[2012] UKUT 360 (TCC)
Appeal number FTC/57/58/59/60/2011

Whether s. 102(1)(b) of the Finance Act 1986 (gift with reservation) applies to a gift of a reversionary underlease containing covenants from the donee mirroring covenants in the donor's head lease. Application of Ingram v. IRC. Decision of the First-tier Tribunal upheld: such covenants do constitute a reservation within the section.

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

(1) MARK BUZZONI (Executor of the estate of Lia Kamhi deceased)
(2) THE LEGIS TRUST LIMITED
(3) VILI HAYIN (or HAYATI) KAMHI
(4) CEFI KAMHI

Appellants

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: The Hon Mrs Justice Proudman DBE
Sitting in public at the Royal Courts of Justice Rolls Building London EC4A 1NL

Mr Robin Mathew QC and Miss Georgia Bedworth, instructed by Bracher Rawlins LLP for the Appellants

Mr Matthew Slater, instructed by the Solicitor to HM Revenue & Customs, for the Respondents

DECISION

TRIBUNAL JUDGE: The Hon Mrs Justice Proudman DBE
RELEASE DATE:

The issue

1. This is an appeal from the decision dated 21st April 2011 of the First-tier Tribunal (Tax Chamber), comprising Mrs Barbara Mosedale and Mr J Stafford. That hearing was an appeal against notices of determination issued to the appellants on 15th October 2009 that a disposal by way of gift by Mrs Lia Kamhi was subject to a reservation of benefit. Permission to appeal to the Upper Tribunal was granted by Mrs Mosedale on 12th July 2011.

2. By s.1 of the Inheritance Tax Act 1984 inheritance tax (IHT) is chargeable on chargeable transfers as defined by s. 2. Transfers within the lifetime of a person can be potentially exempt transfers by s. 101 and Schedule 19 of the Finance Act 1986. This does not apply to disposals by gift with a reservation as defined in s. 102 of and Schedule 20 to the 1986 Act.

3. The Tribunal accepted HMRC's submissions that the property gifted by Mrs Kamhi (who died on 2nd May 2008) as per s. 102 (1)(b) was in the seven years to Mrs Kamhi's death,

> "not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and any benefit to him by contract or otherwise."

4. The appellants are Mrs Kamhi's executor, the trustee of the settlement into which she gifted the property at issue, Legis Trust Limited ("Legis"), and her sons who are the beneficiaries under the settlement. They appeal that decision to the Upper Tribunal. It is an appeal in point of law under s. 11(1) of the Tribunals Courts and Enforcement Act 2007. There was an agreed statement of facts before the First-tier Tribunal and a witness statement by Mr Mark Buzzoni (Mrs Kamhi's executor) on which HMRC declined to cross-examine him. The facts are not in dispute and the facts as found by the Tribunal and stated in paragraphs 7-25 of the decision are accepted.

5. The principal ground of appeal is that the donee Legis (for whom the immediate grantee, Ovalap Nominees Limited ("Ovalap"), acted as nominee) was simply assuming the burden inherent in a sub-demise of the head lease and that the relieving of Mrs Kamhi's burden was not a benefit in the sense used in s.102. The appellants rely on what Lord Hoffmann said in the House of Lords in **Ingram v. Commissioners of Inland Revenue** [2000] 1 AC 293 at 305:

> "What then is the policy of section 102? It requires people to define precisely the interest which they are giving away and the interests, if any, which they are retaining. Once they have given away an interest they may not receive back any benefits from that interest. In *Lang v. Webb* 13 CLR 503, 513 Isaacs J suggested that the policy was to avoid the 'delay, expense and uncertainty' of requiring the revenue to investigate whether a gift was genuine or pretended. It laid down a rule that if the donor continued to derive any benefit from the property in which an interest had been given, it would be treated as a pretended gift unless the benefit could be shown to be referable to a specific proprietary interest which he had retained. This is probably the most plausible explanation and accepting this as the policy, I think there can be no doubt that the interest retained by Lady Ingram was a proprietary interest defined with the necessary precision."

6. The licence to underlet was negotiated at arm's length between Mrs Kamhi and her landlord. It was common ground below that the licence contained covenants usual for such a licence and that without such covenants there would have been no realistic prospect that a licence to underlet would be granted. There was a covenant in the head lease not to underlet unless the undertenant should first enter into a covenant with the landlord to observe all the covenants and obligations on the part of the tenant. The underlease accordingly contained several pages of covenants by Ovalap mirroring the covenants in the head lease (to pay the service charge, to redecorate etc) except only the covenant to pay rent.

The appeal

7. The only question below and on this appeal is whether the future underlease gifted by Mrs Kamhi to the settlement was at any time in the relevant period "not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to [her] by contract or otherwise." The appellants argue that:

- Mrs Kamhi carefully defined the property that was given away.

- She did not derive a benefit from what she gave away. On the contrary, the covenants given by Legis were part and parcel of the property given. The existence of the express covenants in the underlease was simply a matter of conveyancing machinery employed in order to define the gift. This raises the question of the nature of a leasehold interest.

- Her rights under the covenants correlated to the reversion to the underlease, the specific proprietary interest, which she retained.

- The Tribunal fell into the error of assuming that because Mrs Kamhi retained an interest in the physical property, the flat, she retained a benefit for the purposes of s.102. The property comprised in the sub-lease is not physical property but a bundle of rights and obligations involving benefits and burdens.

- Mrs Kamhi did not retain any additional benefit which was not referable to the property which she retained. She did not grant a limited property interest conditional on fulfilment of covenants in favour of herself; on the contrary, the covenants were part of the interest which she had given. Only by complying with the covenants in the head lease can the sub-tenant enjoy the benefit of the sub-demise and ensure that the head lessor does not forfeit the head lease. Accordingly, only by complying with those covenants can the undertenant comply with its obligation to yield up the property at the end of the term.

8. As Lord Hoffmann also said in ***Ingram*** (at 300),

> "…although the section does not allow a donor to have his cake and eat it, there is nothing to stop him from carefully dividing up the cake, eating part and having the rest. If the benefits which the donor continues to enjoy are by virtue of property which was never comprised in the gift, he has not reserved any benefit out of the property of which he disposed…"

9. It is important to understand that, as emphasised in ***Ingram*** (see p 304), the term "property" in s.102 does not refer to something with physical existence, the flat, but to a specific interest, a legal construct, which could coexist with other interests in the same physical entity. Thus the section does not prevent a

donor from deriving benefit from the entity in which he has given away an interest so long as he does not derive a benefit from that interest and any benefit is referable to the specific proprietary interest which is retained. Thus the right to enjoyment of land for a limited period and the right to enjoy it after the expiry of that period can exist simultaneously as property interests in possession and in reversion so that one such interest may form the subject matter of a gift while the other is retained. The appellants rely on this principle in saying that the Tribunal below failed to establish what property was given away by Mrs Kamhi, asserting that this is underlined by paragraph 89 of the decision.

10. Precise definition of the property given away is insufficient by itself. As Lord Hoffmann said in ***Ingram*** at 305:

> "…if the donor continued to derive any benefit from the property in which an interest had been given, it would be treated as a pretended gift unless the benefit could be shown to be referable to a specific proprietary interest which he had retained."

Grounds of appeal

11. Mr Mathew QC for the appellants asserted that the First-tier Tribunal was wrong for a number of reasons but his submissions contain one over-arching point, namely that the covenants in favour of Mrs Kamhi were an inherent part of the character of the alienated property. Mr Mathew submitted that it is counterintuitive to say that a gifted lease must be conferred bare of the rights and obligations which give it character. Mrs Kamhi was, for example, indemnified against her liability to pay service charges. However, argued Mr Mathew, it is the sublessee which benefits from those services; payments under the covenants are consideration for those services relevant to the use of the gift rather than benefits reserved to Mrs Kamhi. She was not indemnified against the consequences of her own actions, voluntarily undertaken.

12. The issue is, submitted Mr Mathew, what is the property given? He answers the question in this way: the obligation to comply with the covenants in the head lease, like the obligation to deliver up at the end of the sub-term, is an essential feature of the grant of a sub-tenancy and thus defines the property given.

13. Mrs Kamhi did not reserve any rent in the strict sense on the grant of the underlease. But the gift which she made was qualified by covenants other than rent. Mr Mathew argued that there is a difference in kind between a covenant to pay rent and a covenant to reimburse Mrs Kamhi for the service charges she had to pay her landlord, since the latter merely constituted a payment by the tenant for use of the facilities. Similarly all the other covenants, in particular those relating to repair, cleaning and redecoration of the premises, merely discharged Mrs Kamhi's liability to her landlord and were not of any substantial benefit to her.

14. I cannot accept Mr Mathew's submission for two reasons. The first one is that of principle and logic. Mrs Kamhi granted a limited property interest in land which was in effect conditional upon fulfilment of the covenants. Such a benefit is either a benefit referable to the property given or it is referable to the property reserved. The nature of a lease is not such that the obligations under the lease can be said to be part of the property given. Payment of rent and service charges is not an essential feature of a lease; the only essential feature is the grant of a right to exclusive possession for a finite period. It is possible to grant a lease without covenants. The covenants themselves do not constitute an interest in land.

15. The second reason is that Mr Mathew's submission is not in my judgment consonant with authority. In ***Ingram*** Lord Hoffmann said (at 304):

> "…a lease is a contract as well as an estate. It involves obligations between the parties enforceable in contract or by virtue of privity of estate. It cannot therefore be regarded as the mere reservation of property like a life interest. This is true and if, in addition to the leasehold estate which she reserved, Lady Ingram had obtained by covenant any additional benefits, as in *Re Nichols, decd* [1975] 1 WLR 534, they would have been benefits reserved. But in a case such as this, when she in fact received no such benefits, the contractual nature of the lease seems to me a matter of conveyancing theory rather than substance."

16. Thus the House of Lords in ***Ingram*** acknowledged the distinction between on the one hand, the grant of an estate in land while reserving another estate, which they held to be a grant of a limited interest rather than the grant of a larger interest with reserved benefit, and, on the other hand, the grant of an interest in land with reserved covenants.

17. Mr Mathew said that I should apply the principle of ***Munro v. Commissioner of Stamp Duties*** [1934] AC 61 and ***Oakes v. Commissioners for Stamp Duty for New South Wales*** [1954] AC 57 to the facts of this case. In ***Munro*** the

owner of a farm was a member of a partnership with his children to whom he had granted a licence or tenancy to occupy the farm. Some years later he gave the freehold interest to his children but continued to occupy the farm as a member of the partnership. The Privy Council held that the gift had been subject to the rights of the partnership so that the donor's occupation was by virtue of property which had never been included in the gift. However the facts of ***Munro*** are not comparable to the facts in the present case. In any event Mrs Kamhi's right to discharge of the service charge and other covenants was not independently granted to her by the settlement, before the gift of the underlease. The covenants were a term of the underlease. This contrasts with ***Munro*** where the donor was given an antecedent property interest coupled with an interest.

18. In ***Oakes*** it is true that relief from a burden was held not necessarily to constitute a benefit for the purposes of an equivalent section. As explained in ***Chick***, however, that related to receipt of a benefit by contract or otherwise and was irrelevant to the question of whether the donor had been excluded from the property given. The Commissioner for Stamp Duties had argued that the donor had derived a benefit from the fact that he had applied the trust income in the maintenance of his children so that, if it had not been available, he would have spent more of his own money. While accepting that there was some advantage to the donor, the Privy Council held that such an advantage was not of benefit to the donor. In ***Chick*** the Privy Council explained this finding as follows:

> "it must be observed that in *Oakes*' case the Board appears to have been dealing with the second limb of the subsection, the question being whether the donor was entirely excluded from any benefit to him of whatsoever kind or in any way whatsoever. It is possible that in the consideration of this very difficult part of the subsection it may be pertinent in some cases to inquire whether the benefit derived by the donor is one that impairs or detracts from the donee's enjoyment of the gift. Their Lordships, with great respect, think that this is a matter which may require further examination, but, as they have already said, they are clearly of opinion that it is not a relevant consideration where the question arises under the first limb of the subsection and is whether the donor has been entirely excluded from the subject-matter of the gift, and they repeat that in the present case that question can only be answered in the negative."

19. In ***Oakes*** itself the reservation of income by way of remuneration out of the gifted property was held to be a reservation at the expense of the interest that was given away. I should say that in the present case it has not been made entirely clear (and it is not common ground) whether the case is said to come within the first or the second limb of s. 102(1)(b), namely whether the gifted

property is said not to have been enjoyed to the exclusion of the donor or whether it is said that there is a benefit to the donor by contract or otherwise. It seems to me that potentially it is both.

20. In ***Earl Grey v. Attorney-General*** [1900] AC 124 (see also the reasoning of the Court of Appeal under the name ***Attorney-General v. Lord Grey*** [1898] 2 QB 534, approved by Lord Shand (at 127)), a donor's right to continue to occupy a house standing on the land given to his son was a benefit reserved out of the gifted property contravening the first limb of s. 102(1)(b) while the son's covenant to pay him a rentcharge and other expenses constituted a benefit to the donor by contract or otherwise in contravention of the second limb.

21. In ***Re Nichols decd*** [1975] 1 WLR 534, a donor transferred his freehold estate to his son with a lease back on the same day. It was held that the covenant to repair in the lease back was not something simply not given and, as a covenant operative and running with the land, it was reserved out of that which was given. The donee could not therefore say that he retained possession of the gifted property to the entire exclusion of the donor or of any benefit to him. The Court of Appeal said (at 543),

> "It appears to us to be just as much a benefit taken by the donor out of that which was given as the power to charge remuneration in the *Oakes* case…"

22. Mr Mathew seeks to distinguish ***Nichols*** (and ***Grey***) on the basis that the repairing covenant did not previously exist (see 543 G of the report and p 303B of ***Ingram***) so that the case is concerned with additional benefits only and has no application to covenants which merely mirror covenants in the head lease. However the important point about the covenants in the present case is not that similar (not of course the same) covenants were contained in the head lease but that the covenants had (and I quote from the judgment of Millett LJ in the Court of Appeal in ***Ingram*** [1997] STC 1234 at 1268,

> "…the effect of transferring to the trustees a liability which would otherwise have been borne by [the donor]."

He had previously explained ***Nichols*** in the following terms:

> "In *Nichols* the lease contained a full repairing covenant by the donee. The right to have his property repaired at the donee's expense was held to be a benefit which the donor did not enjoy before."

23. I find that the Tribunal below correctly decided that this case was on the side of the line of ***Oakes***, ***Worrall***, ***Grey*** and ***Nichols***. The covenants were a reservation from the property given away, and I emphasise that in referring to the property I do not mean the physical flat but the reversionary leasehold interest granted by the underlease.

24. For completeness sake I turn to the specific grounds of appeal. The first is that the decision of the First-tier Tribunal failed to give proper weight to the scheme and purpose of s. 102 in the context of the mischief at which it is directed. Mr Mathew takes the purpose from Lord Hoffmann's speech in ***Ingram*** at 305 cited above. It is common ground that the issue is not only whether Mrs Kamhi did precisely define what she had given away but in particular whether the benefits she reserved were referable to the specific proprietary interest which she retained.

25. Mr Mathew argued for a purposive interpretation of the legislation, since he said that a literal interpretation means that any grant of an underlease by a leasehold owner would be ineffective as a potentially exempt transfer. It cannot, he asserted, be intended that any transaction by a leasehold owner would be caught. This argument is to some extent circular in that the question under consideration is whether such a gift can be fiscally effective. It does not assist to start from the premise that it must be.

26. The purposive construction for which Mr Mathew contends is that covenants which simply mirror those in the head lease are not benefits enjoyed by the donor. However I agree with the First-tier Tribunal that this is an essential difference between an assignment of the lease and the grant of an underlease. While it is true that the donor may remain liable to the head lessor, Mrs Kamhi could and did, under the terms of the underlease, pass her liability on to the trustee who was in effect underwriting her liability.

27. The appellants' second ground was that Mrs Kamhi received no benefit within the meaning of s. 102. It was submitted that it is primarily for the benefit of the undertenant that it should perform the covenants in the head lease. This is so that it can enjoy the sub-demised rights without a forfeiture, and thus that it can deliver up the property at the end of the term in accordance with its obligation to do so.

28. I find this to be a false premise since the donor could in theory undertake the sole obligation to comply with the obligations in the head lease. The fact that,

without negotiation, the donor could not do so without contravening the terms of her head lease is in my view irrelevant.

29. Although it is common ground that benefit falls to be construed widely, it must be precisely identified. The First-tier Tribunal did specify the relevant benefit, namely the benefit to Mrs Kamhi of the trustee owing her covenants mirroring the covenants which she owed under the head lease: see paragraph 73 of the decision. This in my judgment reflects Millett LJ's analysis in the Court of Appeal in ***Ingram*** referred to above.

30. The appellants' third ground was that the gift was "in no way diminished in value or degraded in effect" by the alleged reservation. However it is not necessary that a reservation of benefit under s. 102 should diminish the value of the gift. Although there are dicta in ***Oakes v. Commissioners for Stamp Duty for New South Wales*** [1954] AC 57 which support Mr Mathew's contention in this regard (see e.g. at 73-4) it is clear from the subsequent case of ***Chick v. Commissioner of Stamp Duties*** [1958] AC 435 at 449 that it is irrelevant whether full consideration has been given for the reservation of benefit:

> "If he has not been so excluded, the eye need look no further to see whether his non-exclusion has been advantageous or otherwise to the donee."

31. It is true that ***Chick*** goes on to explain what is said in ***Oakes*** on the basis that ***Oakes*** was considering the question whether the donor was excluded from separate benefit under the second limb of the relevant section rather than from the gifted property under the first limb.

32. In the present case Mr Mathew argues that HMRC are relying on the second limb alone. As I have said, this is not the case. The covenants must logically either be comprised in the property retained or in the property given away. In this case, unlike in ***Oakes***, the covenants were an integral part of the relationship between Mrs Kamhi and the trustee rather than some incidental benefit which was only tangentially referable to the gift. In any event it is hard to reconcile Mr Mathew's submission with the finding that a contractual benefit for full consideration may fall foul of the requirements even if it is not reserved out of the gifted property itself: see ***Attorney-General v. Worrall*** [1895] 1 QB 99, ***St Aubyn v. Attorney-General*** [1952] AC 15 at 47.

33. The appellants' fourth ground is that the tenants' covenants in the head lease would have been implied at law into the underlease if they had not been expressly incorporated. This is based on the premise that it is only if the

tenant complies with the covenants in the head lease that it will continue to enjoy the benefit of the sub-demise (as otherwise the landlord will forfeit the head lease) and comply with its obligation to deliver up the property at the end of the sub-term.

34. However in my judgment it is a fallacy to say that the covenants are therefore implied into the sub-lease. They are not. The sub-lease remains whether or not the covenants are complied with. The landlord may choose not to forfeit and to enforce his rights against the donor.

35. As Mr Slater pointed out, the law implies very few covenants by the tenant into leases: the covenant to yield the premises up at the end of the lease, the covenant to pay rates and taxes; the covenant not to commit waste and to permit a lessor obliged to do repairs to enter and view the state of repair of the premises. In this case the covenants, while no doubt ordinary ones, are not covenants that would necessarily be implied. While there may be scope for argument about such matters as returning the premises at the end of the term in the same state as at the start (I make no finding in that regard), the covenants go much further than that. For example there is an obligation to redecorate the premises every five years and to clean the windows at least once a month. If covenants of this kind were necessarily implied, they would always arise out of the reversionary interest and could always be included.

36. I therefore agree with the Tribunal below that mirror covenants would not necessarily have been implied into the underlease granted by Mrs Kamhi if she had not expressly reserved them. It is, as the Tribunal said, far from obvious that a person making a gift would intend to reserve such covenants.

37. Mr Slater argued that Mrs Kamhi could have granted a leasehold estate to Ovalap without falling into s.102 if, but only if, the leasehold estate contained no rights in favour of Mrs Kamhi beyond those which are inherent in or an incident of that leasehold estate. Ovalap's agreement to bear certain liabilities of the donor was not so inherent and therefore constituted a reservation of benefit. Thus the First-tier Tribunal was right to find that a reservation of covenants, such as the covenant to pay the service charge reserved by the head lease, means that the underlease is not enjoyed to the exclusion, or virtually the entire exclusion, of the donor and any benefit to her by contract or otherwise.

38. Another ground of appeal, which overlaps with the previous one, is that benefits which merely relieved Mrs Kamhi from burdens were insufficient to attract s. 102. Mr Mathew contended that as Mrs Kamhi was liable to her landlord in respect of identical covenants she was doing nothing more than

protecting her interest under the head lease by granting a right of occupation subject to the same covenants.

39. Mr Slater relied on cases in a different context as showing that relief from burden is generally regarded as a benefit: ***Re Clore's Settlement Trusts*** [1966] 1 WLR 955, ***Re Hampden's Settlement Trusts*** [2001] WTLR 195, ***Armsprop Trading Ltd v. Harris Distribution Ltd*** [1997] 1 WLR 1025. In the light of ***Oakes*** I do not find these decisions of assistance in the present context. However there is also more direct authority: see the observations of Lord Halsbury LC in ***Grey v. Attorney-General*** [1900] AC 124 at 126, the observations of Millett LJ in the Court of Appeal in ***Ingram*** at 1268 (cited above) and the observations of Lightman J in ***Commissioners of Inland Revenue v. Eversden*** [2002] EWHC 1360 (Ch), affirmed [2003] EWCA Civ 668.

40. The judgment of Millett LJ in ***Ingram*** is not binding on me as the House of Lords reversed the decision of the Court of Appeal. Millett LJ dissented in that lower court but the terms of his judgment were not expressly approved by the House of Lords. However his judgment is obviously extremely persuasive. I observe that under the heading "*Was the property given enjoyed to the entire exclusion of any benefit to Lady Ingram by contract or otherwise?*", Millett LJ, having considered ***Earl Grey***, ***Oakes*** and ***Nichols***, said (at 1268 h-j),

> "…I conclude that to come within the scope of the second limb of s. 102(1)(b) the benefit must consist of some advantage which the donor did not enjoy before he made the gift, and that it is not sufficient if it consists merely of the property which he owned before the gift and which was not included in it."

41. While I see merit in all Mr Mathew's arguments taken independently of each other, the heart of his argument is to my mind fallacious. It is that since the covenants were an inherent part of the character of the property which Mrs Kamhi gave away they could not constitute benefits to her for the purposes of s. 102. The answer is the simple one that, to quote Millett LJ, there was a benefit to her by transferring to the trustee of her settlement a liability which she would otherwise have borne.

42. The basis of my judgment means that there was no enjoyment "virtually" to the entire exclusion of the donor either.

43. The appeal therefore fails.

The Hon Mrs Justice Proudman DBE

RELEASE DATE: 19 OCTOBER 2012