INGRAM v THE COMMISSIONERS OF INLAND REVENUE: A LEADING DECISION ON THE RESERVATION OF BENEFIT PROVISIONS

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The landmark decision of Ferris J in *Ingram v IRC*[2] is important for a number of reasons. Firstly, it upheld an IHT scheme which very many individuals have carried out. Secondly, it clarifies the law with regard to the reservation of benefit rules. Thirdly, it raises questions of trust and landlord and tenant law which will cause much consternation to landlord and tenant and trust lawyers, not least because of the judge's surprising conclusion that a lease granted by a nominee to his principal is a nullity in English law.

The Facts

The facts are as follows. In March 1987 Lady Ingram was the absolute owner of parcels of land in Berkshire. Lady Ingram wished to settle the property for the benefit of members of her family subject to the retention by her of a sufficient interest to enable her to continue to enjoy the physical occupation of the property, or the rent of those parts which were let. She also wanted to save IHT.

Accordingly, on 29th March 1987, Lady Ingram transferred the property to her solicitor, Mr MacFadyen. On the same date, Mr MacFadyen confirmed that he was not intending to take the property for his own benefit, by executing two Declarations of Nomineeship stating that he held the property as nominee for Lady Ingram.

On 30th March 1987, acting on the direction of Lady Ingram, Mr MacFadyen expressed himself to grant to Lady Ingram two leases bearing that date. In each

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[2] [1995] STC 569.

lease Mr MacFadyen is identified as the landlord and Lady Ingram is identified as the tenant.

On 31st March 1987, Mr MacFadyen, acting at Lady Ingram's direction, executed a number of conveyances and transfers, the combined effect of which was to transfer the property to four trustees. These dispositions were in each case expressed to be subject to the relevant lease in favour of Lady Ingram. Two declarations of trust were executed under which the trustees held the property subject to the leases in favour of Lady Ingram, for the benefit of certain beneficiaries. In summary, therefore, the steps are were as follows:

Step 1 - Lady Ingram conveys freehold to a bare trustee.

Step 2 - The bare trustee grants a lease at law to Lady Ingram.

Step 3 - Acting on Lady Ingram's direction, the bare trustee conveys freehold reversion to new trustees to be held by them upon trust for the family.

The Issues

1. Were the leases valid? If not, what were the consequences?

2. If the answer to 1 is "no", what interest, if any, did Lady Ingram have in the property and when did she obtain such interest?

3. Was there a gift subject to a reservation under section 102 of the Finance Act 1986?

4. If the leases were valid, did *Ramsay v IRC* apply?

1. **Were the leases valid? Can a nominee grant an effective lease to his principal**?

Ferris J said no. His decision will surprise many trust lawyers and conveyancers. In *Rye v Rye* [1962] AC 496, it was held by the House of Lords that two individuals cannot grant to themselves a lease of property of which they are the owners. Lord Radcliffe, however, stated[3], albeit obiter, "I suppose, if there were any conceivable point in the operation, he could similarly demise land to a nominee". Ferris J dismissed this comment saying that Lord Radcliffe "regarded it as an absurdity in all but the most technical of senses". Ferris J stated that it

[3] [1962] AC 496, p 511.

must follow that a single individual cannot grant such a lease to himself. The Inland Revenue argued that a modern view of a lease is that it is not merely the grant of an estate in land but a contract between lessor and lessee and thus, when there cannot be an effective contract, there cannot be an effective lease. In the Scottish case of *Kildrummy (Jersey) Limited v The Inland Revenue Commissioners* [1990] STC 657, the Inner House of the Court of Session went further and said that in the *Law of Scotland* (writer's emphasis) a person could not grant a lease of Scottish land to a nominee.

Ferris J found that the judgments in *Kildrummy* were "correct statements of the law of England as well as that of Scotland" and "the leases purportedly granted by Mr MacFadyen to Lady Ingram were a nullity". The reasoning was that a nominee cannot grant a lease to his principal as a person cannot contract with himself, and leases are a matter of contract law.

With respect, the writer disagrees. Firstly, this conclusion ignores the fundamental distinction between law and equity and the basis of the law of trusts. A trust is given its very existence by the fact that one person is regarded as the owner of property at common law but **equity** regards the other people, namely the beneficiaries, as the beneficial owners. Nominees are trustees and must exercise their powers independently of the beneficiary[4]. Therefore, Lady Ingram was not at law granting a lease to herself.

Secondly, the question is, in the writer's opinion, a matter of land and trust law and not a matter of the common law of contract. While accepting that the proposition that a person cannot contract with himself must be correct, it is a very different matter to say that he cannot contract with a trustee for himself and thus cannot accept a lease from a trustee for himself. The common law must recognise the lease as valid, it is not a lease from a person to herself. *Kildrummy*, whilst it might reflect the Scottish position, cannot, in the writer's view, possibly be considered as a correct statement of the law of England.

2. What interest did Lady Ingram have in the property and when did she obtain such interest?

Both parties contended that Lady Ingram did have an interest equivalent to that which was envisaged as being conferred upon her by the leases, but they differed as to the means by which, and hence the time at which, such interest was obtained.

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4 See 'Leases to Nominees' by James Kessler in this *Review*, Volume 3, 1993/94, Issue 2 p 133.

The Revenue advanced the proposition that Lady Ingram's interest in the property arises as a result of section 65 of the Law of Property Act 1925. Section 65 provides in relation to reservations made after 1925:

> "(1) A reservation of a legal estate shall operate at law without any execution of the conveyance by the grantee of the legal estate out of which the reservation is made, or any regrant by him, so as to create the legal estate reserved, and so as to vest the same in possession in the person (whether being the grantor or not) for whose benefit the reservation is made.
>
> (2) A conveyance of a legal estate expressed to be made subject to another legal estate not in existence immediately before the date of the conveyance shall operate as a reservation, unless a contrary intention appears."

Therefore, section 65(2) would have the effect that the conveyances and transfers executed on 31st March 1987 (Step 3) operate as if they were expressed to reserve to Lady Ingram an interest in the property conveyed equivalent to that which was thought to have been already granted by the leases. This statutory operation takes effect immediately after, or at the earliest simultaneously with, the conveyances and transfers themselves.

Ferris J saw the conceptual difficulty that arises if this is correct. Section 65(2) must refer to the conveyances and transfers executed by Mr MacFadyen on 31st March 1987. Immediately after the execution of that conveyance, the relevant part of the property must have continued to be held in trust for Lady Ingram, because the declaration of trust referred to conveyances of even date which had already taken effect. Therefore, even for "an instant of time, or perhaps a slightly longer period", the trustees continued to hold on a resulting trust for Lady Ingram. It is during this period that section 65 must have operated, however, if it did, it operated to create in favour of Lady Ingram the very interest which Ferris J had found a "legal impossibility" (see paragraph 1 above).

Therefore, Ferris J accepted Mr Venables' argument on behalf of the executors that even if the leases were not valid at law, it was contrary to principle that Lady Ingram should have made a gift greater than that which she intended to make and therefore the beneficiaries under the declarations of trust acquired only the beneficial interest in the freeholds subject to equitable leases of which Lady Ingram was the sole beneficial owner. Lady Ingram acquired these interests simultaneously with the execution of the declarations of trust.

3. Was there a gift with a reservation under section 102 of the Finance Act 1986?

Under section 102(1), the reservation of benefit rule applies when an individual makes a gift and enjoys some benefit from the property that has been given away, that is, it is not "enjoyed to the entire exclusion...of the donor and of any benefit to him by contract or otherwise"[5]. The provisions are taken directly from the corresponding 1881 estate duty legislation. There is little English law directly in point. This is not because the scheme is novel. On the contrary, this type of scheme was common in estate duty days, but there was an understanding on both sides that it worked. When capital transfer tax became inheritance tax in 1986, the reservation of benefit provisions were re-introduced and a new debate as to the efficacy of the scheme began.

In order to see whether the provisions apply, it is essential firstly to identify the precise property disposed of, and to see whether **that** property has been enjoyed to the entire exclusion of the donor. For example, suppose I own a yellow book and an orange book; I give you the yellow book and continue to use the orange book. There is no gift with reservation. They are two distinct pieces of property. Similarly, Lady Ingram owned the lease and the reversion, which are two separate assets. She gave away the reversion and retained the lease. In each case there has been a gift of one item of property and the benefit is derived from the property which is retained.

The Inland Revenue, in effect, did not accept the "orange and yellow book" analogy. Their contention was that when there was no physical separation of the property given and that retained (as was the case with the lease and the reversion) before or at the time of the gift, this amounted to a reservation of a benefit within section 102. This was largely based on the view of the Court of Appeal in *re Nichols deceased* [1975] STC 278 ("the prior independent transaction" case).

Ferris J held that if this proposition was correct, there would be a distinction between the following cases. Firstly, where property can be and is separated into distinct parcels, as where land is divided physically into two identified sections, or shares are divided into two separate blocks and one parcel is given and another retained, there is no reservation of benefit (Ferris J called this "vertical severance"). Secondly, where there is separation of an interest in a particular block of property into a number of separate interests and one interest is gifted and another is retained, there would be a reservation of benefit ("horizontal severance"). This distinction could not be correct. Ferris J recognised that there was not always a reservation where there was horizontal severance. An example is where a resulting trust in favour of the donor occurs where the beneficial interest in the property is not exhausted. This was clearly not a reservation.

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5 Finance Act 1986 Section 102(1)(b).

Ferris J stated "a more pertinent example for present purposes is the creation of a term of years which is to be retained by the donor, subject to which the property is given to a donee." Ferris J therefore held that where the gift and severance were contemporaneous, it was not inevitable that this would result in a reservation within section 102. Indeed, he observed that *Commissioner for Stamp Duties of New South Wales v Perpetual Trustee Co. Ltd* [1943] AC 425 was an example of horizontal severance where the severance was effected at the time of the gift and the Privy Council had rejected the argument that there was a reservation of benefit.

Further, Ferris J held that the subject matter of the gift made by Lady Ingram was the property shorn of the leasehold interests. In reaching this conclusion, he said that two things were of cardinal importance. First, Lady Ingram never intended to give the property to the trustees and beneficiaries free from the leasehold interest which it was common ground that she had. Secondly, the creation and existence of the leasehold interests was not in any way dependent on the concurrence of the trustees and beneficiaries, still less upon the performance by them of some positive act. In terms of substance, Lady Ingram had her leasehold interests from the very same moment that the trustees and beneficiaries had the property subject to those interests. Further, he held that it was not a reservation of benefit merely because severance was at the time of the gift, and not before. Therefore, Lady Ingram had given away the reversion shorn of the leasehold interest. She had given away the "yellow book" but retained the "orange book".

In holding the property was not property subject to a reservation for the purposes of section 102 of the Finance Act 1986, Ferris J stated that he was conscious that this conclusion was not consistent with the provisional view of the Court of Appeal in *re Nichols*. Ferris J stated that the view of the Court of Appeal in *Nichols* was provisional, *obiter*, and ignored the important case of *St Aubyn v Attorney General* [1952] AC 15. Ferris J is to be commended for this statement, as it is a brave judge who does not follow the, albeit erroneous, lead of the Court of Appeal.

4. **Ramsay**

As Ferris J held the leases were a nullity, the argument on *Ramsay* was not material. However, the judge did observe that the *Ramsay* principle would involve a proposition that some artificial step in the three steps outlined above should be left out of account for fiscal purposes. He went on to suggest that the Inland Revenue were suggesting something more limited than this. He did not go on to discuss this in detail but in the writer's view it is difficult to see how *Ramsay* could apply to this case.

Finally, it is interesting to note that Ferris J said that:

> " I do not, therefore, accept the submission that a transaction of this kind entered into by Lady Ingram would, if it is not regarded as involving a

> reservation of benefit, represent a particularly objectionable piece of tax avoidance."

This is obviously welcome. However, it is regrettable to see cases considered on the basis of whether they are "objectionable tax avoidance" rather than on the effect of the transactions in question.

Conclusion

In conclusion, the Lady Ingram case is a welcome victory for taxpayers. Many taxpayers have made such an arrangement and they and their advisors will breathe a sigh of relief. Ferris J was absolutely right on the reservation of benefit position. However, in the writer's view, Ferris J was wrong in holding the leases void at law. We await an appeal with interest.