

Paying the penniless

Fiona Smith examines the implications of Raymond Saul v Holden for making distributions to beneficiaries who have been insolvent



Fiona Smith is a partner in the private client department at Forsters LLP and is also a chartered tax adviser

'On the death of a testator a residuary legatee has an immediate entitlement to have such assets as form the residue of the estate transferred to them at the end of the administration of the estate.'

The recent *Re Hemming; Raymond Saul & Co v Holden* [2009] is an important reminder to practitioners of the need to be vigilant when making distributions to beneficiaries of a deceased's estate. The case concerned a residuary beneficiary who was bankrupt at the time of the death of the testatrix, but whose bankruptcy had been discharged by the time a distribution was proposed. The question that came before the High Court was whether that distribution should be made to the trustee in bankruptcy or to the beneficiary.

Background

Bertha Hemming died on 18 July 2003. She left her residuary estate to her son, Bernard. At the time Mrs Hemming died, she and Bernard owned a farmhouse and a cottage in East Sussex, as tenants in common with equal shares.

On 24 September 2003 Bernard was adjudicated bankrupt and a trustee in bankruptcy was appointed with effect from 14 October that year.

On 17 February 2005 Bernard took out a grant of probate as the sole executor of his mother's will. He was automatically discharged from bankruptcy on 1 April 2005.

The cottage was sold in May 2005 for £125,000. Half of the net proceeds (representing Bernard's share) were paid to his trustee in bankruptcy. The balance, representing Mrs Hemming's share, was kept by Bernard's solicitors, Raymond Saul & Co, who were acting in the administration of Mrs Hemming's estate.

The trustee in bankruptcy wrote to Raymond Saul & Co on 5 July 2005, asking that the firm release £28,969.69 from the money it held, in order to satisfy the balance due in Bernard's bankruptcy. The solicitors refused on the basis that:

- Although Bernard had been the residuary legatee of his mother's estate at the date of his bankruptcy, he had no legal or equitable interest in any of the assets in the estate and would not do so until the administration had been completed. The only right he had was to have his mother's estate properly administered, and so that was the only right the trustee in bankruptcy had.
- Even when Mrs Hemming's estate was fully administered, the trustee in bankruptcy would not be able to claim the assets then forming residue, because Bernard had by then been discharged from his bankruptcy. The solicitors argued that an after-acquired property notice could not be served in respect of any property which Bernard acquired after his discharge, by virtue of s307(2)(c) of the Insolvency Act (IA) 1986.

The trustee in bankruptcy disagreed. She argued that Bernard had an interest in his mother's residuary estate which had vested in her and, therefore, the proceeds of sale of Mrs Hemming's half-share of the cottage belonged to her.

There was subsequent correspondence between Bernard's solicitors and the trustee in bankruptcy, but the issue could not be resolved. Raymond Saul & Co ultimately issued a claim form, pursuant to Part 64 of the Civil Procedure Rules (CPR), seeking a determination of the question whether they should make payment of the residue of Mrs Hemming's estate to Bernard, as a residuary beneficiary, or to the trustee in bankruptcy. On 12 April 2007 Bernard died, and his executor was substituted as a party to the proceedings.

The statute

Section 306(1) of IA 1986 provides that a bankrupt's estate vests in the trustee in bankruptcy immediately on their appointment. By s283(1) a bankrupt's estate comprises:

... all property belonging to or vested in the bankrupt at the commencement of the bankruptcy.

Section 436 of IA 1986 states that 'property':

... includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of or incidental to, property.

Proceeds of sale of the cottage

The parties agreed that until the estate of a testator was fully administered, a residuary legatee or anyone claiming through them did not own, nor have any interest in, any specific asset in the hands of the executors. Accordingly, Bernard did not, when his bankruptcy commenced, own or have any proprietary interest in any of the specific assets in his mother's unadministered estate. Mr Richard Snowden QC (sitting as a deputy judge) reviewed the following leading authorities which supported this view.

Lord Sudeley v Attorney-General [1897]

A testator, whose estate included mortgages on real estate in New Zealand, left his widow a one-quarter share of his residue, which was still being administered when she then died. The Crown argued that she had a personal remedy against her husband's executors in England and that probate duty was therefore payable by her on a one-quarter share of the entire residuary estate of her late husband. Her executors countered that she did not have merely a personal claim against her husband's executors, but a one-quarter share in the New Zealand mortgages as specific property and that, because they were foreign property, their value should not have been included in any assessment for probate duty. The House of Lords unanimously held that the mortgages should have been included in the assessment for probate purposes, because until the assets forming her husband's residue had been ascertained, the widow,

as residuary legatee, had no right *in specie* to any particular assets forming part of the unadministered estate.

Dr Barnardo's Homes National Incorporated Association v Commissioners for Special Purposes of the Income Tax Acts [1921]

A testator left his residuary estate to a charity. The estate included investments from which the executors received income, where tax had been deducted at source. The income was handed over to

In Lord Sudeley, the House of Lords held that a residuary legatee has no right in specie to any particular assets forming part an unadministered estate.

the charity as part of the residue and it argued that it was entitled to repayment of the tax. The House of Lords held that no repayment was due because the income from which tax had been deducted was income of the executors. As Viscount Cave stated (at page 10):

When the personal estate of a testator has been fully administered by his executors and the net residue ascertained, the residuary legatee is entitled to have the residue as so ascertained, with any accrued income, transferred and paid to him: but until that time he has no property in any specific investment forming part of the estate, or in the income from any such investment, and both *corpus* and income are the property of the executors and are applicable by them as a mixed fund for the purposes of administration.

Commissioner of Stamp Duties (Queensland) v Livingston [1965]

A testator and his wife were domiciled in New South Wales. The testator left one-third of his residuary estate to his wife, which included properties in New South Wales and Queensland. While his estate was being administered his widow also died. The authorities in Queensland sought to levy succession duty on the executors of the widow in respect of her share of the assets of the testator in Queensland. As a matter of construction of Queensland law, the Privy Council concluded that succession duty could only be levied by the authorities in Queensland if, at the date of her death, the widow had been the beneficial owner of the Queensland properties. It held that she had not been

the beneficial owner of any specific assets forming part of her husband's unadministered estate and, therefore, her estate was not liable for succession duty.

Marshall v Kerr [1995]

This, the most recent case, concerned the application of capital gains tax legislation to a settlement made by the widow of a testator whose estate was, at the time, still in the course of administration. Lord Browne-Wilkinson commented:

In English law the rights of a testamentary legatee in the unadministered estate of a testator are well settled... A legatee's right is to have the estate duly administered by the personal representatives in accordance with the law. But during the period of administration the legatee has no legal or equitable interest in the assets comprised in the estate.

In the light of the authorities, the deputy judge in *Raymond Saul* concluded that the trustee in bankruptcy had never had any proprietary interest in Mrs Hemming's half-share of the cottage or in the proceeds of the sale of that specific property.

The further issue, and the one raised by the claim under CPR Part 64, however, was which of the executor and the trustee in bankruptcy had the right to payment of Mrs Hemming's residuary estate, as and when the administration was complete.

Entitlement to the residuary estate

Arguments as to who was entitled to the residuary estate were made by opposing counsel as follows:

- Counsel for the solicitors accepted that at the date of his bankruptcy Bernard, as residuary legatee, had a right to have his mother's estate properly administered in accordance with law. He also accepted that this right was a *chose* in action and hence 'property' within the meaning of s436 IA 1986. As such, it vested in the trustee in bankruptcy pursuant to s306. He argued, however, that

the right to due administration was completely separate from the right to payment of the residue. As the residue would only come into existence when the administration of the estate was complete, it was only then that the right to receive it would actually vest in Bernard (or his estate). Counsel maintained that the right to receive the residue never vested in the trustee in bankruptcy.

Counsel referred the Court to Lord Atkinson's statement in the *Dr Barnardo's* case (at page 11):

The case of *Lord Sudeley v Attorney-General*... conclusively established that until the claims against the testator's estate for debts, legacies, testamentary expenses etc, have been satisfied, the residue does not come into actual existence. It is a non-existent thing until that event has occurred. The probability that there will be a residue is not enough. It must be actually ascertained.

Counsel also pointed to Lord Browne-Wilkinson's comments in *Marshall v Kerr* (at page 166 F-G):

... it is crucial to appreciate that the property settled by [the legatee] comprised, not the assets in the deceased's estate... but a separate *chose* in action, the right to due administration of his estate.

- Counsel for the trustee in bankruptcy, on the other hand, argued that a residuary legatee's right to have a testator's estate properly administered necessarily carried with it the right to receive the residue of the estate, once ascertained. She argued that the residue was the 'fruits' of the *chose* in action and the two could not be separated. She also maintained that a residuary legatee had an interest in respect of the assets in the unadministered estate that was sufficient to fall within s436 IA 1986.

The deputy judge acknowledged that the authorities supported the argument that a residuary legatee had no proprietary interest in particular assets in an unadministered estate and that such an interest only arose on completion of the administration. He noted, however, that at least some of the members of the

House of Lords in the *Lord Sudeley* case thought that the right that vested in the residuary legatee went beyond a limited right to compel administration. This view was also borne out by the decision of Buckley J in *Re Leigh* [1970], where he stated (at pages 281G-282A):

- (1) the entire ownership of the property comprised in the estate of a deceased person which remains unadministered is in the deceased's legal personal representatives for the purposes of administration without any differentiation between legal and equitable interests;
- (2) no residuary legatee or person entitled upon the intestacy of the deceased has any proprietary interest in any particular asset comprised in the unadministered estate of the deceased;
- (3) each such legatee or person so entitled is entitled to a *chose* in action, *viz* a right to require the deceased's estate to be duly administered, whereby he can protect those rights to which he hopes to become entitled in possession in the due course of the administration of the deceased's estate;
- (4) each such legatee or person so entitled has a transmissible interest in the estate, notwithstanding that it remains unadministered.

The deputy judge concluded that on the death of a testator a residuary legatee had an immediate entitlement to have such assets as formed the residue of the estate transferred to them at the end of the administration of the estate. This did not give the residuary legatee any present property interest in any of the individual assets forming the estate while it was being administered, nor even an immediate interest of a proprietary nature in the residue of the estate. It did, however, give them an immediate entitlement to future payment, and this right was recognised and protected while the estate was in the course of administration by the right of action to compel the due administration of the estate. The right of the residuary legatee was a composite right to have the estate properly administered and to have the residue (if any) paid to them as and when the administration was complete.

That right was a *chose* in action, which was transmissible. Accordingly, it fell within the first limb of the definition of 'property' in s436 IA 1986. When a residuary legatee became bankrupt, the *chose* in action (ie the composite right referred to above) vested in the trustee in bankruptcy. It would not revert to the bankrupt unless and until their bankruptcy debts and costs had been paid. The right was capable of being asserted by the trustee in bankruptcy against the executors, to preclude them from giving priority to any rival claim to the assets comprising the residue at the end of the administration.

Consequences for the practitioner

This case has given rise to concern among practitioners because not only must a legatee not be bankrupt at the date of distribution of an estate, but also at the date of death and throughout the period of administration. The practical answer must be to ask beneficiaries at the outset whether they are subject to a bankruptcy order and to make appropriate searches at the Land Registry, not only at the time of distribution but also at the outset of an administration and, if necessary, periodically thereafter. Difficulties may arise in some cases, as bankruptcy records are only kept for five years, after which they are deleted. *In re Bennett* [1906] offers some comfort to executors, however. In that case, it was held that an executor who distributed property of an undischarged bankrupt to the bankrupt's next of kin was not liable to the trustee in bankruptcy, and it was for the next of kin to refund the property to the trustee. ■

In re Bennett
[1906] 1 KB 149
Commissioner of Stamp Duties (Queensland) v Livingston
[1965] AC 694
Dr Barnardo's Homes National Incorporated Association v Commissioners for Special Purposes of the Income Tax Acts
[1921] 2 AC 1
Re Leigh
[1970] 1 Ch 277
Lord Sudeley v Attorney-General
[1897] AC 11
Marshall v Kerr
[1995] 1 AC 148
Re Hemming; Raymond Saul & Co v Holden
[2009] WTLR 233