The Personal Tax Planning Review

# "CARBOLIC SMOKE BALL PROTECTS AGAINST INFLUENZA" OR *LADY INGRAM* IN THE HOUSE OF LORDS

Robert Venables QC[1]

## 1 Introductory

### 1.1 The House of Lords Decision

On 10th December, 1998, the House of Lords unanimously allowed the Executors' appeal from the majority decision of the Court of Appeal in *Lady Ingram's Executors v Commissioners of Inland Revenue* [1997] STC 1234. The case concerned a "lease carve-out" scheme effected by Lady Ingram in March 1987 which involved a grant of a lease to her by her trustee, followed by a gift of the freehold reversion. The question was whether it was effective to avoid the inheritance tax gifts with reservation of benefit provisions ("the Provisions") on her death less than two years later. Their Lordships held not only that it was effective but that it would have been equally effective had the method used been that of a conveyance to the donees subject to an obligation imposed on them to grant a lease back, a method which had been eschewed in this case on account of dicta in the Court of Appeal decision in *Nichols v IRC* in 1974.

Their Lordships considered the policy behind the Provisions and concluded that they were intended merely to prevent tax evasion by the making of pretended gifts. They were not intended to prevent a person making a gift of a partial interest in physical property and continuing to enjoy it by virtue of a retained interest.

Their Lordships did not in their speeches express any view about *Ramsay* or *McGuckian*. The Revenue admitted that they could not succeed on *Ramsay* alone,

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but had to succeed also on the *Nichols* point. As their Lordships held the Revenue failed on that point, it was indeed not necessary for them to discuss *Ramsay* and their decision is thus not technically an authority on *Ramsay* at all.[2] Some of their Lordships did have something to say about *Ramsay* and tax avoidance in the course of the argument. These dicta will be most useful to practitioners in indicating which way the wind is blowing.

Their Lordships also held that a lease granted by a trustee to his sole beneficiary, or vice versa, is valid at law. While this is of immense significance to Chancery lawyers, it is of limited interest to tax advisers and is not discussed in this article.

### 1.2 The Author's Personal Position

The decision was triply welcome to me, quite apart from my involvement as Leading Counsel for the Executors. Firstly, it was the only time in my career that there had been challenged in Court a tax planning strategy which I had advised in advance would work. Moreover, I had believed, in 1986, that it was unassailable, both as a matter of tax law and of Chancery law. *Lady Ingram* therefore risked being my *Titanic*. One of the reasons I spend so comparatively little time in court is that I try in general to persuade my clients to adopt only strategies which are difficult for the Revenue to attack. If they are implemented and then attacked, I believe in putting one's strongest case forward in correspondence and persuading the Revenue to cave in rather than litigate. For, as *Lady Ingram* has shown, no argument is so strong that some judges may not reject it, especially if the other party is the Inland Revenue.

Secondly, in my view, and in that, it seems, of virtually the whole of Lincoln's Inn, the decision of the majority of the Court of Appeal was fundamentally wrong as a matter of both tax law and of trust law. The appeal was one which there was little honour in winning and enormous dishonour in losing. The reader will find no self-congratulation in this article; merely relief that justice has eventually been done.

Thirdly, in a letter published in a journal of an association of estate and trusts practitioners, I had been compared to the purveyors of the infamous Carbolic Smoke Ball, fraudulent quacks who promised to pay £100 to anyone who caught influenza

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2 The dissenting judgment of Millet LJ, as he then was, in the Court of Appeal considered the *Ramsay* point in full: [1997] STC 1234 at 1269b-1271a. It was respectfully - and gratefully - adopted by me as part of my argument before the House of Lords. As neither of the other Lords Justices in the Court of Appeal expressed any view on *Ramsay*, Lord Millett's judgment remains authoritative. Lord Millett was Leading Counsel for the Inland Revenue in *Ramsay*. If it was the House of Lords which gave birth to the doctrine, it was he who, to use a Socratic term, was the midwife. Anything he has to say about *Ramsay* is therefore entitled to particular respect.

after using their product as directed and who then fired a volley of outrageous, albeit ultimately unsuccessful, defences against a Mrs Carlill when she sued for her £100.[3]

### 1.3 Should this Article be Published?

Should a barrister who has been involved in a case write about it afterwards? There is admittedly something to be said in favour of his retaining a dignified silence. Yet if, like myself, he is the author of works which have gone into several editions[4] and the decision is one of the House of Lords on a point which is of continuing relevance, it is difficult to see how he can avoid discussion of the case. The problem is that if he is on the losing side, any article written by him risks being characterised as the outpourings of a disappointed counsel. And should he happen to be on the winning side, he can be accused of crowing.

Counsel involved in a case has a unique insight into it. He should be thoroughly on top of the case and its background, especially when it has been argued before the Lords. He can explain the inwardness of the arguments and the sub-text of the decision. He can in some cases, such as *Lady Ingram*, discuss what was said by the judges in argument, which will rarely be otherwise reported. Of course, he may be biassed, yet that is not to my mind an insurmountable objection, provided he discloses his involvement so that the reader is prepared for a possible partiality.

## 2 The Facts[5]

### 2.1 The Background

At the end of March 1987 Lady Ingram was 73 years of age. By a deed of gift made in 1946 her father, James Edward Palmer-Tomkinson, had conveyed to her the freehold of Hurst Lodge, together with some adjoining and adjacent land, all of which was unregistered and amounted in the aggregate to 61 acres or thereabouts. In 1986 Lady Ingram sought Mr Macfadyen's advice as to making lifetime gifts of this property and a further area of land of about 46 acres in the neighbouring parish of Whistley Green, the title to which was registered, in favour of her three daughters

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3 See *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256, CA, which, by a curious coincidence, was cited by me in *Schuldenfrei v Hilton* [1998] STC 404, currently on appeal to the Court of Appeal.

4 In the case of *Marshall v Kerr* 67 TC 56, my *Non-Resident Trusts*; in the case of *Lady Ingram*, my *Inheritance Tax Planning*.

5 This statement of the facts is taken from the judgment of Nourse LJ in the Court of Appeal.

and the children of her deceased son. She was aware that, with the introduction by the Finance Act 1986 (the 1986 Act) of transfers which were potentially exempt from inheritance tax, it could well be advantageous to the donees for her to make lifetime gifts in their favour. At the same time, she wished to retain actual occupation of the land or, in the case of let property, the right to receive the rents. After taking advice from counsel specialising in revenue matters and instructed by Mr Macfadyen[6] on her behalf, Lady Ingram decided that she would make a gift of her freehold interest in the property, subject to a leasehold interest for the next 20 years at no rent which she would retain for herself. Acting on her instructions, Mr Macfadyen prepared the necessary documentation.

2.2 The Transactions

The first step was the execution by Lady Ingram, on 29th March 1987, of a conveyance of the unregistered land and a transfer of the registered land in favour of Mr Macfadyen. Each of those instruments was, in form, an out and out voluntary disposition of the property comprised therein. However, also on 29th March, Mr Macfadyen executed two deed polls, described as declarations of nomineeship, each of which recited that the property had been conveyed or transferred to him upon trust as thereinafter mentioned. By the operative part of each deed Mr Macfadyen declared that he held the property as nominee for Lady Ingram and agreed that he would transfer it to her at such time and in such manner or otherwise deal with it as she should direct or appoint. In the result Mr Macfadyen held the unencumbered freehold interest in the property in trust for Lady Ingram absolutely. There being for present purposes no material difference between the relationships of trustee and beneficiary on the one hand and nominee and principal on the other, I will adopt the terminology used by the parties and refer to Mr Macfadyen and Lady Ingram as nominee and principal respectively.

On the following day, 30th March, Mr Macfadyen, at Lady Ingram's direction, executed two leases, together comprising the whole of the property, in favour of Lady Ingram as tenant for a term of 20 years from 30th March 1987 free of rent. One of them comprised Hurst Lodge, its surrounding land and some neighbouring cottages and the other a separate piece of agricultural land at Hurst and the agricultural land at Whistley Green. Each of them contained covenants by Lady Ingram in a form appropriate to the property comprised in it which it is not suggested did not impose real obligations on her. Each contained an absolute covenant against assignment, underletting, charging, or parting with or sharing the possession or the occupation of the whole or any part or parts of the property. There were also covenants to permit the landlord to enter to do repairs himself and,

6 RV's note: now of Charles Russell.

in the lease of the agricultural land, to deliver up the property at the end of the term in good and substantial repair and condition. In the lease of Hurst Lodge there was a covenant to deliver up the property in such good and substantial repair and condition as was evidenced by the schedule of condition of the property attached thereto. By neither lease was any greater obligation imposed on Lady Ingram to do repairs herself. The only covenant on the part of the landlord was for quiet enjoyment. There was a proviso for forfeiture for breach of covenant.

On the following day, 31st March, again at Lady Ingram's direction, Mr Macfadyen executed two conveyances and a transfer conveying and transferring the freeholds in the various parts of the property to Michael Warren Ingram, Christopher David Palmer-Tomkinson and David Michael Ingram (the trustees). Each of those instruments stated that the property to which it related was conveyed or transferred to the trustees 'to hold ... on trusts declared concerning the same'. Each of them was expressed to take effect subject to and with the benefit of the relevant lease in favour of Lady Ingram. Also on 31st March the trustees executed two declarations of trust, again expressed to be subject to the relevant lease or leases, under each of which the property was declared to be held on trust for sale and immediate absolute interests in the proceeds of sale were declared in favour of Lady Ingram's three daughters and the trustees of a settlement made on 29th March 1987 for the benefit of the children of her deceased son and known as Robin Ingram's children's 1987 settlement. She herself could not in any circumstances have benefited under or by virtue of the declarations of trust, although in each case the property comprised therein could not be sold during her lifetime without her written consent.

## 3 The Statute

Finance Act 1986 section 102 provides:

> "(1) ... this section applies where ... an individual disposes of any property by way of gift and either:
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> (a) possession and enjoyment of the property is not bona fide assumed by the donee at or before the beginning of the relevant period; or
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> (b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise;

and in this section "the relevant period" means a period ending on the date of the donor's death and beginning seven years before that date or, if it is later, on the date of the gift."

## 4 The Arguments on the GROB Rules

### 4.1 The Executors' Case

The case for the Executors was a very simple one. In determining whether property is enjoyed to the exclusion of the donor one must ascertain what is the property gifted; in this case it was a reversion expectant on a twenty-year lease, which leasehold interest Lady Ingram never gave away. If the donor merely enjoys a benefit from that which he has never given away, the section is not brought into play. It is immaterial whether the donor "retains" an interest which subsisted separately prior to the gift or was created contemporaneously with it. In this case, while Lady Ingram continued to enjoy the benefit of the lease, partly through personal occupation of the demised land and partly by collecting rents from sub-let properties, that was not a benefit which trenched on possession and enjoyment of the freehold reversion by the donees. Even if she had not had a lease before the gift, the lease was not given to her by the donees out of the property which had been gifted to them.

### 4.2 The Revenue's Arguments

#### 4.2.1 The Notice of Determination

The Revenue advanced different arguments at different stages. In correspondence, the Capital Taxes Office claimed that the leases were void, citing the Scottish authority of *Kildrummy v IRC*,[7] and that the result was that Lady Ingram had thus given away the unencumbered freehold on 31st March 1987. If that were correct, then her continued occupation and collection of rents would have amounted to a reservation of benefit over the gifted property. The Notice of Determination reflected this. It also raised a doomed argument on associated operations, which was never seriously pressed by Counsel and was conceded in the Revenue's Printed Case in the House of Lords to be unsound.

#### 4.2.2 The Retained Immediate Interest Point

We were fortunate in that the Revenue instructed as Counsel experienced Chancery

7 [1990] STC 657.

practitioners, Edward Nugee QC and Michael Furness. They readily admitted that, on the basis that the leases of 30th March were void, the trustees and their beneficiaries could not in Equity have taken more than Lady Ingram intended to give them. They therefore accepted that, even assuming those leases to be void, Lady Ingram obtained at the very least equitable leases, on the same terms as the void leases, at the latest contemporaneously with the gift of the freeholds on 31st March. Their main argument before Ferris J and the Court of Appeal was that, while accepting the general principle for which the Executors contended, there was an exception where there is the creation at the time of the gift of an immediate limited interest in favour of the donor, i.e. one giving him a right to the present enjoyment of the property; in that case, they argued, there is a reservation of benefit over the whole of the property before its division into different interests. This was an argument which persuaded none of the judges.

4.2.3 The *Nichols* Point

In the Court of Appeal, Nourse LJ advanced another argument, which was adopted by the Revenue. This relied on the New South Wales case of *Lang v Webb* (1912) 13 CLR 503, decided in the High Court of Australia, which he kindly drew to Counsels' attention, and dicta of the Court of Appeal in *Nichols v IRC* [1975] STC 278. Nourse LJ, together with Evans LJ, accepted the Revenue's new submission. Nourse LJ said, at page 1241:

> "Of the two authorities where the two transactions were simultaneous it is convenient to deal first with *Nichols*. In that case a father, in 1954, had decided to make a gift of his family home and the surrounding estate to his son, then aged 22. It was arranged that the father would transfer the whole estate to the son, who would immediately lease the bulk of the property back to the father, the lease to contain a full repairing covenant on the part of the son. The gift of the freehold took effect on 24th June 1955, but the lease did not take effect until 16th July of that year, when it was not in its original form but contained, in addition, a covenant by the son to pay the tithe redemption annuity charged on the property. The father continued to live in the family home and to enjoy the property comprised in the lease, paying less than a rack rent, until his death in 1962.
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> "The Crown claimed estate duty on the father's death in respect of the freehold, primarily on the ground that the lease back had prevented it from being enjoyed to his entire exclusion. The son argued that the father had given him the freehold subject to an equitable obligation to grant a lease back, and that the property disposed of accordingly consisted of the reversion expectant on the determination of the lease. Walton J at first

instance accepted that, if the son had indeed been under an equitable obligation to grant the lease back, the property disposed of would have been the reversion. However, he held that there was no such obligation, so that the property disposed of was the freehold, which, not having been enjoyed to the entire exclusion of the father, was dutiable accordingly. On the son's appeal to this court, it was held that he had been under an equitable obligation to grant the lease back but that, even if the reversion had been possessed and enjoyed to the entire exclusion of the father, the son's full repairing covenant and, it would appear, his covenant to pay tithe redemption annuity were benefits to the father by contract or otherwise within what is now the second limb of s 102(1)(b), so that the freehold was dutiable accordingly.

"The judgment of this court (Russell, Cairns LJJ and Goff J) was delivered by Goff J. Having referred to the gift of the freehold and the material estate duty provisions, they stated the three problems thereby posed which, for the sake of convenience, I have numbered (see [1975] STC 278 at 280, [1975] 1 WLR 534 at 538):

> '... [1] whether all that was given was the beneficial interest in the estate shorn of the benefit of the rights and interests of the donor under the lease back, in which case, prima facie, the gift must fall outside the statutory provision, or [2] whether the gift was of the whole beneficial interest in the property, in which case it is not disputed that the lease back must have prevented the son from assuming bona fide possession and enjoyment immediately upon the gift to the entire exclusion of the father, and also [3] whether the covenants in the lease are such that in any case the son cannot be said to have assumed such possession and enjoyment to the entire exclusion of any benefit to the father by contract or otherwise within the meaning of the section.'

"Problems (1) and (2) arose in the application of what is now the first limb of s 102(1)(b) and problem (3) in the application of the second limb.

"The judgment contains a thorough review of *Earl Grey v A-G*, *Cochrane*, *Munro Perpetual Trustee* and *Oakes*. It does not refer to *St Aubyn* nor to *Lang v Webb*. There then appears this important passage (see [1975] STC 278 at 284-285, [1975] 1 WLR 534 at 543):

> 'Having thus reviewed the authorities, we return to the question what was given, and we think that a grant of the fee simple, subject

> to and with the benefit of a lease back, where such grant is made by a person who owns the whole freehold free from any lease, is a grant of the whole fee simple with something reserved out of it, and not a gift of a partial interest leaving something in the hands of the grantor which he has not given. It is not like a reversion or remainder expectant on a prior interest. It gives an immediate right to the rent, together with a right to distrain for it, and, if there be a proviso for re-entry, a right to forfeit the lease. Of course, where, as in the *Munro* case, the lease, or, as it then may have been, a licence coupled with an interest, arises under a prior independent transaction, no question can arise because the donor then gives all that he has, but where it is a condition of the gift that a lease back shall be created, we think that must, on a true analysis, be a reservation of a benefit out of the gift and not something not given at all.'

"The court then said that it was unnecessary to reach a final conclusion on the point, since there were two unanswerable reasons why the case was caught by the statutory provision, i e the full repairing covenant on the part of the son and his covenant to pay tithe redemption annuity.

"The observations in that important passage were directed to what is now the first limb of s 102(1)(b). What was being said, in the words of the provision itself, was that where there is a gift of the freehold conditional on the grant of a lease back the freehold is not enjoyed to the entire exclusion of the donor. Although *Lang v Webb* was not referred to in the judgment, it was cited in argument and is recorded by Walton J as having been strongly relied on by counsel for the Crown before him, especially the judgment of Isaacs J (see *Nichols v IRC* [1973] STC 497 at 501, [1974] 1 WLR 296 at 299). It is therefore natural to assume that it was strongly relied on by the Crown in this court and that their observations were, at least to some extent, influenced by it.

"In *Lang v Webb* the case stated recorded that in 1908 the deceased had transferred and conveyed a piece of land to each of her three sons; that on the same date as, but subsequently to, the execution of the transfers and conveyances there had been executed by the deceased and each of her sons a lease back for a term of five years of the land which had been transferred and conveyed to him; and that the transfers and conveyances and leases had been executed after discussion and arrangement between the deceased and her three sons and after she had explained to them that she desired to make fixed and permanent provision for them and at the same time to take from

them leases at whatever might be a reasonable rental for grazing purposes having regard to the conditions of the leases, those conditions and the amounts of the rents having been discussed and agreed before the execution of any of the documents. There were further findings to the effect that the rents reserved were in each case fair and reasonable and that after the execution of the documents the whole of the land continued to be occupied by the deceased and was used by her for grazing purposes. On the deceased's death in 1910, before the expiration of the leases, a claim for death duties was made in respect of the freehold, that claim being upheld by the High Court of Australia (Griffith CJ, Barton and Isaacs JJ) (see (1912) 13 CLR 503).

"It is not possible to reconcile all the observations made by the three members of the court. Certainly, the clearest reasoning appears in the judgment of Isaacs J. He agreed (at 514) that in order to find out what is given, it is the real transaction which must be looked at and not merely the form which it takes. He said (at 515):

> 'But there must be no misunderstanding as to what is meant by the transaction ... in the relevant sense it means that you regard the substantial effect of the "conveyance, assignment, gift, delivery or transfer", by which the gift was made. If by an instrument, as in this case, you look at the instrument by which the property passes from the donor to the donee, and, disregarding mere form, ascertain its real effect. What does it give, not how does it give it? In this case the gift is made by the indenture executed by Henrietta Lang, and by that the whole of her estate in the lands was given without any exception or reservation whatever. That was the transaction of gift - complete in itself and unqualified. No other construction is possible. It had to be complete before the donee could execute to her the lease of the property. A lease is a conveyance; and it is more than form, it is substance, when the donor's interest has to be vested in the donee before the donee can convey a smaller interest.
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> That smaller interest was comprised in the gift itself, it was part of it, and is quite different from the case of *Re Cochrane*, where the trust of surplus income and the ultimate contingent trust of corpus were expressly retained by the donor for himself on the face of the instrument, and never in any shape or form included in what he gave.'

"Those observations can be summarised by saying that the property disposed of was the freehold interest in the land because the disposition of that interest had to be complete before the lease back could be granted; that that was a matter of substance and not of form; and that the leasehold interest, having been an interest smaller than the freehold, was comprised in the gift itself and was part of it. This analysis explains and is entirely consistent with the observations of this court in *Nichols*.

"Mr Venables QC, for the executors, submitted, correctly, that those observations, having been unnecessary to this court's decision of the case, were obiter. He further submitted that they were wrong and was even disposed, initially, to suggest that there were good reasons for our not attaching to them the weight we would instinctively attach to any observations of a division of this court thus constituted. I cannot accept that submission. Being in complete agreement with the analysis of Isaacs J, I am satisfied that the observations of this court were correct, although I would not myself attach weight to the rights of the landlord to the rent, to distrain for it and to forfeit the lease. The question then is whether those observations apply to the transactions in the present case.

"Adapting the language of problem (1) as posed by this court in *Nichols* (see [1975] STC 278 at 280, [1975] 1 WLR 534 at 538), I state the executors' case to be that 'all that was given was the beneficial interest in the [property conveyed and transferred by Mr Macfadyen to the trustees on 31st March] shorn of the benefit of the rights and interests of [Lady Ingram] under the [trustees' equitable obligation to treat her in all respects as if the leases had been valid]'.

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"The principal right and interest which Lady Ingram would have had against the trustees was a right to possession of the property. That right mirrored the trustees' obligation to afford her possession. That obligation, just like an obligation to grant her a lease had there been one, was one to which the trustees only became subject when the freehold interest was vested in them. Thus the correlative right or interest in Lady Ingram, just like her interest under a lease had there been one, was, in the language of Isaacs J, a smaller right or interest comprised in the gift itself and part of it. For these reasons, unless there is any other objection, I would hold that the property disposed of was the freehold interest in the property and that the nature of Lady Ingram's rights and interests against the trustees was such that the freehold interest was not enjoyed to her entire exclusion."

### 4.2.4 The House of Lords

In the House of Lords the Revenue more or less abandoned the Retained Immediate Interest Point and focused on the *Nichols* point.

## 5 The House of Lords Decision on *Nichols*

The House of Lords took the contrary view to that of the majority of the Court of Appeal. I had submitted that the decision of Walton J at first instance in *Nichols* was correct: that if the donee took the legal estate subject to an immediately binding equitable obligation to grant a lease back, then the donee was never in equity entitled to an unencumbered freehold. The equitable lease which the donor took was never given away; nor was it taken back from what had been given away. One reached the contrary result only if one concentrated on the conveyancing and ignored the substance. A person who owns a freehold has the right to enjoy the property in perpetuity. One who owns a twenty-year lease has the right to enjoy it for twenty years. Lady Ingram's gift in this case was of the right to enjoy the property from twenty years ahead in perpetuity. The fact that there was in existence a lease and therefore a relationship between donor and donee was irrelevant unless that gave the donor something she had not had before. If, indeed the donee had covenanted to repair the demised premises, the donor would have had something she did not have before. Yet that was not the case here.

Lord Hoffmann gave a speech with the reasoning of which Lords Browne-Wilkinson, Steyn and Clyde concurred. Given the complexity of the argument, it was surprisingly concise. Lord Hutton gave a fully reasoned speech of his own. While it does not differ from Lord Hoffmann's in any material respect, it contains useful quotations from key passages in the authorities.

Lord Hoffmann stated:

> "The theme which runs through the cases is that 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."

He added, in the context of the policy behind the Provisions:

> "Section 102 does not therefore prevent people from deriving benefit from

> the object in which they have given away an interest. It applies only when they derive the benefit from that interest."

On the *Nichols* point, he preferred the reasoning of Walton J to that of the Court of Appeal and Isaacs J in *Lang v Webb*.

## 6 The Policy behind the GROB Provisions

The precise policy behind the Provisions has been a matter of precious little speculation. In the Court of Appeal, Evans LJ had said of my submissions: "I would be prepared to hold in any other context that this produces a result which is so clearly at variance with the apparent object of s 102 that it cannot be regarded as a proper interpretation of the section."[8]

In the House of Lords, I submitted that section 102 was designed to prevent a donor from enjoying a *gratuitous* benefit over what he had gifted and did not apply where he enjoyed a benefit by virtue of rights he had not purported to gift. It was a safeguard against fraud. If a donor purported to give away a property and then continued to live in it, claiming to be the gratuitous licensee of the donee, there might well have been some secret bargain between the parties that the donor should be permitted to remain there, yet it could be one which it was difficult for the Revenue to prove. I cited the only two passages which deal with the point, both in non-English cases. The first was *In Re Cochrane* [1906] 2 IR 200 per Fitzgibbon LJ at 203: "If a man purporting to make to a gift to his daughter tries, Ananias-like "to keep back part" of it for himself .... that is the mischief at which the Act aims."[9] My second citation was of Isaacs J in *Lang v Webb* (1912) 13 CLR 503 at page 513.

Lord Hoffmann said:

> "What, then, is the policy of section 102? It requires people to define precisely the interests which they are giving away and the interests, if any, which they are retaining, Once they have given away an interest they may

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8 He in fact went on to hold that it was not the proper interpretation of the section, but only as the result of a reasoned judgment.

9 The reference is to *The Acts of the Apostles* Chapter 5. Ananias, under pressure from St Peter, sold his possessions, ostensibly in order to gift the entire proceeds to the Christian church. He kept part back, was cursed by St Peter and fell down dead on the spot, apparently without any human intervention. Happily, St Peter's soi-disant successor uses more orthodox methods to increase church income.

not receive back any benefits from that interest. In *Lang v Webb* (1912) 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."

## 7 Tax Avoidance

Evans LJ was quite convinced that Lady Ingram had been guilty of tax avoidance. I submitted before the House of Lords that, applying the test in *IRC v Willoughby*, which had been decided in the Lords after *Lady Ingram* had been argued in the Court of Appeal, that she had not. Tax avoidance is "a course of action designed to conflict with or defeat the evident intention of Parliament". See *IRC v Willoughby* [1997] 1 WLR 1071 per Lord Nolan at 1077F-1080G, especially 1079B-H. In this case, Parliament had decreed that a gift made more than seven years before death which did not fall foul of the gifts with reservation of benefit rules should escape inheritance tax. Lady Ingram was doing no more than "[taking] advantage of a fiscally attractive option afforded to [her] by the tax legislation". Her gift of a freehold reversion was no more than "the acceptance of an offer of freedom from tax which Parliament has deliberately made".

I further submitted that Lady Ingram had indeed changed her position. Inheritance tax is not, like the general rates or the Community Charge or the Council Tax, a tax on the occupation of land. It is not, like value added tax or duties of customs and excise, a tax on consumption. It is a tax on gifts and Lady Ingram had made a genuine gift. This case was at the opposite end of the spectrum from *Ramsay*.

Mr Edward Nugee QC cited the key passage in *Willoughby* to their Lordships. Surely, he argued, there was tax avoidance here: was not Lady Ingram sitting in dignity in Hurst Lodge as much on 1st April as on 30th March 1987? Nothing had really changed except that a tax advantage had been, it was hoped, obtained. He had now heard my submissions on this point three times and found them risible. "*Dis aliter visum*". As Lord Steyn gently but firmly put it to him: "This is not tax avoidance."

## 8 Substance and Form

Nowadays, courts interpret taxing statutes whenever they can in such a way as to ensure that transactions which are in substance the same are taxed the same and that liability to taxation does not depend on form, rather than substance.[10] The decision in *Lady Ingram* is helpful in showing that this can work in favour of the taxpayer, as well as against him.

The Revenue's argument was that, *Ramsay* apart, if the leases granted to Lady Ingram on 30th March were indeed valid, then there was no reservation of benefit, whereas if they came into being, whether at law or merely in equity, only contemporaneously with the gift, there was. As I pointed out, there were at least six different methods by which Lady Ingram could, from the conveyancing point of view, have made her gift, each putting everyone in precisely the same position come 1st April. If the Revenue were right, one of those ways produced a penal charge to tax whereas the others did not. As Lord Hoffmann said *arguendo*, this looked like *Ramsay* in reverse, the triumph of form over substance. It is not surprising that their Lordships rejected the dicta in *Nichols* which lead to this result.

Lord Hoffmann said in his speech:

> "It is a curious feature of the debate in this case that both sides claim that their views reflect the reality and not the mere form of the transaction. But the Revenue's version of reality seems entirely dependent upon the scintilla temporis[11] which must elapse between the conveyance of the freehold to the donee and the creation of the leasehold interest in favour of the donor. For my part, I do not think that a theory based upon the notion of a scintilla temporis can have a very powerful grasp on reality. ... Section 102 is concerned not with conveyancing but with beneficial interests. ... If one looks at the real nature of the transaction, there seems to be no doubt that Ferris J was right in saying that the trustees and beneficiaries never at any time acquired the land free of Lady Ingram's leasehold interest."

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10 Coincidentally, it was Lord Hoffmann who, in an after dinner speech given at a Key Haven residential conference in Oxford a decade ago, had warned specialist tax advisers not to be concerned only with technicalities, as the courts often took a broader view. Ten years ago that warning was very necessary. One would hope that nowadays the message has permeated through.

11 RV's note: literally "a sliver of time".

## 9 A Procedural Point

If the Revenue had succeeded on the points they in fact took, there would have ensued a most interesting argument as to whether it was possible or appropriate on an appeal against a Notice of Determination for the Revenue to ask the Court, as they would have had to, to vary their own Notice. While there is no doubt that on, say, an income tax appeal, the courts have power to increase the amount of tax assessed, the inheritance tax Notice of Determination procedure is couched in very different language. In my submission, the Revenue set out their position in the Notice in whatever terms they thinks fit; if the taxpayer chooses not to appeal against the whole or part of the Notice, then the Revenue are bound by it just as much as the taxpayer, even if the statute does not say so in express terms. Similarly, where a taxpayer has appealed against the whole or part of a Notice, the Revenue cannot ask for the whole or part of their own determination to be set aside and replaced with other determinations they did not make. This is a battle which will have to be fought another day.

## 10 The *Ramsay* Argument

### 10.1 The Revenue's Task

The Revenue accepted they had to succeed on the *Nichols* point, that is to establish that the conveyance of a freehold subject to a binding obligation to grant a lease back, involved a gift with reservation of benefit. They also accepted that they then had to show either that that was what happened here, because the leases granted on 30th March were void, or that the *Ramsay* principle required the events of 29th -31st March to be treated as having happened all at once so that Lady Ingram could somehow be treated as not having been entitled to leasehold interests before the gifts to the donees and as having been granted the leaseholds by the trustees for the donees.

### 10.2 *Craven v White*

To my mind, this was a very bold argument indeed and, while it was likely to fail, if it succeeded, the consequences would be very serious indeed for taxpayers in general. I submitted that it was quite inconsistent with the decided cases and that it was tantamount to inviting their Lordships not to follow the decision of their Lordships' House in *Craven v White*,[12] which rejected the Revenue's submission that *Ramsay* applies wherever there is a tax avoidance or a tax planning motive and

12 [1989] AC 398.

which established that *Ramsay* can apply only where steps are inserted which have no purpose other than the avoidance of tax. There were no such inserted steps here. The requirement that steps must be inserted for a tax avoidance purpose was expressed in *Furniss v Dawson* [1984] AC 474 and was endorsed in *Craven v White* [1989] AC 398. The ratio of *Furniss* was identified (and approved) as imposing, as a limitation on the operation of the *Ramsay* principle, the requirement that "there must be steps inserted which have no commercial (business) purpose": see Lord Keith at 477D to 480B, in particular 479A-B and 479D-E; Lord Templeman at 487D-F and 492D-G; Lord Oliver at 497F-G, 514F-515A; 516E-G; Lord Jauncey 530F-H.

I further submitted that, similarly, in *Craven v White*, their Lordships' House had rejected the Crown's contention, at 460F-461, that the "developing" doctrine was open to "elaboration" and should be developed without any boundary being imposed: Lord Keith at 479H-480A; Lord Templeman at 489C-G; Lord Oliver (with whom Lords Keith and Jauncey agreed) at 503A-504C, especially 503H to 504B, and 509F-H, 515F-516B. In my respectful submission, Millett LJ, as he then was, correctly stated the position at [1987] STC 1269d-e and 1270c-f. In essence, here no steps had been inserted. At the very worst Lady Ingram choose one method rather than another because it was safer from a tax point of view.

10.3 *Fitzwilliam*

I further submitted that the Revenue's argument failed the test in *IRC v Fitzwilliam* [1993] 1 WLR 1189, stated by Lord Keith (with whose reasons Lords Ackner and Mustill agreed) at 1202C that "the correct approach to a consideration of the ... steps in the tax saving plan which the Revenue say were ineffective for the purpose is to ask whether realistically they constituted a single and indivisible whole in which one or more of them is simply an element without independent effect and whether it is intellectually possible so to treat them". There was in this case no "element without independent effect". Nor was it intellectually possible to treat a gift of a freehold reversion as a gift of the entire unencumbered freehold out of which a lease is then taken back. The latter was neither a "natural" or "logically defensible transaction". The suggested re-characterisation was "of a perfectly normal and straightforward ... transaction into a thoroughly abnormal and unusual transaction whose only merit (if that is the right word) is that it attracts a tax disadvantage."[13]

Moreover, I continued, it was irrelevant that all the steps taken were pre-ordained, citing *IRC v Fitzwilliam* [1993] 1 WLR 1189 per Lord Keith at 1204A-B: "the fact of pre-ordainment ... is not sufficient in itself ... to negative the application of an

13 This was a citation from *Pigott v Staines Investments Co Ltd* [1995] 68 TC 342 at 376H-I.

exemption from liability to tax which the series of transactions is intended to create, unless the series is capable of being construed in a manner inconsistent with the application of the exemption."

10.4 *McGuckian*

Before the decision of the House of Lords in *IRC v McGuckian* [1997] STC 908, I very much doubt whether any of these submissions of mine would have been controversial. Some of the dicta in that case gave rise to concern that the law had not after all been settled in *Craven v White*. Edward Nugee QC had been Leading Counsel for the Inland Revenue in that case. It was not unreasonable of him to read the dicta in *McGuckian*, in which he had been the taxpayer's counsel, as an invitation to have a second bite at the cherry.

I submitted that *McGuckian* did not change the law. The ratio was a classic application of the *Ramsay* principle: see 912e-j (Lord Browne-Wilkinson); 914g-h (Lord Lloyd); 918a-e (Lord Steyn); 919f-920e and 922d-g (Lord Clyde). The obiter dicta of Lord Steyn at 915g-h and of Lord Cooke at 920j-921c should not be followed in so far as they might possibly suggest that Lord Brightman's limitations (the requirement of a pre-ordained series of transactions including steps with no commercial or business purpose apart from the avoidance of a liability to tax) enunciated in *Furniss* and approved by their Lordships' House in *Craven v White* are not universals.

10.5 Lord Steyn

Lord Steyn seemed surprised that anyone could have read his speech in *McGuckian* as casting doubt on *Craven v White*. He also expressed the view, *arguendo*, that so too would Lord Cooke. Lord Steyn's speech in *McGuckian*, standing by itself, contains only one ambiguous sentence. Moreover, he expressly referred in his speech to the limits to the *Ramsay* principle, without any hint of disapproval.[14]

Lord Steyn did say that he was not unsympathetic to Mr Nugee's argument that the transactions should all be viewed together. Yet he gave the impression that, in his view, that was not enough to get the Revenue home.

10.6 Lord Browne-Wilkinson

Speaking purely for himself, Lord Browne-Wilkinson expressed the view that the

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14 Lord Cooke's speech was rather a different matter. He was not a member of the Appellate Committee which heard *Lady Ingram*.

courts had expanded the *Ramsay* principle as far as it should go and that, if further anti-avoidance measures were needed, it was for Parliament to enact them. One wonders how many other judges will take the view that, especially now that Parliament is going to enact a GAAR, they need not develop *Ramsay* any further.

### 10.7 Lord Hoffmann

Lord Hoffmann suggested that the application of *Ramsay* was not appropriate in an area, such as stamp duty, where taxation depended on form rather than substance. I did not understand him to be casting any doubt on the other *Ingram* case, where it was held that inserted steps could be disregarded for the purposes of stamp duty.[15] Rather, I took him to be suggesting that where, as here on the Revenue's argument,[16] there were two ways of effecting a transaction which differed in form only and not in substance and the statute taxed one but not the other, then there was no scope for the courts to say they should both be taxed on the *Ramsay* principle. Certainly, this would accord with the modern view that the *Ramsay* principle is simply a rule of statutory interpretation, of which Lord Hoffmann is one of the chief exponents.[17] As he pointed out, in rather more striking language, in *Norglen Ltd v Reeds Rains Prudential Ltd* [1997] 1 WLR 1177 at 1186B-E, one consequence of this is that if the true construction of a statute is X, one cannot then apply the *Ramsay* principle so as to construe it to mean the contradictory

### 10.8 Lords Clyde and Hutton

Lords Clyde and Hutton gave no appearance of being anxious to extend the *Ramsay* principle in this case. This was perhaps unsurprising. Lord Clyde is a Scotts lawyer. In Scotland, greater reverence is paid to the law as a logical system. Lord Hutton had, as the Chief Justice of Northern Ireland, decided *McGuckian* in favour of the taxpayer.

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15 *Ingram v IRC* [1985] STC 835 (Vinelott J).

16 It must be remembered that their *Ramsay* argument came into play only if they succeeded on the *Nichols* point.

17 This view has very widespread and weighty judicial support. See *Craven v White* per Lord Oliver at 502E-H, 504B-D, 505G-H, per Lord Goff 520B-C; per Lord Jauncey 535A-C. Lords Keith and Jauncey agreed with Lord Oliver: 488C and 536G-H. See *IRC v McGuckian* [1997] STC 908 per Lord Steyn at 915c-916g, especially 916e-g, and per Lord Cooke at 920d-920j. See Millett LJ in the Court of Appeal in *Lady Ingram* [1997] STC 1270g-1271a.

10.9 Lord Millett

In the Court of Appeal, Lord Millett dissented and, in a fully reasoned judgment, found against the Revenue on the *Ramsay* point, both on the ground that there were no inserted steps and that the transaction could not be recharacterised as the Revenue contended. Lord Millett is now a Law Lord with considerable Revenue experience and likely to have substantial influence on the outcome of any Revenue appeal on which he sits.

10.10 *Ramsay* and *Willoughby*

I had made in my Printed Case a further submission, which sought to limit the scope of *Ramsay*, namely that *Ramsay* should in principle apply only where there is a tax avoidance, not merely a tax mitigation, motive. I cited the passages from *IRC v Willoughby*, set out in section 7 of this article.

Their Lordships did not ask me to develop this point further. Lord Hoffmann did express the view during the argument of Mr Nugee QC that this was "yet another concept", by which I took him to mean that the application of the *Ramsay* principle was complicated enough already without introducing further refinements. He did not, however, expressly reject it.

10.11 Exclusion of *Ramsay* by Specific Anti-Avoidance Provision

I had also submitted in my Printed Case that where Parliament has introduced a specific anti-avoidance provision, such as the GROB rules, which do not catch a transaction, there is "no room for the court to adopt the *Ramsay* approach in construing an Act which expressly provides for the circumstances and occasions on which" property gifted inter vivos is deemed to be comprised in a person's estate on his death.[18] The formulation was from Lord Browne-Wilkinson's speech in *IRC v Fitzwilliam* [1993] 1 WLR 1189 at 1228D-G. Lord Browne-Wilkinson said that he still had an open mind on this proposition and would be grateful if some learned academic would write an article discussing the point. Until this is done, I proffer some views of my own.

While the proposition advanced cannot be a rule of universal application, yet, given that *Ramsay* is a rule of statutory construction, it is a factor to be taken into account in determining what the true construction of the statute is. The importance of this

18 It was settled in *McGuckian* that *Ramsay* can apply so as to relieve the Revenue from having to rely on an express anti-avoidance provision which would otherwise be operative, but that is another matter.

factor will depend on the circumstances.

The gifts with reservation of benefit provisions are themselves an anti-avoidance provision.[19] What was a little unusual about the Revenue's argument was that they were seeking to apply this anti-avoidance provision to facts recharacterised in the light of *Ramsay*. In my view, one cannot rule out such a course *a priore*.

In my view, too, the mere fact that the provisions make reference at one point to "associated operations"[20] cannot rule out the application of *Ramsay*. Much may depend on the purpose to which one wishes to put *Ramsay*. For example, section 102 comes into play "where an individual disposes of any property by way of gift". Suppose that the sole owner of the share capital of a company procures that the company makes a gift. The company's transfer of value will be imputed to him: Inheritance Tax Act 1984 section 94. Yet because section 102 is couched in the language of estate duty and is inexpertly grafted on to the inheritance tax legislation, the gift is not expressly imputed to him for the purposes of the gifts with reservation of benefit provisions. Thirty years ago, that would have been the end of the matter. The courts would have relied on the absence of a counterpart to section 94 as limiting the construction of section 102. Nowadays, the courts might well take the view that the true construction of "where an individual disposes of any property by way of gift" includes a case where an individual procures that his company disposes of property by way of gift. Certainly, if he had set up the company and funded it in order that it should make the gift, this could be an application of the *Ramsay* principle proper in that there would be inserted steps which would, on the *Furniss v Dawson* extension of *Ramsay*, be ignored.[21]

Where, however, on any realistic construction of the anti-avoidance provision in point, it is not clear that Parliament intended a transaction which has been effected in a certain way to be taxed, then there is no scope for the courts to find a spectral or subliminal meaning in the statute that it should be so taxed. This is the result of the combination of *Norglen* and *Willoughby*.

An interesting case is group relief provision for companies. In UK law, these are subject to extensive specific anti-avoidance provisions, which the Revenue keep

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19 Although, for the reasons given by Lord Hoffmann, the policy behind them was originally anti-evasion.

20 Finance Act 1986 Schedule 20 paragraph 6(1)(c).

21 The court might also reach this conclusion based on the modern purposive approach to the construction of statutes, referred to by Lords Steyn and Cooke in *McGuckian*, which is technically distinguishable from the *Ramsay* principle proper.

under review. In this context, it would be surprising indeed if *Ramsay* could be relied on to defeat an express relief which was not denied by the specific anti-avoidance provisions. It would in general beggar belief that Parliament could have intended the relief ostensibly offered with the one open hand to be so withdrawn by the other, as it were, surreptitiously.

### 10.12 The Need for Realism

While their Lordships seemed generally hostile to the extension of *Ramsay*, it must be remembered that this case was not a very hopeful one for the Revenue. Once their Lordships agreed that Lady Ingram had not engaged in tax avoidance and had not aimed to defeat the spirit of the gifts with reservation of benefit provisions, a *Ramsay* argument that her estate should nevertheless suffer penal taxation[22] had to be a very compelling one indeed. Just as some of their Lordships may have expressed themselves somewhat forcibly in pro-Revenue terms in *McGuckian*, where the taxpayer and/or his advisers were thought to have been unmeritorious, so too one must bear in mind that in this case their remarks *arguendo* were made in the context of what appeared to them an unmeritorious Revenue submission. In every case on which one is advising, one must always keep the general merits firmly in mind.

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22 Lord Hoffmann accepted that section 102 "is in one sense a penal section. Not only may you not have your cake and eat it, but if you eat more than a few *de minimis* crumbs of what was given, you are deemed for tax purposes to have eaten the lot."