

**FIRST-TIER TRIBUNAL
TAX**

BETWEEN

**DAVID MICHAEL FRYER, TRACEY JANE MARSH AND JAYNE
ARNOLD (PERSONAL REPRESENTATIVES OF PATRICIA
ARNOLD DECEASED)**

Appellants

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS (Inheritance Tax)**

Respondents

TRIBUNAL: JOHN CLARK (JUDGE OF THE FIRST-TIER TRIBUNAL)

Sitting in public in London on 7 December 2009

Glyn Evans and Kerry Downes, Independent Financial Advisers, for the Appellants

Nicola Shaw of Counsel, instructed by the **General Counsel and Solicitor to HM Revenue and Customs**, for the Respondents

DECISION

1. The Appellants (“the Executors”) appeal against Notices of Determination issued by the Respondents (“HMRC”) on 15 February 2007. These related to a National Provident Institution (“NPI”) pension policy and the death of Mrs Patricia Arnold, and determined that Mrs Arnold had made a disposition for the purposes of s 3(3) Inheritance Tax Act 1984 (“IHTA 1984”) by deferring her retirement benefits under the policy at the original pension date on 8 September 2002.

The law

2. Section 3 IHTA 1984, at the time relevant to this appeal, provided:

“3 Transfers of value

(1) Subject to the following provisions of this Part of this Act, a transfer of value is a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition; and the amount by which it is less is the value transferred by the transfer.

...

(3) Where the value of a person's estate is diminished and that of another person's estate, or of settled property in which no interest in possession subsists, is increased by the first-mentioned person's omission to exercise a right, he shall be treated for the purposes of this section as having made a disposition at the time (or latest time) when he could have exercised the right, unless it is shown that the omission was not deliberate.

...”

Section 10 IHTA 1984 provides:

“10 Dispositions not intended to confer gratuitous benefit

(1) A disposition is not a transfer of value if it is shown that it was not intended, and was not made in a transaction intended, to confer any gratuitous benefit on any person and either—

(a) that it was made in a transaction at arm's length between persons not connected with each other, or

(b) that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other.

(2) ...

(3) In this section—

“disposition” includes anything treated as a disposition by virtue of section 3(3) above;

“transaction” includes a series of transactions and any associated operations.”

3. Section 221 IHTA 1984 makes provision for notices of determination; there is no need to set it out here. Section 221(5) makes it clear that any notice of determination is “subject to any variation . . . on appeal”. The relevant provision concerning the present appeal (which pre-dated the introduction of the review procedure) is s 224 IHTA, in the form substituted by the Transfer of Tribunal Functions and Revenue and Customs Appeals Order, SI 2009/56 art 3, Sch 1 paras 108, 118 with effect from 1 April 2009:

“224 Determination of appeal by tribunal

If an appeal is notified to the tribunal, the tribunal must confirm the determination appealed against (or that determination as varied on a review under section 223E) unless the tribunal is satisfied that it ought to be varied (or further varied) or quashed.”

The facts

4. The evidence consisted of two bundles of documents, containing extensive correspondence; the principal elements of these documents were contained in a separate core bundle. In addition, reports were provided by two expert witnesses instructed by HMRC. The first had been prepared by Eric Purdy of Adiemus Consulting, an expert (inter alia) in the field of medical insurance underwriting. The main subject matter of this report was Mrs Arnold’s insurability at 8 September 2002. The second had been prepared by Brian Patrick Watson, a Fellow of the Institute of Actuaries, acting as a consultant for Foster & Cranfield. His report related principally to the value of the lump sum and annuity which Mrs Arnold could (in theory) have taken as at 30 July 2003. Both Mr Purdy and Mr Watson were called to give oral evidence.
5. There was a Statement of Agreed Facts in the following form:
 - (1) Mrs Arnold was born on 8 September 1942.
 - (2) On 5 August 1995 Mrs Arnold declared a trust of any Pension Transfer Plan policy issued in connection with her Pension Transfer Plan application together with all rights, benefits and privileges and all monies which might become payable under the policy. The trust was a discretionary trust for a class of beneficiaries which included Mrs Arnold’s children.
 - (3) On 6 November 1995, Mrs Arnold took out a Pension Transfer Plan policy with NPI (“the Plan”). Under the terms of the Plan Mrs Arnold was able to take her retirement benefits at any time between her 50th and 75th birthdays (clause 4.1). If she died before taking her retirement benefits then the value of the assured and additional benefits passed in accordance

with the instructions of Mrs Arnold's legal representatives or to the trustees of any trust of the benefits (clause 4.2). The "normal retirement date" under her policy was 8 September 2002.

(4) On or around 15 April 2002, Mrs Arnold was diagnosed with an advanced ovarian carcinoma. She received some chemotherapy treatment.

(5) Mrs Arnold died on 30 July 2003 without having taken the retirement benefits available under the Plan.

6. In addition to these agreed facts, I find the following from the evidence before me.

General facts

7. The Notices of Determination were issued to each of the Executors respectively on 15 February 2007, in identical form. They stated:

"The Commissioners of [*sic*] Her Majesty's Revenue and Customs have determined –

In relation to –

(a) a National Provident Institution pension policy number [B60496] (the policy)

(b) the death on 30 July 2003 of Mrs Patricia Arnold (the Deceased).

That – the Deceased made a disposition for the purposes of section 3(3) of the Inheritance Tax Act 1984 by deferring her retirement benefits under the policy at the original pension date on 8 September 2002."

8. The documentation for Mrs Arnold's Pension Transfer Plan policy consisted of a Schedule and a "Contracted-in Policy Document" containing the detailed terms applying to the policy. The Schedule specified the "Contract date" as 6 November 1995 and the "Normal retirement date" as 8 September 2002. The "Date on which pensionable service ended" was 8 September 1989. Certain limits relating to the pension were specified.
9. In May 2002, Mr B Squires, who was Mrs Arnold's independent financial adviser at that time, telephoned NPI. As a result of the call, on 29 May 2002 NPI sent him a folder containing details of the benefits and options available, for Mrs Arnold's information. The "Maturity Pack" and cancellation notice were to be sent to Mrs Arnold. Mr Squires was required to complete a form confirming the date on which he had forwarded these to Mrs Arnold. The Maturity Pack included a "Pension Transfer Plan Annuity Illustration".
10. On 18 June 2002 Mr Squires wrote to Mrs Arnold. The first paragraph of the letter was as follows:

“Further to our conversations concerning your pension arrangements I understand that you are not planning to activate the pension on your 60th birthday this year. Nevertheless I have pleasure in enclosing a folder containing details of the benefits and options available for your information.”

Mr Squires also mentioned NPI’s request that Mrs Arnold should appoint additional trustees, and enclosed a deed of appointment, together with a form for nomination of a preferred beneficiary. Mr Squires recommended that Mrs Arnold should consult her solicitor on these documents.

11. The deed appointing additional trustees was executed on 23 June 2002. It referred erroneously to the date of Mrs Arnold’s Declaration of Trust as being that date, and not 5 August 1995. However, the appropriate policy number for the Pension Transfer Plan Policy with NPI was inserted.
12. In a fax dated 24 January 2006 to Mr Downes and Mr Evans, NPI stated in relation to Mrs Arnold’s Pension Transfer Plan:

“I refer to our recent telephone conversation and I can confirm the following.

I am unable to trace any correspondence in the file indicating that Mrs Arnold did not wish to vest her pension benefits.”

On the basis of this confirmation, I find that neither Mrs Arnold nor anyone advising her gave NPI notice of any decision not to vest her pension benefits; she did not take any action in relation to the “Maturity Pack” which Mr Squires sent her.

The experts’ reports

13. In relation to his expert report, Mr Purdy was tendered for cross-examination, but Mr Evans declined to cross-examine him on the grounds that Mr Evans did not consider Mr Purdy’s evidence to be relevant. As a result, Mr Purdy’s evidence was unchallenged.
14. Mr Purdy’s opinion with regard to Mrs Arnold’s insurability at the date of her sixtieth birthday on 8 September 2002 was that she would have been uninsurable at that date. Her diagnosis of advanced ovarian cancer had been made in April 2002 and she was still receiving treatment on 8 September 2002. On the basis of statistics sourced from Cancer Research UK in August 2009, the one-year survival rate for all ovarian cancers was 57.6 per cent, reducing to 29.2 per cent at 5 years, with survival for advanced cancer being 16 per cent at five years. Given this level of likelihood of survival, no terms would have been offered, and any application for insurance would have been declined. Advanced ovarian cancer could be categorised as that which had reached the point at which it had spread to other organs/tissues (metastasized) and this had been confirmed in Mrs Arnold’s medical history.

15. The position in relation to Mr Watson's evidence was initially similar, in that Mr Evans declined to cross-examine Mr Watson on the grounds that his evidence was considered to be irrelevant. Following questions which I put to Mr Watson, Mr Evans then did raise questions relating to the implications of Mr Watson's report. As there were differences of view as to matters arising from the report and Mr Watson's evidence, I deal with these later in this decision.

Arguments for the parties

16. For reasons which I explain below, I set out in more detail than usual the arguments for both parties.

Arguments for the Executors

17. In his skeleton argument Mr Evans indicated that the Executors' argument was based mainly, but not exclusively, on the principle of fair play and the following premises:

- (1) That every individual has the right to arrange their affairs in such a way as to minimize the effect of taxes;
- (2) That to suggest that the burden of proof lay with the Executors was unreasonable. He contended that the burden of proof lay on HMRC;
- (3) That there was no legal requirement at any stage during the term of the policy to inform the provider of a pension of the policyholder's intent to defer taking benefits;
- (4) That the written retirement age (60) for the pension in question was in place by default and even then, not obligatory, as had been confirmed by NPI. There was no material advantage to Mrs Arnold in taking benefits at age 60 rather than at any other time provided by the policy. It followed that the argument that Mrs Arnold had omitted to exercise a right was incorrect, as this right had been open to her at any time between the ages of 50 and 75;
- (5) That Mrs Arnold had been well aware that she could have taken benefits at any time between age 50 and 75 and of the flexibility with which she might have exercised those options in order to minimise income tax on her pension income;
- (6) That the basis on which Mr Oxlade, HMRC's Actuarial Officer, had estimated the loss to the estate (notwithstanding the s 3(3) claim) did not reflect the circumstances under which Mrs Arnold would have taken income.

18. In oral argument Mr Evans put the following points:

- (1) There was no basis for a claim under s 3(3). Benefits could be taken at any time over the 25 year period between age 50 and age 75. Mrs Arnold had not reached the latter age, so had not omitted to exercise that right. The normal retirement date was shown as age 60, but the right to take the pension benefits was at any age over the 25 year period. The only

obligation on NPI was to inform Mrs Arnold of the existence of her rights under the policy. There had been no obligation on Mrs Arnold to take the benefits. There would have been no advantage or disadvantage in her taking the benefits earlier than her 60th birthday.

(2) The position which he had described remained the same through Mrs Arnold's shortened life.

(3) There had been two previous occasions when advisers had suggested to Mrs Arnold that she should take the benefits. On both these occasions her health had been good. She had not required the income. The purpose of pensions was to provide income at a later stage as and when required. Mrs Arnold could not have known that she would be affected by ill health. The timing of her illness and the timing of her need for retirement benefits were entirely matters of chance. The arbitrary retirement date shown in the policy was a result of an earlier statutory provision.

(4) HMRC's case was based on the 1992 Tax Bulletin article; this had been written before pension drawdown arrangements had become possible.

(5) The calculation of the loss to the estate assumed taking an annuity at age 60, using the entire capital net of the tax free cash sum to purchase an annuity for 10 years certain. In actual fact this could not have happened on Mrs Arnold's 60th birthday, because no institution would have granted such an annuity. Further, Mrs Arnold had not needed the income, and even if she had, there would have been far more efficient ways of providing her with income than taking out a 10 year annuity.

19. Mr Evans referred in detail to the Tax Bulletin article (February 1992, entitled "Inheritance Tax: Retirement Benefits Under Private Pension Contracts—Section 3(3) Inheritance Tax Act 1984"). This referred to the benefits, being the retirement benefit and the death benefit as being mutually exclusive. The article had been drafted before the availability of drawdown, but at that time it would have been possible to annuitise part and leave both benefits in existence. The point of the present case was HMRC's claim that Mrs Arnold had deferred the date for taking retirement benefits. Mr Evans re-emphasised his argument that there had been no set date for taking the retirement benefits; the only date when it would have been compulsory was age 75. This was the principal point of challenge to the Tax Bulletin article.
20. Following Miss Shaw's presentation of HMRC's case, Mr Evans made a number of further points in reply:

(1) There was no evidence of an annuity being offered to a person who was terminally ill; it would not have been reasonable to offer a guarantee of income to someone in that position. It had been assumed that there may have been a market; there had been no evidence for this. Mr Evans questioned whether it would have been reasonable for his firm to advise Mrs Arnold in her terminally ill state to attempt to buy an income for life. She would have argued that her advisers were being reckless. According to the hypothesis, the annuity was assumed to be capable of sale to a

reasonable purchaser (and in real life). In the absence of any such purchaser this was not reasonable. A purchaser would not buy an income for life from someone who was terminally ill; this did not reflect a real life scenario.

(2) Mrs Arnold's letter of wishes was not a pro forma; she had used her own words, and there was no mention of any retirement date.

(3) In relation to the definition of deliberate omission, Mr Evans asked how it would have been possible to have an omission to exercise a right which would not have been deliberate. That Mrs Arnold was in no doubt relating to the normal retirement date was not an issue; the most reckless time to have taken benefits would have been at a time when she was terminally ill.

(4) Mrs Arnold's intentions to confer benefits on others, mainly her daughters and their families, were several. This was just one consequence of taking a particular action in choosing to plan her income sensibly.

(5) If what was being said was that Mrs Arnold made a deferral at age 60, indicating that she had at some earlier stage planned to take benefits at age 60, there was no written evidence anywhere suggesting that she had planned to do so.

(6) Mr Evans did not deny that certain providers did offer annuities to persons either with disabilities or who were otherwise impaired, but this was not the same as offering annuities to persons who were terminally ill.

(7) It was unreasonable to expect anyone at the time of taking out a pension contract to plan when to take out benefits. Mr Evans referred to the "spectacular miscalculations" of some pension trustees.

(8) Mrs Arnold and her late husband had sold their business. As a result, Mrs Arnold did not need the money from the pension. It appeared that she was being penalised for not requiring her pension. Mr Evans questioned whether this was a message which should be sent out to the business community or the public.

(9) Mr Evans commented that there had been no reference to any alternative strategy which Mr Arnold could have used at the normal retirement date; if required, he could explain what she might have done. [I indicated that I did not require this.]

(10) At the point when the Tax Bulletin had been published in 1992, the Taxpayers' Charter had been current. There were questions of practicality; Mrs Arnold could not (and would not) have taken out an annuity on her 60th birthday. The s 3(3) claim amounted to saying that she should be penalised for not needing the income. It was claimed that failure to exercise on an arbitrary date had penal consequences. Mr Evans' profession took great interest in these matters.

(11) There was evidence in the correspondence that Mrs Arnold did not consider herself terminally ill at the time of her normal retirement date.

Her actions or inactions had been in ignorance of the possibility that there could be a tax charge. For such an omission to be considered deliberate, one would expect Mrs Arnold to have been aware of the facts and consequences. Had she or Mr Evans' firm been aware of the possibility of a claim under s 3(3), it would have been possible for advice to have been given to her on an alternative strategy to avoid any claim.

Arguments for HMRC

21. Miss Shaw emphasised that this was not a case about tax avoidance or about a taxpayer's entitlement to structure his affairs in the most tax efficient way possible. The appeal was concerned with the issue of whether Mrs Arnold had made a transfer of value for the purposes of s 3(3) IHTA 1984 by failing to draw down her retirement benefits under the NPI policy.
22. Under s 3(1) IHTA 1984, a "transfer of value" required there to be a disposition by a person which resulted in a loss of value to that person's estate. The concept of a "disposition" was widened by s 3(3) to include passive dispositions, meaning omissions which resulted in the enhancement of another person's estate or of settled property in which no interest in possession subsisted.
23. There were three elements to a disposition under s 3(3). The first was a deliberate omission to exercise a right. The second was that this resulted in the value of the disponor's estate being diminished. The third was that the omission led to the value of another person's estate or settled property becoming increased in value. HMRC submitted that each of these three elements was satisfied in the present case:

(1) As to the first, Mrs Arnold had deliberately failed to exercise her right to take the retirement benefits available to her under the policy. The terms permitted her to take the benefits at any time from her 50th birthday (8 September 1992) and the normal retirement date was specified as 8 September 2002 (her 60th birthday). She had been entitled to exercise this right at any time up to her death on 30 July 2003 and she would have been perfectly well aware of her rights. She had not, however, exercised her right. She had expressly rejected the opportunity to exercise her rights when the NPI Maturity Pack had been sent to her in May 2002. By failing to take the retirement benefits Mrs Arnold had made a deliberate omission to exercise a right within s 3(3) IHTA 1984. Miss Shaw argued that there had been nothing inadvertent or ignorant about it.

(2) As to the second, the effect of Mrs Arnold's deliberate omission to exercise her right was that her estate was diminished by the value of the retirement benefits. Up until her death, she could have exercised her right and taken the full value of the benefits permitted under the terms of the NPI policy. As a result of her failure to do so, that value had been lost to her estate.

(3) As to the third, the result of her failure to exercise her right was that the value of the discretionary trust (being settled property in which no interest in possession subsisted) had increased in value.

24. This was HMRC's primary case and Miss Shaw argued that it was sufficient to dispose of the appeal in favour of HMRC, subject to the issue of valuation, unless the Executors could displace the position by bringing themselves within s 10 IHTA 1984.

25. The burden of proof was on the Executors to satisfy the requirements of s 10. Miss Shaw argued that they had adduced no evidence to demonstrate either element:

(1) As to the first element, no intention to confer a gratuitous benefit, she submitted that in order for it to be established it must be demonstrated that Mrs Arnold had had no donative intent. It could be taken that a person intended the natural and probable causes of his or her acts. The effect of Mrs Arnold's failure to take her retirement benefits was that she enhanced the value of the discretionary trust and for the purposes of s 10 IHTA 1984 she was assumed to have intended that result.

(2) Although no evidence had been produced to demonstrate that it was a motivating factor for Mrs Arnold, it had been asserted that she did not take her retirement benefits in order to minimise income tax. In any event, the desire to reduce an income tax liability was not inconsistent with an intention to benefit her daughters through the enhancement in value of the discretionary trust, nor were the two mutually exclusive.

(3) In the same way, the alleged availability of other investments to support her (there being no evidence as to the nature and extent of these other assets) was not inconsistent with and did not displace Mrs Arnold's intention to confer a gratuitous benefit.

(4) The Executors' contentions that there was no requirement on Mrs Arnold to inform NPI of her intention to defer, and that she could take her benefits at any time between ages 50 and 75, did not assist their position in relation to s 10 IHTA 1984.

(5) As to the second requirement in s 10, as to the transaction being such as might be expected in a transaction between persons at arm's length, Miss Shaw submitted that there was nothing "arm's length" about the failure to exercise the right; the Executors had not contended that there had been.

26. Miss Shaw argued that the concessionary treatment provided in accordance with the Tax Bulletin article was not available; the present case had been dealt with entirely in accordance with the statements made in that article.

27. In relation to the issue of valuation, Miss Shaw reviewed Mr Watson's report and his oral evidence. The question of valuation is considered below.

Discussion and conclusions

28. The Notices of Determination refer to Mrs Arnold deferring her retirement benefits under the NPI policy at the original pension date on 8 September 2002. I have found that Mrs Arnold did not take any action to give NPI notice of any decision that she was not going to vest her pension benefits. I am also satisfied that she did not give NPI notice to the opposite effect. She simply took no action in relation to the Maturity Pack. This was because under clause 4.1 of the policy she could choose to take her retirement benefits at any time between age 53 (her age at the inception of the policy on 6 November 1995) and age 75. I find further that at no time following her normal retirement date up to the date of her death did she notify NPI of her wish to vest her pension benefits; in other words, she took no action under clause 4.1 of the policy.
29. For the reasons which I am about to explain, I consider it inappropriate for the Notices of Determination to specify 8 September 2002 as the date of the disposition determined to be made for the purposes of s 3(3) Inheritance Tax Act 1984. To a very limited extent, therefore, I am agreeing with part of Mr Evans' argument. However, this is not a definitive answer to the Notices of Determination issued to the Executors on 15 February 2007.
30. Under s 221(5) and s 224 IHTA 1984, I am required to confirm the determination unless I am satisfied that it ought to be varied or quashed. Is the defect in the determination such as to require it to be quashed, or can it be remedied by variation?
31. The latter question can only be resolved by reference to s 3(3) IHTA 1984. Did Mrs Arnold omit to exercise her rights under the NPI policy? The answer is that at no stage during her lifetime did she opt to take her retirement benefits, as she was entitled to do pursuant to clause 4.1 of the Scheme Rules applying to the policy. Consequently, she omitted throughout her lifetime to exercise her right to take the benefits. The omission was therefore continuing at the date of her death. That being the latest point at which she could have exercised the right, the disposition resulting from the omission must be treated as made on that date. Section 3(3) IHTA 1984 specifies that the disponor

“. . . shall be treated for the purposes of this section as having made a disposition at the time (*or latest time*) when he could have exercised the right . . .” [emphasis added].
32. The words “(or latest time)” are not used in the sense of providing an option, but in the sense of requiring the latest time to be taken as the relevant time if there was more than one occasion at which the right could have been exercised. As the parties agreed, Mrs Arnold's right to take the pension benefits continued at all times from the inception of the contract until the date of her death. The “latest time” was therefore 30 July 2003.
33. The case as prepared on behalf of HMRC discloses some confusion in relation to this. Mr Purdy's report was based on HMRC's instructions to him to provide

an opinion concerning Mrs Arnold's insurability at the date of her 60th birthday, 8 September 2002. However, Mr Watson's report resulted from HMRC's instructions to value annuities which would have been capable of being generated by Mrs Arnold's NPI Pension Transfer Plan at 30 July 2003, the date of her death. At the same time, he had been instructed to advise on the life expectancy of Mrs Arnold at 8 September 2002 based on Mr Purdy's opinion of Mrs Arnold's insurability at that date. If the omission was said to have been made on 8 September 2002, it is not clear why the annuities capable of being generated by the Plan would have needed to be valued as at a later date.

34. It was clear from Miss Shaw's argument before me that the basis for HMRC's claim under s 3(3) IHTA 1984 had been amended. Miss Shaw relied on Mrs Arnold's continuing omission throughout the relevant part of her lifetime to take the retirement benefits. Given the view which I have expressed, this is the appropriate basis for my consideration of the position.
35. There is a "defence" to a claim under s 3(3) IHTA 1984. This involves examining whether the omission was deliberate.
36. Miss Shaw argued HMRC's case on the basis that Mrs Arnold's omission had been deliberate. In doing so, Miss Shaw assumed a greater burden than that imposed by s 3(3). Mr Evans argued that to suggest that the burden of proof lay with the Executors was unreasonable. His contention was that the burden of proof lay on HMRC. However, that contention ignored the words at the end of s 3(3):

". . . , unless it is shown that the omission was not deliberate".

37. These words mean that an omission is to be treated as deliberate unless it can be shown not to have been deliberate. Put another way so as to refer to the parties involved, any omission is taken to be deliberate unless it is established by the disponent or the latter's personal representatives that it was not. The burden of showing this (ie proving the negative) falls on them, ie in this case, the Executors; it is not for HMRC to prove that the omission was deliberate.
38. On the basis, in particular, of Mr Squires' letter of 18 June 2002 (see paragraph 10 above), I am satisfied that when Mrs Arnold received the Maturity Pack in June 2002, she took, or had already taken, a conscious decision not to take her pension benefits at her impending sixtieth birthday. There is no direct evidence as to her subsequent view on the question of whether to take such benefits. The circumstantial evidence suggests that, if she gave it any further thought, she must have decided to continue as she was without taking the pension benefits. As far as the words at the end of s 3(3) are concerned, none of the evidence before me demonstrates that her continuing omission (from June 2002 until 30 July 2003) to exercise her right to take the benefits under clause 4.1 of the policy was not deliberate.

39. I have accepted that Mrs Arnold's omission continued throughout her life, and must therefore be treated as made at the date of her death, and that the omission must be taken to have been deliberate. I therefore have to consider the other elements of s 3(3) IHTA 1984.
40. Was the value of Mrs Arnold's estate diminished by her omission? HMRC's argument is that at any point up to the date of her death, Mrs Arnold could have exercised her right and taken the full value of the retirement benefits permitted under the terms of the policy. By her failure to do so, that value was lost to her estate.
41. For reasons which I explain later, I consider it appropriate to raise a point which was not raised on behalf of the Executors. The basis on which HMRC's argument was put raises the question of the statutory construction to be applied to s 3(3) IHTA 1984. Is it correct to describe a person's estate as being "diminished" by the omission to exercise a right where the result of the omission is that value which might potentially have been added to the estate is not, after all, so added? Mrs Arnold's estate included the right to opt for retirement benefits under the pension plan. It did not include the benefits themselves.
42. My conclusion is that the "loss" of a potential addition of value to the estate does not, as such, diminish it. However, that is not a complete answer to the "diminution" argument. Mrs Arnold had a valuable right; by not exercising it, she allowed the whole of its value to disappear from her estate. Her estate was therefore diminished by her omission to exercise that right, and therefore that condition for the application of s 3(3) IHTA 1984 is fulfilled.
43. The distinction between the loss of potential additional value and the reduction in value of the right (to zero) may appear to be a fine one, but it may have some significance when considering the question of valuation, addressed below.
44. The next question is whether the value of settled property in which no interest in possession subsisted was increased by Mrs Arnold's omission to exercise her rights under clause 4.1. The trust which she had declared on 5 August 1995 was a discretionary trust so did amount to settled property within that description. Clause 4.2 of the Scheme Rules provided that if the policyholder died before the "pension date" (ie the date between 50th and 75th birthdays on which the policyholder chose to receive his or her retirement benefits), NPI would pay to the trustees the death benefits specified in the Schedule. If instead of taking no action Mrs Arnold had exercised her right to take the pension benefits, the whole of the contract value would have been used to provide pension benefits, within approved limits. Thus the "pension date" would have arrived and the trust would have received nothing.
45. It follows that Mrs Arnold's omission to exercise the rights did increase the value of the settled property, as the omission resulted in the death benefits payable under the policy being paid to the trustees. The fact that this increase

occurred after her death does not prevent this condition in s 3(3) IHTA 1984 from being fulfilled, as there is no reference in the sub-section to the time at which the value of the settled property is increased.

46. The description by Mr Hogg of HMRC's Capital Taxes Technical Group in his letter to Mr Evans dated 6 January 2006, if amended by substituting certain references to "omission" for the word "deferral", describes the position as I consider it to be:

"Rather it [ie the Inheritance Tax question to be asked] is, given Mrs Arnold's state of health and life expectancy at the time of the [omission], was this a genuine pension arrangement/decision for Mrs Arnold's benefit? If Mrs Arnold had been in normal health etc with the genuine prospect of taking her retirement benefits at a later date, and in any event at age 75 at the latest, then I would accept this as a genuine pension arrangement within the terms of the 1992 Tax Bulletin. Clearly though she was not in good health and deferral to age 75 was not a viable or realistic option for her. The clear and unequivocal outcome of her [omission] was that the death benefits would be paid outside her estate to her chosen beneficiaries."

Having set up the discretionary trust for any death benefits which might become payable under the policy, her continuing omission from June 2002 onwards to opt for her retirement benefits after she had become aware of her diagnosis, and became more and more aware of its implications (as was clearly implied by a letter dated 7 November 2002 from her solicitors following a meeting with her), meant that the value of her right to opt for those benefits was lost to her estate and also resulted in the death benefits becoming payable to the trust.

47. Putting aside, for the present, the question of valuation, all the necessary conditions for the application of s 3(3) IHTA 1984 are fulfilled. As Miss Shaw indicated, the next stage is to examine whether the Executors can displace its application by establishing that Mrs Arnold's disposition (the omission to exercise her right) fell within s 10 IHTA 1984 as one not intended to confer a gratuitous benefit.
48. Section 10(1) is in two parts, both of which must be demonstrated by the person or persons seeking to rely on it; in this case the relevant persons are the Executors. Dealing with the first part, there are two elements. Can the Executors show that Mrs Arnold's disposition was not intended to confer a gratuitous benefit on any person? If they can, are they also able to show that the disposition was not made in a transaction intended to confer any gratuitous benefit on any person?
49. When Mrs Arnold signed the Declaration of Trust dated 5 August 1995, it is clear that she intended to pass the benefit of any lump sum payable under the NPI policy to the various classes of beneficiaries listed in the Declaration of Trust. In addition, she signed a letter of wishes addressed to the Trustees (she being the only trustee at that time) indicating that the full value of the

arrangement was to go to Tracey Jane Arnold and Jayne Arnold in equal shares. Taken together with Mrs Arnold's continuing omission throughout her life to exercise her option to take her retirement benefits, it is clear that she must have intended to leave the death benefits to become payable and thus to fall into the discretionary trust.

50. In the course of correspondence and argument it was maintained on behalf of the Executors that Mrs Arnold did not take her retirement benefits in order to minimise income tax. However, no evidence to this effect was provided. Assertions in the course of argument cannot be taken as evidence; specific proof is required. Even if I were to assume that Mrs Arnold was likely to have taken this view, it would not rule out the possibility of dual motivation; at the same time as seeking to minimise her income tax, she could still intend to benefit her daughters through the value of the death benefits which would fall into the discretionary trust. In the same way, reference was made to her having other investments providing her with adequate income. Again, as Miss Shaw argued, this assertion on behalf of the Executors was not inconsistent with and did not displace Mrs Arnold's intention to confer a gratuitous benefit.
51. Although I understand that Mrs Arnold's circumstances were likely to have been such as not to require additional pension income, which would probably have increased her income tax liability, I do not consider that this negates an intention in her mind to confer a gratuitous benefit.
52. Even if it could be said that Mrs Arnold did not intend to confer any gratuitous benefit on any person (the basis for such contention presumably being that she did not address her mind to this and so could not be said to have any intention in mind), I do not consider that the second element of the first part of s 10(1) IHTA 1984 can be established. The transaction which Mrs Arnold entered into was the Declaration of Trust. This was clearly intended to confer benefits on the beneficiaries of the trust, in that any death benefits ultimately payable under the NPI policy would be available to the trustees to distribute among the beneficiaries, and in particular to the two beneficiaries named in the letter of wishes, assuming that the trustees decided to follow those wishes. It has therefore not been shown that the "disposition . . . was not made in a transaction intended, to confer any gratuitous benefit on any person . . ."
53. The second part of s 10(1) IHTA 1984, ie s 10(1)(a) and (b), requires it to be shown either that the disposition (ie the omission) was made in a transaction at arm's length between persons not connected with each other, or that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other.
54. There is some logical difficulty in describing an omission as made between parties. However, s 3(3) IHTA 1984 treats the person making the omission as having made a disposition. Section 10(3) IHTA 1984 indicates that in s 10, "disposition" includes anything treated as a disposition by virtue of s 3(3). Going back to s 10(1) IHTA 1984, a disposition by omission such as that made

by Mrs Arnold cannot be described as made in a transaction at arm's length; it is not easy to imagine circumstances in a context such as this in which an omission could fall within that description.

55. The second requirement in s 10(1)(a) is that the disposition was made between persons not connected with each other. Under s 286(3) of the Taxation of Capital Gains Act 1992, which is applied for Inheritance Tax by s 270 IHTA 1984, a trustee of a settlement is connected with any individual who in relation to the settlement is a settlor. Initially Mrs Arnold was both settlor and trustee, but on 23 June 2002 her daughters also became trustees. Clearly Mrs Arnold was connected with the remaining trustees, and arguably with herself in her respective roles as settlor and trustee.
56. Although s 3(3) does not specifically refer to this, I consider it reasonable to infer that an omission which results in an increase in the value of a discretionary trust can be regarded as a disposition to, or in favour of, the trustees of that trust. For the avoidance of doubt, I do not consider this view to be inconsistent with my earlier conclusion that the diminution in the estate is to be calculated as the loss in value of the right rather than the "loss" of potential additions to the estate.
57. To deal briefly with the remaining part of s 10(1) IHTA 1984, ie s 10(1)(b), I do not consider that Mrs Arnold's disposition was such as might be expected to be made in a transaction at arm's length between persons not connected with each other. It was certainly not an "open market" form of transaction.
58. My conclusion is that s 10 IHTA 1984 does not operate to exempt Mrs Arnold's omission to exercise her rights to take her pension benefits from charge under s 3(3) IHTA 1984.

Concessionary treatment

59. In oral argument Miss Shaw referred to the 1992 Tax Bulletin article as containing concessionary treatment, and, on that basis, a matter not for this Tribunal but for the Administrative Court. For the reasons set out below, I question whether it does contain concessionary treatment, but ignoring this for the present, I further question whether Miss Shaw's submission in relation to the Tribunal's jurisdiction is correct.
60. In the case of *Oxfam v Revenue and Customs Commissioners* [2009] EWHC 3078 (Ch), a case dealing with VAT, Sales J held that an argument raised by Oxfam concerning legitimate expectation was one which could properly have been raised in its appeal to the Tribunal. In the final paragraph of his judgment he indicated that he was departing from a widely held view that the Tribunal's jurisdiction was more limited and that he was doing so without the benefit of detailed argument to the contrary before him. Based on Sales J's judgment, it appears that matters of concessionary treatment may well be within this Tribunal's jurisdiction.

61. Having reviewed the article in detail, I do not think that it is dealing with concessionary treatment. It sets out a summary of the views of the CTO (the Capital Taxes Office of the Inland Revenue, HMRC's predecessors) of the circumstances in which a claim under s 3(3) IHTA 1984 might arise with pension arrangements under which the pension benefits are written under trust on terms that the retirement benefit continues to be for the policyholder and the death benefit is assigned, normally to members of the family. This summary reflects the view expressed by the CTO in correspondence with the Association of British Insurers.
62. The CTO explains why in practice the overwhelming majority of pension arrangements are not affected, and sets out reasons in the context of a series of circumstances. It indicates that it would consider raising a claim in any residue of cases only where there was evidence that the policyholder's intention in failing to take up retirement benefits was to increase the estate of someone else (the beneficiaries of the death benefit) rather than to benefit himself or herself. In relation to any such possible claim, the CTO will look closely at certain pension arrangements where the policyholder became aware that he or she was suffering from a terminal illness, or was in such poor health that his or her life was uninsurable, and at or after that time took one of a series of actions mentioned, or (as is relevant to the present case) deferred the date for taking retirement benefits.
63. Even in any of the circumstances mentioned by the CTO, it would not pursue the claim where the death benefit was paid to the policyholder's spouse or dependants (ie any individuals financially dependent on the policyholder). Further, a claim would not normally be pursued where the policyholder survived more than two years after making any of the arrangements described, but the CTO reserves the right to examine each case individually.
64. None of the circumstances mentioned by the CTO in which it indicates that it will not pursue a claim under s 3(3) IHTA 1984 is relevant to the present case. Thus HMRC has not failed to apply concessionary treatment in relation to Mrs Arnold and her estate. It has sought to apply the legislation in the way described in the article.

Decision on the Notices of Determination

65. On the basis of the conclusions which I have reached, I do not consider that the Notices of Determination should be quashed. Instead, they require to be varied.
66. The first variation required is to correct the title used for themselves by HMRC. Under s 1 of the Commissioners for Revenue and Customs Act 2005, the title is "The Commissioners *for* Her Majesty's Revenue and Customs" [my emphasis]. To avoid any possible suggestion that Notices of Determination (or any other documents issued by HMRC) are invalid, it is strongly desirable for the correct title to be used.

67. The Notices refer to Mrs Arnold “deferring” her retirement benefits. This description is inappropriate, given the option available between ages 50 and 75 to take retirement benefits. The appropriate description is omitting during her lifetime to exercise her right to take her retirement benefits. As s 3(3) IHTA 1984 refers to the “latest time”, as already mentioned, it is not necessary to refer specifically to 30 July 2003.
68. I therefore conclude that the Notices of Determination should be amended to the following:

“The Commissioners for Her Majesty’s Revenue and Customs have determined –

In relation to –

(a) a National Provident Institution pension policy number B60496 (the policy)

(b) the death on 30 July 2003 of Mrs Patricia Arnold (the Deceased).

That – the Deceased made a disposition for the purposes of section 3(3) of the Inheritance Tax Act 1984 by omitting during her lifetime to exercise her right to take her retirement benefits under the policy.”

Valuation

69. As an initial general comment on the question of valuation, I must refer to s 3(1) IHTA 1984, which provides that the value transferred is the amount by which the transferor’s estate is less than it would have been but for the disposition. This means that it is not the increase in value of the settled property that matters, but whatever reduction can be said to have been made in the value of the estate as a result of the disposition. I have already concluded that the reduction is the loss of value in the right to opt to take the retirement benefits.
70. Miss Shaw submitted that the value of the loss to the estate was the amount which Mrs Arnold could have drawn down under the policy if she had exercised her right. For the reasons which I have given, I do not consider that this is the appropriate measure of the loss to Mrs Arnold’s estate; I return to this below after considering the valuation evidence given at the hearing.
71. The expert evidence before me was based on the instructions given by HMRC; Mr Watson was instructed, inter alia:
- “ . . . to give my opinion on the open market value of the term certain annuity payable monthly in advance for 5 years and for 10 years capable of being generated by the fund under Mrs Arnold’s NPI Pension Transfer Plan as at 30th July 2003”.
72. In giving his opinion, Mr Watson pointed out that a pension annuity is not legally assignable and therefore the income stream could not, in practice be sold. However, where there was not an actual market value he understood that s

160 IHTA 1984 and case law (*IRC v Crossman* (1937) AC 26 and *Duke of Buccleuch v IRC* (1967) 1 AC 506) allowed for a hypothetical market value to be calculated. Mr Watson stated that in this context the word “hypothetical” meant that if an actual market for the interest under consideration did not exist then a market could be hypothesised; hypothetical did not mean that because the particular interest under consideration would not actually be sold to confirm its market value then any assessment of its market value was hypothetical. I accept his understanding as a correct summary of the relevant law.

73. His evidence was as follows. As at 30 July 2003 the value of Mrs Arnold’s pension fund was £ 147,342.09. If she had opted to take retirement benefits on that date, the maximum lump sum which she could have taken was about £51,800. If she had then opted to buy a lifetime annuity with the balance of the fund (£95,542.09), she would have bought a gross income payable for life of approximately:
- (1) £6,019 guaranteed to be payable for at least 5 years and ignoring Mrs Arnold’s state of health;
 - (2) £5,971 guaranteed to be payable for at least 10 years and ignoring Mrs Arnold’s state of health;
 - (3) £14,331 guaranteed to be payable for at least 5 years and taking account of Mrs Arnold’s state of health;
 - (4) £9,554 guaranteed to be payable for at least 10 years and taking account of Mrs Arnold’s state of health.
74. Mr Watson thought it reasonable to suppose that the market value of the above guaranteed income streams as at 30 July 2003 would have been, respectively:
- (1) £24,000 to £25,000;
 - (2) £38,500 to £42,500;
 - (3) £57,000 to £60,000;
 - (4) £61,500 to £68,000.
75. On the basis of these figures, Miss Shaw argued that in the absence of evidence to the contrary, the highest figures should be taken, so that the loss to the estate was the lump sum of £51,800 plus the maximum income stream valuation of £68,000, totalling £119,800.
76. Mr Evans questioned Mr Watson’s evidence on the basis that it presupposed that the income could have been bought in the first place; there was no evidence to support this. Mr Watson accepted that there was no evidence to this effect, but he was aware that insurance companies provided partnership insurance. There was an active market in annuities, taking into account age, sex and state of health, and he believed that companies would have offered terms to Mrs Arnold. She would definitely have been able to obtain annuities within descriptions (1) and (2) above. He accepted that there was no evidence of someone terminally ill taking such an option. He emphasised that the question

of advisability of exercising the option to take retirement benefits was not within his expertise.

77. I consider that the exercise of assessing what pension Mrs Arnold could have opted to take as at 30 July 2003 is a purely notional one, and I accept that in practice she would have been most unlikely to consider that step at that stage even if she had been physically able to do so. The exercise may appear cold and clinical in nature, but amounts to an objective determination of value, without regard to any possible specific motivations or to the personal physical circumstances of the policyholder (other than taking into account the latter's state of health in assessing what form of annuity might have been chosen).
78. I am satisfied that a policyholder in that notional position would opt for the lump sum of £51,800 and would seek the maximum guaranteed pension for the longest period available, so would take the ten year guaranteed pension taking into account the policyholder's state of health, thereby maximising the income available to the policyholder and the latter's beneficiaries.
79. I now turn to the question of valuing the right to opt to take the retirement benefits, as opposed to valuing the benefits themselves. Mr Watson referred to s 160 IHTA 1984. This states:

“Except as otherwise provided by this Act, the value at any time of any property shall for the purposes of this Act be the price which the property might reasonably be expected to fetch if sold in the open market at that time . . .”

80. Miss Shaw also referred to the judgment of Hoffmann LJ in *IRC v Gray (surviving executor of Lady Fox deceased)* [1994] STC 360 at 371-372, in which he described the approach which should be taken to the circumstances of the hypothetical sale envisaged by the predecessor of s 160. I consider the valuation of Mrs Arnold's right to opt to take retirement benefits in the light of Hoffmann LJ's comments.
81. As Hoffmann LJ pointed out in *Lady Fox* at 371:

“The property must be assumed to have been capable of sale in the open market, even if it was inherently unassignable or held subject to restrictions on sale.”

82. The right to opt to take the benefits is clearly incapable of assignment, as are the benefits themselves. Thus a market for such rights must be postulated despite the impossibility in practice of selling such an asset; it must be assumed that the purchaser would be prepared to buy the right even though the benefits would be based on the seller's position under the terms of the policy. In deciding what a purchaser would be likely to be prepared to pay for the right, it is necessary to take into account the factors which would be relevant to the purchaser's assessment of the value.

83. It can be assumed that the purchaser would wish to opt to take the maximum lump sum of tax free cash available under the plan, ie £51,800, leaving the balance to be applied in the purchase of an annuity.
84. The purchaser would wish to be satisfied that the income was guaranteed for the relevant period. To maximise the benefit to be obtained from the transaction, I consider that the purchaser would intend to seek an annuity guaranteed for the ten year period. I accept the point made by Mr Hogg of HMRC's Capital Taxes Technical Group in his letter of 8 September 2005, in which he commented:
- “. . . given that we need to value at the instance [*sic*] before death when life expectancy is effectively zero, we can only assume that the guaranteed term would be taken into account.”
85. It is clear that in such a situation an enhanced annuity, taking into account the specific health of the individual, would not be viewed as a possibility. However, an annuity guaranteed for a five or ten year term and based on Mrs Arnold's state of health could, in theory, have been available despite her lack of life expectancy as at 30 July 2003. In this connection I am ignoring the possibility of any effect which Mrs Arnold's life expectancy as at that date might have had on Mr Watson's valuations of the annuities; as Mr Purdy only considered her life expectancy as at 8 September 2002, there is no evidence as to what it would have been considered to be on 30 July 2003.
86. The remaining factor which the purchaser would take into account is that he would expect some form of discount on the assumed value, partly to take account of the fact that he was buying a right rather than the benefits themselves, and partly as a commercial incentive to enter into the transaction. A purchaser would not consider that there was any benefit in purchasing the right unless there was a prospect of a suitable return on the money invested.
87. The benefits potentially available to the purchaser by acquiring the rights would be the lump sum and the annuity. The lump sum would be £51,800, and I am satisfied that the purchaser would wish to opt for the ten year guaranteed annuity taking account of Mrs Arnold's state of health. In the absence of any other valuation, I consider it appropriate to adopt Mr Watson's valuation of this at £68,000. Thus the benefits which the purchaser would be seeking to obtain by acquiring and then exercising the right would amount in total to £119,800.
88. What would the purchaser be prepared to pay for the right which would enable him to take these benefits? He would take into account the prospect (or hope) of receiving almost immediately the tax free cash of £51,800, and the fact that the remaining return on the investment would be receivable over the ten year period. Applying what I consider to be reasonable possible levels of discount produces the following results:
- (1) A 20 per cent discount would result in a price of £95,840, yielding a return of 25 per cent calculated on the value of the initial investment;

(2) A 25 per cent discount would result in a price of £89,850, yielding a return of 33.33 per cent on the value of the initial investment;

(3) A 30 per cent discount would result in a price of £83,860, yielding a return of 42 per cent on the value of the initial investment.

89. I accept that these calculations are made on a very simplified basis. Given that there would be a degree of negotiation between seller and buyer, I consider it unlikely that the seller would be prepared to accept a discount as high as 30 per cent, but that the purchaser would insist on a discount of 25 per cent in order to provide an adequate return on his investment over the ten year period.
90. The 25 per cent discount would entail a consideration of £89,850, paid for the two elements, namely the prospect of receiving the £51,800 lump sum within what might turn out to be a relatively short period, and the ten year annuity beginning at the corresponding time. On the assumption that this time fell immediately after making the investment, there would be an immediate return of £51,800 on the initial investment, so that (viewed on a simplistic basis) the amount invested for the purpose of deriving the annuity would be £38,050. For this sum to produce a pre-tax return of £68,000 over the ten year period, the compound interest rate would have to be approximately 5.8 per cent. These combined returns do not seem unreasonable to me, viewed as at 30 July 2003, especially as the notional investor could not assume that the return would be immediate.
91. Given the basis on which the case has been argued, I have had to make assumptions as to the likely price for the right to take benefits, as there was no evidence or argument covering this issue. I do not consider that this would be a suitable case for a further hearing, and therefore I assess the value of the right to take the retirement benefits as £89,850 as at 30 July 2003, the latest date at which Mrs Arnold could have exercised that right.

Conduct of the case

92. This case has raised complex issues. Although Mr Evans sought to make the case on the Executors' behalf, it was clear that he had no previous experience of appearing before these tribunals. He appeared as the Executors' representative, but I have had to treat this appeal as if it were conducted by an unrepresented appellant. In particular, I have sought to draw out points on the Executors' behalf which might have been expected to be made by an experienced representative. This is a case where quite clearly it would have been appropriate for the Executors to be represented by counsel, or by someone else equally experienced in representing parties before the Tribunal.
93. Following the hearing Mr Evans requested a copy of my notes taken at the hearing. I refused this request in the following terms:

“The Appellants' request for a copy of the Judge's notes is refused. In these Tribunals, Judges' notes are not made available to the parties. It is for the parties to keep their own notes of the proceedings. The

decision will record the information which is considered relevant to the determination of the appeal.”

In setting out this decision I have attempted to record in full the arguments put on behalf of each party, in order to ensure that the Executors have a full record of those arguments. I have dealt with my findings of fact and my conclusions in the normal way.

94. In putting the case on behalf of the Executors, Mr Evans relied on the principle of fairness. Subject to the implications of the principle in the *Oxfam* case considered earlier in this decision, the jurisdiction of these Tribunals is limited to matters within their statutory authority. They are required to consider the statutory provisions as they are, not as parties to appeal proceedings might wish them to be. If an appellant is found to fall within a statutory provision, it must be applied, however unfair this may appear to that appellant.

Summary of conclusions

95. The Notices of Determination are varied as set out above. I assess the value of the right to take the retirement benefits at £89,850 as at 30 July 2003. Subject to that variation and to the assessment of the diminution in the estate as £89,950, the Executors’ appeal is dismissed.

Right to apply for permission to appeal

96. The Executors have a right to apply for permission to appeal against this decision pursuant to Rule 39 of the Rules. 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.