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Memorandum

Subject: French *usufruits* and HMRC's attempt to deem settlements (edited)

Date: 25th November, 2020

In relation to settlements and deeming provisions in Revenue matters, the law has recently been very clearly set out by Henderson LJ in the Court of Appeal's unanimous judgement in Barclay's Wealth v HMRC **[2017] EWCA Civ 1512**

As has become frequent, and in view of forthcoming litigation, I am setting out part of the position on the French usufructuary dismemberment which in HMRC's view - it is no more than that - has the same outcome as a settlement and, worse, a structure which has been mis, or perhaps better manhandled into the concept of a settlement under s.43(2) ITA 1984, when there is no trustee, no beneficiary and in consequence no fiduciary duty of the type necessary to constitute a settlement.

The "outcome" is in fact not similar at all, and has never been treated as such by the English courts in matters of private international law or conflict of laws.

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To the fundamentals: there is no actual definition of a trust, or settlement of any real consistency in English law beyond that of Lord Coke's definition of a use:

> *A confidence reposed in some other, not issuing out of the Land, but as a thing collateral annexed in privity to the estate of the land, and to the person touching the land for which cestui que trust has no remedy but to subpoena in the Chancery.* Lewin on trusts 13th Edition p 11.

Maitland considered it to be a fundamental definition, as the use of this type was not repealed by the Statute of Uses, which only addressed a form of conveyancing land tax avoidance technique. It formed the basis of the modern trust.

I stress *not issuing out of the land but as a thing collateral*. *Annexed in privity* means that it is a personal right extended to a closed set of persons or to an individual, not a real right. Even that is not equivalent to the French *usufruit*, which is a right *in rem* and therefore *issues out of the land*, not by way of privity. There is nothing in English law that suggests that s.43(2) ITA can be legitimately applied to a non-trust property or a legal property right, defined as such under the *lex rei sitae*.

What is more, foreign property structures or arrangements which can be recognised as trusts have been defined under English law by the Recognition of Trusts Act 1987, and I would refer the reader to its s.1 (1), (2) and 3) in which it is clear that certain arrangements in English law that are not trusts within the scope of the Convention which is a limited definition can still be recognised as being trusts within and without the jurisdiction. The Act is expressed at its s.3 to Bind the Crown, therefore HMRC. It may be curious, but the French usufructuary *dismemberment* cannot be considered a settlement as it does not

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meet the conditions for recognition as such under the Convention's article 2, neither can a usufructuary dismemberment through a mere devolution be considered as creating a trust settlement under the Convention's article 2.

It is clear that under English law a French usufructuary dismemberment is not and cannot be a settlement as it does not constitute a trust, or any confidence. The legal "outcome" is that usufructuary receives any rents *in specie*, not through the intermediary of any trustee (see Swinfern Eady J in *re Moses* [1908] 2 Ch 235, when he acquiesced to the opinion of the South African Attorney-General on that point which is *ad idem* with the French position). The legal rights created by a dismemberment are just that: legal, not equitable rights.

In *Barclays Wealth* Henderson LJ said:

"In Rysaffe Trustee Co (CI) v IRC [2002] EWHC 1114 (Ch), [2002] STC 872, Park J made the important point, with which I respectfully agree, that the provisions of the 1984 Act relating to settlements are, in the absence of special provision, for the most part left to be interpreted in accordance with the general understanding of trust practitioners: see his judgment at [18] to [21]."

It is the "general understanding of trust practitioners", from Maitland onwards, that a civil law usufructuary dismemberment is not a settlement or a trust. It is only the Revenue and those who adhere to its non-legal "views" that would hold otherwise.

Given the statutory wording of s.43(2) ITA 1984, it is perfectly clear that a settlement has to include property which is held in trust (see its a) and b), not otherwise. A civil law dismemberment cannot

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involve holding the *nue-propriété* on trust for the usufructuary as the usufructuary's rights take effect as a *droit reel* in the property itself, therefore as a legal right, not as a bundle of personal rights against a Trustee.

Henderson LJ states at § 29 of his judgment:

> *29. In order to complete the statutory picture, it is necessary to refer to some key definitions in Chapter I of Part III of the 1984 Act.*
>
> *30. "Settlement" is defined in section 43, as follows:*
>
> > *"43* ***Settlement and related expressions***
> >
> > *(1) The following provisions of this section apply for determining what is to be taken for the purposes of this Act to be a settlement, and what property is, accordingly, referred to as property comprised in a settlement or as settled property.*
> >
> > *(2) "Settlement" means any disposition or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being –*
> >
> > > *(a)* ***held in trust*** *for persons in succession or for any person subject to a contingency, or*
> > >
> > > *(b)* ***held by trustees on trust*** *to accumulate the whole or part of any income of the property or with power to make payments out of that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income, or*
> > >
> > > *(c) …,*
> >
> > ***or would be so held*** *…*

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> *if the disposition or dispositions were regulated by the law of any part of the United Kingdom; or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held ...*"

Henderson LJ continues:

31. *The definition of "settlement" therefore requires a combination of two things: first, a disposition or dispositions of property, and secondly, a state of affairs brought about by that disposition or those dispositions, whereby the property is held in various ways, or would be so held if the conditions at the end of subsection (2) were satisfied. In broad terms, paragraph (a) of subsection (2) covers fixed-interest trusts, such as those in the DBJT, while paragraph (b) covers discretionary trusts, such as those of the 2001 Settlement. Both the DBJT and the 2001 Settlement were governed by Jersey law, but the hypotheses relating to foreign law at the end of the subsection clearly bring them within the scope of the definition.*

So, no matter what other "view" is taken, a usufructuary dismemberment created on the death of an intestate French or English person in France cannot be a settlement under s.43(2) ITA 1984 or under the general law, as there is no disposition, express or otherwise. The succession "devolves" by law under article 912 *Code civil.*

To go further, in relation to an express disposition creating an *inter vivos* lifetime dismemberment, those do not meet eh definition of a settlement either. Why?

The *state of affairs* referred to by Henderson LJ and incidentally by Halsbury in a usufructuary dismemberment cannot be said to be that of a trust or a settlement, neither can its "outcome" be so said as the rights of the usufructuary over the asset take effect *in specie*, not against any trustee. HMRC have accepted, grumpily, that there is no administration involved by a trustee equivalent of the distinct legal rights *in rem* which the dismembered property rights entail. That phrase has always been limited to foundations and anstalts and the like and was stated to be such in Standing Committee A on the Bill which was to become the Finance Act 1975 introducing CTT in which the

sub-sections wording was first introduced. There was no mention made at that stage in Committee that the first phrase of §2 could be of any application to things other than trusts.

There is no manner in which ether the pre-2006 or, worse, the current initial charge, ten-year charge and exit charges on settlements can be said to be apt to these foreign legal rights *in rem* which are not a "state of affairs" or trusts in the nature of settlements as defined in the section.

The arguments for the "state of affairs" being equivalent to a trust evaporate upon the arrival of the Gentleman from Porlock of rights *in specie* into HMRC's decreed pleasure dome and can be flushed down to the imaginary sunless sea by the very Alpha of the definition of a trust. There is no transfer made in any "confidence" other than the operation of the civil law to which a trust is an abomination.

Henderson LJ then considered the effect of deeming provisions. I interject here that HMRC's "view "that a French usufructuary dismemberment can be considered a settlement has to be based on treating the phrase "*or would be so held* …

if the disposition or dispositions were regulated by the law of any part of the United Kingdom

as a deeming provision. Its wording in fact can be read as requiring the contrary, in other words as being limitative to foreign trusts. That is why the term "regulated by" is used, not "governed by". Had the term governed been used, then there might have been some latitude to lie back and take up an opium pipe in the dark "pleasure dome" of the IHT manuals. Indeed, the plain English sense of limitation to trusts is the only sense that can be given to the phrase under its immediately preceding a) and b) coupled with "or would be so held …**IF**…".

It cannot be otherwise for the French usufructuary dismemberment as there is no sign of the trust required by the preceding subsections a) and b) being involved in any express *disposition* creating it.

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Note again that, were the phrase were read in a straightforward manner, the usufructuary dismemberment would not be a settlement as there is no trust. It is a constant in English law that you cannot have a settlement without Coke's confidence, or privity or as Lord Wilberforce put it in *Roome and Denne v Edwards* [1982] AC 279 at page 292 at G : "The Finance Act 1984 contains no definition of "settlement"….. So, a "settlement" must be a situation in which property is held in trust." Need one say more?

Apparently, one has to.

Henderson LJ also stated at §47 in relation to deeming provisions which HMRC assert §2 s.43(2) ITA 1984 to be one:

47. *In support of his submissions on the correct approach to the interpretation of statutory deeming provisions, Mr. Ewart referred us to the well-known statement by Peter Gibson J, sitting in this court with Balcombe and Simon Brown LJJ, in Marshall (Inspector of Taxes) v Kerr [1993] STC 360 at 366:*

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

This statement of principle has been cited with approval in many subsequent cases, including DV3 RS Ltd Partnership v Revenue and Customs Commissioners [2013] EWCA Civ 907, [2013] STC 2150, at [13]

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> *and [14] per Lewison LJ, with whom Gloster and Maurice Kay LJJ agreed. Lewison LJ added, at [15], that the fact that deeming provisions are involved "does not displace the ordinary principles of statutory interpretation*".

I do not accept that the second paragraph of s.46(2) ITA 1984 is a deeming provision - that is HMRC's approach. In my "view", which is I believe the legal one; the subsection has to be applied mechanically and only in an instance where there is an actual express disposition into a foreign trust. The section is not expressed to permit HMRC to go further and adjudicate a trust where there is none on what they advertise as being an "outcome" interpretation. That is a fallacy, and what is said by Henderson LJ supports that conclusion.

S.43(2) ITA §2 is expressed to apply to foreign, non-U.K. dispositions, the section states at a) and b) only into trust.

The disposition or dispositions involved in *Barclays Wealth* were made into a Jersey, in other words a foreign not an English, trust. It was on that basis that the Court of Appeal held that s. 43(2) ITA 1984 paragraph 2 could apply. The logic behind Henderson LJ's judgment in *Barclay's Wealth* is that, as I have previously put forward, is that it only applies to dispositions into trusts, whether foreign or English, not to any form of civil law dismemberment of a given property into separate legal rights *in rem*.

I stress here that in French succession law, the reserved rights of spouses and children vest on death by devolution, not by a disposition. Their succession rights can be modified, extended or even abrogated in some cases by testamentary disposition, but that is not in itself sufficient to bring s.43(2) ITA into play, as its second paragraph only addresses a disposition or disposition taking an express form and constituting a trust. That is how a trust comprised in s.43(2) a) and b) above is created, not otherwise. The wording is more restrictive than the first paragraph of s.43(2) which addresses British forms specifically, over which HMRC can assert an interpretative jurisdiction.

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HMRC's current views on *usufruits* are based upon a fallacy that the Inheritance Tax Act 1984 gives them an overall jurisdiction to deem settlements over worldwide assets independently of *situs* and *domicil*, which if pressed home would lead to the unfortunate conclusion that a Frenchman domiciled in France, with no connection to England can be deemed to have created a settlement over French land simply by doing what any normal Napoleonicaly educated and minded Frenchman in his right state of fiscal mind would do: by dismembering and retaining the *usufruit*, in other words the *jouissance* not enjoyment of his land whilst granting the *nue-propriété* to his children. All these are real rights *in rem*, not personal rights in trusts over immovables.

When seen in the full light of day, the position taken by HMRC is simply wrong, and the reasoning undegrading the Court of Appeal judgment in Barclay's Wealth appears to confirm that position.

There is litigation on *usufruits* in the pipeline, HMRC have had to settle cases with my clients, so it is going to be interesting to see how far HMRC will get in defending its "view". With no disrespect intended and I hope none taken, the matter may need to go to a court and not to a tribunal.

The issue simply resolved by the references in s.43(2) ITA to "a) held in trust" and "b). held in trust" and by "or so held", which can only refer to a), b) and c) above, i.e. held in trust, in the last paragraph of the subsection. It is plain English, not a licensed trip into Coleridge's opiate outcome in a sunless sea by unlicensed administrative "decree".

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