ANNUITIES, REVERSIONS AND STAMP DUTY

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Background

There have been many arrangements concerning residential property designed either to avoid inheritance tax or to enable elderly persons in occupation of property which has considerable equity or is indeed unencumbered by mortgages to unlock part of the value in their main, if not sole, significant asset other than, perhaps, insurance policies.[2] These usually involve some variation upon the theme of a disposal of a partial interest in the house for a cash annuity or by way of a gift as part of an arrangement intended to pass only the reversion or a future interest. The conveyancing issues are technical but the basic rules appear to require a transfer of the freehold interest (or head leasehold) to some person and either the reservation of an interest by the transferor, or the grant of some interest such as a lease back[3] by the transferee or a declaration by the transferor or transferee that the property is held upon specified trusts including some form of interest for the original transferor.

The problems stem from the difficulty of giving away or disposing of a partial interest in the property, particularly where this is of a future or reversionary nature

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2 In another unannounced change of practice the Stamp Office are now treating insurance policies as deferred or contingent cash sums within Stamp Act 1891 section 57 so that, for example, the transfer of assets *in specie* on redemption is now dutiable *ad valorem* as a sale.

3 For the difficulties of creating a mere licence in this type of situation, see *Skipton Building Society v Clayton* (1993) 66 P & CR 223. Other arrangements may involve the creation of irrevocable interests, as in *Errington v Errington and Woods* [1952] 1 All ER 149; or even some form of strict settlement or similar trust, as in *Binions v Evans* [1972] 2 All ER 70.

and which does not or may not take effect in possession; this usually requires a movement of the interest out of which the interest is to be created or reserved.

The inheritance tax issues are, as were those involved in estate duty planning,[4] essentially concerned with attempts to dispose of the property whilst carving out in some way an interest that will enable the taxpayer to continue to reside or make use of the premises without infringing rules relating to reservation of benefit or settlements, thereby possibly bringing the whole value of the land into charge to tax. Such arrangements have encountered various problems on the conveyancing front, mainly turning around the question of whether it is possible to lease to oneself or to lease to a nominee for oneself or to transfer to a nominee who then leases back to the beneficial owner. There are recent cases dealing with this situation suggesting that there are an increasing number of obstacles in the way of such arrangements (such as *Kildrummy (Jersey) Ltd v IRC*[5] and *Ingram v IRC*)[6] and there are the recent intriguing Scottish decisions that pro indiviso owners cannot lease to one of their number[7] and indicating the possible absence of concepts such as equitable and beneficial ownership in Scots conveyancing.[8]

However, these issues relate to questions of inheritance tax which may be something that is deferred into the future and arise only at the time of the death of the relevant party. Unfortunately, such arrangements involving the movement of property are potentially vulnerable to immediate charges to stamp duty. There has

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4 See Finance Act 1894 section 2(3) and *AG v Seccombe* [1911] 2KB 688; *Munroe v Commissioner of Stamp Duties of New South Wales* [1934] AC 61. The question is whether the transaction is a gift coupled with a benefit to the donor, or a sale, on annuities payable in connection with the transfer see *AG v Johnson* [1903] 1 KB 617; *Oakes v Commissioner of Stamp Duties of New South Wales* [1954] AC 57; *AG v Worrall* [1895] 1 QB 99; *Lord Advocate v McKersies* (1887) 9 SLR 438; *Re Fitzwilliam's Agreement* [1950] Ch 448; *AG v Kitchen* [1941] 2 All ER 735; *Grey v AG* [1990] AC 124.

On rights to occupy property, see *Re Cochrane's Settlement Trusts* [1945] Ch 285; *H M Advocate v McTaggart Stewart* (1906) 8F. (Cos) 579; *Chick v Commissioners of Stamp Duties of New South Wales* [1958] AC 435; *O'Connor v Commissioners of Stamp Duties of South Australia* (1932) 47 CLR 601; *Re Harmsworth* [1967] Ch 826.

5 [1990] STC 657.

6 [1995] STC 564.

7 *Clydesdale Bank v Davidson* [1996] SLT 437.

8 *Sharpe v Thompson* [1995] SLT 837.

been, regrettably, a significant number of unannounced changes of practice by the Stamp Office over the last three or four years. To some extent these may represent changes where the long-standing practices appear to have been unknown to current members of the Stamp Office[9] but many of them are, although unannounced, deliberate changes to the policy in order to increase the amount of stamp duty collected. There have also been significant legislative changes relating to transactions involving land in section 241 Finance Act 1994 whereby many of the types of transaction now under consideration which previously would have attracted only fixed charges to stamp duty of 50p[10] or £2[11] are now potentially vulnerable to two charges to *ad valorem* stamp duty upon sums equal to the market value of the land. There has been a movement from negligible stamp duty of a few pounds towards a charge to stamp duty that is potentially 2% of the market value of the property involved and not 1% of the reversionary or partial interest transferred. There has also been the appallingly bad decision in *L M Tenancies 1 plc v IRC*[12] which in the writer's experience is the second worst decision on stamp duty ever.[13] The effect of *L M Tenancies 1 plc v IRC*[14] was used as a basis for a claim for stamp duty, set out in detail later, in relation to sheltered housing for more than 90% of the market value of the property. Fortunately, there has been a very spectacular climb-down by the Stamp Office in relation to certain aspects of the case, which are considered later, but this only works sensibly on the facts of the particular case and the initial claim is an indication of the current level of aggression in the collection of stamp duty that is being exhibited by the Stamp Office. In some ways it might be said that the pursuit of tax is overriding a sensible approach to the law, but more incredible is the inability of the current High Court to see the preposterous nature of decisions which they are delivering and their manifest failure to understand the basic rules and to foresee

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9 Note, for example, the conflicts in the evidence on knowledge of Stamp Office practice in *J Rothschild (Holdings) plc v IRC* [1988] STC 645; affirmed [1989] STC 435.

10 As a conveyance of any kind not hereinbefore described.

11 As a lease for an unascertainable premium or consideration in the form of rent.

12 [1996] STC 880.

13 The claim to the worse decision on stamp duty ever is comfortably made for *Parinv (Hatfield) Ltd v IRC* [1996] STC 933 which, notwithstanding the writer's involvement in law as a practitioner and as an academic over a period of more than 35 years, probably also ranks as one of the worst legal decisions of all time. Hopefully it is limited to all time, in that it would be rather depressing to think that future judicial decisions could get any worse than this.

14 [1996] STC 880.

the consequences of their decisions. Their lack of specialist expertise is so great that they are totally reliant upon the Inland Revenue and are failing to occupy what some people might regard as their proper role of standing between the Inland Revenue and the taxpayer. When the judiciary fail, as they are doing at present, to protect the elderly from the novel and excessive demands of the Inland Revenue, the continuation of their role must be questioned seriously.

It is, therefore, necessary to review the basic principles and consider how these have been distorted by the judiciary and are currently being applied by the Stamp Office in relation to routine transactions of the kind described in outline at the beginning of this article.

Basic Principles

Annuities

For many people their house will be one of their main assets but, like insurance policies, it is essentially illiquid and the essence of many arrangements is seeking to unlock part of the value of the premises in order to provide some form of capital or income upon which to live whilst at the same time retaining the right to live in the house. There are various schemes whereby part interests in the house or reversionary interests or some combination of both are disposed in consideration of the grant of an annuity. Unfortunately, in the current regime and attitudes, an annuity has two dimensions as far as stamp duty is concerned:

(i) *Grant of an annuity on sale*

It would seem, following the decision in *George Wimpey Ltd v IRC*,[15] that an instrument formally granting an annuity is a conveyance and although in many cases relating to land it is possible to avoid charges to stamp duty by relying upon a contract[16] and not taking a conveyance, this is not possible in relation to annuities. The wording of section 60 Stamp Act 1891, which deals with the situation where there is not a formal grant, provides:

> "Where upon the sale of any annuity or other right not before an existence such annuity or other right is not created by actual grant or conveyance,

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15 [1975] STC 248.

16 In relation to transactions it is no longer possible to avoid writing as Law of Property (Miscellaneous Provisions) Act 1989 section 2 renders void any transaction relating to land which is not entered into in writing, unlike the previous law which merely required a written memorandum.

> but is only secured by bond, warrant of attorney, covenant, contract or otherwise, the bond or other instrument, or some one of such instruments, if there be more than one, is to be charged with the same duty as an actual grant or conveyance, and is for the purposes of this Act to be deemed an instrument of conveyance on sale."

Therefore, where there is a grant of an annuity or a contract to grant an annuity in circumstances which amount to a "sale" for stamp duty purposes[17] there is a charge to stamp duty under the head "Conveyance or Transfer on Sale" at the rate of 1% of the amount or value of the consideration pursuant to section 54 or section 60[18] Stamp Act 1891 respectively.

The concept of "sale" has a particular meaning for stamp duty and includes not merely transactions for cash but transactions where the consideration is left outstanding as some form of indebtedness[19] where consideration consists of the issue of or transfer of shares[20] or the issue of debentures or loan notes or the assumption of liabilities.[21] Thus a transfer of holdings of shares by the annuitant

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17 *Faber v IRC* (1936) 155 LT 228; *Massey v Nanney* (1837) Bing NC 478; *Mersey Docks and Harbour Board v IRC* [1897] 2 QB 316.

18 On the grant of a new right *de novo* as a conveyance, see *George Wimpey Ltd v IRC* [1975] STC 248.

19 But note the decision in *Coren v Keighley* (1972) 48 TC 370 where the drafting of the document made a difference between a consideration which was left outstanding secured by a charge on the property and a consideration which was to be regarded as having been paid but dealt with by way of setoff in respect of a loan back with consequences adverse to the taxpayer.

20 Stamp Act 1891 sections 55 and 6; and see *J&P Coates v IRC* [1897] 2 QB 423.

21 Stamp Act 1891 section 57.

as a form of premium *in specie* involves a sale of the annuity.[22] There are, therefore, many situations where most types of annuity are subject to *ad valorem* stamp duty upon creation.[23]

Given the special rules of stamp duty that shares and loan stocks are treated as cash[24] as indicated above, the transfer of shares as the payment of a premium as a consideration *in specie* for the grant of the annuity will involve a double sale, namely:

- a sale of the annuity in consideration of the transfer of the securities; and

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22 The introduction of the CREST system for paperless share trading has given rise to many problems in relation to this type of transaction. For example:

- a transfer of shares by way of a traditional stock transfer form as a premium *in specie* for the grant of an insurance policy has hitherto been regarded as a transaction not involving a sale so that each stock transfer form attracted only the fixed duty of 50p under the head of charge "Conveyance of any kind not herein before described". It is, of course, possible that the current Stamp Office might seek to change their argument and claim that an insurance policy is really only a deferred cash payment within Stamp Act 1891 section 57 - see also *IRC v Willoughby* [1995] STC 14, appeal to House of Lords pending, on an attempt to treat the insurance policy as a mere cloak for the tax efficient holding of personal investments; see also *Fuji Finance Inc v Aetna Life Insurance Co Ltd* [1996] 4 All ER 608 on the line between insurance and debt; see also *Commercial Union Assurance Ltd v IRC* [1938] 2 KB 551.

- an agreement to transfer shares held within CREST will not be followed by a duly stamped transfer and, being an agreement to transfer shares for value (i.e. the issue of the policy), the principal charge to Stamp Duty Reserve Tax contained in Finance Act 1986 section 87 will apply at the rate of 0.5% on the market value of the policy.

In situations such as these it is necessary to investigate whether there is tax to be saved by re-materialising the securities by extracting them from CREST prior to the transaction.

23 Note the restrictions for superannuation annuities and purchased life annuities within the head of charge "Bond, Covenant" in Stamp Act 1891 Schedule 1 and Finance Act 1970 section 64 and Finance Act 1989 section 173.

24 *J&P Coates v IRC* [1887] 29 QB 427.

- a sale of the securities in consideration of the grant of the annuity.

The Stamp Office are likely to claim both duties. Fortunately, where land is involved as the premium or consideration for the granting of the annuity the effect of section 24 Finance Act 1994 is not to convert land into "cash" generally, so that there will be:

- a sale of the land in consideration of the granting of the annuity; and

- a grant of the annuity otherwise than on sale in consideration of the transfer of the land; not subject in stamp duty by reason of the abolition of stamp duty upon annuities chargeable under the head "Bond, Covenant" by section 64 Finance Act 1971.

(ii) *Annuities as the consideration for sale*

It is provided by section 56 Stamp Act 1891 that where the consideration consists of periodical payments the transaction is to be charged with *ad valorem* stamp duty, i.e. it is to be treated as a conveyance on sale. In consequence, the grant of an annuity in consideration of the transfer of property is to be treated as a sale of that property.

The rules for calculating the amounts subject to stamp duty are arbitrary and bear no relationship to either the commercial value of the transaction or, in general, the market value of the interests in the property transferred or the life expectancy of the annuitant, which may be significantly less than 12 years.

Section 56 provides:

"**How consideration consisting of periodical payments to be charged**

(1) Where the consideration, or any part of the consideration, for a conveyance on sale consists of money payable periodically for a definite period not exceeding twenty years, so that the total amount to be paid can be previously ascertained, the conveyance is to be charged in respect of that consideration with *ad valorem* duty on such total amount.

(2) Where the consideration, or any part of the consideration, for a conveyance on sale consists of money payable periodically for a definite period exceeding twenty years or in perpetuity, or for any indefinite period not terminable with life, the conveyance is to be

charged in respect of that consideration with *ad valorem* duty on the total amount which will or may, according to the terms of sale, be payable during the period of twenty years next after the day of the date of the instrument.

(3) Where the consideration, or any part of the consideration, for a conveyance on sale consists of money payable periodically during any life or lives, the conveyance is to be charged in respect of that consideration with *ad valorem* duty on the amount which will or may, according to the terms of sale, be payable during the period of twelve years next after the day of the date of the instrument."

In the type of situation under consideration since the annuity will be payable by reference to a life or lives, the most likely provision to apply is section 56(3) of the Stamp Act 1891 quoted above and, where the annuity is of a fixed amount, the stampable amount will be 12 times the amount of the annual annuity payment.

Variable annuities

Where the annuity is of a variable amount the instrument effecting the transfer of property by way of consideration or "premium" is nevertheless dutiable:

where an amount can be ascertained in accordance with the general contingency principle,[25] stamp duty is chargeable upon that particular ascertainable amount. Contingent or variable payments are within section 56 Stamp Act 1891.[26] Normally the variation will be upward so that the starting annuity represents a minimum figure which will be used to calculate the dutiable amount within section 56;[27]

where all or part of the annuity is unascertainable and the property being transferred as the premium in specie is land, the stamp duty is calculated by reference to the value of the land.[28]

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25 See Monroe and Nock *Law of Stamp Duties* 7th edition paragraph 1-99 and following; Nock *Stamp Duties for Property Transactions* 2nd edition 1996 page 86 and following.

26 *Underground Electric Railway Company of London v IRC* [1966] AC 21.

27 *Independent Television Authority v IRC* [1961] AC 427.

28 Finance Act 1994 section 242.

Index-linked annuities

It was until recently generally accepted that an index-linked annuity was in part "unascertainable" because the rate of change in the RPI was not certain so that the starting figure was the basic element in the computation of stamp duty. However, following the decision in *L M Tenancies 1 plc v IRC*,[29] the Stamp Office will seek to apply the historic increase in RPI over an appropriate period to the future to determine a possible future amount, albeit variable, upon which to base the stamp duty charge. The current Stamp Office practice[30] in relation to index linking is to take the increase in the relevant index over the preceding twelve months and apply that increase to the various adjustment dates so as to discover a provisional figure for the various annual payments. The Stamp Office seek to take the compounding effect out of indexation wherever possible. For example, if the annuity is to be increased every 5 years, the stampable figure will be the amount determined by applying the preceding year's increase to the initial figure identifying sum which is then multiplied by 5, being the review period. The calculation is then reapplied to the revised sum and so on, up to the end of the twelve year period of section 56 Stamp Act 1891. It will, of course, be noticed that the shorter the review period the greater the compounding effect of applying the rate of change in the relevant index to the annuity or rent formula.

Lease and agreement for leases

The Stamp Act 1891 imposes various charges to stamp duty upon leases and agreements for lease.[31]

The dutiable instrument

It is provided that an agreement for lease is dutiable as though it were a lease, even where contingent. The stamp duty paid upon the lease itself is cancelled or reduced by the stamp duty paid upon the agreement for lease.[32] Under the present practice rules[33] the Stamp Office will refuse to stamp the lease unless it

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29 [1996] STC 880.

30 See Hansard November 6, 1996 colum 561.

31 Stamp Act 1891 section 75 (as amended).

32 For the problems and practice and procedure for stamping in these cases, see Nock *Stamp Duties for Property Transactions* 2nd edition Chapters 1 and 8.

33 *Practice Notes on Stamp Duty: Agreement for Lease - Law Society's Gazette* 6th July 1994.

is accompanied by the written agreement for lease or it contains a certificate that there is no written agreement for lease to which it gives effect.[34]

The calculation of the stamp duty

(i) *Premium payments*

There is a charge to stamp duty of 1% upon any premium whether payable to the landlord or any other person[35] which consists of or includes any money, stock, security or other property.[36] The extension to other property has given rise to substantial difficulties in the situations under consideration, because there will frequently be a transfer of the freehold linked to the grant of a lease back as a means of disposing of the reversionary interests; and

(ii) *Duty upon the average rent*[37]

The amount of rent payable depends upon the term of the lease, which is broadly

Indefinite term or not exceeding 7 years	50p per £50 or part thereof
Exceeds 7 years but does not exceed 35 years	£1.00 per £50 or part thereof
Exceeds 35 years but does not exceed 100 years	£6.00 per £50 or part thereof
Exceeds 100 years	£12.00 per £50 or part thereof

34 Different practices apply in Scotland where the difference between an agreement for lease and a lease is less frequently encountered.

35 See,for example, *Attorney General v Brown* (1849) 3 Exch 662.

36 As amended by Finance Act 1994 section 241.

37 Which can include contingent or variable rent: see *Coventry City Council v IRC* [1979] Ch 142, although in that case the judge failed to draw the distinction between a fixed amount payable contingently, such as a rent of £X if demanded, and a rent of an uncertain amount which might vary by reference to circumstances of the future, such as a lease granted where the rent is to be linked to the costs of the building to be constructed after the lease has been granted. In such a case it is difficult to see how any significant "averaging" can be carried out when the period during which the rent will or may be payable cannot be ascertained.

Specific sums apply for small transactions where the rent does not exceed £500 and a certificate of value may be inserted where the premium, if any, does not exceed the current threshold of £60,000 and the rent, if any, does not exceed £600.[38]

Term of the lease

Where there is an instrument that can be treated as a lease for life this is regarded by the Law of Property Act 1925[39] as a lease for a term of 90 years and, in consequence, stamp duty is chargeable at the rate of 12% of the average rent. Where there is a lease with a break clause this is ignored and the stamp duty is calculated by reference to the full potential term of the lease;[40] similarly the existence of an option to renew is ignored but the written notice exercising the option[41] will be dutiable as an agreement to grant the new lease.

Value Added Tax

For these purposes it is the view of the Stamp Office that the dutiable amount will include any Value Added Tax that will or may become payable and this view has been upheld in *Glenrothes Development Corporation v IRC*.[42] That case, however, was concerned with a fixed consideration with a specific amount of Value Added Tax payable thereon at completion; it was not concerned with future Value Added Tax upon deferred or contingent amounts where the rate of Value Added Tax at the time of the calculation of the payment cannot be known. Regrettably, the decision in *L M Tenancies 1 plc v IRC*[43] would appear to have decided in principle in favour of the Stamp Office. That case suggests that when seeking to stamp an instrument where the consideration or rent is linked to a format involving future values, it is possible to take the present values of the factors involved in the formula and to charge stamp duty upon the sum so produced as a provisional or prima facie variable sum. Thus, in relation to rent, there is a formula involving future rates of Value Added Tax. *L M Tenancies 1*

38 Finance Act 1984 section 128.

39 Section 149(6).

40 *Cummins Engine Ltd v IRC* [1985] STC 606.

41 Law of Property (Miscellaneous Provisions) Act 1989 section 2; *Spiro v Glencrown Properties* [1991] 2 WLR 931.

42 [1994] STC 74.

43 [1996] STC 880.

plc v IRC[44] would suggest that the Stamp Office are entitled to use the rate of Value Added Tax in force at the time of the execution of the relevant instrument and calculate the stamp duty accordingly. This means that where the rent is expressed to be subject to Value Added Tax the amount of such Value Added Tax will be included in the chargeable rent. Where the rent is initially exempt but the option to tax will or may become exercisable at some time in the future, the amount of the potential Value Added Tax is added to the rent from the commencement of the lease at the rate in force at the time when the lease is granted or the agreement for lease is entered into. However, there is a potential problem in that if the Value Added Tax is not regarded as forming part of the rent then the Stamp Office may treat this not as rent but as a sum payable by way of further consideration for the grant of a lease of a periodical nature.[45] The effect of this is that the Value Added Tax that will or may become payable as or when the option is exercised constitutes a periodical payment within section 56 Stamp Act 1891. In consequence the stamp duty is charged at the rate of 1% of the amount of Value Added Tax that will or may become payable over the life of the lease or 20 years, whichever is the shorter. The basic result of this is a higher charge to stamp duty than if the Value Added Tax formed part of the rent in all cases where the term of the lease does not exceed 100 years. Unfortunately, the Stamp Office practice in this area is not particularly consistent and it is not a particularly easy issue around which to draft.

Fortunately, however, most of the situations under consideration are concerned with residential or sheltered accommodation where the possibility of the transaction becoming subject to a positive rate of Value Added Tax does not, at present, arise,[46] but the point may need to be considered in other types of transaction involving land transfers and leaseback as premium.

Land Exchanges

Prior to the Finance Act 1994 land exchanges and similar arrangements did not constitute "sales" within the head of charge "Conveyance or Transfer on Sale" and so did not attract *ad valorem* stamp duty except in the case of exchanges of freehold land for freehold land where there was an equality payment in cash in

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44 [1996] STC 880.

45 See SP11/91.

46 See Value Added Tax Act 1994 Schedule 9 Group 1 Item 1 and Schedule 10.

excess of £100.[47] It was the view of the Stamp Office that the ability to exchange interests in land without *ad valorem* stamp duty was an abuse and section 241 of the Finance Act 1994, with typical Stamp Office overkill, provided that where there is a transfer of land or the grant of a lease or an agreement to grant a lease for a consideration which consists not only of the traditional sale consideration such as cash or shares but any other property, it will be subject to a charge to *ad valorem* stamp duty upon the market value of the other property.

These provisions are easy to apply where there is a simple exchange of land. For example, where A agrees to exchange Blackacre in consideration of B's transfer of Whiteacre then there will be two charges to *ad valorem* stamp duty at the rate of 1% each upon the market value of Blackacre and Whiteacre as adjusted for any cash equality payment.[48]

However, there are various issues that need to be considered in more complicated arrangements such as those under review. There are two charges to *ad valorem* stamp duty but it is the view of the Stamp Office that where there is a mutual transfer of property suitable drafting may reduce the charge to stamp duty from 2% to 1% upon the value of the transaction. This depends solely upon the drafting

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47 In practice the Stamp Office applied the rules relating to certificates of value so that where the cash equality payment, including any Value Added Tax, was less than the current threshold of £60,000 only the fixed conveyance duty of 50p per instrument was chargeable - Stamp Act 1891 section 73 (but now amended by Finance Act 1994 section 241).

48 The position can be complicated where both Blackacre and Whiteacre had been opted to tax for the purposes of Value Added Tax. In this situation A will be transferring Blackacre in consideration of B transferring Whiteacre plus the payment of the relevant amount of Value Added Tax and, conversely, B will be transferring Whiteacre in consideration of A transferring Blackacre and paying relevant amount of Value Added Tax. It is the view of the Stamp Office that in such a situation the stamp duty is chargeable not only upon the market value of the relevant item of land transferred by way of consideration but also the relevant Value Added Tax payment. Therefore, in this illustration, stamp duty would be charged at the rate of 1% upon each of the Value Added Tax payments. However, the Stamp Office appear to be prepared to accept that where the contract provides for a setoff of the two items of Value Added Tax, so that the agreement provides only for a single payment of the net difference, the stamp duty will only be charged upon the single payment of the net difference. There is, therefore, a possibility of substantially mitigating the stamp duty from, at least, 1% of the Value Added Tax payments on both sides to a single charge of 1% upon the net amount.

of the consideration clause in the contract[49]. For these purposes it would seem that the Stamp Office take the view that where A agrees to transfer land to B, either:

- "in consideration of the transfer of the land"; or
- "as consideration for a transfer of the other land"

by B to A, this will be regarded as an exchange and therefore subject to charges to *ad valorem* stamp duty upon the relative market values of both of the properties pursuant to section 241 Finance Act 1994, i.e. a 2% charge.

"To be satisfied by"

However, it would appear, that as a result of the decision in *Connell v Begej*,[50] where the contract provides that A is to transfer property to B in consideration of the sum of £X to be satisfied by the transfer of B's land and the payment of a small sum by way of equality this will be treated as a single sale, so that transfer of A's land to B will attract the charge of 1% upon the value of B's land plus the cash equality but the transfer of B's land to A will be dutiable only 50p as a "Conveyance of any kind not hereinbefore described", i.e. a conveyance otherwise than on sale. It is, however, in the view of the Stamp Office crucial that:

> the transaction produces a sale of the more valuable property, and there is a cash sum by way of equality. For example, if A's and B's land are exactly equal in value then as far as the Stamp Office are concerned it would not be possible to achieve a single sale but there would be an exchange producing a double "sale".

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[49] See *Portman v IRC* 35 ATC 349 for the importance of planning the stamp duty drafting from the contract stage and not leaving it until the completion stage. In that case A agreed to sell land to B for a cash sum; B agreed to sell land to A for a cash sum; the completion was dealt with by way of Deed of Exchange and the payment of equality money. It was held that in view of the contracts the Deed of Exchange was in fact the completion instrument for two conveyances on sale attracting stamp duty of 1% upon each of the cash sums in the two original contracts. In order to avoid this problem the contract should have been dealt with as an exchange of the land in a single contract with the payment of cash equality if any.

[50] (1993) 39 EG 123.

Furniss v Dawson

It has been held that *Furniss v Dawson* applies to stamp duty[51] and although for many years there has been no evidence of the new approach being used for stamp duty, the current Stamp Office may well seek to resurrect the point. It is the view of the Stamp Office that where, in this type of situation, the parties insert a small cash sum that has no real significance and which is inserted solely for the object of producing a single sale for stamp duty purposes, they can ignore that cash sum and treat the transaction as two exchanges without a cash equality payment and therefore as a double sale.[52] This risk should be borne in mind when inserting token cash sums or nominal rents for the production of a *prima facie* sum within the general contingency principle in order to escape from the market value and double sale regimes of the Finance Act 1994.

Transfer and leaseback

Another major problem arising out of section 241, particularly relevant to the present purposes, is the ambit of the provisions. They are not limited to simple cases of exchanges of land such as that illustrated above but apply, *inter alia*, to the grant of leases for consideration other than cash. Therefore, where A agrees to transfer Blackacre to B in consideration of B agreeing to grant and/or granting a lease of Whiteacre then the effect of section 241 Finance Act 1994 is to create two charges to *ad valorem* stamp duty:

- Blackacre is transferred by A in consideration of a stampable consideration equal to the market value of the lease of Whiteacre to be granted by B; and

- B will be receiving the transfer of the land of Blackacre for a stampable consideration equal to the market value of the lease of Whiteacre.

In this situation, therefore, there are three potential charges to *ad valorem* stamp duty:

- *ad valorem* stamp duty under the head "Conveyance or Transfer on Sale" on the transfer of Blackacre;

[51] *Ingram v IRC* [1985] STC 832.

[52] See Inland Revenue Tax Bulletin, August 1995.

- *ad valorem* stamp duty under the head "Lease or Tack" in respect of a premium for the grant of the lease; and

- *ad valorem* stamp duty under the head "Lease or Tack" in respect of the rent, if any, reserved by the grant of the lease of Whiteacre by B to A.

This is not restricted to situations where two properties are involved. There is for these purposes a similar charge where A and B enter into a transaction for the sale or disposal of A's freehold interest in Blackacre in consideration of a leaseback of Blackacre. In some respects this has always been a situation such as where A owns Blackacre which is worth £1 million which he agrees to sell to B for £1 million and B agrees to grant a leaseback to A for a full market rent of £100,000 subject to review.[53] B would pay stamp duty of 1% upon £1 million upon the transfer of Blackacre and A, as tenant, would be subject to stamp duty upon the agreement for lease and/or lease of Blackacre at the appropriate rate by reference to the rent of £100,000[54] there being no value in the freehold in excess of the cash sum paid to constitute a premium in kind within section 241 Finance Act 1994.

The position is, however, now significantly more complicated, particularly in the context of home annuity and reversionary arrangements where it is unlikely that there will be a disposal of the entire interest in the house.

For example, A is the freeholder of Blackacre and he wishes to transfer the house to the trustees of a settlement but to retain a lease for life, either rent free or at a rent below the market rent. Subject to the conveyancing and land law difficulties in this area,[55] the stamp duty consequences would be that if the transfer were regarded as a transfer of the freehold land in consideration of the grant of the leaseback, and there is every reason to believe that in practice the Stamp Office would take this view at every available opportunity, the liability to stamp duty

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53 A review provision would be required since in its absence the Stamp Office might claim that because the rent was not reviewable the leaseback had the potential for obtaining some equity or market value as the rent fell below market rents over time.

54 This would be upon the basis that the £100,000 is a rent which is reviewable upwards only and so represents a minimum rent subject to the charge of stamp duty; but see the comments later on Finance Act 1994 section 242 and *LM Tenancies 1 plc v IRC* [1996] STC 880.

55 See, for example, *Ingram v IRC* [1995] STC 564.

would, in view of the Stamp Office, be based upon the exchange of the freehold interest for the leaseback, so that:

- the transfer of Blackacre would be subject to stamp duty at the rate of 1% upon the market value of the leaseback, which could be substantial if the lease were rent free;

- the lease would be treated as being granted for a premium equal to the market value of the freehold interest being transferred; and

- if there were a rent payable under the lease, whilst this would reduce the market value of the lease for the purposes of assessing the stamp duty upon the transfer of the freehold interest, it would attract stamp duty in its own right as a rent payable under a lease and if, as is possible, the lease were for a significant term or for life the stamp duty could easily rise to 12% of that rent.

For example, if Blackacre is worth £200,000 and there is reserved to the person a lease rent free which is granted for 25 years and has a market value of £75,000, the stamp duty would be:

- upon the transfer of the freehold interest, 1% upon £75,000 being the value of the leaseback by way of consideration; and

- 1% upon £200,000 as a premium for the grant of the lease being the market value of the freehold interest.[56]

The total charge to stamp duty would be £2750 plus the expense and inconvenience of having to agree valuations with the Stamp Office.[57]

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[56] It is assumed in this illustration that there is no rent to attract duty or reduce the value of the lease.

[57] It seems that in practice the Stamp Office will accept the valuations of the parties provided that:

- they are acting at arm's length;
- the valuations are prepared by professional advisers; and
- the valuations are reasonably contemporaneous with the execution of the relevant instrument. This turning point can be a potential problem where agreements for lease are involved since should there be a delay between the agreement for lease and completion by the grant of the lease the Stamp Office may regard the valuation prepared for the negotiations leading to the agreement for lease as being too old to constitute acceptable evidence of the market value at the time

It is, however, questionable whether the Stamp Office analysis is correct, particularly in the light of *Ingram v IRC*,[58] as that case essentially indicates what the owner of the freehold interest is doing is simply disposing of a future reversionary interest.

Consistent with this view, the transaction should not, as is the Stamp Office approach, be regarded as a whole disposal of the freehold and a whole disposal of a leaseback, but simply a part disposal by the present occupier of an interest which falls into possession in 25 years' time. On the facts of this illustration, since there is no consideration being provided for what is simply a transfer of the reversion, it takes the form of a gift and would prima facie attract stamp duty of 50p within the head of charge "Conveyance of any kind not hereinbefore described", i.e. otherwise than on sale. However, it should be exempt from stamp duty and free from the need for adjudication by reason of being certified pursuant to Category "L" of the Stamp Duty (Exempt Instruments) Regulations 1987.[59]

It may, of course, be a very difficult issue as to whether this type of analysis would be correct. Although there are suggestions by Megarry J in *Sargaison v Roberts*[60] that when deciding matters of taxation the liability of the taxpayer should not depend upon accidents or antique conveyancing requirements, it is the myopic view of the Stamp Office that these cases, being not directly concerned with stamp duty, have no bearing upon the matter. There is a one-way view of case law by the Stamp Office. Although other divisions of the Inland Revenue may take points based upon cases decided in relation to stamp duty, it is the consistent theme of the Stamp Office over the last few years that cases not decided directly upon stamp duty but upon other areas of law are not of any relevance to stamp duty, notwithstanding that they may be expressed in terms of general principle and analysis of basic rules of general law. Consequently, although these decisions are concerned with the significance of conveyancing machinery in the tax context, because they are not directly applying the law of stamp duty they have no bearing whatsoever and the general principles of land law and the true analysis of the transaction within the context of general principles of land law is irrelevant for stamp duty purposes.

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when the lease itself is executed.

[58] [1995] STC 564; see also on the identification of what is disposed of *Park v IRC* [1970] 1 All ER 611; *Nicholls v IRC* [1975] STC 278.

[59] SI 1987 No 517.

[60] [1969] 3 All ER 1072.

There are, of course, numerous cases dealing with the question of whether there has been a transfer and/or a reservation of benefit[61] and these cases may, of course, be important in construing the effect of the particular instrument. Nevertheless, the startling and frustrating point being applied by the Stamp Office remains based upon a disposal of the whole of the freehold interest and the grant of a completely new leaseback, not merely a disposal of the reversionary interest with complicated conveyancing machinery

Where the leaseback or the interest retained is some form of life interest then the market value of the lease will be tested by reference to actuarial factors which will, of course, be an eventually complicated and expensive exercise in the context of a relatively small transaction.

Lease or licence

Stamp duty is chargeable only upon leases or agreements for lease; there is no stamp duty upon a licence to occupy land,[62] notwithstanding section 60 Stamp Act 1891.[63]

Attempts to mitigate the arrangement by seeking to restrict the interest retained by the freeholder to some form of licence has usually been met by the Stamp Office contending that the licence is really some form of tenancy.[64] The extent to which the Stamp Office have pursued the claim for duty can be shown by the fact that, on the advice of the Inland Revenue Solicitor, it has been contended that a transfer of a part interest in property into joint names linked with an undertaking or covenant by the new joint owner not to seek vacant possession or not to evict the transferor, or an agreement that the purchaser will not call for completion until the death of the transferee or until a sale is proposed, provided that certain conditions are met, is upon a true analysis a lease for life notwithstanding the lack of any interest in land being conferred by the right to defer completion of the transfer in

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61 See, for example, the cases on estate duty cited above.

62 See, for example, *Thames Conservators v IRC* (1886) 18 QBD 279.

63 See also *Great Northern Railway v IRC* [1901] 1 KB 416 on the nature of "property" required for Stamp Act 1891 section 60 to apply.

64 On difficulties of creating merely licences in this area, see *Skipton Building Society v Clayton* (1993) 66 P and CR 223.

this fashion.[65] It may well be that an undertaking or arrangement whereby the joint owners agree not to exercise any powers of sale unless the transferor consents or wishes to cease to reside at the premises would also upon this approach be regarded as a lease for life. It is considered that these analyses are inappropriate since they do not vest any estate in the land in the transferor but are merely restrictions upon the rights conferred upon the new joint owner similar to the restrictions imposed upon trustees who may not be able to sell without the consent of the life tenant.

Variable or contingent payments

As mentioned above, annuities may be of a variable amount or the leaseback may be for a rent which changes from time to time, and at present index linking in some form is not unusual.

It is a traditional principle of stamp duty that *ad valorem* duties can be assessed only by reference to the circumstances as they exist at the time when the instrument is executed.[66] In consequence, where the consideration or rent is unascertainable at the time of the contract for sale or the agreement for lease or the grant of the lease, then *ad valorem* stamp duty was not chargeable.

Prima facie sum

However, for many years the Stamp Office have been seeking to develop the so-called contingency principle which states that where the consideration or rent is not finally determined at the time of the execution of the relevant instrument but it is possible to find a *prima facie* sum that will or may become payable, they are entitled to charge stamp duty by reference to that *prima facie* sum. This has been applied by the Stamp Office where there is a minimum rent subject to increase or

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65 On the nature of the right of a transferor to remain in occupation of the property or of the transferee to enter into occupation, see, for example, *Musselwhite v Musselwhite & Son* [1962] 1 All ER 201; *Shaw v Foster* (1872) LR 5 HL 321; *Re Birmingham* [1959] Ch 523; *Lysaght v Edwards* (1876) 2 Ch D499; *Wall v Bright* (1820) 1 Jac and W 494: these are, however, not cases upon stamp duty and so unlikely to be accepted as authoritative by the Stamp Office.

66 See *George Wimpey v IRC* [1975] STC 248; *William Cory & Son Ltd v IRC* [1965] 3 All ER 917.

a maximum rent subject to reduction or a starting figure that is capable of being increased or reduced.[67]

Land and statutory intervention

Where land is involved the position was changed by section 242 Finance Act 1994 which provides:

> "(1) Where, for the purposes of stamp duty chargeable under or by reference to the heading "Conveyance or Transfer on sale" in Schedule 1 to the Stamp Act 1891, the consideration, or any part of the consideration, for -
>
> (a) the transfer or vesting of any estate or interest in land, or
>
> (b) the grant of any lease or tack,
>
> cannot, apart from this subsection, be ascertained at the time the instrument in question is executed, the consideration for the transfer, vesting or grant shall for those purposes be taken to be the market value immediately before the instrument is executed of the estate or interest transferred or vested or, as the case may be, the lease or tack granted."

As indicated above, this may be relevant where the land is transferred for a variable annuity. To a large extent it may be a matter of drafting whether "part of" such an annuity is unascertainable.[68] It appears to be the view of the Stamp Office that where there is in effect a single composite consideration, albeit partially unascertainable, the new rules do not apply and the basic sum represents the amount by reference to which the stamp duty is to be calculated; but if the consideration has two components one of which is unascertainable, the market value or market rent rules may apply.[69]

There is, therefore, a question of the interaction of the general contingency principle with the new provisions relating to land transactions. The arrangement is provided for by section 242(3) Finance Act 1994 which provides:

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67 See, for example, *Underground Electric Railway Company of London v IRC* [1906] AC 21; *Independent Television Authority v IRC* [1961] AC 427; *Coventry City Council v IRC* [1979] Ch 142.

68 See Inland Revenue Tax Bulletin, August 1995.

69 See further Nock *Stamp Duties for Property Transactions* 2nd edition (1996) Chapter 3 and Chapter 8.

"(3) For the purposes of this section -

(a) the cases where consideration or rent cannot be ascertained at any time do not include cases where the consideration or rent could be ascertained on the assumption that any future event mentioned in the instrument in question were or were not to occur ..."

After some debate it appears that the view of the Stamp Office is that the effect of section 242(3) is that the new statutory provisions are designed to supplement rather than to replace the general contingency principle.[70] The effect of this is that if the Stamp Office can find a *prima facie* sum within the general contingency principle then this will be the stampable consideration or rent and the market value provisions of section 242 Finance Act 1994 will not apply. The statutory provisions will become effective only where no *prima facie* sum can be found or where the consideration is in two parts, part of which is ascertainable and part of which is unascertainable. An illustration of this latter type of situation would be where there is a lease for a rent of £X plus a further sum equal to 25% of the profits derived from a business or subletting of the property. In this situation since the rent has two components, a fixed element and an unascertainable element, part of the rent would be unascertainable so that section 242 Finance Act 1994 would apply to impose stamp duty upon the market rent.[71]

Index linking

The question of this interface between the general contingency principle and section 242 has acquired considerable importance by reason of the dramatic extension of the general contingency principle by the appallingly bad decision in *LM Tenancies 1 plc v IRC*.[72] In this case the parties adopted the long-standing arrangement whereby the consideration payable was a sum equal to the market value of a specified parcel of gilt edged securities 28 days following the execution

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[70] See Inland Revenue Tax Bulletin, August 1995.

[71] However, this may be a matter of drafting since it appears from the Inland Revenue Tax Bulletin of August 1995 that if the rent is expressed as 40% of the profits of the business but such rent to be not less than £X, this would be regarded as a single rent, albeit variable, with a prima facie minimum sum within the general contingency principle which will attract the charge to stamp duty. However, the Stamp Office indicate in the Tax Bulletin (supra) that if small sums are included in the documentation with the sole or main object of producing a token *prima facie* sum in order to attract the general contingency principle these may be treated as not being a proper purchase price or as not a proper rent and so capable of being ignored.

[72] [1996] STC 880.

of the instrument. The traditional theory[73] applied consistently over many generations had been that where the consideration was expressed to be by reference to future market values it was unascertainable for the purposes of the contingency principle, with the consequence that no *ad valorem* stamp duty could be charged under any relevant head. However, the Stamp Office argued successfully that where there is a reference to the future market value of a property then this is contractually a reference to a cash sum equal to the market value of the relevant asset at the date of execution of the instrument, which cash sum is to be increased or reduced by reference to the change in the market value of the asset between the instrument date and the valuation date. There was, in the view of the judge, therefore, a *prima facie* sum, of an amount equal to the market value of the relevant gilt edged securities at the time of execution of the instrument. This is clearly a massive change in the law and is one which judges in previous cases have been reluctant to support.

The strength of the so-called contingency principle derives very much from the comments made in *Underground Electric Railway Co of London Ltd v IRC*[74] and in the *Independent Television Authority v IRC.*[75] The view expressed in the latter case was that there was not a general principle but that the same words should, so far as the context permitted, bear the same meaning in different parts of the stamp duty legislation. This point totally escaped the judge in *LM Tenancies 1 plc v IRC*[76] who believed, mistakenly, that there was a general contingency principle which existed outside the particular heads of charge. It is understood that the case is being taken to the Court of Appeal when, hopefully, stamp duty will be put back upon proper and sensible principles but in the meantime the Stamp Office are using *L M Tenancies 1 plc v IRC*[77] as a springboard into more exciting areas such as those under consideration.

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73 Note the comments of several judges in *Independent Television Authority v IRC* [1961] AC 427 that had they not been bound by the views expressed in *Underground Electric Railway Company of London v IRC* [1906] AC 21, which they found difficult to comprehend upon the law and the facts, they would have found against the Stamp Office and that they were doing no more than applying that decision and were not prepared to extend it. The contrary approach was taken by the Judge in *LM Tenancies 1 plc v IRC* [1996] STC 880 who manifestly did not understand the earlier decision and ignored the reservations of even members of the House of Lords.

74 [1906] AC 21.

75 [1961] AC 427.

76 [1996] STC 880.

77 [1996] STC 880.

Immediately following the decision in *L M Tenancies 1 plc v IRC*[78] a most startling contention was put forward by the Stamp Office on the advice of the Inland Revenue Solicitor. The case concerned a lease of sheltered housing. The basic terms of the agreement for lease and lease were a cash premium of £68,000 and a ground rent starting at £300 but which was to be reviewed and increased by reference to the change in the level of the RPI over a 21 year period. It was generally thought that future increases in the RPI were unascertainable and that the stamp duty would be charged by reference to the market value and market rent at the time of the execution of the relevant documents. Upon the basis that the parties were acting at arm's length it was thought that the £68,000 premium and £300 ground rent represented the current market value.[79] However, the Stamp Office contended that they could take the current increase in the RPI and extrapolate this historical data into the future and apply this to the rent review at each 20 or 21 year review date. The result was a claim for stamp duty of approximately £65,000.[80] In support of the use of historical data the Stamp Office pointed out that in *L M Tenancies 1 plc v IRC*[81] the instruments had been executed on a Saturday when there was no market for gilt edged securities. The judge had, therefore, adopted the Stamp Office suggestion and taken the value for the previous Friday as being evidence of the value on the Saturday; this was regarded as further support by the Stamp Office for their view that they could use historical data in order to arrive at future values. The assessment was disputed upon the basis that *L M Tenancies 1 plc v IRC*[82] was wrongly decided but that even if correctly decided it was not a legitimate extension of the principle to use historical data, particularly where the data was a movement over time and not a value on a single occasion, in order to arrive at a current figure for future values.

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78 [1996] STC 880.

79 See *Lap Shun Textiles v Collector of Stamp Duty* [1976] AC 530 for the view that arm's length negotiation is reasonable evidence of market value; and compare *Stanton v Drayton* [1982] STC 585 on arm's length negotiation as being more or less conclusive as to market value; the latter being concerned with capital gains tax is paid scant regard by the Stamp Office, notwithstanding it is a matter of general principle capable of wider application than the capital gains tax context in which it appears.

80 Fortunately, because this was a case of sheltered housing, the question of Value Added Tax upon this reviewable rent did not arise, but had the rent being subject to Value Added Tax or subject to the exercise of the option to tax the stamp duty would have been of the order of £76,000.

81 [1996] STC 880.

82 [1996] STC 880.

The Stamp Office, possibly under political pressure,[83] backed down quite spectacularly but they have continued to maintain that they are entitled to use historical data in order to arrive at current figures for future values. What they have done is to change the basis of calculation and, therefore, the construction of the contract. The contract in *LM Tenancies 1 plc v IRC*[84] was construed by the judge as stating that the rent was a provisional figure equal to the £300 plus a starting figure to be derived by taking the future market value. By applying this to the RPI the contract was to be treated as saying that the rent was £300 to be increased each 21 years by a provisional figure equal to £300 adjusted by reference to the increase in the RPI over the preceding 21 years, being the period equal to the review period in question. This provisional figure would be increased or reduced in practice depending upon whether the actual increase in RPI over the future 21 year period was greater or less than that which had occurred over the historical 21 year period taken as the starting figure. This applied, in accordance with the contract, the full compounding effect of increases in the RPI. The Stamp Office have withdrawn the compounding effect and now contend that the documentation in the RPI situation is to be taken not as applying the RPI on the compound basis but by taking the increase in RPI in the year or period preceding the execution of the relevant instrument and multiplying that by the number of years between each review date. In this situation, assuming that the RPI in the 12 months preceding the execution of the document was 2%, the contract or lease was stating that the rent would be 2% of the ground rent (i.e. £6) multiplied by 21, i.e. the rent provisionally increased by reference to RPI would be increased by £126. This, of course, is manifestly not how the review clause in the documentation is to operate, because the effect of compounding in the RPI will be given full effect the relevant review date; and so not only has *L M Tenancies 1 plc v IRC*[85] been used to construe unascertainable future rents as provisional sums at the date of execution by reference to historical data, it has also been used to change the effect of RPI from compound to simple interest type of calculations.

The current position clearly lacks any grounding in the documentation as well as any significant intellectual backing. There is nothing in *L M Tenancies 1 plc v IRC*[86] which justifies taking a moving target such as an increase or rate of change over a period of time as opposed to a one-off valuation. Moreover, notwithstanding the use of the market values from the Friday preceding the

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[83] See Hansard Nov 6th 1996 column 561.

[84] [1996] STC 880.

[85] [1996] STC 880.

[86] [1996] STC 880.

execution of the instrument this is not a justification for taking historical data since the judge was clearly using that as evidence of the market value in default of anything else as far as the date of execution was concerned.

It will not have escaped notice that the argument based upon historical changes in RPI as future values was available in *Independent Television Authority v IRC*[87] but was not taken. The Stamp Office justification for not taking the point then but raising it now is that the judges in the House of Lords in that case did not have the benefit of the judgment in *L M Tenancies 1 plc v IRC*[88] - which is a surprising line to take, namely that the point was not available to be taken in the earlier case because the then state of the law did not justify it, but a later change in the law which could have been made at the earlier date now makes the point valid.

There is no need to comment upon argument which by itself indicates the fallacies in the Stamp Office contention.

Nevertheless, notwithstanding that the decision in *L M Tenancies 1 plc v IRC*[89] is manifestly inconsistent with traditional stamp duty principles and practices and is not an application that is a manifest extension if not actually new departure from the principles in the preceding cases, it is clear that the Stamp Office intend to use and develop this decision quite significantly. It does, therefore, represent a significant problem where, in relation to home reversion schemes or annuity arrangements, parties are seeking to cope with longevity and to protect their investments against inflation. There are, therefore, potential problems where any annuity arrangement carries provisions for index linking or increasing in the future or where attempts are made to preserve the reversionary interest of the person providing the funds against inflation. Thus where there is a transfer of an interest in a house for an index-linked annuity, the stampable consideration is to be determined pursuant to section 56, Stamp Act 1891 and the annual historic increase in RPI will be applied.

It seems not unlikely that, unless there is a significant change of attitude by the Stamp Office in their pursuit of every pound of available taxation, there are likely to be many hard fought battles in relation to attempts by the elderly to provide themselves with a reasonable degree of comfort or to protect their estates from taxation on their death.

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87 [1961] AC 427.

88 [1996] STC 880.

89 [1996] STC 880.