INTRODUCTION

Appropriation is the act of a personal representative (PR) or trustee by which they set aside property from the estate or trust to satisfy the entitlement of a beneficiary, either in part or in full. The appropriated asset may be shares, land or cash and, once appropriated, the PR or trustee has no right to call back all or any part so appropriated unless a specific provision is made (e.g. land is appropriated subject to a charge in favour of the PR or trustee).

Residuary beneficiaries have no right to call for any specific asset to be appropriated to them. However, once appropriated, the beneficial entitlement vests in the beneficiary who then has a right to call for that asset to be transferred or assented to them, or in accordance with their directions.\(^1\)

Powers to appropriate

- **Personal representatives:** have a statutory power to appropriate – s.41 *Administration of Estates Act 1925* (AEA 1925) (the Statutory Power). That power may be varied by the terms of the will.

An appropriation under the Statutory Power is subject to consent of the beneficiary in whose favour the appropriation is to be made (s.41(1) AEA 1925). In the absence of consent, the appropriation is invalid. If, say, land is to be appropriated to three beneficiaries (whether jointly or as tenants in common), the consent of all three is required. There are particular rules as to consent where the beneficiary is a minor or otherwise lacking capacity.

Modern wills often waive the need for consent, whether by specifically excluding that part of s.41 AEA 1925, or by the inclusion of a power tailored to the needs of the estate.

- **Trustees:** have a common law power to appropriate, which may be replaced or extended by specific provision within the trust instrument – s.41 AEA 1925 does not apply to trustees unless specifically incorporated by the trust instrument (which is unusual).

- **Care:** many modern trust instruments, including wills, contain specific powers of appropriation. Some also include provision as to the value to be used for appropriation, which is discussed below (Valuation). It is always important to check the terms of the trust instrument before making an appropriation.

Making an appropriation

It is good practice for any appropriation to be recorded in writing. However, an appropriation of an interest in land must always be evidenced in writing (s.53(1) *Law of Property Act 1925*).

Generally, PRs and trustees will resolve to appropriate assets to beneficiaries, and sign a resolution to that effect. Where consent is required, the resolution to appropriate should

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\(^1\) If the administration of an estate is unduly delayed, it may be open to the beneficiaries to apply to court for directions for the distribution of the estate.
specifically be subject to receipt of the appropriate consent(s) and, once received, updated to record that fact. Once the resolution is completed by the relevant parties, and any required consent obtained, the beneficiary has a right to call for the appropriated asset(s) to be transferred to them.

In cases where a deed of appropriation might be used, consideration should be given to the beneficiary(s) being party to the deed to signify their consent, thus speeding up the process.

Where legal title to the appropriated asset is registered, the PRs or trustees will need to execute the appropriate documentation to effect the transfer of the legal title to the beneficiary.

Where a cash distribution is made, the instruction to the bank to make the payment (e.g. signing the cheque), is often treated as the exercise of the power of appropriation.

Chattels are often handed over to the beneficiaries without any specific appropriation being made. However, unless the PRs or trustees reserve any specific rights when handing over chattels an effective appropriation will have taken place – even if consent is required, there is no requirement for this to be in writing. However, if challenged at a later date, how is such consent evidenced?

**Can a PR appropriate assets before grant?**

This will depend on whether the PR is an executor named in the will.

The authority of an executor stems from the will and a grant merely confirms their title. Accordingly, an executor may appropriate assets before a grant is issued to them, even if the legal title to that asset cannot be transferred until the grant has been issued.

Where assets are passed over to a beneficiary ‘subject to receipt of the grant’, this will be a conditional appropriation and will only be effective once the grant has been issued.

Whenever making an appropriation before grant, or releasing assets to a beneficiary subject to receipt of the grant, the executor should be wholly satisfied that the asset will be available for appropriation to the intended beneficiary. If, for any reason, the estate proves to be insufficient, or the asset is subject to a claim by another person, the executor may be personally liable for any costs incurred in recovering the asset, and/or compensating the third party.

Where the PR is not an executor, their right to administer the estate will arise from the issue of a grant entitling them to distribute the estate, so that no valid appropriation can be made before the grant is issued. It must be noted that not all grants of representation empower the PRs to distribute an estate (e.g. a grant ad colligenda bona, or a grant pendente lite).

- **Care**: a pre-grant appropriation will be ‘intermeddling’ and so may bind the executor to administer the estate.

**Valuation**

Assets are appropriated at their value as at the date of appropriation – *Re Charteris*, *(Charteris v Biddulph [1917] 2 Ch. 379)*. However, where assets are appropriated to the
beneficiaries in proportion to their respective interests, it may be convenient to use the book value for accounting purposes (and to avoid incurring valuation fees for no clear benefit).

Care needs to be taken where the will, or trust instrument (or, perhaps, the beneficiaries) permits, or requires, another basis for the value to be used for appropriation (e.g. the STEP Standard Provisions, 2nd Edition, special provision 22). HMRC has indicated that it may deem this to give rise to a transfer of value for IHT purposes, on the basis that for IHT purposes the ‘correct’ basis of valuation for appropriation is as set down in Re Charteris so that an appropriation at a different value represents a transfer of value between the beneficiaries involved.

Capital gains tax (CGT)

When an asset is appropriated by PRs, s.62(4) Taxation of Chargeable Gains Act 1992 provides that the beneficiary acquires such asset at its date of death value for the purposes of UK CGT. This is regardless of the value attributed to any asset for appropriation purposes.

This only applies for UK CGT and, if a beneficiary is tax resident outside of the UK the tax code applicable to them may apply a different acquisition value. For example, in some jurisdictions, such as the US, the beneficiary will be deemed to have acquired the asset at the deceased’s acquisition value. However, the tax treatment of a beneficiary does not affect their entitlement under the will or trust instrument.

Gifts subject to inheritance tax

Testamentary gifts are free of UK inheritance tax (IHT) unless the will specifically charges them to tax (s.211 Inheritance Tax Act 1984 – IHTA 1984). However, where a gift is to be made out of a trust (however created), say following the termination of an interest in possession, the recipient of that gift is liable for the IHT thereon, in much the same way as the beneficiary of a testamentary gift subject to tax is under s.211(3) IHTA 1984.

The beneficiary’s liability to IHT and interest thereon cannot be fully quantified until the final IHT liability has been agreed.

In order to protect themselves, before appropriating to the beneficiary entitled any asset(s) gifted subject to tax PRs should consider obtaining funds from them covering the full potential IHT liability (including interest). If the gift is of cash, it should be sufficient to retain monies to cover the potential liability.

Where the beneficiary is also entitled to an interest in residue, the PRs have no automatic right of set-off, enabling them to just deduct the IHT liability from residue, and the beneficiary’s specific agreement should be obtained before adopting such course.

Equal/proportionate appropriation?

The need to use a current valuation when appropriating is particularly important when assets are appropriated either:

- In satisfaction of a cash legacy, or
• If appropriated other than in proportion to the residuary beneficiaries' entitlements (e.g. all shares appropriated to one of three beneficiaries), or
• If, on the termination of a trust, distributions are not made to beneficiaries of equal entitlement at the same time and in proportion to their entitlement.

In the last two situations, unless distributions proportionate to the other beneficiaries' entitlement are made at the same time there will be an ‘unequal’ distribution and those beneficiaries whose entitlement is balanced at a later date will should be compensated for the delayed distribution. As the compensation is a charge on the entitlement of the beneficiary who has been paid ahead of the others, PRs/trustees should be wary of fully distributing to any such beneficiary ahead of also finalising distributions to the other beneficiaries. If the PRs/trustees are unable to ‘equalise’ distributions out of the preferred beneficiary(s) entitlement, the other beneficiaries might look to them to remedy the situation from their personal resources.

Specific legacies/devisees, and the doctrine of relation back

Where assets are specifically gifted under the terms of a will (e.g. I give my property 1 High Street to my brother Fred), strictly speaking the assets remain in the estate until such time as the executor appropriates them to the beneficiary entitled. Once appropriated, the doctrine of ‘relation back’ applies to the effect that any transactions relating to the asset are treated as having been the acts, etc. of the beneficiary (e.g. dividends, rent received and maintenance costs).

In anticipation of the appropriation, PRs may omit from the estate tax return details of the income (or deemed income) arising on the specific gift – the appropriate tax voucher(s) to be provided to the beneficiary entitled once the appropriation is made. If, for any reason, no appropriation is made, so that the doctrine of relation back is not triggered, PRs will need to consider submitting a corrected estate tax return to HMRC.

The executor should formally appropriate to the beneficiary the subject matter of any specific gifts as this is an assurance that the estate is sufficient to meet its liabilities without recourse to those assets.

If specifically gifted assets are, say, sold by the executor without first being appropriated the doctrine of relation back will not be triggered. Accordingly, the disposal will be that of the executor for CGT purposes and the gain or loss will be attributed to the estate and not to the beneficiary. This is an aspect that is perhaps too often overlooked.

Termination of a trust

On the termination of a trust, whether in whole or in part, the assets exiting the trust are deemed to have been disposed of by the trustees and acquired by the beneficiaries on the date they cease to be within the trust. Depending upon why the assets exit the trust the trustees' gain may be exempt from CGT (e.g. on the termination of a ‘qualifying’ interest in possession), or may be subject to CGT (e.g. on a distribution from a discretionary trust).

However, as soon as the assets are no longer subject to the terms of the trust, the trustees hold as bare trustee for CGT purposes. Should the beneficiaries decide to take the assets other than in the proportion to which they are entitled, there will be a disposal for CGT
purposes between the beneficiaries. The beneficiaries who dispose of their share in the asset(s) will need to disclose the disposal to HMRC and may need to negotiate the disposal value (although this should be relatively straightforward if, say, quoted shares are involved).

**Estates - assets held at the completion of the administration**

It is generally accepted that once the administration of an estate is completed (Completion), any unappropriated assets remaining under the control of the PRs are deemed to have been appropriated to the beneficiaries entitled as at the date of Completion.

HMRC generally views Completion as the date upon which the liabilities of the estate have been established and residue can be ascertained. This does not mean the liabilities must have been paid – merely that they have been definitively quantified.

This can cause complications and, therefore, the better view is that once the PRs are satisfied they no longer require recourse to an asset, it might be appropriated to the beneficiaries. It also enables ‘tidier’ record keeping, and ensures that the PRs and their tax advisers recognise the sale is not made by the PRs as such who, by that time, might have no annual CGT allowance in the estate.

Additionally, if any of the beneficiaries entitled are tax resident outside of the UK, an actual appropriation will help focus minds on whether there is any need to disclose to HMRC a sale of the asset to and pay UK CGT on the disposal of their entitlement within 30 days of the sale completing. This is particularly relevant where UK land is involved.

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2 The requirement to notify HMRC and pay the CGT on UK property sales will also apply to UK tax residents with effect from 5 April 2020.