was not put to the judicial test until the case of Becker v. Wright in 1965.(42 TC 591). There had been earlier cases (e.g. CIR v. Countess of Kenmare in 1957, 37 TC 383) which had considered the application of the settlement provisions to cases involving a foreign element, but they had only concerned areas of legislation introduced much later which included specific provisions dealing with the foreign element.

88. The Accountant, June 10, 1922 p823.

89. The case concerned a father who owned a farm with a value of £60 per annum which was occupied by a married son paying £10 per annum rent. The Inspector of Taxes refused to set off the son's personal allowances against the Schedule A income (based upon the annual value) and was treating the income as the father's. The only basis upon which this could be done was under section 20 sub-section 1(a) by treating the disposition as revocable. (The Accountant 1923, p221.).

90. The Accountant 1926, vol. 1, p.3, January 2, 1926.

91. The Accountant Tax Supplement, October 13, 1928, p515 and subsequent weeks.

92. Ibid.

93. The terms of a form of deed in common use at the time was given at the lecture (delivered by Mr A W Rowlinson, ACA, on October 1 at the Midland Hotel, Manchester) but a copy of it was not in the article.

94. See the provisos to section 20 of the Finance Act 1922. The point was made clear in the case of Wiggins v. Watson, (see earlier), where income was payable to a child for the joint life of the child and the father, and the Revenue conceded that there was no possibility of attacking the arrangement on those grounds.

95. The Accountant Tax Supplement, November 17, 1928, p583 and December 8, 1928, p621.

96. Ibid. January 26, 1929 and May 25, 1929.

97. Ibid. August 23, 1930, p339.

98. Duke of Westminster v CIR, (1935) 19 TC 490.

99. An article in The Accountant Tax Supplement finishes with a warning that deeds should be carefully drafted because "the Revenue is quick to sieze upon technical points" (The Accountant Tax Supplement, 1933, p.258).

1. PRO File IR40/4806.

2. The Law Journal 8, 15, and 20 December 1934.

3. "Avoiding Surtax Payments - Liability under Personal Income Transfers". The Financial News, January 2, 1935.

4. The Financial News, in three consecutive weeks beginning February 11, 1935.

5. The Evening Standard, April 20, 22, 25, 26, 1935.

6. The Financial News, May 9, 1935.

7. Ibid. Such advice can now be seen to be rather too simplified. See for example CIR v National Book League. (37 TC 455).

8. The Revenue were keeping details of these advertisements and examples are shown in Appendix C1.

9. The letter in fact refers to evasion but it is clear that it is referring to avoidance.

10. Finance Act 1923, section 23.

11. Finance Act 1923, section 29.

12. For details see "Sowing some of the Seeds of the Present Anti-Evasion System, - the 1920s." David Stopforth, The British Tax Review 1985, vol.1, p.28.

13. The Finance Act of 1927 required that a greater amount of detail be provided in a tax return (section 43-44) while section 23 of the Finance Act 1930 empowered the Special Commissioners to obtain copies of the registers of securities of corporate bodies.

14. Finance Act 1927, sections 31-32.

15. The Committee was actually called "The Board's Committee on Evasion" but there is no mention of evasion in any of the committee papers or minutes - the subject matter was entirely avoidance.

16. See "The Cabinet Review of Tax Avoidance" earlier in this chapter.

17. The Research Division dealt with about 500 of the largest incomes.

18. PRO File IR 40/6084.

19. PRO File IR40/4576.

20. Ibid. "Note on Evasion by Millionaires by the Special Commissioners" dated January 8, 1931.

21. PRO File IR40/4574 p41.

22. PRO File IR40/4576. Memo July 5, 1933.

23. Ibid.

24. Ibid.

25. Ibid.

26. Ibid.

27. PRO File IR40/4574 p30.

28. The figures include out-and-out dispositions and other cases not within the intention of Finance Act 1922 Section 20.

29. Ibid. p31.

30. Ibid.

31. Ibid.

32. Ibid.

33. Ibid.

34. Minutes of Sixth Meeting, November 17, 1933.

35. Minutes of the Second Meeting of the Committee on Avoidance, October 17, 1933 on PRO File IR40/4574.

36. Ibid.

37. Appendix C to Report at p83-85.

38. Ibid para 86. The committee referred to an advertisement which recommended that deeds should be drawn up without a power of revocation because "there is the chance that such legislation will render ineffective those deeds which contain a power of revocation, whereas we feel convinced that the form of deed which we favour will not be so attacked. We consider it wiser to rely upon the fact that when the child reaches 21 he or she can discharge the parent's liability if such action is then desired" (Report of the Boards' Tax Avoidance Committee, paragraph 86).

39. Ibid. p32.

40. Ibid. p33.

41. Ibid.

42. Sixth meeting, para (1)(a).

43. Ibid. para 1(b).

44. Ibid. para 1(c).

45. PRO IR40/4576, p22, Mr Preston.

46. Ibid.

47. PRO File IR40/4574 p50.

48. Ibid.

49. Ibid.

50. Mr Joseph Rank. Ibid.

51. Ibid. p34.

52. Ibid. p50.

53. Ibid. p49.

54. Ibid.

55. Ibid.

56. Ibid. p50.

57. Ibid. p51.

08. Ibid.

59. The Committee's proposals are set out in Appendix D to the committee's report. PRO file IR40/4574 p86.

60. Second meeting of Committee.

61. Ibid.

62. Committee's Report p52.

63. Ibid.

64. PRO File IR40/4576.

65. Ibid.

66. Ibid.

67. Ibid. Mrs Rena Miller had settled £8,768 on trustees to accumulate for ten years, after which the funds would revert to herself or such person as she should by will or deed appoint.

    The Honorable Ivor G Guest by deed dated April 9, 1924 had settled upon trustees investments worth £200,000. The trustees had power to advance him up to £20,000 in all and subject thereto the income was to accumulate until 1939, when the balance of capital and income would pass to him absolutely if living. If he died before that date the money was to go to his children.

    Sir J Colman had entered into a similar arrangement to that of The Honorable Ivor G Guest.

68. Ibid. Mr Whybrow's memo "On Evasion Generally" dated 5th July 1933.

69. Ibid.

70. Ibid.

71. Ibid.

72. Ibid.

73. Ibid.

74. This change of attitude from that at the eleventh meeting may well have arisen when it was realised how few settlements of this type there were. PRO File IR40/4574, p55.

75. Ibid. Appendix E.

76. Ibid. p54.

77. Committee's Report p67.

78. The unreported case of D A Bevan.

79. Memorandum prepared for the Committee on PRO File IR40/4574 p28-29.

80. Committee's Report p70.

81. Copeman v Coleman, (1939), 22 TC 594.

82 Ibid. p66.

83. Ibid. p67.

84. Ibid.

85. Ibid. p70.

86. Cmd. 5131.

87. Ibid. p298.

CHAPTER 5 - FOOTNOTES

1 Handwritten note on report of C.I. Claims for the year ended March 31, 1929, on PRO File IR46/6084

2 Memorandum May 17, 1930 on PRO File IR40/6084

3 The limits were accordingly set at £60, £135 and £385. It was assumed that settlements involving income in excess of £385 per annum would be those which resulted in avoidance of surtax.

4 Report of interview, October 17, 1930, PRO File IR40/6084

5 Ibid. Claims Branch memorandum October 25, 1930.

6 Ibid. Claims Branch memorandum April 17, 1931.

7. Ibid.

8 Claims Branch memorandum July 6 1931, on PRO file IR40/6034.

9 PRO File IR40/6034

10 Boards order, August 25, 1931, referred to on P.R.O. File IR40/6034

11 (1932 - 33) 17 TC 728

12 G W Booth, Claims Branch October 26 1931, PRO File IR40/6084

13 Claims Branch memorandum April 20 1934, PRO File IR40/6084

14 Claims Branch memorandum May 15, 1934, on PRO File IR40/6684

15 Memorandum to Chief Inspector from J.T. Young, May 17, 1934, PRO File IR40/6084

16 Hansard, May 1, 1934, col.143, Mr Chamberlain

17 Claims Branch April 15, 1935, PRO File IR40/6084

18 The British Taxpayers Association accounted for over fifteen new deeds a week.

19 Claims Branch memorandum, April 15, 1935, PRO File IR40/6084

20 Ibid.

21 Ibid.

22 Memorandum to Chancellor from E R Forber, November 28, 1935, on PRO File IR63/141 p24. This was not the first time the problem had been put before the Chancellor as the report of the Board's Tax Avoidance Committee had been submitted to him in July 1934, following which he had instructed the Revenue to draft clauses to deal with avoidance by the transfer of assets abroad and of certain aspects of avoidance of estate duty. Both clauses were prepared and passed to the Chancellor in February of 1935 but he did not feel able to include them in the 1935 Finance Bill.

23 PRO File IR63/141 p24-35

24 The book was by Jasper More and was published in October 1935. The Revenue described it to the Chancellor as 'outrageous'.

25 PRO File IR63/141 p32-33

26 Ibid.

27 Ibid. p29

28 Ibid. p28-29

29 Ibid. p60

30 Ibid. p43

31 Ibid.

32 Ibid. p45

33 Ibid.

34 Ibid. p49

35 Ibid. p45

36 Ibid. p46 Suggesting that the Revenue should advise taxpayers how to reduce their liability seems rather strange, but it is something which is virtually done today for student covenants.

37 Ibid. p46

38 Memorandum to Hopkins from Forber, December 6, 1935, PRO IR63/141, p49

39 Ibid.

40 Memorandum from Hopkins to Fisher, December 9, 1935, PRO IR63/141, p56

41 PRO File IR63/141 p57

42 Ibid.

43 Ibid.

44 Ibid. p59-61

45 Ibid. p60

46 Ibid.

47 Ibid.

48 Ibid. p61

49 Ibid.

50 Ibid. p77-83

51 This seems to be misrepresenting the original reasons for aggregation of the income of married persons

52 PRO File IR63/141 p82

53 Ibid.

54 Ibid.

55 Ibid.

56 Ibid. p53

57 Ibid.

58 Ibid. p10

59 Ibid. He could not suggest any better way of dealing with the matter than the general flat rate increase in the child allowance.

60 Ibid. p84. This information had been requested at his first meeting with the Revenue on January 6, 1936 but he had not got an answer.

61 Ibid. p86

62 Ibid. p100

63 Ibid.

64 Ibid.

65 Ibid. p105

66 Ibid. p106

67 Ibid.

68 Parliamentary Counsel, Finance Bill 1936 File, p3599

69 Ibid.

70 Ibid. p3611

71 Ibid. p3611-3621

72 Parliamentary Counsel, Finance Bill 1936 File, p3617

73 There is nothing on the files to positively indicate the Revenue's agreement

74 Parliamentary Counsel, Finance Bill 1936 File, p3603

75 Ibid. p6321

76 At this time, considerable discussion of the drafts at all stages was dealt with by means of informal telephone conversations and ad hoc meetings between the draftsman and the Revenue officials.

77 PRO File IR63/141 p.178-187

78 Ibid. p180

79 Ibid. p181

80 Ibid.

81 Ibid. p184-185

82 Parliamentary Counsel, Finance Bill 1936 File p3647

83 Ibid. p3657

84 (1935) 19 TC 279

85 19 TC 290 at line 7

86 Parliamentary Counsel, Finance Bill 1936 File p3671-3672

87 Ibid. p3673

88 Ibid. p3675

89 Ibid. Since 1920 there had on average only been one such non-committal resolution every three years, and they had been defended on the grounds that the length and complexity of the provisions which it was proposed to found on the resolution were such that it was undesirable to trouble Parliament with such a mass of detail at the resolution stage. The draftsman doubted that this argument justified the use of such are solution in the present case.

90 PRO File IR63/141 p188

91 Ibid. p188-194

92 Ibid. p195. It obviously was not thought politic to write to the Chancellor direct.

93 Ibid. p196

94 Ibid.

95 Ibid.

96 Hansard, April 21, 1936, col. 45, Mr Chamberlain

97 Ibid.

98 Ibid. col. 46

99 Ibid. col. 47

1 Ibid. col. 47

2 Ibid. col. 48

3 PRO File T171/325; notes on resolution 14, p44 et seq

4 Ibid. p45

5 Ibid. p46

6 Ibid. p55-60

7 The Finance Act dealt with these problems in a slightly more simple fashion.

8 Ibid. p68

9 Ibid.

10 Ibid. p69

11 (1932) 17 TC 451

12 PRO File IR63/141 p197

13 The question of reciprocal arrangements was raised and the Chancellor explained that it was already covered.

14 In the Ways and Means Debate on the Budget proposals

15 Hansard, April 22, 1936, col. 229, Major Hills

16 Ibid.

17 Ibid.

18 Hansard, April 27, 1936, Mr Alan Herbert.

19 Ibid. cols 675-694.

20 The argument here appears to be that where the income was spent on education it should be caught, but any excess should not as it would represent money which would not have been spent by the parent on the child

21 Ibid. col. 682, Sir Ronald Ross.

22 Ibid. col.676, Sir Charles MacAndrew.

23 Ibid. col.677, Sir Charles MacAndrew.

24 Ibid.

25 Ibid.

26. Ibid. col. 678 Mr Benson.

27 Ibid. col. 685, Mr Chamberlain.

28 Ibid. col. 686

29 Ibid. As a side issue in the debate, there was considerable discussion of the difference between evasion and avoidance, with certain Members, particularly on the Labour side, continually referring to evasion when the transactions being discussed involved avoidance. They were constantly being corrected by other Members who particularly emphasised the relatively recent case law decisions which had mentioned that there was no immorality or dishonesty involved in avoiding taxation. (This is probably an early stage in the semantic distinction between evasion and avoidance. In 1936, about half of those speaking on the subject in the House of Commons made a distinction between evasion and avoidance. In almost all the Inland Revenue papers of that time the distinction was made.)

30 PRO File IR63/141 p199

31 Ibid. p201

32 Ibid.

33 Ibid. p202

34 Hansard, col. 691, Lt Col Acland-Troyte.

35 PRO File IR63/141 p202. A parent with an income of £700 a year saved £9 by settling £50 of income; a parent with £1500 a year saved £15.15s by settling £150; and a parent with £3,000 saved £76.17.6d by settling £300.

36 Ibid. p203

37 Ibid. p204

38 Ibid.

39 Ibid. p205

40 Ibid.

41 Ibid. p206

42 Ibid.

43 Ibid. p207

44 PRO File IR63/141, p.198, Neville Chamberlain, May 4, 1936,

45 Ibid. p208-210

46 Ibid.

47 Parliamentary Counsel, Finance Bill 1936 File, p3681-3685

48 Ibid. p3683

49 Ibid.

50. Ibid. Letter May 6, 1936.

51 Normally there is a prolonged exchange of memoranda as each change is explained and discussed

52 PRO File IR63/141 p234-246

53 Ibid. p223-230

54 The Times, May 19, 1936

55 PRO File IR63/141 p226

56 Ibid.

57 Ibid. p228

58 Ibid.

59 Ibid. p229

60 Agreement noted by Chancellor alongside the relevant paragraph. Ibid.

61 Ibid. p229

62 Ibid. p230

63 Agreement noted by the Chancellor alongside the relevant paragraph. Ibid.

64 Ibid. p243. A copy of such a circular had been obtained by the Revenue - p244 and indicates just how efficient their intelligence system was.

65 Ibid. p243 No details of how this was to be achieved are on the files.

66 Ibid.

67 Hansard, May 20, 1936, col. 1235, Mr Benson.

68 Ibid. col. 1240, Mr Benson.

69 Ibid. col. 1327, Mr Morrison

70 Ibid. col. 1257, Mr Chamberlain

71 Ibid.

72 Ibid. col. 1266.

73 Ibid.

74 Paragraph b of sub-section 2.

75 (1932) CIR v Clarkson-Webb, 17 TC 451.

76 (1935) 19 TC 279

77 Parliamentary Counsel, Finance Bill 1936 File, p1320-1321

78 Hansard, June 15, 1936, col. 738

79 Parliamentary Counsel, Finance Bill 1936 File p1324

80 Ibid.

81 See Chapter 9

82 Ibid. col. 950

83 Ibid. col. 751, Mr. Benson.

84. Parliamentary Counsel Finance Bill 1936 File, p1343.

85 Hansard, June 15, 1936 col. 757

86 Ibid. col. 758

87 Ibid. cols 759-763

88 Parliamentary Counsel Finance Bill 1936 File, p1345

89 Ibid. p1357

90 Ibid.

91 Ibid. p1358

92 Ibid.

93 Ibid.

94 Hansard, June 15, 1936 col.830, Mr Benson.

95 Ibid. col. 841 Mr Albery

96 Ibid. col. 842 Mr H G Williams

97 Sir John Withers, Ibid col. 847 Other similar comments can be found at col. 837, Mr Samuel and col. 838, Mr Crowder

98 Ibid. col. 848

99. These policies involved the payment of premiums to an insurance company until the child attained school age when the insurance company would commence paying a sum to the parent each year with which to pay school fees.

1 Hansard, June 15, 1936, col. 845, Major Hills

2 Parliamentary Counsel, Finance Bill 1936 File, p3809-3810

3 Ibid. p3813

4 PRO File NSC18/44-National Savings Committee Intelligence Matters and Liaison on Savings Matters. The problem mainly concerned interest on Post Office Savings Bank accounts and Trustee Savings Bank accounts.

5 Parliamentary Counsel, Finance Bill 1936 File, p3815

6 Ibid. p3829

7 Section 437(3) ICTA 1970. As an incidental matter, the draftsman expressed the view that the clause did not enable both the settlor and his wife each to settle £5 of income on a child without being caught.

8 See for example sub-section 7

9 Ibid. p3825

10 PRO File IR63/141 p255-261

11 A proviso was added to exclude such cases Proviso 2 to sub-section 7

12 Hansard, July 1, 1936, col. 456, Mr W S Morrison. The apparent reason for this was that the law in Scotland was extremely severe and it would be very difficult to get anyone to act as a trustees if they were exposed to its full rigours

13 Ibid. col.457, Mr. Benson

14 Ibid. col.458, Mr Spence

15 Parliamentary Counsel, Finance Bill 1936 File, p877

16 Ibid. p3881

17 Hansard, July 1, 1936, col.448, Mr Chamberlain

18 A party to a settlement would have been able to reply to questions from the Commissioners that he took the view that the particulars requested did not relate to the settlement, and if this were to happen the Commissioners would then have to take some form of action against the person in order to determine the question whether or not the particulars did relate to the settlement.

19 Ibid. col.451, Sir Stafford Cripps.

20 Hansard, July 1, 1936, col. 453, The Attorney-General

21 Ibid. col.456

22 Hansard, July 3, 1936, col. 820, Mr Chamberlain.

CHAPTER 6 - FOOTNOTES

1. Mr. Chamberlain, Hansard, July 3, 1936, col. 820.

2. See Appendix D4.

3. See Chapter 4.

4. Hansard, July 16, 1937, cols. 1753-4, Sir John Simon.

5. PRO File IR 63/143 p57.

6. The Chairman of the Board of Inland Revenue.

7. It seems unlikely that this type of avoidance was widespread prior to 1937, because if it had been, the Board would probably have approached the Chancellor to request legislation. The Board's Tax Avoidance Committee were aware of such avoidance in 1934 but it was probably not until 1936 when the children's settlement loophole was closed that it began to become more common. Barristers like Foster preparing such deeds would have noticed the growth in their use before the Inland Revenue.

8. Simon's Plan to Stop Surtax Evasion - Douglas Jay - City Editor, Daily Herald, July 3, 1937. The question arises as to who leaked this. In the writer's opinion it is likely to be Foster as he had suggested in his letter that widely drawn anti-avoidance provisions similar to those used in Germany should be introduced. The article described how the Chancellor was considering introducing "a clause making automatically illegal any device clearly designed to evade taxation." It also referred to the great success that similar provisions had met with in other countries. In point of fact there is no evidence that the Chancellor was considering such provisions as it was not until July 26, 1937, when Foster had obtained a translation of the German provisions, that he wrote to the Chancellor with his detailed proposals for a general anti-avoidance clause. Very few people could have known of Foster's promise to follow up his original letter with detailed proposals on a general anti-avoidance clause. This leads the writer to believe that it is highly likely that Foster himself leaked a slightly distorted story to the press and provided the background to them by which they could explain the avoidance involved.

9. PRO File IR63/143, p65, July 5, 1937.

10. Ibid.

11. PRO File IR63/143 p66-71.

12. Although the provisions of clause 13 of the Finance Bill of 1937, (S14 of the Finance Act), were retrospective to the year 1935/36, retrospection was thought to be justifiable in that case because it was directed against very artificial devices intended to circumvent section 19 of the Finance Act 1936 dealing with close company apportionments. A distinction was drawn between this

retrospection and the current proposals on the grounds that the latter "would be dealing with a new subject and ought therefore to be confined to the surtax payable in the year 1938." (Ibid. p70). This distinction would have probably seemed somewhat artificial to those who had entered into such settlements in 1937/38 expecting their surtax bill to be based upon the legislation in operation in that year, and this was probably why the Chancellor gave his warning.

13. Hansard, July 16, 1937, cols. 1753-4, Sir John Simon.

14. An extract from the Chancellor's speech is in Appendix E1.

15. Taxation, July 24, 1937, p289.

16. PRO File T171/340.

17. The Chancellor must have had discussions with Foster at some time because Foster's letter makes the following statement:-

"Your idea of enacting a clause designed to hit all sham or artificial transactions seems to be absolutely right."

The Chancellor has a handwritten note on the letter saying:-

"I did not say so. I merely wanted to know." (Ibid).

18. Ibid.

19. The relevant provision was as follows:- "No person shall in connection with the sale or disposal or proposed sale or disposal of any potatoes, enter or offer to enter into any fictitious or artificial transaction or make or demand any unreasonable charge."

20. Very often there are handwritten notes alongside a memorandum and this particular Chancellor was very prone to doing this.

21. It seems that Foster was determined not to give up his cause, for on March 24, 1938, The Times carried an article on the subject which he almost certainly wrote. The main classes of avoidance were explained and it was argued that specifically targeted anti-avoidance provisions were unsatisfactory and that what was required was a general provision dealing with tax avoidance as a whole. The leader article in the same newspaper was headed "Tax Evasion" when in fact it was exclusively concerned with tax avoidance. Both the article and the leader roundly condemned what was going on, and suggested that the use of tax avoidance by the wealthy was being "exploited by the professional organisers of social discontent." There is far too much in the two articles which represents not only the ideas but also some of the exact phrases and even sentences used by Foster in his correspondence with the Chancellor for it to be anything else other than his work. No doubt he even arranged for a German lawyer to write to The Times on March 29 to explain the German methods of preventing tax avoidance - a matter which Foster himself had arranged to be

brought to the attention of the Chancellor. The two articles produced a considerable response in the letters columns of 26th, 28th and 29th of March, reflecting a variety of views and excuses as to why tax avoidance was taking place. Jasper More, the author of the first book entirely devoted to tax avoidance methods in the UK, was one of the correspondents who believed that the impulse to resort to evasion or avoidance arose not from the desire of the citizen to inflict injustice on his fellow taxpayers but from the conviction that he himself was the victim of injustice. (The Times, March 28, 1938).

22. PRO File T171/340.

23. The memorandum also dealt with avoidance through the transfer of assets abroad, the valuation of stock on the termination of business and a form of stamp duty avoidance relating to conveyances of property on sale. According to the covering note sending a copy of this memorandum to Parliamentary Counsel, these matters completed the Revenue's programme for dealing with avoidance. Parliamentary Counsel, Finance Bill 1938 File, p3921.

24. Memorandum to the Chancellor, PRO File T171/340.

25. (1933) 17 TC 741.

26. The example provided to the Chancellor by the Revenue was based upon the deed which had been passed to them by Foster under which the settlor was required to make annual payments to trustees to be held in trust for the beneficiaries in such shares as the settlor directed but under which the settlor had a power to revoke the settlement with the consent of specified persons. On revocation the settlor could require the trustees to hand him the trust fund. The settlor thus obtained surtax deductions for his annual payments and could then at some later stage get back the equivalent of his annual payments, plus any income earned from the investment of them, as a capital sum.

27. Memorandum to the Chancellor, PRO File T171/340

28. The tests of irrevocability in the Finance Act 1922 would then become redundant.

29. Handwritten note on memorandum from the Inland Revenue on PRO File T171/341.

30. Parliamentary Counsel, Finance Bill 1938 File, p.3921.

31. PRO File T171/340.

32. Ibid.

33. There is no date shown on this letter but it is clear from later references to it that it was written before March 31, 1938.

34. Letter to Woods from Gregg dated March 31, 1938 on PRO File T171/340.

35. The problem had been discussed by the Board's Avoidance Committee in 1934.

36. Section 25, Income Tax Act 1918.

37. PRO File T171/340.

38. Ibid.

39. Ibid.

40. Ibid.

41. Parliamentary Counsel, Finance Bill 1938 File, February 19, 1938.

42. Parliamentary Counsel Finance Bill 1938 File, p3993.

43. Ibid.

44. See chapter 10.

45. PRO File T171/340.

46. Ibid.

47. Section 21(3)(a) F.A. 1936.

48. No objection was raised if the payments were in fact made over to beneficiaries, because if the settlor had paid them directly to a beneficiary under a deed creating a charge for a term of not less than six years, he would have received a deduction.

49. PRO File T171/340.

50. Parliamentary Counsel, Finance Bill 1938 File, letter from Gregg to the draftsman, Stainton, February 26, 1938, p3993.

51. PRO File T171/340.

52. The Revenue's suggested action would also have brought the income tax treatment of the trust into line with that for Estate Duty.

53. Parliamentary Counsel had prepared a draft clause and discussed it with the Revenue before the Chancellor changed his mind. The actual notification from the Chancellor of his change of mind could not be found on the files examined.

54. PRO File T171/340, Memorandum to Chancellor dated February 11, 1938.

55. The report of the Board's Tax Avoidance Committee - P.R.O. File IR40/4574-at p53 indicates that there was one trust in which the

income accumulated in 1932/33 was £200,000 and that "in three other cases the invested funds amount to some two and a half million pounds." By relating this to the amount of tax lost it would seem to follow that there were only a handful of cases which the Revenue wished to attack under their irrevocable settlement proposals.

56. Parliamentary Counsel Finance Bill 1938 File, p3923.

57. PRO File T171/340.

58. Parliamentary Counsel Finance Bill 1938 File, p4013. There is no evidence on file of the actual proposal being put to the Chancellor of his agreement to taking action.

59. Extract from Gregg's letter dated March 8, 1938 on Parliamentary Counsel Finance Bill 1938 Files at p4013. There is no indication on the extract as to whom the letter was addressed.

60. See chapter 11.

61. PRO File T171/340.

62. (1931) 15 TC 729

63. Parliamentary Counsel, Finance Bill 1938 Files, April 5, 1938.

64. No other Chancellor in the years in which the settlement legislation was introduced or amended appears to have circulated extracts of his draft speech to outsiders.

65. PRO File T171/340. It is apparent from the letter that Latter had provided assistance to the Chancellor on this subject before.

66. The draft as amended by Latter is almost identical to the relevant part of the final speech reported in Hansard.

67. Letter to Latter from the Chancellor of the Exchequer, April 19, 1938, PRO File T171/340.

68. The draftsman explained this lack of referential legislation to the Revenue in the following terms:-
"I must warn you that there is at present a very active agitation on foot to do away with the type of legislation of which this clause is an example. Some thirty MPs, all supporters of the Government, have recently presented a memorial to the Prime Minister praying that this kind of legislation should be stopped or that if it must continue the whole of the section amended should be set out in a schedule with the amendments incorporated. I think it possible that members who are supporting this movement are sufficiently powerful to require that at least the second course should be adopted in the case of this clause." (Memo from Stainton to Verity, March 12, 1938, Parliamentary Counsel, Finance Bill 1938 File, p4031). Apparently section 21(5) of the Finance

Act 1936 was one of the major examples of the kind of legislation which the MPs wished to stop.

69. Although section 451 underwent fairly major modifications in 1981, the basic situations it is aimed at are still precisely the same.

70. This let-out was provided so that settlements containing a power of revocation which was only exercisable after a considerable period would be treated no worse than they would if there were no ensuing period of revocability. Six years was chosen to correspond with the period in section 20(1)(b) of the Finance Act 1922 - PRO File IR63/147A p185.

71. Even where there was no power of revocation, it was still possible to draw up a settlement in such a manner that the income or capital would revert to the settlor or his wife should certain contingencies arise. This loophole was apparently being widely used to avoid surtax - ibid, p186. Under the proposed legislation if income was actually distributed to beneficiaries then it was to be treated as theirs because it could not then revert to the settlor or his wife. However, any undistributed income was to be treated as the settlor's if he or his wife retained an interest.

72. There were some minor points of disagreement between the Inland Revenue and the draftsman but these largely concerned cases at the fringe of the provisions and circumstances which were unlikely to be met in the normal case.

73. This decision appears to have been taken without reference to ministers and illustrates how, once the basic approach has been agreed, the details are usually left to the civil servants.

74. (1939) 31 TC 1.

75. Undated memo from the draftsman to the Revenue - Parliamentary Counsel, Finance Bill 1938 File, p4185.

76. For example, where a settlor settled a sum on trust for his sister for her life on protective trusts with remainder to her children, if any, with an ultimate remainder to his brother, then if the sister committed some act which brought section 33 of the Trustee Act 1925 into operation, the persons amongst whom the trustees might distribute the income would be the sister and, if she had no children, the brother. However, if the brother had died before that time, those persons would be the sister and the settlor.

77. It was thought that the most likely case would be where a settlor made a settlement on protective trusts for one of his parents. If that parent could be persuaded to charge or attempt to charge the interest in the trust then the settlor, being a child of the beneficiary, could benefit.

78. Parliamentary Counsel, Finance Bill 1938 File, p4193.

79. There is nothing on the files examined to indicate how the draftsman was persuaded to change his view. It is likely that the matter was dealt with at a meeting with Revenue officials.

80. There is no indication on the files examined as to why no special let-out was provided for marriage settlements subject to Scots Law.

81. During the Ways and Means Report Stage debates the Solicitor General gave quite a detailed account of what was behind the Budget resolution, but discussion did not focus on the avoidance which was to be prevented but more on classes of avoidance which had not been stopped - for example, Hansard May 4, 1938, cols. 935-937, Mr Benson.

82. Parliamentary Counsel, Finance Bill 1938 File, p4237.

83. Ibid.

84. One such settlement was to provide a public school education for children whose parents could not otherwise afford it. Ibid.

85. Ibid. p4239.

86. Ibid.

87. Ibid.

88. Ibid. p4241.

89. Parliamentary Counsel, Finance Bill 1938 File, p4231.

90. Ibid.

91. Ibid.

92. Ibid. p4235.

93. Parliamentary Counsel, Finance Bill 1938 File, p4243.

94. Parliamentary Counsel, Finance Bill 1938 File, p4229. It appears that the draftsman was rather annoyed with Brass and thought that if the four settlements were made after the Chancellor had delivered his warning there was no principle of fairness upon which he was entitled to escape the consequences of neglecting that warning. He thought it was unjustifiable to let him off "the consequences of his perfectly obvious attempts to escape income tax, an attempt which seems to have been made after he had been warned what would happen if he made it." Ibid. p4247.

95. Hansard, June 27, 1938, col.1627.- In fact the settlements referred to were his own - see text.

96. Ibid. col.1628.

97. Hansard, June 20, 1922, cols. 1205-1208.

98. Ibid.

99. The effect of not providing some escape clause was said by some

Members to be that any additional tax liability would be recouped out of future charitable dispositions. - a proposition which does not necessarily follow.

1. One example given was that of a civil servant with a relatively small salary whose family included an adult mentally retarded child. A settlement had been made in favour of the child but a power to revoke had been reserved. The reason given for having retained this power was that if anything should happen to the civil servant his income might be reduced and he would have to reconsider the whole position - Hansard, June 20, 1922, col. 1631.

2. Ibid. col.1638.

3. Ibid. col.1635

4. Ibid. col.1636.

5. Ibid.

6. Hansard, July 12, 1938, col.1178.

7. Ibid. cols. 1168-1175.

8. Ibid. col. 1173.

9. Mr. Higgs M.P. and Sir John Wardlaw-Milne, P.R.O. File IR63/147 p463.

10. Board of Inland Revenue, PRO File IR63/147.

11. Normally there are many drafts before a final form is agreed but in this case agreement was reached remarkably quickly.

12. The only purpose of the company in such a case would normally have been to receive and invest the annual payments and it would not usually have paid any dividends.

13. PRO File IR 63/147 p192.

14. Revocable settlements were caught by clause 32, but the Revenue expected some of them to be converted into irrevocable settlements to escape that clause and thought it reasonable for them to be treated in the same way as irrevocable settlements created after the Budget date and brought within the scope of clause 33 - PRO File IR 63/147 p192. A husband and wife were treated as one for the purpose of the clause so that where a settlement by the husband included annual payments by a wife, or vice versa, or a wife made separate annual payments to a company connected with the settlement, such arrangements would be caught - PRO File IR 63/147 p192.

15. PRO File IR63/147 p191.

16. Ibid.

17. See chapter 5.

18. PRO File IR63/147 p191.

19. Ibid.

20. Hansard, June 27, 1938, col. 1642, Mr Benson.

21. The unearthing of these more complex schemes appears to have been related to the examination of the methods which were being used to get around the anti-avoidance provisions concerning the transfer of assets abroad introduced by section 18 of the Finance Act 1936. (Parliamentary Counsel Finance Bill 1938 File, p4217-4219.) Amendments to that legislation were made by section 28 of the Finance Act 1938 and one change specifically attacked capital sums received by an individual. The definition of a capital sum for both the transfer of assets abroad provisions and the settlement provisions are almost identical - Finance Act 1938, section 28 (2) and section 40 (5). (See now ICTA 1970 section 478 (2) and section 451 (8).)

22. Parliamentary Counsel Finance Bill 1938 File, p4083.

23. The note is unsigned and undated and there is no indication within its text as to who wrote it.

24. Parliamentary Counsel Finance Bill 1938 File, p4087.

25. Ibid. p4089.

26. Ibid. p567.

27. Ibid. p4197.

28. Ibid. p629.

29. Ibid. p4193.

30. PRO File IR63/147, p195.

31. IRC v Bates, (1966) 44 TC 225.

32. A body corporate connected with a settlement was defined in clause 35(4)(e) as a body whose income was apportionable to the trustees under the close company provisions or a body whose income would have been apportionable if it were resident in the UK.

33. See the comments on clause 32, earlier in this chapter.

34. PRO IR 63/147 p293.

35. Ibid. p295.

36. Hansard,June 27, 1938, col.1843, The Attorney-General.

37. PRO File IR63/147 p295.

38. Ibid.

39. (1935) 19 TC 279.

40. F.A.1922 S21.

41. PRO File IR63/147 p200.

42. (1932) 17 TC 140.

43. Sums paid to bodies corporate connected with the settlement or to the trustees of another settlement made by the same settlor were excluded, as otherwise it would have been simple to ensure that income was distributed to one of these associates.

44. The reference to the place of incorporation was ill-advised and was replaced by a reference to the place of residence by S79 of the Finance Act 1965.

45. Hansard, July 15, 1938, Finance Bill 3rd reading, col.1098, Mr. Benson

46. The main changes were made in 1946 and 1965.

CHAPTER 7 - FOOTNOTES

1. (1943) 25TC 93.

2. PRO File IR 40/5690.

3. Taxation April 16, 1938, Query T2757; July 16, 1938, Query T2822; October 1, 1938, Query T2878; November 11, 1938, Query T2923; June 3, 1939, Query T3068; May 31, 1941, Query T3470; September 13, 1941, Query T3533; September 27, 1941, Query T3540; October 4, 1941, Query T3542; May 9, 1942, Query T3664; May 29, 1943, Query T3883.

4. Between April 1939 and October 1943 "Taxation" ran eleven full scale articles concerning the settlement provisions as follows:- July 19, 1939 Childrens' Settlements; March 2, 1940, Position of Childrens' Settlements; March 13, 1940, Capital Payments to Settlors; May 25, 1940, Settlements for Accumulation; August 3, 1940, Variable Annual Payments; March 8, 1941, Power to Revoke; April 12, 1941, Arrangements; June 14, 1941, Settlements and Companies; November 14, 1942, Pre-1936 Childrens' Settlements; August 7, 1943, Effective Childrens' Settlements (I); August 21, 1943, Effective Childrens' Settlements (II). As well as the articles there were numerous short pieces drawing the attention of readers to new cases as well as case analyses and minor points of interest concerning the settlement provisions.

5. Hansard, December 12, 1940, col.996, Mr Cocks.

6. Ibid.

7. Hansard, May 22, 1941, col. 1612, Sir Kingsley Wood.

8. Ibid.

9. Taxation, vol. 22, No.590, p234, col.2.

10. Ibid. p235.

11. Taxation, vol. 26, No.671, March 1, 1941, "The Ethics of War Taxation".

12. Ibid. p322.

13. On July 5, 1941, a query was published concerning a scheme which attempted to get round the anti-avoidance provisions concerning settlements on children. It is most strange that no replies were published and it may well be that the editor had decided to remove all references to blatant avoidance from the journal. No explanation is given for the lack of any reply. Taxation, July 5, 1941, p222, Query T3500.

14. Taxation Practioner, December 1941.

15. Taxation 6 December, 1941, p147.

16. Taxation, Vol.30, No.805, p338, "Tax Avoidance in Wartime".

17. Taxation, November 15, 1941, p102; November 29, 1941, p133; December 13, 1941, p167; January 10, 1942, p232.

18. "Income Tax Evasion", The Times, February 12, 1943, p5.

19. The Times, February 20, 1943, p5.

20. At the beginning of the war standard rate tax was increased by two shillings in the pound and the rates of surtax were also considerably increased to give a top rate of tax of seventeen shillings in the pound.

21. Instructions to surtax examiners. PRO File IR112/22.

22. Per the Master of the Rolls.

23. (1938) 22 TC 416.

24. PRO File IR40/5241. Only three names are given; Lord Wedamere, Hon. B L Bathhurst and De Palma. They were all to be asked whether they were prepared to accept the Warden case as binding on them and to settle on the basis of its outcome. There is nothing on the file to indicate whether they agreed to this proposal, but the fact that there are no further cases on this point is a strong indication of their agreement.

25. (1943) 25 TC 84.

26. (1939) 22 TC 594.

27. PRO File IR40/6149A T1686/1140, August 9, 1934.

28. Ibid. Memo, July 28, 1934.

29. PRO File IR40/6149A. Parker minors T1686/53/57.

30. CIR v Morton, (1941) 24TC 259, Dalgety v CIR, (1941) 24TC 280, CIR v Rainsford-Hannay (1941) 24TC 273.

31. PRO File IR40/6149A - Memo from C I Claims Branch to Secretary Taxes, February 10, 1940, Papers T/2005/185/1939.

32. There is no explanation of this on the files and no evidence as to whether or not the Special Commissioners were able to assist, but the Intelligence Division made it clear that they were willing to get involved in tracking down these cases - PRO File IR40/6149A, February 20, 1940.

33. Friedlander, T2004/284/39, heard October 16, 1939, and Lady Norman, ST22347 heard November 2, 1939.

34. (1941-1943) 25 TC 317.

35. (1943) 25 TC 93.

36. PRO File IR63/161 p124, para 4.

37. It is known that the Board of Inland Revenue considered whether or not to make an assessment on Lord Pembroke - PRO IR63/161 p124, para. 5 but it is not known whether any assessment was actually made. It would seem, however, that it was almost certain that they would have gone ahead with the assessment given the advice they had received.

38. PRO IR63/162 p46, para. 7. An example appears in the report of current taxation cases by Roy E Borneman (Barrister at Law) in "Taxation" June 19, 1943, p177, where he says that Mr Justice Macnaghten held that because there were two settlors, section 38 (2) of the Finance Act 1938 could not apply.

39. Ibid.

40. PRO File IR63/162 p190.

41. Ibid.

42. PRO File IR63/161 p123-127.

43. Ibid. p125, para. 7.

44. 16 TC 293.

45. PRO File IR63/161 p123, J.H. Stamp.

46. Ibid.

47. Ibid.

48. Ibid. p125, para. 9.

49. Ibid. p126, para. 9(d).

50. For all their clever scheming, when the Vestey case eventually did reach the House of Lords it was decided against the Inland Revenue on other grounds. Lord Vestey's Executors and Vestey v CIR (1949) 31 TC 1.

51. PRO File IR63/161 p126, para 10.

52. PRO File IR63/161 p123.

53. PRO File IR63/161 p122.

54. Parliamentary Counsel, Finance Bill 1943 File p1275. There is nothing on the files to indicate whether the Public Bill Office objected to the form of words used in the draft resolution and, as the draft is not on file, it is not known whether or not any changes were made.

55. PRO File IR63/161 p121.

56. Parliamentary Counsel Finance Bill 1943 File, p1279.

57. Parliamentary Counsel Finance Bill 1943 File p1293 and p1301.

58. Ibid. p1301.

59. Ibid. p1313.

60. (1943) 25 TC 84.

61. Parliamentary Counsel Finance Bill 1943 File p1314.

62. In Herbert v CIR the Crown had contended that they could assess whichever person they liked in a joint settlor case but Macnaghten J. had strongly disagreed with this contention.

63. Parliamentary Counsel Finance Bill 1943 File, p1325.

64. Ibid. p1331.

65. Ibid. p1329.

66. Ibid. p1330.

67. Ibid. p1337.

68. Hansard, April 21, 1943, col. 1780-81, Sir Donald Somervell.

69. For example, where A settled £5,000 on B's mother such that the income was to be accumulated for 20 years and then the whole of the settlement funds were to go to B, and B made a separate settlement on A's mother with the ultimate benefit for A, then B would be regarded as the settlor of A's settlement and A would be regarded as the settlor of B's settlement, and any undistributed income would be treated as the income of the deemed settlor because the deemed settlor would have an interest in the income due to the fact that it might eventually come to him, i.e. it would be caught by Finance Act 1938 section 38(4).

70. For example, where new investments were bought out of the proceeds of the sale of the original property, including any accumulated income from either the original property or any property substituted for it.

71. For instance, where there were two settlors and the settlement property was sold and the proceeds of the property provided by each settlor was used to buy a single investment, an appropriate apportionment would be made.

CHAPTER 8 - FOOTNOTES

1. Mauray v CIR in the Court of Appeal, (1944) 26 TC 95, and Russell v CIR in the Court of Appeal, (1944) 26 TC 255.

2. (1944) 26 TC 265.

3. The other cases in which the Revenue were successful were Clark and the Langridge Trust and Investment Co. Ltd. v CIR, (1944) 28 TC 55, Hood Barrs v CIR, (1945) 27 TC 385, Waley Cohen v CIR, 1945, 26 TC 471 and Taylor v CIR (1945) 27 TC 93.

4. Hansard, June 2, 1943, col.265, Mr. Buchanan; Hansard, May 4, 1938, col.944, Mr. Benson; Hansard, June 27, 1938, col.1178, Mr. Benson.

5. Duke of Westminster v IRC, (1935) 19 TC 490.

6. Finance Act 1946, section 28(1)(d).

7. Hansard, June 19, 1946, col. 532 The Solicitor-General.

8. Hansard, April 17, 1946, col. 2820, Mr James Callaghan.

9. PRO File IR40/4574.

10. Ibid. para. 123.

11. The most recent discussion of the problem in Parliament prior to the enacting of the legislation was in 1943 - Hansard, June 2, 1943, col. 310-312, Mr Buchanan and Sir K Wood. The Chancellor avoided a question on the subject by saying that what was needed was a review of the whole question of charitable covenants.

12. What discussion there was took place in the Ways and Means Report Stage Debate on April 17, 1946.

13. Hansard, April 17, 1946, col. 2808, Mr York.

14. Sent to the Inland Revenue on March 21, 1946. Parliamentary Counsel Finance Bill 1946 File p1919.

15. PRO File IR63/172, p20.

16. Hansard, April 17, 1946, col. 2808-2809.

17. Finance Act 1965, section 12.

18. Hansard, April 17, 1946, cols 2808-2813, Mr Callaghan, Mr. York, Captain Crookshank, Sir W. Darling, Mr. Douglas, Earl Winterton.

19. Ibid.

20. Hansard, June 20, 1946, col.547.

21. See Chapter 4.

22. See Chapter 4.

23. There are various references to this in the materials examined, including PRO File IR63/172, p52 and Hansard, June 20, 1946, col. 531 and 533, The Solicitor-General.

24. PRO File IR63/171 p190.

25. PRO File IR40/4574 p34 and p50.

26. Hansard, June 2, 1943, col. 167 Sir Kingsley Wood.

27. PRO File IR63/171 p190.

28. PRO File IR63/171 p189 - 190.

29. Ibid.

30. Ibid.

31. Ibid.

32. Ibid.

33. Ibid.

34. Ibid. p189.

35. Ibid. February 14, 1946.

36. Ibid. p190.

37. Ibid.

38. The form of this undertaking is not in the papers examined.

39. Parliamentary Counsel Finance Bill 1946 File, p1916.

40. These words are found in Section 28 (1)(d) of the Finance Act 1946.

41. S12 Finance Act 1965 - now found in section 457 ICTA 1970

42. PRO IR63/172 p52, para. 7 - Board's notes on clauses.

43. PRO File IR63/172, p52.

44. Hansard, April 17, 1946, col. 2807 Mr York.

45. Ibid. col. 2817, The Solicitor-General.

46. Hansard, April 17, 1946, col. 2808, Mr Attewell.

47. Ibid. col. 2814, Mr. Keeling; col. 2815, Major Legge-Bourke.

48. Ibid. col. 2815, Mr Fletcher.

49. Ibid. col. 2818, Mr Dalton.

50. Ibid.

51. Ibid.

52. Ibid. col. 2822, Sir W Darling.

53. Hansard, April 30, 1946, col. 33 and May 14, 1946, col. 1678.

54. Notwithstanding that the National Trust is a charity.

55. PRO File IR63/172, p167-8.

56. Ibid.

57. Hansard, June 20, 1946, col. 529, Mr. Keeling.

58. Ibid.

59. Ibid.

60. Hansard, June 20, 1946, col. 539, Mr Assheton.

61. Ibid.

62. Ibid. col. 531.

63. Ibid. col. 532.

64. Ibid. col. 540, Mr Assheton

65. Ibid. col. 537, Sir Hugh Lucas-Tooth.

66. Ibid. col. 542, Mr Dalton.

67. Ibid.

68. PRO File IR63/172 p286.

69. PRO File T171/384.

70. Board's Memorandum No. 3 to The Royal Commission on Taxation of Profits and Income, National Library of Scotland, Ref. GRG19.

71. Statistics for later years are not available from the files examined by the writer. However, further commentary on the subject is available in "Charitable Covenants by Individuals - The History of the Background to their Tax Treatment and their Costs to the Exchequer", David Stopforth, British Tax Review 1986, p101-117.

CHAPTER 9 - FOOTNOTES

1. (1957) 37 TC 383.

2. (1957) 37 TC 416.

3. Prior to consolidation this was the Finance Act 1938 section 38 (2) and is now section 446 ICTA 1970.

4. S20 F.A. 1958.

5. S22 F.A. 1958.

6. Correction and minor improvements are permitted under the Consolidation of Enactments (Procedure) Act 1949.

7. Modifications to section 404 and 405 of I.T.A. 1952 made by F.A. 1958 section 21 (5).

8. The exact date was not available from the files examined but in a memorandum by Parliamentary Counsel dated November 14, 1949, he refers to "the six months or so which we have so far spent in trying to get a Consolidation Bill on its feet...." Parliamentary Counsel 1952 Consolidation Files, vol. XIII.

9. Memorandum by Parliamentary Counsel. Parliamentary Counsel Consolidation Files vol. XIII.

10. Ibid.

11. Ibid.

12. Ibid.

13. Ibid.

14. Ibid.

15. The Nicholas Committee.

16. Cmd. 8174.

17. Report of the Joint Committee on Consolidation - HL7, 17-I, HC62-I, January 29, 1952.

18. (1957) 37 TC 383.

19. See Viscount Simonds p408, Lord Reid p412 and Lord Cohen p413.

20. Letter from Johnstone to Fiennes, February 6, 1958. Parliamentary Counsel Finance Bill 1958 Files, p766.

21. Ibid.

22. Ibid.

23. Hughes v Bank of New Zealand, Lord Wright at 21 TC p504.

24. Parliamentary Counsel Finance Bill 1958 File, p766.

25. This was particularly so at a time when legislation amending section 404 and 405 was in preparation in any case.

26. Ibid. p767.

27. The relevant part of section 407 (4) is in the following terms:-

    "This section shall apply to any settlement (wherever made) made after the 26th day of April, 1938, and where income arising under any settlement (wherever made) made on or before that date is treated as the income of the settlor by virtue of section 404 of this Act ...".

28. Ibid. p767.

29. Ibid. p770.

30. Ibid.

31. Parliamentary Counsel Finance Bill 1958 File p768.

32. Ibid. p770.

33. Ibid.

34. It is interesting to see that the Revenue were aware of the unfairness of section 404 and 405 in certain circumstances but chose to do nothing about it.

35. Ibid. p770.

36. Ibid.

37. Ibid. p772.

38. Dreyfus v CIR, House of Lords, (1955) 36 TC 126.

39. Parliamentary Counsel Finance Bill 1958 File, p770.

40. Ibid. p768.

41. Ibid. p771.

42. Ibid.

43. Ibid. p773.

44. 36 TC at p139 and p155.

45. Parliamentary Counsel File, Finance Bill 1958 p773.

46. Ibid. p774.

47. Ibid.

48. Ibid.

49. Taxation, Vol. LX p257-259, "Revocable Settlements." December 28, 1957.

50. Memo from Johnstone to Rowe, March 6, 1958, Parliamentary Counsel, Finance Bill 1958 File, p775. After explaining the difference between the phraseology of the 1938 Act and the 1952 consolidation, the article went on to pose the question as to whether that difference "lent itself to an argument that the principle of Kenmare does not apply to post-1952 Act settlements."

51. Ibid. p784.

52. Ibid.

53. Ibid. p785.

54. Hansard, May 12, 1958, col.43-44, Mr Simon.

55. For example, Hood Barrs v CIR (1946) 27 TC 385 and Thomas v Marshall (1953) 34 TC 178.

56. For example, Glyn v CIR, (1948) 30 TC 321, Scott v CIR (1957) 37 TC 486 and CIR v Russell (1955) 36 TC 83.

57. (1950) 32 TC 211.

58. Now section 451 ICTA 1970.

59. Section 42 of the Finance Act 1981.

60. (1957) 37 TC 416.

61. Parliamentary Counsel Finance Bill 1958 File, p756.

62. Ibid.

63. Parliamentary Counsel, Finance Bill 1958 File, p755.

64. Ibid. p756.

65. Ibid.

66. Section 21 of the Finance Act 1958.

67. Hansard, April 26, 1938 col.55.

68. Parliamentary Counsel, Finance Bill 1958 File, p757.

69. Ibid. p758, Memo to Mr Maude from Hartog of the Inland Revenue.

70. Ibid. p758.

71. Ibid. p759-765.

72. A very detailed note was attached to the memorandum setting out the starting dates of all the past anti-avoidance settlement legislation and explaining why each of those dates had been chosen.

73. A similar let-out was provided at the report stage to the original legislation in 1938.

74. Parliamentary Counsel Finance Bill 1958 File, p753, Johnstone of the Revenue to Fiennes of Parliamentary Counsel.

75. Ibid. February 3, 1958.

76. Ibid. p769.

77. Parliamentary Counsel Finance Bill 1958 File, p753.

78. 37 TC at p436.

79. Parliamentary Counsel Finance Bill 1958 File, p753.

80. Ibid.

81. Ibid.

82. Finance Act 1938 section 38(7).

83. Ibid. p772.

84. Ibid.

85. Parliamentary Counsel Finance Bill 1958 File, p775.

86. Ibid. p772.

87. Ibid. p775.

88. Ibid. p777.

89. Finance Act 1958 S21(3).

90. Hansard, April 15, 1958, col.62, Derick Heathcoat Amory.

91. Ibid.

92. Hansard, May 12, 1958, col.43 - Mr Simon. The lack of discussion may well have been due to the fact that the Chancellor had announced in his Budget Speech that he intended to introduce proposals to attack dividend stripping retrospectively to October 1955, and yet by the time of the second reading he had changed his mind about retrospection. Thus, when the House came to consider the anti-avoidance clauses almost the whole debate revolved around the merits or otherwise of retrospective legislation to catch the severe loss of tax that had been taking place through dividend stripping.

93. Precise details as to which Law Society and which of the Accountancy bodies is not available from the files.

94. Parliamentary Counsel Finance Bill 1958 Files, p792.

95. Ibid. p793.

96. Ibid.

97. Ibid.

98. Hansard, July 10, 1958, col. 1044, The Solicitor General.

99. Hansard, June 18, 1958, cols. 1266-1267, Mr Fletcher-Cooke.

1. Ibid. col. 1273, The Solicitor-General.

2. Ibid. col. 1268-1269, Mr Diamond.

3. Ibid. col. 1272, The Solicitor-General.

4. Ibid.

5. Parliamentary Counsel Finance Bill 1958 File, p802.

6. Hansard, June 18, 1958 col. 1259, Major Hicks-Beach.

7. Parliamentary Counsel Finance Bill 1958 Files, p802-803.

8. Hansard June 18, 1958, col. 1260, Mr Fletcher-Cooke.

9. Ibid. col. 1263.

10. Ibid.

11. Parliamentary Counsel Finance Bill 1958 File, p802.

12. Ibid.

13. Ibid.

14. Hansard July 10, 1958, col. 1040, The Solicitor-General.

15. Ibid. col. 1041, The Solicitor-General.

16. Ibid.

17. Hansard, July 15, 1958, col. 1042, Major W Hicks Beach.

18. Ibid. col. 1042, Mr Mitchison.

19. Ibid. col. 1042-1043, The Solicitor-General.

20. Hansard, June 18, 1958, col. 1260 Mr Fletcher-Cooke.

21. Parliamentary Counsel, Finance Bill 1958 File, p802.

22. Ibid.

23. Ibid.

24. Ibid.

25. Ibid.

26. Ibid. p803.

27. Hansard, June 18, 1958, col. 1261 Mr Fletcher-Cooke.

28. Ibid.

29. Hansard, June 18, 1958, col. 1264, The Solicitor-General.

30. Ibid.

31. Parliamentary Counsel, Finance Bill 1958 File, p803.

32. Ibid.

33. Ibid.

34. Hansard, July 15, 1958, col. 1040.

35. Parliamentary Counsel, Finance Bill 1958 File, p803.

36. Parliamentary Counsel, Finance Bill 1958 File, p811.

37. Section 21(4) Finance Act 1958.

38. Memorandum to the Chancellor's Private Secretary dated June 13, 1958. Parliamentary Counsel, Finance Bill 1958 File, p791.

39. For example see comments by Mr. Benson discussed in Chapter 6.

40. Hansard, July 15, 1958, col. 1056, The Solicitor-General.

41. Parliamentary Counsel, Finance Bill 1958 File, p789.

42. Now ICTA 1970 section 445(1) and 446(1).

43. Now ICTA 1970 sections 452-454.

44. Parliamentary Counsel, Finance Bill 1958 File, p801.

45. Ibid. p805.

46. Ibid. p811.

47. Hansard, July 15, 1958, col. 1057, The Solicitor-General.

48. Ibid. col. 1058, Mr Houghton.

49. Ibid.

50. Parliamentary Counsel, Finance Bill 1958 File, p794.

51. Ibid.

52. See the immediately preceding part of this chapter.

53. Ibid.

54. Ibid. p806.

55. Hansard, July 10, 1958 cols 1048-1049, The Solicitor-General.

56. Finance Act 1958 section 20(5) and (6).

57. The Conservative Member for Stockport from 1924 to 1933, and for East Willesden from 1938 to 1945.

58. Section 397(1) I.T.A. 1952.

59. Parliamentary Counsel Finance Bill 1958 File, p809.

60. Ibid.

61. Ibid. p808.

62. Ibid. p807.

63. Ibid. p805.

64. Ibid. p805.

65. Ibid.

66. Finance Act 1958 section 20(4).

CHAPTER 10 - FOOTNOTES

1. The Labour Party were returned to Office after thirteen years in Opposition.

2. For example, Crossland v Hawkins, (1961), 39 TC 493; CIR v Leiner, (1964), 41 TC 589.

3. CIR v De Vigier, (1964), 42 TC 24; CIR v Bates, (1966), 44 TC 225.

4. Parliamentary Counsel, Finance Bill 1965 File, p7443.

5. (1960) 38 TC 625.

6. Hansard, April 4, 1960, col. 32, The Chancellor of the Exchequer.

7. See section 46 (1) and schedule 6 Finance Act 1960

8. Section 17 and schedule 4 I.T.M.A. 1964.

9. Section 402 and section 410 I.T.A. 1952.

10. Sections 404, 405 and 408.

11. According to whether it was income tax or surtax.

12. Sections 394 (1), 400 (1) and 406 (3) I.T.A. 1952.

13. Schedule 3, Part II I.T.A. 1964

14. Hansard, April 6, 1965, col. 261, The Chancellor of the Exchequer, Mr. James Callaghan.

15. Ibid.

16. Section 411 I.T.A. 1952.

17. Section 411 (1)(b) I.T.A. 1952.

18. Chapter III of Part XVIII I.T.A. 1952.

19. Chapter I, II and V of Part XVIII I.T.A. 1952.

20. Parliamentary Counsel, Finance Bill 1965 File, p9909.

21. Ibid.

22. Ibid. p9911.

23. Ibid.

24. An attack which did not in fact materialise as such but which probably ended up as the aggregation of children's income provisions of the Finance Act 1968.

25. Ibid. p9911.

26. Parliamentary Counsel, Finance Bill 1965 File, p9913.

27. Ibid.

28. Section 411 (4) I.T.A. 1952.

29. Hansard, June 22, 1965, col. 1696, Mr Diamond.

30. The settlor would merely have transferred assets to various settlements in which, in one way or another, he had retained an interest, and by doing so he would have avoided the surtax which might otherwise have become payable when short-term gains were made on the subsequent disposal of those assets.

31. Parliamentary Counsel, Finance Bill 1962, File p855.

32. Ibid.

33. Ibid.

34. Ibid. p856.

35. Chapter III of Part XVIII.

36. Parliamentary Counsel, Finance Bill 1962 File, p855.

37. Ibid. p857.

38. Ibid.

39. Ibid. An example would be where under section 398 (1)(b) I.T.A. 1952, income was not allocated to any particular child of the settlor and some of the children who could benefit were infants while others were not.

40. Parliamentary Counsel, Finance Bill 1962 File, p857.

41. Section 16 and schedule 10 Finance Act 1962.

42. Ibid.

43. Ibid.

44. Section 12(5) Finance Act 1962.

45. Schedule 10, Finance Act 1962.

46. Ibid.

47. Section 12 (6) Finance Act 1962.

48. Section 16 and schedule 10 Finance Act 1962.

49. Ibid.

50. Section 12 (6) Finance Act 1962 .

51. Hansard, May 31, 1965, cols. 1347-1368, Mr Grimond, Mr Heath, Mr Kimball, Mr Hall, Sir H Lucas-Tooth.

52. Section 411(2) I.T.A. 1952 (Now section 454 (3) ICTA 1970).

53. Hansard, May 31, 1965, col. 1347-1368.

54. Section 42(1) Finance Act 1965.

55. Powers under I.T.A. 1952, section 410, were given by F.A. 1965 Sch.10.

56. Section 28 TMA 1970.

57. In paragraph 9 of schedule 10 Finance Act 1965.

58. Section 28 TMA 1970. Settled property for the purposes of these information powers merely meant any property held on trust other than a bare trust. Although these powers are apparently narrower than those which were given in the Finance Act 1965, this is not really the case as section 42 only applied where there was a trust and the Inland Revenue could probably still proceed under the income tax information powers to obtain particulars from any person who was a party to the settlement.

59. Section 80 Finance Act 1981.

60. Section 71 (1) Finance Act 1984.

61. Labour Party Manifesto.

62. See chapter 8.

63. Parliamentary Counsel, Finance Bill 1965 File, p7443-7452 Feb. 15, 1965.

64. Ibid. p7444.

65. Ibid. p7445.

66. Ibid. In 1954 the Revenue estimated that there were 110,000 deeds in favour of individuals and that on average they involved £250 per annum. It was estimated that about 40,000 to 50,000 of them involved surtax payers and that half of all surtax payers with income in excess of £10,000 claimed relief in respect of such deeds. (Boards Memorandum No. 119 to the Royal Commission on the Taxation of Profits and Income, National Library of Scotland, ref. GRG19).

67. Ibid.

68. Ibid.

69. Ibid.

70. Ibid.

71. Ibid. p7446.

72. Ibid.

73. Ibid. p7447.

74. Ibid.

75. Ibid.

76. Ibid. p7446.

77. Section 415(1)(b) I.T.A. 1982.

78. Parliamentary Counsel, Finance Bill 1965 File, p7446.

79. Ibid.

80. Final Report Cmd.9474, paras.155-157.

81. Parliamentary Counsel, Finance Bill 1965 File, p7446.

82. Ibid.

83. Ibid.

84. Ibid. p7447.

85. Ibid. p7448.

86. Ibid.

87. The aggregation of children's income with that of the parents by the Finance Act 1968 achieved the effect the Revenue wanted, but the provisions were repealed a few years later.

88. Ibid. p7449.

89. Ibid.

90. Ibid. p7449.

91. Ibid.

92. Ibid. p7449.

93. Ibid.

94. Ibid. p7450.

95. Ibid.

96. Ibid. (Section 228 was repealed by the Finance Act 1969).

97. Parliamentary Counsel, Finance Bill 1965 File, p7450.

98. See Chapter 5. At that time it was argued that because such capital must have been built up out of income which had already suffered tax it would be unfair to deem the income arising from that taxed capital to be the settlor's.

99. Parliamentary Counsel, Finance Bill 1965 File, p7450.

1. Ibid. p7451.

2. Ibid.

3. Ibid.

4. Ibid.

5. Ibid.

6. Certain exceptions apply for income already deemed to be that of the settlor or income arising under a charitable trust or pension scheme. Section 16 Finance Act 1973.

7. Parliamentary Counsel, Finance Bill 1965 File, p7453.

8. Memorandum from the Inland Revenue to the draftsman, March 15, 1965. Parliamentary Counsel File, Finance Bill 1965, p7453.

9. Section 415 I.T.A. 1952

10. Parliamentary Counsel, Finance Bill 1965 File, p7453.

11. Ibid. p7456-7458.

12. Ibid. p7459.

13. Ibid. p7455.

14. Ibid. p7459.

15. Section 415 I.T.A. 1952.

16. Parliamentary Counsel, Finance Bill 1965 File, p7462.

17. Finance (No.2) Bill 1965, clause 12, Bill 159.

18. Hansard, April 6, 1965, col.253, Mr James Callaghan.

19. Amendment 35.

20. Parliamentary Counsel, Finance Bill 1965 File, p5078.

21. Ibid.

22. Hansard, May 20, 1965, col.1799, Dame Patricia Hornsby-Smith.

23. For example, Roman Catholics who were paying to support other people's children to go to fee-paying schools to ensure a Catholic

education and people who supported elderly housekeepers who had looked after their aged parents. Ibid. col 1801-1802, Dame Patricia Hornsby-Smith.

24. Hansard, May 10, 1965, col. 1817, Mr Harold Lever.

25. Amendment 36.

26. Parliamentary Counsel, Finance Bill 1965 File, p5082.

27. Ibid.

28. Amendments 37, 93 and 323.

29. Parliamentary Counsel, Finance Bill 1965 File, p5083.

30. Ibid. The Revenue realised that class (c) could well merely be a variant of class (b) becase the annuity to a retired partner could be in payment for the purchase of his share of the business.

31. Ibid. They also pointed out that the Finance Bill already imposed a new burden on the retiring partner due to the fact that he would dispose of his interest in the partnership assets and thus become liable to capital gains tax on his retirement.

32. Ibid. p5084.

33. Ibid.

34. Ibid. p5084. It is not clear what the Revenue were getting at, but perhaps a more concrete example of the kind of case which would have been within the amendment, but was unacceptable, was the marriage settlement in which marriage was full consideration for the covenant.

35. Ibid. p5084.

36. Ibid.

37. Amendment 323.

38. Parliamentary Counsel, Finance Bill 1965 File, p5086.

39. Amendment 93.

40. Parliamentary Counsel, Finance Bill 1965, p5087.

41. Hansard, May 20, 1965, col. 1796-1797, Sir H. d'Avigdor-Goldsmid.

42. Ibid.

43. Ibid.

44. Hansard, May 20, 1965, col.1814, Mr MacDermot.

45. Ibid.

46. Hansard, May 20, 1965, col.1805, John Osborne.

47. Hansard, May 20, 1965, col.1814.

48. Which Institute and which Society was not made clear.

49. Parliamentary Counsel, Finance Bill 1965 File p.6531.

50. Ibid.

51. Ibid. p6532. Messrs Deloitte, Plender Griffiths & Co., Messrs Peat, Marwick Mitchell & Co., and Messrs Price Waterhouse & Co.

52. Ibid. p6533.

53. Ibid. p5083-5087.

54. Ibid. p7467-7471. The memorandum shows that it was issued in June 1965 but the exact date is not stated. As it specifically relates to John Osborne's letter it must have been prepared sometime after June 16, 1965.

55. Ibid. p7469.

56. Ibid. p7472.

57. The decision in Scoble v Secretary of State for India, (4 TC 478) was therefore to be unaffected.

58. Parliamentary Counsel, Finance Bill 1965, p7472.

59. Ibid. p7473.

60. Ibid. p7495.

61. Ibid.

62. Ibid. p7469.

63. Ibid.

64. Ibid.

65. Ibid.

66. Ibid. p7473

67. Ibid. p7473.

68. Ibid.

69. Ibid. p7475.

70. 1979 STC 793.

71. Hansard July 7, 1965 col. 1614, Mr John Osborne.

72. Ibid. col.1617, Mr MacDermot.

73. Ibid. col. 1618, Mr MacDermot.

74. Ibid. For example in a partnership between father and son it would have been easy for the son to obtain a surtax deduction for an annuity paid to his father ex-gratia. The Financial Secretary's response is taken almost verbatim from the notes provided to him by the Board of Inland Revenue.

75. Ibid. col. 1615-1618, Mr Osborne. He asked whether payments to retired partners and their widows and dependants had to be for a seven year period - col. 1615 but the answer he was given concerned whether or not covenants renewed after they had expired would qualify - col. 1618. (They would not; the renewal would be an act of bounty). A further point he raised was whether, when an annuity was increased, relief would be obtained on the increase. No reply was given to this question, but clearly an increase which was not reflected in the original agreement would not qualify for surtax relief.

76. Hansard, July 7, 1965, col. 1618, Mr MacDermot.

77. It is not known which Society or Institute.

78. Parliamentary Counsel, Finance Bill 1966 File, p4038.

79. Ibid.

80. Ibid. p4039.

81. Ibid. p4039.

82. Ibid. p4042. Memorandum to the Chancellor from Niall MacDermot, The Financial Secretary to the Treasury, April 6, 1966.

83. Ibid. p4041.

84. Ibid.

85. Ibid. p4042.

86. Ibid, p4047.

87. Section 361(1)(b) I.T.A. 1952.

88. Parliamentary Counsel, Finance Bill 1966 File, p4040-4041.

89. Ibid. p4041.

90. Ibid. p4039.

91. Ibid. p4042. Memorandum to Chancellor of the Exchequer from Niall MacDermot, April 6, 1966.

92. Ibid. p4043.

93. A handwritten note on Parliamentary Counsel's copy of the instructions to draft substitutes the word 'retirement' for the word 'death'. Ibid.

94. Ibid. p4044.

95. Ibid. p4046.

96. Ibid. p4050.

97. Section 12 (3)(a) Finance Act 1965.

98. Opinion of H.H. Monroe. Extracts are on Parliamentary Counsel, Finance Bill 1966 File, p4045.

99. Ibid.

1. Ibid.

2. The position in Scotland was not mentioned.

3. Ibid. p4040.

4. Ibid.

5. Ibid.

6. Section 12 (3)(b), Finance Act 1965,

7. Parliamentary Counsel, Finance Bill 1966 File, p4038, memorandum April 1, 1966.

8. Ibid. p4042, April 6, 1966.

9. A particular concern of the Revenue was to ensure in the case of a chain of sole proprietors, that where A sold his business to B and B sold it to C, then C should not be able to obtain a surtax deduction for an annuity to A. Ibid. p4046. They were, however, quite content that annuities from B to A and from C to B should be eligible for relief. Ibid.

10. The draftsman suggested an amendment to meet the case where a business was wound up without affecting the liability of the previous partners under the partnership agreement. The Inland Revenue noticed that Parliamentary Counsel's draft did not cover the case of partnerships which had acquired a business from an individual in consideration of an annuity where there was a subsequent change in the partners.

11. Hansard, May 3, 1966, col.1437, Mr James Callaghan.

12. Amendment 98.

13. Hansard, May 3, 1966 col. 1463.

14. Parliamentary Counsel, Finance Bill 1966 File, p2178.

15. Hansard, June 20, 1966, col. 145-150, Mrs Thatcher.

16. Ibid. col. 146-147, Mrs Thatcher.

17. Ibid. col.148, Mr John Diamond, The Chief Secretary to the Treasury.

18. Ibid. col.149, Mrs Thatcher.

19. Parliamentary Counsel, Finance Bill 1966 File, p2179.

20. Hansard, June 20, 1966, col.147, Mrs Thatcher.

21. Ibid. col. 148-149, Mr John Diamond.

22. Parliamentary Counsel Finance Bill 1966 File, p4071. The representations were made by the Association of Certified and Corporate Accountants in their comments on the Finance Bill 1966.

23. Ibid. p4072.

24. Ibid.

25. Ibid.

26. This ignores the tax liability of the purchaser of the annuity, but it must be admitted that where the retired partner was liable to very high rates of surtax the commutation of the annuity would probably have provided a considerable tax advantage.

27. Hansard, July 12, 1966, col. 1397, Mr Diamond.

28. Section 457 ICTA 1970.

29. Sub-section 4A inserted by section 34 (4) and (5) Finance Act 1980.

30. Sub-section 1(A) inserted by section 56 (2) and (6) Finance Act 1980.

31. Most particularly in Potts' Executors IRC, (1951) 32 TC 211.

CHAPTER 11 - FOOTNOTES

1. (1979) 54 TC 1

2. 1981 STC 441.

3. Watson v Holland 1984 STC 372, and Blausten v CIR (1971) 47 TC 542.

4. (1966) 44 TC 1.

5. 1982 STC 442.

6. The Conservatives had made a promise to repeal these provisions at the first opportunity. Hansard, Standing Committee A, May 20 1968, col. 1076, Mr MacLeod.

7. Cmd. 9105, paras. 122-126.

8. Ibid. Minority Report, paras. 23-28.

9. See for example, Parliamentary Counsel Finance Bill 1968 Files, p4508.

10. Ibid. At that time, the Revenue believed that aggregation would involve "a considerable recasting of the United Kingdom tax system" - but made no recommendation for or against its adoption Parliamentary Counsel, Finance Bill 1965 File, p7446 .

11. Parliamentary Counsel, Finance Bill 1968 File, p 4509.

12. Parliamentary Counsel Finance Bill 1968 Files Vol 14. The yield from this change was expected to be between twenty million and twenty-five million pounds per annum and it was estimated that 250 staff would be required to deal with it.

13. The proposal to aggregate capital gains was dropped even before the Bill was published.

14. Parliamentary Counsel, Finance Bill 1968 File, p4508.

15. Ibid. p4509.

16. Hansard, March 19, 1968, col. 293, Mr Roy Jenkins.

17. Parliamentary Counsel, Finance Bill 1968 File, p1831.

18. Trustees were obliged to provide the parent with details of the trust income arising to an infant beneficiary schedule 8, para 9, Finance Act 1968.

19. Aggregation was not to apply to any child who had ceased full-time education and had taken up employment or business. Detailed rules were set out regarding with which parent the income was to be aggregated in cases where, for instance, they were no longer married or one or other was non-resident.

20. Schedule 8, para 2, Finance Act 1968.

21. Finance Act 1965, section 12.

22. Schedule 8, para 6, Finance Act 1968. The parent could obtain a certificate from the Inland Revenue for production to the trustees, showing the extra tax he had paid because of the aggregation of the child's income from the trust. In the converse case, where a parent benefited from aggregation, (because for example he had incurred a trading loss), the excess repayment over the amount he would have received had there been no aggregation, was repayable to the child or, in the case of income arising under a trust, to the trustees.

23. The Radcliffe Royal Commission, Cmd. 9105, paras 23-28 of minority report.

24. Parliamentary Counsel, Finance Bill 1968 File, p1831.

25. Ibid.

26. Ibid.

27. Ibid. An amendment was put down by a group of Conservative Members aimed at re-instating the £5 exemption limit under the settlement provisions. What they failed to realise was that even with that £5 exemption limit the income would still be regarded as the parents because of the general rules of aggregation. Parliamentary Counsel, Finance Bill 1968 File, p2361.

28. Letter of May 9, 1968 from Sir Miles Thomas to the Chancellor. Parliamentary Counsel, Finance Bill 1968, Vol. 13. In fact the provisions had no effect when the assets were provided by the parents.

29. Hansard, Standing Committee A, May 20, 1968, col. 1086.

30. The first related to income from damages for personal injuries paid by the Criminal Injuries Compensation Board, while the second was an exception for payments made to a female infant by the putative father of a child of that infant for the maintenance, education or benefit of his child. The latter provision was to prevent the ridiculous situation where income paid to an unmarried infant mother in respect of an illegitimate child could be treated as the income of the child's maternal grandfather.

31. Hansard, Standing Committee F, June 18, 1969, col. 269-271, Mr Patrick Jenkin.

32. Ibid. col. 272, Mr Taverne.

33. Ibid.

34. For example, Hansard, July 3, 1968, col. 1634.

35. "A Better Tomorrow", p 9.

36. Memorandum, September 3, 1970 Parliamentary Counsel, Finance Bill 1971 File, p3159.

37. Ibid. p3160.

38. The reason for this difference was the reduction in the age of majority which had taken place in the meantime.

39. Parliamentary Counsel, Finance Bill 1971 File, p3162.

40. Hansard, Standing Committee F, June 16, 1969, col. 241-246, Mr Patrick Jenkin.

41. Parliamentary Counsel, Finance Bill 1971 File, p3166. It had not taken into account any surtax liability which would have occurred had the individual been entitled to the income during the period of accumulation, and did not require the withdrawal of any child allowance which had been given on the basis that there was no income in that period.

42. Ibid.

43. Ibid.

44. Ibid. p3167. They also suggested that it was better from a national savings standpoint to have the money locked up in tax free saving certificates.

45. Section 16(2)(d) Finance Act 1971.

46. Cmnd. 3342.

47. Ibid. para. 427.

48. Ibid.

49. Parliamentary Counsel, Finance Bill 1969 File, p2320.

50. Ibid. p2322. The Revenue also drew attention to the fact that the Latey Committee had not itself been entirely consistent in that it recommended that the power of the courts to award maintenance up to the age of 21 should be preserved, quite independently of any decision to change the age of majority. (Cmnd. 3342, para. 249). The Revenue thus were able to argue that the settlement provisions were also a special case.

51. Hansard, Standing Committee F, June 16, 1969 col. 261, Mr Jenkin.

52. Parliamentary Counsel, Finance Bill 1971 File, p3165-3166.

53. Ibid. p3175.

54. Ibid.

55. Ibid. p3179.

56. Ibid.

57. Ibid.

58. It was estimated that there were about a hundred thousand families with income exceeding £2,000 a year in respect of whom child allowance was given for children over 18, but it was thought that most families below that income level would not bother to enter into settlements. The Revenue calculated that if one hundred thousand transfers of income of say, £100 a year were made, the loss of tax would be in the order of three to four million pounds per annum but they thought this most unlikely. Parliamentary Counsel, Finance Bill 1971 File, p3179-3180.

59. The Inland Revenue's expectation that the student grant rules would be altered so that income from parental settlements would be taken into account in calculating the student's income for grant purposes did not materialise, and when, some years later, the child allowance was replaced by a non-taxable child benefit, the way was open to a considerably greater loss of revenue than they had anticipated. The use of student covenants by parents now seems to be an accepted part of our tax system, irrespective of the cost to the Exchequer, and it almost appears that the Inland Revenue assist in the process by producing detailed explanatory notes of how to use the scheme. This has presumably been done on the grounds that in the long run, it saves them work.

60. Parliamentary Counsel, Finance Bill 1971 File, p3181 and p3191.

61. Ibid. p1011 Mr John Pardoe. This went even further than the official Opposition amendment which only proposed the deletion of the aggregation provisions.

62. Hansard, June 19, 1968, col. 1213-1245, June 20, 1968, col. 1343-1344, July 3, 1968, col. 1628-9. Mr Richard Wainwright.

63. Hansard, May 12, 1971, cols. 452-518.

64. Sections 18-27 Finance Act 1969.

65. Parliamentary Counsel, Finance Bill 1969 File, p4860.

66. Murray v CIR, (1926) 11 TC 133, and MacFarlane v CIR, (1929) 14 TC 432.

67. Parliamentary Counsel, Finance Bill 1969 File, p4860.

68. Ibid. For example, if a trust were created in which the settlor had a life interest, then if the trustees borrowed say £1,000 - probably on security provided by the settlor - and that produced an investment income of £50 and the interest payable was £100, the measure of income of the settlor would be nil. However, if the individual had himself borrowed the £1,000 he would have had investment income of £50 with no relief whatsoever for the £100 of interest payable.

69. Ibid. p4887. Thus revocable settlements allowing a reversion of property, and settlements involving a discretionary power for the benefit of the settlor were unaffected.

70. ITA 1952 section 407(1)(a), section 405 and section 408.

71. Ibid. p4866 and p4921.

72. Although this would appear to cause double taxation of the same income, it in fact produces exactly the same result as would apply where an individual paid interest on a non-qualifying loan.

73. I,T.A. 1952, section 408. Now ICTA 1970 section 451.

74. Parliamentary Counsel, Finance Bill 1969 File, p4887.

75. Hansard, Standing Committee F, June 18, 1969, col. 536-537.

76. Ibid. p4921.

77. Ibid.

78. Ibid. cols. 537-538.

79. Finance Act 1972 schedule 28 Part V.

80. Finance Act 1974, schedule 1, para 27.

81. Finance Act 1976, section 84.

82. Finance Act 1976, section 55.

83. Hansard, July 14, 1977, col. 827, Mr Joel Barnett.

84. New clause 11.

85. Parliamentary Counsel, Finance Bill 1977 File, p2947.

86. Ibid.

87. Ibid. p2948.

88. New clause 6.

89. Hansard, July 13, 1976, cols. 595-599, new clause 37.

90. Parliamentary Counsel, Finance Bill 1977 File, p2942.

91. Ibid. p2943.

92. Ibid.

93. Ibid. p2945.

94. Mr Joel Barnett.

95. Letter to John Pardoe from Joel Barnett, June 2, 1977, Parliamentary Counsel, Finance Bill 1977 File, p.2951.

96. This was eventually put down as new clause 121.

97. Ibid. p2952.

98. Ibid. p1358.

99. Hansard, Standing Committee D, June 22, 1977, col. 1090-1109.

1. Hansard, July 14, 1977, col. 814 Mr Ridley.

2. Parliamentary Counsel, Finance Bill 1977 File, p2955-2965.

3. Ibid. p2948.

4. Ibid. p2961.

5. Under any of ICTA 1970 section 447, 448 or 457.

6. Finance Act 1973, section 16(2)(b).

7. Ibid.

8. (1930) 15 TC 25.

9. Finance Act 1973 section 17 therefore had to be excluded and this meant that the payments would then fall within section 52 or 53 of ICTA 1970.

10. Ibid. p2962.

11. Ibid.

12. Ibid. p2969.

13. Ibid. p2966-2968.

14. Ibid. p2969-2985.

15. Defined in section 455 ICTA 1970.

16. Ibid. p2962.

17. June 23, 1977.

18. Parliamentary Counsel, Finance Bill 1977 File, p2962.

19. Ibid.

20. In most cases this would almost certainly have resulted in no repayment supplement being payable.

21. Parliamentary Counsel, Finance Bill 1977 File, p2976.

22. Ibid.

23. Hansard, July 14, 1977, cols. 809-829.

24. Hansard, July 14, 1977, col. 821, Mr Cormack.

25. Ibid. col. 828, Mr Joel Barnett.

26. Parliamentary Counsel, Finance Bill 1977 File, p2987. In effect, to include such an exception to the perpetuity rule would have given a non-tax advantage to a kind of settlement which was eligible for a tax advantage.

27. Ibid.

28. Ibid. p2988.

29. Section 52 Finance Act 1980.

30. Parliamentary Counsel, Finance Bill 1977 File, p2949.

31. Section 52 Finance Act 1980.

32. In section 38 Finance Act 1977.

33. Section 52(1) Finance Act 1980.

34. Section 88(2) Finance Act 1980.

35. Section 52(7) Finance Act 1980.

36. Section 52(2) Finance Act 1980.

37. Section 52(3) Finance Act 1980.

38. Parliamentary Counsel, Finance Bill 1980 File, p942.

39. Ibid. p941.

40. Ibid. p942.

41. Ibid. p942. This would have involved keeping records and making calculations for a very long time.

42. Ibid.

43. Ibid. This not only resulted in the most simple solution from the Revenue's point of view, but also charged the maximum justifiable amount of tax.

44. Section 62 Finance Act 1982. Such separate treatment also applied for certain other income tax purposes.

45. Section 93(6) Finance Act 1982.

46. Para 2(2), schedule 10, Finance Act 1982.

47. (1966) 44 TC 1.

48. Parliamentary Counsel, Finance Bill 1965 File, p7473.

49. Ibid. p7475. The Bulmer case probably appeared to inflict only limited damage on the settlement provisions due to the specific narrow points involved.

50. See IRC v Plummer (1979) 54 TC 1.

51. Ibid.

52. Parliamentary Counsel, Finance Bill 1977 File, p3371.

53. Ibid. p3370, December 15, 1976.

54. George Wimpey & Co. - see later.

55. Parliamentary Counsel, Finance Bill 1977 File, p3372.

56. Ibid.

57. Ibid. p3373.

58. Ibid.

59. Ibid.

60. Ibid. p3374.

61. Ibid.

62. Ibid.

63. Ibid.

64. Ibid. p3376.

65. On January 28, 1977.

66. Parliamentary Counsel, Finance Bill 1977 File, p3377.

67. Ibid.

68. Ibid. p3378.

69. Ibid. p3379.

70. Ibid. Many people in the Revenue had an interest in this problem and the drafting instructions were sent to them for comment. Some confusion seems to have arisen between the Revenue and the draftsman because of this as the Revenue, when sending the instructions to the draftsman, indicated to him that they were circulating copies internally and were merely sending a copy to the draftsman "so that you may be thinking about the problems involved." (Ibid. p3377). The draftsman interpreted this as being "no more than an invitation to cogitate," (Ibid. p3381) and did not reply until he was reminded almost two weeks later.

71. Ibid. p3382.

72. Ibid. p3385.

73. Ibid. p3386.

74. Ibid. p3387.

75. Ibid. p3388.

76. Ibid.

77. Section 256(2) and 257 ICTA 1970.

78. As a matter of prudence, however, no credits had been taken for that particular benefit in the accounts.

79. The Sunday Times, May 29, 1977, p53. £18.2 Million of Wimpey Tax - Lorana Sullivan.

80. Reported in the Financial Times, June 14, 1977.

81. Parliamentary Counsel, Finance Bill 1977 File, p3407-3410.

82. Ibid. p3409. The Revenue were dissatisfied with the Wimpey Chairman's justification for using the scheme. They explained that any change of accountancy practice would only have advanced a tax liability, whereas the gain derived from the avoidance arrangement was a permanent reduction in tax. The permanent reduction was also greatly in excess of the increase in liability arising from the change of accountancy practice. Ibid. p3408.

83. Ibid. p3409.

84. Ibid.

85. Ibid. p3410.

86. Ibid.

87. Ibid. p3410.

88. Ibid.

89. Ibid.

90. Ibid. p3413.

91. It was not until the Finance Act of 1978 that full-scale retrospection was introduced to withdraw any possibility of loss relief in connection with dealings in commodity futures. Finance Act 1978 section 31.

92. Ibid. p3400.

93. Ibid. p3404.

94. Hansard, Standing Committee D, June 21, 1977, col. 972, Mr Peter Rees.

95. Parliamentary Counsel, Finance Bill 1977 File, p3417.

96. Ibid.

97. Hansard, Standing Committee D, col. 973, June 21, 1977, Mr Peter Rees.

98. Ibid. col. 976, Mr Denzil Davies.

99. Ibid. The propositions (a) and (b) do not seem to follow from the terms of the legislation.

1. Ibid. col. 977 Mr Denzil Davies. The Revenue had found half a dozen cases of such payments to non-residents at that time.

2. Ibid.

3. Ibid. col. 971, Mr Peter Rees.

4. Ibid. col. 972, Mr Denzil Davies.

5. Parliamentary Counsel, Finance Bill 1977 File, p3419.

6. Ibid. p3415. Their objection was probably that there would be a tax deductible annuity with no corresponding taxable income, as there normally would be in the case of an interest in possession.

7. Ibid.

8. Ibid.

9. (1951) 32 TC 211.

10. Ibid, p236, Lord MacDermott.

11. (1964) 42 TC 24.

12. Ibid. p35, Lord Evershed.

13. (1966) 44 TC 225.

14. Ibid. p261-262.

15. Ibid. p261, Lord Reid.

16. Parliamentary Counsel, Finance Bill 1969 File, p4887.

17. 1981 STC 441.

18. Ibid. p451.

19. The Taxation of Certain Sums Paid to Settlors: section 451, Taxes Act 1970. September 1980.

20. Section 42(7) and (8) Finance Act 1981. The words now appear in the definition of a capital sum paid to the settlor in section 451 (9).

21. (1948) 30 TC 345.

22. Lord Uthwatt at p366.

23. Section 44 (2) Finance Act 1981.

24. The relevant legislation is as follows:
a) Finance Act 1971 schedule 6 paras. 59-68 removed references to the Board and to the standard rate.
b) Finance Act 1973 section 16 (7) amended section 451 to bring it into line with the new additional rate tax.
c) Finance Act 1978 schedule 2 paras. 12 and 13 made amendments to the definition of excess liability on the introduction of lower rate income tax).

25. The occasions on which these problems have arisen in the period 1966 to 1988 are:-
    a) Finance Act 1976 section 66 (5)(b) which determines the priority of the charge under section 451 when a charge also arises on the release or write-off of a loan to an employee.
    b) Finance Act 1984 section 97, dealing with off-shore income gains of non-resident trustees apportioned to beneficiaries and section 100 dealing with such gains of trustees holding assets for certain minors who would but for infancy be absolutely entitled.
    c) Finance Act 1985 schedule 23 para.9, dealing with the accrued income scheme.

FOOTNOTES - CHAPTER 12

1. Lindblom, C.E., Bargaining, The Hidden Hand In Government, Santa Monica, California, Rand Corp 1955.

2. See Michael Zander, The Law Making Process, (London: Weidenfield and Nicholson, 1980) pp. 2-6. One example is Robinson and Sandford, Tax Policy-Making In The United Kingdom. (London: Heinemann, 1983)

3 See Brian Smith, Policy Making in British Government, (London: Martin Robertson and Co Ltd, 1986) pp. 34-38.

4. Anyone doubting this should read Joel Barnett, Inside the Treasury, (London: Andre Deutch, 1982).

5. Ibid, p19.

6. Joel Barnett records his long running battle with the Revenue over the length of their papers but doubted that this had any effect. Ibid p24.

7. Peter Kellner and Lord Crowther-Hunt, The Civil Sevants, (London: Macdonald, 1980) p216.

8. This weakness of new ministers is discussed in The Civil Servants. Ibid. p212.

9. For example, Howe, Sir Geoffrey, 1977, "The Reform of Tax Machinery", British Tax Review No.2 , Robinson and Sandford, Tax Policy-Making In The United Kingdom, London: (Heinemann, 1983)

10. Lord Morrison of Lambeth, Government and Parliament, 3rd ed., (Oxford University Press 1964), p178.

11. R.H.S. Crossman, The Diaries of a Cabinet Minister, 1975.

12. Ibid. Vol. 1, pp. 628-9.

13. Ibid.

14. J.A.G. Griffith, Parliamentary Scrutiny of Government Bills, (London: George Allen & Unwin, 1974).

15. Max Weber, Law in Economy and Society (Cambridge: Harvard University Press, 1954), p323.

16. Peter Kellner and Lord Crowther-Hunt, The Civil Servants, London, (Macdonald, 1980), p285.

17. This is a well-established convention mentioned in paragraph 25 of the Memorandum of Guidance for Government Officials appearing before Parliamentary Select Committees (May 1980). This can be found in Appendix 2 of Englefield D. Whitehall and Westminster (Harlow: Longman, 1985)

18. Michael Heseltine, Sunday Times, July 23, 1978.

APPENDICES

<u>APPENDIX A</u>

1. Income Tax : Rates of Tax 1913-14 to 1919-20

2. Super-Tax Rates

3. Income Tax : Estimated Number of Individuals With Total Income Above The Exemption Limit

4. Super-Tax : Numbers Assessed, Income Assessed And Tax Charged

5. Income Tax and Super-Tax : Amount And Effective Rate of Tax On Specimen Incomes

6. Queries Concerning Settlements In "The Accountant" 1916-1922

Total Income from all sources		RATES OF TAX Reduced Rates of Tax Chargeable									
		1913-14 (Normal rate 1/2)		1914-15 (Normal rate 1/8)		1915-16 (Normal rate 3/-)		1916-17 and 1917-18 (Normal rate 5/-)		1918-19 and 1919-20 (Normal rate 6/-)	
		On Earned Income	On Unearned Income	On Earned Income	On Unearned Income	On Earned Income	On Unearned Income	On Earned Income	On Unearned Income	On Earned Income	On Unearned Income
Ex-ceeding £	Not ex-deeding £	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.
130	160	-	-	-	-	1 $9\frac{3}{5}$	2 $4\frac{4}{5}$	2 3	3 0	2 3	3 0
160	300	0 9	Normal	1 0	1 4	1 $9\frac{3}{5}$	2 $4\frac{4}{5}$	2 3	3 0	2 3	3 0
300	500	0 9	"	1 0	1 $6\frac{2}{3}$	1 $9\frac{3}{5}$	2 $9\frac{3}{5}$	2 3	3 0	2 3	3 0
500	1,000	0 9	"	1 0	Normal	1 $9\frac{3}{5}$	Normal	2 6	3 6	3 0	3 9
1,000	1,500	0 0	"	1 2	"	2 $1\frac{1}{5}$	"	3 0	4 0	3 9	4 6
1,500	2,000	0 9	"	1 4	"	2 $4\frac{4}{5}$	"	3 8	4 6	4 6	5 3
2,000	2,500	1 0	"	1 $6\frac{2}{3}$	"	2 $9\frac{3}{5}$	"	4 4	Normal	5 3	Normal
2,500	3,000	1 0	"	Normal	"	Normal	"	Normal	"	Normal	"
3,000	-	Normal	"	"	"	"	"	"	"	"	"

Source : 64th Report of the Commissioners of Inland Revenue

SUPER-TAX : RATES

Year	Income Chargeable	Rates of Super-tax	
1909-10 to 1913-14	Exceeding £5,000	6d. for every £1 of the amount by which the total income exceeded £3,000.	
1914-15 *	Exceeding £3,000	In respect of the first £2,500 of the income	NIL
		In respect of the excess over £2,500	s. d.
		For every £1 of the first £500 of the excess (to £3,000)	0 6⅔
		For every £1 of the next £1,000 of the excess (to £4,000)	0 9⅓
		For every £1 of the next £1,000 of the excess (to £5,000)	1 0
		For every £1 of the next £1,000 of the excess (to £6,000)	1 2⅔
		For every £1 of the next £1,000 of the excess (to £7,000)	1 5⅓
		For every £1 of the next £1,000 of the excess (to £8,000)	1 8
		For every £1 of the remainder of the excess (above £8,000)	1 9⅓
1915-16) 1916-17) 1917-18)	Exceeding £3,000	In respect of the first £2,500 of the income	NIL
		In respect of the excess over £2,500	s. d.
		For every £1 of the first £500 of the excess (to £3,000)	0 10
		For every £1 of the next £1,000 of the excess (to £4,000)	1 2
		For every £1 of the next £1,000 of the excess (to £5,000)	1 6
		For every £1 of the next £1,000 of the excess (to £6,000)	1 10
		For every £1 of the next £1,000 of the excess (to £7,000)	2 2
		For every £1 of the next £1,000 of the excess (to £8,000)	2 6
		For every £1 of the next £1,000 of the excess (to £9,000)	2 10
		For every £1 of the next £1,000 of the excess (to £10,000)	3 2
		For every £1 of the remainder of the excess (above £10,000)	3 6

1918-19 1919-20	Exceeding £2,500	In respect of the first £2,000 of the income	NIL
		In respect of the excess over £2,000	s. d.
		For every £1 of the first £500 of the excess (to £2,500)	1 0
		For every £1 of the next £500 of the excess (to £3,000)	1 6
		For every £1 of the next £1,000 of the excess (to £4,000)	2 0
		For every £1 of the next £1,000 of the excess (to £5,000)	2 6
		For every £1 of the next £1,000 of the excess (to £6,000)	3 0
		For every £1 of the next £2,000 of the excess (to £8,000)	3 6
		For every £1 of the next £2,000 of the excess (to £10,000)	4 0
		For every £1 of the remainder of the excess (above £10,000)	4 6
1920-21 to 1923-24	Exceeding £2,000	In respect of the first £2,000 of the income	NIL
		In respect of the excess over £2,000	s. d.
		For every £1 of the first £500 of the excess (to £2,500)	1 6
		For every £1 of the next £500 of the excess (to £3,000)	2 0
		For every £1 of the next £1,000 of the excess (to £4,000)	2 6
		For every £1 of the next £1,000 of the excess (to £5,000)	3 0
		For every £1 of the next £1,000 of the excess (to £6,000)	3 6
		For every £1 of the next £1,000 of the excess (to £7,000)	4 0
		For every £1 of the next £1,000 of the excess (to £8,000)	4 6
		For every £1 of the next £12,000 of the excess (to £20,000)	5 0
		For every £1 of the next £10,000 of the excess (to £30,000)	5 6
		For every £1 of the remainder of the excess (above £30,000)	6 0

*The amount of Super-tax payable for 1914-15 at the rates originally fixed by Parliament was increased by one-third under the provisions of the Finance Act 1914 (Session 2). These figures accordingly represent the rates thus increased at which Super-tax was charged for the year in question.

Source : The 68th Inland Revenue Report.

APPENDIX A3

INCOME TAX : ESTIMATED NUMBER OF INDIVIDUALS WITH TOTAL INCOMES ABOVE THE EXEMPTION LIMIT*

Year	Number of individuals: Entirely relieved from tax by the operation of abatements and allowances	Chargeable with tax	Total Number of Individuals
UNITED KINGDOM			
1913-14	70,000	1,130,000	1,200,000
1914-15	100,000	1,140,000	1,240,000
1915-16	120,000	1,360,000	1,480,000
1916-17	1,080,000	2,184,000	3,264,000
1917-18	1,520,000	2,956,000	4,476,000
1918-19	2,200,000	3,547,000	5,747,000
1919-20	3,900,000	3,900,000	7,800,000
1920-21	3,150,000	3,000,000	6,150,000
1921-22	2,900,000	2,600,000	5,500,000
1922-23	2,735,000	2,425,000	5,160,000
GT. BRITAIN AND N.I.			
1922-23	2,700,000	2,375,000	5,075,000
1923-24	2,350,000	2,450,000	4,800,000
1924-25	2,800,000	2,400,000	5,200,000
1925-26	2,400,000	2,200,000	4,600,000
1926-27	2,100,000	2,150,000	4,250,000
1927-28	2,400,000	2,250,000	4,650,000

*The effective exemption limit was, for the years 1916-17 to 1919-20 inclusive, £130 actual income and for the remaining years, £135 assessable income.

Source: The 67th and 71st Inland Revenue Reports.

APPENDIX A4

SUPER-TAX

Numbers Assessed, Income Assessed And Tax Charged

Year	No. of Persons	Income (£ million)	Super-Tax (£ million)
1913/14	14,008	175	3.34
1914/15	30,211	244	11.25
1915/16	29,465	233	18.41
1916/17	31,985	261	21.41
1917/18	35,286	297	25.46
1918/19	47,465	350	40.59
1919/20	54,201	406	47.52
1920/21	79,962	529	70.80
1921/22	93,273	590	74.10
1922/23	91,448	530	62.30

Note: Super-tax was charged on the income of the previous year.

Source: Derived from various Reports of the Commissioners of Inland Revenue.

APPENDIX A5

INCOME TAX AND SUPER-TAX - AMOUNT AND EFFECTIVE RATE OF TAX ON SPECIMEN INCOMES

Table I : Unmarried Individual : Income all Investment Income

Income	1913-14		1919-20		1920-21 and 1921-22	
	Total Tax	Effective Rate	Total Tax	Effective Rate	Total Tax	Effective Rate
£	£	Pence	£	Pence	£	Pence
130	-	-	-	-	-	-
150	-	-	5	7.2	2	3.6
200	2	2.8	12	14.4	10	11.7
300	8	6.5	27	21.6	25	19.8
400	14	8.4	42	25.2	46	27.5
500	20	9.8	60	28.8	76	36.4
700	37	12.6	118	40.5	136	46.5
1,000	58	14.0	188	45.0	226	54.2
1,500	88	14.0	338	54.0	376	60.1
2,000	117	14.0	525	63.0	526	63.1
2,500	146	14.0	750	72.0	713	68.4
3,000	175	14.0	963	77.0	913	73.0
4,000	233	14.0	1,363	81.8	1,338	80.3
5,000	292	14.0	1,788	85.8	1,788	85.3
7,000	508	17.4	2,713	93.0	2,763	94.7
9,000	675	18.0	3,688	98.3	3,838	102.4
12,000	925	18.5	5,238	104.8	5,488	109.8
20,000	1,592	19.1	9,438	113.2	9,888	118.7
30,000	2,425	19.4	14,688	117.5	15,638	125.1
50,000	4,092	19.6	25,188	120.9	27,638	132.7
100,000	8,258	19.8	51,438	123.4	57,638	138.3

APPENDIX A5
(Continued)

Table II : Married Individual and Three Children : Income all Earned Income

Income	1913-14 Total Tax	1913-14 Effective Rate	1919-20 Total Tax	1919-20 Effective Rate	1920-21 and 1921-22 Total Tax	1920-21 and 1921-22 Effective Rate
£	£	Pence	£	Pence	£	Pence
130	-	-	-	-	-	-
150	-	-	-	-	-	-
200	-	-	-	-	-	-
300	4	3.3	5	3.6	-	-
400	8	4.7	16	9.5	7	4.1
500	12	5.8	29	14.0	20	9.7
700	24	8.1	74	25.2	61	20.8
1,000	38	9.0	144	34.6	142	34.0
1,500	56	9.0	281	45.0	277	44.3
2,000	75	9.0	450	54.0	412	49.4
2,500	125	12.0	656	63.0	599	57.5
3,000	150	12.0	963	77.0	799	63.9
4,000	233	14.0	1,363	81.8	1,224	73.4
5,000	292	14.0	1,788	85.8	1,674	80.4
7,000	508	17.4	2,713	93.0	2,649	90.8
9,000	675	18.0	3,688	98.3	3,724	99.3
12,000	925	18.5	5,238	104.8	5,374	107.5
20,000	1,592	19.1	9,438	113.2	9,774	117.3
30,000	2,425	19.4	14,688	117.5	15,524	124.2
50,000	4,092	19.6	25,188	120.9	27,524	132.1
100,000	8,258	19.8	51,438	123.4	57,524	138.1

Source : Derived from Appendices to the Report of the Committee on National Debt and Taxation Cmd 2800 pp.126-127

QUERIES CONCERNING SETTLEMENTS IN 'THE ACCOUNTANT' 1916-1922

February 19th, 1916
A parent held all the shares of a private limited company and also loaned to the company £1,000 at 5%. He now desires to give and transfer this £1,000 equally to his two children who are minors, pay the interst to their credit less tax and then as parent claim repayment of the tax deducted. It is asked by "Lancastrian" if the payment of the loan and the reinvestment will be sufficient without a legal deed.

Answer. The method will be sufficient so long as the gift is valid as against the parent and is not merely a change in form which may at any time at the parents option be ignored and the loan become absolutely the property of the parent. The sole point is that the income must actually be the income of the minors and this is a question of fact determinable on the facts pertaining. If the loan is repaid to the father, then he reinvests the amount in the names of the children with a view to both capital and income being property of the children, repayment should be made and moreover if the income is immediately vested in the children the practice allows exemption and repayment.

November 3rd 1917
A and B have minor sons, and have conceived the idea of lodging securities at the bank with a view to investing in commercial and industrial shares in the names of the sons, so that the latter could claim repayment of income tax. The shares will be held in the names of the minors jointly, but A and B will invest the money and as guardians, will be at liberty to sell.

Original answer - A properly executed deed of gift is valid as far as transferring income to the minors, who, being absolutely entitled to the income could claim repayment of tax. If, however, the trust is created with power to the father to retake possession, at his discretion, of the securities, it cannot be contended that the minor has any interest in the income other than as a gift from the father. Repayment would be refused in this case. So long however, as the income belongs for the time being absolutely to the minors, repayment can be claimed.

The correspondent asked for a more definite reply to the query and stated that A and B proposed to lodge security at a bank and obtain a loan thereon. This money they propose lending to the sons, and, acting on behalf of the latter, to invest in shares. When A and B think proper they propose to reverse the process, i.e. the sons to sell the shares and with the proceeds to repay the loan to A and B. The latter will then repay the loan to the bank and reclaim the securities. The shares held would be in the names of the children and the income would belong absolutely to the latter. There is no intention of transferring anything by a deed of gift.

The further answer is -
The determining factors were given in the previous reply, showing what must be done in order to secure exemption. The position is that the minors must have an absolute interest in the income, i.e. that the income is not that of the parents. The answer to the query is thus in the negative as the parents are the source of the income to be attributed to the children and have every control over it in the sense that they could at any time take the income which therefore becomes a gift from the parents of income of the parents. (Author's comment - this view seems to be incorrect)

12th October 1918
A person bought in the daughter's name stock to the value of £500. There is no deed of gift and the daughter is a minor. It is queried whether the daughter can claim repayment and whether the father can exclude the dividend from his return.

Answer:- A deed of gift is not necessary to constitute a valid disposal but if the giver is able at his discretion to retake possession of the shares there is not gift but only loan. If therefore there is a bona fide gift the dividends are part of the daughter's income and she may claim repayment so that the dividends can then be excluded from the father's return.

June 4th, 1921
A query was received from a widow who intends entering into a deed with each of her unmarried children covenanting to pay during their joint lives £150 per annum to each. The children would then pay her £3 per week for board and lodging. This would be a voluntary payment, or any rate not mentioned in the deeds. If the board and lodging payments become regular it is asked whether these should be added to the income although in a sense they are voluntary payments.

Answer:- The annuity becomes income of the recipient.

APPENDIX B

1. Finance Bill 1922 Clause 13

2. Finance Act 1922 Section 20

APPENDIX B1

FINANCE BILL 1922 CLAUSE 13. (AS INTRODUCED)

13. (1) Any income

(a) of which any person is able, or has at any time since the fifth day of April, nineteen hundred and twenty-two, been able, without the consent of any other person not being his wife or her husband, by means of the exercise of any power of appointment, power of revocation or otherwise howsoever, to obtain for himself the beneficial enjoyment; or

(b) which by virtue or in consequence of any disposition made, directly or indirectly, by any person after the first day of May, nineteen hundred and twenty-two (other than a disposition made for valuable and sufficient consideration), is payable to or applicable for the benefit of any other person for a period which cannot exceed six years; or

(c) which by virtue or in consequence of any disposition made, directly or indirectly, by any person whether before or after the commencement of this Act, is payable to or applicable for the benefit of a child of that person for some period less than the life of the child;

shall, subject to the provisions of this section, but in cases under the above paragraph (c) only if and so long as the child is an infant and unmarried, be deemed for the purposes of the enactments relating to income tax (including super-tax) to be the income of the person who is or was able to obtain the beneficial enjoyment thereof, or by whom the disposition was made, as the case may be, and not to be for those purposes the income of any other person.

2. Where by virtue of paragraph (b) or paragraph (c) of sub-section (1) of this section any income tax or super-tax becomes chargeable on and is paid by the person by whom the disposition was made, that person shall be entitled to recover from any trustee or other person to whom the income is payable by virtue or in consequence of the disposition the amount of the tax so paid, and for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of the income in respect of which he has so paid tax and the amount of the tax so paid, and any certificate so furnished shall be conclusive evidence of the facts appearing thereby.

3. Where any person obtains in respect of any allowance or relief a repayment of income tax in excess of the amount of the repayment to which he would but for the provisions of paragraph (b) or paragraph (c) of sub-section (1) of this section have been entitled, an amount equal to the excess shall be paid by him to the trustee or other person to whom the income is payable by virtue or in consequence of the disposition, or where there are two or more such persons shall be apportioned among those persons as the case may require.

If any question arises as to the amount of any payment or as to any apportionment to be made under this sub-section, that question shall be decided by the General Commissioners whose decision thereon shall be final.

(4) Any income, which is deemed by virtue of this section to be the income of any person, shall be deemed to be the highest part of his income.

(5) In this section, unless the context otherwise requires -
The expression 'child' includes step-child or illegitimate child;

The expression 'disposition' includes any trust, covenant, agreement or arrangement.

FINANCE ACT 1922, SECTION 20

--(1) Any income

(a) of which any person is able, or has, at any time since the fifth day of April, nineteen hundred and twenty-two, been able, without the consent of any other person by means of the exercise of any power of appointment, power of revocation or otherwise howsoever by virtue or in consequence of a disposition made directly or indirectly by himself, to obtain for himself the beneficial enjoyment; or

(b) which by virtue or in consequence of any disposition made, directly or indirectly, by any person after the first day of May, nineteen hundred and twenty-two (other than a disposition made for valuable and sufficient consideration), is payable to or applicable for the benefit of any other person for a period which cannot exceed six years; or

(c) which by virtue or in consequence of any disposition made, directly or indirectly, by any person after the fifth day of April, nineteen hundred and fourteen, is payable to or applicable for the benefit of a child of that person for some period less than the life of the child;

shall, subject to the provisions of this section, but in cases under the above paragraph (c) only if and so long as the child is an infant and unmarried, be deemed for the purposes of the enactments relating to income tax (including super-tax) to be the income of the person who is or was able to obtain the beneficial enjoyment thereof, or of the person, if living, by whom the disposition was made, as the case may be, and not to be for those purposes the income of any other person:

Provided that in cases under the above paragaph (a) -

(i) where any such power as aforesaid can be exercised by a person with the consent of the wife or the husband of that person, the power shall, for the purposes of the said paragraph, be deemed to be exercisable without the consent of another person, except where the husband and wife are living apart either by agreement or under an order of a court of competent jurisdiction; and

(ii) where any such power as aforesaid is exercisable by the wife or the husband of the person who made the disposition, the power shall, for the purposes of the said paragraph, be deemed to be exercisable by the person who made the disposition.

Provided also that

(i) the above paragraph (c) shall not apply as regards any income which is derived from capital which, at the end of the period during which that income is payable to or applicable for the benefit of the child, is required by the disposition to be held on trust absolutely for, or to be transferred to, the child, or any income which is payable to or applicable for the benefit of a child during the whole period of the life of the person by whom the disposition was made; and

(ii) for the purposes of the said paragraph (c) income shall not be deemed to be payable to or applicable for the benefit of a child for some period less than its life by reason only that the disposition contains a provision for the payment to some other person of the income in the event of the bankruptcy of the child, or of an assignment thereof, or a charge thereon being executed by the child.

(2) Where by virtue of paragraph (b) or paragraph (c) of sub-section (1) of this section any income tax or super-tax becomes chargeable on and is paid by the person by whom the disposition was made, that person shall be entitled to recover from any trustee or other person to whom the income is payable by virtue or in consequence of the disposition the amount of the tax so paid, and for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of the income in respect of which he has so paid tax and the amount of the tax so paid, and any certificate so furnished shall be conclusive evidence of the facts appearing thereby.

(3) Where any person obtains in respect of any allowance or relief a repayment of income tax in excess of the amount of the repayment to which he would but for the provisions of paragraph (b) or paragraph (c) of sub-section (1) of this section have been entitled, an amount equal to the excess shall be paid by him to the trustee or other person to whom the income is payable by virtue or in consequence of the disposition, or where there are two or more such persons shall be apportioned among those persons as the case may require.

If any question arises as to the amount of any payment or as to any apportionment to be made under this sub-section, that question shall be decided by the General Commissioners whose decision thereon shall be final.

(4) Any income, which is deemed by virtue of this section to be the income of any person, shall be deemed to be the highest part of his income.

(5) In this section, unless the context otherwise requires - The expression "child" includes step-child or illegitimate child;

The expression "disposition" includes any trust, covenant, agreement or arrangement.

APPENDIX C

1. Advertisements For The Use of Covenants

2. Total Number of New Claims Re Minors Submitted To Claims Branch For Years Ending 31 March 1923 to 31 March 1928

3. Claims Received In Respect of New Settlements On Minors By Their Parents And The Annual Income Transferred.

APPENDIX C1

ADVERTISEMENTS FOR THE USE OF COVENANTS

Hemel Hempstead Gazette, 14th March 1935. St. Peters Church Annual Parochial Meeting.

"Mr. Tyler suggested covenants and pointed out that they involved something for nothing."

The Times, 26th March 1935. Advertisement by British Social Hygiene Council.

Liverpool Post and Mercury, 3rd April 1935. The King George Jubilee Trust inserted an advert pointing out to the philanthrope the advantages of deeds of covenant. The Imperial Tobacco Company had given £25,000. The Oil and Coloured Trades Journal, 29th March 1935 contains an advertisement regarding the Chemical Council (a charity) and indicates that contributions by covenant would get tax relief.

Daily Telegraph, 8th January 1936. "Why pay tax on your child's education and maintenance? You need not! - British Taxpayers Association Limited, Grand Buildings, Trafalgar Square, London.

Daily Telegraph, 21st January 1936. "By signing a deed of covenant with Brompton Hospital for a period of seven years, you enable the hospital to reclaim the income tax paid by you upon your subscription, so that your subscription of £5 5s is actually worth £6.15.6 to the hospital and gives both help and encouragement in its work of the prevention and cure of consumption (Enquiries to the Secretary, Brompton Hospital, SW3)". Daily Telegraph, 21st January 1936. "Income Tax need not be paid on your child's education - write Taxpayers Protection Association Limited, Doland House, Regent Street, London SW1".

APPENDIX C2

TOTAL NUMBERS OF NEW CLAIMS RE MINORS SUBMITTED TO CLAIMS BRANCH
FOR YEARS ENDING 31 MARCH 1923 TO 31 MARCH 1928

Year to 31 March	Number of Claims
1923	5010
1924	5224
1925	5841
1926	5824
1927	5919
1928	6777

Note: The above figures include cases of 'out and out' dispositions of capital and other cases not within the intention of FA 1922 S20.

Source: PRO File IR40/4574

CLAIMS RECEIVED[1] IN RESPECT OF NEW SETTLEMENTS ON MINORS BY THEIR PARENTS AND THE ANNUAL INCOME TRANSFERRED

Year To	Irrevocable Dispostions		Limited Power of Revocation[2]		Caught by S20 FA 1922		Totals	
	Number	Income Transferred	Number	Income Transferred	Number	Income Transferred	Number	Income
		£		£		£		£
31/ 3/29	529	Not known	50	Not known	11	Not known	590	Not known
31/ 3/30	618	"	104	"	27	"	749	"
31/ 3/31	1,216	"	286	"	59	"	1,561	"
31/ 3/32	1,831	"	466	"	Not available	"	2,297	"
31/ 3/33	2,371	"	291[3]	"	Not available	"	2,662	"
31/ 3/34	2,796	457,267	1,541[4]	325,498	48	7,819	4,385	790,584
31/ 3/35	4,385	450,487	6,792	901,330	8	28,711	11,185	1,380,528
31/ 3/36	3,171	423,595	18,404	2,523,865	412	49,913	21,987	2,997,373
31/ 3/37[5]	1,999	259,969	25,005	3,427,141	367	45,308	27,371	3,732,418
31/ 3/38[5]	512	135,574	878	177,082	71	14,762	1,461	327,418
31/ 3/39[5]	218	61,363	196	56,002	53	6,042	467	123,407
31/ 3/40	123	44,035	67	17,588	36	4,356	226	65,979

Notes

1. The figures relate to the number of new claims actually received by Claims Branch in the year stated, irrespective of the year to which the first claim relates. The claims made for any year are thought to give an approximation of the number of settlements made in the previous year.

2. These settlements contained revocation powers such that they were not caught by Section 20 Finance Act 1922, e.g. where consent of some person other than the settlor's spouse was required.

3. The considerable decrease in the number of cases involving a limited power of revocation was thought by the Revenue to be due to the uncertainty surrounding their treatment. The test case of Watson v. Wiggins (in which the taxpayer was successful) only finally cleared the House of Lords on February 21, 1933.

4. The increase of over 400% in the number of revocable deeds was thought by the Revenue to be largely due to the publicity attaching to the decision of Watson v. Wiggins - see Note 3 above.

5. The statistics relate to new claims received in the year shown but relating to settlements made before April 22, 1936, when the anti-avoidance provisions were severely tightened up.

Source: Derived from PRO File IR40/6084

APPENDIX D

1. Income Transferred By New Non-Parental Settlements on Minors 1933/34 to 1939/40

2. Finance Bill 1936, Clause 19

3. Finance Act 1936. Settlements on Children

4. New Claims Arising In 1936-37 To 1939-40 In Respect of Settlements After 22 May 1936 By Parents On Their Minor Children

APPENDIX D1

INCOME TRANSFERRED BY NEW NON-PARENTAL SETTLEMENTS ON MINORS 1933/34 TO 1939/40

Year to 31 March	Irrevocable	Revocable	Caught by S20 FA 1922	Amending Deeds
1934	46,634	13,699	943	-
1935	51,695	16,690	1,416	-
1936	57,453	37,774	297	-
1937	61,845	58,141	1,455	-
1938	54,921	28,758	386	-
1939	61,588	33,051	1,736	16,384
1940	76,243	10,702	1,074	470

Note 1 The statistics are based upon new claims made to Claims Branch in the year involved and therefore exclude existing settlements. Figures for cumulation settlements are excluded.

Source: Derived from PRO File IR40/6084

APPENDIX D2

FINANCE BILL, 1936 - Clause 19

19. (1) Where, by virtue or in consequence of any settlement to which this section 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 commencement of that year the child was an infant and unmarried, be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year and not as the income of any other person.

(2) Subject as hereafter provided, for the purpose of this section

(a) income which, by virtue or in consequence of a settlement to which this section applies, is so dealt with that it, or assets representing it, will or may become payable or applicable to or for the benefit of a child of the settlor in the future (whether on the fulfilment of a condition, or the happening of a contingency, or as the result of the exercise of a power or discretion conferred on any person, or otherwise) shall be deemed to be paid to or for the benefit of that child; and

(b) any income dealt with as aforesaid which is not required by the settlement to be allocated, at the time when it is so dealt with, to any particular child or children of the settlor shall be deemed to be paid in equal shares to or for the benefit of each of the children to or for the benefit of whom or any of whom the income or assets representing it will or may become payable or applicable.

(3) The following provisions of this subsection shall have effect as respects a settlement to which this section applies, being an irrevocable settlement made or entered into on or after the twenty-second day of April nineteen hundred and thirty-six, that is to say

(a) the provisions of the last foregoing subsection shall not apply to any income which is dealt with as therein mentioned by virtue or in consequence of such a settlement, unless and except to the extent that that income consists of, or represents directly or indirectly, sums paid by the settlor which are allowable as deductions in computing his total income for the purpose of the Income Tax Acts; and

(b) where any income has been so dealt with by virtue or in consequence of such a settlement, any sum whatsoever paid by virtue or in consequence of the settlement, or any enactment relating thereto, to or for the benefit of a child of the settlor, being a child who at the commencement of the year of assessment in which the sum is paid is an infant and unmarried, shall be deemed for the purposes of subsection (1) of this section to be paid as income, unless and except to the extent that the sum so paid together with any other sums previously so paid (whether to that child or to any other child who, at the commencement of the year of assessment in which that other sum was so paid, was an infant and unmarried) exceeds the aggregate amount of the income which has arisen under the settlement since it took effect.

(4) Subsections (2) and (3) of section twenty of the Finance Act 1922, shall have effect as if references to paragraph (c) of subsection (1) of that section included references to the foregoing provisions of this section, as if references to a disposition included references to a settlement, and as if the reference to the making of a disposition included a reference to the making of or entering into a settlement, and subsection (4) of that section shall have effect as if the reference to that section included a reference to the said provisions of this section.

(5) No repayment shall be made under section twenty-five of the Income Tax Act, 1918, on account of tax paid in respect of any income which by virtue of this section has been treated as the income of a settlor.

(6) The General or Special Commissioners may by notice in writing require any person to furnish them within such time as they may direct (not being less than twenty-eight days), with such particulars as they think necessary for the purpose of this section, and if that person without reasonable excuse fails to comply with the notice, he shall be liable to a penalty not exceeding fifty pounds, and, after judgment has been given for that penalty, to a further penalty of the like amount for every day during which the failure continues.

(7) For the purposes of this section, a settlement shall not be deemed to be irrevocable, if the terms thereof provide:

(a) for the payment to the settlor or the wife or husband of the settlor for his or her benefit, or for the application for the benefit of the settlor or the wife or husband of the settlor, of any income or assets in any circumstances whatsoever during the life of any child of the settlor to or for the benefit of whom any income, or assets representing it, is or are or may be payable or applicable by virtue or in consequence of the settlement; or

(b) for the determination of the settlement by the act or on the default of any person; or

(c) for the payment of any penalty by any person in the event of his failing to comply with the provisions of the settlement, or for the total or partial indemnification or exoneration of any person in the event of his failing to enforce the provisions of the settlement.

(8) In this section

(a) the expression "child" includes a stepchild, an adopted child and an illegitimate child;

(b) the expression "settlement" includes any disposition, trust, covenant, agreement, arrangement or transfer of assets;

(c) the expression "settlor", in relation to a settlement, includes any person by whom the settlement was made or entered into directly or indirectly, and in particular (but without prejudice to the generality of the foregoing words of this definition) includes any person who has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement;

(d) the expression "income" except where it last occurs in subsection (1) of this section, includes any income chargeable to income tax by deduction or otherwise and any income which would have been so chargeable if it had been received in the United Kingdom by a person resident and ordinarily resident in the United Kingdom, but does not include income arising under a settlement in a year of assessment for which the settlor is not chargeable to income tax as a resident in the United Kingdom.

(9) This section applies to every settlement, wheresoever it was made or entered into, and whether it was made or entered into before or after the passing of this Act, except an irrevocable settlement made before the twenty-second day of April, nineteen hundred and thirty-six.

(10) Paragraph (c) of subsection (1) of section twenty of the Finance Act, 1922, and any other provisions of that section relating to that paragraph, shall cease to have effect as respects any settlement to which this section applies.

F.A. 1936. Settlements on children.

21.—(1) Where, by virtue or in consequence of any settlement to which this section 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 commencement of that year the child was an infant and unmarried, be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year and not as the income of any other person.

Provisions as to income settled on children.

(2) Subject as hereafter provided, for the purpose of this section—

(*a*) income which, by virtue or in consequence of a settlement to which this section applies, is so dealt with that it, or assets representing it, will or may become payable or applicable to or for the benefit of a child of the settlor in the future (whether on the fulfilment of a condition, or the happening of a contingency, or as the result of the exercise of a power or discretion conferred on any person, or otherwise) shall be deemed to be paid to or for the benefit of that child; and

(*b*) any income dealt with as aforesaid which is not required by the settlement to be allocated, at the time when it is so dealt with, to any particular child or children of the settlor shall be deemed to be paid in equal shares to or for the benefit of each of the children to or for the benefit of whom or any of whom the income or assets representing it will or may become payable or applicable.

(3) Where any income is dealt with as mentioned in the last foregoing subsection by virtue or in consequence of a settlement to which this section applies, being a settlement which, at the time when the income is so dealt with, is an irrevocable settlement—

(*a*) the provisions of the last foregoing subsection shall not apply to that income unless and except to the extent that that income consists of, or represents directly or indirectly, sums paid by the settlor which are allowable as deductions in computing his total income for the purpose of the Income Tax Acts; and

(*b*) any sum whatsoever paid thereafter by virtue or in consequence of the settlement, or any enactment relating thereto, to or for the benefit of a child of the settlor, being a child who at the commencement of the year of assessment in which the sum is paid is an infant and unmarried, shall be deemed for the purposes of subsection (1) of this section to be paid as income, unless and except to the extent that the sum so paid together with any other sums previously so paid (whether to that child or to any other child who, at the commencement of the year of assessment in which that other sum was so paid, was an infant and unmarried) exceeds the aggregate amount of the income which by virtue or in consequence of the settlement has been paid to or for the benefit of a child of the settlor, or dealt with as mentioned in subsection (2) of this section, since the date when the settlement took effect or the date when it became irrevocable, whichever is the later.

(4) Income paid to or for the benefit of a child of a settlor shall not be treated as provided in subsection (1) of this section for any year of assessment in which the aggregate amount of the income paid to or for the benefit of that child, which, but for this subsection, would be so treated by virtue of the foregoing provisions of this section, does not exceed five pounds.

(5) Subsections (2) and (3) of section twenty of the Finance Act, 1922, shall have effect as if references to paragraph (*c*) of subsection (1) of that section included references to the foregoing provisions of this section, as if references to a disposition included references to a settlement, and as if the reference to the making of a disposition included a reference to the making of or entering into a settlement, and subsection (4) of that section shall have effect as if the reference to that section included a reference to the said provisions of this section.

(6) No repayment shall be made under section twenty-five of the Income Tax Act, 1918, on account of tax paid in respect of any income which by virtue of this section has been treated as the income of a settlor.

(7) The General or Special Commissioners may by notice in writing require any party to a settlement to furnish them within such time as they may direct (not being less than twenty-eight days), with such particulars as they think necessary for the purpose of this section, and if that person without reasonable excuse fails to comply with the notice, he shall be liable to a penalty not exceeding fifty pounds, and, after judgment has been given for that penalty, to a further penalty of the like amount for every day during which the failure continues.

(8) For the purposes of this section, a settlement shall not be deemed to be irrevocable, if the terms thereof provide—

(*a*) for the payment to the settlor or, during the life of the settlor, to the wife or husband of the settlor for his or her benefit, or for the application for the benefit of the settlor or, during the life of the settlor, of the wife or husband of the settlor, of any income or assets in any circumstances whatsoever during the life of any child of the settlor to or for the benefit of whom any income, or assets representing it, is or are or may be payable or applicable by virtue or in consequence of the settlement; or

(*b*) for the determination of the settlement by the act or on the default of any person; or

(*c*) for the payment of any penalty by the settlor in the event of his failing to comply with the provisions of the settlement:

Provided that a settlement shall not be deemed to be revocable by reason only—

(i) that it contains a provision whereunder any income or assets will or may become payable to or applicable for the benefit of the settlor, or the wife or husband of the settlor, on the bankruptcy of any such child as is mentioned in paragraph (*a*) of this subsection or in the event of an assignment of or charge on that income or those assets being executed by such a child; or

(ii) that it provides for the determination of the settlement as aforesaid in such a manner that the determination will not, during the lifetime of any such child as aforesaid, benefit any person other than such a child, or the wife, husband, or issue of such a child; or

(iii) in the case of a settlement to which section thirty-three of the Trustee Act, 1925, applies, that it directs income to be held for the benefit of such a child as aforesaid on protective trusts, unless the trust period is a period less than the life of the child or the settlement specifies some event on the happening of which the child would, if the income were payable during the trust period to him absolutely during that period, be deprived of the right to receive the income or part thereof.

(9) In this section—

(*a*) the expression "child" includes a stepchild, an adopted child and an illegitimate child;

(*b*) the expression "settlement" includes any disposition, trust, covenant, agreement, arrangement or transfer of assets;

(*c*) the expression "settlor", in relation to a settlement, includes any person by whom the settlement was made or entered into directly or indirectly, and in particular (but without prejudice to the generality of the foregoing words of this definition) includes any person who has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement;

(*d*) the expression "income," except in the third and fourth places where it occurs in subsection (1) of this section, includes any income chargeable to income tax by deduction or otherwise and any income which would have been so chargeable if it had been received in the United Kingdom by a person resident and ordinarily resident in the United Kingdom, but does not include income arising under a settlement in a year of assessment for which the settlor is not chargeable to income tax as a resident in the United Kingdom.

(10) This section applies to every settlement, wheresoever it was made or entered into, and whether it was made or entered into before or after the passing of this Act, except a settlement made or entered into before the twenty-second day of April, nineteen hundred and thirty-six, which immediately before that date was irrevocable.

(11) Paragraph (*c*) of subsection (1) of section twenty of the Finance Act, 1922, and any other provisions of that subsection relating to that paragraph, shall cease to have effect as respects any settlement to which this section applies.

NEW CLAIMS ARISING IN 1936-37 TO 1939-40 IN RESPECT OF SETTLEMENTS AFTER 22 MAY 1936 BY PARENTS ON THEIR MINOR CHILDREN

	DEEDS OF COVENANT		CAPITAL SETTLEMENTS		OUTRIGHT TRANSFERS (GIFTS)		TOTAL		
	Number	Income	Number	Income	Number	Income	Number	Income	
1936/37									
Claims Approved	4	20	0	0	5	20	9	40	Note 1
Claims Refused	14	2946	8	1398	14	864	36	5208	
Total	18	2966	8	1398	19	884	45	5248	Note 2
1937/38									
Claims Approved	72	10714	7	188	106	318	185	11220	Note 3
Claims Refused	62	15119	93	10024	266	12797	421	37940	
Trusts for Accumulation			30	4692			30	4692	
	134	25833	130	14904	372	13115	636	53852	Note 4
1938/39									
Claims Approved	72	21396	41	2857	320	3067	433	27320	Note 5
Claims Refused	156	23378	230	24252	795	65961	1181	113591	
Trusts for Accumulation			75	53628			75	53628	
Total	228	44774	346	80737	1115	69208	1689	194539	Note 6
1939/40 [NINE MONTHS THEREOF] Note 7									
Claims Approved	34	3776	23	993	267	3523	324	8292	
Claims Refused	134	27523	152	20547	613	44993	899	93063	
Trusts for Accumulation			71	12559		-	71	12559	Note 8
	168	31299	246	34099	880	48516	1294	113914	

Note 1. These claims all related to settlements of income excluded from S21 FA1936 by sub-section (4) i.e. income not exceeding £5.

Note 2. The very low figures were thought by Claims Branch to indicate "that there has been a practical suspension of activity in children's deeds" (Memo 14/8/37).

Note 3. These claims were admissable on the same grounds as those referred to in Note 1 but also a new class or admissable claim was being made i.e. claims in respect of the child's year of birth only. Such claims were based upon the fact that S21(1) FA 1936 referred to the child being an infant and unmarried at the beginning of the year and as the child did not exist at that time the provisions could not apply.

Note 4. The papers indicate that "the lull which occurred after the Finance Act 1936 has ended" (Memorandum from Claims Branch to Chief Inspector 19 August 1938).

Note 5. A further class of admissable claim had started to be received in respect of cases where the settlor was not resident in U.K.

Note 6. Despite the considerable increase in claims received over those of the previous year "they are still of extremely moderate proportions compared with those prior to the introduction of the 1936 Budget". (Memo from Claims Branch to Chief Inspector of Taxes 14 October 1939)

Note 7. For the period from September 1939 to December 1939 District Inspectors had discretion to deal with claims without submission to C.I. Claims and the figures above are exclusive of such cases. Even allowing for this "the figures illustrate clearly the continued success of Section 21 Finance Act 1936 for the purpose for which it was introduced". (Memo from Claims Branch 5 August 1940).

Note 8. Irrevocable trusts for accumulation were not caught by Section 21 FA 1936 yet clearly they were not popular at this time.

Source : Derived From PRI File IR40/6084

APPENDIX E

1. The Chancellor's Warning

2. Finance Bill 1938 - Settlement Provisions

3. Finance Act 1938 - Settlement Provisions

The Chancellor's Warning
(Hansard 16 July 1937, Cols. 1753-4)

In Clauses 12 and 13 of the Bill we have made provision to prevent evasion of tax. Those were evasions which had become prominent and which were in danger of becoming common, and we have not only legislated against them, but in one case at least, in view of the warning given by my predecessor, we have legislated retrospectively. I think it my duty to say a little more on the subject, because I do not suppose that by our present provision we have necessarily covered every possible evasion for the future. I am fully alive to the fact that there are other forms of avoidance of taxation which have been suggested and which may be practised, not only the field of income-tax, but also in the field of death duties, and, for my part, I think it may become necessary to deal with these matters further at an early date.

It is utterly impossible when a Chancellor of the Exchequer has inherited another Finance Bill, at the moment to cover every form of avoidance, and, of course, the process we have adopted is to deal as a matter of extreme urgency with the cases which we knew were the most dangerous, and might become most prominent. I am not going to specify the various methods by which avoidance may be practised. I do not know that I could do so. They are extremely complicated and, in any case, I do not wish to give them any advertisement whatever. But I think it is desirable to refer to one method to which my attention has been particularly drawn. That is the method which was referred to by the hon. member for the Park Division of Sheffield, when he quoted a passage from the financial column of a newspaper. It is the formation of cumulating trusts, under which sur-tax payers are able to reduce their liability by transfer of income under trusts which are outside the provisions of Section 20 of the Finance Act, 1922. I believe that there are reasons for thinking that there is some growth in that form of avoidance, and if there is, early legislation to deal with it is essential.

I wish now to give a clear warning to anyone who may be contemplating the adoption of this particular device or any other form of avoidance that we shall certainly not hesitate to introduce provisions to deal with the subject. I should make it clear that legislation of this character, if it should be necessary, will be applied to the sur-tax payable in the year in which the legislation is introduced, because it is calculated on the previous year, and therefore it may affect not only future arrangements of this sort but also those, if any, which are now being made or have been made in the recent past. I feel that members in all quarters of the House will think that in taking that course I have done right, and I intend to do my best to carry out what I have suggested.

DRAFT CLAUSES.

Provisions as respects Settlements.

—(1) Where, in any year of assessment, under any settlement—

Income arising under certain settlements to be treated as income of settlor.

(*a*) the settlor might, in the event of the exercise, whether by himself or any other person, and whether with or without the consent of any other person, of any power of revoking or otherwise determining the settlement or any provision thereof, have become entitled to the beneficial enjoyment of any income; or

(*b*) the settlor might, in the event of the exercise of any such power as aforesaid or on the payment of a penalty, have ceased to be liable to pay any sums by virtue or in consequence of the settlement;

any income arising under the settlement in that year to the beneficial enjoyment of which he might have become so entitled, and any sums paid by him in that year which he might have ceased to be liable to pay as aforesaid, shall be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year and not as the income of any other person.

In this subsection references to a settlor, except in the last place where that word occurs, shall be construed as including references to the wife or husband of the settlor.

(2) If and so long as the settlor has under any settlement any interest in any income or property, any income arising under the settlement during the life of the settlor in any year of assessment shall, to the extent to which it is not distributed, be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year, and not as the income of any other person:

Provided that—

(*a*) if and so long as the settlor has an interest neither in the whole of the income at any time arising under the settlement nor in the whole of the property at any time comprised in the settlement, the amount of income to be treated as the income of the settlor by virtue of this subsection shall be such part of the income which, but for this proviso, would be so treated as, in the opinion of the General or Special Commissioners, is proportionate to the extent of the interest of the settlor; and

(*b*) where income arising under the settlement has been treated as the income of the settlor for any year of assessment by virtue of the last foregoing subsection, the amount of income to be treated as his for that year by virtue of this subsection shall not exceed the amount (if any) by which the income which, but for this proviso, would be so treated exceeds the income which has been treated as his by virtue of the last foregoing subsection.

(3) For the purpose of the last foregoing subsection, the settlor shall be deemed to have an interest in income or property under a settlement if under that settlement any income or property is, or will or may become, payable to or applicable for the benefit of the settlor or the wife or husband of the settlor in any circumstances whatsoever :

Provided that the settlor shall not be deemed to have an interest in any income or property if and so long as under the settlement that income or property cannot become payable or applicable as aforesaid, except in the event of

(*a*) the bankruptcy of some person who is or may become beneficially entitled to that income or property ; or

(*b*) any assignment of or charge on that income or property being made or given by some such person ; or

(*c*) in the case of a marriage settlement, the death of both the parties to the marriage and of all or any of the children of the marriage ; or (*d*) the death under the age of twenty-five or some lower age of some person who would be beneficially entitled to that income or property on attaining that age.

(4) The provisions of Part I of the Schedule to this Act shall have effect as respects the recovery by a settlor of tax with which he becomes chargeable by virtue of subsection (2) of this section, and the recovery from a settlor of any additional relief to which he becomes entitled by virtue of that subsection, and in that Schedule this section is referred to as "the first relative section".

(5) No repayment shall be made under section twenty-five of the Income Tax Act, 1918 (which relates to relief from tax in respect of income accumulated under trusts) on account of tax paid in respect of any income which by virtue of this section has been treated as the income of a settlor.

(6) The foregoing provisions of this section shall apply for the purposes of assessment to income tax for the year 1937–38 and subsequent years and shall apply in relation to any settlement, wherever made and whether made before or after the passing of this Act:

Provided that—

(*a*) for the year 1937–38 no income shall be charged to tax at the standard rate by virtue of the provisions of this section, but surtax shall be assessed and charged as if any income which would, but for this proviso, have been charged as aforesaid had in fact been so charged; and

(*b*) for the purpose of granting relief from tax at the standard rate in respect of any income which for the year 1937–38 is treated as the income of a settlor by virtue of subsection (1) of this section but would be treated as the income of some other person but for that subsection, that income shall be treated as the income of that other person.

Disallowance of deduction from total income of

B.—(1) Where, by virtue or in consequence of any settlement to which this section applies, the settlor pays in any year of assessment to the trustees of the settlement any sums which would, but for this subsection, be allowable as deductions in computing his total income for that year for the purposes of surtax, those sums shall not be so allowable to the extent to which the aggregate amount thereof falls within— certain sums paid by settlor.

(*a*) the amount of income arising under the settlement in that year which has not been distributed; less

(*b*) the amount of income so arising in that year which is treated as the income of the settlor by virtue of subsection (2) of the last foregoing section:

Provided that this subsection shall not apply to any sums which have been treated as the income of the settlor by virtue of subsection (1) of the last foregoing section.

(2) For the purpose of the last foregoing subsection, any sum paid in any year of assessment by the settlor to any body corporate connected with the settlement in that year shall be treated as if it had been paid to the trustees of the settlement in that year by virtue or in consequence of the settlement.

(3) No relief shall be given under any of the provisions of the Income Tax Acts on account of tax paid in respect of so much of any income arising under a settlement in any year of assessment as is equal to the aggregate amount of any sums paid by the settlor in that year which have been disallowed as deductions by virtue of this section.

(4) This section shall apply to any settlement (wherever made) made after the twenty-sixth day of April, nineteen hundred and thirty-eight, and where income arising under any settlement (wherever made) made on or before that date is treated as the income of the settlor by virtue of subsection (1) of the last foregoing section but ceases to be so treated by reason of any variation of the terms of the settlement made after that date, or would have been so treated but for such a variation, this section shall apply to that settlement as from the date of the variation.

(5) In this section references to sums paid by a settlor shall include references to sums paid by the wife or husband of the settlor.

C. -(1) Any sum paid directly or indirectly, by way of loan or repayment of a loan or otherwise than as income, in any relevant year of assessment by the trustees of a settlement to which this section applies to the settlor, shall—

Sums paid to settlor otherwise than as income.

(*a*) to the extent to which the amount of that sum falls within the amount of income available up to the end of that year, be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year;

(*b*) to the extent to which the amount of that sum exceeds the amount of income available up to the end of that year but falls within the amount of the income available up to the end of the next following year, be treated for the purposes aforesaid as the income of the settlor for the next following year;

and so on:

(2) For the purpose of the last foregoing subsection, the amount of income available up to the end of any year shall, in relation to any sum paid as aforesaid, be taken to be the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less

(*a*) the aggregate amount of any other sums paid as aforesaid in any previous relevant year or previously paid as aforesaid in that year; and

(*b*) an amount equal to tax at the standard rate on the amount of income arising under the settlement in that year and any previous relevant year which has not been distributed.

(*c*) any income arising under the settlement in that year or any previous relevant year which has not been distributed and has been treated as the income of the settlor by virtue of any of the provisions of the section immediately preceding the last foregoing section; and

(*d*) any sums paid by virtue or in consequence of the settlement, to the extent that they have been disallowed, by virtue of the last foregoing section, as deductions in computing the settlor's income for that year or any previous relevant year.

(*e*) an amount equal to tax for that year on—

(i) the aggregate amount of income arising under the settlement in that year and any previous year which has not been distributed, less

(ii) the aggregate amount of the income and sums referred to in paragraphs (*b*), (*c*) and (*d*) of this subsection.

(3) For the purpose of this subsection, any sums paid to the settlor in any year of assessment by any body corporate connected with the settlement in that year shall be treated as having been paid by the trustees of the settlement in that year.

(4) Where the whole or any part of any sum is treated by virtue of this section as income of the settlor for any year, it shall be treated as income of such an amount as, after deduction of tax at the standard rate for that year, would be equal to that sum or that part thereof.

(5) This section applies to any settlement wherever made and whether made before or after the commencement of this Act, and in this section—

(*a*) the expression "capital sum" means—

(i) any sum paid by way of loan or repayment of a loan; and

(ii) any other sum paid otherwise than as income which is not paid for valuable and sufficient consideration;

but does not include any sum which could not have become payable to the settlor except in one of the events specified in the proviso to subsection (3) of the section immediately preceding the last foregoing section;

(*b*) the expression "relevant year" means any year of assessment after the year 1937–38; and

(*c*) references to sums paid to the settlor include references to sums paid to the wife or husband of the settlor.

Supplementary provisions as to settlements.

D. (1) The provisions of Part II of the Schedule to this Act shall have effect for the purpose of carrying the last three foregoing sections into effect and otherwise for supplementing the provisions of those sections, and those sections are referred to in that Part of that Schedule as " relative " sections.

(2) Paragraph (*a*) of subsection (1) of section twenty of the Finance Act, 1922, shall cease to have effect, and shall be deemed to have ceased to have effect for the purpose of assessment to surtax for the year 1937–38.

(3) Subject to the last foregoing subsection, the provisions of this and the last three foregoing sections shall be in addition to and not in derogation of any other provisions of the Income Tax Acts.

(4) For the purposes of this and the last three foregoing sections—

(*a*) the expression " income arising under a settlement " includes—

(i) any income chargeable to income tax by deduction or otherwise, and any income which would have been so chargeable if it had been received in the United Kingdom by a person domiciled, resident and ordinarily resident in the United Kingdom; and

(ii) where the amount of the income of any body corporate has been apportioned under section twenty-one of the Finance Act, 1922, for any year or period, or could have been so apportioned if the body corporate were incorporated in any part of the United Kingdom, so much of the income of the body corporate for that year or period as is equal to the amount which has been or could have been so apportioned to the trustees of the settlement;

but, where the settlor is not domiciled, or not resident, or not ordinarily resident, in the United Kingdom in any year of assessment, does not include income arising under the settlement in that year in respect of which the settlor, if he were actually entitled thereto, would not be chargeable to income tax by deduction or otherwise by reason of his not being so domiciled, resident or ordinarily resident;

(*b*) the expression "settlement" includes any disposition, trust, covenant, agreement or arrangement, and the expression "settlor" in relation to a settlement means any person by whom the settlement was made;

(*c*) a person shall be deemed to have made a settlement if he has made or entered into the settlement directly or indirectly, and in particular (but without prejudice to the generality of the foregoing words of this paragraph) if he has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement;

(*d*) income arising under a settlement in any year of assessment shall be deemed not to have been distributed if and to the extent that it exceeds the aggregate amount of—

(i) the sums paid in that year by the trustees of the settlement to any persons (not being a body corporate connected with the settlement and not being the trustees of another settlement made by the settlor or the trustees of the settlement) in such manner that they fall to be treated in that year, otherwise than by virtue of the last preceding section, as the income of those persons for the purposes of income tax, or would fall to be so treated if those persons were domiciled, resident and ordinarily resident in the United Kingdom and the sums had been paid to them therein; and

(ii) any expenses of the trustees of the settlement which are paid in that year and are properly chargeable to income; and

(iii) in a case where the trustees of a settlement are trustees for charitable purposes only, the amount of any income in respect of which exemption from tax may be granted under section thirty-seven of the Income Tax Act, 1918, or section thirty of the Finance Act, 1921.

(*e*) a body corporate shall be deemed to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment—

(i) has been apportioned to the trustees of the settlement under section twenty-one of the Finance Act, 1922, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or

(ii) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom.

SCHEDULE.

SUPPLEMENTARY PROVISIONS AS TO SETTLEMENTS.

PART I.

ADJUSTMENTS BETWEEN THE SETTLOR AND TRUSTEES.

1. Where by virtue of any provision of the first relative section any income tax becomes chargeable on and is paid by a settlor, he shall be entitled—

(a) to recover from any trustee, or other person to whom income arises under the settlement, the amount of the tax so paid: and

(b) for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of income in respect of which he has so paid tax and the amount of tax so paid.

2. Any certificate furnished under the last foregoing paragraph shall be conclusive evidence of the facts stated therein.

3. Where any person obtains, in respect of any allowance or relief, a repayment of income tax in excess of the amount of the repayment to which he would, but for the provisions of subsection (2) of the first relative section, have been entitled, an amount equal to the excess shall be paid by him to the trustees or other person to whom income arises under the settlement, or where there are two or more such persons shall be apportioned among those persons, as the case may require.

4. If any question arises as to the amount of any payment or as to any apportionment to be made under the last foregoing paragraph, that question shall be decided by the General Commissioners whose decision thereon shall be final.

5. Any income which is treated by virtue of any provision of the relative section as income of a settlor shall be deemed for the purpose of this schedule to be the highest part of his income.

PART II.

MISCELLANEOUS.

1. Tax chargeable at the standard rate by virtue of the first or third of the relative sections shall be charged under Case VI of Schedule D.

2. In computing the liability to income tax of a settlor chargeable by virtue of any of the provisions of the first relative section, the same deductions and reliefs shall be allowed as would

have been allowed if the income treated as his by virtue of that provision had actually been received by him.

3. In computing the liability to income tax of a settlor chargeable by virtue of the third relative section, the same deductions and reliefs shall be allowed as would have been allowed if the amount treated as his income by virtue of that section had actually been received by him as income.

4. The General or Special Commissioners may by notice in writing require any person, being a party to a settlement, to furnish them (within such time as they may direct, not being less than twenty eight days) with such particulars as they think necessary for the purposes of any of the provisions of the relative sections, and if that person without reasonable excuse fails to comply with the notice he shall be liable to a penalty not exceeding fifty pounds and, after judgment has been given for that penalty, to a further penalty of the like amount for every day during which the failure continues.

5. Without prejudice to the provisions of the last foregoing paragraph, if any party to a settlement fails to furnish any particulars required under the last foregoing paragraph, or if the General or Special Commissioners are not satisfied with any particulars furnished under that paragraph, they may make an estimate of the amount of income which by virtue of any of the provisions of the first or third relative sections, is to be treated as the income of the settlor.

FINANCE ACT 1938 - SETTLEMENT PROVISIONS

PART IV.

INCOME TAX (SETTLEMENTS).

Income arising under certain settlements to be treated as income of settlor.

38.—(1) If and so long as the terms of any settlement are such that—

(*a*) any person has or may have power, whether immediately or in the future, and whether with or without the consent of any other person, to revoke or otherwise determine the settlement or any provision thereof and, in the event of the exercise of the power, the settlor or the wife or husband of the settlor will or may cease to be liable to make any annual payments payable by virtue or in consequence of any provision of the settlement; or

(*b*) the settlor or the wife or husband of the settlor may, whether immediately or in the future, cease, on the payment of a penalty, to be liable to make any annual payments payable by virtue or in consequence of any provision of the settlement;

any sums payable by the settlor or the wife or husband of the settlor by virtue or in consequence of that provision of the settlement in any year of assessment shall be treated as the income of the settlor for that year and not as the income of any other person:

Provided that, where any such power as is referred to in paragraph (*a*) of this subsection cannot be exercised within the period of six years from the time when the first of the annual payments so referred to becomes payable, and the like annual payments are payable in each year throughout that period, the said paragraph (*a*) shall not apply so long as the said power cannot be exercised.

(2) If and so long as the terms of any settlement are such that—

(*a*) any person has or may have power, whether immediately or in the future, and whether with or without the consent of any other person, to revoke or otherwise determine the settlement or any provision thereof; and

(*b*) in the event of the exercise of the power, the settlor or the wife or husband of the settlor will or may become beneficially entitled to the whole or any part of the property then comprised in the settlement or of the income arising from the whole or any part of the property so comprised;

any income arising under the settlement from the property comprised in the settlement in any year of assessment or from a corresponding part of that property, or a corresponding part of any such income, as the case may be, shall be treated as the

F.A. 1938. Income under Settlements.

(ii) any assignment of or charge on that income or property being made or given by some such person; or

(iii) in the case of a marriage settlement, the death of both the parties to the marriage and of all or any of the children of the marriage; or

(iv) the death under the age of twenty-five or some lower age of some person who would be beneficially entitled to that income or property on attaining that age; or

(*b*) if and so long as some person is alive and under the age of twenty-five during whose life that income or property cannot become payable or applicable as aforesaid except in the event of that person becoming bankrupt or assigning or charging his interest in that income or property.

(5) The provisions of Part I of the Third Schedule to this Act shall have effect as respects the recovery by a settlor of tax with which he becomes chargeable, and the recovery from a settlor of any additional relief to which he becomes entitled, by virtue of this section.

(6) No repayment shall be made under section twenty-five of the Income Tax Act, 1918 (which relates to relief from tax in respect of income accumulated under trusts) on account of tax paid in respect of any income which by virtue of this section has been treated as the income of a settlor.

(7) The foregoing provisions of this section shall apply for the purposes of assessment to income tax for the year 1937–38 and subsequent years and shall apply in relation to any settlement, wherever made and whether made before or after the passing of this Act:

Provided that—

(*a*) for the year 1937–38 no income shall be charged to tax at the standard rate by virtue of this section, but surtax shall be assessed and charged as if any income which would, but for this proviso, have been charged as aforesaid had in fact been so charged; and

(*b*) for the purpose of granting relief from tax at the standard rate in respect of any income which for the year 1937–38 is treated as the income of a settlor by virtue of subsection (1) or subsection (2) of this section but would be treated as the income of some other person but for that subsection, that income shall be treated as the income of that other person; and income of the settlor for that year and not as the income of any other person :

Provided that, where any such power as aforesaid cannot be exercised within six years from the time when any particular property first becomes comprised in the settlement, this subsection shall not apply to income arising under the settlement from that property, or from property representing that property, so long as the power cannot be exercised.

(3) If and so long as the settlor has an interest in any income arising under or property comprised in a settlement, any income so arising during the life of the settlor in any year of assessment shall, to the extent to which it is not distributed, be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year, and not as the income of any other person :

Provided that—

(*a*) if and so long as that interest is an interest neither in the whole of the income arising under the settlement nor in the whole of the property comprised in the settlement, the amount of income to be treated as the income of the settlor by virtue of this subsection shall be such part of the income which, but for this proviso, would be so treated as is proportionate to the extent of that interest ; and

(*b*) where it is shown that any amount of the income which is not distributed in any year of assessment consists of income which falls to be treated as the income of the settlor for that year by virtue of either of the last two foregoing subsections, that amount shall be deducted from the amount of income which, but for this proviso, would be treated as his for that year by virtue of this subsection.

(4) For the purpose of the last foregoing subsection, the settlor shall be deemed to have an interest in income arising under or property comprised in a settlement, if any income or property which may at any time arise under or be comprised in that settlement is, or will or may become, payable to or applicable for the benefit of the settlor or the wife or husband of the settlor in any circumstances whatsoever :

Provided that the settlor shall not be deemed to have an interest in any income arising under or property comprised in a settlement—

(*a*) if and so long as that income or property cannot become payable or applicable as aforesaid except in the event of—

(i) the bankruptcy of some person who is or may become beneficially entitled to that income or property ; or

(c) the provisions of this subsection shall have effect, in relation to a settlement made before the twenty-seventh day of April nineteen hundred and thirty-eight, subject to the provisions of Part II of the Third Schedule to this Act, and in that Part of that Schedule this section is referred to as " the relative section ".

Disallowance of deduction from total income of certain sums paid by settlor.

39.—(1) Where, by virtue or in consequence of any settlement to which this section applies, the settlor pays directly or indirectly in any year of assessment to the trustees of the settlement any sums which would, but for this subsection, be allowable as deductions in computing his total income for that year for the purposes of surtax, those sums shall not be so allowable to the extent to which the aggregate amount thereof falls within the amount of income arising under the settlement in that year which has not been distributed, less—

(a) so much of any income arising under the settlement in that year which has not been distributed as is shown to consist of income which has been treated as the income of the settlor by virtue of subsection (1) or subsection (2) of the last foregoing section; and

(b) the amount of income so arising in that year which is treated as the income of the settlor by virtue of subsection (3) of the last foregoing section.

(2) For the purpose of the last foregoing subsection, any sum paid in any year of assessment by the settlor to any body corporate connected with the settlement in that year shall be treated as if it had been paid to the trustees of the settlement in that year by virtue or in consequence of the settlement.

(3) No relief shall be given under any of the provisions of the Income Tax Acts on account of tax paid in respect of so much of any income arising under a settlement in any year of assessment as is equal to the aggregate amount of any sums paid by the settlor in that year which are not allowable as deductions by virtue of this section.

(4) This section shall apply to any settlement (wherever made) made after the twenty-sixth day of April nineteen hundred and thirty-eight, and where income arising under any settlement (wherever made) made on or before that date is treated as the income of the settlor by virtue of subsection (1) or subsection (2) of the last foregoing section but ceases to be so treated by reason of any variation of the terms of the settlement made after that

date, or would have been so treated but for such a variation, this section shall apply to that settlement as from the date when the variation takes effect.

(5) In this section references to sums paid by a settlor shall include references to sums paid by the wife or husband of the settlor.

ums paid o settlor therwise han as ncome.

40.—(1) Any capital sum paid directly or indirectly in any relevant year of assessment by the trustees of a settlement to which this section applies to the settlor shall—

(*a*) to the extent to which the amount of that sum falls within the amount of income available up to the end of that year, be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year;

(*b*) to the extent to which the amount of that sum exceeds the amount of income available up to the end of that year but falls within the amount of the income available up to the end of the next following year, be treated for the purposes aforesaid as the income of the settlor for the next following year;

and so on.

(2) For the purpose of the last foregoing subsection, the amount of income available up to the end of any year shall, in relation to any capital sum paid as aforesaid, be taken to be the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less—

(*a*) the amount of any other capital sums paid to the settlor in any relevant year before that sum was paid; and

(*b*) so much of any income arising under the settlement in that year and any previous relevant year which has not been distributed as is shown to consist of income which has been treated as income of the settlor by virtue of subsection (1) or subsection (2) of section thirty-eight of this Act; and

(*c*) any income arising under the settlement in that year and any previous relevant year which has been treated as the income of the settlor by virtue of subsection (3) of section thirty-eight of this Act; and

(*d*) any sums paid by virtue or in consequence of the settlement, to the extent that they are not allowable, by virtue of the last foregoing section, as deductions in computing the settlor's income for that year or any previous relevant year; and (*e*) an amount equal to tax at the standard rate on—

(i) the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less

(ii) the aggregate amount of the income and sums referred to in paragraphs (*b*), (*c*) and (*d*) of this subsection.

(3) For the purpose of this section, any capital sum paid to the settlor in any year of assessment by any body corporate connected with the settlement in that year shall be treated as having been paid by the trustees of the settlement in that year.

(4) Where the whole or any part of any sum is treated by virtue of this section as income of the settlor for any year, it shall be treated as income of such an amount as, after deduction of tax at the standard rate for that year, would be equal to that sum or that part thereof.

(5) This section applies to any settlement wherever made and whether made before or after the commencement of this Act, and in this section—

(*a*) the expression " capital sum " means—

(i) any sum paid by way of loan or repayment of a loan ; and

(ii) any other sum paid otherwise than as income, being a sum which is not paid for full consideration in money or money's worth ;

but does not include any sum which could not have become payable to the settlor except in one of the events specified in the proviso to subsection (4) of section thirty-eight of this Act ;

(*b*) the expression " relevant year " means any year of assessment after the year 1937–38 ;

(*c*) references to sums paid to the settlor include references to sums paid to the wife or husband of the settlor.

41.—(1) The provisions of Part III of the Third Schedule to this Act shall have effect for the purpose of carrying this Part of this Act into effect and otherwise for supplementing the provisions thereof. Supplementary provisions as to settlements.

(2) Paragraph (*a*) of subsection (1) of section twenty of the Finance Act, 1922, shall cease to have effect, and shall be deemed to have ceased to have effect for the purpose of assessment to surtax for the year 1937–38.

F.A. 1938. Settlements : supplementary provisions.

(3) Subject to the last foregoing subsection, the provisions of this Part of this Act shall be in addition to and not in derogation of any other provisions of the Income Tax Acts.

(4) For the purposes of this Part of this Act—

(*a*) the expression " income arising under a settlement " includes—

(i) any income chargeable to income tax by deduction or otherwise, and any income which would have been so chargeable if it had been received in the United Kingdom by a person domiciled, resident and ordinarily resident in the United Kingdom ; and

(ii) where the amount of the income of any body corporate has been apportioned under section twenty-one of the Finance Act, 1922, for any year or period, or could have been so apportioned if the body corporate were incorporated in any part of the United Kingdom, so much of the income of the body corporate for that year or period as is equal to the amount which has been or could have been so apportioned to the trustees of or a beneficiary under the settlement ;

but, where the settlor is not domiciled, or not resident, or not ordinarily resident, in the United Kingdom in any year of assessment, does not include income arising under the settlement in that year in respect of which the settlor, if he were actually entitled thereto, would not be chargeable to income tax by deduction or otherwise by reason of his not being so domiciled, resident or ordinarily resident ;

(*b*) the expression " settlement " includes any disposition, trust, covenant, agreement or arrangement, and the expression " settlor " in relation to a settlement means any person by whom the settlement was made ;

(*c*) a person shall be deemed to have made a settlement if he has made or entered into the settlement directly or indirectly, and in particular (but without prejudice to the generality of the foregoing words of this paragraph) if he has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement ;

(*d*) income arising under a settlement in any year of assessment shall be deemed not to have been distributed if and to the extent that it exceeds the aggregate amount of—

(i) the sums paid in that year by the trustees of the settlement to any persons (not being a body corporate connected with the settlement and not being the trustees of another settlement made by the settlor or the trustees of the settlement) in such manner that they fall to be treated in that year, otherwise than by virtue of the last preceding section, as the income of those persons for the purposes of income tax, or would fall to be so treated if those persons were domiciled, resident and ordinarily resident in the United Kingdom and the sums had been paid to them therein; and

(ii) any expenses of the trustees of the settlement paid in that year which, in the absence of any express provision of the settlement, would be properly chargeable to income, in so far as such expenses are not included in the sums mentioned in the last foregoing sub-paragraph; and

(iii) in a case where the trustees of the settlement are trustees for charitable purposes, the amount by which any income arising under the settlement in that year in respect of which exemption from tax may be granted under section thirty-seven of the Income Tax Act, 1918, or section thirty of the Finance Act, 1921, exceeds the aggregate amount of any such sums or expenses as aforesaid paid in that year which are properly chargeable to that income;

(*e*) a body corporate shall be deemed to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment—

(i) has been apportioned to the trustees of or a beneficiary under the settlement under section twenty-one of the Finance Act, 1922, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or

F.A. 1938. Short title, construction, etc.

(ii) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom.

SCHEDULES.

* * * * *

THIRD SCHEDULE.

SUPPLEMENTARY PROVISIONS AS TO SETTLEMENTS.

Sections 38 to 41.

PART I.

ADJUSTMENTS BETWEEN THE SETTLOR AND TRUSTEES.

1. Where by virtue of any provision of section thirty-eight of this Act any income tax becomes chargeable on and is paid by a settlor, he shall be entitled—

(*a*) to recover from any trustee, or other person to whom income arises under the settlement, the amount of the tax so paid; and

(*b*) for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of income in respect of which he has so paid tax and the amount of tax so paid.

2. Any certificate furnished under the last foregoing paragraph shall be conclusive evidence of the facts stated therein.

3. Where any person obtains, in respect of any allowance or relief, a repayment of income tax in excess of the amount of the repayment to which he would, but for the provisions of the said section, have been entitled, an amount equal to the excess shall be paid by him to the trustees or other person to whom income arises under the settlement, or where there are two or more such persons shall be apportioned among those persons, as the case may require.

4. If any question arises as to the amount of any payment or as to any apportionment to be made under the last foregoing paragraph, that question shall be decided by the General Commissioners whose decision thereon shall be final.

5. Any income which is treated by virtue of any provision of the said section as income of a settlor shall be deemed for the purpose of this Schedule to be the highest part of his income.

PART II.

SPECIAL PROVISIONS AS RESPECTS SETTLEMENTS MADE BEFORE 27TH APRIL, 1938.

1. Subject to the provisions of this Part of this Schedule, in the case of a settlement made before the twenty-seventh day

of April nineteen hundred and thirty-eight, subsection (1) of the relative section shall not, by reason only of the provisions of paragraph (*a*) thereof, apply to sums payable by the settlor by virtue or in consequence of any provision of the settlement in a year to which this Part of this Schedule applies, if—

(*a*) at the expiration of three months from the date of the passing of this Act—

(i) no person has or can have any such power as is referred to in the said paragraph (*a*) ; and

(ii) the settlor has not received and is not entitled to receive any consideration in respect of the release or disclaimer of any such power ; or

(*b*) the like annual payments have been payable by the settlor by virtue or in consequence of that provision of the settlement in each of the seven years of assessment ending with a year to which this Part of this Schedule applies ; or

(*c*) before the expiration of three months from the date of the passing of this Act—

(i) the settlement, or the provision by virtue or in consequence whereof the annual payments are payable, has been revoked ; and

(ii) a new settlement has been made by the settlor by virtue or in consequence whereof the settlor is liable to make the like annual payments and cannot, except in the event of his death, cease to be liable to make those payments before the expiration of six years from the date when the first of the annual payments payable by virtue or in consequence of the revoked settlement became payable :

Provided that, where any income arising under the settlement in a year to which this Part of this Schedule applies has not been distributed, the foregoing provisions of this paragraph shall have effect as if there were substituted for the reference to sums payable by the settlor in that year a reference to the amount, if any, by which the sums so payable in that year exceed the income arising under the settlement in that year which has not been distributed.

2. Subject to the provisions of this Part of this Schedule, in the case of a settlement made before the twenty-seventh day of April nineteen hundred and thirty-eight, income arising under the settlement in any year to which this Part of this Schedule applies which would, but for this paragraph, be treated by virtue of subsection (2) of the relative section as the income of the settlor and not as the income of any other person, shall not be so treated or, in a case where any income arising under the

settlement in that year has not been distributed, shall not be so treated to the extent that it exceeds the amount of income arising under the settlement in that year which has not been distributed if, at the expiration of three months from the date of the passing of this Act—

(*a*) no person has or can have any such power as is referred to in the said subsection (2) ; and

(*b*) the settlor has not received and is not entitled to receive any consideration in respect of the release or disclaimer of any such power.

3. The foregoing provisions of this Part of this Schedule shall not apply to any settlement if, in any year to which this Part of this Schedule applies, any capital sum within the meaning of section forty of this Act has been paid to the settlor directly or indirectly by the trustees of the settlement or any body corporate connected with the settlement in that year.

4. Notwithstanding that the payments payable by virtue or in consequence of any such new settlement as is referred to in sub-paragraph (*c*) (ii) of paragraph 1 of this Part of this Schedule are payable to or applicable for the benefit of another person for a period which cannot exceed six years from the date when the settlement was made, they shall not be treated as the income of the settlor by virtue of paragraph (*b*) of subsection (1) of section twenty of the Finance Act, 1922.

5. Paragraphs 1 and 2 of this Part of this Schedule shall not apply to any income which would have been treated as the income of the settlor for any purpose by virtue of paragraph (*a*) of subsection (1) of section twenty of the Finance Act, 1922, but for the provisions of this Act relating to that paragraph.

6. In this Part of this Schedule references to the settlor, except where that expression first occurs in paragraph 2, include references to the wife or husband of the settlor.

7. The years to which this Part of this Schedule applies are the year 1937–38 and the year 1938–39.

PART III.

MISCELLANEOUS.

1. Tax chargeable at the standard rate by virtue of sections thirty-eight or forty of this Act shall be charged under Case VI of Schedule D.

2. In computing the liability to income tax of a settlor chargeable by virtue of any of the provisions of section thirty-eight of this Act, the same deductions and reliefs shall be

allowed as would have been allowed if the income treated as his by virtue of that provision had been received by him.

3. In computing the liability to income tax of a settlor chargeable by virtue of section forty of this Act, the same deductions and reliefs shall be allowed as would have been allowed if the amount treated as his income by virtue of that section had been received by him as income.

4. The General or Special Commissioners may by notice in writing require any person, being a party to a settlement, to furnish them (within such time as they may direct, not being less than twenty-eight days) with such particulars as they think necessary for the purposes of any of the provisions of Part IV of this Act, and if that person without reasonable excuse fails to comply with the notice he shall be liable to a penalty not exceeding fifty pounds and, after judgment has been given for that penalty, to a further penalty of the like amount for every day during which the failure continues.

5. Without prejudice to the provisions of the last foregoing paragraph, if any party to a settlement fails to furnish any particulars required under the last foregoing paragraph, or if the General or Special Commissioners are not satisfied with any particulars furnished under that paragraph, they may make an estimate of the amount of income which by virtue of any of the provisions of sections thirty-eight or forty of this Act, is to be treated as the income of the settlor.

APPENDIX F1

1. Investigations Of Settlements On Minors By Persons Other Than Parents

2. Extract from Cl. Claims File - B.C. Moon

3. Opinions In The Case Of Brig. General H. Clifton Brown, M.P. v. C.I.R.

4. Opinion In The Case of Rothman Minors

5. Finance Act 1943, Section 20 and Schedule 6

INVESTIGATIONS OF SETTLEMENTS ON MINORS BY PERSONS OTHER THAN PARENTS

The cases selected for investigation were those made by grandparents and other relatives where the respective incomes of grandparent and parent indicated a probability that the settlement would not be implemented. (PRO IR40 6084 were dated 19 August 1938).

1st October 1937 to 30 June 1938

Cases taken up for investigation	131	(note 1)
Claims allowed	56	
Claims refused	35	
Cases still under investigation at 30 June 1938	40	
Amount of income included in claims disallowed		£17040 (note 2)

1 July 1938 to 31 March 1939

Cases b/f	40	
New cases taken up	46	(note 3)
	86	
Claims allowed	36	
Claims refused	23	(note 4)
Cases still under investigation at 31 March 1939	27	
Amount of income included in claims disallowed		£8743

1 April 1939 to 31 March 1940

Cases b/f	27	
New cases taken up	57	
	84	
Claims allowed	32	
Claims refused	23	
Cases still under investigation at 31 March 1940	29	
Amount of income included in disallowed claims		£7154

Note 1. The investigation of such claims was seen by the Revenue as "a direct attack upon the widespread opinion among accountants and solicitors that the legal form of a deed or arrangement of deeds is in itself conclusive evidence of a transfer of income." (ibid).

Note 2. These investigations were time consuming "but the results are encouraging and the amount of income tax and sur-tax saved is substantial" (ibid).

Note 3. The reduction in the number of cases taken up did "not indicate any relaxation of our efforts." It was thought to show the extent to which the work had been successful in discouraging bogus claims. (memo 14 October 1939).

Note 4. Several cases had been reported to the Board for consideration of penalty or other proceedings and details of the names of the taxpayers and their agents are shown on the file.

Source : Derived From PRO IR40/6084

APPENDIX F2

Source : PRO File IR40/6091

T/1686/54
1939

CHIEF INSPECTOR
OF TAXES
(CLAIMS).

B.C. MOON.

C.I.(C.)1686/1408/
1939.

SECRETARY, (TAXES)

The deed of 19.2.34 (full copy flagged in Folder M. 3092 attached) contains the following clause.

> " 3. THE HUSBAND and the wife in consideration of the premises and for the consideration aforesaid respectively covenant with the Grantor that for purpose of determining the weekly income of the husband and of the wife and each of them during the period of Ten years secondly hereinbefore mentioned he the husband and also the wife will be just and faithful to the Grantor and at all times give to the Grantor full information and truthful explanations of all matters relating to his or her income capital and finances and inform the Grantor as soon as may be of any change in the husbands weekly earnings or in his or her investments or otherwise and should the husband and wife or either of them neglect or fail to give such information as aforesaid the Grantor shall after one calendar month's notice in writing be freed and discharged from all liability under this Deed of Covenant and all payments covenanted to be made until such information shall be given."

The clause appears to amount to a power of revocation in the event of a breach of covenant by either of the beneficiaries and, strictly, to be caught by Section 38 (1)(a) Finance Act 1938 in accordance with the ruling on T.2005/185/38.

The case is submitted for instructions as the somewhat similar case of H.H. Watson (T.1686/40/39), submitted on 1.5.39, is apparently still under consideration. This case is, however, distinguishable in so far as the Settlor in this case can be freed from his obligation only for such period during which the beneficiaries may withhold information as to their incomes etc.

I shall be obliged if an early decision can be given as the claimant is pressing for repayment of the 1938/39 claim.

[signature]

CHIEF INSPECTOR OF TAXES
CORRESPONDENCE
24 AUG 1939
DIVISION
CLAIMS BRANCH

Regy.
Please attach T.1686/40/39.
[initials]
22.8.39

Mr Miller
T.1686/40/39 is w T.1686/55/39 referred to Mr Verity 25/8.
you today.

TAXES REGISTRY
28 AUG 1939

C.I. (Claims)
I think that, so long as the power to determine the annual payments does not come into being, the deed of 19 February, 1934, may be treated as outside Section 38, Finance Act 1938.
[initials]
29.8.39

No. 57 C.I.(C.)

.... B. & S., Ltd. Gp. 694

(Continued)

19 39

F INSPECTOR
F TAXES
(CLAIMS).

RECEIVED 1939

Bd Moore

C.I.(C.)/

City South E

H.M. INSPECTOR OF TAXES CITY SOUTH "E" 14 SEP 1939 RECD.

So long as there is no breach of the covenants by the Husband and the Wife to give the Grantor full information of all matters relating to their incomes etc. the deed of 19/2/34 may be treated as outside Section 38 FA1938 and payments payable by the Grantor under clause 2 of the deed may continue to be treated as the income of the beneficiaries.

CHIEF INSPECTOR OF TAXES ... 1939 DIVISION CLAIMS BRANCH

Chief Inspector,
(Claims).

Noted and papers returned herewith.

CITY SOUTH "E"
14/9/1939

Cro
(Intelligence)

ay like
A
pps for
as soon
sible.

TAXES
- 3 OCT 1939

Secretary (Taxes)

District has been instructed as above and your file is returned finally please.

CHIEF INSPECTOR OF TAXES CORRESPONDENCE

Source : PRO File IR40/6091

BRIGADIER GENERAL H. CLIFTON BROWN, M.P.

v.

COMMISSIONERS OF INLAND REVENUE.

The amount involved in this case is tax on £297 only, and I had apprehended that the Appellant might not think it worth while to proceed with his appeal. Apparently, however, he proposes to do so, and the case is in the provisional list for the forthcoming Revenue Paper.

Before delivering briefs to the Attorney General and Junior Counsel (involving liability for brief fees of considerably over £100) I think it desirable to draw the Board's attention to certain difficulties which I feel.

The case is the familiar one of a landed proprietor turning himself into a company for tax evasion purposes, but it has this following super-added feature, namely that the Appellant transferred his two estates (and also a block of investments) to the company in return for (a) preference shares and (b) ordinary shares. The Appellant himself has all the preference shares (except one held by his wife) but the ordinary shares he has had allotted to a second company (a trust company) to hold upon trust for his 3 daughters. Broadly speaking, the trust company holds these ordinary shares in trust for the daughters contingently on they or their issue being alive at the expiration of 20 years from the date of the settlement. In the meantime all the Trustee Company is entitled to receive and apply for the daughters' benefit is such ordinary dividends (if any) as may be declared. In point of fact none have yet been declared (or indeed seem likely to be), as on the accounts the net profits have been sufficient only to admit of payment of small preference dividends which of course go to the Appellant himself. The eldest daughter is of age, and her ultimate share is three ~~figures~~ fifths: the two younger daughters are minors, and their ultimate share is one ~~figure~~ fifths each.

In these circumstances, the Crown have contended, and the Special Commissioners have held, that two ~~gifts~~ fifths of the statutory income of the Estate Company (namely the Schedule A, and the investment income) is "income paid to or for the benefit of" these two younger daughters, within the meaning of Section 21 of the Finance Act 1936. The grounds of this contention are that although neither the Trust Company nor the daughters have as yet either received or become entitled to receive anything at all, nevertheless, the rents and other incomings of the Company have been expended by the Company on the maintenance and upkeep of the Company's estates, and this must be regarded as "income paid to or for the benefit of" the daughters (to the extent of two-fifths) for the reason that this expenditure enures to their benefit, in that it maintains and enhances the value of the estates and therefore of the ordinary shares in which the daughters are interested. Subsection (2) is also relied on, in that it can be said that the expenditure of these rents etc. on the maintenance of the Company's property may conduce to the payment of ordinary dividends in the future, in which the daughters will be interested.

The contentions against the Crown are:

... the settlement of the

..., and no dividends have been paid on these shares,

...natively:-

...'annual value" is not "income" capable of being "paid ... for the benefit of" anybody within the meaning of the ...on.

...ven if it is, there has not in fact been anything "paid ... for the benefit of" the daughters. The expenditure by the ...ny of its own rents etc. on the maintenance of its own ...es is too remote to be regarded as paid for the benefit ...e daughters. It is expenditure primarily for the ...it of the Company, and secondly for the benefit of the ...llant himself, because, as matters stand at present, he ... the whole of such small net profits as there are, by ...of preference dividends.

On the facts of the case, I do not feel much ...ulty on contention (a). Contention (b) raises a difficult ... of construction on the section, but my chief difficulty is ...tention (c), in which (on further consideration) I feel ... is much force.

The Board would doubtless be reluctant to abandon a ...able decision of the Special Commissioners without an ... to defend it in Court, but in the rather special ...stances I feel inclined to suggest that bevore incurring ...r substantial costs I should ask Mr. Stamp and Mr. Hills ...ould be briefed with the Attorney General if the case ...is) to consider the case and advise whether they think it ... arguable. If they take an adverse view, it might be ... for the Board to abandon the case without actually ...ng it into Court, even though this would involve liability ... Appellant's costs.

I shall be glad of the Board's instructions as early as ...ent.

F N S Preston

11th APRIL, 1940.

S.L. 11342/P.B.

BRIG-GENERAL H. CLIFTON BROWN, M.P.

SUR-TAX APPEAL (ADDITIONAL ASSESSMENT) 1936/37.

FINANCE ACT 1936, SECTION 21.

I have to report to the Board that the above appeal s heard before the Special Commissioners in London on the ; February 1939.

Mr. F. Heyworth Talbot of Counsel appeared for the ellant who was also present, and Mr. Miller of this office resented the Crown.

The facts and contentions of the parties may be marised as follows:--

On the 10th January 1935, a company, Colgate Trustees , was registered with a nominal share capital of 100 shares 1. each, of which 2 have been issued and are held by the llant and his wife.

On the 24th January 1935, a deed (copy annexed) was between Brig-Gen. H.C. Brown as settlor and the Colgate tees Ltd. (referred to as the Trust Company). The Deed tes that the Settlor intends to form a private unlimited any to be called The Holmbush Estate Co.; to transfer to Estate Company a certain estate in the County of Sussex; o cause the ordinary shares of the Estate Company, or of them, to be issued to and registered in the name of rust Company, such shares and the income thereof to be upon trust for such of the Settlor's three daughters as be living on the 24th January 1955; each of the ters living at that date to take an entailed interest. eed contains provision for the Settlor to revoke the trusts declare new trusts in favour of members of the Settlor's (which expression by definition in clause 1 (c) includes ife)

The daughters referred to and their shares of the trust fund are:-

Elizabeth Clifton Brown, born 28th January, 1914 - Share 3/5ths
Katherine Clifton Brown born 10th June, 1917 Share 1/5th
Eirene Margaret Clifton Brown, born March 1921. Share 1/5th

The Holmbush Estate Co. was registered on the 1st February 1935 with a nominal share capital of 5,000 £1. preference shares and 50,000 £1. ordinary shares. The preference shares are held by the Appellant and his wife, and the issued ordinary shares (48,900) by the Trust Company.

The appellant did in fact on the 8th February 1935 transfer to the Holmbush Estate Company real property of the value of £35,000 and £17,000 3½% conversion Loan.

The accounts of the Holmbush Estate Company for the years ended 31st December 1935, 1936 and 1937 were produced and copies are annexed. These showed the following results:-

Year to 31/12/1935	Loss	£28.	7.	11.
" " 31/12/1936	Profit	£64.	1.	6.
" " 31/12/1937	Profit	£72.	0.	5.

It was agreed that for the year 1936/37 (i.e. year under appeal) the Net Schedule A assessments amounted to £1,627 less Maintenance Claims £1,165.10.0. and that the gross income on the £17,000 3½% conversion loan was £595.

It was further agreed that for the year 1936/37 a Preference dividend of £125 had been paid but no dividend on the ordinary shares had at any time been declared.

On behalf of the appellant it was contended:-

(1) That as there was a binding trust created by the deed dated 24/1/35, it was unnecessary to look beyond that document to ascertain

(Continued)

the terms of the settlement. Finance Act 1936, Sec.21 (9) defines the expression "settlement" as including any "Trust".

(2) The only "income" of the trust was the dividends which might be declared by the Holmbush Estate Company as no dividend on the shares held by the Trustee Company had so far been declared. The Trust Company had received no income which could be paid or applied or accumulated for the benefit of the beneficiaries or any other persons.

Alternatively:-

(3) If the expression "settlement" must be taken to include not only the Trust deed, but the formation of The Holmbush Estate Company and the Colgate Trustees Ltd, then, under the provisions of Rule 2 (a) of Sec. 21, Finance Act 1936 there must be an income (an actual income in fact) capable of being paid or applied to the benefit of the child either presently or in the future. In the present case the accounts showed that there was no such income. A "notional income" could be neither paid or applied to or for the benefit of any person. (Reference was made to the recent cases of Commissioners of Inland Revenue v. Sigma Trust Ltd, and Commissioners of Inland Revenue v. Kered Ltd.)

On behalf of the Crown it was contended
[int]er alia:-

(1) That the expression "settlement" included the whole arrangement entered into by the appellant. (Reference was made to Commissioners of Inland Revenue v. Clarkson Webb, 17 T.C. 451). The Special Commissioners were, therefore, entitled to review the whole of the operations to ascertain the true intention of the settlor.

(2) That the meaning of the word "income available" in the Kered and Sigma cases, as laid down by the Court of Appeal, had reference only to the special section with which the Court was dealing and had no reference to the present case. For the purposes of the present case, Subsection 9 (d) of Section 21, Finance Act 1936, specifically defined the expression "Income" as any income "chargeable to tax by deduction or otherwise". This clearly demonstrated that it was "income tax" income, and not "actual" income that was involved.

(3) That the income involved in the present case was the income which the settlor would have included in his own return, had no settlement been made by him, and that that income was represented by the Schedule A value of the properties transferred, (less maintenance claim allowed) and the gross interest on the £17,000 3½% Conversion Loan.

At the conclusion of the hearing the Special Commissioners dismissed the appeal and the additional assessment was confirmed in the agreed sum of £297.

Dissatisfaction was thereupon expressed on behalf of the appellant.

J W Breslin

3rd February, 1939.

APPENDIX F4

<u>T.2005/185/39</u>
<u>S.L. 12908</u>

Source : PRO File IR40/6091

<u>ROTHMAN MINORS.</u>

The facts of this case so far as it is possible to ascertain them at this stage appear to be as follows.

Louis Trust Ltd. was registered on the 24th March 1934, the nominal capital was 80 £1 A shares and 400 1/- B shares. 398 B shares were issued to Sydney Rothman for cash. 2 of the A shares were issued in April 1934 to L.J. Rothman and V.M. Rothman, both of whom are children of Sydney Rothman and infants during the years in question. The £2 necessary to take up the 2 A shares were given by Mr. Sydney Rothman to his children. On the 31st May 1934 Sydney Rothman sold to the company 50,000 shares in Rothmans Ltd for £120. As the shares paid a dividend of £1600 the transaction was for all practical purposes a gift by Sydney Rothman to the company. The sole Director at all times was Mr. Sydney Rothman. Under the articles of the company the B shares are entitled to 5% of the profits distributed, and carry voting control. The A shares are entitled to the remainder of the profits. On a winding up the B shares are entitled to a return of the paid up capital, after which all the assets go to the A shares.

The Company has, up to date, distributed all its income, which consists solely of dividends on the Rothman shares, to the children as holders of the A shares, with the exception of 5% paid to the B shares, and the question that arises is whether the transaction can be attacked either under Section 21 of the Finance Act 1936 or Section 38 of the Finance Act, 1938. There does not seem to be any chance of success under Section 38(3) as a full distribution has been made. The question that arises under Section 21 of the Financ Act, 1936 and Section 38(2) of the Finance Act, 1938 appears to be substantially the same, namely do the transactions set

the gift
[illegible]
is not done)

out above constitute a settlement within the meaning of the respective sections and are they revocable?

Reduced to simple terms the substance of the transaction appears to be that Sydney Rothman has formed a company, given the company 50,000 valuable shares, and given his children shares in the company which under the articles carry the right to almost all the income of the company. Is such a transaction a settlement within either of the two sections? In my view there are difficulties in the way of such a contention, and they have been set out by Sir John Shaw in his report of 12th July 1939 on papers T.2005/96/39. A somewhat similar transaction, however, was held to be a settlement within Section ~~38~~ 21 in Copeman ~~and~~ v. Coleman and the Special Commissioners have in two recent appeals [Friedlander T.2004/284/39 heard 16.X.39 and Lady Norman S.T.22347 heard 2.XI.39] held that somewhat similar arrangements are settlements within Section 38. I consider therefore that there is at least a good chance of the Court holding that the present transaction is a settlement also. If so, is it revocable? I am inclined to think that it is arguable that it is. If a series of transactions under which the income of certain property (in the present case the Rothman shares) becomes payable to A is a settlement, and the person who carries out such transaction is the Settlor, it seems to me that he is able to revoke the settlement if he can carry out another series of transactions as a result of which the income again becomes payable to himself. In the present case Sydney Rothman could regain almost all the income of the Rothman shares by procuring the issue of the remaining 78 "A" shares for himself; and by then putting the company into liquidation ~~could~~ might be able to procure the shares from the liquidator.

28. 1.

In view of the difficulties set out in Sir John Shaw's report to which I have referred I do not wish to be taken as expressing the view that success in an attempt to apply Section 21 or Section 38 is assured, and in the two recent cases above referred to the Special Commissioners have held that there was no power to revoke. The Board have, however, demanded cases, and in view of that fact and of the fact that the present scheme is clearly one for avoiding the payment of Sur-tax upon income expended upon children's education, I think there is sufficient chance of success to justify the Board in attacking the scheme. Liability should be claimed under Section 21 of the Finance Act, 1936 and Section 38(2) of the Finance Act, 1938.

I should add that if the Board wish to challenge this type of scheme the present seems a rather better one upon which to do so then Friedlander or Lady Norman.

In the present case there is no body of Trustees holding shares who would be bound by their duties to take proceedings to restrain the Settlor from obtaining the income or assets for himself. It may, however, be held that Rothman as Director of the Company could not issue shares to himself without adequate consideration and so INJURE THE RIGHT OF EXISTING shareholders, and in this connection I should draw the attention of the Board to the opinion of Mr. Stamp referred to in my report of 23rd December 1937 on papers T.2004/358/37 P.W. Lee.

Similar considerations apply to the case of Parker Minors T.1686/53/37. Mr. England's opinion of 23rd July 1937 was of course given with reference to Section 21 Finance Act 1936 only and before Copeman ~~and~~ v. Coleman.

[signature]

Finance Act, 1943.

20. For the removal of doubts, it is hereby declared that the provisions of Part IV of the Finance Act, 1938, and section twenty-one of the Finance Act, 1936 (which relate to the income tax to be paid in the case of certain settlements) and the provisions of section twenty of the Finance Act, 1922 (which relates to certain revocable and other dispositions) have effect in accordance with the provisions of the Sixth Schedule to this Act in the case of any settlement or disposition where there is more than one settlor or more than one person who made the disposition.

Application of certain enactments to settlements and dispositions where there is more than one settlor or disponer.
26 Geo. 5. & 1 Edw. 8 c. 34.
12 & 13 Geo. 5. c. 17

Finance Act, 1943.

SIXTH SCHEDULE.

APPLICATION OF ENACTMENTS TO SETTLEMENTS AND DISPOSITIONS WHERE THERE IS MORE THAN ONE SETTLOR OR PERSON WHO MADE THE DISPOSITION.

PART I.

Application of Part IV of the Finance Act, 1938.

1. Subject to the provisions of this Part of this Schedule, Part IV of the Finance Act, 1938, has effect in relation to each settlor as if he were the only settlor.

2. References in the said Part IV to the property comprised in the settlement include, in relation to any settlor, only property originating from that settlor and references in the said Part IV to income arising under the settlement include, in relation to any settlor, only income originating from that settlor.

3. In considering for the purposes of the said Part IV, in relation to any settlor, whether any, and if so, how much, of the income arising under the settlement has been distributed, any sums paid partly out of income originating from that settlor and partly out of other income must (so far as not apportioned by the terms of the settlement) be apportioned evenly over all that income.

4. The references in subsection (1) of section thirty-eight and in section thirty-nine to sums payable by virtue or in consequence of any provision of the settlement or sums paid by virtue or in consequence of the settlement include, in relation to any settlor, only sums payable or paid by that settlor.

5.—(1) References in this Part of this Schedule to property originating from a settlor are references to—

(*a*) property which that settlor has provided directly or indirectly for the purposes of the settlement; and

(*b*) property representing that property; and

(*c*) so much of any property which represents both property provided as aforesaid and other property as, on a just apportionment, represents the property so provided.

(2) References in this Part of this Schedule to income originating from a settlor are references to—

(*a*) income from property originating from that settlor; and

(*b*) so much of any such income of a body corporate as is mentioned in sub-paragraph (ii) of paragraph (*a*) of subsection (4) of section forty-one of the Finance Act, 1938, as corresponds to property originating from the settlor which is comprised in the settlement; and

(*c*) income provided directly or indirectly by that settlor.

(3) In this paragraph—

(*a*) references to property or income which a settlor has provided directly or indirectly include references to property or income which has been provided directly or indirectly by another person in pursuance of reciprocal arrangements with that settlor, but do not include references to property or income which that settlor has provided directly or indirectly in pursuance of reciprocal arrangements with another person;

Finance Act, 1943.

(*b*) references to property which represents other property include references to property which represents accumulated income from that other property.

PART II.

Application of Finance Act, 1936, *s.* 21.

1. Subject to the provisions of this Part of this Schedule, section twenty-one of the Finance Act, 1936, has effect in relation to each settlor as if he were the only settlor.

2. For the purposes of the said section twenty-one, only the following can be taken into account, in relation to any settlor, as income paid by virtue or in consequence of the settlement to or for the benefit of a child of the settlor, that is to say,—

(*a*) income originating from that settlor; and

(*b*) in a case in which paragraph (*b*) of subsection (3) of the said section twenty-one applies, any sums which are under that paragraph to be deemed to be paid as income:

Provided that in applying the said paragraph (*b*) to any settlor—

(i) the references to sums paid by virtue or in consequence of the settlement or any enactment relating thereto include only sums paid out of property originating from that settlor or income originating from that settlor; and

(ii) the reference to the income which by virtue or in consequence of the settlement has been paid to or for the benefit of a child of the settlor or dealt with as mentioned in subsection (2) of the said section includes only income originating from that settlor.

3. The references in this Part of this Schedule to income originating, and property originating, from a settlor have the meanings assigned to them by paragraph 5 of Part I of this Schedule, except that paragraph (*b*) of sub-paragraph (2) of the said paragraph 5 must be treated as omitted.

PART III.

Application of Finance Act, 1922, *s.* 20.

1. Subject to the provisions of this Part of this Schedule, section twenty of the Finance Act, 1922, has effect in relation to each person who has made the disposition as if he were the only person who had made it.

2. References in the said section twenty to income payable or applicable by virtue or in consequence of the disposition include, in relation to any person making the disposition, only—

(*a*) income from property which that person has provided directly or indirectly for the purposes of the disposition; and

(*b*) income from property representing that property; and

(*c*) income from so much of any property which represents both property provided as aforesaid and other property as, on a just apportionment, represents the property so provided; and

(*d*) income provided directly or indirectly by that person.

3. In this Part of this Schedule, references to property which represents other property include references to property which represents accumulated income from that other property.

APPENDIX G

1. Section 28 Finance Act 1946

2. Charitable Deeds Of Covenant 1946 To 1954.

Section 28 Finance Act 1946

28 (1) Where, during the life of the settlor, income arising under a settlement made on or after the tenth day of April, nineteen hundred and forty-six, is, under the settlement and in the events that occur, payable to or applicable for the benefit of any person other than the settlor, then, unless, under the settlement and in the said events, the income either:

(a) is payable to an individual for his own use; or
(b) is applicable for the benefit of an individual named in that behalf in the settlement or of two or more individuals named in that behalf therein; or
(c) is applicable for the benefit of a child or children of an individual named in that behalf in the settlement; or
(d) is income from property of which the settlor has divested himself absolutely by the settlement; or
(e) is income which, by virtue of some provision of the Income Tax Acts other than this section, is to be treated for the purposes of those Acts as income of the settlor.

the income shall be treated for the purposes of surtax as the income of the settlor and not as the income of any other person:

Provided that the exceptions provided for by paragraphs (a), (b) and (c) of this subsection shall not apply where the named individual or individuals or, in the case of the said paragraph (c), either the named individual or the child or any of the children in question, is in the service of the settlor or accustomed to act as the solicitor or agent of the settlor.

(2) The settlor shall not be deemed for the purposes of this section to have divested himself absolutely of any property if that property or any income therefrom or any property directly or indirectly representing proceeds of, or of income from, that property or any income therefrom is, or will or may become, payable to him or applicable for his benefit in any circumstances whatsoever:

Provided that a settlor shall not be deemed not to have divested himself absolutely of any property by reason only that that property or income therefrom or any such other property or income as aforesaid may become payable to him or applicable for his benefit in the event of:

(a) the bankruptcy of some person who is or may become beneficially entitled to any such property or income; or

(b) an assignment of or charge on any such property or income being made or given by some such person; or

(c) in the case of a marriage settlement, the death of both the parties to the marriage and of all or any of the children of the marriage; or

(d) the death under the age of twenty-five or some lower age of some person who would be beneficially entitled to that property or income on attaining that age.

(3) In this section, the expressions "income arising under a settlement", "settlement" and "settlor" have the meanings assigned to them for the purposes of Part IV of the Finance Act, 1938, by subsection (4) of section forty-one of that Act; and Part I of the Sixth Schedule to the Finance Act, 1943 (which relates to settlements with more than one settlor) shall have effect in relation to this section as it has effect in relation to the said Part IV.

CHARITABLE DEEDS OF COVENANT, 1946 TO 1954

	REPAYMENTS IN YEAR ENDED 30 SEPTEMBER								
	1946	1947	1948	1949	1950	1951	1952	1953	1954(3)
NEW DEEDS	66,059	63,469	65,710	70,876	78,917	85,027	103,077	126,456	Not known
OLD DEEDS	228,247	270,574	286,735	317,301	335,398	359,012	388,569	412,656	Not known
TOTAL	294,306	334,043	352,445	388,177	414,315	444,039	491,646	539,112	575,254
BODIES SUBMITTING CLAIMS (1)	11,331	12,736	12,643	12,175	13,072	13,537	15,134	16,879	Not known
TAX REPAID (2)	£2,607,073	£2,743,197	£2,980,036	£2,799,034	£2,954,056	£3,708,853	£3,466,050	£3,812,628	£3,749,620
OLD DEEDS EXPIRING		23,732	47,308	35,144	52,779	55,303	55,470	78,990	Not known

(1) The Nathan Committee (1952) Cmnd 8710 states that there were 110,000 trusts known to the Charity Commissioners and the Ministry of Education - para 103.

(2) The total cost of the charity exemption in the early 1950's was estimated by the Board to be £35 million per annum Cmnd 9474 para 163.

(3) Information for this year is based upon that in Cmnd 9749 para 179.

APPENDIX H

1. Income Tax Act 1952 - Settlement Provisions

2. Finance Act 1958 Section 21

3. Finance Act 1958 Section 22

4. Finance Act 1958 Section 20

INCOME TAX ACT 1952, SETTLEMENT PROVISIONS

PART XVIII

SPECIAL PROVISIONS FOR TAXATION OF SETTLORS, ETC. IN RESPECT OF SETTLED OR TRANSFERRED INCOME

CHAPTER I

DISPOSITIONS OF INCOME FOR SHORT PERIODS AND IRREVOCABLE DISPOSITIONS IN FAVOUR OF CHILDREN EFFECTED BEFORE APRIL 22ND, 1936

392. Any income which, by virtue or in consequence of any disposition made, directly or indirectly, by any person after the first day of May, nineteen hundred and twenty-two (other than a disposition made for valuable and sufficient consideration), is payable to or applicable for the benefit of any other person for a period which cannot exceed six years shall be deemed for all the purposes of this Act to be the income of the person, if living, by whom the disposition was made, and not to be the income of any other person.

393.—(1) Subject to the provisions of this section, any income which, by virtue or in consequence of any disposition made, directly or indirectly, by any person after the fifth day of April, nineteen hundred and fourteen, is payable to or applicable for the benefit of a child of that person for some period less than the life of the child shall, if and so long as the child is an infant and unmarried, be deemed for all the purposes of this Act to be the income of the person, if living, by whom the disposition was made and not to be the income of any other person.

(2) This section shall not apply in relation to any settlement, as defined for the purpose of Chapter II of this Part of this Act, except a settlement made or entered into before the twenty-second day of April, nineteen hundred and thirty-six, which, immediately before that date, was an irrevocable settlement within the meaning of the said Chapter II.

(3) This section shall not apply as regards any income which is derived from capital which, at the end of the period during which that income is payable to or applicable for the benefit of the child, is required by the disposition to be held on trust absolutely for, or to be transferred to, the child, or any income which is payable to or applicable for the benefit of a child during the whole period of the life of the person by whom the disposition was made.

(4) Income shall not be deemed, for the purposes of this section, to be payable to or applicable for the benefit of a child

for some period less than its life by reason only that the disposition contains a provision for the payment to some other person of the income in the event of the bankruptcy of the child, or of an assignment thereof, or a charge thereon, being executed by the child.

Adjustments between disponor and trustees.

394.—(1) Where, by virtue of this Chapter, any income tax becomes chargeable on and is paid by the person by whom a disposition was made, that person shall be entitled—

(*a*) to recover from any trustee or other person to whom the income is payable by virtue or in consequence of the disposition the amount of the tax so paid; and

(*b*) for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of the income in respect of which he has so paid tax and the amount of the tax so paid.

and any certificate so furnished shall be conclusive evidence of the facts appearing thereby.

(2) Where any person obtains in respect of any allowance or relief a repayment of income tax in excess of the amount of the repayment to which he would but for the provisions of this Chapter have been entitled, an amount equal to the excess shall be paid by him to the trustee or other person to whom the income is payable by virtue or in consequence of the disposition, or, where there are two or more such persons, shall be apportioned among those persons as the case may require.

If any question arises as to the amount of any payment or as to any apportionment to be made under this subsection, that question shall be decided by the General Commissioners whose decision thereon shall be final.

(3) Any income which is deemed by virtue of this Chapter to be the income of any person shall be deemed to be the highest part of his income.

Application of Chapter I to dispositions where there is more than one disponor.

395.—(1) In the case of any disposition where there is more than one person who made the disposition, this Chapter shall, subject to the provisions of this section, have effect in relation to each person who made the disposition as if he were the only person who had made it.

(2) In the case of any such disposition, references in this Chapter to income payable or applicable by virtue or in consequence of the disposition include, in relation to any person making the disposition, only—

(*a*) income from property which that person has provided directly or indirectly for the purposes of the disposition; and (*b*) income from property representing that property; and

(*c*) income from so much of any property which represents both property provided as aforesaid and other property as, on a just apportionment, represents the property so provided; and

(*d*) income provided directly or indirectly by that person.

(3) In this section, references to property which represents other property include references to property which represents accumulated income from that other property.

396. In this Chapter, unless the context otherwise requires—

" child " includes a stepchild or illegitimate child; and

" disposition " includes any trust, covenant, agreement or arrangement.

Chapter II

Settlements on Children Generally

397.—(1) Where, by virtue or in consequence of any settlement to which this 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 commencement of that year the child was an infant and unmarried, be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person.

(2) This Chapter applies to every settlement, wheresoever it was made or entered into, and whether it was made or entered into before or after the passing of this Act, except a settlement made or entered into before the twenty-second day of April, nineteen hundred and thirty-six, which immediately before that date was irrevocable.

(3) Income paid to or for the benefit of a child of a settlor shall not be treated as provided in subsection (1) of this section for any year of assessment in which the aggregate amount of the income paid to or for the benefit of that child, which, but for this subsection, would be so treated by virtue of this Chapter, does not exceed five pounds.

(4) This Chapter shall not apply in relation to any income arising under a settlement in any year of assessment for which the settlor is not chargeable to income tax as a resident in the United Kingdom, and references in this Chapter to income shall be construed accordingly.

398.—(1) Subject to the provisions of this section, for the purposes of this Chapter—

(*a*) income which, by virtue or in consequence of a settlement to which this Chapter applies, is so dealt with that it, or assets representing it, will or may become payable or applicable to or for the benefit of a child of the

PART XVIII —*cont.*

settlor in the future (whether on the fulfilment of a condition, or the happening of a contingency, or as the result of the exercise of a power or discretion conferred on any person, or otherwise) shall be deemed to be paid to or for the benefit of that child; and

(*b*) any income dealt with as aforesaid which is not required by the settlement to be allocated, at the time when it is so dealt with, to any particular child or children of the settlor shall be deemed to be paid in equal shares to or for the benefit of each of the children to or for the benefit of whom or any of whom the income or assets representing it will or may become payable or applicable.

(2) Where any income is dealt with as mentioned in subsection (1) of this section by virtue or in consequence of a settlement to which this Chapter applies, being a settlement which, at the time when the income is so dealt with, is an irrevocable settlement—

(*a*) the provisions of subsection (1) of this section shall not apply to that income unless and except to the extent that that income consists of, or represents directly or indirectly, sums paid by the settlor which are allowable as deductions in computing his total income; and

(*b*) any sum whatsoever paid thereafter by virtue or in consequence of the settlement, or any enactment relating thereto, to or for the benefit of a child of the settlor, being a child who, at the commencement of the year of assessment in which the sum is paid is an infant and unmarried, shall be deemed for the purposes of the last preceding section to be paid as income, unless and except to the extent that the sum so paid together with any other sums previously so paid (whether to that child or to any other child who, at the commencement of the year of assessment in which that other sum was so paid, was an infant and unmarried) exceeds the aggregate amount of the income which, by virtue or in consequence of the settlement, has been paid to or for the benefit of a child of the settlor, or dealt with as mentioned in subsection (1) of this section, since the date when the settlement took effect or the date when it became irrevocable, whichever is the later.

Meaning of "irrevocable".

399. For the purposes of this Chapter, a settlement shall not be deemed to be irrevocable if the terms thereof provide—

(*a*) for the payment to the settlor or, during the life of the settlor, to the wife or husband of the settlor for his or her benefit, or for the application for the benefit of the settlor or, during the life of the settlor, of the wife or husband of the settlor, of any income or assets in any circumstances whatsoever during the life of any child of the settlor to or for the benefit of whom any income, or assets representing it, is or are or may be payable or applicable by virtue or in consequence of the settlement; or

(*b*) for the determination of the settlement by the act or on the default of any person; or

(*c*) for the payment of any penalty by the settlor in the event of his failing to comply with the provisions of the settlement:

Provided that a settlement shall not be deemed to be revocable by reason only—

(i) that it contains a provision under which any income or assets will or may become payable to or applicable for the benefit of the settlor, or the wife or husband of the settlor, on the bankruptcy of any such child as is mentioned in paragraph (*a*) of this section or in the event of an assignment of or charge on that income or those assets being executed by such a child; or

(ii) that it provides for the determination of the settlement as aforesaid in such a manner that the determination will not, during the lifetime of any such child as aforesaid, benefit any person other than such a child, or the wife, husband or issue of such a child or

(iii) in the case of a settlement to which section thirty-three of the Trustee Act, 1925, applies, that it directs income to be held for the benefit of such a child as aforesaid on protective trusts, unless the trust period is a period less than the life of the child or the settlement specifies some event on the happening of which the child would, if the income were payable during the trust period to him absolutely during that period, be deprived of the right to receive the income or part thereof.

400.—(1) Where, by virtue of this Chapter, any income tax becomes chargeable on and is paid by the person by whom a settlement was made or entered into, that person shall be entitled—

(*a*) to recover from any trustee or other person to whom the income is payable by virtue or in consequence of the settlement the amount of the tax so paid; and

(*b*) for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of income in respect of which he has so paid tax and the amount of the tax so paid,

and any certificate so furnished shall be conclusive evidence of the facts appearing thereby.

PART XVIII
—*cont.*

(2) Where any person obtains in respect of any allowance or relief a repayment of income tax in excess of the amount of the repayment to which he would but for the provisions of this Chapter have been entitled, an amount equal to the excess shall be paid by him to the trustee or other person to whom the income is payable by virtue or in consequence of the settlement, or, where there are two or more such persons, shall be apportioned among those persons as the case may require.

If any question arises as to the amount of any payment or as to any apportionment to be made under this subsection, that question shall be decided by the General Commissioners whose decision thereon shall be final.

(3) Any income which is deemed by virtue of this Chapter to be the income of any person shall be deemed to be the highest part of his income.

(4) No repayment shall be made under section two hundred and twenty-eight of this Act (which provides for relief where income is accumulated for the benefit of a person contingently on his attaining some specified age or marrying) on account of tax paid in respect of any income which by virtue of this Chapter has been treated as income of a settlor.

Application of Chapter II to settlements with more than one settlor.

401.—(1) In the case of any settlement where there is more than one settlor, this Chapter shall, subject to the provisions of this section, have effect in relation to each settlor as if he were the only settlor.

(2) In the case of any such settlement as aforesaid, only the following can, for the purposes of this Chapter, be taken into account, in relation to any settlor, as income paid by virtue or in consequence of the settlement to or for the benefit of a child of the settlor, that is to say—

(*a*) income originating from that settlor; and

(*b*) in a case in which paragraph (*b*) of subsection (2) of section three hundred and ninety-eight of this Act applies, any sums which are under that paragraph to be deemed to be paid as income:

Provided that in applying the said paragraph (*b*) to any settlor—

(i) the references to sums paid by virtue or in consequence of the settlement or any enactment relating thereto include only sums paid out of property originating from that settlor or income originating from that settlor; and

(ii) the reference to income which by virtue or in consequence of the settlement has been paid to or for the benefit of a child of the settlor or dealt with as mentioned in subsection (1) of that section includes only income originating from that settlor.

(3) References in this section to property originating from a settlor are references to—

(*a*) property which that settlor has provided directly or indirectly for the purposes of the settlement; and

(*b*) property representing that property; and

(*c*) so much of any property which represents both property provided as aforesaid and other property as, on a just apportionment, represents the property so provided.

(4) References in this section to income originating from a settlor are references to—

(*a*) income from property originating from that settlor; and

(*b*) income provided directly or indirectly by that settlor.

(5) In subsections (3) and (4) of this section—

(*a*) references to property or income which a settlor has provided directly or indirectly include references to property or income which has been provided directly or indirectly by another person in pursuance of reciprocal arrangements with that settlor but do not include references to property or income which that settlor has provided directly or indirectly in pursuance of reciprocal arrangements with another person; and

(*b*) references to property which represents other property include references to property which represents accumulated income from that other property.

402. The General or Special Commissioners may by notice in writing require any party to a settlement to furnish them within such time as they may direct (not being less than twenty-eight days) with such particulars as they think necessary for the purposes of this Chapter, and if that person without reasonable excuse fails to comply with the notice he shall be liable to a penalty not exceeding fifty pounds and, after judgment has been given for that penalty, to a further penalty of the like amount for every day during which the failure continues.

403. In this Chapter—

"child" includes a stepchild, an adopted child and an illegitimate child;

"settlement" includes any disposition, trust, covenant, agreement, arrangement or transfer of assets;

"settlor", in relation to a settlement, includes any person by whom the settlement was made or entered into directly or indirectly, and in particular (but without prejudice to the generality of the preceding words of this definition) includes any person who has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement;

"income", except in the phrase (occurring in subsection (1) of section three hundred and ninety-seven of this Act) "be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person", includes any income chargeable to income tax by deduction or otherwise and any income which would have been so chargeable if it had been received in the United Kingdom by a person resident and ordinarily resident in the United Kingdom.

CHAPTER III

REVOCABLE SETTLEMENTS, SETTLEMENTS WHERE SETTLOR RETAINS AN INTEREST, ETC.

Revocable settlements.

404.—(1) If and so long as the terms of any settlement are such that—

(*a*) any person has or may have power, whether immediately or in the future, and whether with or without the consent of any other person, to revoke or otherwise determine the settlement or any provision thereof and, in the event of the exercise of the power, the settlor or the wife or husband of the settlor will or may cease to be liable to make any annual payments payable by virtue or in consequence of any provision of the settlement; or

(*b*) the settlor or the wife or husband of the settlor may, whether immediately or in the future, cease, on the payment of a penalty, to be liable to make any annual payments payable by virtue or in consequence of any provision of the settlement,

any sums payable by the settlor or the wife or husband of the settlor by virtue or in consequence of that provision of the settlement in any year of assessment shall be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person:

Provided that, where any such power as is referred to in paragraph (*a*) of this subsection cannot be exercised within the period of six years from the time when the first of the annual payments so referred to becomes payable, and the like annual payments are payable in each year throughout that period, the said paragraph (*a*) shall not apply so long as the said power cannot be exercised.

(2) If and so long as the terms of any settlement are such that—

(*a*) any person has or may have power, whether immediately or in the future, and whether with or without the consent of any other person, to revoke or otherwise determine the settlement or any provision thereof; and

(*b*) in the event of the exercise of the power, the settlor or the wife or husband of the settlor will or may become beneficially entitled to the whole or any part of the property then comprised in the settlement or of the income arising from the whole or any part of the property so comprised,

any income arising under the settlement from the property comprised in the settlement in any year of assessment or from a corresponding part of that property, or a corresponding part of any such income, as the case may be, shall be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person:

Provided that, where any such power as aforesaid cannot be exercised within six years from the time when any particular property first becomes comprised in the settlement, this subsection shall not apply to income arising under the settlement from that property, or from property representing that property, so long as the power cannot be exercised.

405.—(1) If and so long as the settlor has an interest in any income arising under or property comprised in a settlement, any income so arising during the life of the settlor in any year of assessment shall, to the extent to which it is not distributed, be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person:

Provided that—

(*a*) if and so long as that interest is an interest neither in the whole of the income arising under the settlement nor in the whole of the property comprised in the settlement, the amount of income to be treated as the income of the settlor by virtue of this subsection shall be such part of the income which, but for this proviso, would be so treated as is proportionate to the extent of that interest; and

(*b*) where it is shown that any amount of the income which is not distributed in any year of assessment consists of income which falls to be treated as the income of the settlor for that year by virtue of the last preceding section, that amount shall be deducted from the amount of income which, but for this proviso, would be treated as his for that year by virtue of this subsection.

PART XVIII —*cont.*

(2) For the purpose of subsection (1) of this section, the settlor shall be deemed to have an interest in income arising under or property comprised in a settlement if any income or property which may at any time arise under or be comprised in that settlement is, or will or may become, payable to or applicable for the benefit of the settlor or the wife or husband of the settlor in any circumstances whatsoever:

Provided that the settlor shall not be deemed to have an interest in any income arising under or property comprised in a settlement—

(*a*) if and so long as that income or property cannot become payable or applicable as aforesaid except in the event of—

(i) the bankruptcy of some person who is or may become beneficially entitled to that income or property; or

(ii) any assignment of or charge on that income or property being made or given by some such person; or

(iii) in the case of a marriage settlement, the death of both the parties to the marriage and of all or any of the children of the marriage; or

(iv) the death under the age of twenty-five or some lower age of some person who would be beneficially entitled to that income or property on attaining that age; or

(*b*) if and so long as some person is alive and under the age of twenty-five during whose life that income or property cannot become payable or applicable as aforesaid except in the event of that person becoming bankrupt or assigning or charging his interest in that income or property.

Provisions supplemental to sections 404 and 405.

406.—(1) Tax chargeable at the standard rate by virtue of the preceding provisions of this Chapter shall be charged under Case VI of Schedule D.

(2) In computing the liability to income tax of a settlor chargeable by virtue of any of the said preceding provisions, the same deductions and reliefs shall be allowed as would have been allowed if the income treated as his by virtue of that provision had been received by him.

(3) Where, by virtue of any of the said preceding provisions, any income tax becomes chargeable on and is paid by a settlor, he shall be entitled—

(*a*) to recover from any trustee, or other person to whom income arises under the settlement, the amount of the tax so paid; and (*b*) for that purpose to require the Commissioners concerned to furnish to him a certificate specifying the amount of income in respect of which he has so paid tax and the amount of tax so paid.

Any certificate so furnished shall be conclusive evidence of the facts stated therein.

(4) Where any person obtains, in respect of any allowance or relief, a repayment of income tax in excess of the amount of the repayment to which he would, but for any of the said preceding provisions, have been entitled, an amount equal to the excess shall be paid by him to the trustee or other person to whom income arises under the settlement, or, where there are two or more such persons, shall be apportioned among those persons as the case may require.

If any question arises as to the amount of any payment or as to any apportionment to be made under this subsection, that question shall be decided by the General Commissioners whose decision thereon shall be final.

(5) Any income which is treated by virtue of any of the said preceding provisions as income of a settlor shall be deemed for the purpose of this section to be the highest part of his income.

(6) No repayment shall be made under section two hundred and twenty-eight of this Act (which provides for relief where income is accumulated for the benefit of a person contingently on his attaining some specified age or marrying) on account of tax paid in respect of any income which by virtue of any of the said preceding provisions has been treated as income of a settlor.

407.—(1) Where, by virtue or in consequence of any settlement to which this section applies, the settlor pays directly or indirectly in any year of assessment to the trustees of the settlement any sums which would, but for this subsection, be allowable as deductions in computing his total income for that year for the purposes of surtax, those sums shall not be so allowable to the extent to which the aggregate amount thereof falls within the amount of income arising under the settlement in that year which has not been distributed, less—

(*a*) so much of any income arising under the settlement in that year which has not been distributed as is shown to consist of income which has been treated as the income of the settlor by virtue of section four hundred and four of this Act; and

(*b*) the amount of income so arising in that year which is treated as the income of the settlor by virtue of section four hundred and five of this Act.

(2) For the purposes of subsection (1) of this section, any sum paid in any year of assessment by the settlor to any body cor-

porate connected with the settlement in that year shall be treated as if it had been paid to the trustees of the settlement in that year by virtue or in consequence of the settlement.

(3) No relief shall be given under any of the provisions of this Act on account of tax paid in respect of so much of any income arising under a settlement in any year of assessment as is equal to the aggregate amount of any sums paid by the settlor in that year which are not allowable as deductions by virtue of this section.

(4) This section shall apply to any settlement (wherever made) made after the twenty-sixth day of April, nineteen hundred and thirty-eight, and where income arising under any settlement (wherever made) made on or before that date is treated as the income of the settlor by virtue of section four hundred and four of this Act but ceases to be so treated by reason of any variation of the terms of the settlement made after that date, or would have been so treated but for such a variation, this section shall apply to that settlement as from the date when the variation takes effect.

(5) In this section, references to sums paid by a settlor include references to sums paid by the wife or husband of the settlor.

Sums paid to settlor otherwise than as income.

408.—(1) Any capital sum paid directly or indirectly in any relevant year of assessment by the trustees of a settlement to which this section applies to the settlor shall—

(*a*) to the extent to which the amount of that sum falls within the amount of income available up to the end of that year, be treated for all the purposes of this Act as the income of the settlor for that year;

(*b*) to the extent to which the amount of that sum exceeds the amount of income available up to the end of that year but falls within the amount of the income available up to the end of the next following year, be treated for the purposes aforesaid as the income of the settlor for the next following year,

and so on.

(2) For the purposes of subsection (1) of this section, the amount of income available up to the end of any year shall, in relation to any capital sum paid as aforesaid, be taken to be the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less—

(*a*) the amount of any other capital sums paid to the settlor in any relevant year before that sum was paid; and

(*b*) so much of any income arising under the settlement in that year and any previous relevant year which has not been distributed as is shown to consist of income which has been treated as income of the settlor by virtue of section four hundred and four of this Act; and

(*c*) any income arising under the settlement in that year and any previous relevant year which has been treated as the income of the settlor by virtue of section four hundred and five of this Act; and

(*d*) any sums paid by virtue or in consequence of the settlement, to the extent that they are not allowable, by virtue of the last preceding section, as deductions in computing the settlor's income for that year or any previous relevant year; and

(*e*) an amount equal to tax at the standard rate on—

(i) the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less

(ii) the aggregate amount of the income and sums referred to in paragraphs (*b*), (*c*) and (*d*) of this subsection.

(3) For the purpose of this section, any capital sum paid to the settlor in any year of assessment by any body corporate connected with the settlement in that year shall be treated as having been paid by the trustees of the settlement in that year.

(4) Where the whole or any part of any sum is treated by virtue of this section as income of the settlor for any year, it shall be treated as income of such an amount as, after deduction of tax at the standard rate for that year, would be equal to that sum or that part thereof.

(5) Tax chargeable at the standard rate by virtue of this section shall be charged under Case VI of Schedule D.

(6) In computing the liability to income tax of a settlor chargeable by virtue of this section, the same deductions and reliefs shall be allowed as would have been allowed if the amount treated as his income by virtue of this section had been received by him as income.

(7) This section applies to any settlement wherever made, and whether made before or after the passing of this Act, and in this section—

" capital sum " means—

(i) any sum paid by way of loan or repayment of a loan; and

(ii) any other sum paid otherwise than as income, being a sum which is not paid for full consideration in money or money's worth,

but does not include any sum which could not have become payable to the settlor except in one of the events specified in the proviso to subsection (2) of section four hundred and five of this Act; and

PART XVIII
—*cont.*

"relevant year" means any year of assessment after the year 1937-38; and

references to sums paid to the settlor include references to sums paid to the wife or husband of the settlor.

Application of Chapter III to settlements where there is more than one settlor.

409.—(1) In the case of any settlement where there is more than one settlor, this Chapter shall, subject to the provisions of this section, have effect in relation to each settlor as if he were the only settlor.

(2) References in this Chapter to the property comprised in a settlement include, in relation to any settlor, only property originating from that settlor and references in this Chapter to income arising under the settlement include, in relation to any settlor, only income originating from that settlor.

(3) In considering for the purposes of this Chapter, in relation to any settlor, whether any, and if so, how much, of the income arising under the settlement has been distributed, any sums paid partly out of income originating from that settlor and partly out of other income must (so far as not apportioned by the terms of the settlement) be apportioned evenly over all that income.

(4) References in subsection (1) of section four hundred and four of this Act and in section four hundred and seven of this Act to sums payable by virtue or in consequence of any provision of the settlement or sums paid by virtue or in consequence of the settlement include, in relation to any settlor, only sums payable or paid by that settlor.

(5) References in this section to property originating from a settlor are references to—

(*a*) property which that settlor has provided directly or indirectly for the purposes of the settlement; and

(*b*) property representing that property; and

(*c*) so much of any property which represents both property provided as aforesaid and other property as, on a just apportionment, represents the property so provided.

(6) References in this section to income originating from a settlor are references to—

(*a*) income from property originating from that settlor; and

(*b*) so much of any such income of a body corporate as is mentioned in paragraph (*b*) of subsection (1) of section four hundred and eleven of this Act as corresponds to property originating from the settlor which is comprised in the settlement; and

(*c*) income provided directly or indirectly by that settlor.

(7) In subsections (5) and (6) of this section—

(*a*) references to property or income which a settlor has provided directly or indirectly include references to property or income which has been provided directly or indirectly by another person in pursuance of reciprocal arrangements with that settlor, but do not include references to property or income which that settlor has provided directly or indirectly in pursuance of reciprocal arrangements with another person; and

(*b*) references to property which represents other property include references to property which represents accumulated income from that other property.

410.—(1) The General or Special Commissioners may by notice in writing require any person, being a party to a settlement, to furnish them within such time as they may direct (not being less than twenty-eight days) with such particulars as they think necessary for the purposes of any of the provisions of this Chapter, and if that person without reasonable excuse fails to comply with the notice, he shall be liable to a penalty not exceeding fifty pounds and, after judgment has been given for that penalty, to a further penalty of the like amount for every day during which the failure continues.

(2) Without prejudice to the provisions of subsection (1) of this section, if any party to a settlement fails to furnish any particulars required under that subsection, or if the General or Special Commissioners are not satisfied with any particulars furnished under that subsection, they may make an estimate of the amount of income which, by virtue of any of the provisions of sections four hundred and four, four hundred and five and four hundred and eight of this Act, is to be treated as the income of the settlor.

411.—(1) In this Chapter, "income arising under a settlement" includes—

(*a*) any income chargeable to income tax by deduction or otherwise, and any income which would have been so chargeable if it had been received in the United Kingdom by a person domiciled, resident and ordinarily resident in the United Kingdom; and

(*b*) where the amount of the income of any body corporate has been apportioned under Chapter III of Part IX of this Act for any year or period, or could have been so apportioned if the body corporate were incorporated in any part of the United Kingdom, so much of the income of the body corporate for that year or period as is equal to the amount which has been or could have been so apportioned to the trustees of or a beneficiary under the settlement,

but, where the settlor is not domiciled, or not resident, or not ordinarily resident, in the United Kingdom in any year of assessment, does not include income arising under the settlement in that year in respect of which the settlor, if he were actually

PART XVIII —*cont.*

entitled thereto, would not be chargeable to income tax by deduction or otherwise by reason of his not being so domiciled, resident or ordinarily resident.

(2) In this Chapter, "settlement" includes any disposition, trust, covenant, agreement or arrangement, and "settlor", in relation to a settlement, means any person by whom the settlement was made; and a person shall be deemed for the purposes of this Chapter to have made a settlement if he has made or entered into the settlement directly or indirectly, and in particular (but without prejudice to the generality of the preceding words) if he has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement.

(3) For the purposes of this Chapter, income arising under a settlement in any year of assessment shall be deemed not to have been distributed if and to the extent that it exceeds the aggregate amount of—

(*a*) the sums paid in that year by the trustees of the settlement to any persons (not being a body corporate connected with the settlement and not being the trustees of another settlement made by the settlor or the trustees of the settlement) in such manner that they fall to be treated in that year, otherwise than by virtue of section four hundred and eight of this Act, as the income of those persons for the purposes of income tax, or would fall to be so treated if those persons were domiciled, resident and ordinarily resident in the United Kingdom and the sums had been paid to them therein; and

(*b*) any expenses of the trustees of the settlement paid in that year which, in the absence of any express provision of the settlement, would be properly chargeable to income, in so far as such expenses are not included in the sums mentioned in paragraph (*a*) of this subsection; and

(*c*) in a case where the trustees of the settlement are trustees for charitable purposes, the amount by which any income arising under the settlement in that year in respect of which exemption from tax may be granted under sections four hundred and forty-seven and four hundred and forty-eight of this Act exceeds the aggregate amount of any such sums or expenses as aforesaid paid in that year which are properly chargeable to that income.

(4) For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement in any year of

assessment if any of the income thereof for any year or period ending in that year of assessment—

(*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III of Part IX of this Act, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or

(*b*) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom.

(5) The provisions of this Chapter shall be in addition to and not in derogation of any other provisions of this Act.

CHAPTER IV

TRANSACTIONS RESULTING IN TRANSFER OF INCOME TO PERSONS ABROAD

PART XVIII —*cont.*

CHAPTER V

SURTAX LIABILITY OF SETTLORS IN CERTAIN CASES NOT OTHERWISE DEALT WITH IN PART XVIII

Surtax on income under certain settlements not otherwise dealt with.

415.—(1) Where, during the life of the settlor, income arising under a settlement made on or after the tenth day of April, nineteen hundred and forty-six, is, under the settlement and in the events that occur, payable to or applicable for the benefit of any person other than the settlor, then, unless, under the settlement and in the said events, the income either—

(*a*) is payable to an individual for his own use; or

(*b*) is applicable for the benefit of an individual named in that behalf in the settlement, or of two or more individuals named in that behalf therein; or

(*c*) is applicable for the benefit of a child or children of an individual named in that behalf in the settlement; or

(*d*) is income from property of which the settlor has divested himself absolutely by the settlement; or

(*e*) is income which, by virtue of some provision of this Act not contained in this Chapter, is to be treated for the purposes of this Act as income of the settlor,

the income shall be treated for the purposes of surtax as the income of the settlor and not as the income of any other person:

Provided that the exceptions provided for by paragraphs (*a*), (*b*) and (*c*) of this subsection shall not apply where the named individual or individuals or, in the case of the said paragraph (*c*), either the named individual or the child or any of the children in question, is in the service of the settlor or accustomed to act as the solicitor or agent of the settlor.

(2) The settlor shall not be deemed for the purposes of this section to have divested himself absolutely of any property if that property or any income therefrom or any property directly or indirectly representing proceeds of, or of income from, that property or any income therefrom is, or will or may become, payable to him or applicable for his benefit in any circumstances whatsoever:

Provided that a settlor shall not be deemed not to have divested himself absolutely of any property by reason only that that property or income therefrom or any such other property or income as aforesaid may become payable to him or applicable for his benefit in the event of—

(*a*) the bankruptcy of some person who is or may become beneficially entitled to any such property or income; or

(*b*) an assignment of or charge on any such property or income being made or given by some such person; or

(*c*) in the case of a marriage settlement, the death of both parties to the marriage and of all or any of the children of the marriage; or

(*d*) the death under the age of twenty-five or some lower age of some person who would be beneficially entitled to that property or income on attaining that age.

(3) In this section, "income arising under a settlement", "settlement" and "settlor" have the meanings assigned to them for the purposes of Chapter III of this Part of this Act by subsections (1) and (2) of section four hundred and eleven of this Act; and section four hundred and nine of this Act (which relates to settlements with more than one settlor) shall have effect in relation to this section as it has effect in relation to the said Chapter III.

FINANCE ACT 1958 SECTION S21

Revocable settlements and settlements made abroad.

21.—(1) In subsection (1) of section four hundred and four of the Income Tax Act, 1952,—

(*a*) the references to a power to revoke or otherwise determine a settlement or any provision thereof shall be deemed to include references to any power to diminish the amount of any payments which are or may be payable under the settlement or any provision thereof and to any power to diminish the amount of any annual payments which the settlor or the wife or husband of the settlor is or may be liable to make by virtue or in consequence of any provision of the settlement;

(*b*) the references to the settlor or the wife or husband of the settlor ceasing to be liable to make any annual payments payable by virtue or in consequence of any provision of the settlement shall be deemed to include references to a diminution of the amount of any such annual payments which the settlor or the wife or husband of the settlor is or may be liable to make;

but the sums to be treated under the said subsection (1) as the income of the settlor for any year of assessment and not as the income of any other person shall, where that subsection would not apply but for paragraph (*b*) of this subsection, be such part only of the sums payable as aforesaid by the settlor or the wife or husband of the settlor in that year as corresponds to the diminution mentioned in that paragraph.

(2) In subsection (2) of the said section four hundred and four the references to a power to revoke or otherwise determine a settlement or any provision thereof shall be deemed to include references to—

(*a*) any power to diminish the property comprised in the settlement; and

(*b*) any power to diminish the amount of any payments which are or may be payable under the settlement or any provision thereof to any person other than the settlor and the wife or husband of the settlor.

(3) Subject to subsection (4) of this section, the foregoing provisions of this section shall apply for all the purposes of income tax for the year 1958-59 and subsequent years of assessment and also for estimating an individual's total income for the purposes of surtax for the year 1957-58.

(4) Where, in the case of any settlement made before the sixteenth day of April, nineteen hundred and fifty-eight, any sums payable by the settlor or by the wife or husband of the settlor, or any income arising under the settlement, would, by virtue of the foregoing provisions of this section, fall to be treated (whether for purposes of surtax or for all the purposes of income tax) as the income of the settlor and not as the income of any other person, but would not fall to be so treated apart from those provisions, the sums or income shall not be so treated if—

(*a*) no power by reason of which they or it would fall to be so treated has been exercised after the fifteenth day of April, nineteen hundred and fifty-eight, or is or can become exercisable after the fifth day of April, nineteen hundred and fifty-nine, or such later date as the Commissioners of Inland Revenue may in any particular case allow; and

(*b*) neither the settlor nor the wife or husband of the settlor has received or is entitled to any consideration or benefit in connection with the fulfilment of the condition set out in paragraph (*a*) of this subsection;

or if, in the case of a settlement to which subsection (1) of the said section four hundred and four applies by virtue of subsection (1) of this section, the settlement was entered into in connection with any judicial separation or any agreement between spouses to live separate and apart or with the dissolution or annulment of a marriage.

(5) For the removal of doubts it is hereby declared that sections four hundred and four and four hundred and five of the Income Tax Act, 1952 (which re-enact, without amendment, the provisions of subsections (1) to (4) of section thirty-eight of the Finance Act, 1938), apply and always have applied in relation to any settlement in relation to which the said section thirty-eight would have applied but for its repeal by the said Act of 1952, that is to say, in relation to any settlement, wherever made.

FINANCE ACT 1958, SECTION 22

Settlements—discretionary power for benefit of settlor, etc.

22.—(1) If and so long as the terms of any settlement (wherever made) are such that any person has or may have power, whether immediately or in the future, and whether with or without the consent of any person—

(*a*) to pay or apply to or for the benefit of the settlor or the wife or husband of the settlor the whole or any part of the income or property which may at any time arise under or be comprised in the settlement; or

(*b*) to secure the payment or application to or for the benefit of the settlor or the wife or husband of the settlor of the whole or any part of that income or property;

being a power exercisable at his discretion, any income arising under the settlement in any year of assessment or, as the case may be, any income so arising from the property comprised in the settlement or from a corresponding part of that property. or a corresponding part of any such income, shall (so far as it is not so treated apart from this section) be treated for all the purposes of the Income Tax Acts as the income of the settlor for that year and not as the income of any other person, subject however to the following provisions of this section.

(2) Where the power mentioned in subsection (1) of this section cannot be exercised within six years from the time when any income or class of income first arises under the settlement or from the time when any particular property first becomes comprised in the settlement, then, so long as the power cannot be exercised, that subsection shall not apply to any income arising under the settlement or, as the case may be, any income of that class or income from that property or property representing that property.

(3) Where, under the proviso to subsection (2) of section four hundred and five of the Income Tax Act, 1952, the settlor is not deemed to have an interest in any income arising under or property comprised in the settlement, subsection (1) of this section shall not apply to that income or, as the case may be, to income arising from that property.

(4) Subject to subsection (5) of this section, the foregoing provisions of this section shall apply for all the purposes of income tax for the year 1958-59 and subsequent years of assessment and also for estimating an individual's total income for the purposes of surtax for the year 1957-58.

(5) Where, in the case of any settlement made before the ninth day of July, nineteen hundred and fifty-eight, any income arising under the settlement would, by virtue of the foregoing provisions of this section, fall to be treated (whether for purposes of surtax or for all the purposes of income tax) as the income of the settlor and not as the income of any other person, but would not fall to be so treated apart from those provisions, it shall not be so treated if—

(*a*) no power by reason of which it would fall to be so treated has been exercised after the eighth day of July, nineteen hundred and fifty-eight, or is or can become exercisable after the fifth day of April, nineteen hundred and fifty-nine, or such later date as the Commissioners of Inland Revenue may in any particular case allow; and

(*b*) neither the settlor nor the wife or husband of the settlor has received or is entitled to any consideration or benefit in connection with the fulfilment of the condition set out in paragraph (*a*) of this subsection.

(6) This section shall be deemed to be included in Chapter III of Part XVIII of the Income Tax Act, 1952, and to precede section four hundred and six thereof, and the references in subsection (1) of section four hundred and seven and subsection (2) of section four hundred and eight of that Act to section four hundred and four thereof shall be construed as including references to this section.

FINANCE ACT 1958, SECTION 20

20.—(1) Chapter II of Part XVIII of the Income Tax Act, 1952 (which relates to settlements on children), shall be amended in accordance with the following provisions of this section. **Settlements on children.**

(2) In relation to a payment to which this subsection applies, the words " at the time of the payment " shall be substituted for the words " at the commencement of that year " in subsection (1) of section three hundred and ninety-seven of that Act (which relates to payments in any year of assessment to or for the benefit of a child who at the commencement of that year was an infant and unmarried) and for the words " at the commencement of the year of assessment in which the sum is paid " in paragraph (*b*) of subsection (2) of section three hundred and ninety-eight of that Act (which makes provision supplementary to the said section three hundred and ninety-seven).

(3) The reference in the said paragraph (*b*) to another sum previously paid to or for the benefit of a child who, at the commencement of the year of assessment in which it was paid, was an infant and unmarried, shall be construed, in relation to a payment to which this subsection applies of any such sum, as a reference to a sum so paid to or for the benefit of a child who at the time of the payment was an infant and unmarried.

(4) Subsections (2) and (3) of this section apply to any payment made after the year 1957-58, except a payment made in the year 1958-59 to or for the benefit of a child born after the sixth day of April, nineteen hundred and fifty-eight, and so made by virtue or in consequence of a settlement made before the ninth day of July of that year.

(5) In paragraph (ii) of the proviso to section three hundred and ninety-nine of the Income Tax Act, 1952 (which enables a settlement to be treated as irrevocable for the purposes of the said Chapter II notwithstanding that it provides for its determination, if the determination will not, during the lifetime of such a child as is mentioned in that section, benefit any person other than such a child, or the wife, husband or issue of such a child), for the words from " any person " to " issue of such a child " there shall be substituted the words " the settlor or the wife or husband of the settlor ".

(6) In relation to a settlement which would not have been irrevocable within the meaning of the said Chapter II but for subsection (5) of this section, the reference in paragraph (*b*) of subsection (2) of the said section three hundred and ninety-eight to the date when it became irrevocable shall be construed as referring to the sixth day of April, nineteen hundred and fifty-eight.

APPENDIX I

1. Finance Act 1962, Schedule 10

2. Finance Bill 1965, Section 12

3. Finance Act 1965 Section 12

4. Finance Bill 1966 Clause 21

5. Finance Act 1966 Section 23

Finance Act 1962 Sch. 10

Chapter 11 of Part XVIII (Settlements on children)	The definition of "income" in section four hundred and three shall apply in relation to gains arising from the acquisition and disposal of chargeable assets as it would apply if the gains were profits from a trade of dealing in the assets, and any such gains shall be treated as payable in the first instance to the person to whom they accrue; but, in the case of settled property within the meaning of Case VII, paragraph (a) of subsection (1) of section three hundred and ninety-eight of that Act shall have effect in relation to gains so arising from the settled property only in so far as they exceed losses so arising therefrom.
Chapter III of Part XVIII, including the Finance Act 1958, section 22 (Revocable settlements etc.)	In the definition in section four hundred and eleven of "income arising under a settlement" references to income shall include the amount of any gains arising from the acquisition and disposal of chargeable assets subject to the like deduction for losses so arising as would be made under Case VII; but that amount shall be left out of account under section four hundred and seven.

Finance Bill 1965

12. (1) In subsection (1) of section 415 of the Income Tax Act 1952 (under which income arising under a settlement is treated for the purposes of surtax as the income of the settlor unless the income falls into one of the paragraphs of that subsection) paragraphs (a), (b) and (c) (which relate to income payable to or applicable for the benefit of individuals) shall cease to have effect.

(2) In subsection (2) of the said section 415 (which has the effect that income arising under a settlement is treated for the purposes of surtax as the income of the settlor if it is income from property and that property, or any property or income derived from it, is, or will or may become payable to or applicable for the benefit of the settlor) references to any property or income becoming payable to or applicable for the benefit of the settlor shall include references to property or income payable to or applicable for the benefit of the wife or husband of the settlor.

(3) This section applies to settlements made on or after 7th April 1965.

FINANCE ACT 1965, SECTION 12

Surtax on income under certain settlements.
1952 c. 10.

12.—(1) In subsection (1) of section 415 of the Income Tax Act 1952 (under which income arising under a settlement is treated for the purposes of surtax as the income of the settlor unless the income falls into one of the paragraphs of that subsection) paragraphs (*a*), (*b*) and (*c*) (which relate to income payable to or applicable for the benefit of individuals) shall cease to have effect.

(2) In subsection (2) of the said section 415 (which has the effect that income arising under a settlement is treated for the purposes of surtax as the income of the settlor if it is income from property and that property, or any property or income derived from it, is, or will or may become payable to him or applicable for his benefit) for the words "payable to him or applicable for his benefit", where they first occur, there shall be substituted the words "payable to or applicable for the benefit of the settlor or the wife or husband of the settlor", and, where they next occur, there shall be substituted the words "payable or applicable as aforesaid".

(3) Notwithstanding subsection (1) of this section, subsection (1) of the said section 415 shall not apply to income consisting of annual payments made—

(*a*) under a partnership agreement, by a member of a partnership to or for the benefit of a person, or, if he is dead, the widow or dependants of a person, who has ceased to be a member of the partnership by retirement or death; or

(*b*) by any person, in connection with the acquisition by him of the whole or part of a business, to or for the benefit of the person from whom it is acquired or, if he is dead, his widow or dependants,

being, in either case, payments made under a liability incurred for full consideration; or to income arising under a settlement made by one party to a marriage by way of provision for the other after the dissolution or annulment of the marriage or while they are separated under an order of a court or under a separation agreement, being income payable to or applicable for the benefit of that other party.

(4) This section applies to settlements made on or after 7th April 1965.

FINANCE BILL 1966, CLAUSE 21

Surtax on income under certain settlements: exceptions to s. 415(1) of Act of 1952.
1965 c. 25.
1952 c. 10.

21.—(1) Notwithstanding section 12(1) of the Finance Act 1965 (which extends section 415(1) of the Income Tax Act 1952 so as to treat certain income arising under a settlement as being for surtax purposes the income of the settlor) the said section 415(1) shall not apply to income consisting of annual payments made under a partnership agreement to or for the benefit of a former member, or the widow or dependants of a deceased former member, of the partnership, being payments made under a liability incurred for full consideration.

(2) Notwithstanding the said section 12(1), the said section 415(1) shall not apply to income consisting of annual payments made by an individual, in connection with the acquisition by him of the whole or part of a business—

(*a*) to or for the benefit of the individual from whom it is acquired or, if he is dead, to or for the benefit of his widow or dependants, or

(*b*) if the acquisition was from a partnership, to or for the benefit of a former member, or the widow or dependants of a deceased former member, of that or any preceding partnership, or to or for the benefit of an individual from whom the business or part was acquired by that or any preceding partnership or, if he is dead, to or for the benefit of the widow or dependants of such an individual,

being payments made under a liability incurred for full consideration.

(3) Payments made in respect of any individual under a liability incurred in connection with an acquisition from a partnership shall not be excluded from the operation of the said section 415(1) by virtue of paragraph (*b*) of the last foregoing subsection unless they are made in substitution, wholly or in part, for other payments which, if they had been made, would themselves have been excluded from its operation.

(4) Where the right of a former member of a partnership to payments falling due not more than ten years after he ceased to be a member of that partnership has devolved on his death, subsections (1) and (2) above shall apply to the payments as they would apply if he had not died.

(5) Notwithstanding the said section 12(1), the said section 415(1) shall not apply to income arising under a settlement made by one party to a marriage by way of provision for the other after the dissolution or annulment of the marriage, or while they are separated under an order of a court or under a separation agreement, or in such circumstances that the separation is likely to be permanent, being income payable to or applicable for the benefit of that other party.

(6) For the purposes of this section—

(*a*) "former member", in relation to a partnership, means an individual who has ceased to be a member of that partnership on retirement or death,

(*b*) a partnership becomes a "preceding partnership" of another if it transfers its business or part of its business to another and one or more individuals are members of both, and any preceding partnership of the transferor by reference to any part of the business transferred shall also become a preceding partnership of the transferee.

(7) This section shall be in substitution for section 12(3) of the Finance Act 1965, and shall have effect for the year 1965-66 as well as for later years of assessment.

FINANCE ACT 1966, SECTION 23

23. Surtax on income under certain settlements: exceptions to s. 415 (1) of Act of 1952.—(1) Notwithstanding section 12 (1) of the Finance Act 1965 (which extends section 415 (1) of the Income Tax Act 1952 so as to treat certain income arising under a settlement as being for surtax purposes the income of the settlor) the said section 415 (1) shall not apply to income consisting of annual payments made under a partnership agreement to or for the benefit of a former member[1], or the widow or dependants of a deceased former member, of the partnership, being payments made under a liability incurred for full consideration.

(2) Notwithstanding the said section 12 (1), the said section 415 (1) shall not apply to income consisting of annual payments made by an individual, in connection with the acquisition by him of the whole or part of a business—

(*a*) to or for the benefit of the individual from whom it is acquired or, if he is dead, to or for the benefit of his widow or dependants, or

(*b*) if the acquisition was from a partnership, to or for the benefit of a former member, or the widow or dependants of a deceased former member, of that or any preceding partnership[1], or to or for the benefit of an individual from whom the business or part was acquired by that or any preceding partnership or, if he is dead, to or for the benefit of the widow or dependants of such an individual,

being payments made under a liability incurred for full consideration.

(3) Payments made in respect of any individual under a liability incurred in connection with an acquisition from a partnership shall only be excluded from the operation of the said section 415 (1) by virtue of paragraph (*b*) of the last foregoing subsection if, and to the extent that, they are made in substitution for, or matched by reductions in, other payments which would themselves be excluded from its operation.

(4) Where the right of a former member of a partnership to payments falling due not more than ten years after he ceased to be a member of that partnership has devolved on his death, subsections (1) and (2) above shall apply to the payments as they would apply if he had not died.

(5) Notwithstanding the said section 12 (1), the said section 415 (1) shall not apply to income arising under a settlement made by one party to a marriage by way of provision for the other after the dissolution or annulment of the marriage, or while they are separated under an order of a court or under a separation agreement or in such circumstances that the separation is likely to be permanent, being income payable to or applicable for the benefit of that other party.

(6) For the purposes of this section—

(*a*) "former member", in relation to a partnership, means an individual who has ceased to be a member of that partnership on retirement or death,

(*b*) a partnership becomes a "preceding partnership" of another if it transfers its business or part of its business to another and one or more individuals are members of both, and any preceding partnership of the transferor by reference to any part of the business transferred shall also become a preceding partnership of the transferee.

(7) This section shall be in substitution for section 12 (3) of the Finance Act 1965, and shall have effect for the year 1965–66[1] as well as for later years of assessment[1].

APPENDIX J

1. The Example Of The Charity Form Of Avoidance Provided To The Chief Secretary To The Treasury - December 15, 1976

2. Text Of An Anonymous Letter Sent To The Chairman Of The Board Of Inland Revenue

THE EXAMPLE OF THE CHARITY FORM OF AVOIDANCE PROVIDED TO THE CHIEF SECRETARY TO THE TREASURY - DECEMBER 15, 1976

A charity which was specially formed for the purpose borrowed money from a finance house and used it to buy annuities from high rate taxpayers. Suppose one taxpayer, A, undertook to pay £10,000 net for five years or for his life, in return for (say) £49,000. A is required to use this money, and £1,000 of his own, to purchase promissory notes for £50,000 from a subsidiary of the finance house. (Thus the money has moved round from the finance house to one of its subsidiaries.) The promissory notes are lodged with the charity who in turn use them as security for their loan. With the aid of bridging finance, each instalment of the annuity is effectively paid from the proceeds of part of the promissory notes and goes to reduce the charity's loan. (With each payment, therefore, the money moves again in a circle in the opposite direction.) It is is contended that the annuity is sold for an open market price and that consequently A is entitled to a deduction of £15,384 (£10,000 net grossed up at 35 per cent) in computing his liability to higher rate tax and investment income surcharge for each year in which the annuity is payable; basic rate income tax deducted from each instalment of the annuity. In figures, the position would be thus:

A pays each year to the charity	£10,000
Higher rate tax saving expected: £15,384 at say 48 per cent (83 - 35 per cent)	£ 7,384
Net annual cost	£ 2,616
Cost over five years	£13,080
Received from the charity	£49,000
Profit to A	£35,920
Charity receives each year from A	£10,000
Basic rate tax reclaimed	£ 5,384
	£15,384
Receipts for five years	£76,920
Payment to A	£49,000
Profit to charity	£27,920

It is the intention that the Revenue should lose 5 x £7,384 + £5,384 = £63,840.

A and the charity gain £35,920 + £27,920 = £63,840, all at the expense of the Revenue.

ANONYMOUS LETTER SENT TO THE CHAIRMAN OF THE BOARD OF INLAND REVENUE

20th March 1977

Sir William Pile KCB MBE
The Boardroom
Somerset House

Dear Sir William

REPREHENSIBLE TAX AVOIDANCE

I do not think you have dealt with the scheme currently being peddled round the City.

I wonder if you appreciate that your failure to take more effective long term measures ("artificial transactions of which the main purpose is the avoidance of tax shall be void for tax purposes") against these schemes leads to intolerable pressure on corporate tax advisers whose Boards are inclined to favour avoidance of any kind? In this context you will perhaps understand why this letter is not signed.

I enclose, I trust for your early attention, brief details of the latest scheme to exploit S 248.

If this letter becomes the basis on which you kill this scheme I would very much appreciate an acknowledgement - you might think an insertion in the personal column of The Times on 27th March would be appropriate.

TAX SCHEME

P acquires an investment company, Q, with £1,000 share capital and they make a Section 256 (2) election.

P enters into an annuity, tied to the death of a named individual, but for 7 years minimum, for (say) £1,000,000 per annum in favour of Q.

Q pays P £6,000,000, being the actuarial value of the covenant.
Q borrows the £6,000,000.

P pays the first instalment of £1,000,000 under a Section 256 (2) election.

Q converts its share capital so that all the voting rights are passed into 100 shares. R acquires 75% control of Q from P (75% for group relief purposes).

P pays a non-resident company £5,000,000 in consideration for the non-resident company taking over the residual liability under the covenant. P sells its remaining share in Q to R.