"REAL VALUES" (1)
The Aggregation of Interests when Valuing an Individual's Estate for the Purposes of Inheritance Tax

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A Case Report

Introduction

The case of *The Executors of the Honourable Myra Alice Lady Fox (Deceased) v Commissioners of Inland Revenue* (DET/1/1990) before the Lands Tribunal decided some very important questions relating to the valuation of an individual's estate for the purposes of Capital Transfer Tax. The case centred on the Revenue's ability to take the aggregate value of freehold and business (partnership) interests over a single piece of land to constitute the value of that individual's estate for CTT purposes. The aim of the Revenue in attempting to aggregate the two sets of beneficial interests together was to increase the value of the estate for CTT purposes.

The purpose of this article is simply to present the decision of the Tribunal in the light of the facts surrounding the case. Comment has been kept to a minimum in favour of exposition although where appropriate the author has digressed into commentary.[1]

The Commissioners of Inland Revenue issued a notice on the executors of Lady Fox's estate to ascertain the value of her freehold interest in an area of land known as the "Croxton Park Estate" in Cambridgeshire immediately before her death. Lady Fox's executors appealed against the notice.

Lady Fox had farmed the Croxton Park Estate in partnership with two others prior to her death. For this purpose she had granted herself and her partners a number of tenancies over the land.

Lady Fox died on 27th March 1981 and therefore the terms of s.38 and Schedule 4 of Finance Act 1975 apply for the purposes of valuing the property.

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[1] It is anticipated that a more general article on the subject of valuation will appear in the second issue of the *Personal Tax Planning Review* as a sequel to this article.

The "relevant amount" referred to in the notice is the value of the property to which Lady Fox was beneficially entitled before her death.

The Terms of the Notice

The notice of determination purported to aggregate Lady Fox's freehold interest in the property with her share of the partnership business "as a single unit of property for the purposes of s.38 Finance Act 1975".

The "relevant amount" was therefore the vacant possession value of the property (£6,125,000), less an amount representing the shares in the partnership of Lady Fox's partners (£560,625): a total of £5,565,000.

The "relevant amount" was then apportioned according to a mathematical formula set out in the notice between the partners according to their partnership shares.

The value to be attributed to the freehold interest was said, in the notice of determination, to be £4,280,768.

The Facts

The facts were agreed between the parties. The Croxton Park Estate is an agricultural estate situated approximately 14 miles west of Cambridge. It is made up of a Grade II listed mansion house, parkland, woodland, agricultural land and buildings. The gross external area of the mansion house is 2,000 square metres. The whole estate comprises an area of 3,400 acres of which the notice of determination refers to 3,163.36 acres. That latter area is covered by four tenancies in favour of the farming partnership as follows:

Tenancy 1:	2,705.942 acres
Tenancy 2:	28.160 acres
Tenancy 3:	166.618 acres
Tenancy 4:	191.789 acres[2]

At the valuation date, the mansion house and the buildings were in a poor state of repair. The arable land was mainly "Grade II, MAFF agricultural land classification with little variation in quality".

At all material times, Lady Fox owned the freehold interest in the estate.

The estate was subject to four tenancies, as mentioned above. The terms of those tenancies were as follows.

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[2] The more astute among the readership will have realised that these areas form a total of 3,092.509 acres. The difference of 70.851 acres is apparently attributable to changes in the Ordinance Survey maps, referred to in the tenancy agreements, up to the present day.

Tenancy 1

Lady Fox, in the capacity of landlord[3], entered into an agreement on 1st September 1972 with herself and Major Norman Fraser, trading as the partnership known as Croxton Park Farms, as tenants. The land was known as the Croxton Park Farm, being the 2,705.942 acres set out earlier. The rent from 1st September 1972 was £250 per annum.

Tenancy 2

Lady Fox, as landlord, entered into a second agreement on 7th December 1973 with herself and Major Fraser, trading as Croxton Park Farms, as tenants. The effect of this agreement was twofold: first it increased the holding referred to in Tenancy 1 by 28.16 acres and secondly increased the rent from 11th October to £260 per annum.

Tenancy 3

Lady Fox, as landlord, entered into an agreement with herself, Major Fraser and Edward Crees (the last of whom had entered into the Croxton Park Farms partnership after Tenancy 2) on 23rd August 1977. Again there was a double aim: first to increase the holding in Tenancies 1 and 2 by 166.618 acres (being the whole of a property known as West Farm) and secondly to increase the rent to £270 from 3rd November 1976.

Tenancy 4

Lady Fox, as landlord, entered into a fourth agreement with herself, Major Fraser and Mr Crees trading in the same partnership as in Tenancy 3, on 16th January 1978. A number of smaller farms, totalling 191.789 acres, were thus added to the land farmed by the partnership. The rent was increased to £4,500 per annum from 11th October.

The original partnership deed between Lady Fox and Major Fraser was dated 1st September 1972 and a further deed was created on 21st November 1974 to include Mr Crees. The parties agreed to farm the land leased to them by Lady Fox in partnership. Originally the profits and losses were to have been shared in the following proportions:

Lady Fox:	98%
Major Fraser:	2%

However, with the accession of Mr Crees, those proportions were altered to the following from 1st April 1975:

Lady Fox:	92.5%
Major Fraser:	2.5%
Mr Crees:	5.0%

The terms of the partnership deed were, briefly, as follows:

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[3] While I confess the term "landlady" is more accurate, the members of the Tribunal and the authorities prefer the masculine soubriquet. It does have the advantage of shedding all "Rising Damp" connotations.

Lady Fox agreed to grant the partnership a tenancy from year to year upon the terms and conditions set out in a draft attached to the original partnership deed.

The capital of the partnership was to be £5,600 which was subscribed in cash as to £5,000 by Lady Fox and then as to the remainder in equal shares by Major Fraser and Mr Crees.

All additional capital required by the partnership from time to time was to be provided by Lady Fox alone. Major Fraser and Mr Crees were to be under no obligation to subscribe any such sums.

Any difference arising as to any matter connected with the partnership business should be decided by Lady Fox provided that, except with the consent of both Major Fraser and Mr Crees, no change was to be made in the nature of the partnership business and no other partner was to be admitted to the partnership.

The form of control over the partnership was of some interest. It was provided that Lady Fox was to have absolute competence over the day to day control and running of the business. The almost sleeping (somnambulant, perhaps) nature of the other two partners is evident from the findings of the Tribunal. Major Fraser had retired from the army and had retired also from employment with Beecham Animal Health Limited. On entering into the partnership with Lady Fox he had been 61 years old. Mr Crees was a partner in Strutt and Parker who farmed on his own account at a farm on which he lived. He also gave consultancy advice to Lady Fox. He was 57 at the date of the inception of the second partnership agreement.

All the losses of the partnership were to be borne by Lady Fox over a ceiling of £300 placed on Major Fraser and Mr Crees' liabilities in any accounting year.

The tenancy agreements were assets of the partnership.

In the years ended 31st March 1980 and 31st March 1981 the partnership made pre-tax profits of £140,197 and £127,440 respectively.

No planning permission with respect to any of the land referred to in the notice of determination existed at the valuation date which would have affected the value of the land. The land was situated in a rural area of high landscape value and planning permission for any material development was unlikely. Similarly there were no outgoings, easements nor other restrictions which would have affected the value of the land.

After the valuation date, the tenancies were surrendered as follows:

Weald Farm (comprised in Tenancy 4 and partially in Tenancy 1) was surrendered on 29th September 1982 in consideration of a rent reduction of £1,000 per annum on the rest of the estate.

In 7th October 1983, land comprised in part of Tenancy 3 was surrendered in return for an abatement of rent for one year in the sum of £40,000.

The remaining land subject to the tenancies, being 2,364.869 acres, was surrendered on 9th March 1984 for £827,000. This sum (less £16,963 in professional fees) was divided as follows:

Lady Fox's PRs: £749,284 (92.5%)

Major Fraser: £ 20,251 (2.5%)
Mr Crees: £ 40,502 (5.0%)

The values were agreed between the Revenue and Lady Fox's executors as follows:

> The vacant possession value of the land referred to in the notice of determination: £6,125,000.
>
> The investment value of the freehold reversion in isolation: £2,751,000.

The Issues

(1) Should the freehold reversion and the partnership share be treated as one unit of property for the purposes of s.38 Finance Act 1975?

(2) If the freehold reversion and the partnership are to be so treated, should the value to be attributed to the freehold reversion be ascertained in the manner and in the amount contended for by the Crown or in some other (and if so, what) manner and/or amount?

(3) In any event, is the value of (or the value to be attributed to) the freehold reversion for the purposes of s.38 FA 1975 the sum of £4,280,768[4] or £2,751,000, or some other (and if so, what) sum?

The Jurisdiction of the Lands Tribunal

Appeal against a notice of determination is brought under Schedule 4 paragraph 7 of the Finance 1975 Act. The several jurisdictions of judicial and quasi-judicial bodies to hear such appeals are governed by sub-paragraphs (2) to (5). As is apparent from the issues for determination listed above, there are complex questions as to which body should hear the appeal. While the matter is fundamentally one of valuation, there are clearly points of legal principle to be decided.

Paragraph 7 provides:

> "(2) Subject to the following provisions of this paragraph the appeal shall be to the Special Commissioners...
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> (4) Neither the Special Commissioners nor the High Court shall determine any question as to the value of land in the United Kingdom on any appeal under this paragraph, but on any such question the appeal shall be to the Lands Tribunal..."

On an analogy with *Edwards v Bairstow and Harrison* [1956] AC 14 you must decide whether you are faced with a question of law or of fact. Where the matter can be said to be a matter solely of determining value, that is clearly a problem for the Lands Tribunal to solve. However, on these facts the Tribunal was faced with the more complex matter of which items of property, in which Lady Fox had a beneficial interest, should be aggregated together to determine the value of her estate. Given that the House of Lords has been troubled by this question before[5], we can admire the pluck of a Lands Tribunal which is prepared to face the issue. The President of the Tribunal answered this initial question in this way:

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[4] This sum is the amount which the Revenue sought to apportion to the value of the freehold interest in Lady Fox's estate by taking into account what it considered to be the relevant partnership shares.

[5] see below.

> "We too have had doubts as to whether the Lands Tribunal has jurisdiction in this appeal, because, on its face, the notice of determination appears to lot together land and personalty. However, we have accepted the assurances of counsel that the Tribunal has jurisdiction and have done so because the purpose of the notice of determination, in the end, is to determine a value for the land and nothing but land."

There is, of course, a sense in which this begs the question. However, the matter had first been before the Special Commissioner, Mr R H Widdows. He had been unable to see any clear answer to the problem in his written observations on jurisdiction. The matter came then, in any event, before the Lands Tribunal.

The Relevant Law

Lady Fox died in 1981, as stated above, and therefore the provisions of the Finance Act 1975 apply to the valuation of her estate for the purposes of Capital Transfer Tax.

Statute

S.22(1) FA 1975 provides:

> "On the death of any person after the passing of this Act tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death..."

By s.23(1) FA 1975:

> "For the purposes of this Part of this Act, a person's estate is the aggregate of all the property to which he is beneficially entitled..."

The provision which governs the process of valuing a deceased's estate is s.38 FA 1975:

> "Except as otherwise provided by this Part of this Act, the value at any time of any property shall for the purposes of capital transfer tax be the price which the property might reasonably be expected to fetch if sold in the open market at that time; but the price shall not be assumed to be reduced on the grounds that the whole property is to be placed on the market at one and the same time."

The Revenue issued its notice of determination under the purview of Schedule 4 paragraph 6 of the 1975 Act. The relevant provisions are:

> "(1) Where it appears to the Board that a transfer of value has been made or where a claim under this Part of this Act is made to the Board in connection with a transfer of value, the Board may give notice in writing to any person who appears to the Board to be the transferor or the claimant or to be liable for any of the tax chargeable on the value transferred, stating that they have determined the matters specified in the notice.
>
> (2) The matters that may be specified in a notice under this paragraph in relation to any transfer of value are all or any of the following...
>
> > (b) the value transferred and the value of any property to which the value transferred is wholly or partly attributable..."

The appeal was brought under the auspices of Schedule 4 paragraph 7:

> "(1) A person on whom a notice under paragraph 6 above has been served may, within thirty days of the service of the notice, appeal against any determination specified in it by notice in writing given to the Board and specifying the grounds of appeal."

The House of Lords' Approaches

Two well-known House of Lords decisions were referred to in the Tribunal's decision, the first of which was *IRC v Crossman* [1937] AC 26[6] and the second *The Duke of Buccleuch v IRC* [1967] AC 506.

In the latter case Lord Reid had a three-limbed approach. The deceased's entire estate was not envisaged by the statute's valuation provisions but rather any part which it was proper to treat as a unit for valuation purposes. One had to envisage a hypothetical sale of the actual unit on the day on which death occurred, after having taken such steps as were reasonable to attract as much competition as possible for the particular piece of property. The estate had to be considered as it was when the deceased died. Generally, the estate would consist of easily identifiable, natural units and there could be no justification for requiring elaborate subdivisions.

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[6] These cases will be expounded on in more detail in the sequel to this article.

The First Issue

The question was whether or not the freehold reversion and the partnership share should be treated as one unit of property for the purposes of s.38 FA 1975.

The taxpayer argued that land cannot be aggregated with property other than land for the purposes of s.38. Consequently, the Revenue could not make a determination under Schedule 4 paragraph 6 which lotted together Lady Fox's freehold interest and her share in the partnership.

The Revenue argued that by dint of s.23(1) FA 1975, an individual's estate is the aggregate of all property to which she is beneficially entitled. Accordingly the Tribunal would be compelled to proceed on the basis that all of Lady Fox's beneficially-owned property was on the market at one and the same time.

Also, the Revenue argued that Lady Fox's partnership share was itself an interest in land, further to the Court of Appeal decision in *Cooper v Critchley* [1955] 1 Ch 431.

In the alternative, the Revenue argued that the value of Lady Fox's freehold interest and of her 92.5% partnership share was a question "as to" the value of land[7] and therefore within the Lands Tribunal's competence. This would have enabled the Tribunal to take the aggregate of the two interests regardless of the submissions which had been made concerning the jurisdiction of the Tribunal.

The decision of the Tribunal is unequivocal:

> "We do not accept that Lady Fox's share in the partnership was itself an interest in land. The tenancies were assets of the partnership but it does not follow that a share in the partnership was anything other than personalty or a chose in action. Accordingly, we agree with Mr Bramwell that the freehold interest and the share did not constitute a single unit of property for the purposes of s.38 of the Act and that as a matter of law the Commissioners of Inland Revenue had no power to lot the two together in the notice of determination."

The Tribunal agreed further with the taxpayer that the freehold interest and the partnership did not constitute a natural unit of property within the meaning of the speeches in the House of Lords in *Duke of Buccleuch v IRC*. It was found that there was no reason to suppose that a purchaser of the property would have paid more than the agreed investment value of the freehold reversion. The taxpayer's further argument was that in fact, a purchaser would be likely to pay less because a lot made up of the freehold interest and the partnership share would not appeal to any identifiable sector of the market.

If the interests could have been lotted together, the Tribunal accepted that s.38 required that the single unit be valued as a single unit and that the apportionment in the notice of determination was neither admissible nor appropriate.

Therefore the Tribunal decided that the value of Lady Fox's freehold interest was to be ascertained by reference to its investment value, being the agreed sum of £2,751,000.

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[7] Schedule 4 paragraph 7(4) Finance Act 1975.

The Second Issue

Were it the case that the two interests were to be aggregated, the second issue concerned the method of valuing the freehold. Two values had been given for the freehold: an amount representing the value with vacant possession (£6,125,000) and an amount representing the freehold reversion subject to the agricultural tenancies at the date of Lady Fox's death (£2,751,000).

The taxpayer asserted that the figure of £2,751,000 was correct because no purchaser would pay a price near the vacant possession value. The taxpayer also argued that the risks involved in having the land tenanted were not materially reduced by an agreed surrender of the interest on the death of the tenant. Nor would any process of "stepping into the shoes" of Lady Fox afford sufficient certainty of obtaining vacant possession for a prospective purchaser because it yielded less than the full benefits of freehold ownership with vacant possession. Potential purchasers would act no differently to purchasers of any other let farm. To aggregate the two would require a purchaser who wanted both to own the freehold and to farm the land contained in the estate[8].

The Revenue adduced evidence that for a purchaser to obtain vacant possession (the measure of value which they claimed was correct) she would need to be able to buy the 92.5% share in the farming partnership. In effect, the partnership deeds provided a means of securing vacant possession by manipulating the 92.5% partnership share. Accordingly, the Revenue were prepared to allow a discount to cater for the 7.5% of the interest which the purchaser would not be able to enjoy.

The Tribunal was of the opinion that, were it the case that the Revenue could lot together the two interests, their evidence paid "more realistic regard to the circumstances actually prevailing and likely to have been within the knowledge of the hypothetical purchaser at the valuation date".

The Tribunal found as follows on the second issue:

> "On the evidence in the instant case the route[9] to vacant possession was indeed novel, indirect and possibly uncertain in outcome. There was no guarantee that the minority [partnership] shareholders would accept the allocated sum of circa £100,000 [in the Revenue's estimation, a sum adequate to compensate the 7.5% partnership interest for the early termination of its interest], nor that any acceptance would be immediate upon purchase of the reversion for a considerable sum. Moreover, it was unlikely that the return on capital from rents and/or farming in the short term would cover the cost of finance for purchase with the result that delay[10] would prove expensive for the hypothetical purchaser. For these reasons, if Mr

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8 It may well be that because of the esoteric nature of this property, such a purchaser may be more difficult to locate than might otherwise be the case.

9 as suggested by the Revenue

10 in obtaining vacant possession

> Clegg's [witness for the Revenue] valuation were adopted, we would wish to investigate further the question whether 7.5% discount for risk and profit made by Mr Clegg is sufficient. Mr Bramwell said that we could not adjust either value (£2,751,000 or £4,280,768 [being Mr Clegg's mathematically apportioned amount to the freehold reversion]): it was an all or nothing case. [The Revenue] disagreed. Certainly, we had no argument or evidence as to adjustment and accordingly we refrain from making any adjustment."

It is important to note that while the statute provides that market value at the date of death is the appropriate measure of value here, it fails to direct how that computation is to be carried out. Consequently, the Tribunal considered the point to be at large and itself free to choose.

The Third Issue

The Tribunal declared that because it had neither heard argument nor seen evidence as to what adjustment (if any) might be made to the sum of £2,751,000, it would not alter its finding on the sum of £2,751,000.

Consulting Editor's Note

It is perhaps surprising that the Revenue did not cite *Attorney-General of Ceylon v Mackie*[11]. In this Privy Council decision, the deceased possessed 9201 out of 19800 preference shares and all the 5000 management shares in a rubber company. Under the Singalese Estate Duty Ordinance 1938, the value of any property for estate duty purposes was the price it would fetch if sold in open market at time of death. Holders of nine-tenths of the shares in the company could compulsorily acquire the rest. It was admitted that a purchaser of management shares would also require enough preference shares to give voting control.

It was held that one must be supposed to take the course which would get the largest price for the combined holding of shares and to offer for sale together with the management shares the whole or at least the greater part of the preference shares owned by D.

The principle established by this case can be very important in the context of a family farm where the freehold reversion to agricultural land is owned by a person and the tenancy is owned by a company in which he has a substantial interest[12]. I would have thought it equally applicable where the tenant is a partnership of which the freeholder is a member.

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11 [1952] 2 AER 775

12 See my *Passing Down the Family Farm* Second Edition with Second Cumulative Supplement to winter 1990/91 published by Key Haven Publications PLC Chapter 7.