

## CHAPTER 25

## CAPITAL AND INCOME

## 1. SCOPE OF CHAPTER

**General**

**25-01** AT THE END ADD: And though a charitable trust does not give rise to successive interests, where the charity has a permanent endowment, the trustees must know which receipts are income and which are capital, since the latter cannot in general be spent on its purposes.

**Reform**

**25-03** DELETE THE ENTIRE PARAGRAPH AND NN.4-11 AND REPLACE BY: Proposals have been made by the Law Commission for reform of the law stated in this chapter.<sup>4</sup> The proposals, which to some considerable extent depart from the prior consultation paper,<sup>5</sup> include the following:

- (1) Distributions from corporations to trustees holding shares, if tax-exempt, would be treated as capital. The practical effect would be that shares received in consequence of direct and indirect demergers would be treated as capital, making a change in the former but not the latter case.<sup>6</sup> There would be a provision to allow further categories of distribution to be so treated by delegated legislation if they became tax-exempt. The proposal would apply to existing and not merely to new trusts. That is the remnant of earlier proposals (i) to treat most distributions from corporations as capital and (ii) to give trustees a power to allocate all trust receipts between capital and income as a matter of discretion, so that the rules for classifying trust receipts (both existing and new) would have become default rules only. The reason for abandoning those proposals is that the reform would have effectively abolished the 'income in possession' trust so far as concerned the

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<sup>4</sup> Law Commission Report *Capital and Income in Trusts: Classification and Apportionment* (LC No.315, 2009).

<sup>5</sup> Law Commission Consultation Paper No. 175 *Capital and Income in Trusts: Classification and Apportionment* (2004). See too the Trust Law Committee's Report *Capital and Income of Trusts* (1999).

<sup>6</sup> For direct demergers, see §§ 25-30 *et seq.*; for indirect demergers, see § 25-34.

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income taxation of corporate distributions; hence the restriction of the current proposal to tax-exempt distributions.

- (2) No change is now proposed to the existing rules for classifying other corporate distributions or any other trust receipts.<sup>7</sup>
- (3) No change is now proposed to the existing rules for classifying trust expenses.<sup>8</sup> The earlier proposal to give trustees a power to allocate all trust expenses (like trust receipts) between capital and income as a matter of discretion has been abandoned.
- (4) The existing equitable rules of apportionment would all be abolished, including both branches of the rule in *Howe v Lord Dartmouth*,<sup>9</sup> subject to any contrary provision in the trust instrument. That reform would apply only to new trusts.
- (5) The statutory provision for apportionment by time<sup>10-11</sup> would likewise become inapplicable to new trusts.

Much of this chapter would be obsolete in relation to new trusts if those proposals were implemented.

## 2. WHAT RECEIPTS ARE CAPITAL AND WHAT ARE INCOME

### General

**25-05** NOTE 13. AT THE END OF THE FIRST SENTENCE INSERT: *cf. Aribisala v St James Homes (Grosvenor Dock) Ltd* [2007] EWHC 1694 (Ch); [2007] 3 E.G.L.R. 39.

AT THE END OF THE FOURTH SENTENCE INSERT A NEW NOTE 14a: As in *Cunard's Trustees v I.R.C.* [1946] 1 All E.R. 159, CA.

<sup>7</sup> For the existing rules as to distributions from corporations, see §§ 25-21 *et seq.*; for the existing rules as to receipts from land, see §§ 25-06 *et seq.*; and for the existing rules as to other receipts, see §§ 25-41 *et seq.*

<sup>8</sup> For the existing rules as to trust expenses, see §§ 25-52 *et seq.*

<sup>9</sup> For the first branch of the rule in *Howe v Lord Dartmouth*, see §§ 25-70 *et seq.*; for the second branch, see §§ 25-97 *et seq.*; for the other equitable rules of apportionment, see §§ 25-88 *et seq.*, §§ 25-116 *et seq.* and §§ 25-123 *et seq.*

<sup>10-11</sup> For which see §§ 25-129 *et seq.*

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DELETE THE LAST SENTENCE AND N.17 AND REPLACE BY: But a direction or power to treat income as capital, having the effect that the income would be retained, had formerly to be confined so as to be compatible with the statutory restrictions on accumulations, now repealed (for most instruments taking effect on or after April 6, 2010).<sup>17</sup>

**Land***Leases*

- 25–13** NOTE 37. DELETE THE SECOND SENTENCE AND REPLACE BY: In *Re Medows* [1898] 1 Ch. 300 the tenant for life of a manor was held solely entitled to fines paid by tenants for the renewal of leases of copyhold land when he was under no obligation to renew but the receipt of a fine on renewal was the customary mode of enjoyment of the manor.

**Shares, debentures and other securities***Ordinary dividends*

- 25–23** NOTE 98. ADD: A special dividend out of distributable profits has been treated as income in the hands of trustees even though it amounted to substantially the whole of the current market value of the shares and even though the rights of those shares to participate in capital was reduced at the same time as the dividend was authorised: *Trustees of the Bessie Taube Discretionary Settlement Trust v R.C.C.* [2010] UKFTT 473 (TC).

*Enhanced scrip dividends*

- 25–29** AT THE END OF THE THIRD SENTENCE INSERT A NEW NOTE 14a: For example, in *Howell v Trippier* [2004] EWCA Civ 885; [2004] S.T.C. 1245 the cash dividend was £700 and the bonus shares offered in the alternative were worth over £15 million.

AFTER THE FIFTH SENTENCE OF THE TEXT INSERT: Legislation apart, the treatment of the shares distributed is as follows.

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<sup>17</sup> See §§ 5–100 to 5–100B (including online supplement), § 5–107.

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AT THE END OF THE TEXT ADD: It has been held, however, that the effect of the income tax legislation is to deem the scrip to be income not merely for the purposes of income tax<sup>18a</sup> but also for trust purposes.<sup>18b</sup>

*Distributions of shares in other companies—direct demergers*

- 25–31** NOTE 25. In the second sentence delete *Re Rudd’s Settlement Trusts* and replace by *Re Rudd’s Will Trusts*.

*Trustees controlling company*

- 25–40** AT THE END ADD: Where the terms of a trust require minimum annual distributions to be made to income beneficiaries determined by reference to the total return of trust assets, the trustees may cause a company controlled by them to pay sufficient income to the trustees to enable those distributions to be made.<sup>51a</sup>

AFTER § 25–44 INSERT THE FOLLOWING NEW PARAGRAPH AND HEADING:

**National Savings Certificates**

- 25–44A** The nature of returns (to use a neutral expression) on National Savings Certificates depends on the terms and conditions of the particular issue. The index-linked growth, and not merely the interest, has been held to be income.<sup>59a</sup>

**Damages and equitable compensation**

- 25–47** AFTER THE FIFTH SENTENCE INSERT: Where the income beneficiary is precluded from complaining of a loss of income by laches or acquiescence but the capital beneficiary is not,

<sup>18a</sup> See *Howell v Trippier* [2004] EWCA Civ 885; [2004] S.T.C. 1245, a decision on Income and Corporation Taxes Act 1988, s.249(6) (repealed and replaced by Income Tax (Trading and Other Income) Act 2005, s.410).

<sup>18b</sup> *Pierce v Wood* [2009] EWHC 3225 (Ch); [2010] W.T.L.R. 253, holding that to be the effect of *Howell v Trippier*, above; *sed quaere*.

<sup>51a</sup> *Canada Trust Co. v Browne* [2010] ONSC 4118; (2010–11) 13 I.T.E.L.R. 648 at [44]–[59].

<sup>59a</sup> *Martin v Triggs Turner Barton* [2009] EWHC 1920 (Ch); [2009] All E.R. (D) 12 (Aug) at [101]–[105]. *Cf. Re Holder* [1953] Ch. 468.

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compensation for the loss will be payable only after the termination of the income interest and will go solely to the capital beneficiary.<sup>66a</sup>

**3. USUAL INCIDENCE OF EXPENSES****Generally**

**25–52** DELETE THE PENULTIMATE SENTENCE AND N.92 AND REPLACE BY: Otherwise, the test is the benefit of the whole trust estate, so that expenses incurred for the benefit of both the income and capital beneficiaries must be charged against capital alone; it is only those expenses which are incurred exclusively for the benefit of the income beneficiaries that may be charged against income.<sup>92</sup>

NOTE 93. DELETE AND REPLACE BY: *ibid.*, at [17], [30]–[33], [37].

**25–53** NOTE 96. AFTER THE SECOND SENTENCE INSERT: (For later proceedings, see *Page v West* [2010] EWHC 504 (Ch); [2010] W.T.L.R. 1811, citing this passage of the text at [42]).

**Loss on business**

**25–60** NOTE 29. AFTER THE REFERENCE TO *Upton v Brown* INSERT: *Raftland Pty Ltd v Commissioner of Taxation* [2008] HCA 21 at [66]–[69], citing this paragraph of the text.

**Trust administration***Trustee's remuneration*

**25–61** NOTE 33. DELETE THE FIRST SENTENCE AND REPLACE BY: Public Trustee (Fees) Order 2008 (SI 2008/611), art.3.

**25–62** DELETE THE EIGHTH SENTENCE AND N.38 AND REPLACE BY: Time charges should be apportioned according to the work actually done, so that capital bears the general costs of administering the trust but income bears the costs of work which is exclusively for the benefit of income beneficiaries, e.g. time spent in considering to whom and in what amounts income

<sup>66a</sup> *Sinclair v Sinclair* [2009] EWHC 926 (Ch) at [74]–[75]. See too §§ 44–38.

<sup>92</sup> *R.C.C. v Trustees of the Peter Clay Discretionary Trust* [2008] EWCA Civ 1441; [2009] Ch. 296 at [29].

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should be distributed where there is a discretionary trust of income;<sup>38</sup> and the same treatment should be given to a fixed fee.<sup>38a</sup>

*Other general administration costs*

**25–63** NOTE 44. DELETE THE SECOND SENTENCE AND INSERT AT THE END OF THE FIRST: (point not considered on appeal in the HC or the CA, see [2007] EWHC 2661 (Ch); [2008] Ch. 291 and [2008] EWCA Civ 1441; [2009] Ch. 296, but Special Commissioners’ ruling consistent with the CA’s decision).

NOTE 46. DELETE AND REPLACE BY: *R.C.C. v Trustees of the Peter Clay Discretionary Trust*, above, at [40]–[41].

NOTE 49. AT THE END ADD: (point not taken on appeal in the HC or the CA, see [2007] EWHC 2661 (Ch) at [37] and [2008] EWCA Civ 1441; [2009] Ch. 296 at [6]).

*Accounts and audit*

**25–64** NOTE 50. AFTER THE FIRST SENTENCE INSERT: The Special Commissioners’ decision on that point was not appealed either to the HC or to the CA, see [2008] EWCA Civ 1441; [2009] Ch. 296 at [6]–[7], [17]; but the judgment of the CA seems to be at least consistent with it, at [32]–[33].

DELETE THE LAST TWO SENTENCES OF THE TEXT AND REPLACE BY: But even though it is part of the purpose of the accounts to identify the trust income, that function is as much for the benefit of the capital beneficiaries as for that of the income beneficiaries, unless there is accountancy work concerning the income beneficiaries alone (*e.g.* where there are concurrent income interests); and except in such a case it seems difficult to justify any course except that of debiting the whole cost to capital.<sup>54–55</sup>

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<sup>38</sup> *R.C.C. v Trustees of the Peter Clay Discretionary Trust* [2008] EWCA Civ 1441; [2009] Ch. 296 at [30]–[33], [38].

<sup>38a</sup> *ibid.*

<sup>54–55</sup> In *Trustees of the Peter Clay Discretionary Trust v. R.C.C.* [2007] SPC 595; [2007] S.T.C. (S.C.D.) 362 the Special Commissioners approved the debiting of the costs of the income accounts to income and the costs of the balance sheet and capital account to capital; but although that part of their decision was not the subject of the appeal to the CA, the judgment of that court is not readily

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**25–65** NOTE 58. DELETE.

DELETE THE LAST SENTENCE AND N.59 AND REPLACE BY: Nonetheless, the decision has recently been treated as standing for the proposition that where work is done for the benefit of both tenant for life and remainderman it is done for the estate as a whole and should therefore fall entirely on capital, the income beneficiary contributing by his loss of income on the amount expended;<sup>58–59</sup> and so it seems that the cost of the audit should be so borne.

*Legal costs*

**25–66** NOTE 65. AT THE END ADD: For the incidence of the costs of an unsuccessful claim for breach of trust, to the extent that they are ultimately borne by the trust fund, see § 21–98 (including online supplement).

**A general discretion under the Trustee Act 2000?**

**25–67** NOTE 76. FOR THE REFERENCE TO Kessler, *Drafting Trusts and Will Trusts*, SEE NOW (9th edn), § 21–28. FOR THE REFERENCE TO Underhill and Hayton, *Law of Trusts and Trustees*, SEE NOW (18th edn), §§ 47.2 to 47.4. FOR THE REFERENCE TO Thomas and Hudson, *Law of Trusts*, SEE NOW (2nd edn), § 10.70.

**Time of obligation and time apportionment**

**25–69** NOTE 80. DELETE AND REPLACE BY: *Cf. R.C.C. v Trustees of the Peter Clay Discretionary Trust* [2007] EWHC 2661 (Ch); [2008] Ch. 291 at [50]–[56], holding that expenses could properly be deducted from income on either an accruals basis or a cash basis for the purpose of income tax, if done consistently (point not taken on appeal, [2008] EWCA Civ 1441; [2009] Ch. 296).

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reconcilable with it, see [2008] EWCA Civ 1441; [2009] Ch. 296. *Cf.* the treatment of the cost of auditing trust accounts, see § 25–65.

<sup>58–59</sup> *Trustees of the Peter Clay Discretionary Trust v. R.C.C.*, above, at [22]–[24], [28].

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**5. INCOME OF PARTS OF ESTATE LATER APPLIED TO DEBTS AND  
LEGACIES – *ALLHUSEN V WHITTELL***

**The rule in *Allhusen v Whittell***

**25–88** NOTE 40. DELETE THE REFERENCE IN THE SECOND SENTENCE TO Income and Corporation Taxes Act 1988 AND REPLACE BY Corporation Tax Act 2009.

**When the rule in *Allhusen v Whittell* does not apply**

**25–93** NOTE 57. FOR THE REFERENCE TO *Williams on Wills*, SEE NOW (9th edn), Vol.2, §§ 214.19, 214.43 to 214.47. FOR THE REFERENCE TO Kessler, *Drafting Trusts and Will Trusts*, SEE NOW (9th edn), § 21–32.

NOTE 63. DELETE THE REFERENCE IN THE SECOND SENTENCE TO Income and Corporation Taxes Act 1988 AND REPLACE BY Corporation Tax Act 2009.

**6. APPORTIONMENT OF INCOME PENDING CONVERSION – SECOND  
BRANCH OF THE RULE IN *HOWE V LORD DARTMOUTH***

**Where the second branch of the rule does not apply**

**25–99** NOTE 84. FOR THE REFERENCE TO *Williams on Wills*, SEE NOW (9th edn), Vol.2, §§ 214.19, 214.35 to 214.42. FOR THE REFERENCE TO Kessler, *Drafting Trusts and Will Trusts*, SEE NOW (9th edn), § 21–32.

*Power to postpone sale or retain investments*

**25–102** NOTE 97. FOR THE REFERENCE TO Underhill and Hayton, *Law of Trusts and Trustees*, SEE NOW (18th) edn, § 46.11.

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**7. LIFE TENANT'S RIGHTS IN REVERSIONARY INTERESTS – *RE EARL OF CHESTERFIELD'S TRUSTS*****Where the rule does not apply**

**25–121** NOTE 52. FOR THE REFERENCE TO *Williams on Wills*, SEE NOW (9th edn), Vol.2, §§ 214.19, 214.35 to 214.42. FOR THE REFERENCE TO Kessler, *Drafting Trusts and Will Trusts*, SEE NOW (9th edn), § 21–32.

**9. TIME APPORTIONMENT****The Apportionment Act 1870***Interest*

**25–132** NOTE 96. DELETE AND REPLACE BY: Under Inheritance Tax Act 1984, s.235 (as amended by Finance Act 1989, s.180(4), (7) and Finance Act 2009, s.105(4)(b)).

**Excluding apportionment**

**25–142** NOTE 24. FOR THE REFERENCE TO *Williams on Wills*, SEE NOW (9th edn), Vol.2, §§ 214.19, 214.48 to 214.54. FOR THE REFERENCE TO Kessler, *Drafting Trusts and Will Trusts*, SEE NOW (9th edn), § 21–54.

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