THE HIGH COURT
(REVENUE)

[Record No. 2004 368R]

BETWEEN

P.O. CAHILL (INSPECTOR OF TAXES)

APPELLANT

AND
PATRICK J. O'DRISCOLL MICHAEL O'DRISCOLL
AND WILLIAM F. O'DRISCOLL

RESPONDENTS

Judgment of Mr. Justice Michael Hanna delivered on the 9th day of June, 2005

1. This case comes before me as a case stated by Mr. Ronan S. Kelly, Appeal Commissioner for the opinion of this Court pursuant to the provisions of s. 941 of the Taxes Consolidation Act, 1997 (formerly s. 428, Income Tax Act, 1967). The appellant is Mr. P. O'Cahill, Inspector of Taxes. The respondents are partners in the firm of Messrs P.J. O'Driscoll & Sons, Solicitors who carry on practice in Cork and Dublin.

2. The case involves the rate of income tax applicable to interest earned on clients' funds deposited by the respondents in the course of their practice as solicitors. Funds received from or on behalf of clients of the firm could properly be deposited in two ways. Firstly, there might be a designated, specific deposit account referable to one specific client. In those circumstances, it was straight forward for the firm to match client with the interest earned and to make payment accordingly. This case stated is not concerned with such deposits. Rather, we are concerned with interest earned arising from a general client deposit account with numerous in flows and out flows of monies concerning numerous clients which gave rise to obvious (though apparently, not insurmountable) problems in matching client to interest. In such cases, it is not difficult to understand that many clients might have only the briefest of visitations to the general deposit account and that, in many such instances, only the most modest sums of interest would accrue.

3. The tax year with which we are concerned is 1991-1992. The Inspector of Taxes had raised income tax assessments on the interest earned on the general client account at the higher rate then applicable of 52%. The Appeal Commissioner took the view that the said interest was taxable at the standard rate in accordance with the provisions of s. 2 of the Finance Act, 1991 (now s. 15 of the Taxes Consolidation Act, 1997). Subsections 1 and 2 of that section provide as follows:

> *2.—(1) Income tax shall be charged for the year 1991-92 and for each subsequent year of assessment and shall, subject to subs. (2), be so charged at the rate of tax specified in the Table to this section as the standard rate.*
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> *(2) Where a person who is charged to income tax for the year 1991-92 or any subsequent year of assessment is an individual (other than an individual acting in a fiduciary or representative capacity), he shall, notwithstanding anything in the Income Tax Acts but subject to section 5 (3) of the Finance Act, 1974, be charged to tax on his taxable income—*
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> > *(a) in a case in which he is assessed to tax otherwise than in accordance with the provisions of section 194 (inserted by the Finance Act, 1980) of the Income Tax Act, 1967, at the rates specified in Part I of the Table to this section, or*
> >
> > *(b) in a case in which he is assessed to tax in accordance with the provisions of the said section 194, at the rates specified in Part II of the said Table,*
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> *and the rates in each Part of that Table shall be known, respectively, by the description specified in column (3), in each such Part opposite the mention of the rate or rates, as the case may be, in column (2) of that Part."*

4. In the Appeal's Commissioner's view and that of the respondents, the impact of that section was to cause tax to be levied at the then standard rate of 29%. The respondents, as solicitors, were holding their clients' monies in trust and were acting in a fiduciary capacity thereby attracting the lesser rate of tax. The respondents' contention is that the money and the interest earned thereon, at all times, belonged to the clients on whose behalf they were acting. On behalf of the respondents, Mr. McCann S.C. sought to rely on the decision of the House of Lords in *Brown v. Inland Revenue Commissioners* [1965] A.C. 244. That case involved a Scottish solicitor who sought to claim earned income relief against his liability for income tax. He did so by reference to interest earned on client's money which he had deposited. No issue arose as to any impropriety on the part of Mr. Brown. He was following a common but not invariable practice and called in aid a practice directive of the Scottish Law Society approving of what he had done. The mechanics of what occurred in Mr. Brown's case are, however, of secondary importance to the principles enunciated by the House of Lords and, in particular, by Lord Reid. He says, beginning at p. 256, that:-

> *"The general principle is well settled. A solicitor has a fiduciary duty to his clients and any person who has such a duty "shall not take any secret remuneration or any financial benefit not authorised by the law, or by his contract, or by the trust deed under which he acts, as the case may be"*
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> *(per Lord Normand in Dale v. Inland Revenue Commissioners [1954] A.C. 11, 27; [1953] 3 W.L.R. 448; [1953] 2 All E.R. 671, H.L.). If the person in a fiduciary position does gain or receive any financial benefit arising out of the use of the property of the beneficiary he cannot keep it, unless he can show such authority.*
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> *This interest was earned by using clients' money. It may be true that it could only have been earned by aggregating the money of a large number of clients and could not have been earned for each client by using the money of that client alone. But that does not appear to me to make any difference in law though it may remove any possible suggestion that the solicitor was simply appropriating for himself money which he could and should have credited to his clients. I can see that if clients' money is dealt with in this way it may be quite impracticable to determine with any accuracy what share of the interest should be credited to any particular client. One might, it is true, begin by assuming that if half the money in the clients' general current account is put on deposit receipt then half the money at the credit of each client is to be regarded as included in the sum put on deposit receipt. But the position changes from day to day. The whole of the money then at the credit of certain clients may have been paid out by the solicitor long before the deposit receipt is uplifted, the general current account having been kept in credit by money coming in from other clients. So notionally the*

ownership of the £ 5,000 on deposit receipt will change from day to day. No doubt an accountant could devise a fair method of apportioning the interest. But to make even a rough approximation might well cost more than the whole of the accrued interest. On the other hand, if the solicitor is deterred by this difficulty from putting such money on deposit receipt it must just remain on current account. No interest will be earned and the only gainer will be the bank.

So it is not very surprising that a similar practice has been followed for a long time not only by the appellant's firm but by a number of other solicitors. The commissioners accepted the evidence of an accountant employed by the Law Society that it was fairly common in his experience but by no means universal. Unfortunately we do not know what was the practice of those who did not follow this practice. The appellant founds on a passage in the report of the council of the Law Society of Scotland for 1951:"The council have also been asked for their views regarding the question of the disposal of interest on deposit receipts or deposits with savings banks for unnamed clients. They have expressed the opinion that if the allocation of interest on a general sum taken out of the client account and placed on deposit receipt or with a savings bank is so difficult or involves so much work as to be substantially impracticable, the solicitor is entitled to retain the interest in the form of a general charge against clients for the work involved in keeping the clients' banking account(s)."

This opinion, coming from so responsible a body, negatives any possible suggestion of professional malpractice by the appellant or any other solicitor who has acted in accordance with it. But it was not argued that it has any binding force and I do not think that it can be supported in law. I do not see how the difficulty in discovering who is the owner can make the money the property of the solicitor. Nor am I aware of any authority for making a general or collective charge against clients."

5. Although also placing some reliance on the case of *Aplin v. White (H.M. Inspector of Taxes)* [1973] 1 W.L.R. 1311 it is, I believe, correct to say that the respondents relied on the clear authority of *Brown v. Inland Revenue Commissioners* as underpinning the fiduciary or representative capacity in which they held funds in the general deposit account on behalf of clients.

6. Not so, argued Mr. McBratney S.C., on behalf of the appellant. No such fiduciary relationship existed because such relationship was sundered or set at nought as a consequence of the Solicitors Professional Practice, Conduct and Discipline Regulations, 1986 (Statutory Instruments 405 of 1986). These regulations seek to control and to direct the manner in which certain client funds are handled by members of the solicitors profession. Mr. McBratney S.C. relied on the following portions of the said regulations:-

"5. (1) Subject to Section 7 of these Regulations and to subsection (2) hereof a solicitor shall as and from the Operative Date

(a) Keep Client's Money in a separate deposit or savings Client Account or in a separate deposit receipt Client Account and shall account and pay to such Client the interest earned thereon,

or

(b) Pay or account to the Client out of the solicitor's own money a sum equivalent to the interest which would have accrued for the benefit of the Client if that client's money had been paid into an account for the benefit of the Client in the manner prescribed in paragraph (a) of this sub-section at the appropriate deposit rate of the main or principal Bank to the practice of the solicitor for a deposit of an amount equal to the amount of the relevant Client's Money.

(2) A solicitor is required to act as provided in subsection (1) of this Section in each case in which the amount of any sum received or sum or balance held if placed on deposit in a bank at the rate fixed pursuant to paragraph (b) of sub-section (1) of this Regulation would produce a sum of not less than IR£50 after deduction of deposit interest retention tax.

PROVIDED HOWEVER that a solicitor shall not be required to pay or credit interest to a Client in any case before the funds representing such sum or balance have been cleared and actually credited to an appropriate Client Account.

6. Except as provided by these Regulations a solicitor shall not be liable by virtue of the relation between solicitor and Client to account to a Client for interest received by the solicitor on Client's Money.

7. (i) Nothing in these Regulations shall affect any arrangement in writing whenever made between a solicitor and his Client as to the application of the Client's Money or interest on it.

(ii) Nothing in these Regulations shall apply to Trust Money received by a solicitor and further no provision of these Regulations shall be construed as altering the Rule of Law whereby such a solicitor has to account to any trust in relation to which he is a trustee for all and any benefit (including bank or other interest) received by him unless he has appropriate and express authority enabling him to receive such benefit."

7. The effect of Regulation 5(2) is that solicitors need not account for any interest less than £50. Removing that obligation effectively destroys any notion of a fiduciary relationship. You cannot be a trustee if you do not have to account.

8. The respondents contend that if this Regulation is to be construed in a manner suggested by the appellant, this would, in effect, amount to a parliamentary conveyance or transfer of ownership in the clients' funds. The sums at all times remain the property of the client as does the interest earned on them.

9. There can be no question but that the duty to account is a hallmark of trusteeship. The position is well expressed in Delaney, *Equity and the Law of Trusts in Ireland* (3rd ed., Thomson Round Hall, 2003) at page 413:-

"Duty to Keep Accounts and Provide Information

A trustee is obliged to keep clear and accurate accounts of the trust properly and a beneficiary is entitled to inspect these accounts although in theory if he wants a copy of them he must pay for them. This obligation to keep accounts arises independently of any question that a breach of duty may have occurred as was made clear by Chatterton VC in

Moore v. McGlynn, [1894] 1 I.R. 74, 86 where he pointed out that the obligation arises merely by virtue of the relationship of trustee and beneficiary."

10. Therefore, in the context of an identified trust fund and easily identified cestuis qui trust it is readily manageable and understood. However, it certainly is not difficult to understand how, in terms of general solicitors' deposit accounts, matters can get very complex and time consuming particularly when one may be talking about numerous clients with attendant numerous miniscule amounts of interest. It seems to me that the 1986 Regulations were intended to deal practically with just this sort of problem. Regulation 5 deals with both designated accounts (Regulation 5(1) (a)) where one is dealing with an individual client or a more general account (Regulation 5 (1) (b)) with which we are concerned in this case. Regulation 5(2) is mandatory upon solicitors save as otherwise envisaged in the regulations. In the absence, for example, of an arrangement in writing to different effect, a solicitor is mandated and is without option or discretion to act in accordance with regulation 5(1) (a) and (b). Nothing in the regulation would prevent a solicitor from dealing in a similar way with sums of less than IR£50 or, indeed, coming to some arrangement in writing with a client. However, it does not, in my view, disturb the client's ownership of the monies. Nor does it abrogate the solicitor's stewardship thereof. The general principles enunciated by Lord Reid in Brown v. Inland Revenue Commissioners fairly represent Irish law.

11. It is and remains the law that client's funds held by solicitors in the circumstances that arise here remain the property of the client. The integrity of the client's ownership of the funds is demonstrated by two statutory provisions. Firstly, with regard to the priority of claims to client's monies held by a solicitor in a bank account, s. 68 of the Solicitors Act, 1954 provides as follows:-

> *"Where a solicitor keeps in a bank account for moneys of clients or of any trust of which the sole trustee is a solicitor or the trustees are a solicitor with a partner, clerk or servant of his or with more than one of such persons, neither the State nor any person shall have or obtain any recourse or right against moneys standing to the credit of that account in respect of a claim or right against the solicitor until all proper claims of the clients, or of the persons interested in the trust, against those moneys have been fully satisfied."*

12. Further, section 32 of the Solicitors (Amendment) Act, 1960 regulates a situation where a solicitor is adjudicated a bankrupt or enters into a composition with his creditors or a deed of arrangement for the benefit of his creditors or dies insolvent and:-

> *"…the sum at the credit of the client account kept by the solicitor at a bank in accordance with regulations made under section 66 of the Principal Act, or, where two or more such accounts are kept by the solicitor, the total of the sums at the credit of the said accounts, is less than the total of the sums received by the solicitor in the course of his practice on behalf of his clients and remaining due by him to them, then, notwithstanding any rule of law to the contrary, the sum at the credit of the said client account, or where the solicitor has kept two or more client accounts the total of the sums at the credit clients of the solicitor according to the respective sums received by the solicitor in the course of his practice on behalf of his clients and remaining due by him to them,*
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> *then, notwithstanding any rule of law to the contrary, the sum at the credit of the said client account, or where the solicitor has kept two or more client accounts the total of the sums at the credit of those accounts, shall be divisible proportionately amongst the clients of the solicitor according to the respective sums received by the solicitor in the course of his practice on behalf of his clients and remaining due by him to them."*

13. I do not believe that it was the intention of the Oireachtas to modify either the general law with regard to trusts or to purport to adjust statutory provision of the nature above referred to by means of a statutory instrument. A client's monies and the interest earned thereon remain the property of the client held in trust by the solicitor and the fiduciary relationship between solicitor and client remains intact.

14. Accordingly, in response to the question posed by the Appeals Commissioner as to whether he was correct in law in holding that interest earned on sums belonging to the respondents' clients was not the income of the respondents and, accordingly, was not liable to tax at 52%, I answer in the affirmative.