

IN THE COURT OF APPEAL

INGRAM AND ANOTHER

Appellants

- v -

INLAND REVENUE COMMISSIONERS

Respondents

LORD JUSTICE NOURSE:

Introduction

On the last three days of March 1987 Jane Lindsay Ingram, the widow of Sir Herbert Ingram Bt, carried into effect a series of voluntary transactions whose object was to avoid or reduce the inheritance tax prospectively payable on her death in respect of her family home, Hurst Lodge, near Twyford in Berkshire, while enabling her to continue to live there free of rent under a term of years which was likely to exceed her lifetime. Lady Ingram died on 3rd February 1989. Shortly stated, the question for decision is whether the disposition of the freehold subject to the term of years was a gift with reservation, having the effect of cancelling the reduction in inheritance tax which would have been achieved had there been no such reservation. Mr. Justice Ferris has answered that question in the negative and in favour of Lady Ingram's executors. The Crown appeals to this court. The outcome of the appeal depends largely on estate duty authorities decided between 1898 and 1974 which it must have been generally expected would cease to have any application after the replacement of that duty by capital transfer tax in 1975.

The decision of Mr. Justice Ferris is reported at [1995] 4 All ER 334. Since it is essential to a decision of the appeal that the nature and effect of the transactions should be carefully analysed, I will describe them in my own words. In order to do that I must start with the background facts, most of which are deposed to in an affidavit of Lady Ingram's solicitor, Mr. Michael Macfadyen of the firm of Norton Rose, who had advised her and her family in relation to their tax affairs since about 1980 and now acts for her executors, Michael Warren Ingram and Christopher David Palmer-Tomkinson.

The background

At the end of March 1987 Lady Ingram was 73 years of age. By a deed of gift made in 1946 her father, James Edward Palmer-Tomkinson, had conveyed to her the freehold of Hurst Lodge, together with some adjoining and adjacent land, all of which was unregistered and amounted in the aggregate to 60 acres or thereabouts. In 1986 Lady

Ingram sought Mr. Macfadyen's advice as to making lifetime gifts of this property and a further area of land of about 45 acres in the neighbouring parish of Whistley Green, the title to which was registered, in favour of her three daughters and the children of her deceased son. She was aware that, with the introduction of the Finance Act 1986 of transfers which were potentially exempt from inheritance tax, it could well be advantageous to the donees for her to make lifetime gifts in their favour. At the same time, she wished to retain actual occupation of the land or, in the case of let property, the right to receive the rents. After taking advice from counsel specialising in revenue matters instructed by Mr. Macfadyen on her behalf, Lady Ingram decided that she would make a gift of her freehold interest in the property, subject to a leasehold interest for the next 20 years at no rent which she would retain for herself. Acting on her instructions, Mr. Macfadyen prepared the necessary documentation.

The transactions

The first step was the execution by Lady Ingram, on 29th March, of a conveyance of the unregistered land and a transfer of the registered land in favour of Mr. Macfadyen. Each of those instruments was in form an out and out voluntary disposition of the property comprised therein. However, also on 29th March, Mr. Macfadyen executed two deed polls, described as declarations of nomineehip, each of which recited that the property had been conveyed or transferred to him upon trust as thereafter mentioned. By the operative part of each deed Mr. Macfadyen declared that he held the property as nominee for Lady Ingram and agreed that he would transfer it to her at such time and in such manner or otherwise deal with it as she should direct or appoint. In the result Mr. Macfadyen held the unencumbered freehold interest in the property in trust for Lady Ingram absolutely. There being for present purposes no material difference between the relationship of trustee and beneficiary on the one hand and nominee and principal on the other, I will adopt the terminology used by the parties and refer to Mr. Macfadyen and Lady Ingram as nominee and principal respectively.

On the following day, 30th March, Mr Macfadyen, at Lady Ingram's direction, executed two leases, together comprising the whole of the property, in favour of Lady Ingram as tenant for a term of 20 years from 30th March 1987 free of rent. One of them comprised Hurst Lodge, its surrounding land and some neighbouring cottages and the other a separate piece of agricultural land at Hurst and the agricultural land at Whistley Green. Each of them contained covenants by Lady Ingram in a form appropriate to the property comprised in it which it is not suggested did not impose real obligations on her. Each contained an absolute covenant against assignment, underletting, charging, or parting with or sharing the possession of the occupation of the whole or any part or parts of the property. There were also covenants to permit the landlord to enter to do repairs himself and, in the lease of the agricultural land, to deliver up the property at the end of the term in good and substantial repair and condition. In the lease of Hurst Lodge there was a covenant to deliver up the property in such good and substantial repair and condition as was evidenced by the schedule of condition of the property attached thereto. By neither lease was any greater obligation imposed on Lady Ingram to do repairs herself. The only covenant on the part of the landlord was for quiet enjoyment. There was a proviso for forfeiture for breach of covenant.

On the following day, 31st March, again at Lady Ingram's direction, Mr. Macfadyen executed two conveyances and a transfer conveying and transferring the freeholds in the various parts of the property to Michael Warren Ingram, Christopher David Palmer-Tomkinson and David Michael Ingram ("the trustees"). Each of those instruments stated that the property to which it related was conveyed or transferred to the trustees "to hold .. on trusts declared concerning the same". Each of them was expressed to take effect subject to and with the benefit of the relevant lease in favour of Lady Ingram. Also on 31st March the trustees executed two declarations of trust, again expressed to be subject to the relevant lease or leases, under each of which the property was declared to be held on trust for sale and immediate absolute interests in the proceeds of sale were declared in favour of Lady Ingram's three daughters and the trustees of a settlement made on 29th March 1987 for the benefit of the children of her deceased son and known as Robin Ingram's children's 1987 settlement. She herself could not in any circumstances have benefited under or by virtue of the declarations of trust, although in each case the property comprised therein could not be sold during her lifetime without her written consent.

The judge thought that there was an instant of time between the execution of the conveyances and transfer and the execution of the declarations of trust, during which the trustees held the property in trust for Lady Ingram. I do not think that that can be a correct view of the matter. It is true that in his affidavit Mr. Macfadyen, having referred first to the execution of the conveyances and transfer on 31st March, then states that on the same day the trustees executed the declarations of trust. That may well indicate that the conveyances and transfer were executed first. However, I think that the correct inference, especially in view of the words in the declarations of trust "on trusts ... declared" (not "on trusts to be declared"), is that the conveyances and transfer and the declarations of trust were all intended to take effect, and did take effect, at one and the same time.

The decision of the judge

The intended fiscal consequences of the transactions, the best result they could achieve as a result of Lady Ingram's death within two years ("consequence (e)"), the nature of the Crown's claim, the route by which it contended that the claim was made good and the issues to which the case gives rise are stated in the judgment of Mr. Justice Ferris at [1995] 4 All ER, 338B to 339F, and need not be repeated. In a full and clear judgment the judge decided, first, that the leases in favour of Lady Ingram, having been granted by a nominee to his principal, were a nullity; secondly, that the freehold interests in the property were, after 31st March 1987 and subject to an equitable interest in Lady Ingram equivalent to that which she would have taken had the leases been valid, enjoyed to the entire exclusion of Lady Ingram and of any benefit to her by contract or otherwise. In view of his decision that the leases were a nullity it was unnecessary for him to decide, thirdly, whether, had they been valid, the Ramsay principle would have applied with the same result as if they had been a nullity. The same issues having been raised in this court, I will deal with them in the same order as the judge.

Were the leases to Lady Ingram a nullity?

This question was considered by Mr. Justice Ferris at [1995] 4 All ER 339F to 345E. Since I am in complete agreement with his reasoning and conclusion, I can deal with it relatively briefly. Mr. Nugee QC submitted that the question was, as a matter of principle, concluded in favour of the Crown by the decision of the House of Lords in *Rye v. Rye* [1962] AC 496, the decision of the Inner House of the Court of Session in *Kildrummy (Jersey) Ltd. v. IRC* [1990] STC 657, being effectively a working out of the consequences of the earlier decision. In Mr. Nugee's submission the key passage in *Rye v. Rye* appears in the speech of Lord Denning, at p.514:

"I come to the clear opinion that even under the 1925 Act a person cannot grant a tenancy to himself: for the simple reason that every tenancy is based upon an agreement between two persons and contains covenants expressed or implied by the one person with the other. Now, if a man cannot agree with himself and cannot covenant with himself, I do not see how he can grant a tenancy to himself. Is the tenancy to be good and the covenants bad? I do not think so. The one transactions cannot be split up in that way. The tenancy must stand or fall with the agreement on which it is founded and with the covenants contained in it: and as they fall, so does the tenancy."

In that case it was held that two individuals cannot grant a lease to themselves. Mr. Nugee submitted that, since it is clear that a nominee cannot contract with his principal so as to create rights and obligations in relation to the subject of the nominee'ship, it follows that a nominee cannot grant a lease to his principal, at any rate one which is not a bare term containing no covenants by either party. The specific authority for that proposition is *Kildrummy*. Mr. Nugee submitted that the facts of that case are for all relevant purposes indistinguishable from those of this case and, further, that there is no material difference between the laws of Scotland and England on this point.

In my judgment Mr. Nugee's submissions are correct. The logic of the passages quoted by Mr. Justice Ferris from the judgments of the Lord President (Lord Hope) and Lords Sutherland and Clyde in *Kildrummy*, at [1995] 4 All ER 343J to 345A, is unanswerable, and I agree with him that their reasoning is based on principles which are part of English law just as much as they are part of Scots law. Indeed, I would think that no system of law could sensibly allow you to assume the burden of an obligation to someone whose only function was to hold the benefit of it for yourself. That is no less whimsical a transaction than the grant of a lease to yourself. Although neither lease in the present case contained a covenant to pay rent, each of them contained covenants by Lady Ingram creating real obligations to Mr. Macfadyen which could only have been held by him for her benefit. So the covenants were a nonsense and bad from the start. Just as Lord Denning said of a lease to yourself, you cannot split up the transaction so as to hold the tenancy good and the covenants bad; as the covenants fall, so does the tenancy. Therefore the leases were a nullity. As to the consequences of that, two alternative views have been put forward, one preferred by the Crown and the other by the executors, although each side maintained that whichever view was correct the result would be the same.

The consequences of the leases having been a nullity

The Crown's preferred view is that the conveyances and transfer by Mr. Macfadyen to the trustees on 31st March operated as a grant by the trustees of legal leases to Lady Ingram in the form of those which were purported to be granted to her by Mr. Macfadyen on 30th March. Their operation in that manner is said to have been the result of section 65 of the Law of Property Act 1925 which, so far as material, provides:

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

What is said by the Crown is that the conveyances and transfer by Mr. Macfadyen to the trustees, having been expressed to be made subject to the leases by Mr. Macfadyen to Lady Ingram (each of which was a "legal estate not in existence" immediately beforehand), operated as a reservation by virtue of subsection (2), the reservation operating for the benefit of Lady Ingram by virtue of subsection (1). Although this may, on a literal reading, be a tenable view of section 65, I cannot believe that it was intended to have that effect. Mr. Justice Ferris rejected it because he thought that there was an instant of time between the execution of the conveyances and transfer and the execution of the declarations of trust, during which the trustees held the property in trust for Lady Ingram; that section 65 must have operated, if it operated at all, during that instant; but that if it did, then it operated to create in favour of Lady Ingram the very interests which he had held had created a legal impossibility; see [1995] 4 All ER, 346D to G.

Being of the opinion that the conveyances and transfer and the declarations of trust took effect at one and the same time, I do not base my own rejection of the Crown's preferred view quite on that ground. There is, I think, an anterior and more fundamental ground, which is that section 65(2), in referring to "another legal estate not in existence" can only have been intended to refer to a legal estate which was capable of existence. The leases purportedly granted by Mr. Macfadyen to Lady Ingram were incapable of existence and thus outside the ambit of section 65(2).

In my judgment the correct view is that preferred by the executors. I will state it in my own words. The immediate consequence of the leases having been a nullity was that on 30th March Mr. Macfadyen continued to hold the unencumbered freehold interest in the property in trust for Lady Ingram absolutely. When, on 31st March and at her direction, he conveyed and transferred the freehold interest to the trustees, they likewise took it free from any lease at law. However, being volunteers, moreover volunteers with notice, through the terms of the conveyances and transfers and the declarations of trust, of Lady Ingram's intention, they took subject to an obligation in

equity to give effect to that intention, in other words to treat her in all respects as if the leases had been valid. To the further consequences of that I will return in due course.

Was the property disposed of, after 31st March 1987, enjoyed to the entire exclusion of Lady Ingram and of any benefit to her by contract or otherwise?

The broad effect of section 102 of the Finance Act 1986, to which the marginal note is "Gifts with reservation", is that, subject to familiar exemptions under subsection (5), the property comprised in such a gift is treated for the purposes of inheritance tax as property to which the donor was beneficially entitled immediately before his death, being taxable accordingly. So far as material, section 102(1) provides:

"this section applies where, on or after 18th March 1986, an individual disposes of any property by way of gift and either (a) possession and enjoyment of the property is not bona fide assumed by the donee at or before the beginning of the relevant period; or (b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise;"

There is then a definition, under which "the relevant period" in this case was between 31st March 1987 and 3rd February 1989, the date of Lady Ingram's death.

With the exception of the words "or virtually to the entire exclusion", on which nothing turns here, section 102(1) is agreed to have an effect identical to that of the corresponding, although somewhat differently worded, provisions of the estate duty legislation; see in particular section 11(1) of the Customs and Inland Revenue Act 1889, which described the dutiable property thus:

"property taken under any gift, whenever made, of which property bona fide possession and enjoyment shall not have been assumed by the donee immediately upon the gift and thenceforward retained, to the entire exclusion of the donor, and of any benefit to him by contract or otherwise."

These were comparable provisions in the Victorian and New South Wales death duties legislation considered in the Australian cases hereafter referred to.

Although it is usual, and no doubt convenient, to speak of a gift with or subject to a reservation, or of the reservation of a benefit, such expressions are not substitute for the wording of the provision itself, which must be meticulously applied to the facts of the particular case. It was only rarely that an estate duty claim was squarely based on what is now paragraph (a) of section 102(1), the example usually cited being *Advocate (HM) v. M'Taggart Stewart* (1906) 43 SLR 465. Here it is agreed that the outcome depends on paragraph (b). In other words, section 102 will apply unless, between 31st March 1987 and 3rd February 1989, the property disposed of by Lady Ingram was continuously enjoyed to the entire exclusion (1) of Lady Ingram and (2)

of any benefit to her by contract or otherwise, to which I will refer as the first and second limbs of section 102(1)(b). The Crown's case is based mainly on the first limb.

We were referred to the following estate duty authorities bearing on the first limb of section 102(1)(b), which I list in chronological sequence: *A-G v. Earl Grey* [1898] 1 QB 318 (Div. Ct.), [1898] 2 QB 534 (CA), sub nom. *Grey (Earl) v. A-G* [1900] AC 124 (HL); *Re Cochrane* [1905] 2 IR 626 (Div. Ct.), [1906] 2 IR 200 (CA); *Lang v. Webb* (1912) 13 CLR 503 (HC Aus.); *Munro v. Commissioner of Stamp Duties* [1934] AC 61 (PC); *Commissioner of Stamp Duties of New South Wales v. Perpetual Trustee Co. Ltd.* [1943] AC 425 (PC); *St. Aubyn v. A-G* [1952] AC 15 (HL); *Oakes v. Commissioner of Stamp Duties of New South Wales* [1954] AC 57 (PC); and *Re Nichols, decd.* [1974] 1 WLR 295 (Walton J), [1975] 1 WLR 534 (CA). Of these authorities the only two which deal with a simultaneous gift of the freehold and the grant of a lease back are *Lang v. Webb* and *Nichols*.

The estate duty authorities demonstrate that the application of the first limb of section 102(1)(b) to any particular case essentially depends on the identification of the property disposed of. That is because, as Lord Russell of Killowen, when delivering the judgment of the Privy Council in *Perpetual Trustee* observed at [1943] AC, 446:

"the entire exclusion of the donor from ... enjoyment which is contemplated ... is entire exclusion from ... enjoyment of the beneficial interest in property which has been given by the gift, and ... enjoyment by the donor of some beneficial interest therein which he has not included in the gift is not inconsistent with the entire exclusion from ... enjoyment which the subsection requires."

That statement of the principle has since been consistently approved, for example by Lord Radcliffe in *St. Aubyn* at [1952] AC, 50.

An example of the distinction made by Lord Russell which provides a helpful introduction to the present case is *Munro*.

There, in 1909, the deceased orally agreed with his six children that he and they would carry on the business of graziers on land owned by him as partners under a partnership at will. In 1913 the deceased transferred by way of gift the freehold interest in portions of the land to each of his four sons and to trustees for each of his two daughters and their children. The transfers were taken subject to the partnership agreement. In 1919 the deceased and his children entered into a formal partnership agreement, which provided that during his lifetime no partner should withdraw from the partnership. On the deceased's death in 1929 a claim for death duties was made in respect of the land transferred to his children in 1913. In delivering the judgment of the Privy Council rejecting the claim, Lord Tomlin said at [1934] AC 67:

"It is unnecessary to determine the precise nature of the right of the partnership at the time of the transfers. It was either a tenancy during the term of the partnership or a licence coupled with an

interest. In either view what was comprised in the gift was, in the case of each of the gifts to the children and the trustees, the property shorn of the right which belonged to the partnership, and upon this footing it is in their Lordships' opinion plain that the donee in each case assumed bona fide possession and enjoyment of the gift immediately upon the gift and thenceforward retained it to the exclusion of the donor."

In *Munro*, so far from there being a simultaneous gift of the freehold and the grant of a lease back, the grant of the lease or licence preceded the gift of the freehold by some four years. Of the two authorities where the two transactions were simultaneous it is convenient to deal first with *Nichols*. In that case a father, in 1954, had decided to make a gift of his family home and the surrounding estate to his son, then aged 22. It was arranged that the father would transfer the whole estate to the son, who would immediately lease the bulk of the property back to the father, the lease to contain a full repairing covenant on the part of the son. The gift of the freehold took effect on 24th June 1955, but the lease did not take effect until 16th July of that year, when it was not in its original form but contained, in addition, a covenant by the son to pay the tithe redemption annuity charged on the property. The father continued to live in the family home and to enjoy the property comprised in the lease, paying less than a rack rent, until his death in 1962.

The Crown claimed estate duty on the father's death in respect of the freehold, primarily on the ground that the lease back had prevented it from being enjoyed to his entire exclusion. The son argued that the father had given him the freehold subject to an equitable obligation to grant a lease back, and that the property disposed of accordingly consisted of the reversion expectant on the determination of the lease. Walton J at first instance accepted that, if the son had indeed been under an equitable obligation to grant the lease back, the property disposed of would have been the reversion. However, he held that there was no such obligation, so that the property disposed of was the freehold, which, not having been enjoyed to the entire exclusion of the father, was dutiable accordingly. On the son's appeal to this court, it was held that he had been under an equitable obligation to grant the lease back and that, irrespective of whether the property disposed of had been the freehold or the reversion, his full repairing covenant and, it would appear, his covenant to pay tithe redemption annuity were benefits to the father by contract or otherwise within what is now the second limb of section 102(1)(b), so that the freehold was dutiable accordingly.

The judgment of this court (Russell and Cairns LJJ and Goff J) was delivered by Goff J. At [1975] 1 WLR 538D-E, having referred to the gift of the freehold and the material estate duty provisions, he stated the three problems thereby posed which, for the sake of convenience, I have numbered:

"(1) whether all that was given was the beneficial interest in the estate shorn of the benefit of the rights and interests of the donor under the lease back, in which case, prima facie, the gift must fall outside the statutory provision, or (2) whether the gift was of the whole beneficial interest in the property, in which case it is not

disputed that the lease back must have prevented the son from assuming bona fide possession and enjoyment immediately upon the gift to the entire exclusion of the father, and also (3) whether the covenants in the lease are such that in any case the son cannot be said to have assumed such possession and enjoyment to the entire exclusion of any benefit to the father by contract or otherwise within the meaning of the section."

Problems (1) and (2) arose in the application of what is now the first limb of section 102(1)(b) and problem (3) in the application of the second limb.

The judgment contains a thorough review of *Grey*, *Cochrane*, *Munro*, *Perpetual Trustee and Oakes*. It does not refer to *St. Aubyn*, nor to *Lang v. Webb*. There then appears, at p.543C, this important passage:

"Having thus reviewed the authorities, we return to the question what was given, and we think that a grant of the fee simple, subject to and with the benefit of a lease back, where such grant is made by a person who owns the freehold free from any lease, is a grant of the whole fee simple with something reserved out of it, and not a gift of a partial interest leaving something in the hands of the grantor which he has not given. It is not like a reversion or remainder expectant on a prior interest. It gives an immediate right to the rent, together with a right to distrain for it, and if there be a proviso for re-entry, a right to forfeit the lease. Of course, where, as in *Munro*, the lease, or, as it then may have been, a licence coupled with an interest, arises under a prior independent transaction, no question can arise because the donor then gives all that he has, but where it is a condition of the gift that a lease back shall be created, we think that must, on a true analysis, be a reservation of a benefit out of the gift and not something not given at all."

The court then said that it was unnecessary to reach a final conclusion on the point, since there were two unanswerable reasons why the case was caught by the statutory provision, i.e. the full repairing covenant on the part of the son and his covenant to pay title redemption annuity.

The observations in that important passage were directed to what is now the first limb of section 102(1)(B). What was being said, in the words of the provision itself, was that where there is a gift of the freehold conditional on the grant of a lease back the freehold is not enjoyed to the entire exclusion of the donor. Although *Lang v. Webb* was not referred to in the judgment, it was cited in argument and is recorded by Walton J as having been strongly relied on by counsel for the Crown before him, especially the judgment of Isaacs J; see [1974] 1 WLR, 299A-B. it is therefore natural to assume that it was strongly relied on by the Crown in this court and that their observation were, at least to some extent, influenced by it.

In *Lang v. Webb* the case stated recorded that in 1908 the deceased had transferred

and conveyed a piece of land to each of her three sons; that on the same date as, but subsequently to, the execution of the transfers and conveyances there had been executed by the deceased and each of her sons a lease back for a term of five years of the land which had been transferred and conveyed to him; and that the transfers and conveyances and leases had been executed after discussion and arrangement between the deceased and her three sons and after she had explained to them that she desired to make fixed and permanent provision for them and at the same time to take from them leases at whatever might be a reasonable rental for grazing purposes having regard to the conditions of the leases, those conditions and the amounts of the rents having been discussed and agreed before the execution of any of the documents. There were further findings to the effect that the rents reserved were in each case fair and reasonable and that after the execution of the documents the whole of the land continued to be occupied by the deceased and was used by her for grazing purposes. On the deceased's death in 1910, before the expiration of the leases, a claim for death duties was made in respect of the freehold, that claim being upheld by the High Court of Australia (Griffith CJ, Barton and Isaacs JJ).

It is not possible to reconcile all the observations made by the three members of the court. Certainly, the clearest reasoning appears in the judgment of Isaacs J. At p.514 he agreed that in order to find out what is given, it is the real transaction which must be looked at and not merely the form which it takes. At p.515, he said:

"But there must be no misunderstanding as to what is meant by the transaction ... in the relevant sense it means that you regard the substantial effect of the 'conveyance, assignment, gift, delivery or transfer', by which the gift was made. If by an instrument, as in this case, you look at the instrument by which the property passes from the donor to the donee, and, disregarding mere form, ascertain its real effect. What does it give, not how does it give it? In this case the gift is made by the indenture executed by Henrietta Lang, and by that the whole of her estate in the lands was given without any exception or reservation whatever. That was the transaction of gift - complete in itself and unqualified. No other construction is possible. It had to be complete before the donee could execute to her the lease of the property. A lease is a conveyance; and it is more than form, it is substance, when the donor's interest has to be vested in the donee before the donee can convey a smaller interest. That smaller interest was comprised in the gift itself, it was part of it, and is quite different from the case of *Re Cochrane*, where the trust of surplus income and the ultimate contingent trust of corpus were expressly retained by the donor for himself on the face of the instrument, and never in any shape or form included in what he gave."

Those observations can be summarised by saying that the property disposed of was the freehold interest in the land because the disposition of that interest had to be complete before the lease back could be granted; that that was a matter of substance and not of form: and that the leasehold interest, having been an interest smaller than

the freehold, was comprised in the gift itself and was part of it. This analysis explains and is entirely consistent with the observations of this court in *Nichols*.

Mr. Venables QC, for the executors, submitted, correctly, that those observations, having been unnecessary to this court's decision of the case, were obiter. He further submitted that they were wrong and was even disposed, initially, to suggest that there were good reasons for our not attaching to them the weight we would instinctively attach to any observations of a division of this court thus constituted. I cannot accept that submission. Being in complete agreement with the analysis of Isaacs J, I am satisfied that the observations of this court were correct, although I would not myself attach weight to the rights of the landlord to the rent, to distrain for it and to forfeit the lease. The question then is whether those observations apply to the transactions in the present case.

Adapting the language of problem (1) a posed by this court in *Nichols*, at [1975] 1 WLR 538D-E, I state the executors' case to be that "all that was given was the beneficial interest in the [property conveyed and transferred by Mr Macfadyen to the trustees on 31st March] shorn of the benefit of the rights and interests of [Lady Ingram] under the [trustees' equitable obligation to treat her in all respects as if the leases had been valid]." If that is the correct view, the property disposed of was undoubtedly enjoyed to the entire exclusion of Lady Ingram within the first limb of section 102(1)(b). In order to decide whether it is correct or not, it is necessary to start with a consideration of Lady Ingram's rights and interests under the trustees' equitable obligation towards her.

Both sides proceeded in argument on the footing that Lady Ingram was entitled to a lease in equity. There was, I think, no examination of what that really meant. There having been no agreement by the trustees to grant leases to Lady Ingram, it seems improbable that she could have obtained a specific decree to that effect against them. It would appear to follow that she was not entitled to an equitable lease in the full sense, it being made clear in the judgment of Sir George Jessel MR in *Walsh v. Lonsdale* (1882) 21 Ch. D. 9, 14, that the existence of a lease in equity under an agreement for a lease depends upon the agreement being specifically enforceable. So it appears that Lady Ingram's rights and interests may have been limited to those which were available to her by way of injunctive relief to compel the trustees to treat her in all respects as if the leases had been valid. I will proceed on that footing, being the one which is, if anything, the more favourable to the executors.

The principal right and interest which Lady Ingram would have had against the trustees was a right to possession of the property. That right mirrored the trustees' obligation to afford her possession. That obligation, just like an obligation to grant her a lease had there been one, was one to which the trustees only became subject when the freehold interest was vested in them. Thus the correlative right or interest in Lady Ingram, just like her interest under a lease had there been one, was, in the language of Isaacs J, a smaller right or interest comprised in the gift itself and part of it. For these reasons, unless there is any other objection, I would hold that the property disposed of was the freehold interest in the property and that the nature of Lady Ingram's rights and interests against the trustees was such that the freehold interest was not enjoyed to her entire exclusion.

The objection suggested, as I understand it, is that the equitable obligation, having been imposed on the trustees, did not impinge on the interests of the beneficiaries under the declarations of trust, which can therefore be regarded as having been shorn of the benefit of the rights and interests of Lady Ingram. That is a proposition to which I am quite unable to assent. The interest of a beneficiary under a trust can only take effect subject to those obligations to which his trustee is subject. Here the beneficiaries were no less volunteers with notice, through the terms of the declarations of trust, of Lady Ingram's intention than the trustees. They were equally subject to an obligation in equity to give effect to that intention which could, if necessary, have been enforced against them. Accordingly, Lady Ingram's rights and interests were just as much smaller rights and interests comprised in the gift to the beneficiaries as they were in the disposition to the trustees. That was not a matter of conveyancing or of form. It was, as Isaacs J said, a matter of substance.

The reality of this state of affairs can be illustrated by supposed events which could theoretically have occurred. Immediately after 31st March 1987 Lady Ingram's daughters and the trustees of Robin Ingram's children's 1987 settlement, being together absolutely entitled to the beneficial interest in the property as against the trustees, could have joined together and directed them to turn Lady Ingram out of the property. The direction would have been ineffective, not because the trustees could have refused to comply with a direction given to them by all their beneficiaries, being adult and sui juris, but because their interests in the property were as much subject to Lady Ingram's rights and interests as the trustees'. More generally, it must be clearly said that it would run quite contrary to the principle of the estate duty authorities, indeed it might be said to the principle of any known impost on property, for the mere interposition of trustees, especially between a donor and beneficiaries with absolute interests, to be the decisive factor in avoiding a liability for inheritance tax.

It has also been suggested that the Crown's claim is inconsistent with the view which has been taken of the case where A gives freehold land to B absolutely, subject to a rentcharge in favour of A; cf. *Grey*. In *St. Aubyn* at [1952] AC, 49, Lord Radcliffe said:

"In substance the position of Lord St. Levan was the position of a man who creates a rentcharge in his own favour upon property which is in his absolute disposition and then makes a gift of that property subject to that charge. Nothing is then given except the interest so charged. Is possession and enjoyment of what is given exclusive of the donor or of any benefit to him, despite his continued receipt of the amounts secured by his charge? I conclude that it is, for I cannot imagine that, had the law been otherwise, the case of *Grey* would have taken the course that it did. In that case Earl Grey had at least created a rentcharge for himself on parting with his estates ..."

The short answer to this suggestion is that a rentcharge, unlike a lease, can be created by way of reservation. It is unnecessary to dispose of the freehold and take a grant back. This is made clear in *Megarry and Wade's Law of Real Property*, 5th ed., at

p.822, where it is said:

"Apart from statute, a legal rentcharge can be created inter vivos only by a deed, although it has always been possible for a person disposing of land to reserve a rentcharge to himself, without the grantee of the land executing the deed."

A footnote refers to Co. Litt. 143a, which I take to be a reference to the following:

"'Reserving.' Reserve commeth of the Latine word *reservo*, that is, to provide for store; as when a man departeth with his land, reserveth or provideth for himselfe a rent for his owne livelihood. And sometime it hath the force of saving or excepting. So as sometime it serveth to reserve a new thing, viz. a rent, and sometime to except part of the thing in esse that is granted."

Alternatively to its claim under the first limb of section 102(1)(b), the Crown relies on the second limb. Here the claim is effectively based only on the covenants for quiet enjoyment, which, it is said, gave Lady Ingram a benefit by contract or otherwise. I disagree. A covenant for quiet enjoyment is in reality no more than a contractual backing for the landlord's obligation not to derogate from his grant. If that be an oversimplification, I cannot see that the covenant can give a benefit of sufficient significance to fall within the second limb. It is of a wholly different order from the covenants on the part of the son in *Nichols*.

The Ramsay principle

My conclusion that the leases were nullity makes it unnecessary for me to decide whether, had they been valid, the Ramsay principle would have applied with the same result as if they had been a nullity. Moreover, the scope of that principle is now a matter of such uncertainty that it is unprofitable to express any view as to its application in a case where it is unnecessary to do so. I should add that since, at the conclusion of Mr. Venables' argument, two members of the court were of a clear opinion that the leases were a nullity, we did not ask Mr. Nugee to deal with this point.

Conclusion

My conclusions that the leases were a nullity and that the transactions fell within the first limb of section 102(1)(b) are a sufficient basis for the Crown to succeed on this appeal. I desire to emphasise that had the leases been valid then, subject to the application of the Ramsay principle, the outcome of this case would have been governed by *Munro* and the Crown's claim would have failed. It was unfortunate for the promoters of the scheme that in March 1987 the consequences of *Rye v. Rye* had not been elucidated by the decision in *Kildrummy*.

I would allow this appeal.

LORD JUSTICE EVANS:

In March 1987 Lady Ingram, then aged 73, lived at Hurst Lodge near Twyford in Berkshire. The property was given to her by her father in 1946 and she had lived there ever since. On 29th March she conveyed it for no consideration to her solicitor, Mr. Michael Macfadyen. She took this dramatic step on legal advice and with the legitimate object of reducing the inheritance tax which would become payable on her death. The effect of the conveyance was minimal, because by a separate Deed signed on the same day Mr. Macfadyen declared that he held the property as Nominee for Lady Ingram and that he would comply with her directions in relation to it in all respects.

On the following day, acting therefore on her instructions and as her Nominee, Mr. Macfadyen granted Lady Ingram a lease of the property for the period of 20 years, non-assignable and rent free and with the minimum of covenants on the part of the landlord.

Next, on 31st March, Mr. Macfadyen conveyed the property to Trustees "on trusts declared [concerning] the same" and subject to Lady Ingram's lease. By a supplemental Deed also dated 31st March the Trusts were declared by the Trustees in favour of the next generation of Lady Ingram's family, her three children and the two children of a fourth child, who had died.

Lady Ingram's occupation and enjoyment of Hurst Lodge was uninterrupted by these transactions, and she continued to live there until she died two years later in February 1989.

Upon her death, inheritance tax became payable on her estate under the Finance Act 1986. This included, it is accepted, the value of the remaining period of her 20 year lease, but not, her executors contend, the value of the freehold which became vested in the trustees for her children and grandchildren in consequence of the March 1987 transactions described below.

The Revenue, who are the appellants, claim that inheritance tax nevertheless is payable on the value of the freehold under section 102 of the Act. Section 102(3) provides that property which immediately before her death was "property subject to a reservation", as defined in section 102(2), shall be treated for the relevant tax purposes as if it was her property at that time. The relevant words of definition are found in section 102(1):-

"102(1). Gifts with reservation (1) ... this section applies where ...
an individual disposes of any property by way of gift and either -
(a) possession and enjoyment of the property is not bona fide

assumed by the donee at or before the beginning of the relevant period; or (b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise ..."

and the relevant period is seven years ending on the date of death.

This statutory provision can be traced back through the Capital Transfer Tax and Estate Duty legislation to section 38 of the Customs and Inland Revenue Act, 1881. Initially concerned with property taken as a donatio mortis causa within a three-month period before the death, the period was successively extended to twelve months in 1889 and to seven years in 1968.

At first sight, nothing could be clearer than that the statutory definition applies when freehold property is given to or in trust for a person's children but subject to an arrangement which permits the donor to remain in occupation and to have full enjoyment of the property until he or she dies. In the first of the cases to which we have been referred, *Earl Grey v. the Attorney General* [1900] AC 124, the Earl of Halsbury L.C. began his speech as follows:-

"My Lords, there are some cases so extremely plain that it is difficult to give a better exposition of the question than that which the statute itself provides" (p.126).

Four of the five other members of the House of Lords concurred, without giving reasons of their own.

Subsequent authorities, however, have demonstrated that the interpretation of the statutory words in this taxation context requires a close and careful analysis, even or perhaps especially in what might otherwise seem to be an equally clear case. The contention of the Executors, ably presented by Mr. Venables QC on their behalf, is that the "property" which was given to Trustees for the family beneficiaries was the freehold subject to Lady Ingram's 20-year lease, or in other words the freehold without that leasehold interest, and that neither (a) or (b) of the requirements of section 102(1) applies. The Trustees did assume possession and enjoyment of the property, so defined, though they had no right to occupy the land until the lease expired, and they enjoyed that property to the entire exclusion of Lady Ingram, who had no further interest in or enjoyment of it. She received no "benefit by contract or otherwise" from the transaction because the right to occupy the property was one which already, as freehold owner, she enjoyed.

It is accepted that if she had retained a life interest in the property then her taxable estate would nevertheless have included the full value of the property, under separate provisions of the inheritance tax legislation, which do not operate when she remained in occupation under the lease. The issue raised, therefore, is whether her retention of a leasehold interest takes the case outside section 102(1), notwithstanding that the terms and period of the lease were designed to enable her to occupy the property rent free for the rest of her life.

As will be apparent, the respondent's interpretation of section 102(1) centres upon the meaning of "property", which clearly refers to the subject-matter of the gift. If only the freehold reversion was given, then they rely upon the judgment of the House of Lords in *St. Aubyn v. Attorney General* [1952] AC 15 where both Lord Simonds and Lord Radcliffe in their speeches re-stated the importance of identifying the property that was given. If the donor gives only part of his property to the donee, then the operation of section 102(1) is limited to the part which he gives. Lord Simonds illustrated this by reference to the simple case where the donor owns two separate properties, estates in Yorkshire and Wiltshire respectively, and makes a gift of one but retains the other. He continued:-

"... equally so, if, his interest being not in two geographically separate estates but in land and capital moneys, he surrenders his interest in the one form of property and retains it in the other" (page 22).

In that case, the relevant facts of which are lucidly explained by Ferris J. in his judgment under appeal, reported at [1995] 4 All ER 334, the donor exercised powers of appointment "to make some part of the settled property his own", and it was "wholly irrelevant that by a contemporaneous or later transaction he surrenders his life interest in other parts of it" (page 22). The different parts of the property were distinct personal assets, none being real property or an interest in realty, and the part which he gave by releasing his life interest was not "property subject to a reservation" for the purposes of section 102. The donor did not receive a "benefit by contract or otherwise" merely because by a separate transaction he enlarged his life interest into an absolute interest in other property.

That decision may now have to be read subject to the principle stated by the House of Lords in *Ramsay (WT) Ltd v. IRC* [1982] AC 300 but there can be no doubt that as regards the application of what is now section 102 of the 1986 Act the judgment remains good law.

Lords Simonds and Radcliffe considered the earlier authorities in some detail, including *Earl Grey v. A.G.* (above), judgments of the Privy Council in two Australian cases, *Munro v. Commissioner of Stamp Duties* [1934] AC 61 and *Commissioner etc. for NSW v. Perpetual Trustee Company* [1943] AC 425, *Re Cochrane* [1906] IR 200 a decision of the Court of Appeal of Ireland, and *AG v. Worrall* [1895] 1 QB 99. The last is a judgment of the Court of Appeal which was approved both by Lord Simonds and Lord Radcliffe, though with considerable reservations by the former (see pages 25 and 47 respectively). It establishes that "a benefit by contract or otherwise" may be reserved by the donor notwithstanding that it "does not arise by way of reservation out of that which is given" (Lord Simonds at page 26). The donor gave his son the benefit of a debt of about £24,000 which was owing to him, in return for which the son covenanted to pay the father an annuity of £735 p.a. during his life. Lord Radcliffe said:-

"It seems to me reasonable enough for a court to hold in those circumstances that the son had not obtained the enjoyment of what

was given free from a contractual benefit to the father which encumbered the enjoyment of the very thing that was given" (page 47).

Although the debt was secured by a mortgage on land which was acquired by the son from the debtor who was its owner, the annuity was not secured on the land and it could not be said to "arise out of that which was given", namely the right to receive the debt. On the other hand, the case was not authority for the converse proposition that "all benefits are within the mischief of the section, whether they are by way of reservation out of the subject matter of the gift or not" (page 48).

Lord Radcliffe summarised the authorities as follows:-

"A man may have an arrangement which gives him contractual benefits that affect an estate and may subsequently make a gift of his interest in that estate; if he does the donee has possession and enjoyment of what is given, to the entire exclusion of the donor or of any benefit to him. That is the Munro case. Shares may be made the subject of a trust for another person, the maker of the trust having the right under it to be one of the trustees, to retain in his control the voting-power in respect of the shares and to take an ultimate resulting interest; yet that benefit does not bring the property within the mischief of a similar provision. That is *Commissioner of Stamp Duties for New South Wales v. Perpetual Trust Co. Ltd.* No more is possession and enjoyment of a gift compromised if a man vests property in trustees upon trust to provide out of it certain limited benefits for a donee, but subject thereto upon trust for himself. That is *In re Cochrane*. All these decisions proceed upon a common principle, namely, that it is the possession and enjoyment of the actual property given that has to be taken account of, and that if that property is, as it may be, a limited equitable interest or an equitable interest distinct from another such interest which is not given or an interest in property subject to an interest that is retained, it is of no consequence for this purpose that the retained interest remains in the beneficial enjoyment of the person who provides the gift."

These statements of principle were followed by Lord Reid giving the judgment of the Privy Council in a further Australian case, *Oakes v. Commissioner etc. of NSW* [1954] AC 57. After referring to *St. Aubyn v. AG* Lord Reid said:-

"... it is now clear that it is not sufficient to bring a case within the scope of these sections to take the situation as a whole and find that the settlor has continued to enjoy substantial advantages which have some relation to the settled property; it is necessary to consider the nature and source of each of these advantages and determine whether or not it is a benefit of such a kind as to come

within the scope of the section" (p.72)

One potential benefit to the donor, as the settlor of property in trust for his children, was the advantage which was assumed to accrue to him from the fact that income from the settled property was available to be spent on the maintenance of the children, and therefore was expenditure the burden of which might have fallen on him. This advantage or benefit to him did not bring the case within the scope of the section, because it "did not impair or diminish the value of the gift to them or their enjoyment of it" (pages 73-4). But the settlor also retained a right to take remuneration as a beneficial interest in the property which he had reserved when making the deed of trust, and therefore was regarded as a reservation from the gift which was within the section. If it had been such a beneficial interest, then the section would not have applied (page 76).

So the ground is laid for Mr. Venables' submission. A person is entitled to segregate and give away part of his property. The fact that he continues to receive the benefits of owning or enjoying other property which he retains does not mean that there is a reservation for the purposes of section 102. "The property" in question is the property which he gives, and it is in relation to that property that the question must be asked, whether its possession and enjoyment was bona fide assumed by the donee at the time of the gift (strictly, "at or before the beginning of the relevant period"), and enjoyed thereafter to the exclusion of the donor. Moreover, the segregation can be made at the same time as and as part of the same transaction as the gift, and the same principle applies when the donor sub-divides his legal interest in the property into different equitable parts (e.g. the resulting trust for the balance of income in *Re Cochrane*).

Therefore, it is submitted, a person is entitled to create a leasehold interest in land which he owns, in favour of himself or another, and thereby to segregate the freehold reversion in the property. If he then gives the freehold interest to a donee who takes possession and enjoyment of it for himself, and provided the donor has no further enjoyment of that property and receives no collateral benefit by contract or otherwise within paragraph (b), then the freehold interest does not become liable to tax under section 102.

I would be prepared to hold in any other context that this produces a result which is so clearly at variance with the apparent object of section 102 that it cannot be regarded as a proper interpretation of the section. However, I appreciate that in the context of tax legislation it is necessary to consider the legal analysis with the utmost precision, so that the taxpayer shall not become liable to tax unless that is clearly and unequivocally the effect of the statutory provisions.

Approaching the matter in this way, in my judgment the section does apply in the circumstances of the present case, and the taxpayer's submission fails. The essential reason is that the leasehold interest which the donor retains cannot come into existence until the freehold passes to the donee. I use the present tense deliberately, because Mr. Venables stresses that the transactions can and should be regarded as having taken place simultaneously, and Mr. Nugee QC for the Revenue does not

contend otherwise. The inescapable fact is that the leasehold is a derivative interest which, being in favour of the donor, could not take effect in law or, I would add, in equity until the donee becomes a party to the transaction. This does not mean that the freehold reversion can never be "the property" for the purposes of section 102(1), because there might be a lease in favour of a third party, either pre-existing or granted by the donor as part of the same transaction as the gift, and in such circumstances the donee would acquire only the freehold subject to that lease (or, as it may be, encumbered by an equitable obligation to grant that lease). But the situation is different when the donor purports to grant the lease to himself, for the simple reason that he cannot make such a contract or create the separate interest, in the capacity of lessee, unless there is an owner of the freehold (or superior lessee) who can contract as lessor. The donee, or when the property is conveyed to trustees by way of gift, the beneficiaries as donees may receive the property subject to an equitable obligation to grant a lease to the donor, but until they do so they cannot make that grant. It follows that the lease cannot become effective either in law or equity unless the freehold interest is transferred at least momentarily to them. Thereafter, they possess and enjoy the property by virtue of their right to receive rent and other benefits as lessors and of their rights as owners of the freehold reversion.

If this view is correct, then the result is entirely consistent with what I regard as the apparent object of the section. Mr. Venables accepts, as I understood his submission, that if the donor was to remain in occupation as licensee or by virtue of some permission given by the donee, then the section would apply. He distinguishes the case of a lease because, he submits, that is a legal or equitable interest which the donor "carves out" of the property before or at the time of the gift. But he cannot do that unilaterally, and by parity of reasoning the donor is in the same position as lessee as he would be if he was granted a licence. Moreover, the submission leads to the strange conclusion that a collateral payment or other benefit by contract or otherwise, as well as the grant of a licence to occupy the land, would be within the scope of section 102, whereas the grant or reservation of a right to occupy the property on a more secure basis as lessee would not.

I have reached this conclusion in the light of the authorities before *In re Nichols* dec'd [1975] 1 WLR 534, where the Court of Appeal formed a clear view on this very issue, although they stated expressly that they did not base their decision upon it. The relevant passages from page 543 are quoted by Nourse LJ and I need not repeat them here. The final sentence which contrasts "a reservation of a benefit out of the gift" with "something not given at all" has to be read bearing in mind the words of the statute and of the earlier authorities. The contrast is between a benefit which is retained by the donor out of the property gifted, and on the other hand the retention of other property which is not gifted at all.

It is said that land may be gifted subject to a rentcharge in favour of the donor and that in such a case the section does not apply. In *Earl Grey v. AG* the term of the conveyance to the defendant (donee) were these:-

"... the said Earl Grey did convey to the defendant ... all his real estate other than the mansion house and the appurtenances, to the use that the said Earl Grey should thenceforth during his life

receive an annual rent-charge of 4000L to be issuing out of the said hereditament, and subject thereto to the use of the defendant in fee simple." ([1898] 2 QB at 535.)

This was expressly referred to by Lord Halsbury as something which was reserved to the settlor and within the express language of the statute ([1900] AC at 126). The later authorities, in my judgment, do not cast doubt upon this being a ground of decision in Earl Grey's case and correct as a matter of principle. Lord Radcliffe in *St. Aubyn v. AG* envisaged that Lord St. Levan, the donor in that case who was held not liable for tax, was in the same position as "a man who creates a rentcharge in his own favour upon property which is in his absolute disposition and then makes a gift of that property subject to that charge" ([1952] AC at 50). Lord Radcliffe did not refer in terms to the owner of the freehold and moreover he referred to a situation where a rentcharge could validly be created in favour of the donor before the gift was made. If that could not be done, unless the property was first vested in the donee, then the situation envisaged by Lord Radcliffe would not arise, and in my respectful view his dictum does not prevent the application of principle in the interpretation of section 102 which I have tried to describe.

Lease to principal by nominee

I have assumed above that the lease which Mr. Macfadyen purported to grant to Lady Ingram as her nominee was equivalent in law to a lease granted by Lady Ingram to herself, and therefore was of no effect. The judge's conclusion on this issue in my view was correct. I would not dissent from any of Millett LJ's analysis of the relationship between trustee and beneficiary, or between principal and agent, but with due diffidence I do consider that the transaction offends what conveniently he calls the two-party rule. Lady Ingram must be taken to have directed Mr. Macfadyen to make the lease contract with herself. I do not see how that can be described as the meeting of minds which is essential for the creation of consensual obligations. The law which permits a valid leasehold interest to be kept separate from the freehold reversion notwithstanding that the same person acquires the beneficial interests in both seems to me to be concerned with a different issue.

Conclusion

I therefore would hold that there was no effective lease by Mr. Macfadyen to Lady Ingram and that the gift to trustees which he made on her behalf was subject to a reservation in her favour, within the scope of section 102(1) of the Act. This would be clear, in my judgment, if the gift was made direct to the beneficiaries, and I do not consider that the interposition of trustees changes the nature of the gift. I express no view on the possible application of the Ramsay principle, on which no argument was addressed to us.

I agree with the judgment of Nourse.

LORD JUSTICE MILLETT:

In the course of his submissions Counsel for the Revenue cited a passage from the 1954 edition of Potter & Monroe's Tax Planning in which the authors warned, in words which remain as true today as when they were first written:

"A man cannot eat his cake and have it. Moreover, it is not the function of his lawyer to devise a scheme whereby this fact of life is falsified. If a man disposes of his property for another's benefit, certain tax results may follow; but the results cannot be achieved unless the disposition is in the first place effected not as a fiction but as a fact."

A man may, however, genuinely dispose of his property by way of gift while retaining an interest in the property given or obtaining some other benefit from the donee in return. Such a transaction has traditionally been described as "a gift subject to a reservation" and it is still so described in the legislation which is in force today. From the inception of estate duty in 1894, Parliament denied to such gifts the tax advantages which it was willing to accord to gifts made without reservation. It did so by making it a condition of relief (a) that possession and enjoyment of the property should be immediately assumed by the donee and (b) that thenceforward the property should be

"enjoyed to the entire exclusion ... of the donor and of any benefit to him by contract or otherwise."

The grammatical structure of these provisions indicated that the property in question was the property given; and accordingly, adopting a somewhat literal construction of the statute to the possible detriment of its evident legislative purpose, the Courts laid down a settled rule that it was only the possession and enjoyment of the actual property given from which the donor must be excluded. It was, therefore, necessary in every case to identify with precision the interest which formed the subject-matter of the gift. If the donor was not excluded from possession and enjoyment of the very interest which he had given, then relief from estate duty was not denied merely because the donor continued in possession and enjoyment of some other interest in the same property which he had not given. As Lord Radcliffe expressed it in *St. Aubyn v. Attorney General* [1952] AC 15 at p.49:

"... if [the interest given] is, as it may be, a limited equitable interest or an equitable interest distinct from another such interest which is not given or an interest in property subject to an interest that is retained, it is of no consequence for this purpose that the retained interest remains in the beneficial enjoyment of the person who provides the gift."

The distinction between a gift of the whole property with a gift back of a limited

interest in the property on the one hand and a gift of a limited interest only in the property, the donor retaining what he has not given on the other, is not always easy to draw. The distinction is an artificial one which depends on form rather than substance. It was trenchantly criticised by Lord Radcliffe in *St. Aubyn v. Attorney General (supra)* at pp.44-45, where he deplored the fact that, when Parliament had found the time in 1940 to repeal and re-enact the legislation concerning gifts with reservation of benefit, it had not taken the opportunity to make it intelligible.

The replacement of estate duty by capital transfer tax made it unnecessary to retain the provisions which dealt with gifts with reservation of benefit, and they were duly repealed. The replacement of capital transfer tax in turn by inheritance tax in 1986, however, made it necessary once more to deal with the problems caused by such gifts. Parliament did so by Section 102 of the Finance Act 1986. Despite the criticisms which had been levelled at the earlier legislation, it re-enacted it almost verbatim. It thereby revived the artificial distinction between a gift where the donor remains in possession and enjoyment of the subject-matter of the gift and a gift where he remains in possession and enjoyment of some other interest in the same property which is excluded from the gift. Given that in either case the donor's purpose is to obtain a tax advantage, and that in either case he may be with equal justification be said "to want to eat his cake and have it", Parliament must be taken to have considered the one course of action but not the other to be what Lord Scarman described as "the safe channel of acceptable tax avoidance": see *Furniss v. Dawson* [1984] AC 474 at p.513. The difference between acceptable and unacceptable tax avoidance is pre-eminently a matter for the legislature. If Parliament has drawn the line in a particular place, however incongruously, it is not for the Courts to draw it elsewhere.

Lady Ingram's scheme.

Lady Ingram wished to take appropriate steps to achieve an eventual saving of inheritance tax if she lived long enough. To this end she decided to make a potentially exempt transfer of her country estate to her children. She did not, however, wish to give up the right to continue to live there rent free during the rest of her life. She could not achieve her object by retaining a life interest in the property, for this would constitute an interest in possession in settled property and on the death of a person entitled to such an interest inheritance tax is charged on the capital value of the property in which the interest subsists: see Schedule 5 to the Finance Act 1978. Nor could she take a lease for life or for a period determinable by reference to her death, since such a lease is treated as an interest in possession in settled property. Accordingly, Lady Ingram was advised to retain for her own benefit a leasehold interest for a fixed period which was likely to be of sufficient duration to exceed the remainder of her lifetime and to make a gift of the freehold reversion to her children.

To this end (disregarding immaterial features) Lady Ingram took the following steps or procured them to be taken:

- (1) Lady Ingram conveyed the freehold interest in the property to her Solicitor, Mr Macfadyen, for no consideration. This transaction, of course, did not pass any beneficial interest to Mr Macfadyen.
- (2) Immediately afterwards Mr Macfadyen executed a deed by which he declared

that he held the property as nominee for Lady Ingram and agreed to transfer it back to her or otherwise deal with it as she might direct. This merely gave formal recognition to the effect of the conveyance to Mr Macfadyen.

(3) On the following day, and at Lady Ingram's direction, Mr Macfadyen granted a lease of the property to Lady Ingram for a term of 20 years free of rent. The lease contained an absolute covenant against assignment, underletting or parting with possession, and appropriate but fairly minimal covenants on the part of each party.

(4) On the following day, again at Lady Ingram's direction, Mr Macfadyen conveyed the freehold interest in the property subject to and with the benefit of the lease to named trustees.

(5) Immediately afterwards the trustees executed a Declaration of Trust by which they declared that they held the property which had been conveyed to them (that is to say the freehold interest in the property subject to and with the benefit of the lease) in trust for Lady Ingram's intended beneficiaries.

The rival contentions.

Lady Ingram set out to create and retain for her own benefit a 20 year lease of the property and to give only the freehold reversion subject to and with the benefit of the lease to her children. The Revenue acknowledge that, if that is what she did, then she succeeded in making a potentially exempt transfer of the freehold reversion in the property and not a gift of the property subject to a reservation. But the Revenue contend that that is not what she did, and (implicitly) that it is not possible to do it.

The Judge held that it is not possible for a nominee to grant a lease to his principal, with the result that the purported lease was a nullity. (Although Mr Macfadyen is described in the documents as Lady Ingram's nominee, the Judge of course fully recognised that the relationship between them was not that of principal and agent but that of bare trustee and beneficiary.) Accordingly, he held that Lady Ingram's leasehold interest did not come into existence until the trustees executed the Declaration of Trust, which was when Lady Ingram for the first time ceased to be beneficially entitled to the freehold. The lease then vested in Lady Ingram and the freehold reversion vested in her intended beneficiaries simultaneously. On this analysis Lady Ingram's leasehold interest must have taken effect in equity only, although she undoubtedly intended to take a legal term of years. On the Judge's analysis Lady Ingram and the beneficiaries acquired their respective beneficial interests in the property at one and the same moment, and it followed that there was no prior point of time at which the trustees or beneficiaries had a more extensive interest out of which Lady Ingram's interest was carved. It was clear that Lady Ingram never intended to give the property to the beneficiaries unencumbered by her leasehold interest. The Judge held that the beneficial interests should be treated as vesting in such manner as would give effect to her intention, with the result that the subject-matter of the gift which Lady Ingram made was the freehold shorn of the leasehold interest.

The Revenue appeal against the Judge's conclusion that the subject-matter of the gift was the freehold reversion shorn of the leasehold interest, and submit that, even if the two interests did vest simultaneously, they came into existence at the same time and were indissolubly bound together. The Revenue contend that in the circumstances Lady Ingram's leasehold interest was necessarily carved out of the

subject-matter of the gift. Lady Ingram's executors cross-appeal against that Judge's ruling that the grant by Macfadyen was ineffective to create and vest a legal term of years in Lady Ingram. If all else fails, the Revenue invoke the principles established by the House of Lords in *Ramsay (W. T.) Ltd v. Inland Revenue Commissioners* [1982] AC 300 and *Furniss v. Dawson* to defeat Lady Ingram's scheme.

The first question is whether the Judge was correct in ruling that the lease to Lady Ingram was ineffective to vest a legal term of years in her. Can a nominee grant an effective lease to his principal?

There is no direct English or, so far as I know, Commonwealth authority on this question, which therefore falls to be decided as a matter of principle.

In *Rye v. Rye* [1962] AC 496 the House of Lords held that it is not possible for a man to grant a lease to himself. The reasons are succinctly stated in the speech of Lord Denning at p.513:

"This makes it necessary to determine the point of law: Is it possible for a person to grant a tenancy to himself? Or for two persons to grant a tenancy to themselves? At common law it was clearly impossible. *Nemo potest esse tenens et dominus*. A person cannot be, at the same time, both landlord and tenant of the same premises: for as soon as the tenancy and the reversion are in the same hands, the tenancy is merged, that is, sunk or drowned, in the reversion; see 2 Blackstone's Commentaries 177. Neither could a person at common law covenant with himself, nor could two persons with themselves. Neither could one person covenant with himself *and* other jointly. Such a covenant, said Pollock CB is "senseless", see *Faulkner v. Lowe* (1848), 2 Exch at p.597."

These two reasons correspond to the dual character of a lease in English law as both contract and conveyance. A man cannot convey to himself; and he cannot contract with himself. But he can convey to a nominee for himself, and if he can contract with a nominee for himself there is no reason why he should not be able to grant a lease to a nominee for himself. Lord Radcliffe was of opinion that he could. In *Rye v. Rye* at p.511 he said:

"He could, of course, put land in trust for himself by conveying it to a nominee, and, I suppose, if there was any conceivable point in the operation, he could similarly demise land to a nominee."

Lord Radcliffe's remark was *obiter* and expressed in tentative terms; but he clearly considered that such a transaction gave rise to no obvious conceptual difficulty.

The Judge relied on an observation of Lord Macnaghten in *Henderson v. Attwood* [1894] AC 150 which at first sight appears to support the contrary view. The case concerned a purported sale by a mortgagee to a nominee for himself. Giving the opinion of the Privy Council, Lord Macnaghten said at p.158:

"The so-called sale was of course inoperative. A man cannot contract with himself. A man cannot sell to himself, either in his own person or in the person of another."

I shall have to return to this passage later.

The Judge principally relied, however, on the Scottish case of *Kildrummy Jersey Limited v. IRC* [1990] STC 657, in which the Inner House of the Court of Session held that it was not possible in Scottish law for a man to grant a lease to a nominee for himself. The Lord President, Lord Hope, said at p.662:

"I have, as I have said, no difficulty in the concept by which the title to property and the beneficial interest are separated, the title being held by a nominee. There is no reason to doubt the efficacy of this arrangement where the property in question has some independent existence of its own ... But I know of no case, and none was cited to us, where it has been held that a nominee may contract with his principal so as to create new rights and obligations involving no third party whatever which are to be held only upon his principal's behalf. That seems to me to conflict with the principle that a man cannot contract with himself ..."

After quoting the observation of Lord Macmillan in *Henderson v. Astwood* to which I have referred Lord Hope continued:

"The whole basis of a contractual obligation is the agreement of two or more parties as to the act or thing to be done. This is as true of a lease as it is of any other kind of contract. It is impossible to conceive of a lease by a man in his own favour. The essence of a lease lies in the tenant's right to exclusive possession of the subject let, and the landlord's obligation to put and maintain him in that possession ... I do not see how a man can contract with his own nominee to the effect that his own nominee is to be entitled to that exclusive possession against himself, this to be held for his own behoof. The truth of the matter is that the separate interests of landlord and tenant are incapable of creation by such an arrangement ..."

Lord Hope then cited *Grey v. Ellison* (1856) 1 Giff. 438 in addition to Scottish authorities before continuing:

"The position would have been different if [the nominee] had been contracting with [the principals] for its own benefit, but since it was acting from the outset as their trustee or agent and as their nominee [the principals] were in effect seeking to enter into a contract with themselves for their own benefit."

Lord Sutherland said (at 669):

"A contract of lease ... involves the creation of mutual rights and obligations which can only be given any meaning if the contract is between two independent parties. [The nominees] had no interest of their own to enter into such a contract, any rights and obligations accruing thereunder being exercisable only as nominees for [the principals]. Under a normal lease the landlords cede occupation of the property to the tenants in return for certain obligations, but if the tenants are in fact mere nominees of the landlords the whole lease becomes a pure fiction. Accordingly, in the special circumstances of this case I am of the opinion that the purported lease is not a contract to which the law can give effect and must be treated as a nullity."

Lord Clyde, the third member of the Court, said (at 670):

"But where the same person is both debtor and creditor in the same matter there can be no obligation created. It is in my view ineffective to enter into a contract with continuing mutual rights and obligations with oneself and it is whimsical to grant a lease of one's own property to oneself (see *Grey v. Ellison* (1856) 1 Giff. 438, 65 ER 990. To attempt to grant a lease to a nominee for oneself seems to me a similarly barren exercise."

I have some difficulty in accepting this reasoning as accurately representing the position in English law. It appears to my mind to treat a lease as exclusively contractual in nature and the relationship between a bare trustee and his beneficiary as analogous to that between an agent and his principal. This may be so in Scottish law or in a civilian system, but it would be an unsafe foundation upon which to base a proposition of English law which is not supported by clear English authority. As will appear later, I am of opinion that neither the passage in Lords Macnaghten's speech in *Henderson v. Astwood* nor the decision of the House of Lords in *Grey v. Ellison* provides such support.

I propose to examine the Revenue's contention that a man cannot grant a lease to a nominee for himself (for it is common ground that the proposition and its converse must yield the same answer) as a matter of principle. In doing so I shall take the lease first as property and secondly as contract.

There is no doubt that a lease is property. It is a legal estate in land. It may be created by grant or attornment as well as by contract and need not contain any covenants at all. The mortgage term and the portions term are examples of leases which contain no covenants and which consist of nothing more than the vesting of a term of years. It was formerly the practice for a mortgagor to attorn tenant to his mortgagee. The tenancy contained no covenants and was merely a device to give the mortgagee a right to obtain summary judgment for possession under the Small Tenements Recovery Act 1838 (which was repealed in 1972). But it was effective to create the relationship of landlord and tenant: see *Regent Oil Co Ltd v. J A Gregory (Hatch End) Ltd* [1966] Ch. 402.

The Revenue argue that, while a lease need not contain any covenants, it is consensual and must be capable of existing as a contract. While this is usually the case, I doubt that there is any absolute rule to this effect. The relationship of landlord and tenant has its source in medieval law, and was originally exclusively contractual. But it has long since outgrown its origins, and the term of years to which the relationship gives rise to one of the two interests in land which can exist as a legal estate. It normally arises by agreement, but it can be created by statute, and the obligations to which it gives rise are enforceable by privity of estate.

It is easy to make too much of the contractual nature of the relationship. The feature of a tenancy which distinguishes it from a licence or merely contractual right of occupation is the lessee's right to exclusive possession. But this right is a consequence of the ownership of the legal estate; it is not merely a contractual right, or it could not be the feature which distinguishes a lease from a licence. It would not, therefore, in my opinion be an accurate description of the position in English law to say that the landlord was under a contractual obligation to put and maintain his tenant in exclusive possession; still less to imply that the right to exclusive possession depended on the existence of any such contract. That would equate a lease with a mere licence.

Insofar as a lease is a conveyance, that is to say in so far as it lies in grant, there is no difficulty in the proposition that a man can vest a term of years in a nominee for himself. There is no question of the same person being at the same time both landlord and tenant at law, for the two legal estates are vested in different persons; while the rule that a man cannot be both landlord and tenant does not apply in equity, which allows the question of merger to be governed by intention.

In this connection *Belaney v. Belaney* (1867) 2 Ch. App. 138 is instructive. The testator purchased the residue of a 99 year lease and took an assignment of the term. In the following year he bought the freehold reversion and, by a deed which recited that he was desirous that the term should not merge in the freehold, the reversion was conveyed to a trustee for him. He afterwards made a will bequeathing his personal estate. Lord Chelmsford held that the reversion did not pass, but that the term did. He said at p.1452:

"It is most important to observe, that in the conveyance of the reversion, taken by the testator within a year after the assignment of the term to him, it is stated that the conveyance is taken to a trustee for the express purpose of preventing merger. *The term, therefore, remained in the testator as personal estate*" (my emphasis).

This result could not have been achieved if the freehold had been conveyed to the testator himself, for before the Judicature Act merger took effect without regard to the intention of the parties. But the device of taking the freehold in the name of a nominee was sufficient to prevent merger and to keep the term of years alive as a separate interest even though it was in the same beneficial ownership as the reversion. If the result is legally possible, Lady Ingram's deliberate attempt to achieve it cannot be dismissed as a nullity or a "barren exercise".

The Revenue argue that the grant of the lease to Lady Ingram by her nominee was devoid of any legal effect. But that is not correct. Had Mr Macfadyen fraudulently and in breach of trust conveyed the fee simple in the land free from encumbrances to a bona fide purchaser for value without notice before granting any lease to Lady Ingram, the purchaser would have taken free from her equitable interest. Had Mr Macfadyen done so after granting her the lease the purchaser would have taken subject to her lease (though not her equitable interest in the reversion) even if he had no notice of it because it was a legal estate. Of course on the facts of this case the example is somewhat fanciful, since Lady Ingram's occupation of the land would have given the purchaser notice of her interest. But the Revenue's argument must be tested generally; the validity of a lease by a nominee to his principal cannot be made to depend on whether the lessee is in possession. In my judgment the grant of such a lease is not without legal effect. The Revenue object that this reasoning is circular, since it presupposes that Lady Ingram's lease is valid. But I think that it is the Revenue's argument which is circular, since it contends that the lease is a nullity because it is incapable of having legal effect only if it is a nullity.

I turn next to consider the lease as contract. The proposition that a man cannot contract with a nominee for himself requires close examination. Several different objections may be made to such a transaction, and it is necessary to distinguish between them. One, with which alone we are concerned, is that there cannot be a contract unless there are at least two parties to it. This is the objection made in *Kildrummy Jersey Limited v. IRC*. It is directed to the intrinsic validity of the contract, and applies whether the principal is a beneficial owner or a trustee. It is based on what may conveniently be called "the two party rule". A quite different objection is that the equitable interests of beneficiaries under a trust are not capable of being overreached by a transaction between the trustee and his nominee. For this purpose there must be not merely two parties to the transaction but two independent parties who are capable of dealing with each other at arms' length. In my opinion this is the context in which Lord Macnaghten's words in *Henderson v. Astwood* must be understood. The doctrine applies only where the principal is himself a trustee and is part of the rule against self-dealing. We are not concerned with it.

An agent can of course contract with his principal, provided that he is contracting on his own behalf, that is to say as principal. The agency contract itself is just such a contract. What an agent cannot do is contract with his principal as agent for and on behalf of his principal so as to make his principal and not himself liable to sue and be sued on the contract. Such a contract is obviously impossible, since the agent drops out leaving only the principal liable to himself. It infringes the two party rule. For the same reason two agents of the same principal cannot contract with each other. This is the *ratio* of *Grey v. Ellison*. That case was concerned with a policy of insurance which one department of an insurance company purported to effect with another department of the same company. Although different individuals were parties to the contract, they all contracted as agents for the company with the intention that it alone should be able to sue and be sued on the policy. The policy was held to be a nullity. It infringed the two party rule.

But a trustee who contracts with his beneficiary contracts as principal, even when he enters into the contract for the benefit of the trust estate and not on his own behalf. He contracts so as to make himself personally liable to sue and be sued on the contract.

though he will usually have a right of indemnity out of the trust fund. The fact that he may hold the benefit of the contract and any damages which he recovers in trust for the covenantor does not make the contract nonsensical, still less void. To put the same point another way, it is conceptually impossible for an agent to contract with his principal as agent for and on behalf of his principal so as to make the principal the only person liable to sue and be sued on the contract. But it is not conceptually impossible for a trustee to contract with his beneficiary and hold the benefit of the contract in trust for the beneficiary. It is no doubt an economic absurdity, unless it is intended to be a step in some other transaction having an economic effect. But it is not a legal absurdity. It does not infringe the two party rule.

I reject the idea that no rational system of law could sensibly allow a party to assume an obligation to a party whose only function was to hold the benefit of the obligation for the benefit of the person subject to it. This might be so in a unified system like Scottish law, but in a divided system like ours it is possible for the parties to create obligations which are enforceable at law while being subject to equitable defences. Such obligations will not be enforced, but they are not nullities. Where the only objection is one of circuity of action they are capable of ripening into enforceable obligations when third parties become interested.

A covenant by a trustee with his beneficiary the benefit of which the trustee holds in trust for the beneficiary cannot in my judgment be dismissed as a mere whimsey. The covenant is good at law, but subject to equitable defences. Before 1873 it would have been enforced by the common law courts. It would not be enforced today, but only because enforcement would involve circuity of action: see *Hirachand Punamchand v. Temple* [1911] 2 KB 330. This is a procedural bar, not a substantive one. Once the circuity disappears, so does all objection to enforcement. If the covenant were a nullity from the start, it could not be resuscitated.

The other objection is based on the rule which precludes a trustee from purchasing the trust property. The rule is discussed in Snell's Equity (29th ed.) at p.249. The purchase is not a nullity, though it is voidable at the instance of any beneficiary however honest and fair the transaction may be and even if it is at a price higher than that which could be obtained on the open market. It does not matter whether the trustee is a sole trustee who purchases from himself or only one of several trustees who purchases from his co-trustees. The vice of the transaction is not that it is unfair or that it is not the product of negotiations between independent parties dealing with each other at arms' length, but that it infringes the principle that a man may not put himself in a situation where his interest conflicts with his duty. It is obvious that a trustee cannot circumvent the self-dealing rule by using a nominee to buy the trust property on his behalf.

The rule has been thought in modern times to operate harshly where one of several trustees purchases the trust property at a fair price properly negotiated with his co-trustees. Where the trustee is a sole trustee, however, and purports to exercise his power of sale by selling the trust property to a nominee for himself masquerading as an independent third party, the transaction is objectionable on more than one ground. Both purchase and sale are bad. The purchase is bad because it contravenes the self-dealing rule; it is a purchase of trust property by a trustee. The sale is bad because it purports to be that which it is not. viz. an arms' length sale of the trust property to an

independent third party. A trustee's power of sale does not authorise the trustee to sell the trust property except to someone with whom he can deal at arms' length. A sale to his nominee, being unauthorised, is incapable of overreaching the interests of the beneficiaries.

The leading cases are *Lewis v. Hillman* (1852) 3 HLC 607; *Ingle v. Richards (No. 1)* (1860) 28 Beav. 281; *Farrer v. Farrer's Ltd* (1888) 40 Ch. D. 395; *Henderson v. Astwood*; and *Williams v. Scott* [1900] AC 499. In *Lewis v. Hillman* a sale by a sole trustee to his nominee posing as a bona fide purchaser was held to be incapable of overreaching the interests of the beneficiaries. It was, as Lord St Leonards expressed it, "powerless for that purpose". Similarly in *Farrer v. Farrer's Ltd*. Lindley LJ observed that a power of sale does not authorise the donee of the power to take the property at a price fixed by himself. If the sale is unauthorised, it cannot affect the beneficial interests.

The reasons for this conclusion are variously stated in the cases. They are (i) that a general power of sale given to a trustee does not authorise a sale in contravention of the self-dealing rule; (ii) that the very word "sale" connotes a transaction between independent parties dealing with each other at arms' length, so that whatever else a transaction between a principal and his nominee may be it is not a "sale"; and (iii) that the beneficial interests under a trust are not affected by any transaction by the trustees which is not entered into between independent parties dealing with each other at arms' length. None of these reasons are of any relevance in the present case: the first and third because Lady Ingram was an absolute owner; and the second because the word "lease" is not like the word "sale" and does not import any connotation of bargain. It is analogous to words like "conveyance", "transfer" or "payment" which denote merely the passing of property from one person to another whether preceded by a bargain between them or not.

In this connection *Farrer v. Farrer's Limited* is instructive. A sale by a mortgagee to a company of which he was a director and shareholder was held to be effective to extinguish the equity of redemption, but only because the sale was negotiated between the mortgagee and the other directors at arms' length. It is clear from Lindley LJ's judgment that a sale by a mortgagee to a company of which he was sole director and only shareholder would be ineffective. Yet an absolute owner can grant an effective lease of his land to his own company, just as he can effectively sell and transfer his business to his own company. The truth is that the effectiveness of a contract to extinguish beneficial interests depends on there being two independent minds to conduct negotiations; but the intrinsic validity of a contract merely depends on there being two parties, not two independent minds.

In many of the cases reference is made to the two party rule, usually by way of preface to a statement of the self-dealing rule and its consequences. But contravention of the two party rule is not in my opinion the ground upon which any of the cases proceeded; nor could it be, seeing that in all of them the arrangements between the trustee and his nominee had been completed by conveyance.

Henderson v. Astwood was merely one of these cases. It was concerned with a sale by a mortgagee, ostensibly to a third party but in reality to his nominee, who executed a declaration that he held the land in trust for the mortgagee. and who subsequently sold

and conveyed the land to a bona fide purchaser for value without notice of the defect in the title. This last-mentioned sale was held to be valid, but the transaction between the mortgagee and his nominee was held to be ineffective to extinguish the equity of redemption. The result was that on the taking of the mortgage account the mortgagor was entitled to the benefit of the sale to the ultimate purchaser.

The observation of Lord Macnaghten to which I have already referred must be understood in this context. His statement that "a man cannot contract with himself", while true, did not in my judgment form part of the reasoning which led to his conclusion. This did not depend on the intrinsic validity as a contract of the arrangements which the mortgagee had entered into with his nominee, for these had been carried out, but on whether they constituted an effective exercise of the mortgagee's power of sale. Moreover Lord Macnaghten did not say that a man cannot contract with his nominee and he should not be understood as having said so. In my opinion his words provide no support for the conclusion of the Judge in the present case or that of the Court of Session in *Kildrummy Jersey Limited v. IRC*.

In my judgment a nominee may grant an effective lease to his principal, and accordingly, the lease which Mr Macfadyen granted to Lady Ingram was effective to vest a legal term of years in her. The transaction did not contravene the two party rule, for there were two parties to the contract. It is true that they were not independent parties dealing with each other at arms' length, and had Lady Ingram been a trustee the lease would not have bound the interests of her beneficiaries; but this does not render the lease a nullity whether as property or contract. In my judgment, once the lease was granted, Lady Ingram was in the same situation as the testator in *Belaney v. Belaney*. Pending the execution of the Declaration of Trust, and while Lady Ingram remained solely and beneficially entitled to the freehold and leasehold interests, the covenants in the lease were in abeyance because of the circuitry of action which would be involved in any attempt by either party to enforce them. But she had succeeded in separating the two legal estates, which were in different ownership, and was in a position to deal separately with her beneficial interest in the freehold reversion and her legal estate in the term of years.

I reach this conclusion with satisfaction for two reasons. In the first place, a lease by a nominee to his principal is unobjectionable on any but the most technical grounds and should be upheld if not conceptually impossible. In the second place, a decision to the contrary effect would create new opportunities for fraud. Such a lease would normally contain new opportunities for fraud. Such a lease would normally contain nothing on its face to indicate any defect - the lease which Mr Mcfadyen granted to Lady Ingram did not - and could be used as security to raise money or to enable the lessee to grant an underlease. This was not fully explored in argument, no doubt because the lease to Lady Ingram contained an absolute prohibition against assignment or subletting. But the Revenue's argument must be tested generally; the validity of a lease by a nominee to his principal cannot be made to depend on the presence or absence of such a covenant. If the Revenue are right and the lease is a nullity then the position of a mortgagee or underlessee must be considered. It seems that he can obtain no title; but there is no very obvious reason of legal policy why he should lose the estate. Moreover, it is contrary to principle that a purchaser should have to investigate the beneficial interests in order to satisfy himself as to the legal title.

Summary. I can summarise my reasons for upholding the transaction as follows: (1) A man can convey one of the two legal estates in land, i.e. the fee simple absolute in possession, to a nominee for himself. There is no rational basis for denying him the ability to vest the other, i.e. a term of years absolute, in a nominee for himself. (2) The right to exclusive possession is what distinguishes a lease from a contractual right of occupation. The right is a proprietary right, not a contractual right. (3) A trustee does not contract as agent for his beneficiary but as principal. A contract by a trustee with his beneficiary does not contravene the two party rule, and is good at law. (4) Before 1873 such a contract would have been enforced by the common law courts, though the action might have been restrained by the Court of Chancery. Today proceedings to enforce such a contract would be stayed for circuitry of action. But the contract would not be a nullity, and enforcement would be permitted once the circuitry was eliminated by, for example, an assignment. (5) A lease can be validly created even though it achieves nothing beyond the vesting of the legal estate. It is difficult to see why it should be possible to grant a lease which contains no covenants at all but not a lease containing covenants which are temporarily unenforceable on procedural grounds. (6) The law permits a man who acquires the freehold and leasehold interests by different transactions to keep the interests separate by vesting one in himself and the other in a nominee for himself. Such a transaction is very common. Yet it produces the very result which Lady Ingram set out to achieve, and which is stigmatised as nonsensical or whimsical. (7) The lease in question is good on its fact. If void, it is a potent instrument of fraud. It should not be necessary for a purchaser to investigate the equitable interests in order to satisfy himself as to the legal title. (8) The principle for which the Revenue contend rests on bare assertion. Neither principle nor authority compels its acceptance. The English authorities. The English authorities relied on in *Kildrummy*, when properly analysed, provide no support.

Was the property given enjoyed to the entire exclusion of Lady Ingram?

This is the first limb of Section 102(1)(b), which stipulates that the property must be enjoyed by the donee to the entire exclusion (i) of the donor and (ii) of any benefit to him by contract or otherwise. On the view which I have formed of the validity of the lease, no contravention can have occurred. Lady Ingram created two separate interests in the land and made a gift of only of them. The property which formed the subject-matter of the gift was not the unencumbered freehold but the freehold reversion subject to and with the benefit of the lease. But I proceed to consider the case on the footing that the lease was invalid.

In analysing the transaction on this footing it is necessary to begin by observing that Inheritance Tax is charged on the value transferred by a chargeable transfer, and like its predecessor Estate Duty is charged by reference to the beneficial interests in property and not the bare legal estate. Neither Mr Macfadyen nor the trustees took any beneficial interest in the land. Lady Ingram made no gift to them. The only gift which she made was to her intended beneficiaries. They are therefore the donees for the purposes of Section 102. The gift to them took effect under and by virtue of the Declaration of Trust. Whether the conveyance by Mr Macfadyen to the trustees preceded the Declaration of Trust or not it did not affect the beneficial interests, but operated in effect as an appointment of new trustees in place of Mr Macfadyen. Its only effect was that the trusts fell to be declared by them and not by Mr Macfadyen.

The trustees were not, of course, intended to take any beneficial interest for themselves, and they knew from the form of the conveyance to them, which was expressed to be subject to and with the benefit of the lease to Lady Ingram, that the beneficiaries were intended to take only the freehold reversion to her lease. In those circumstances they took the conveyance subject to an equitable obligation to give effect to her intentions. They were bound in equity to recognise Lady Ingram's right to the lease and to hold the reversion, but only the reversion, in trust for the beneficiaries. The respective rights of Lady Ingram and the beneficiaries arose at the same time and under the same instrument, that is to say the Declaration of Trust, and they were enforceable against the same persons, that is to say the trustees. In my judgment the same result would have been achieved and in much the same manner if Lady Ingram had simply conveyed the land to the trustees upon trust to grant the lease to her and to stand possessed of the freehold reversion in trust for the beneficiaries.

With this preamble I turn to the question whether the subject-matter of the gift to the beneficiaries under the Declaration of Trust was enjoyed to the entire exclusion of Lady Ingram. This depends on identifying the subject-matter of the gift. In my opinion, it consisted on the freehold reversion expectant on the lease and not the unencumbered freehold, with the result that Lady Ingram was entirely excluded therefrom. My reasons are as follows.

Where the gift does not exhaust the whole of the donor's beneficial interest in the property, as where he gives a life interest but not the ultimate interest in the capital, the distinction between an interest which is reserved out of the property given and an interest which is not given is easy to draw. It is less easy where the donor retains a present interest in the property which did not exist as a separate interest before the gift.

In *Earl Grey v. Attorney-General* [1898] 2 QB 534 (CA), [1900] AC 124 (House of Lords) the donor conveyed land to his son by way of gift but reserved an annual rent charge during his life which was charged on the land conveyed and which his son covenanted to pay (together with the other liabilities of the donor), and retained the right to occupy the mansion house which stood on the land conveyed together with other benefits. He also reserved a power of revocation. It is difficult to see how it could have been supposed for a moment that the gift was effective save estate duty. The gift was revocable; the donor had reserved an interest for life; he had retained the right to occupy part of the land which formed the subject-matter of the gift; and he had clearly reserved a benefit by contract or otherwise in the shape of the son's covenant to pay the rent charge. This was a benefit which the donor did not possess before the gift. It was security for the rent charge which guaranteed payment even if the land produced insufficient income to support it. Not surprisingly the executors received short shrift from Lord Halsbury in the House of Lords (in a speech which Lord Russell of Killowen was later to describe as "unreserved in more senses than one": see *Commissioner for Stamp Duties, New South Wales v. Perpetual Trustee Co.* [1943] AC 425 at p.444). For present purposes, however, what is important is the way in which the rent charge was regarded in other judgments of high authority since.

In the Court of Appeal A L Smith LJ relied exclusively on the son's covenant to pay the rent charge and to pay the rent charge and to bear the other liabilities of the donor, Rigby LJ thought that the reservation of the rent charge and the son's covenant to pay

it were "so plain as to require no further notice". Vaughan Williams LJ agreed that the son's covenant to pay the donor's debt was a sufficient reservation of a benefit. But, he said, such a benefit was

"totally different from the prior estate created by the use in respect of the rent charge and I mention this because I am inclined to agree with the appellant that the rent charge must be treated as something entirely outside the gift."

In the House of Lords Lord Halsbury lumped the rent charge with the other benefits and the case was dismissed as too plain for argument.

In *Re Cochrane* [1905] 2 IR 626 Palles CB distinguished *Earl Grey v. Attorney-General* on the specific ground that the rent charge in that case was secured by the son's personal covenant. He said at p.638

"The limitation of this annuity, although prior to the gift, was, as well as being charged on the land secured by personal covenant of the grantee, and this covenant, according to *The Attorney-General v. Worrall* [1895] 1 QB 99, made its subject-matter a reservation of the gift within the meaning of [the statute]; and therefore, even if Lord Halsbury's words, "The settlement itself has reserved £4,000 a year" mean, as they probably do, "reserved *out of the gift*" they are in no sense contrary to our present decision. The law made it a reservation *out of the gift* by reason of the personal covenant."

This is a neat explanation of Lord Halsbury's reasoning, even if it is one which is unlikely to have occurred to Lord Halsbury himself. Palles CB clearly shared the opinion of Vaughan William LJ, that without a covenant to pay it the reservation of a rent charge is not in itself a benefit reserved out of the property given but is merely property not given.

The decision in *Re Cochrane* was affirmed by the Irish Court of Appeal at [1906] 2 IR 200 where Fitzgibbon LJ commented that if ever there was a case to which the statute applied it was *The Attorney-General v. Grey*. He referred to the various benefits which the donor had retained in that case, including the son's covenant to pay the rent charge, but he did not mention the reservation of the rent charge itself. Too much perhaps should not be made of this; but the same cannot be said of the speeches of Lord Russell in *Commissioner for Stamp Duties, New South Wales v. Perpetual Trustee Co.* and Lord Radcliffe in *St Aubyn v. Attorney-General*. In the last-mentioned case Lord Radcliffe made it clear that in his opinion it was not the creation of the rent charge but the existence of the son's covenants which caused liability for estate duty to attach in *Grey v. The Attorney-General*; that this was the explanation of that case given by the Court of Appeal in *Re Cochrane*; that Lord Russell's speech in the *Perpetual Trustee* case was directed to the same point; and that he (Lord Radcliffe) agreed with those views.

Any statement of law which has the concurrence of Vaughan Williams LJ, Palles CB, and Lord Radcliffe and which has been attributed to Lord Russell is deserving of the

most profound respect. It is persuasive authority of the most compelling kind. I respectfully adopt it. It follows that it is in my opinion possible for a donor to create and retain for his own benefit a present interest in property, such as a rent charge, which did not exist as a separate interest before the gift and to make a gift of property subject thereto without thereby reserving it out of the subject-matter of the gift. Neither the fact that the interest retained by the donor is a present interest which did not exist before the gift nor the fact that the interests given and retained are brought into existence simultaneously compels the conclusion that the interest which the donor retains is reserved out of the subject-matter of the gift.

The question is whether this principle permits a donor to create and retain for his own benefit a legal term of years and to make a gift of the freehold reversion. This question was considered by this Court in *Re Nichols dec'd.* [1975] 1 WLR 543. In that case a father conveyed land by way of gift to his son and took a lease back. Walton J held that the donee was under no more than a filial duty to grant the lease back, and that accordingly he had received by way of gift the whole unencumbered freehold interest from which the donor was not excluded thereafter. The Court of Appeal held that on the evidence the donee had been subject to an obligation binding in equity to grant the lease back. Superficially, therefore, the lease back was similar to the rent charge which was reserved in *The Attorney-General v. Grey*. Giving the judgment of the Court Goff J said at p.543:

"Having thus reviewed the authorities, we return to the question what was given, and we think that a grant of the fee simple, subject to and with the benefit of a lease back, where such grant is made by a person who owns the whole freehold free from any lease, is a grant of the whole fee simple with something reserved out of it, and not a gift of a partial interest leaving something in the hands of the grantor which he has not given. It is not like a reversion or remainder expectant on a prior interest. It gives an immediate right to the rent, together with a right to distrain for it, and, if there be a proviso for re-entry, a right to forfeit the lease. Of course, where, as in [*Munro v. Commissioner for Stamp Duties* [1934] AC 61, [1933] All ER Rep 185], the lease, or, as it then may have been, a licence coupled with an interest, arises under a prior independent transaction, no question can arise because the donor then gives all that he has, but where it is a condition of the gift that a lease back shall be created, we think that must, on a true analysis, be a reservation of a benefit out of gift and not something not given at all."

The passage is *obiter*, since the court found it unnecessary to reach a final conclusion on the point. It is not strictly binding upon us; but it represents the considered view of the court and is of high persuasive authority. It is, however, worthy of remark that although *St Aubyn v. Attorney-General* was cited it is not mentioned in the judgment; nor is any reference made to the view of Vaughan Williams LJ in *Grey v. The Attorney-General*, the explanation of that case given in *Re Cochrane*, or the approval of that explanation by Lord Radcliffe in the *Perpetual Trustee* case. While, therefore, I accent the conclusion stated in the passage in *Re Nichols* cited above. I am unable

fully to accept the reasons by which the court reached it.

In my judgment the reason why a lease takes effect by way of regrant is not that it is a present interest which gives an immediate right to the rent, for this would apply equally to a rent charge. The true reason is that a lease is not, like a rent charge, merely an encumbrance charged upon the freehold which can be created by way of reservation without any regrant, and it is not, like a life interest, merely part of the freehold which can be retained without being disposed of. It is a derivative interest carved out of the freehold and must be granted by the freeholder. A man cannot grant a lease to himself, and he cannot reserve a lease to himself. Accordingly, the lease must take effect by way of regrant by the grantee of the freehold, and the grantee cannot grant it until the interest out of which it is to be carved has been vested in him. The point is made by Isaacs J in *Lang v. Webb* (1912) 13 CLR 503 at p.515:

"... you look at the instrument by which the property passes from the donor to the donee, and, disregarding mere form, ascertain its real effect. What does it give, not how does it give it? In this case the gift is made by the indenture executed by Henrietta Lang, and by that the whole of her estate in the lands was given without any exception or reservation whatever. That was the transaction of gift - complete in itself and unqualified. No other construction is possible. *It had to be complete before the donee could execute to her the lease of the property. A lease is a conveyance; and it is more than form, it is substance, when the donor's interest has to be vested in the donee before the donee can convey a smaller interest.*" (my emphasis).

Accordingly it is not possible for a donor to create and retain for his own benefit a lease on his own land and to give away only the reversion expectant on the lease by conveying the land to the donee and taking a lease back from the donee. Nor can the desired result be achieved by expressing the conveyance to the donee to be subject to the leasehold interest retained by the donor. Section 65 of the Law of Property Act 1925 provides that

"(1) A reservation of a legal estate shall operate at law without any execution of the conveyance by the grantee of the legal estate out of which the reservation is made, or any regrant by him, so as to create the legal estate reserved, and so as to vest the same in possession in the person (whether the grantor or not) for whose benefit the reservation is made.

(2) A conveyance of a legal estate expressed to be made subject to another legal estate not in existence immediately before the date of the conveyance, shall operate as a reservation, unless the contrary is shown."

At first sight these provisions might appear to dispense with any requirement for an actual regrant. But in *St Edmundsbury and Ipswich Diocesan Board of Finance (No. 2)* [1975] 1 WLR 468 this Court held that the words "without ... anv regrant" mean

only "without any words of regrant". The lease back to the grantor is still created out of absolute interest by way of regrant by the grantee.

It is for the same reason not possible to achieve the desired result by conveying the land to the donee subject to an equitable obligation to grant a lease back to the donor (as in *Re Nichols dec'd.*) or (which comes to the same thing) subject to an equitable obligation to give effect to a lease which the donor has purported to reserve to himself. In either case the donee's conscience is not affected until he receives the freehold, and then his obligation is to grant (or give effect to) the lease out of the interest which he has received. The fact that the donee was "never intended to have the freehold interest free from and unencumbered by the lease" is in my opinion beside the point. What is determinative is that the donor can only obtain the lease from the donee and out of the interest which the donor has previously vested in him.

But these are conveyancing problems, not Inheritance Tax problems. It does not follow that it is impossible for a donor to create and retain for his own benefit a leasehold interest and give away the freehold reversion if appropriate conveyancing machinery is employed. In my opinion it is possible to do this, provided that the donor does not receive the lease by way of regrant from the donee. There are at least two methods by which the participation of the donee may be avoided: (i) by the use of a nominee (by which I mean a bare trustee) to grant or take the lease before making a gift of the reversion; or (ii) by conveying the land to a trustee upon trust to grant the lease to the settlor and subject thereto to hold the reversion in trust for the donee. In the present case Lady Ingram chose the first of these methods, and I have already concluded that she was successful. But even if the lease which Mr Macfadyen granted to Lady Ingram was a nullity. I am of opinion that Lady Ingram took her leasehold interest from the trustees without any participation by the donees, and accordingly, was successful in excluding the leasehold interest from the subject-matter of the gift.

If the lease actually granted to Lady Ingram was a nullity, then she never acquired a legal estate. But as I have already explained she did acquire a right to compel the trustees to grant the lease to her. Her right arose under and by virtue of the conveyance to the trustees. It was their conscience which was affected by knowledge of Lady Ingram's intention to retain a leasehold interest, so that they could not take the legal estate under the conveyance to them and deny Lady Ingram her right to remain in exclusive possession. The consciences of the beneficiaries were not affected; the only property settled upon them was the freehold reversion subject to and with the benefit of the lease which the trustees were duty bound to grant to Lady Ingram; and they could take only that which was left after the trustees had discharged their equitable obligation to her. The difference between the present case and the case of *Re Nichols* the donee of the freehold reversion and the grantor of the lease were one and the same, whereas in the present case they were not.

In reaching this conclusion I have not overlooked the submission of Counsel for the taxpayer in *Re Cochrane* (at [1905] 2 IR 631) which was approved by this Court in *Re Nichols dec'd.* (at p.542) that the interposition of trustees was not relevant. This could easily be misunderstood. It comes to no more than this, that it makes no difference whether the donor makes a gift direct to the donee or vests the property in trustees and directs them to make the gift. On either footing the gift is made by the donor and not by the trustees. and the subject matter of the gift is the property which the donor

directs the trustees to hold in trust for the donee. So in the present case the donor was Lady Ingram, not the trustees, and the subject-matter of the gift was the property which the beneficiaries took beneficially under the Declaration of Trust, not the legal estate which the trustees took under the conveyance. The acts of nominee are attributed to his principal.

But it does not follow that the interposition of trustees can be disregarded, or that the Court is absolved from the necessity of analysing the transaction properly in order to identify the property taken by the donee. In the present case the interposition of the trustees did not affect the substance of the transaction, which was a gift by her (and not the trustees) to the beneficiaries (and not the trustees). But it enabled Lady Ingram to overcome the conveyancing problem to which her desire to create a leasehold interest and exclude it from the gift gave rise. That is precisely the kind of problem which has traditionally been solved by resort to a use of trust, as in *Belaney v. Belaney*.

If donor and donee agree that the donor will convey freehold land to the donee and the donee will grant a lease back to the donor, then the lease takes effect by way of regrant and is an interest reserved out of the property given. It makes no difference that the donee takes the conveyance of the freehold in the name of a nominee and directs the nominee to grant the lease back to the donor. The regrant by the donee's nominee is a regrant by the donee, for it is made at his direction.

But that is not this case. The freehold interest in the land was taken by the trustees as Lady Ingram's nominees. It was their notice of her intentions which obliged them to grant or give effect to the lease in her favour; and which disentitled them from taking the freehold estate free from the lease either for their own benefit or as trustees for the beneficiaries. It was by her direction that they held the leasehold interest in trust for her and declared trusts of the freehold reversion for the beneficiaries. The beneficiaries were passive recipients of Lady Ingram's bounty, which never extended beyond the reversion expectant on her lease.

Since writing the above I have had the advantage of reading the draft judgment of Nourse LJ. I accept, of course, that the beneficiaries could not have directed the trustees not to grant the lease, and that this is because the trustees could not have refused to grant it even if they had wanted to. Where I differ from him is that I regard the trustees and the beneficiaries as suffering from different disabilities. The trustees were entitled to the freehold estate, but their interest was subject to Lady Ingram's right to call for a lease. They could not decline to grant the lease without being in breach of an obligation which was binding on them. The beneficiaries were not subject to any such obligation. But they were given only what was left after the trustees had fulfilled their obligation to grant the lease. They could not prevent this because it did not affect the property in which their beneficial interests subsisted. Had Lady Ingram conveyed land to the trustees and directed them to stand possessed of an undivided one half share for herself and the other half share for the beneficiaries, the beneficiaries could not have prevented the trustees from giving effect to her interest. Their interest would not be subject to hers; it simply would not extend to hers. That, in my opinion, is the position in the present case.

Was the property given enjoyed to the entire exclusion of any benefit to Lady Ingram by contract or otherwise?

This is the second limb of Section 102(1)(b). This question can be easily disposed of. It is clearly established that to bring a case within this limb it is not necessary that the benefit to the donor should be by way of reservation out of the subject-matter of the gift: *Attorney-General v. Worrall* [1895] 1 QB 99.

In *The Attorney-General v. Grey* the donor's right to continue to occupy the mansion house which stood on the land given to the son was a benefit reserved out of the property given and contravened the first limb of paragraph (b), while the son's covenant to pay the rent charge and to bear the donor's other expenses constituted a benefit to him by contract or otherwise which contravened the second limb. In *Oakes v. Commissioner of Stamp Duties of New South Wales* [1954] AC 57 a father made a gift of land in favour of himself and his four children in equal shares but retained wide powers of management for which he reserved the right to charge remuneration. It was held that the donor was entirely excluded from the subject-matter of the gift, which was the four-fifths interest given to the children, and that his retention of powers of management did not affect the matter. This was because the donor is entirely excluded if he only holds the property in a fiduciary capacity and deals with it in accordance with his fiduciary duty. But the right to charge remuneration was a different matter. This amounted to a benefit to the donor by contract or otherwise. Lord Reid said (at p.76) that if the right to take remuneration could be regarded as a beneficial interest in the property reserved by the donor when making the gift, then his remuneration would not be a benefit within the scope of this limb of paragraph (b). (I interpose to say that it would be, like a rent charge, an interest in the property not given.)

In *Re Nichols* the lease contained a full repairing covenant by the donee. The right to have his property repaired at the donee's expense was held to be a benefit which the donor did not enjoy before.

From these cases I conclude that to come within the scope of the second limb of Section 102(1)(b) the benefit must consist of some advantage which the donor did not enjoy before he made the gift, and that it is not sufficient if it consists merely of the property which he owned before the gift and which was not included in it.

No such benefit has been identified in the present case. The lease itself was merely property not comprised in the gift. It contained no covenants which would have the effect of transferring to the trustees a liability which would otherwise be borne by Lady Ingram.

The Revenue relied on the landlord's covenant for quiet enjoyment, but in my judgment there is nothing in this point. Such a covenant was present in both *Re Nichols* and *Munro v. Commissioner of Stamp Duties of New South Wales* [1954] AC 57. The Court did not rely on the covenant in *Re Nichols* and the decision in *Munro* would have gone the other way if the covenant were material. In my judgment it is not a benefit within the meaning of the second limb of paragraph (b) because it cannot be separated from the lessee's right of exclusive possession under the lease. It reinforces that right by preventing the landlord and those claiming under him from interfering

with the lessee's right of exclusive possession. Thus it merely prevents the donee and his successors from interfering with the donor's continued enjoyment of property which was not included in the gift.

In my judgment Lady Ingram did not reserve a benefit by contract or otherwise within the meaning of the Section.

The Ramsay doctrine.

The *Ramsay* principle allows the court to disregard the artificial division of a single transaction into several steps or the insertion of steps which have no purpose except the avoidance of tax which would otherwise be chargeable. There is no room for the invocation of the *Ramsay* principle in the present case unless (i) (as I would hold) the lease was valid and (ii) (contrary to my opinion) the effectiveness of the gift as a potentially exempt transfer depended on the validity of the lease. If the lease was a nullity, it is not necessary to invoke the *Ramsay* principle in order to disregard it. If on the other hand the conveyance and Declaration of Trust would still constitute a potentially exempt transfer even if the lease were invalid, then disregarding the unnecessary creation of the lease would not affect the outcome. Since none of us was minded to reach a conclusion which could make the *Ramsay* principle relevant, we did not hear argument on it. Nevertheless, I shall express my own views on the subject, since it has some bearing on what might be regarded as the broader merits of the executor's case.

It is conceded by them that the several steps in the scheme were intended to be carried through as a whole and that they may properly be regarded as a preordained series of transactions or as a single composite transaction within the principle enunciated by the House of Lords in *Ramsay (W. T.) Limited v. Inland Revenue Commissioners* and *Furniss v. Dawson*. This is not, however, enough by itself to enable the Revenue to defeat the scheme.

Once it is found or admitted that the several steps were planned and carried through as a whole, thus forming a single composite transaction, the next question is whether the transaction as a whole or any steps artificially inserted into it have any purpose other than the avoidance of tax. These are then disregarded, not in the sense of being treated as if they did not take place, but in the sense that they cannot affect the application of the statute. As Learned Hand J put it in the seminal case of *Helvering v. Gregory* 69 F 2d 809 (2d Cir. 1934)

"We cannot treat as inoperative the transfer of shares by A Co.; or the issue by B Co. of its own shares ... B Co. had juristic personality ... All these steps were real; their only defect was that they were not what the statute meant."

The final question is whether the transaction so identified comes within a particular taxing or relieving statutory provision. As Lord Brightman said in *Furniss v. Dawson* (at p.527)

"The court must then look at the end result. Precisely how the end

result will be taxed will depend on the terms of the taxing statute sought to be applied."

This is a matter of statutory construction: see *Commissioners of Inland Revenue v. McGuckian* [1997] 1 WLR 991 where Lord Browne-Wilkinson said at p.998:

"The approach pioneered in *Ramsay* and developed in later decisions is an approach to construction, viz. that construing tax legislation, the statutory provisions are to be applied to the substance of the transaction, disregarding artificial steps in the composite transaction or series of transactions inserted only for the purpose of seeking to obtain a tax advantage. The question is not what was the effect of the insertion of the artificial steps but what was its purpose. Having identified the artificial steps inserted with that purpose and disregarded them, then what is left is to apply the statutory language of the taxing Act to the transaction carried through stripped of its artificial steps."

In my judgment the Revenue's attempt to invoke the *Ramsay* doctrine fails at each of the last two steps. It is, of course, beyond dispute that Lady Ingram was tax motivated. If Inheritance Tax had not existed she would not have attempted to make a potentially exempt transfer of her property. But this is not sufficient to disregard the transaction or any steps in it, or it would not be possible to make a potentially exempt transfer at all. What is required to enable the court to disregard a transaction or step in a transaction is not the presence of a tax avoidance *motive*, but the absence of any other *purpose*. This is often described as the absence of any business purpose; but in this context "business purpose" does not mean "commercial purpose" but simply "non-fiscal purpose". The circular and self-cancelling scheme in *Ramsay* and the artificial splitting of the disposal into two in *Furniss v. Dawson* had no purpose at all except the avoidance of tax; see Lord Wilberforce at [1982] AC 326 describing "transactions designed only to avoid tax and lacking otherwise in economic or commercial reality" and citing *Ketsch v. United States* (1960) 364 US 361, 366 and *Gilbert v. Commissioner of Internal Revenue* (1957) 248 F 2d 399, 411.

In the present case Lady Ingram set out to make a genuine gift of a reversionary interest in her property to her children. Although motivated by a desire to save tax, this was a non-fiscal purpose. The transaction was not a mere paper transaction and cannot simply be disregarded for tax purposes like the scheme in *Ramsay*. Nor was any of the steps artificially inserted into the transaction for an exclusively fiscal purpose. The structure of the transaction, which is what makes the scheme appear artificial, was not, as in *Furniss v. Dawson*, tax motivated. The several steps by which the transaction was effected were an integral part of the proper and appropriate conveyancing method to achieve the gift of the freehold reversion which Lady Ingram intended to make. They were necessitated by the conveyancing problem inherent in the need to separate the two interests in land so that Lady Ingram could deal with only one of them. Had she been entitled to a fund of money, a single step would have been sufficient. In my judgment, there is no justification for disregarding any of the steps in the transaction.

The final step is to apply Section 102, not to the individual steps in the transaction, but to the substance of the transaction or "its end result". In my judgment that does not help the Revenue in the present case. As Lord Steyn put it in *IRC v. McGuckian* (at p.1000) the *Ramsay* doctrine is based on a broad purposive construction of the statute and a rejection of formalism, its end result was a gift of the freehold reversion. A gift of the freehold reversion and a gift of the unencumbered freehold with a lease back to the donor are two quite different legal transactions, though with very similar economic effects. One might have expected Parliament to treat them in the same way for the purpose of Inheritance Tax; but by adopting the earlier legislation verbatim it has evinced a clear intention to treat them differently. It is not possible, in my opinion, to adopt a broad purposive approach to the interpretation of Section 102 which disregards its legislative history and attributes to Parliament a purpose which it evidently did not have.

Conclusion

I return to the point which I made at the very beginning of this elaborate and, I fear, overlong judgment. Lady Ingram made no attempt to avoid tax by pretending to make a gift while retaining the subject-matter of the gift. She attempted to retain a present interest in land and to make a gift of only that which she did not retain. The distinction is highly artificial; but it is inherent in the legislation, as construed by the highest court over many generations, that liability or exemption from tax depends on this distinction. If this creates what is popularly described as a "loophole", it is one which Parliament must be taken to have intended to revive when it re-enacted the earlier legislation verbatim in 1986.

It is beyond dispute that Lady Ingram could have made a potentially exempt transfer of her land while reserving a rent charge equal to its current annual value. But she wished to retain exclusive possession of the land itself and not merely its income. There is nothing in the nature of Inheritance Tax or in the detailed legislation by which it is enacted which makes this distinction material; and this is not surprising, for the two transactions have similar economic effect. The only obstacle which faced Lady Ingram was a conveyancing problem; and the only question which we have to decide is whether the conveyancing machinery which she employed to overcome it was successful.

I think it was. I would dismiss the appeal.