[2020] UKFTT 0053 (TC)

TC07549

INHERITANCE TAX – avoidance – "home loan scheme" – purported sale of house to interest-in-possession trust – mislabelled agreements - validity of sale – s2 Law of Property (Miscellaneous Provisions) Act 1989 – s163 Inheritance Tax Act 1984

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2016/07095

BETWEEN

(1) JOHN LEONARD MCNEILL SHELFORD, ILONA CHARLOTTE LAZAR, ROBIN PATRICK HERBERT AND MICHAEL ALAN HERBERT (AS EXECUTORS OF JOHN SELWYN HERBERT, DECEASED); AND
(2) JOHN LEONARD MCNEILL SHELFORD (AS TRUSTEE OF THE HERBERT LIFE INTEREST TRUST SETTLEMENT)

Appellants

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: JUDGE ALEKSANDER

Sitting in public at Taylor House, London EC1 on 15 to 17 May 2019

William Massey QC, Emma Chamberlain and Oliver Conolly, counsel, instructed by Edwin Coe LLP, for the Appellants

Jonathan Davey QC and Thomas Chacko, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. These appeals are against the determinations by HMRC issued on 22 August 2016 under s222 Inheritance Tax Act 1984 ("IHTA"). The inheritance tax ("IHT") in dispute is £560,000.

2. The determinations were issued, all in the same terms, to each of the four executors of John Selwyn Herbert ("Mr Herbert"), who died on 27 September 2013 and also to the surviving trustee of the settlement created by Mr Herbert on 21 March 2002. A single formal notice of appeal, including a request for a review was submitted on behalf of the five Appellants on 21 September 2016. The outcome of the review, upholding the determinations, was notified by letters in identical terms to each of the Appellants sent on 14 November 2016. The Appeal was notified to the Tribunal on 6 December 2016. Section 224, IHTA requires that the Tribunal must confirm the HMRC determinations unless the Tribunal is satisfied that the determinations should be varied (or further varied) or quashed.

3. The appeal concerns the correct IHT analysis of an IHT planning arrangement entered into by Mr Herbert in 2002. The arrangement is referred to by HMRC as "the Home Loan Scheme" in their 2006 guidance to the Pre-Owned Asset Tax ("POAT") which had been introduced by s84 and Schedule 15 Finance Act 2004, and HMRC commented on the IHT effect of the Home Loan Scheme at section 5 of their guidance.

4. It is acknowledged by the Appellants that the purpose of the IHT planning arrangements was to remove the value of Mr Herbert's home from his estate for IHT purposes, whilst enabling him to continue to live in the home rent-free for the rest of his life.

5. At the hearing of the appeal, the Appellants were represented by Mr Massey, Ms Chamberlain, and Mr Conolly, and HMRC were represented by Mr Davey and Mr Chacko.

6. I heard evidence from John Shelford, one of the Appellants. He is the surviving trustee of the Herbert Life Interest Trust Settlement ("the Trust") and one of Mr Herbert's executors. Brian Watson, a director of HE Foster & Cranfield Limited, provided an expert report dated 6 September 2017 on the valuation of the loan described later in this decision. Mr Watson is a Fellow of the Institute and Faculty of Actuaries and is an expert in the valuation of financial interests. His report was not challenged by HMRC, and he was not required to attend the hearing to be cross-examined.

7. In addition, several bundles of documents were admitted in evidence.

8. At the conclusion of the oral hearing, I gave directions for the parties to make written submissions on the application of s163 IHTA if I were to find that the arrangements between Mr. Herbert and the Trust were to be treated as a sale of the freehold to the trustees for consideration – completion and payment of the consideration deferred to the date of his death and no earlier date. This decision takes account of those written submissions.

9. The IHT determinations are all in similar terms, which state:

> In relation to –
>
> A Settlement dated 21st March 2002 (“the Life Settlement”) made between John Selwyn Herbert (“the Deceased”) of the one part and Mr Herbert and Mr John Shelford (“the Trustees”) under which the Deceased was entitled to an interest in possession in the property settled therein,
>
> An Agreement dated 22 March 2002 made between the Deceased of the one part and the Life Trustees under which the Deceased agreed to sell his life interest in his residence 12 Hammersmith Terrace, London, W6 9TS to the

Trustees in consideration of the Trustees issuing an Unsecured Loan Note of even date in the sum of £1,400,000 ("the Debt");

A Deed of Assignment dated 16 April 2002 made between the Deceased and Mr Robin Patrick Herbert, Mr Michael Alan Herbert, and Ms Ilona Charlotte Lazar ("the Assignees") assigning the Loan Note to the Assignees.

Which together are referred to as "the Arrangements"; and

The transfer of value for the purposes of inheritance tax on the death of the Deceased on 27 September 2013.

That, having regard to section 103 of the Finance Act 1986 ("FA'86"), the liability that is sought to be deducted from the estate of the Deceased in relation to the Debt consists of an incumbrance that was created by the assignment by the Deceased of his interest in 12 Hammersmith Terrace to the Trustees of the Life Settlement; and accordingly that, as the whole of the consideration given for the incumbrance was property derived from the Deceased, the value of the said liability shall be abated to nil in determining the value of the Deceased's estate for the purposes of the charge to inheritance tax under section 4(1) of the Inheritance Tax Act 1984 ("IHTA")

In the alternative

That, having regard to the purpose and effect of the totality of the Arrangements, the assignment by the Deceased of his interest in 12 Hammersmith Terrace to the Trustees of the Life Settlement was a "gift" for the purposes of section 102 of the Finance Act 1986 and that 12 Hammersmith Terrace was property subject to a reservation at the death of the Deceased, with the consequence that 12 Hammersmith Terrace must be treated for the purposes of the IHTA as property to which the Deceased was beneficially entitled immediately before his death, to the extent that the property would not already form part of the value transferred by the transfer of value that is treated as made on death under section 4(1) of the IHTA as a result of his interest in possession arising under the Life Settlement.

In the alternative

That, the Arrangements were a composite transaction effected by associated operations within the meaning given by section 268 of the IHTA and that, having regard to the provisions of section 102 of, and paragraph 6(1)(c) Schedule 20 to the FA86, the Debt was property subject to a reservation at the death of the Deceased, with the consequence that the Debt must be treated for the purposes of the IHTA as property to which the Deceased was beneficially entitled immediately before his death."

BACKGROUND FACTS

10. The background facts are, for the most part, not in dispute, and I find them to be as follows.

11. Mr Herbert, a widower with three children, owned and lived in the freehold house, 12 Hammersmith Terrace, London W6 9TS ("the House").

12. Mr Shelford is a solicitor, and was a partner in Edwin Coe (the solicitors representing the Appellants in this appeal) and for much of that time was head of the firm's private client department. He stepped down as a partner in April 2011, but acted as consultant in the firm from then until he retired in December 2017 (I note that Edwin Coe converted from a partnership to an LLP at some point between the creation of the Trust and Mr Herbert's death – but when I refer to Edwin Coe, my reference is to either the partnership or the LLP as relevant at the time in question).

13. Mr Shelford acted for Mr Herbert's parents-in-law, and was a trustee of trusts established by Mr Herbert's mother-in-law. Following the death of Mr Herbert's mother-in-law, Mr Shelford came to know Mr Herbert well, and became a good friend. However, he only became Mr Herbert's solicitor following the retirement of Mr Herbert's brother-in-law (who was also a solicitor), which was towards the end of Mr Herbert's life.

14. Sometime in 2001, Mr Herbert obtained IHT advice from Stevens & Bolton (a firm of solicitors to whom he was introduced by his financial advisors, Smith & Williamson). They advised him to implement the Home Loan Scheme. Mr Herbert asked Mr Shelford to act as trustee of the necessary settlement. All the documents giving effect to the Home Loan Scheme were drafted by Stevens & Bolton, and none were the subject of any negotiation.

15. On 8 February 2002, Foxtons (the estate agents) wrote to Mr Herbert. From the content of the letter, it appears that Mr Herbert had invited Foxtons to visit the House with a view to acting as agents on its sale. In the letter Foxtons recommended that the House be put on the market for sale at an asking price of £1,400,000. Both HMRC and the Appellants accept (and I find) that the House was worth £1.4m on 22 March 2002.

16. The Trust deed is dated 21 March 2002. Under the terms of the deed, Mr Herbert established the Trust with a nominal sum of £10. He and Mr John Shelford were the Trustees. Although £10 was never given to Mr Shelford (as provided for in the Trust deed), £10 was held in Stevens & Bolton's client account for the benefit of the Trust, and it must have been the case (and I find) that Mr Herbert transferred £10 to Stevens & Bolton prior to 21 March 2002 to hold in their client account on behalf of the Trustees.

17. Under the terms of the Trust deed, the Trustees were directed to hold the Trust fund:

> (a) In trust for Mr Herbert for life;
>
> (b) With power to pay or apply the capital of the Trust Fund to or for the benefit of Mr Herbert in such manner as they should decide;
>
> (c) Subject to these on trust for Mr Herbert’s children then living in equal shares, such shares not to vest absolutely in the children, but to be retained on further trusts for those children and their children;
>
> (d) With power at any time during the Trust Period for the Trustees (being at least two in number)
>
> > (i) to appoint any part of the Trust Fund in which an Appointable Share existed to or for the benefit of any of the Discretionary Beneficiaries (the Settlor Mr Herbert, his children and remoter issue born before the Vesting Day, and any further person or class added by the Trustees); and
> >
> > (ii) to transfer any Appointable Share to the trustees of any other settlement;
>
> (e) Subject to all those trusts and powers, to hold the income on discretionary and accumulation trusts, with powers of advancement and appointment in favour of any of the Discretionary Beneficiaries;
>
> (f) The ultimate default trust was in favour of charity.

18. Mr Herbert (as seller) and he and Mr Shelford (as buyers in their capacity as trustees of the Trust) entered into an agreement for sale ("the Sale Agreement") under which Mr Herbert agreed to sell the House to the Trustees for a price of £1,400,000. The Sale Agreement is dated 22 March 2002.

19. The Sale Agreement incorporated by reference the Standard Conditions of Sale (3rd Edition).

20. The following terms are extracted from the Sale Agreement:

> AGREEMENT
> (incorporating the Standard Conditions of Sale (3rd Edition))
>
> Agreement Date: 22nd March 2002
>
> Seller: John Selwyn Herbert of 12 Hammersmith Terrace London W6 9TS
>
> Buyer: The said John Selwyn Herbert and John Shelford of 2 Stone Buildings, Lincoln's Inn, London WC2A 3TH as Trustees of the Herbert Life Interest Settlement
>
> Property: Freehold 12 Hammersmith Terrace London W6 9TS
>
> Title Number: LN142371
>
> Incumbrances on the Property The matters contained and referred to in the Charges Register of the title above mentioned at the date hereof
>
> Title Guarantee: Full
>
> Completion Date: 28 days after the service of a Notice requiring Completion served by one party hereto to the other or 21 years (less three days) from the date hereof (whichever shall be the earlier).
>
> Contract rate: The Law Society's interest rate
>
> Purchase Price: £1,400,000
> Deposit: £1,400,000
>
> Balance: £0.00
> Amount payable for chattels: £0.00
> Balance payable on Completion: £0.00
>
> The Seller will sell and the Buyer will buy the Property for the Purchase Price
>
> This Agreement continues on Pages 2 and 3
>
> WARNING This is a formal document designed to create legal rights and legal obligations. Take advice before using it
>
> [Signed by Mr Herbert and Mr Shelford]

> 1 (a) This Agreement incorporates the Standard Conditions of Sale (3rd Edition). Where there is a conflict between those Conditions and this Agreement, this Agreement prevails.
>
> (b) Where the context so admits terms used or defined in this Agreement have the same meaning when used in the Conditions.
>
> 2 The property is sold with vacant possession on completion.
>
> 3 The Buyer will be entitled to vacant possession of the Property from the date of this Agreement, whereupon the provisions of Standard Condition 5.2 will apply.
>
> 4 The Property is sold subject to the Incumbrances on the Property. Details of such matters having been supplied to the Buyer or his Solicitors prior to the signing hereof he shall be deemed to purchase with full knowledge of

such matters and shall not raise any objection or requisition in respect of the same.

5 This Agreement constitutes the entire contract between the Seller and the Buyer and may only be varied or modified (whether by way of collateral contract or otherwise) in writing under the hands of the Seller and the Buyer or their respective Solicitors.

The Buyer hereby acknowledges that he has not entered into this Agreement in reliance wholly or partially on any statement or representation made to him by or on behalf of the Seller or otherwise save as to such of the written statements of the Seller's Solicitors prior to the making of this Agreement as were not susceptible of independent verification by inspection and search and enquiry of any local or other Public Authority (whether or not such search inspection or enquiry have been made).

6 Title having been deduced to the Buyer's solicitors prior to the date hereof the Buyer buys with full knowledge of the contents thereof as the Buyer hereby acknowledges and shall raise no requisition or objection in relation thereto.

[…]

21. The following provisions are extracted from the Standard Conditions of Sale (3rd Edition)

2.2 **Deposit**

2.2.1 The buyer is to pay or send a deposit of 10 per cent of the purchase price no later than the date of the contract. Except on a sale by auction, payment is to be made by banker's draft or by cheque drawn on a solicitors' clearing bank account.

[…]

2.2.3 Any deposit […] is to be held by the seller's solicitors as stakeholder on terms that on completion it is paid to the seller with accrued interest.

[…]

5.2 **Occupation by buyer**

5.2.1 If the buyer is not already lawfully in the property, and the seller agrees to let him into occupation, the buyer occupies on the following terms.

5.2.2 The buyer is a licensee and not a tenant. The terms of the licence are that the buyer:

(a) cannot transfer it

(b) may permit members of his household to occupy the property

(c) is to pay or indemnify the seller against all outgoings and other expenses in respect of the property

(d) is to pay the seller a fee calculated at the contract rate on a sum equal to the purchase price (less any deposit paid) for the period of the licence

(e) is entitled to any rents and profits from any part of the property which he does not occupy

(f) is to keep the property in as good a state of repair as it was in when he went into occupation (except for fair wear and tear) and is not to alter it

(g) is to insure the property in a sum which is not less than the purchase price against all risks in respect of which comparable premises are normally insured, and

(h) is to quit the property when the licence ends.

5.2.3 On the creation of the buyer's licence, condition 5.1 ceases to apply, which means that the buyer then assumes risk until completion.

5.2.4 The buyer is not in occupation for the purposes of this condition if he merely exercises rights of access given solely to do work agreed by the seller.

5.2.5 The buyer's licence ends on the earliest of: completion date, rescission of the contract or when five working days' notice given by one party to the other takes effect.

5.2.6 If the buyer is in occupation of the property after his licence has come to an end and the contract is subsequently completed he is to pay the seller compensation for his continued occupation calculated at the same rate as the fee mentioned in condition 5.2.2(d).

5.2.7 The buyer's right to raise requisitions is unaffected.

22. Mr Shelford described the Sale Agreement as giving effect to a stamp duty savings scheme, and I agree that it was probably the intention of Stevens & Bolton to implement a "resting on contract" stamp duty deferral arrangement. However, for the reasons described below, it is apparent that Stevens & Bolton had given little thought to the amendments that needed to be made to their standard precedents to give effect to such a stamp duty savings arrangement and the Home Loan Scheme.

23. Mr Herbert (as lender) entered into a loan agreement (executed as a deed) ("the Loan Agreement") with himself and Mr Shelford (as borrowers in their capacity as trustees of the Trust), which is also dated 22 March 2002. The HMRC determinations and correspondence, and Mr Wallace's expert report refer to a "loan note". This is in fact a reference to the Loan Agreement (and to the rights of Mr Herbert and his assigns under that agreement) - there was never any "note" (in the form of a negotiable instrument or other documentary intangible) representing the indebtedness of the Trustees.

24. The following terms are extracted from the Loan Agreement:

WHEREAS:

(A) The Trustees are the present trustees of a settlement made on 21 March 2002 between John Selwyn Herbert of the one part ("the Settlor") and the Trustees of the other part and known as the Herbert Life Interest Settlement ("the Settlement")

(B) Pursuant to an agreement for the sale and purchase of the freehold property know as 12 Hammersmith Terrace London W6 9TS ("the Property") made on the date hereof between the parties hereto ("the Sale Agreement") the Lender has agreed to sell the Property to the Trustees whereby the sum of £1,400,000 is payable on the date stated therein

(C) The parties wish to record their agreement that the Trustees shall not pay the said sum on that date to the Lender, but the Lender shall lend the sum to the Trustees on the following terms

NOW IT IS HEREBY AGREED as follows:

1. The Lender hereby lends the Trustees the sum of £1,400,000 ("the Loan")

2. The Loan shall not carry interest at any time up to and following the due date for its repayment

3. The Loan shall be repayable by written demand given at any time to the Trustees after the death of the Settlor

4. The liability of the Trustees to repay the Loan shall in any event be limited in the following manner:

(a) So long as the whole of the Trust Fund is retained by the Trustees their liability shall be limited to the net realisable value of the assets held by the Trustees from time to time as trustees of the Settlement;

[…]

5. The Trustees shall be entitled to repay the Loan in whole or in part at any time

6. The Lender may assign his/her rights in whole or in part under this Agreement at any time (only by giving notice thereof to the Trustees) and reference in this Agreement to the Lender shall be construed as including his/her assigns and successors in title

7. References in this Agreement to the Trustees shall be construed as including their successors in title as trustees of the Settlement

8. This Agreement shall be governed by the laws of England and Wales

9. This Agreement shall be binding upon the parties' respective heirs successors and assigns

10. Any notice to be given under this Agreement shall be duly given by sending it in the post in a prepaid envelope to the address of the Lender or the Trustees (as the case may be) as set out in the parties clause or such other address as may be subsequently notified by either party to the other

[Executed as a deed by Mr Herbert and Mr Shelford]

25. Mr Shelford's evidence is that the documents were sent by Stevens & Bolton to one of his colleagues at Edwin Coe in February or March 2002. Mr Shelford arranged for this colleague to review the documents to check that they were consistent with other "home loan scheme" type documents that Edwin Coe had seen from other clients at that time. Mr Herbert met Mr Shelford at Edwin Coe (on a date before 21 March 2002). Mr Shelford did not himself advise Mr Herbert on the details of the documents or the Home Loan Scheme, but he did give some "high level" guidance to Mr Herbert about some of the consequences of placing his home in a trust. Mr Shelford did not himself read the documents in any detail (although he did review the first page of the property sale agreement, and verified that the terms of the Trust gave Mr Herbert a vested life interest and entitled Mr Herbert to continue to reside in the House). At the meeting, all the documents were signed by Mr Herbert and Mr Shelford, but the documents were not dated. They were then returned to Stevens & Bolton.

26. Mr Shelford confirmed in his evidence that the Trustees were not represented by any firm of solicitors (or anyone else), and that the title documents relating to the House were left with Stevens & Bolton, and were never produced to the Trustees. Mr Shelford also confirmed that apart from the £10 held in Stevens & Bolton's client account, at the time the documents were signed and subsequently dated, the Trustees had no assets.

27. Mr Shelford also confirmed that although Mr Herbert might have had close to £1 million in cash or liquid assets in 2002, he did not have £1.4 million, and therefore could not have advanced a loan of that amount.

28. Mr Shelford's evidence was that the only basis on which he, as a Trustee, was prepared to enter into the Sale Agreement was because he was aware that Mr Herbert was prepared to execute the Loan Agreement, and that the obligation to pay the deposit under the Sale Agreement would be set-off against the amount due under the Loan Agreement. Mr Shelford described these two agreements as being "linked".

29. Mr Herbert and his three children entered into a deed of assignment (which was executed in four counterparts) ("the Deed of Assignment") which were all dated 16 April 2002. The Deed of Assignment was executed by Mr Herbert and his children. Mr Shelford was not a party to these deeds, and was not able to give evidence as to their execution. But from the correspondence in the bundles, it is clear that the counterparts were circulated to the children by Stevens & Bolton, and signed and returned by them (undated) to Stevens & Bolton.

30. Under the Deed of Assignment, Mr Herbert assigned his interest in the debt created by the Loan Agreement to his children absolutely in equal shares as tenants in common. The assignment was declared to be irrevocable. No consideration was given for the assignment. Notice of the assignment was given to the Trustees pursuant to the requirements of s136, Law of Property Act 1925 and clause 6 of the Loan Agreement.

31. At all times until his death, Mr Herbert continued to reside at the House. He did not pay any rent. Mr Herbert also remained as the person recorded as the registered proprietor of the House at HM Land Registry.

32. The terms of the Loan Agreement allowed the Trustees to prepay the loan at any time, but they did not do so. The terms of the Sale Agreement allowed Mr Herbert and the Trustees to serve a completion notice at any time, but neither did so.

33. With effect from 2005/06, Mr Herbert became liable to POAT. POAT aggregating in total to £196,013 was paid for the tax years 2005/06 to 2013/14, down to the date of Mr Herbert's death.

34. On 8 February 2009, Mr Herbert made a will.

35. Mr Hebert died on 27 September 2013.

36. It is agreed by the parties that the House was worth £2.85 million at Mr Herbert's death, and I so find.

37. Mr D'Alton was appointed as an additional trustee of the Trust on 13 May 2016.

38. A Form TR1, transferring legal title to the House was filed with HM Land Registry on 25 May 2016. The TR1 was (incorrectly) dated 22 March 2002 and stated that the transfer was for no monetary value. No stamp duty was paid at that time on the TR1 and the TR1 was not stamped "PD". The transfer was registered at HM Land Registry on 3 June 2016. At some subsequent time the Appellants must have been advised that the TR1 was liable to *ad valorem* duty as a conveyance on sale and liable to be stamped PD under s28 Finance Act 1931, and that it would not be admissible in evidence without being stamped. A copy of the TR1 (with a corrected transfer date of 26 May 2016) was submitted to HMRC for stamping. Duty of £56,000 plus penalties and interest were paid and the stamp duty and PD stamp were impressed on the TR1 on 23 March 2018.

39. On 13 June 2016, Robin Herbert (one of Mr Herbert's children) assigned part of his entitlement to his wife Zunetta Herbert.

40. On 30 June 2016, the House was sold to unrelated third parties for £3.9 million.

41. Mr D'Alton retired as a trustee on 27 September 2016.

42. By written demands made in June and July 2018, the three children of John Herbert plus Zunetta Herbert called for payment of the amounts due to them under the Loan Agreement. These were paid to them by the trustees.

NATURE OF AGREEMENTS REACHED UNDER THE DOCUMENTS

43. The various documents creating the Trust, the Sale Agreement, the Loan Agreement, the Deed of Assignment, and other ancillary documents were all prepared by Stevens & Bolton. These documents were circulated to the various parties in advance, signed by them (without making any amendments) and returned (undated) to Stevens & Bolton. Mr Shelford did not recognise the handwriting inserting the dates into the various documents, and confirmed that it was not his, was not Mr Herbert's, and was not any of his colleagues at Edwin Coe. The logical inference is (and I so find) that the documents were dated by someone at Stevens & Bolton on the relevant dates as and when the documents were intended to become effective.

44. I am aware that it is common practice for legal documents to be executed by parties in advance of the effective date, and then returned to the relevant party's solicitor undated. The solicitor completes the date to give the document effect under the terms of an authority given to him by his client. I do not consider that there is anything particularly unusual in the fact that this process was adopted by Stevens & Bolton, and I find that the documents took effect (subject to the points I make below) on the dates appearing on their face. There is no evidence to suggest that any of the agreements were backdated, and I expressly find that they were not backdated.

45. It is not disputed that the Trust deed dated 21 March 2002 was effective to create the Trust, and that £10 was settled on the Trust by Mr Herbert (and paid into Stevens & Bolton's client account on behalf of the Trustees), and I so find.

46. What is in dispute is the analysis of the sale of the property to the Trust, the effect of the Loan Agreement, and the subsequent assignment of the debt created by the Loan Agreement.

47. Mr Massey submitted that the effect of the various documents was that

(1) Mr Herbert agreed to sell the House to the Trustees under the Sale Agreement for £1,400,000, payable forthwith by the Trustees under that agreement;

(2) Mr Herbert had bound himself to pay the Trustees £1,400,000 forthwith on the terms of the Loan Agreement;

(3) The Trustees' obligation to pay Mr Herbert the £1,400,000 and Mr Herbert's obligation to pay the Trustees the £1,400,000 were each set off against the other (see *Spargo's Case Re Harmony & Montague Tin and Cooper Mining Co* (1872-73) L.R. 8 Ch.App. 407);

(4) The Trustees, having paid the purchase price and accepted title, became entitled to call for the legal title (and could obtain an order for specific performance if the seller failed to transfer the legal title to them). In consequence they obtained an equitable interest in the freehold of the House, holding it on the trusts of the Trust. (See *Jerome v Kelly* [2004] UKHL 25, *per* Lord Walker at paragraphs [31]-[32]);

(5) Mr Herbert, having paid the Trustees £1,400,000 under the terms of the Loan Agreement, was entitled to the contractual rights under the Loan Agreement being the right to receive £1,400,000 after his death.

(6) The rights are set out in Clause 3 of the Loan Agreement, the principal right being that the Loan was repayable by written demand given at any time to the Trustees after Mr Herbert's death. The lender's rights were assignable.

(7) By the Deed of Assignment dated 16 April 2002, Mr Herbert assigned the benefit of the Loan Agreement to his three children in equal shares (giving notice to the Trustees).

48. However, Mr Massey subsequently modified these submissions. Rather than the sale consideration being set-off against the loan proceeds, Mr Massey submitted that Mr Herbert released his contractual right to be paid £1.4m under the Sale Agreement in consideration of the Trustees' obligations to make payment under the Loan Agreement. This was "discharge by agreement", as analysed in *Chitty on Contracts* (Chapter 22, 33rd Edition):

> **Section 3. - Accord and Satisfaction**
>
> **Definition**
>
> 22-012
>
> Accord and satisfaction is the purchase of a release from an obligation whether arising under contract or tort by means of any valuable consideration, not being the actual performance of the obligation itself. The accord is the agreement by which the obligation is discharged. The satisfaction is the consideration which makes the agreement operative.
>
> [The authors cite *Close British Russian Gazette and Trade Outlook Ltd v Associated Newspapers Ltd* [1933] 2 K.B. 616, 643 and *Bank of Credit and Commerce International SA v Ali* [1999] I.C.R. 1068, 1078].
>
> Thus, although a release not in the form of a deed is normally ineffective to discharge a contract which is executory on one side only, it will operate as a discharge if the other party agrees to accept some other or additional consideration in return for the right which he abandons.

49. Mr Massey submits that the Loan Agreement operated as a discharge, because Mr Herbert agreed to accept other consideration in return for the immediate right to £1.4 million which he abandoned.

50. There are a number of difficulties with this analysis that I raised with Mr Massey and Mr Davey during the course of the hearing.

51. Mr Shelford described the Sale Agreement as giving effect to a stamp duty "savings" arrangement, by providing for payment of the consideration on exchange of contract, and deferring completion (and therefore the payment of stamp duty) until a later date. These stamp duty deferral arrangements were not unusual at the time, and only became ineffective with the replacement of stamp duty by stamp duty land tax in 2003. But I am aware that to put such arrangements into place successfully requires modification to standard precedent property agreements and procedures and careful drafting and implementation.

52. I note that the reference in Standard Condition 2.2.1 to a 10% deposit is inconsistent with the 100% deposit provided for in the body of the Sale Agreement itself, but clause 1(a) of the Sale Agreement provides in these circumstances that the provisions of the Sale Agreement prevail over the Standard Conditions.

53. But the Standard Conditions provide for the deposit to be paid to the Seller's solicitors (Stevens & Bolton) as stakeholders no later than the date of the agreement. As these requirements are not inconsistent with any provisions in the Sale Agreement, they are

incorporated into the Sale Agreement by virtue of clause 1(a) (Standard Conditions 2.2.1 and 2.2.3).

54. In my view *Spargo's Case* cannot apply to set-off the loan to be made under the Loan Agreement against the deposit to be paid under the Sale Agreement. *Spargo's Case* applies when there are transactions which

> "resolves itself into paying money by A. to B. and then handing it back again by B. to A., if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing the money backwards and forwards" (per Mellish LJ at p414)

55. In this case, if the parties followed the terms of the Loan Agreement and the Sale Agreement, the money would not go from Mr Herbert to the Trustees (under the Loan Agreement) and then back to Mr Herbert under the Sale Agreement. Rather the agreements provide for the loan to be advanced by Mr Herbert to the Trustees, and an equal amount to be paid by the Trustees to Stevens & Bolton to hold as stakeholders pending completion. So, the flow of payments is from A to B, and then from B to C. These are not circumstances to which set-off can be applied.

56. Nor do I consider that these are circumstances in which the obligation to pay the deposit can be said to have been released and discharged by the assumption by the Trustees of the obligations under the Loan Agreement. Whilst it is not precisely on point, I am supported in this approach by the decision of this Tribunal in *Leeds Design Innovation v HMRC* [2014] UKFTT 009 (TC) which considered whether a refinancing of an employee loan (with the same lender) amounted to the discharge or payment of the accrued but unpaid interest on the loan. The Tribunal said:

> 34. We have concluded from this evidence that the taxpayers did not suffer any actual cost as a result of the re-financing, which from their perspective was very similar to a "book entry" as their debts were rolled over into the new re-financing agreement. Taking HMRC's reference to *Minsham Properties*, we agree that in these circumstances Mr Noble and Mr Connolly cannot be treated as having paid the interest since it has not actually, from their perspective, been discharged. We take from *Minsham Properties* that if interest is added to existing outstanding indebtedness, that will not generally be treated as a payment. Here the interest payments were not "placed at the disposal of any other person" but actually remained outstanding and due, although under the terms of a new agreement.
>
> 35. In approaching the question of when interest should be treated as paid, the courts have tended to avoid an over legalistic approach and preferred to ask whether by reference to ordinary language and taking account of commercial common sense and practice, a payment should be treated as having been made. For example in *Paton (as Fenton's Trustee) v Commissioners of Inland Revenue* (1935) 21 TC 626 Lord Atkin observed that to treat capitalised interest as having been paid would be " a travesty of the actual facts … the interest is not capitalised because it has been paid, but because in fact it has not been paid". Equally here, while there might have been a notional settlement of the interest or discount as a result of it being rolled up into the new loans, in no sense has there been any reduction in the liabilities of the payers, the debt obligation (the discount payment) has merely changed in form.
>
> 36. We do not think that *McNiven*, to which Mr Thornhill referred, answers this point and we agree with HMRC that other than the new loan agreements being signed, the re-financing had no other commercial or legal

> consequences for the taxpayers. In *McNiven*, it was accepted that the interest payments had been discharged for the purposes of s 338 Taxes Act 1988 (the trustees had received a cash payment and withholding tax had been paid on that payment). The court was asking not whether the payment should be treated as having been discharged, but whether the fact that the cash to make those payments had been provided as part of a circular flow of cash with the intention to create tax losses coloured the tax treatment of the payment. In fact the court stressed that the question of whether payment had been made was a question of fact, and one which had to be determined by reference to commercial concepts.

57. Similar points can be made in relation to the obligation of the Trustees to pay the deposit for the House – whilst there might have been a "notional settlement" of the deposit as a result of it being "rolled up into the new loan", in no sense has there been any discharge of the liability of the Trustees to pay the deposit, rather their obligation to pay the deposit has merely changed in form.

58. And in any event, particularly once you consider the other issues that arise out of the terms of the Sale Agreement, it is a step too far to treat the Loan Agreement as discharging the outstanding obligations of the Trustees under the Sale Agreement – as it requires a substantial re-writing of the terms of the Sale Agreement, beyond anything contained in the terms of the Loan Agreement.

59. These other issues include:

(1) Clause 2 of the Sale Agreement provides that the House is to be sold with vacant possession. But Mr Herbert remained in occupation of the House throughout;

(2) Clause 3 of the Sale Agreement is strange (as was acknowledged by Mr Massey). It states that the Buyer is entitled to vacant possession from the date of the agreement, whereupon clause 5.2 of the Standard Conditions applies. Standard Condition 5.2 allows the buyer (the Trustees) to go into occupation as licensee, on payment of a fee. But in this case Mr Herbert is both seller and one of the buyers (in his capacity as a Trustee of the Trust), and Mr Herbert is already in possession. So, this clause makes no sense; and

(3) Clauses 4 and 6 of the Sale Agreement provide for incumbrances to be disclosed to the Trustees (or their solicitors) prior to the signing of the Sale Agreement, and for title to the House to be deduced to the Trustees' solicitors. But Mr Shelford's evidence was that Stevens & Bolton kept the title documents and did not produce them to anyone, never mind that the Trustees were not represented by solicitors (or anyone for that matter).

60. I also note that at the time the Sale Agreement was made effective, which must have been before the Loan Agreement became effective given the provisions of recital (C) of the Loan Agreement, the Trustees had only £10 in assets held for their benefit in Stevens & Bolton's client account. The only basis on which they could realistically enter into the Sale Agreement and agree to pay the deposit was because they knew that Mr Herbert would lend the Trustees £1.4m (and this was confirmed by Mr Shelford in the course of his evidence). But Mr Herbert did not have £1.4m to lend to the Trustees. He could only realistically enter into the Loan Agreement (and agree to lend the Trustees £1.4m) on the basis that his obligation to lend the money would be extinguished through set-off against the deposit for the House. I therefore find that the Sale Agreement and the Loan Agreement must be read together as a single agreement (although embodied in two documents).

61. Mr Massey submitted that the fact that the arrangements for the sale and the loan were embodied in separate agreements very strongly suggests that the parties did not intend to sell the House "for an IOU", and leave the purchase price unpaid. But Mr Massey also made submissions that it would be wholly wrong to look at one agreement without looking at the other – and that "there is no doubt that the property had been agreed to be sold and the consideration was not in fact the £1.4m as set out under the agreement for sale, but had been morphed into the loan note effectively - the rights under the loan agreement". I agree with Mr Massey's latter statement - the two documents have to be read together as embodying a single agreement: it was impossible and never intended for the two to be severed and given separate effect as Mr Herbert did not have £1.4m in cash to lend to the Trustees, and the Trustees did not have £1.4m in cash to be able to pay the deposit.

SHAM OR MISLABELLING

62. During the course of oral argument, I raised the question of whether the Sale Agreement (even when read together with the Loan Agreement) is a sham, in the sense articulated by Diplock J (as he then was) in *Snook v London and West Riding Investments* [1967] 2 QB 786 (CA) at 802, where he described a sham as:

> [...] acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. [...] [F]or acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.
> (Although this judgment was not produced during the course of the hearing, its principles were considered in submissions).

63. I find that neither Mr Herbert nor Mr Shelford ever intended that the terms of the Sale Agreement be honoured. There was never any intention that £1.4m be paid as a deposit to Stevens & Bolton as stakeholders. There was never any intention that incumbrances be disclosed by Mr Herbert or by his solicitors to the Trustees or their solicitors, and there was never any intention that title be deduced to the Trustees' solicitors (and, of course, the Trustees had no solicitors).

64. I also find that it was the intention of neither Mr Herbert nor Mr Shelford that the terms of the Loan Agreement be honoured. Mr Herbert did not have £1.4m to lend to the Trustees. The Loan Agreement could only operate through what Mr Massey describes as a set-off against the deposit to be paid under the Sale Agreement – and the Sale Agreement provided for the deposit to be paid to Stevens & Bolton as stakeholders.

65. Mr Massey submitted that it was the intention of the parties that the obligation to make the loan would be discharged by the obligation to pay the deposit – and vice versa – and that these contracts should be interpreted in the light of the intention of the parties and in a way that allows the agreements to be given effect. And I can see the merits in Mr Massey's submissions – but these submissions reinforce the point that the terms of the agreements reflect neither the intentions of the parties nor their actions – which merely supports the argument that these agreements are in some sense shams.

66. However, sham was never pleaded by HMRC in their Statement of Case, and as sham is (at its root) a fraud, it must be clearly pleaded by HMRC before such a finding can be made. It is therefore not open to me to make a finding that the Sale Agreement is a sham.

67. Mr Davey submits that it was never part of HMRC's case that the Sale Agreement is a sham. But Mr Davey submits that there has been "mislabelling" of the Loan Agreement and the Sale Agreement, and his colleague Mr Chacko referred me to the decision of the House of Lords in *AG Securities v Vaughan and others; Antoniades v Villiers and another* [1990] 1 AC 417. The appeal concerned the avoidance of the Rent Acts by the grant of licences to occupiers rather than leases. In the *Antoniades* part of the appeal, a couple, Mr. Villiers and Miss Bridger, were looking for a flat. The landlord granted separate licences to each of them of a small one-bedroom attic apartment. The flat was not fully furnished, and the landlord agreed to supply the couple with a double bed. It was clear from the evidence that Mr Villiers and Miss Bridger were co-habiting, and that the landlord was aware of this. The terms of the licences provided that the Rent Acts did not apply, that they did not have exclusive possession of the flat, and that the landlord was entitled to come and live with them. The House of Lords held that the two licences were interdependent on each other and were therefore to be read together as constituting one single transaction. Since it was the intention of Mr. Villiers and Miss Bridger to occupy the flat as man and wife, and since that intention was known to the landlord, the House of Lords held that the true nature of the arrangement was to create a joint tenancy. The provisions in the licences purporting to reserve to the landlord a power to share the flat and to authorise other persons to share the flat were held not to be genuine. The flat was small and was unsuitable for sharing. The landlord did not genuinely intend to exercise the powers, and these provisions were only intended to deprive Mr Villiers and Miss Bridger of the protection of the Rent Acts. The House of Lords held that the agreements created a joint tenancy and not a licence, and Mr. Villiers' and Miss Bridger's appeal would therefore be allowed.

68. Mr Chacko submits that there are similarities in this appeal with the facts in *Antoniades*. In this appeal, as in *Antoniades*, (a) there are two agreements that need to be read together, and which are in substance one contract; and (b) there are provisions in the agreements which must be ignored because they are wrong. It is not that these provisions are dishonest or a sham, but rather are statements which do not have the legal effect that they purport to have. He referred me to the speech of Lord Templeman who (disagreeing with the judgment of Bingham LJ (as he then was) in the Court of Appeal) said:

> Clause 16 [the provision reserving the right of the landlord to share occupation] was only designed to disguise the grant of a tenancy and to contract out of the Rent Acts. In this case in the Court of Appeal Bingham LJ said:
>
> > "The written agreements cannot possibly be construed as giving the occupants (jointly or severally) exclusive possession of the flat or any part of it. They stipulate with reiterated emphasis that the occupants shall not have exclusive possession."
>
> My Lords, in *Street v Mountford* [1985] AC 809 this House stipulated with reiterated emphasis that an express statement of intention is not decisive and that the court must pay attention to the facts and surrounding circumstances and to what people do as well as to what people say.

69. Lord Oliver in his speech describes the licence agreements as having "an air of total unreality about these documents read as separate and individual licences in the light of the circumstance that the appellants were together seeking a flat as a quasi-matrimonial home."

70. Mr Chacko describes the situation in the *Antoniades* appeal as the "mislabelling" of a lease as a licence, and submits that a similar analysis can be applied to the Sale Agreement and the Loan Agreement in this case. He notes that the House of Lords made findings that some aspects of the licence agreements were shams – for example that the landlord had a

right to live in the flat (when he did not) – but submits that neither he nor Mr Davey are making that kind of submission here.

71. I agree with Mr Davey's and Mr Chacko's submissions that the Loan Agreement and the Sale Agreement have been mislabelled. There is an air of unreality about them read as separate agreements in the light of all the circumstances. I find that the true effect of the Sale Agreement and the Loan Agreement (when read together, and having taken account of the true intentions and actions of the parties), was that Mr Herbert agreed to sell the House to the Trustees, with completion to occur (and the consideration to be paid) on notice following his death.

72. The true effect of the subsequent Deed of Assignment was that Mr Herbert gifted to his three children his benefit under the composite sale and loan agreement (namely the right of his estate to be paid the consideration on completion after his death).

VALIDITY OF SALE AGREEMENT

73. I need to address the impact of s2, Law of Property (Miscellaneous Provisions) Act 1989 ("LPMPA") on my finding as to the true effect of the agreement concluded between Mr Herbert and the Trustees.

74. Section 2 LPMPA provides that

> (1) A contract for the sale or other disposition of an interest in land can only be made in writing and only by incorporating all the terms which the parties have expressly agreed in one document, or where contracts are exchanged, in each.
>
> (2) The terms may be incorporated in a document either by being set out in it or by reference to some other document.

75. Mr Davey submits that the Sale Agreement is invalid as it does not comply with the requirements of s2 LPMPA.

76. Section 2 LPMPA has been described by the Court of Appeal as "merciless" (*Keay & Anor v Morris Homes (West Midlands) Ltd* [2012] EWCA Civ 900 at [9] – not cited to me). If a contract for the sale of land does not include *all* the expressly agreed terms of the sale, it is void.

77. In the light of my analysis above, I agree with Mr Davey, and I find that the requirements of s2 are not met, as the Sale Agreement does not incorporate all of the terms of the contract for the sale of the freehold of the House.

78. Mr Massey submits that it is not open to HMRC to raise s2 as an issue in the appeal, since it was not put to Mr Shelford in cross-examination, and not advanced at any point in the oral hearing. The issue was only raised in the course of written submissions following the oral hearing. I disagree with Mr Massey's submission. It is a matter of legal construction whether the Sale Agreement is valid under s2, and the issue does not therefore need to be put to Mr Shelford as a witness of fact. This issue is fundamental to the analysis of the transactions that are the subject of this appeal, and must be addressed. Although s2 is not mentioned in terms in HMRC's Statement of Case, the Statement of Case does argue (at paragraphs 19-20) that "no disposition of the freehold ever took place in 2002", which is sufficient in my view to permit HMRC to argue that the Sale Agreement is void as a result of s2. Whilst it would have been desirable for HMRC to have raised s2 in their Skeleton and during the course of oral argument, I consider that the Appellants have had the opportunity to consider and respond to the s2 issue in the course of their written submissions, and have therefore had an adequate opportunity to address the issues raised by HMRC.

79. Mr Massey submits that the requirements of s2 have been satisfied as the Sale Agreement as Clause 5 is an "entire agreement" provision, which permits "no oral modification". Mr Massey submits that the Loan Agreement did not operate as a variation or modification of the Sale Agreement, rather it operated as a collateral agreement, by which the obligation to pay the deposit was released and discharged by the Trustees assuming the obligations under the Loan Agreement. The Sale Agreement therefore stands by itself and is valid. But for the reasons given above, I have rejected this submission.

80. Alternatively, Mr Massey submits that s2 is satisfied as the Loan Agreement incorporated the terms of the Sale Agreement by reference, as the Loan Agreement expressly confirmed the terms of the Sale Agreement in Recital (B), subject to the agreement (expressly recorded in Recital (C)) that the Trustees would not pay Mr Herbert the stated £1.4 million on the date specified in the Sale Agreement but the £1.4 million would be due and payable in accordance with the terms set out in the Loan Agreement. I was referred to paragraph [11] of Arden LJ's decision in in *Courtney v Corp Ltd* [2006] EWCA Civ 518 which could be paraphrased as follows:

> ... there is nothing that was expressly agreed between the parties that was not put into either the [Loan Agreement] or the [Sale Agreement] referred to in it.

81. Since the Loan Agreement incorporated by reference all the terms of the Sale Agreement, as well as the variation to them, Mr Massey submits that it satisfied the requirement of s.2 LPMPA, and it is of no relevance that, the Sale Agreement did not incorporate by reference the terms of the Loan Agreement.

82. I disagree with these submissions. First, recitals are not operative provisions of any agreement, they are merely assertions of facts by the parties. Unless there is something in the operative provisions of an agreement, the mere reference to the existence of another agreement in recitals cannot incorporate the provisions of that other agreement into the first agreement by reference. And there is nothing in any of the operative provisions in either the Sale Agreement or the Loan Agreement that incorporates the terms of one into the other. Recital (B) merely records the existence of the Sale Agreement, it does not incorporate the terms of the Sale Agreement into the Loan Agreement by reference. This is very different from the circumstances considered by Arden LJ (as she then was) in the *Courtney* case, where the agreement for the purposes of s2 was a letter, and that letter expressly provided (in its operative provisions) to the agreement being "subject to our formal terms and conditions" which were set out in another document.

83. But more importantly, the written terms of the Loan Agreement and the Sale Agreement did not reflect the true agreement reached between the parties as to the sale of the House. And it must therefore follow that the written documents cannot have satisfied s2, as the written documents (even when read together) did not contain all the terms governing the sale of the House.

84. I therefore find that the agreement reached between the parties relating to the sale of the House to the Trustees and the purported loan by Mr Herbert to the Trustees were void as a result of the impact of s2 LPMPA.

85. In consequence, the Deed of Assignment had nothing on which to "bite", as there were no sale proceeds or loan benefit which could be assigned. I find that this is a fundamental common mistake and in consequence the Deed of Assignment was also void.

86. I therefore find that the House formed part of Mr Herbert's estate at his death. When Mr Herbert died, the House was worth £2.95 million, and this amount must be included in the value of Mr Herbert's estate on death.

ALTERNATIVE ANALYSIS

87. As this decision may well be the subject of an appeal, and as these matters have been argued before me, I now go on to consider what would have been the inheritance tax analysis in the event that I am wrong, and that the agreement for the sale of the House to the Trustees was not void.

88. In this alternative analysis, at the time of his death, (a) the House would have formed part of Mr Herbert's estate, although it was subject to a sale agreement in favour of the Trustees; and (b) Mr Herbert's estate would have had no entitlement to the sale proceeds, as this right had been gifted to his children.

89. On the basis of these findings, it follows, and I find, that the Trustees did not acquire an unfettered equitable interest in the House on 22 March 2002. As stated by Lord Walker in *Jerome v Kelly* at [32]:

> Beneficial ownership of the land is in a sense split between the seller and buyer on the provisional assumptions that specific performance is available and that the contract will in due course be completed, if necessary, by the Court ordering specific performance. In the meantime, the seller is entitled to enjoyment of the land or its rental income. The provisional assumptions may be falsified by events, such as rescission of the contract (either under a contractual term or on breach). If the contract proceeds to completion the equitable interest can be viewed as passing to the buyer in stages, as title is made and accepted and as the purchase price is paid in full.

90. Mr Herbert retained beneficial ownership of the House and continued to enjoy the House (and in particular, continued to occupy it) notwithstanding the agreement for the sale of the House to the Trustees.

91. The equitable interest in the House only passed to the Trustees following the death of Mr Herbert, when the consideration was paid to Mr Herbert's children and daughter-in-law (in consequence of the assignment of Mr Herbert's the right to the consideration by the Deed of Assignment). In fact the registered title was transferred to the Trustees (and sold on to the unrelated third parties) before the consideration was paid to the children and daughter-in-law – but in such circumstances some form of implied or constructive trust would be impressed on the House, and its sale proceeds, against which the children and daughter-in-law would have a tracing remedy, and they thereby retained an equitable interest in the House (or its proceeds of sale).

92. The unchallenged expert evidence of Mr Watson is that the value of the debt due under the terms of the Loan Agreement on 22 March 2002 was £532,500. He substantially discounted the value from £1.4m nominal to take account of the fact that it was interest-free, unsecured, illiquid, and only repayable in the event of Mr Herbert's death. As Mr Watson's evidence is unchallenged, it is unnecessary to review his reasons in any more detail. But I note that in addition to the factors considered by Mr Watson, the loan is also of limited recourse, limited solely to the assets held within the Trust, so that if the Trust's assets decreased in value, the creditor's rights to recover against the Trustees would be correspondingly reduced.

93. It follows, submits Mr Davey, that the sale of the House to the Trustees was at a significant undervalue as Mr Herbert agreed to sell the House for £1.4m payable on his death.

The entitlement to be paid £1.4m on Mr Herbert's death only had a value of £532,000 on 22 March 2002, whereas the House was worth £1.4m on that date.

94. Mr Massey submits that Mr Watson's valuation only applies to the rights given by Mr Herbert to his children, the transfer of which reduced Mr Herbert's estate and gave rise to a potentially exempt transfer. The valuation is of no assistance, submits Mr Massey, in determining whether the consideration from the Trustees for the purchase of the House was less than full, as any such determination would also need to take account of the value of the right of Mr Herbert to remain in the property pending completion of the sale. However, Mr Massey advanced no evidence to support this submission.

95. It was not disputed that the creation of the Trust by the transfer of £10 by Mr Herbert to Stevens & Bolton (who held it for the benefit of the Trustees in their client account) gave rise to no transfer of value as defined in s.3 IHTA. This was because, by virtue of his life interest under Clause 4(1) of the Settlement, Mr Herbert had an interest in possession in the whole of the Trust Fund and so, by s.49(1) IHTA, the £10 held by the Trustees remained treated for IHT purposes as property to which he was beneficially entitled. There were no other tax consequences.

96. Mr Massey's original submission was that the effect of the Sale Agreement and the Loan Agreement was that the Trustees:

> (1) acquired the equitable interest in the freehold of the House under the Sale Agreement; but
>
> (2) were under a contractual obligation to pay to Mr Herbert’s executors or assignees pursuant to the Loan Agreement the sum of £1.4 million (not immediately but on written demand at any time after his death).

97. Mr Massey submits that these transactions did not give rise to a transfer of value for IHT purposes because, although as a result of the transaction, Mr Herbert now only had in his free estate the contractual right to be paid £1.4m on his death, he was treated by s.49(1) IHTA as beneficially entitled to the property comprised in the Settlement, being the House (subject to the obligation to repay the £1.4m loan on his death).

98. Under this analysis, the value of the House at death (£2.85m) was included in the valuation of Mr Herbert's estate at death, but this was subject to a reduction of £1.4m to reflect the obligation of the Trustees to repay the loan to the children, and that net amount was included in the IHT return.

99. Mr Massey acknowledges that the Sale Agreement gave rise to a disposal by Mr Herbert for capital gains tax purposes, and capital gains tax was paid by Mr Herbert in respect of the sale.

100. Mr Massey submits that even if these contracts were "mislabelled" (as I have found), this makes no material difference in the IHT analysis as:

> (1) the Loan Agreement and Sale Agreement would take effect as an estate contract;
>
> (2) Mr Herbert acquired the immediate benefit of an estate contract, being the right to £1.4m payable on his death, a right which he assigned to his children in April 2002;
>
> (3) Mr Herbert's executors were subject to the obligation to transfer the freehold title to the Trustees following his death;
>
> (4) the Trustees were subject to the obligation to pay to Mr Herbert's assignees £1.4m following his death; and

(5) the Trustees acquired the immediate benefit of the right to call for the freehold title on Mr Herbert's death.

101. Mr Massey submits that from an IHT perspective, the analysis is the same as under the "Home Loan Scheme". In particular, that there had been no diminution in the value of Mr Herbert's estate as a result of the Sale and Loan Agreements. There would have been a potentially exempt transfer to Mr Herbert's children of Mr Herbert's entitlement to the sale proceeds - the donees would simply have the benefit of the right to be paid the sale consideration for the House following Mr Herbert's death.

Section 163 IHTA

102. Mr Chacko argued that s163 IHTA applies in the event (as I have found) that Mr Herbert had agreed to sell the House to the Trustees, with completion (and payment of the consideration) to be deferred until after his death.

103. Section 163 provides as follows:

> **163 Restriction on freedom to dispose**
>
> (1) Where, by a contract made at any time, the right to dispose of any property has been excluded or restricted, then, in determining the value of the property for the purpose of the first relevant event happening after that time—
>
> (a) the exclusion or restriction shall be taken into account only to the extent (if any) that consideration in money or money's worth was given for it, but
>
> (b) if the contract was a chargeable transfer or was part of associated operations which together were a chargeable transfer, an allowance shall be made for the value transferred thereby (calculated as if no tax had been chargeable on it) or for so much of the value transferred as is attributable to the exclusion or restriction.
>
> (2) Where the contract was made before 27th March 1974 subsection (1) above applies only if the first relevant event is a transfer made on death.
>
> (3) In this section "relevant event", in relation to any property, means—
>
> (a) a chargeable transfer in the case of which the whole or part of the value transferred is attributable to the value of the property; and
>
> (b) anything which would be such a chargeable transfer but for this section.

104. Mr Massey makes the point that HMRC placed no reliance on s163 until towards the end of their oral submissions, and that s163 was not raised in any of the IHT determinations or in HMRC's Statement of Case. But s163 was only raised by HMRC in response to my suggestion during the oral hearing that the Sale Agreement and Loan Agreement might be a sham, or at any rate mislabelled. And because the s163 point had only been raised at a late stage, I gave directions for the parties to be allowed to file written submissions on this issue following the conclusion of the oral hearing, so the Appellants have had every opportunity to provide a considered response to HMRC's submissions.

105. Mr Chacko submits that in entering into an agreement to sell the House, Mr Herbert excluded or restricted his ability to dispose of the House.

106. Mr Massey argues that if HMRC's construction of s163 is correct, then any uncompleted contract for the sale of land must fall within s163 – as, by definition, if a seller agrees to sell land to a buyer, she or he is not free to sell that land to anyone else – and this is

a perverse reading of s163. In these circumstances, the seller has not restricted his right to dispose of property, but rather has exercised that right.

107. Mr Massey gave the example of a seller agreeing to sell Blackacre to an unrelated third party for £1m (market value), for completion in 6 months. The seller dies after 5 months (before completion), at which point Blackacre is worth £1.2m. On HMRC's analysis, s163 would apply, and the seller's estate would be liable to IHT on £1.2m, even though the estate is only entitled to receive £1m. Such a counter-intuitive result suggests, submits Mr Massey, that HMRC's analysis is wrong.

108. Mr Massey drew my attention to various textbooks (*McCutcheon on Inheritance Tax*, *Dymond's Capital Taxes*, and *Simon's Taxes)* and to HMRC's own published guidance. All of these refer to s163 in the context of options. Neither the textbooks nor HMRC's manual consider the application of s163 to an uncompleted contract of sale. But both parties acknowledge that s163, on its terms, is not restricted solely to options.

109. Both HMRC and the Appellants gave an example of a call option granted over Blackacre for no consideration. Under the terms of the option, the option holder can call for Blackacre at a price of £1.2m for five years (and Blackacre is worth £1m on the date the option is granted). Mr Massey accepts that s163 potentially engaged in this example.

110. But Mr Massey submits that there is a fundamental difference between the grant of an option and the entry into an agreement for sale. On the grant of a call option, the grantor obtains no right to sell to the option holder; and correspondingly the option holder is under no obligation to buy from the grantor. By granting the option, the grantor restricts his freedom to dispose of the property because he cannot dispose of it free of the option. In contrast to an option, an agreement for sale imposes an immediately binding obligation on the purchaser to buy, and correspondingly confers on the seller an immediate right to the agreed consideration for the sale. Mr Massey submits that there is good reason to treat grants of option differently from agreements for sale for IHT purposes. If, immediately after the grant, the grantor was to give away the contingent right to the exercise price under the option, such right would be worth nothing or next to nothing, because the option need not be exercised. So, the grantor would make little or no transfer of value. If the option holder then exercised his option, the grantor's estate would, in the absence of s163, be reduced by £1m without any transfer of value occurring. By contrast, in the case of an uncompleted contract for sale, the seller receives a right of substantial value, and on a gift of the benefit of the right to the sale proceeds, a substantial transfer of value would take place. The mischief which s163 targets is present in the case of the grant of an option, but not in the case of an uncompleted but binding contract for sale.

111. Mr Massey further distinguishes uncompleted contracts from call options because in the case of a call option there are two dispositions for which consideration may be given (i) the grant of the option itself, and (ii) the sale on the exercise of the option. But in the case of an agreement for sale, there is only one disposition, the contract of sale.

112. I am nor persuaded by Mr Massey's explanation of why there is a mischief that needs to be addressed by s163 in the case of an option, but not in the case of an uncompleted contract. The grantor's right to option proceeds is not necessarily valueless because an option holder does not have to exercise a call option – the value of the contingent right to the exercise proceeds will depend on the precise facts and circumstances, not least the view the parties may take on likely future changes in value of the underlying asset. I am certainly aware of the "Black Scholes" pricing model being used to value option rights in the case of options relating to shares and other securities.

113. In the case of call options, the option is generally only exercised if the underlying asset is worth more than the option price at the time of exercise. Taking the option example given above, if Blackacre was worth £1.5m as at the date of death, it would be £1.5m that would be taken into account in valuing the grantor's estate, even though the estate would only receive £1.2m on the option being exercised. Whether the provisions of s163 can be said to operate intuitively (or counter-intuitively) will depend critically on the particular factual circumstances: not least any change in the value of the property in question - both in the case of a call option and in the case of an uncompleted contract. And, of course, in the case of this appeal, the Sale Agreement was never intended to be a "typical" uncompleted unconditional contract for sale. As drafted, it had some characteristics that were similar to put and call options – completion would only occur following the giving of notice by one party to the other (there was no fixed completion date, and a far distant long-stop date of 21 years). It was anticipated and intended that the Sale Agreement would not be completed for a very long time, until after Mr Herbert's death. In the course of his evidence, Mr Shelford confirmed that "this is not a conventional contract".

114. Nor am I persuaded by the argument that options and sale agreements can be distinguished because there are two dispositions in the case of an option, but only one in the case of a sale agreement. It is not difficult to envisage two dispositions occurring in the case of a sale agreement, for example where an unconditional deposit is paid on exchange of a conditional contract (as is often the case on the purchase of land by a developer), and the balance of the consideration is paid on completion.

115. I also note Lord Walker's comments in *Jerome v Kelly* at paragraph [37]:

> While the contract subsisted, it would probably have been a breach of contract for the [sellers] to sell the land to another purchaser, or indeed to make any transfer of it […]. Even though the contract was protected by registration, the sellers would have been acting contrary to their contractual duty in depriving themselves of their personal power to complete the contract. But there was no inhibition on any of the sellers making an assignment of his or her own beneficial interest, and that is what the taxpayer and his wife did (as to part of their respective interests). The land remained vested in the same [sellers], who continued to be bound by the contract with [the buyers] but there was a partial change of beneficial interest.

116. I find that Mr Herbert, by entering into an agreement to sell the House to the Trustees, restricted his right to freely dispose of the House, and that s163 applies to the valuation of the House at the time of Mr Herbert's death. There is nothing in s163 which suggests that it cannot apply to an uncompleted contract of sale, and the kind of "counter-intuitive" results (which Mr Massey submits demonstrate that s163 should not apply to uncompleted contracts) can be found to arise with options.

117. But Mr Massey further submits that independently of the application of s163 to uncompleted contracts, the operation of s49(1) IHTA in the facts of this case exclude the application of s163. This is because the Trustees' right to acquire the House and dispose of it freely are deemed to be owned by Mr Herbert as the interest-in-possession holder under the Trust. I am not persuaded by this submission, as the Trustees only have a right to dispose freely of the House once they have paid for it, and title has been transferred to them, so even if all of the Trustees' rights are attributed to Mr Herbert (and I am not convinced, and do not find, that s49(1) necessarily has that effect), those rights do not include a right to dispose freely of the House whilst the contract remains uncompleted and the purchase price unpaid. I also note that at the time the contract to buy the House was concluded, and even immediately

following Mr Herbert's death, the Trustees did not have sufficient cash to be able to buy the House. They would either have had to raise a loan secured on the house to finance the purchase, or to sub-sell the House on to a third party (as they effectively did).

118. I therefore find that by agreeing to sell the House to the Trustees, Mr Herbert's right to freely dispose of House was restricted. In consequence. s163 applies when valuing the House, and the value of the House as at the date of death (£2.85m without regard to the terms of the sale to the Trustees), is included in the value of Mr Herbert's estate.

119. Mr Massey submits that if s163 applies, s163(1)(a) will operate to reduce the value of the House brought into charge. This is on the basis that £1.4m is the consideration given for the agreement for the sale of the House, and it is that agreement that is the very thing that restricted Mr Herbert's ability freely to sell the House. Mr Davey submits that the £1.4m consideration payable by the Trustees is not consideration given for the right to acquire the House, rather it is consideration for the House itself.

120. I agree with Mr Davey that no consideration is to be brought into account under s163(1)(a), as the £1.4m is consideration for the purchase of the House, not consideration given for the right to acquire the House.

121. Section 163(1)(a) also requires that the consideration in money or money's worth is actually given for the restriction. In this case the £1.4m consideration was not paid until 2018, well after the date of Mr Herbert's death in 2013, which is the date of the "first relevant event" for the purposes of the section.

122. If the Trustees had paid a deposit to Mr Herbert at the time the contract was exchanged, my analysis might have been different (just as if consideration was given for the grant of an option). But as this point was not argued before me, I make no finding in this regard. And in any event, I have found that no deposit was paid.

Settled estate

123. The value of a person's estate immediately before his death is the aggregate of all the property to which he is beneficially entitled. It includes settled property in which he has a qualifying interest in possession, since he is by s49(1) IHTA treated as beneficially entitled to it. As Mr Herbert had a qualifying interest in possession in the property comprised in the Trust, the assets of the Trust are included in the computation of the value of Mr Herbert's estate. Although s.49(1) IHTA does not expressly provide that the value of the settled property is reduced by the Trust liabilities, it is well-settled that that is what it must mean (see the decision of Mann J in the High Court in *St Barbe Green and another v Inland Revenue Commissioners* [2005] STC 288 at paragraph 12).

124. As at the date of death, the Trustees had a contractual obligation to pay £1.4m to Mr Herbert's children as consideration for a property that was then worth £2.85m.

125. Therefore, as at the date of Mr Herbert's death, the value of the settled estate was the £10 originally settled by Mr Herbert (together with any accumulated interest on that amount) plus £1.45m (£2.85m less £1.4m), and this amount should be included in the IHT computation.

126. Both Mr Massey and Mr Davey made brief submissions as to whether the stamp duty payable on the TR1, transferring the House to the Trustees, should be allowed as a deduction in the computation of the liability of the settled estate to IHT. I note that there is no liability on the Trust or the Trustees to pay stamp duty. Stamp duty is a tax on documents, not on persons, and there is no obligation to pay stamp duty – rather unstamped documents are under certain legal disabilities (in particular they cannot be enrolled in any register and are not admissible in evidence in civil proceedings). Stamp duty has been described as a "voluntary

tax", and its voluntary nature is one of the reasons which lead to its repeal and replacement by stamp duty land tax. I recognise that in practice the Trustees have to pay the stamp duty arising on the TR1 in order to have the TR1 registered at HM Land Registry, but this does not make the duty an incumbrance on the property for the purposes of s162 IHTA. Nor do I consider that the stamp duty liability qualifies as an allowable expense under s164. Section 164 provides that expenses incurred by the transferor in making the transfer (but borne by the transferee) shall be treated as reducing the value transferred. Expenses are not defined for the purposes of IHT, but they are defined for the purposes of capital gains tax as including stamp duty, and it would be reasonable for stamp duty to be treated as an expense incurred in making a transfer. However, the stamp duty on the TR1 is not payable by the transferor (Mr Herbert) but by the Trustees (as buyers), and as it is not an expense incurred by Mr Herbert (or his estate) it does not fall within s164, even though the cost is borne by the Trustees.

127. I appreciate that this conclusion will lead to an element of economic double taxation, as the House is included in the valuation of both Mr Herbert's estate and the settled estate at its market value on death (although with a deduction for the purchase consideration payable to the children in the case of the Trust). However, this serves as a warning that the implementation of tax avoidance schemes can sometime have the consequence of the participants paying more tax than if they had done nothing: if you play with fire, do not be surprised if your fingers are burnt.

OTHER MATTERS

128. There was a dispute about the value of the gift of the sale proceeds made by Mr Herbert to his children pursuant to the Deed of Assignment. In the light of my other findings, I do not consider that anything turns on this point, but as the issue was argued before me, it is better that I address it. Mr Chacko submits that as at the date of the Deed of Assignment, the gift had negligible value. This followed, he argued, from the fact that as at the date of the gift, the House was worth no more than the £1.4m consideration payable. The assets of the Trust would therefore have negligible net value, as the value of the right to the House would be more than offset by the liability to pay the consideration and the need to pay to stamp the TR1. As the liability of the Trustees to pay the consideration was limited in recourse to the assets of the Trust (importing clause 4 of the Loan Agreement), the value of that debt (as gifted to the children) would be negligible.

129. I do not agree with Mr Chacko's submission. Whilst it may be true that the net value of the Trust's assets was negligible, it does not therefore follow that the right to the sale consideration in the hands of the children had negligible value. Even if the children's right to the sale consideration was of limited recourse, they would have had recourse to the Trustees' right to acquire a House worth £1.4m. The liability to pay the consideration would not be taken into account when limiting recourse, as it is this liability which is itself the payment due to the children. Indeed, it was valued by Mr Watson at, and I find that it was worth, £532,000 on the date the gift was made.

130. In the light of my findings about the true nature of the sale agreement between Mr Herbert and the Trustees, and the application of s163 IHTA, I have not analysed the application of ss 102 and 103 Finance Act 1986 to either the purported disposition of the House to the Trustees or of the disposition of the sale consideration to Mr Herbert's children, whether the various transactions are "associated operations", nor whether the *Ramsay* line of cases and a purposive construction of legislation is relevant.

CONCLUSIONS

131. As I have found that the agreement for the sale of the House by Mr Herbert to the Trustees was void, the House formed part of his estate on his death.

132. As the sale was void, it follows that (a) on Mr Herbert's death the House did not form part of the settled estate; and (b) the gift to the children made under the Deed of Assignment was also void.

133. As I have found that Mr Herbert did not dispose of the House, he would not have had any liability to POAT, nor to any capital gains tax on the purported sale of the House to the Trustees.

134. The HMRC IHT determinations will need to be varied to reflect my findings in this decision. I leave it to the parties to reach agreement on the terms of the variations (including any entitlement that Mr Herbert's estate may have to a refund of prior payments of POAT and to capital gains tax). To avoid any doubt, as I have heard no argument in relation to Mr Herbert's estate's entitlement to refunds of POAT or capital gains tax (including the application of relevant time limits), I make no findings in these regards.

135. If the parties are unable to reach agreement, they may make application for me to decide on the necessary variations to the determinations.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

136. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

NICHOLAS ALEKSANDER

TRIBUNAL JUDGE

RELEASE DATE: 27 JANUARY 2020

List of authorities referred to by the parties in the course of submissions, but not mentioned in this decision:
Baldwin v Belcher (1844) 1 Jo & Lat 18
Evans v Evans (1853) 22 LJ 785
Shaw v Forster (1872) LR 5 HL 321
A-G v Worrall [1895] 1 QB 99
A-G v Grey [1898] 2 QB 534
Jones v Barnett [1899] 1 Ch 611
Grey v A-G [1900] AC 124
Re Cochrane [1906] 2 IR 626
Munro v Commr for Stamp Duties [1933] AC 61
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St Aubyn v A-G [1952] AC 15
Oakes v Commr for Stamp Duties [1953] AC 57
Nichols v IRC [1975] 1 WLR 534
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Jenks v Dickinson [1997] STC 853
Ingram v IRC [1997] STC 1234
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Rysaffe Trustee Co (CI) Ltd v IRC [2002] STC 872
IRC v Eversden [2003] STC 822
Barclays Mercantile Business Finance Ltd v Mawson [2005] 1 AC 684
Jones v Garnett [2007] UKHL 35
Phizackerley v HMRC [2007] WTLR. 745
DCC Holdings v HMRC [2010] UKSC 58
Berry v HMRC [2011] UKUT 81 (TCC)
Buzzoni v HMRC [2013] EWCA Civ 1684
Coll v Walters [2016] EWHC 831 (Admin)
UBS v HMRC [2016] UKSC 13
Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd [2018] UKPC 7
Viscount Hood v HMRC [2018] EWCA Civ 2405