Neutral Citation: [2023] UKFTT 00316 (TC)

Case Number: TC08776

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing
Appeal reference: TC/2019/02044

INHERITANCE TAX– deceased was beneficiary of an interest in possession trust established in 2002 – s49 IHTA 1984 considered – were loan notes issued by the trust a liability to be "taken into account except as otherwise provided" per s5(3)? – St Barbe Green *considered – held: yes – did s103 IHTA 1984 apply to abate the loan note liability? – held: yes – did s175A IHTA 1984 apply in the alternative, such that the loan liability would not be taken into account – and did the tribunal have jurisdiction to consider s175A? – held: yes (to both questions) – loan notes (as asset) had been gifted to another family trust of which deceased's children were beneficiaries – did s102 apply to treat the loan notes (as asset) as part of deceased's estate? – did children's trust have exclusive enjoyment of the loan notes (as asset)?* – Buzzoni *and* Hood *considered – held: s102 did not apply, as benefit to deceased did not "trench upon" children's trust's enjoyment of loan notes*

Heard on: 12-15 December 2022
Judgment date: 28 March 2023

Before

TRIBUNAL JUDGE ZACHARY CITRON
DR CAROLINE SMALL

Between

JAMES CHARLES PRIDE AS TRUSTEE OF THE ESTATE OF THE LATE GERALDINE JILL PRIDE

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Richard Vallat KC and Laura Ruxandu of counsel, instructed by Edwin Coe LLP

For the Respondents: Jonathan Davey KC and Ben Elliott of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

PRELIMINARIES

1. The form of the hearing was V (video) on the tribunal video service. A face to face hearing was not held because rail strikes planned for the week in which the hearing took place would have made it difficult for some of the participants to attend such a hearing.

2. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

3. Unless otherwise indicated, references in this decision to "sections" or to "s" are to sections of Inheritance Act 1984 (the "**Act**") – except that references to sections (or "s") 102 and 103 are to those sections of Finance Act ("**FA**") 1986. The text of most of the legislation referred to is set out in the appendix.

THE GIST OF THIS APPEAL

4. Geraldine Jill Pride ("**Mrs Pride**") died on 31 October 2016 at the age of 88. Immediately before her death she was, most relevantly to this appeal, the "principal beneficiary" of a family trust (the "**property trust**") that had been established on 10 October 2002. Immediately before Mrs Pride's death, the property trust

(1) held a property in Poole (the "**flat**") (being leased to an unrelated party);

(2) was the provider of an indemnity to St James' Place Corporate Nominee Ltd ("**Nominee**"), which had issued certain loan notes (the "**loan notes**") (at that time held by another family trust (the "**children's trust**") that had been created on 18 November 2002); in effect, the property trust was the debtor under the loan notes;

(3) held two St James' Place International Investment Bonds investment bonds (the "**bonds**"). The property trust had acquired these in 2002 for £800,000, being the proceeds of sale of another property in Poole (the "**house**") that had been transferred to the property trust by Mrs Pride.

5. One issue in this case was whether, by reason of s103 or s175A, the value of the loan notes (as a liability of the property trust) was to be left out of account in determining the value of Mrs Pride's estate immediately before death: the appellant said these sections did not apply (and also that the tribunal had no jurisdiction in relation to s175A); HMRC said that one or other of these sections did so apply. We refer to this below as **issue 1**.

6. The other issue was whether, by reason of s102, the loan notes (as assets) formed part of Mrs Pride's estate immediately before death: the appellant said they did not, HMRC said that they did. We refer to this (and other arguments raised by HMRC in relation to s102) below as **issue 2**.

EVIDENCE

7. We had a hearing bundle of 462 pages, including

(1) documentation relating to the creation of the property trust, the children's trust and the loan notes in 2002;

(2) a witness statement from James Pride, Mrs Pride's son (and the appellant in his capacity as executor of her estate), who was involved in the 2002 transactions and a trustee of both trusts; and

(3) a report prepared by an expert instructed by HMRC, Brian Watson of HE Foster & Cranfield Ltd, as to the value of the loan notes as at 20 November 2002.

8. Both Mr Pride and Mr Watson attended the hearing and were cross examined.

INHERITANCE TAX BASICS

9. Inheritance tax is charged on the value transferred by a "chargeable transfer". A chargeable transfer is a "transfer of value" which is made by an individual but is not an exempt transfer. A "transfer of value" is:

> … a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition; and the amount by which it is less is the value transferred by the transfer. (s3(1))

10. On the death of any person, tax is charged as if, immediately before his death, he had made a transfer of value equal to the value of his estate at that time: s4(1).

11. A person's estate is the aggregate of all the property to which he is beneficially entitled (other than 'excluded property') (s5(1)).

12. In determining the value of a person's estate at any time, his liabilities at that time shall be taken into account (except as otherwise provided): s5(3). Except in the case of a liability imposed by law, a liability incurred by a transferor shall be taken into account only to the extent that it was incurred for a consideration in money or money's worth: s5(5)).

13. Section 49(1) provides as follows:

> A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists.

FURTHER FACTUAL FINDINGS

More about the property trust and the children's trust

14. As "principal beneficiary" of the property trust, Mrs Pride was entitled to the income of the "trust fund". In addition, under clause 2.1(B) of the property trust deed, the trustee could "transfer or raise and pay" the trust fund "to or for the absolute use and benefit" of Mrs Pride as principal beneficiary, or "raise and pay or apply" the trust fund "for the advancement or otherwise for the benefit" of Mrs Pride.

15. The "principal beneficiaries" of the children's trust were Mrs Pride's children, James Pride and his sister, Jane Poulston. The capital and income of the children's trust "trust fund" was to be held for the principal beneficiaries in equal shares.

16. The initial trustees of both the property trust and the children's trust were Mrs Pride and James Pride.

17. The exercise of the "power of appointment" under the children's trust (giving the trustees absolute discretion to "appoint" certain matters relating to their holding the income and capital of the trust fund for the benefit of the beneficiaries) was subject, amongst other things, to the consent of Mrs Pride during her lifetime (clause 4.1(a)(iv)).

How the property trust came to hold the flat

18. The property trust came to hold the flat in the following way:

(1) by an agreement dated 4 October 2002, Mrs Pride contracted to buy the flat from a third party for £535,000; the completion date was 10 October 2002;

(2) by an agreement dated 10 October 2002, Mrs Pride contracted to "sub-sell" the flat to the trustees of the property trust on the same terms (save that no deposit would be required). The sub-sale agreement required that Mrs Pride direct the third party sellers to transfer the flat to the property trust trustees;

(3) the flat was transferred by the third party sellers to the property trust trustees on 10 October 2002. The transfer document said that £535,000 has been received by the third party sellers from the property trust trustees at the request and direction of Mrs Pride.

How the property trust came to hold the bonds

19. The property trust came to hold the bonds in the following way:

(1) on 10 October 2002 Mrs Pride agreed, subject to contract, to sell the house to third party purchasers for £800,000;

(2) by an agreement dated 19 November 2002, Mrs Pride contracted to sell the house to the trustees of the property trust for £800,000. The completion date was in 23 years;

(3) on 20 November 2002, the property trust trustees contracted to sell the house to the third party purchasers for £800,000;

(4) by a "notice to complete sale of legal title" dated 21 November 2002, the property trust trustees directed Mrs Pride to execute a transfer of the house in favour of the third party purchasers for £800,000;

(5) Mrs Pride then transferred the house to the third party purchasers;

(6) the trustees of the property trust invested the proceeds of the sale of the house (£800,000) in the bonds.

More about the loan notes

20. Two documents dated 20 November 2002 effectively created the loan notes:

(1) by an instrument of that date executed as a deed by Nominee, Nominee "constituted" the loan notes, which it had resolved to create. Their issue price was £1,335,000. Under their terms and conditions,

(a) Nominee was to pay £5,099,366 to the noteholder on 20 November 2025. However,

(i) Nominee could early-redeem all the loan notes, prior to 20 November 2025, by notice, on an anniversary of the issue date. The amount payable on such early-redemption was

(A) £1,335,000 increased by the "yield to redemption" compounded annually from the issue date to the early-redemption date ("yield to redemption" meaning the rate (expressed as a percentage) such that if £1,335,000 were invested at that rate compounded annually then the value of that sum at 20 November 2025 would be £5,099,366); plus

(B) 2.5 per cent of that amount; and

(ii) the noteholder could early-redeem the notes prior to 20 November 2025 for £1,335,000, by notice;

(b) (the "economics" behind the above terms was that

(i) £1,335,000 is the sum of £535,000 (the 2002 value of the flat) and £800,000 (the 2002 value of the house); and

(ii) £5,099,366 reflects £1,335,000 growing at 6% compound per annum for 23 years until 20 November 2025);

(c) the notes were transferable.

(2) by a nominee agreement "relating to" the issue of the loan notes of that date (to which the trustees of the property trust, Nominee and Mrs Pride (as "lender") were party), the trustees of the property trust appointed Nominee, as nominee, in the making of the instrument described immediately above and the issue of the loan notes "upon the terms and conditions of" that nominee agreement. The agreement

(a) authorised Nominee to make the instrument "in the form previously agreed by" the property trust trustees and to issue the loan notes. Nominee was to notify the property trust trustees of any notices relating to the instrument or the loan notes but was under no obligation to exercise any rights or take any action in relation to those documents unless it received instructions from the property trust trustees to do so;

(b) contained an indemnity from the property trust trustees in favour of Nominee in respect of all present and future liabilities arising from the making of the instrument or the issue of the loan notes;

(c) contained an acknowledgement by Mrs Pride that Nominee made the instrument and issued the loan notes as nominee for the property trust trustees and for Mrs Pride; and in the same clause, Mrs Pride released Nominee from liability if the funds subject to the property trust were insufficient to repay in full the loan notes (according to its repayment terms as set summarised above).

21. The issuance of the loan notes was in satisfaction of the property trust trustees' contractual liabilities to pay amounts to Mrs Pride, as set out at [18(2)] and [19(2)] above (the thinking behind this finding is set out at [54] below).

22. By stock transfer form dated 21 November 2002, Mrs Pride transferred the loan notes to the children's trust trustees. A memorandum of the same date signed by Mrs Pride as donor and by the children's trust trustees stated that this transfer was by way of gift.

Mr Watson's report as to the value of loan notes at 20 November 2002

23. Mr Watson, an actuary, based his advice on the value of the loan notes on Foster & Cranfield's experience of selling financial interests at auction, although Foster & Cranfield had not offered a financial interest similar to the loan notes for sale. His report noted the following:

(1) the loan notes were unsecured and "illiquid" in the sense of being difficult to sell (for cash) at short notice;

(2) at the time the loan notes become due to be repaid, Mrs Pride might still be alive and in occupation of the flat. Mr Watson stated that "it would be reasonable for an investor to take the view that the [property trust] trustees would not raise funds for the repayment of the loan notes by selling [the flat] and making Mrs Pride homeless";

(3) for the same reason, Mr Watson did into think that an investor would buy the loan notes with the intention of exercising the early redemption option;

(4) there was additional uncertainty that there might not be sufficient assets in the property trust trust fund to pay the amount due under the loan notes;

(5) there was no identifiable market in instruments such as the loan notes;

(6) it was possible that investors would have been unwilling to take the risk that the property trust trustees would not exercise their powers under clause 2.1(B) to transfer the trust fund to Mrs Pride.

24. Mr Watson's report said that it followed from the above that if the loan notes were offered for sale, they would only be of interest to speculative investors who would require a high rate of return. Mr Watson thought it reasonable to use a yield derived by reference to the interest rate charged on other types of unsecured lending, such as credit cards. He therefore assumed that the lowest yield which an investor buying the loan note in November 2002 would be willing to accept was 15%. Using that yield led Mr Watson to the conclusion that investors would have paid no more than £205,000 for the loan notes in November 2002.

The 2002 transactions as one scheme

25. Apart from the steps taken with third parties as regards the house and the flat, all the steps taken in 2002, as set out above, were part of a single inheritance tax planning arrangement devised by St James' Place Partnership. The trust-related documentation was prepared by Simmons & Simmons, a top City law firm.

Mrs Pride's living arrangements after the 2002 transactions

26. Mrs Pride was aged 74 at the time of the 2002 transactions: the house had been her family home up to then, and the flat was where she then intended to start living.

27. By trustees' resolution signed on 20 November 2002, the trustees of the property trust declared that Mrs Pride, as beneficiary of the trust fund, had the right to occupy both the house and the flat on terms including that Mrs Pride had responsibility for maintenance, utilities and insurance and would not sublet. However, as the house was transferred to the third parties, it was not available for Mrs Pride to occupy after 21 November 2002.

28. Mrs Pride lived in the flat from around Christmas 2002 until she moved into sheltered accommodation in September 2005; she moved into a nursing home in January 2012. The trustees of the property trust rented out the flat from 1 February 2006 until Mrs Pride's death. Up to her death, Mrs Pride remained entitled to the rental income from the flat under the terms of the property trust.

Events leading to this appeal

29. On 11 April 20l7 James Pride, as executor and trustee of Mrs Pride's estate (and advised at this point by legal advisers Gateley Plc), delivered an "account" to HMRC under s216 (form IHT400) with supporting schedules (running to 60 pages). A schedule to the account stated that Mrs Pride had an interest in possession that started before 22 March 2006 and remained in existence until the date of death – the property trust – and gave the following details:

(1) *Assets in the trust (land, etc)*: the flat; value of £650,000 at date of death

(2) *Mortgages, secured loans and other debts payable out of assets shown above*: "proportion of" the loan notes; value of £625,194

(3) *Net assets*: £24,806

(4) *Other assets in the trust*: the bonds; value of £2,363,942 at date of death

(5) *Details of liabilities to be deducted from assets listed above*: "proportion of" the loan notes; amount of £2,363,942

(6) *Net assets*: 0

30. On 18 October 2018, HMRC issued a notice of determination under s221 in which they determined, in the alternative:

(1) that, having regard to s103, the liability that is sought to be deducted from Mrs Pride's estate in relation to the "debt" (defined as the £1,335,000 owed to Mrs Pride by the property trust as a result of the property transfers in 2002) consists of an incumbrance that was created by the assignment by Mrs Pride of her interest in the flat and the house to the trustees of the property trust; and accordingly that, as the whole of the consideration given for the encumbrance was property derived from Mrs Pride, the value of the said liability shall be abated to nil in determining the value of Mrs Pride's estate for the purposes of the s4(1);

(2) that, having regard to the purpose and effect of the totality of the 2002 arrangements, the assignment by Mrs Pride of her interest in the flat and the house to the trustees of the property trust was a "gift" for the purposes of s102. On Mrs Pride's death, the flat and the bonds were property subject to a reservation of benefit under schedule 20, paragraph 5, FA 1986 with the consequence that the assets of the property trust must be treated for the purposes of the Act as property to which Mrs Pride was beneficially entitled immediately before her death, to the extent that the property would not already form part of the value transferred by the transfer of value that is treated as made on death under s4(1) as a result of her interest in possession arising under the property trust;

(3) that the 2002 arrangements were a composite transaction effected by associated operations within the meaning given by s268 and that, having regard to the provisions of s102 of, and paragraph 6(1)(c) Schedule 20 to, FA86, the "debt" (as above) was property subject to a reservation at the death of Mrs Pride, with the consequence that the debt must be treated for the purposes of the Act as property to which Mrs Pride was beneficially entitled immediately before her death.

31. On 15 November 2018, Mr Pride appealed against the above determinations. On 1 March 2019, HMRC notified Mr Pride of the conclusion of their review, being to uphold the determinations. On 27 March 2019, Mr Pride notified his appeal to the tribunal.

JURISDICTION OF THE TRIBUNAL IN THIS APPEAL

32. The right of appeal in this case is against any determination specified in a notice under s221: s222(1)). If an appellant notifies an appeal to the tribunal, the tribunal is to determine "the matter in question" (s223G(4)) (which means the matter to which the appeal relates: s223I(1)(a)). The tribunal must confirm the determination appealed against unless it is satisfied that it ought to be varied or quashed: s224.

PRELIMINARY POINT TO ISSUE 1: WERE THE LOAN NOTES A LIABILITY TO BE "TAKEN INTO ACCOUNT, EXCEPT AS OTHERWISE PROVIDED" PER S5(3)?

33. The technical question of whether the loan notes were a liability to be "taken into account, except as otherwise provided" (per s5(3)) in determining the value of Mrs Pride's estate immediately before her death, affects the analysis under both s103 and s175A.

34. The appellant argued that the loan note liability is not "taken into account" in determining the value of Mrs Pride's estate per s5(3), because

(1) Mrs Pride was beneficially entitled to an interest in possession in "settled property" (being the property in the property trust);

(2) hence, under s49(1), Mrs Pride was to be treated as beneficially entitled to the property of the property trust;

(3) the High Court in *St Barbe Green v IRC* [2005] STC 288 at [12] said that, in s49(1), "property" must mean "net property" i.e. the value of the property net of trust liabilities;

(4) hence, Mrs Pride's estate immediately before death included (only) the "net" value of the property trust; and so the loan notes were not a liability to be "taken into account, except as otherwise provided" per s5(3) in determining the value of Mrs Pride's estate immediately before death.

The first three of the above propositions were common ground; but the fourth was disputed.

35. In *St Barbe Green*, the deceased's "personal" estate (as opposed to his interests as life tenant under certain trusts) had more liabilities than assets i.e. it was insolvent. The issue in the case was whether the excess of his liabilities over the assets in his personal estate could be used to reduce the value of the assets in the trusts (that fell to be part of his estate per s49(1)). The trustees argued that the effect of s5(3) was that the free estate was to be aggregated with the settlements, so that the balance of the free estate was available to reduce the assets in the trusts. It was held that the net liabilities were not available to reduce the estate beyond the value of the personal estate's assets that were liable to meet them.

36. At [12], Mann J stated that "the property" in s49(1) must mean "net property" in the sense of the value of the property *net of trust liabilities*; as he put it, we have in s49(1) the notion of property *from which liabilities have been notionally deducted*. The judge said that the same notion can be applied in s5(1) (which refers to the aggregate of all "the property" to which someone is beneficially entitled i.e. like s49(1), it refers to "the property").

37. Mann J then dealt with s5(3) – which, by providing that liabilities are to be taken into account, *appears to provide for the same point*. The judge explained that s5(3) is "in part confirmatory" (of the "net property" notion) – but "in the main" its purpose is to provide the qualification, *except as otherwise provided for* in the Act.

38. The force of Mann J's reading of the provisions, as he says at "g" in [12], is to achieve *consistency* in relation to the use of the word "property" in s49 and s5(1).

39. It is clear to us that what Mann J was *not* saying was that his "net property" notion was in any way at odds with, or different from, the effect of s5(3) (being that liabilities are *taken into account*). Indeed, if this were the case, then what Mann J held to be the "main" purpose of s5(3) – to make the taking into account of liabilities subject to provision otherwise in the Act – would apply to s5(1) "net property", but not to s49(1) "net property" – a plainly *inconsistent* (and nonsensical) result.

40. We do not therefore accept the appellant's argument. We find that the loan notes *are* liabilities subject to s5(3), and so are to be taken into account in determining the value of Mrs Pride's estate, except as otherwise provided by the Act.

ISSUE 1 (S103 AND S175A)

Section 103

41. In order for s103 to apply on the facts of this case, it must be the case that, in determining the value of Mrs Pride's estate immediately before her death, account would be taken (apart from s103(1)) of a liability consisting of

(1) a debt incurred by Mrs Pride; or

(2) an incumbrance created by a disposition made by Mrs Pride.

42. We now consider whether the loan notes – or any other relevant liability – answer to one of these descriptions.

Were the loan notes a debt incurred by Mrs Pride?

43. We find that, viewed realistically, the loan notes were a debt incurred by the property trust. Nominee was clearly a (mere) nominee in relation to the obligations of the issuer of the

loan notes; it was the property trust that assumed those liabilities via its indemnification of Nominee.

44. The next question is whether, by reason of the deeming provision in s49(1), that liability was a debt incurred *by Mrs Pride*. The appellant argued that s49(1) did not have this effect.

45. In *Fowler v HMRC* [2020] STC 1476, a case that considered the effect of a deeming provision in a UK tax statute on construction of a double tax treaty, the Supreme Court said this (at [27]) about deeming provisions:

> There are useful but not conclusive dicta in reported authorities about the way in which, in general, statutory deeming provisions ought to be interpreted and applied. They are not conclusive because they may fairly be said to point in different directions, even if not actually contradictory. The relevant dicta are mainly collected in a summary by Lord Walker in *DCC Holdings (UK) Ltd v Revenue and Customs Comrs* [2010] UKSC 58, [2011] STC 326, [2011] 1 WLR 44, paras [37]–[39], collected from *IRC v Metrolands (Property Finance) Ltd* [1981] STC 193, [1981] 1 WLR 637, *Marshall (Inspector of Taxes) v Kerr* [1994] STC 638, [1995] 1 AC 148 and *Jenks v Dickinson (Inspector of Taxes)* [1997] STC 853, 69 TC 458. They include the following guidance, which has remained consistent over many years:
>
> (1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
>
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
>
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
>
> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.
>
> (5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real. As Lord Asquith memorably put it in *East End Dwellings Co Ltd v Finsbury BC* [1951] 2 All ER 587 at 599, [1952] AC 109 at 133:
>
> > 'The statute says that one must imagine a certain state of affairs. It does not say that, having done so, one must cause or permit one's imagination to boggle when it comes to the inevitable corollaries of that state of affairs.'

46. Here, the statutory fiction of s49(1), interpreted in line with *St Barbe Green*, is that trust property, subject to trust liabilities, is beneficially held by the trust beneficiary, here, Mrs Pride. The purpose of the statutory fiction is plainly to bring the trust assets and liabilities into (in this case) Mrs Pride's estate for inheritance tax purposes. The persons between whom the statutory fiction is to be resorted to, are plainly Mrs Pride (personally) and the trust in which she had a beneficial interest, namely the property trust. Thus, when another part of the Act – in this instance, s103 – asks whether Mrs Pride "incurred" the debt comprised in the trust liability in question, it seems to us it is an inevitable consequence of Mrs Pride's deemed 'holding' of the liability, that she did 'incur' the debt; and that this is not an unjust, absurd or anomalous result. We acknowledge the slight oddity of Mrs Pride being deemed to have incurred the debt

represented by the loan notes when, at the time the debt was created (back in 2002), Mrs Pride was herself the creditor; however, this is not in our view an unjust, absurd or anomalous result (in terms of its substantive effect on inheritance tax) – it just means that, had Mrs Pride not transferred the loan notes to the children's trust, Mrs Pride's estate would have had equal and offsetting assets and liabilities represented by the loan notes (subject, as provided for in s5(3), to any provision in the Act to the effect that the liability side of the loan notes was not to be taken into account).

47. We thus find that, by operation of s49(1), the loan notes were to be treated as a debt incurred by Mrs Pride.

Alternative analysis: was an incumbrance, created on Mrs Pride's disposition of the house and flat to the property trust, to be taken into account in determining the value of Mrs Pride's estate?

48. HMRC argued, as an alternative way of applying s103 in this case, that

(1) an incumbrance was created on Mrs Pride's dispositions of the house and the flat in 2002, and

(2) that such incumbrance would, apart from s103(1), be taken into account in valuing Mrs Pride's estate immediately before death.

49. The "incumbrance" for which HMRC argued, per the first of the two limbs above, was the trustees' lien over trust property (an "incumbrance" being "a claim, lien, or liability attached to property" per *Jones v Barnett* [1899] 1 Ch 611 at 620)), created when the property trust trustees (properly) incurred the debt represented by the loan notes (or, possibly, when those trustees incurred the property trust's debt to Mrs Pride as seller of the two properties, which was replaced by the loan notes).

50. By way of authority, HMRC cited:

(1) the Privy Council in *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2018] UKPC 7 at [59]:

> "… it is necessary to start by setting out some well-established principles of English trust law… (v) A trustee is entitled to procure debts properly incurred as trustee to be paid out of the trust estate or, if he pays it in the first instance from his own pocket, to be indemnified out of the trust estate: *In re Blundell* (1888) 40 Ch D 370, 376. To secure his right of indemnity, the trustee has an equitable lien on the trust assets: *Lewin on Trusts*, 19th ed (2015), para 21-043."

(2) the passage in *Lewin on Trusts* endorsed by the Privy Council states (in part):

> "A trustee, and each of the trustees separately where the trustees are more than one in number, has a first charge or lien upon the trust fund, conferring an equitable interest in the trust fund, in respect of the liabilities, costs and expenses covered by his right of indemnity. The trustee's charge takes priority over the claims of the beneficiaries, and of purchasers or mortgagees claiming under them. The trustee's right of indemnity as secured by the charge or lien comprises rights of reimbursement, exoneration, retention, and realisation …"

51. We were not persuaded by this alternative argument: even accepting that this lien, cum incumbrance, was created on Mrs Pride's dispositions of the two properties, it was not claimed in the s216 account for Mrs Pride's estate, or indeed anywhere else by the appellant, that the *trustees' lien* was the liability to be taken into account in determining the value of Mrs Pride's estate immediately before her death. Rather, it was the *loan notes* that were said to be the liability to be so taken into account – and the loan notes were not an "incumbrance".

Did the consideration given for the loan notes derive from Mrs Pride?

52. The effect of [47] above is that account *would* be taken, in determining the value of Mrs Pride's estate immediately before her death, of a debt incurred by Mrs Pride, namely, the loan notes. The effect of s103(1) is that such liability is subject to abatement to an extent proportionate to the value of any of the consideration given for the debt which consisted of (amongst other things) property derived from Mrs Pride.

53. "Property" includes rights and interests of any description per s272 (with which s103, as part of Part V of FA 1986, is to be construed as one: s114(5) FA 1986).

54. The contemporaneous legal documentation before the tribunal did not expressly state why the property trust agreed, on 20 November 2002, to take on the obligations under the loan notes (via the nominee agreement) – or, in the language of s103(1), the "consideration given" for the loan note debt. But the "economic substance" behind the property trust taking on the loan note debt was not difficult to fathom: Mrs Pride had transferred the flat to the property trust on 10 October 2002 but not been paid the agreed price of £535,000; and similarly, Mrs Pride transferred the house to the property trust on 20 November 2002, but had not been paid the agreed price of £850,000; the loan notes gave Mrs Pride a right to the money to which she was entitled, albeit in 23 years, with 6% compound interest. In legal terms, the consideration given for the loan note debt was probably Mrs Pride's giving up her right to be paid, at completion of the two property transfers (and so we have found at [21] above); alternatively, the correct legal analysis may be that the consideration given for the loan note debt was the transfers of the properties themselves. In either case, it is clearly the case that, viewed realistically, the entirety of the consideration given for the loan note debt consisted of property of Mrs Pride's (i.e. the flat and the house).

55. Does the fact that the consideration was property *of Mrs Pride's* mean (as the appellant submitted) that it was not property *derived from Mrs Pride*? This would seem an interpretation at odds with the clear purpose of the provision: a provision expressly worded to catch property *derived from* Mrs Pride, interpreted purposively, also includes property *of* Mrs Pride's. Moreover, the definition, in s103(3), of "property derived from the deceased" as, inter alia, "any property which was the subject matter of a disposition made by the deceased, either by himself alone or in concert or by arrangement with any other person …", is perfectly consistent with our interpretation.

56. We find that the extent of the abatement of the liability represented by the loan notes should be 100%, given that the *whole* of the consideration given for the loan note debt consisted of property derived from Mrs Pride.

Conclusion on s103

57. By reason of the foregoing analysis, s103(1) applies in this case such, that, in determining the value of Mrs Pride's estate immediately before death, the loan note liability falls to be abated in its entirety. The first alternative determination under s221 (see [30(1)] above) is to be varied to reflect this conclusion.

Section 175A

58. HMRC asked the tribunal to consider whether "in the alternative" (in case we came to the view that s103 did not apply) s175A applied. Although we have concluded that s103 does apply, we shall nevertheless give our conclusions on the issues raised by s175A, in case we are wrong about s103 (and because the issues were argued before us).

59. The reason that s175A is potentially relevant, on the facts of this case, is that

(1) in our view, the loan notes were (subject to provisions to the contrary such as s103 and s175A) a liability to be taken into account in determining the value of Mrs Pride's estate immediately before death (see [40] above);

(2) the liability represented by the loan notes was never discharged; rather, the loan notes were released on 19 October 2017; and

(3) the conditions in s175A(2)(a) and (b) may not be satisfied.

60. Three types of issues are raised by s175A in this case:

(1) whether the tribunal has jurisdiction to consider s175A, given the terms of the s221 notice of determination in this case (the "**jurisdiction issue**");

(2) whether, assuming the tribunal has jurisdiction, it is right as a procedural matter to permit HMRC to argue that s175A applied (the "**case management issue**");

(3) whether in substance s175A is engaged on the facts of this case (the "**substantive issue**").

Further fact-finding relevant to the jurisdiction and case management issues

61. The following took place in the period between the appellant's delivering the s216 account (11 April 2017) and the issuance of the s221 notice of determination (18 October 2018):

(1) On 27 July 2017 Gateley Plc (legal advisers) sent deeds for the release of the loan notes to Mr Pride along with documentation for the winding up the property trust and the children's trust.

(2) By deed of release made on 19 October 2017, the children's trust trustees released Nominee from its liability in respect of the loan notes.

(3) A letter to Mr Pride from HMRC of 11 December 2017 set out certain "points of enquiry". Amongst the requests was for copies of the loan notes, "in particular the repayment terms and conditions"; and "full details of the individual(s) or entities entitled to the loan note repayment along with the legal documentation confirming their entitlement to repayment".

(4) On 15 December 2017 Mr Pride responded to HMRC with copies of the 2002 documentation creating the loan notes, and also stated: "The individuals entitled to the loan repayment are myself and my sister in equal shares." Nothing was said about the release of the loan notes that had occurred two months earlier.

(5) A letter to Mr Pride from HMRC of 18 January 2018 gave HMRC's views on the inheritance tax implications arising from Mrs Pride's "utilisation of a variant of the Home Loan: Double Trust arrangements". The letter gave three alternative approaches, such that inheritance tax of about £1.7 million was payable. The first was that the value of the loan notes should be taken as nil (based on s103). The second and third were based on s102. Towards the end of the letter, HMRC said that "in addition to" their comments above, s175A also applies. The letter then said: "If HMRC should be unsuccessful in their litigation of the home loan scheme the debt must be repaid, or no deduction can be claimed against the value of the settlement on death" (this being a summary of the operation of s175A, on the understanding that the loan notes remained outstanding).

62. The following took place after the appellant notified his appeal to the tribunal (i.e. after 27 March 2019):

(1) HMRC did not raise s175A in their statement of case (13 September 2021).

(2) A list of documents provided by the appellant in around October 2021 included, as an item of the list, the deed of release of 19 October 2017; per the tribunal's directions, a copy of that deed should have been provided to HMRC at the same time, but in the event was not provided to HMRC by the appellant until 20 July 2022.

(3) HMRC raised s175A in their skeleton argument dated 4 November 2022.

The jurisdiction issue

63. There was, broadly speaking, agreement between the parties that the case law on the scope of income tax appeals against closure notices was relevant to the jurisdiction issue, notwithstanding the differences between the appeal mechanisms as between income tax and inheritance tax.

64. One such case, *Fidex Ltd v HMRC* [2016] STC 1920 (Court of Appeal), concerned a tax avoidance scheme aimed at creating a tax loss in the hands of the taxpayer, as a result of the 'derecognition' (for accounting purposes) of bonds held by the taxpayer. HMRC issued a closure notice disallowing the loss, stating that the accounting derecognition should not have occurred. The taxpayer appealed and HMRC then sought to argue that the loss fell to be disallowed under a different statutory provision (due to the taxpayer having an "unallowable purpose" in being a party to the loan represented by the bonds). One of the issues was whether HMRC were precluded from arguing that the "unallowable purpose" provision applied, as it had not been mentioned in the closure notice. The Court of Appeal, upholding the tribunals below, decided this point in HMRC's favour.

65. The following extracts from Kitchin LJ's judgement in *Fidex* seem to us to encapsulate the main principles in an income tax context that could have relevance to the inheritance tax position before us in this appeal:

> [45] In my judgment the principles to be applied are those set out by Henderson J as approved by and elaborated upon by the Supreme Court. So far as material to this appeal, they may be summarised in the following propositions:
>
> (i) The scope and subject matter of an appeal are defined by the *conclusions* stated in the *closure notice* and by the *amendments* required to give effect to those *conclusions*.
>
> (ii) What matters are the *conclusions* set out in the closure notice, not the process of reasoning by which HMRC reached those *conclusions*.
>
> (iii) The *closure notice* must be read in context in order properly to understand its meaning.
>
> (iv) Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the *conclusions* set out in the *closure notice*.
>
> …
>
> [51] The UT went on to express the view, with which I agree, that it is not appropriate to construe a *closure notice* as if it is a statute or as though its conclusions, grounds and amendments are necessarily contained in watertight compartments, labelled accordingly. It also emphasised, again rightly in my judgment, that while there must be respect for the principle that the appeal does not provide an opportunity for a new roving enquiry into a company's tax return, the FTT is not deprived of jurisdiction where it reasonably concludes that a new issue raised on an appeal represents an alternative or an additional ground for supporting a *conclusion* in the *closure notice*.

…

> [61] The scope and subject matter of the appeal to the FTT were defined by the conclusions stated in the *closure notice* and the *amendments* required to give effect to them. HMRC were not, however, restricted on appeal to the process of reasoning by which they had reached those *conclusions* and they were free to deploy new arguments in support of them, subject to the exercise by the FTT of its case management powers to ensure that Fidex was not ambushed. ...

66. As can be seen from the above (and in particular from the words we have italicised), in the income tax context, HMRC's closure notices state *conclusions* and make *amendments*; appeals may be brought against such conclusions or amendments; if the appellant notifies an appeal to tribunal, the tribunal is to determine "the matter in question" (i.e. the matter to which the appeal relates); if the tribunal decides that appellant is overcharged by the income tax assessment, it shall be reduced accordingly (but otherwise stand good).

67. In the inheritance tax context, under s221, determinations are made of "matters" specified in the notice. The matters that may be specified in a notice are listed in s221(2). They include the "value transferred", the "tax chargeable" and any other matter relevant for the purposes of the Act: s221(2)(f). Appeals are made against determinations (see [32] above).

68. Adapting the *Fidex* principles in the extracts above to the inheritance tax context, it seems to us that the scope and subject matter of the appeal to this tribunal is defined by the matters determined in the s221 notice.

69. In our view, the matters determined in the s221 notice are not (as the appellant appeared to argue) limited to the literal text of the determination. A "matter" has a broader meaning than that. In this case, the matter determined in the first of the three alternative determinations (see [30(1)] above) was, in substance, whether the loan note liability fell to be taken into account in determining the value of Mrs Pride's estate immediately before death. HMRC clearly arrived at that determination by applying s103 (and not by applying s175A); but that does not, in our view, confine the "matter" determined to the s103 analysis.

70. We are fortified in this view by the dicta from *Fidex*, in the somewhat different context of income tax appeals, to the effect that whilst the appeal does not provide an opportunity for a new roving enquiry, the tribunal is not deprived of jurisdiction where it reasonably concludes that a new issue raised on an appeal represents an alternative or an additional ground for supporting the income tax equivalent of a matter determined in a s221 notice.

71. We are also fortified in our view by the context, which, relevantly, was that

(1) prior to their making the s221 determination, HMRC asked for information about the loan notes, their repayment terms, and the identity of those entitled to repayment (their 11 December 2017 letter to Mr Pride); but

(2) as Mr Pride's response said nothing about the release of the loan notes that had taken place; and stated that he and his sister were the individuals entitled upon repayment (his letter of 15 December 2017), HMRC were under the impression, up to including the time when the s221 determination was issued, that the liability under the loan notes on their original terms (i.e. repayment due in 2025 unless either party exercised their early-redemption rights) remained in force (and that neither party had exercised their early-redemption rights).

What we draw from this context is that the reason that HMRC did not cite s175A as an alternative in the notice in determination was that they were not furnished with the complete relevant information when they asked questions about the loan notes. Here, s175A does not in

our view represent something "new" or "roving", but rather a provision leading to the same substantive outcome as that set out in the determination, and which would have been specified in the determination had the appellant given a more complete response to HMRC's enquiries.

72. We conclude that the tribunal has jurisdiction to determine the substantive issue.

The case management issue

73. The background to the case management issue is that HMRC did not raise s175A in their statement of case (13 September 2021); they first raised it 14 months later in their skeleton argument (4 November 2022), between five and six weeks before the start of the hearing.

74. We gave an oral decision on the case management issue on the first day of the hearing, permitting HMRC to raise and argue the substantive issue, subject to our determination of the jurisdiction issue (which we reserved to our written decision). Our reasoning was as follows.

75. The basic principles to be applied are:

(1) per the tribunal's procedure rules, the tribunal regulates its own procedure, subject always to the overriding objective of dealing with cases fairly and justly;

(2) the principles set out in *Quah International v Goldman Sachs* [2015] EWHC 759 (Comm) including

(a) the heavy burden on a party seeking a "very late" amendment to particulars of their claim to show the strength of the new case and why justice to him, his opponent and other court users requires him to be able to pursue it;

(b) a "very late" amendment is one where the trial date has been fixed and where permitting the amendment would cause the trial date to be lost;

(c) "lateness" is a relative concept, depending on a review of the nature of the proposed amendment, the quality of the explanation for its timing, and a fair appreciation of the consequences in terms of work wasted and consequential work to be done;

(d) there must be good reason for the delay;

(e) a much stricter view is now taken of non-compliance with rules and directions of the court;

(3) the importance of avoiding ambush.

76. We balanced

(1) the injustice to HMRC if s175A is not considered, given its prima facie relevance, as against

(2) the unfairness to the appellant if he does not have enough time to adequately prepare submissions or evidence relevant to s175A.

77. As regards the importance of compliance with the tribunal's rules, HMRC's "excuse" for their lateness in raising s175A was that, until 20 July 2022, when they received a copy of the deed of release of the loan notes, they did not know that the loan notes had been released on 19 October 2017 (and so would never be discharged, which in turn meant that the substantive issue could arise). We accept this as a valid "excuse" in that

(1) Mr Pride did not tell HMRC about the release of the loan notes in his 15 December 2017 response to HMRC's questions about the repayment terms; and

(2) whilst the deed of release was included in the appellant's list of documents in October 2021, until they saw the document in late July 2022, HMRC could not reasonably have been sure of what exactly it said.

This means that HMRC are "at fault" "only" for the 3½ month delay from 20 July to 4 November 2022.

78. On the other side, the appellant is "at fault" for the delay of about 9 months between his including the deed of release in his list of documents, and his providing a copy to HMRC (October 2021 to 20 July 2022).

79. As regards the risk of "ambush" to the appellant, given that

(1) he was on notice of HMRC's desire to raise the issue, from about five weeks before the hearing, and

(2) the substantive issue, factually, was the reason as to why the loan notes were released (and so were not to be discharged) (we have in mind s175A(2)) – something that the appellant (who was already giving evidence at the hearing) was well positioned to address in evidence,

we did not consider there to be material unfairness (or "ambush") to the appellant in allowing s175A to be raised. As safeguards, we invited his counsel to alert us if, in the course of the hearing and as HMRC developed their s175A arguments, there was unfairness we had not anticipated when giving the ruling on the first day; we also gave the appellant the opportunity to make post-hearing written submissions on the substantive issue (which his counsel did, in the event, make). (We do not admit a subsequent, uninvited written submission by HMRC, made on 30 January 2023, as we were clear in our ruling that it was fair and just that the appellant had the last word on this issue).

80. We concluded that the "justice" of the tribunal considering a relevant legal issue outweighed any unfairness to the appellant; and that HMRC's delay in raising the issue (of about three months, if one allows for two weeks to review the document sent by the appellant on 20 July 2022) was not, in context, so serious as to shift the balance of fairness and justice to the opposite result.

The substantive issue

81. We have already explained our conclusion, at [40] above, that the liabilities of the property trust (here, the loan notes) were, by virtue of s49, and unless otherwise provided, liabilities to be taken into account in determining the value of Mrs Pride's estate. This means that such liabilities do fall within the ambit of s175A(1).

82. The appellant submitted that there is a "latest time" for testing whether a liability had been discharged per s175A(1)(a), namely the time when the s216 account is delivered to HMRC; and if, at that time, the liability is not so discharged, then the conditions in s175A(2)(a) and (b) (relating to the reason for its not being discharged) are also tested *at that time*. The argument was that, otherwise, to be certain of whether s175A applied, one would have to wait to see if the liability in question was ever discharged (which, the appellant submitted, was not "practical").

83. We see no basis for this approach in the statute: s175A(1)(a) states, plainly and clearly, that the liability may be taken into account

(1) to the extent it is discharged

(2) out of the estate etc

(3) on or after death

(4) in money or money's worth;

there is no suggestion of a "latest time" for examining whether the liability is discharged (or indeed that such time should be the date of delivery of the s216 account). The core question being asked by the statutory provision is whether or not the liability is discharged out of the estate etc (and, if it is not, why – these are the conditions in s175A(2)(a) and (b)); the fact that the liability remains undischarged at one particular moment of time, due to its not yet having fallen due, matters not.

84. The statutory purpose is self-evident: it prevents "pseudo" liabilities i.e. ones that are never actually discharged, from being taken into account so as reduce the value of an estate, *unless* non-discharge is arm's length and not tax driven.

85. The appellant's submission (that delivery of the s216 accounts was the "latest time" for applying s175A(1)(a)) rested on what was said to be "practical" and to give "certainty". The appellant argued that the alternative was to wait, potentially "forever", to see whether or not the liability was discharged. These arguments do not sway us from what we see as the clear meaning of the statute as set out above, particularly as:

(1) the concern about having to wait "forever" was overdone and strayed into the academic: clearly, any liability, realistically so identified, will have a due date in the foreseeable future; and

(2) our jurisdiction is to decide whether the notice of determination was correct – it is not our function to opine on what the appellant should or could have put in his s216 account (per s216, "specifying to the best of his knowledge and belief all appropriate property and the value of that property"), or the mechanics of amending that account if circumstances changed after it was delivered. The parties' arguments entered into these areas because it was contended by the appellant that, as at the date when the s216 account was delivered, the conditions in s175A(2) *were* satisfied (even if, as the appellant's submissions appeared to accept, the condition in s175A(2)(a) was not satisfied once the loan notes were released (i.e. at a later date)). We have no jurisdiction to resolve questions about the s216 account; but we are satisfied that none of those considerations impact on the plain meaning of s175A as we have explained it above.

86. Turning now to the questions asked by s175A and how we answer them:

(1) per s175A(1)(a), the liability represented by the loan notes was not discharged, on or after Mrs Pride's death, out of the estate, or otherwise; rather, the liability was released by the holders of the loan notes by the deed of release of 19 October 2017;

(2) it follows that we must apply s175A(2);

(3) we have had regard to the minutes of the children's trust trustees' meeting of 19 October 2017, which said this:

> "The trustees seek repayment of the [loan notes]. They noted further advice from Gateley Plc that there was an identity of interest in the two trusts and it would be quicker to release the [loan notes] and confirm the distribution of the [property trust] trust fund to [James Pride and Jane Poulston] through the trust.
>
> Pursuant to clause 5 of the [children's trust] the trustees resolved to act accordingly and to sign the deed of release which had been provided by Gateley Plc".

(4) applying s175A(2)(a), read together with s175A(3), there was no real commercial reason for the loan note liability not being discharged, because

(a) the liability was not to a person dealing at arm's length (as is emphasised by the text of the minutes, quoted above), and

(b) if it had been, that person (here, the children's trust) *would* require the liability to be discharged (the reason being that it would not, under those circumstances, have been in the children's trust's interests to release the loan notes);

(5) the foregoing is sufficient to conclude that, per s175A(2), and assuming s103 does not have the same effect, the loan notes may not be taken into account in determining the value of Mrs Pride's estate immediately before her death (as both s175A(2)(a) and (b) must be satisfied to take the liability into account);

(6) however, for completeness, we also find that s175A(2)(b) is not satisfied here: it was a main purpose of the release of the loan notes to secure a tax advantage, namely to avoid income tax (for the children's trust) on the deemed interest accrual in favour of the children's trust. We make this finding based on

(a) the fact that the potential for income tax on repayment of the loan notes had been flagged in the advice received when setting up the trust arrangements in 2002: a letter from Simmons & Simmons (the City firm that advised Mrs Pride on the trust arrangements) to Preston & Redman (local solicitors, also acting for Mrs Pride) of 28 October 2002 said as follows:

> "Although the Loan Document must provide that there be an increase in the amount due on repayment of the loan which would be subject to income tax, it also includes provision that the loan may be repaid at par and, if this is done, then no increase over the Issue Price will arise on repayment which will be liable to income tax" (point 4, page 3), and
>
> "Although there is provision in the Loan Document for a higher amount to be paid on the Final Repayment Date, as mentioned above, the loan can be repaid at par so there need be no tax liability on repayment" (point 6, page 4)

together with

(b) inferences from all the circumstances when the loan notes were released in October 2017: following Mrs Pride's death, there was a desire to unwind the trusts, and so the income tax considerations on repaying the loan notes, flagged in the 2002 advice, once again came to the fore; and

(c) Mr Pride's evidence in cross examination: although he parried with the questioner as much as he reasonably could, Mr Pride did not in substance deny that income tax considerations were a main purpose of releasing the loan notes in October 2017.

Conclusion on s175A

87. We conclude that, if we are wrong in our conclusions about s103, such that s103 does not apply to abate the loan note liability to nil in determining the value of Mrs Pride's estate immediately before death, then s175A would apply to the same substantive effect i.e. the loan note liability may not be taken into account in determining that value. Our decision in such "alternative" circumstances would have been to vary the first alternative determination under s221, to the effect described in the preceding sentence.

ISSUE 2 (S102)

88. HMRC argued that the property disposed of by way of gift, and "subject to a reservation" for s102 purposes, on the facts of this case, could be

(1) the loan notes (as an asset, as held by the children's trust), or

(2) the flat and the bonds (as held by the property trust).

We consider these alternatives in turn.

The argument that the loan notes (as an asset) were the property disposed of by way of gift, and "subject to a reservation"

89. The transfer of the loan notes to the children's trust on 21 November 2002 was clearly a "disposal by way of gift" by Mrs Pride and so s102(1) is potentially engaged – if the loan notes were "property subject to a reservation".

90. One relevant question in this regard is that asked in s102(1)(b) – whether, in the last seven years of Mrs Pride's life (31 October 2009 to 31 October 2016), the loan notes were not "enjoyed" by children's trust to the exclusion of Mrs Pride and any benefit to Mrs Pride?

91. The other relevant question is that asked in s102(1)(a): was possession and enjoyment of the loan notes not bona fide assumed by the children's trust at or before 31 October 2009?

92. We now look at these questions in turn.

Were the loan notes not "enjoyed" by children's trust to the exclusion of Mrs Pride and any benefit to Mrs Pride?

93. HMRC argued that paragraph 6(1)(c) Schedule 20 FA 1986 was in point: this provides that a benefit to Mrs Pride (by contract or otherwise) includes any benefit obtained by virtue of any "associated operations" of which the disposal by way of gift was one. "Associated operations" is defined in s268, the text of which is in the appendix. In our view, the 2002 transactions were "associated operations" and a benefit to Mrs Pride arising from those was her position as principal beneficiary of the property trust. We thus agree with HMRC to this extent – that, when considering whether the loan notes were "enjoyed" by children's trust to the exclusion of Mrs Pride *and any benefit to Mrs Pride*, the italicised expression includes the benefit comprised in Mrs Pride's being principal beneficiary under the property trust.

94. HMRC further argued that a benefit obtained by Mrs Pride by virtue of the associated operations was the fact that the loan notes were not early-redeemed. Unpacking this argument, what it sought to say was that the property trust (of which Mrs Pride was principal beneficiary) could only last so long as the loan notes remained outstanding – because, once the loan notes fell due, the property trust in effect had to be liquidated in order to raise the money to pay the loan note holders. In our view, however, *the benefit to Mrs Pride* was, simply, her position as principal beneficiary of the property trust; the terms of the loan notes may well have *enabled* that benefit to occur – but those terms were not, in themselves, a benefit to Mrs Pride.

95. The question, then, is whether the children's trust "enjoyed" the loan notes (as an asset) to the entire exclusion of Mrs Pride and of the benefit to her by reason of her being principal beneficiary under the property trust.

96. HMRC argued that the children's trust did not so enjoy the loan notes (as an asset) – essentially because, in the language of the case law, Mrs Pride's benefit, by reason of her being principal beneficiary under the property trust, "trenched upon" the children's trust's enjoyment of the loan notes.

97. Moses LJ explained "trenching" as follows in *Buzzoni v HMRC* [2013] EWCA Civ 1684 at [50-51]:

> "50. ... The second limb of section 102(1)(b) of the 1986 Act requires consideration of whether the donee's enjoyment of the property gifted is to the exclusion of any benefit to the donor. The focus is not primarily on the question whether the donor has obtained a benefit from the gifted property but whether the donee's enjoyment of that property remains exclusive. The statutory question is whether the donee enjoyed the property to the entire exclusion or virtually to the entire exclusion of any benefit to the donor. If the benefit to the donor does not have any impact on the donee's enjoyment, in my view, then the donee's enjoyment is to the entire exclusion of any benefit to the donor.
>
> 51. Millett LJ said that to come within the scope of the second limb of the subsection the benefit must consist of some advantage which the donor did not enjoy before he made the gift. That was sufficient in *In re Nichols, decd* [1975] 1WLR 534 and would have been in *Ingram's* case [2000] 1AC 293 where any such advantage clearly would have had an impact on the subject matter of the gift. But whilst that is a necessary condition, there will be cases in which it is not a sufficient condition. As I have said, the subsection, in its focus on the exclusivity of the donee's enjoyment of the gifted property, may demand further inquiry as to whether the benefit has any impact upon the donee's enjoyment. If the benefit is irrelevant to such enjoyment it does not "trench upon" the exclusivity of donee's enjoyment."

Or, as Moses LJ put it pithily at [55]:

> "The statutory criterion *is* the exclusivity of enjoyment of the gifted property. If the donor's benefit makes no difference or virtually no difference to the donee's enjoyment of that property, it is not possible to say that the donee's enjoyment was other than to the exclusion of any benefit to the donee."

98. These passages explain the conclusion in *Buzzoni*, at [57], that the imposition of "duplicative" obligations on the property in question (duplicative in the sense that the obligation on the donee to make certain payments to the donor "merely mirrored but did not add to" obligations to which the property was already subject), did not render the gifted property "subject to a reservation" – they made no difference to the donee's enjoyment of the property.

99. The opposite conclusion was reached on the facts in *Hood v HMRC* [2018] STC 2355 – there, the gift in question was "a gift of an interest in land subject to, and with the benefit of, the obligations which the parties agreed to undertake in the sub-lease" (see at [59]); "the benefit to the donor was inseparable from the gift" (see at [61]); and, per Henderson LJ, the central point being made in the relevant case law was that "if the gift of a leasehold interest is accompanied by positive covenants which confer additional benefits on the donor, then there is a reservation of benefit within s102(1)(b)" (see at [64]). The reason that s102 was found not to apply in *Buzzoni*, on the basis of the "further enquiry as to whether the benefit has an impact upon the donee's enjoyment", was the fact that in *Buzzoni* the donee had entered into separate covenants with the head lessor in the licence to underlet (see at [65]).

100. HMRC essentially argued that Mrs Pride's benefit – her position as beneficiary under the property trust – trenched upon the children's trust's exclusive enjoyment of the loan notes because the benefit could only be enjoyed so long as the loan notes remaining outstanding. In our view this argument fails because "enjoyment" of the loan notes, as assets, self-evidently depends on the *terms* of the loan notes; and by their terms, they were not repayable until 2025 (and there were significant economic costs to a party calling for early-redemption).

"Enjoyment" of the loan notes, as assets, *per their terms*, was not affected, or trenched upon, by Mrs Pride's position as beneficiary under the property trust. In contrast with *Hood*, the gift of the loan notes (as assets) was not accompanied by, or inseparable from, the undertaking of any obligations by the children's trust with respect to Mrs Pride; rather, the terms of the gifted property itself were such that payment did not fall due until 2025 – and it is that fact (rather than the gifting of the loan notes to the children's trust) that allowed the property trust (and Mrs Pride's benefit as its principal beneficiary) to endure until then.

101. Furthermore, although opting for early-redemption of the loan notes ran counter to the economic interests of the children's trust as their holder, there was nothing in the legal arrangements that prevented early-redemption and the consequent need to liquidate the property trust to obtain the funds needed to pay off the loan notes: Mrs pride's position as principal beneficiary under the property trust was, in this regard, *subject to* the rights of the loan note holders (rather than her position affecting, or trenching upon, the rights of the loan note holders).

102. We conclude that the loan notes *were* enjoyed by children's trust to the entire exclusion of Mrs Pride and any benefit to Mrs Pride, from 31 October 2009 to 31 October 2016.

Was possession and enjoyment of the loan notes not bona fide assumed by the children's trust at or before 31 October 2009?

103. HMRC argued that the children's trust did not bona fide assume possession and enjoyment of the loan notes at or before 31 October 2009 because there was no realistic possibility of the loan notes being repaid in Mrs Pride's lifetime. We agree that there was no realistic possibility of the loan notes being repaid until they were due for repayment – in 2025 – but, as above, this was simply a function of their terms. To possess and enjoy the loan notes was, self-evidently, to do so on their terms; and in our view this was assumed by the children's trust from the time that the loan notes were transferred to it, in 2002.

104. We conclude that possession and enjoyment of the loan notes *was* bona fide assumed by the children's trust prior to 31 October 2009.

The argument that the assets of the property trust (the flat and the bonds) were the property disposed of by way of gift, and "subject to a reservation"

Consequence of the argument

105. Under s102(3), the consequence of the assets of the property trust (the flat and the bonds) being property disposed of by way of gift, and "subject to a reservation" in relation to Mrs Pride immediately before her death, is that, to the extent the property would not, apart from that section, form part of Mrs Pride's death immediately before death, that property is treated as property to which she was beneficially entitled immediately before death.

106. In this case, however, by reason of s49, the property trust assets are already treated as property to which Mrs Pride was beneficially entitled.

107. It seems to us, therefore, that it is an academic exercise, as to whether this argument succeeds: on its terms, the section has no impact in the circumstances of this case. We shall nevertheless deal with it briefly, as it was argued in front of us. In our view, this argument turns on whether it can be said that Mrs Pride disposed of the flat and the house in 2002 "by way of gift" (the bonds, being derived from the house, are treated as property comprised in the gift for s102 purposes, by operation of paragraph 5 Schedule 20 FA 1986).

Did Mrs Pride dispose of the flat and the house in 2002 "by way of gift"?

108. The appellant relied on *R v Hinks* [2001] 2 AC 241 (House of Lords) at 266G to argue that a "gift" requires an intention to give:

> "The making of a gift is the act of the donor. It involves the donor in forming the intention to give and then acting on that intention by doing whatever it is necessary for him to do to transfer the relevant property to the donee."

109. The appellant argued that Mrs Pride, in 2002, had no such intention: her transfers of the properties were for consideration with, it was asserted, no donative intent (even if the disposal of the properties to the property trust was, on analysis, at an undervalue: it was asserted that the consideration was perceived at the time to be market value.)

110. HMRC relied on *Jones v Garnett* [2007] 1WLR 2030, where the House of Lords decided that the same factors which made an arrangement between the taxpayer and his wife a "settlement" under s660G Income and Corporation Taxes Act 1988 – being that the settlor had to provide a benefit that would not have been provided in a transaction at arm's length – also made the taxpayer's consent to his wife's purchase of an ordinary share, in a company to which he was willing to provide his services for a minimal salary, an outright gift for the purposes of section 660A(6) of that Act.

111. HMRC argued that the transfers of the properties in 2002 were not arm's length because:

(1) the loan notes were "limited recourse" (the amount repayable was effectively capped at the value of the property trust assets);

(2) there was a 41 day gap between the sale of the flat (10 October 2002) and the issue of loan notes (20 November 2002), giving rise to £4,807 of interest forgone by Mrs Pride;

(3) of the conclusions of Mr Watson's report;

(4) there was no true intention ever to repay the loan notes.

112. In our view, the loan notes were capable of being an arm's length settlement of the property trust's contractual liabilities to pay amounts to Mrs Pride in exchange for the property transfers – in effect, deferring payment until 2025, and limiting recourse to the then-value of the assets in the trust fund – provided that the implied interest rate adequately compensated Mrs Pride for the risks she was taking. Mr Watson's report in effect said that the implied interest rate was not enough to compensate her adequately. In cross examination, Mr Watson admitted that the loan notes were worth £1,335,000 (the amount for which the holder could early-redeem them) and that, on the day they were issued, payment of such amount was an arm's length bargain for Mrs Pride. However, in our view, this point does not dispose of the question of whether the disposals were by way of gift, since it was so clearly an element of the overall arrangements that the loan notes would *not* be immediately redeemed upon issue. Whilst, on the one hand, we were not persuaded that there was never any intention to repay the loan notes (i.e. to respect their terms), and were doubtful that some of the risks highlighted in Mr Watson's report were realistic (because they were matters within Mrs Pride's control, such as whether the property trust would transfer its assets to her), we felt there was an absence of positive evidence adduced by the appellant that the terms of the loan notes were "economic" as between unrelated parties. In particular, we would have expected to see contemporaneous documentary evidence in the form of a report commissioned at the time to explain the implied interest rate in the loan notes in the light of the risks being borne. Oral evidence from Mr Pride twenty years after the event was, in our view, inadequate to prove this point.

113. In sum, the evidence before the tribunal was inadequate for us to come to a reasoned view, on the balance of probabilities, as to whether the terms of loan notes were "economic" as between unrelated parties; and in such circumstances, in our view, it is not possible to determine whether, realistically, the disposals of the properties by Mrs Pride in 2002 was "by way of gift". The burden of proof was on the appellant to persuade us that the disposals were

not "by way of gift"; it follows from what we have just said that the appellant has not discharged that burden.

114. HMRC also presented a "recharacterisation" argument whereby the disposal of the properties to the property trust in exchange for the loan notes, and the transfer of the loan notes as a gift to the children's trust, could be melded together so as to produce an "effective" disposal of the flat and the house to the children's trust, by way of gift. We reject this argument since we do not find it be a "realistic" view of the facts – the reality, in our view, was clearly that the gift to the children's trust was of the loan notes. We also note that, were this the correct (and realistic) view of the facts in this case, our s49 and s103 analyses would be incorrect, as, if the true analysis was that the properties were "gifted" to the children's trust, then there would be no true interest in possession trust on which s49 could operate (and the loan notes would somehow have to be disregarded entirely).

Conclusion on s102

115. For the reasons given at [102, 104 and 107] above, we conclude that s102 does not apply in this case. The second and third alternative determinations under s221 (see [30(2) and (3)] are to be varied to reflect his conclusion.

DISPOSAL

116. The alternative determinations under s221 (see [30] above) are to be varied in the manner described at [57] and [115] above.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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

ZACHARY CITRON
TRIBUNAL JUDGE

Release date: 28th MARCH 2023

APPENDIX

SECTION 102

Gifts with reservation

(1) Subject to subsections (5) and (6) below, this section applies where, on or after 28th 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;

and in this section "the relevant period" means a period ending on the date of the donor's death and beginning seven years before that date or, if it is later, on the date of the gift.

(2) If and so long as—

(a) possession and enjoyment of any property is not bona fide assumed as mentioned in subsection (1)(a) above, or

(b) any property is not enjoyed as mentioned in subsection (1)(b) above,

the property is referred to (in relation to the gift and the donor) as property subject to a reservation.

(3) If, immediately before the death of the donor, there is any property which, in relation to him, is property subject to a reservation then, to the extent that the property would not, apart from this section, form part of the donor's estate immediately before his death, that property shall be treated for the purposes of the 1984 Act as property to which he was beneficially entitled immediately before his death.

(4) If, at a time before the end of the relevant period, any property ceases to be property subject to a reservation, the donor shall be treated for the purposes of the 1984 Act as having at that time made a disposition of the property by a disposition which is a potentially exempt transfer.

(5) This section does not apply if or, as the case may be, to the extent that the disposal of the property by way of gift is an exempt transfer by virtue of any of the following provisions of Part II of the 1984 Act,—

(a) section 18 (transfers between spouses or civil partners), except as provided by subsections (5A) and (5B) below;

(b) section 20 (small gifts);

(c) section 22 (gifts in consideration of marriage or civil partnership);

(d) section 23 (gifts to charities);

(e) section 24 (gifts to political parties);

(ee) section 24A (gifts to housing associations);

(f) section 25 (gifts for national purposes, etc);

(g). . . .

(h) section 27 (maintenance funds for historic buildings);

(i) section 28 (employee trusts); and

(j) section 28A (employee-ownership trusts).

(5A) Subsection (5)(a) above does not prevent this section from applying if or, as the case may be, to the extent that—

(a) the property becomes settled property by virtue of the gift,

(b) by reason of the donor's spouse or civil partner ("the relevant beneficiary") becoming beneficially entitled to an interest in possession in the settled property, the disposal is or, as the case may be, is to any extent an exempt transfer by virtue of section 18 of the 1984 Act in consequence of the operation of section 49 of that Act (treatment of interests in possession),

(c) at some time after the disposal, but before the death of the donor, the relevant beneficiary's interest in possession comes to an end, and

(d) on the occasion on which that interest comes to an end, the relevant beneficiary does not become beneficially entitled to the settled property or to another interest in possession in the settled property.

(5B) If or, as the case may be, to the extent that this section applies by virtue of subsection (5A) above, it has effect as if the disposal by way of gift had been made immediately after the relevant beneficiary's interest in possession came to an end.

(5C) For the purposes of subsections (5A) and (5B) above—

(a) section 51(1)(b) of the 1984 Act (disposal of interest in possession treated as coming to end of interest) applies as it applies for the purposes of Chapter 2 of Part 3 of that Act; and

(b) references to any property or to an interest in any property include references to part of any property or interest.

(6) This section does not apply if the disposal of property by way of gift is made under the terms of a policy issued in respect of an insurance made before 18th March 1986 unless the policy is varied on or after that date so as to increase the benefits secured or to extend the

term of the insurance; and, for this purpose, any change in the terms of the policy which is made in pursuance of an option or other power conferred by the policy shall be deemed to be a variation of the policy.

(7) If a policy issued as mentioned in subsection (6) above confers an option or other power under which benefits and premiums may be increased to take account of increases in the retail price index (as defined in section 8(3) of the 1984 Act) or any similar index specified in the policy, then, to the extent that the right to exercise on or before 1st August 1986, the exercise of that option or power before that date shall be disregarded for the purposes of subsection (6) above.

(8) Schedule 20 to this Act has effect for supplementing this section.

SECTION 103

Treatment of certain debts and incumbrances

(1) Subject to subsection (2) below, if, in determining the value of a person's estate immediately before his death, account would be taken, apart from this subsection, of a liability consisting of a debt incurred by him or an incumbrance created by a disposition made by him, that liability shall be subject to abatement to an extent proportionate to the value of any of the consideration given for the debt or incumbrance which consisted of—

(a) property derived from the deceased; or

(b) consideration (not being property derived from the deceased) given by any person who was at the time entitled to, or amongst whose resources there were at any time included, any property derived from the deceased.

(2) If, in the case where the whole or part of the consideration given for a debt or incumbrance consisted of such consideration as is mentioned in subsection (1)(b) above, it is shown that the value of the consideration given, or of that part thereof, as the case may be, exceeded that which could have been rendered available by application of all the property derived from the deceased, other than such (if any) of that property—

(a) as is included in the consideration given, or

(b) as to which it is shown that the disposition of which it, or the property which it represented, was the subject matter was not made with reference to, or with a view to enabling or facilitating, the giving of the consideration or the recoupment in any manner of the cost thereof, no abatement shall be made under subsection (1) above in respect of the excess.

(3) In subsections (1) and (2) above "property derived from" means, subject to subsection (4) below, any property which was the subject matter of a disposition made by the deceased, either by himself alone or in concert or by arrangement with any other person or which

represented any of the subject matter of such a disposition, whether directly or indirectly, and whether by virtue of on or more intermediate dispositions.

(4) If the disposition first-mentioned in subsection (3) above was not a transfer of value and it is shown that the disposition was not part of associated operations which included—

(a) a disposition by the deceased, either alone or in concert or by arrangement with any other person, otherwise than for full consideration in money or money's worth paid to the deceased for his own use or benefit; or

(b) a disposition by any other person operating to reduce the value of the property of the deceased,

that first-mentioned disposition shall be left out of account for the purposes of subsections (1) to (3) above.

(5) If, before a person's death but on or after 18th March 1986, money or money's worth is paid or applied by him—

(a) in or towards the satisfaction or discharge of a debt or incumbrance in the case of which subsection (1) above would have effect on his death if the debt or incumbrance had not been satisfied or discharged, or

(b) in reduction of debt or incumbrance in the case of which that subsection has effect on his death,

the 1984 Act shall have effect as if, at the time of the payment or application, the person concerned had made a transfer of value equal to the money or money's worth and that transfer were a potentially exempt transfer.

(6) Any reference in this section to a debt is a reference to a debt incurred on or after 18th March 1986 and any reference to an incumbrance created by a disposition is a reference to an incumbrance created by an disposition made on or after that date; and in this section "subject matter" includes, in relation to any disposition, any annual or periodical payment made or payable under or by virtue of the disposition.

(7) In determining the value of a person's estate immediately before his death, no account shall be taken (by virtue of section 5 of the 1984 Act) of any liability arising under or in connection with a policy of life insurance issued in respect of an insurance made on or after 1st July 1986 unless the whole of the sums assured under that policy form part of that person's estate immediately before his death.

SECTION 175A

Discharge of liabilities after death

(1) In determining the value of a person's estate immediately before death, a liability may be taken into account to the extent that—

(a) it is discharged on or after death, out of the estate or from excluded property owned by the person immediately before death, in money or money's worth, and

(b) it is not otherwise prevented, under any provision of this Act, from being taken into account.

(2) Where the whole or any part of a liability is not discharged in accordance with paragraph (a) of subsection (1), the liability or (as the case may be) the part may only be taken into account for the purpose mentioned in that subsection to the extent that—

(a) there is a real commercial reason for the liability or the part not being discharged,

(b) securing a tax advantage is not the main purpose, or one of the main purposes, of leaving the liability or part undischarged, and

(c) the liability or the part is not otherwise prevented, under any provision of this Act, from being taken into account.

(3) For the purposes of subsection (2)(a) there is a real commercial reason for a liability, or part of a liability, not being discharged where it is shown that—

(a) the liability is to a person dealing at arm's length, or

(b) if the liability were to a person dealing at arm's length, that person would not require the liability to be discharged.

(4) Where, by virtue of this section, a liability is not taken into account in determining the value of a person's estate immediately before death, the liability is also not to be taken into account in determining the extent to which the estate of any spouse or civil partner of the person is increased for the purposes of section 18.

(5) In subsection (2)(b) “tax advantage” means—

(a) a relief from tax or increased relief from tax,

(b) a repayment of tax or increased repayment of tax,

(c) the avoidance, reduction or delay of a charge to tax or an assessment to tax, or

(d) the avoidance of a possible assessment to tax or determination in respect of tax.

(6) In subsection (5) “tax” includes income tax and capital gains tax.

(7) Where the liability is discharged as mentioned in subsection (1)(a) only in part—

(a) any part of the liability that is attributable as mentioned in section 162A(1) or (5) is, so far possible, taken to be discharged first,

(aa) any part of the liability that is attributable as mentioned in section 162AA(1) is, so far as possible, taken to be discharged only after any part of the liability within paragraph (a) is discharged,

(b) any part of the liability that is attributable as mentioned in section 162B(1)(b), (3)(b) or (5)(c) is, so far as possible, taken to be discharged only after any parts of the liability within paragraph (a) or (aa) are is discharged, and

(c) the liability so far as it is not attributable as mentioned in any of paragraphs (a) to (b) is, so far as possible, taken to be discharged only after any parts of the liability within any of those paragraphs are discharged.

SECTION 268

Associated operations

(1) In this Act "associated operations" means, subject to subsection (2) below, any two or more operations of any kind, being—

(a) operations which affect the same property, or one of which affects some property and the other or others of which affect property which represents, whether directly or indirectly, that property, or income arising from that property, or any property representing accumulations of any such income, or

(b) any two operations of which one is effected with reference to the other, or with a view to enabling the other to be effected or facilitating its being effected, and any further operation having a like relation to any of those two, and so on.

whether those operations are effected by the same person or different persons, and whether or not they are simultaneous; and "operation" includes an omission.

(2) The granting of a lease for full consideration in money or money's worth shall not be taken to be associated with any operation effected more than three years after the grant, and no operation effected on or after 27th March 1974 shall be taken to be associated with an operation effected before that date.

(3) Where a transfer of value is made by associated operations carried out at different times it shall be treated as made at the time of the last of them; but where any one or more of the earlier operations also constitute a transfer of value made by the same transferor, the value transferred by the earlier operations shall be treated as reducing the value transferred by all the operations taken together, except to the extent that the transfer constituted by the earlier operations but not that made by all the operations taken together is exempt under section 18 above.