GIFTS WITH RESERVATION: THE IMPACT OF FINANCE ACT 1999[1]

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1 *Lady Ingram*: The House of Lords Decision[3]

In December 1998, the House of Lords unanimously allowed the Executors' appeal from the majority decision of the Court of Appeal in *Lady Ingram's Executors v Commissioners of Inland Revenue*.[4] The case concerned a "lease carve-out" scheme effected by Lady Ingram in March 1987 which involved a grant of a lease to her by her trustee, followed by a gift of the freehold reversion. The question was whether it was effective to avoid the inheritance tax gifts with reservation of benefit provisions ("the Provisions") on her death less than two years later. Their Lordships held not only that it was effective but that it would have been equally effective had the method used been that of a conveyance to the donees subject to an obligation imposed on them to grant a lease back, a method which had been eschewed in this case on account of *dicta* in the Court of Appeal decision in *Nichols v IRC* in 1974.

The case for the Executors was a very simple one. In determining whether property is enjoyed to the exclusion of the donor one must ascertain what is the property gifted; in this case it was a reversion expectant on a twenty-year lease, which

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1 This article is a condensed version of part of my *Inheritance Tax Planning* 4th edition, now in preparation and scheduled to be published after the 2003 Budget Speech.

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3 See my article "Carbolic Smoke Ball Protects Against Influenza" or *Lady Ingram* in the House of Lords in *The Personal Tax Planning Review* Volume 6 issue 3 page 177.

4 [1999] STC 37.

leasehold interest Lady Ingram never gave away. If the donor merely enjoys a benefit from that which he has never given away, the section is not brought into play. It is immaterial whether the donor "retains" an interest which subsisted separately prior to the gift or was created contemporaneously with it. In this case, while Lady Ingram continued to enjoy the benefit of the lease, partly through personal occupation of the demised land and partly by collecting rents from sub-let properties, that was not a benefit which trenched on possession and enjoyment of the freehold reversion by the donees. Even if she had not had a lease before the gift, the lease was not given to her by the donees out of the property which had been gifted to them. That argument was accepted by their Lordships.

The main argument of the Revenue before Ferris J and the Court of Appeal was that, while accepting the general principle for which the Executors contended, there was an exception where there is the creation at the time of the gift of an immediate limited interest in favour of the donor, i.e. one giving him a right to the present enjoyment of the property; in that case, they argued, there is a reservation of benefit over the whole of the property before its division into different interests. This was an argument which persuaded none of the judges. It is important to bear it in mind to understand what the Revenue thought it was trying to achieve in procuring a change in the law in response to the decision.

2 The Revenue Reaction

The House of Lords decided unanimously not only that the appeal succeeded but that Lady Ingram had not been engaged in tax avoidance and what she had done was not contrary to the spirit of the gifts with reservation of benefit provisions. As Lord Hoffmann explained:

> "The theme which runs through the cases is that although the section does not allow a donor to have his cake and eat it, there is nothing to stop him from carefully dividing up the cake, eating part and having the rest. If the benefits which the donor continues to enjoy are by virtue of property which was never comprised in the gift, he has not reserved any benefit out of the property of which he disposed."

He added, in the context of the policy behind the Provisions:

> "Section 102 does not therefore prevent people from deriving benefit from the object in which they have given away an interest. It applies only when they derive the benefit from that interest."

Their Lordships had accepted my arguments that inheritance tax is a tax on the

transfers of capital, not on the occupation or enjoyment of property, and the fact that Lady Ingram was sitting in dignity in her home in much the same way after her gift as before was immaterial. What had changed was that she had irrevocably diminished the value of her estate.

A naive person might therefore have expected the Revenue to accept the wise pronouncements of their Lordships and leave the law unaltered or, possibly, to take the hint that the provisions can operate unfairly, [5] and amend or replace them accordingly. A realist might have expected some change, but would scarcely have been prepared for the effrontery of what is called in New Labour English "spin" and in plain English "deceit". In the 1999 Budget Press Release "Inheritance tax—blocking tax avoidance" it was stated:

> " Loopholes which result in the avoidance of inheritance tax are to be closed, the Chancellor announced today.
>
> The changes, which confirm the Government's determination to stamp out tax avoidance, relate to what is often referred to as making a 'gift with reservation'. This is when, for example, someone gives away his/her house but continues to live in the property. The changes restore the tax position as it was understood to be prior to the House of Lords' ruling in the case of *Ingram v IRC.*"

This statement is Orwellian in its audacity.[6]

The statement continues:

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5 Per Lord Hoffmann "[Section 102] is in one sense a penal section. Not only may you not have your cake and eat it, but if you eat more than a few *de minimis* crumbs of what was given, you are deemed for tax purposes to have eaten the lot."

6 There is more of the same in the "Details" section (italics supplied):

> "1. Legislation (FA 1986 s 102, Sch 20) contains special rules on the taxation of lifetime gifts where the person making the gift (the donor) reserves or receives any material benefit from the gifted asset. They are intended to prevent the avoidance of the inheritance tax charge on death through a lifetime gift aimed at reducing the value of the donor's estate for the purposes of the tax, *while leaving the donor effectively in much the same position in terms of his or her continued enjoyment of the asset concerned as it was before the gift.*
>
> 2. The recent decision of the House of Lords in Ingram and another v IRC [1999] STC 37 has shown that *these special rules do not work as they should.*
>
> 3. The Government is extending the existing provisions so that they will work *as originally intended.*"

> "The new provisions will apply to gifts of interests in land where—
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> the gift is made on or after 9th March 1999;
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> there is some interest, right or arrangement which enables or entitles the donor to occupy the land to a significant degree or enjoy a significant right in relation to the land without paying full consideration;
>
> the gift is made within seven years after the interest, right or arrangement concerned is granted, acquired or entered into."

There is no attempt to explain how this is supposed to "restore the tax position as it was understood to be prior to the House of Lords' ruling in the case of *Ingram v IRC*". Indeed, there can be none. The new law, Finance Act 1999, sections 102A, 102B and 102C, reflects the Revenue's annoyance with a person being able to gift an interest in real property and still to continue to occupy it without the totality of it being comprised in his estate. It has learned nothing from the House of Lords speeches. The new law is neither firmly grounded in principle nor based on any coherent policy. Its effect is even more capricious than section 102 itself.

3 Overview of the Finance Act 1999 Additions

3.1 Order of Application of Sections

Finance Act 1999 added to Finance Act 1986 sections 102A, 102B and 102C, with effect from 9th March 1999. I shall refer to these three sections as "the 1999 code". Section 102 was not amended. There are three substantive sections, 102, 102A and 102B. Section 102C is an interpretation section. The order of application of the sections is very important. If section 102B "applies", it ousts section 102 and section 102B.[7] If section 102B does not apply, but section 102 applies, it ousts section 102A.[8] Section 102A will apply only where neither section 102B nor section 102 applies.

As will be seen, there is some uncertainty as to when section 102B "applies". See 6.

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7 Section 102C(6).

8 Section 102C(7).

3.2 Common Features

The three substantive sections have several features in common. Each requires that "an individual disposes of" certain property "by way of gift". In the case of section 102, the property can be "any property". In the case of section 102A, the property must be an "interest in land". In the case of section 102B, the property must be "an undivided share of an interest in land".[9]

Where any of the three sections is operative, the effect is to treat the property gifted (or property representing it under the substituted property provisions) as being "property subject to a reservation". Section 102(3) will then come into play if the property is still property subject to a reservation on the donor's death and section 102(4) will come into play if, within the last seven years of his life, it ceases to be property subject to a reservation.[10]

An unresolved problem in relation to section 102 is the case where the donor gifts property but there is a reservation of benefit in respect of only part of the property. For example, he gifts two semi-detached houses and continues to live in one of them. Does section 102 apply to both houses or merely to the one? Well-advised donors can, of course, avoid the problem, at least so far as section 102 is concerned, by making separate disposals by way of gift.[11]

The wording of section 102A is certainly not more helpful in this regard: section 102A(3) expressly refers to a "part of the land". See 4.2. Section 102B is more ambiguous: see 5.

None of the sections applies to the extent that the disposal of property by way of gift is an exempt transfer by virtue of any of the provisions of the Inheritance Tax Act set out in section 102(5).[12]

It will be recalled that, in order to determine whether any property which is disposed of by way of gift is enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise for the

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9 But see 7 on the application of the substituted property provisions to both section 102A and section 102B.

10 See section 102A(2)(b), section 102B(2)(b) and, for the definition of "the relevant period", section 102C(1). For the effect of section 102(3) and (4), see 5A.

11 Care must be taken in relation to easements.

12 Section 102C(2).

purposes of section 102, Schedule 20, paragraph 6(1) provides that in the case of property which is an interest in land, any occupation by the donor of the whole or any part of the land is to be disregarded in certain circumstances where it results from an unforeseen change in the circumstances of the donor since the time of the gift.[13] Similarly, in applying sections 102A and 102B

> "no account is to taken of –
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> (a) occupation of land by a donor, or
>
> (b) an arrangement which enables land to be occupied by a donor,
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> in circumstances where the occupation, or occupation pursuant to the arrangement, would be disregarded in accordance with paragraph 6(1)(b) of Schedule 20 to Finance Act 1986."[14]

The provisions of Schedule 20 are in general to have effect for the purposes of sections 102A and 102B as they have effect for the purposes of section 102.[15] The exception is paragraph 6. This exception would not appear to be of enormous consequence.

Paragraph 6(1)(a) provides that, "in the case of property which is an interest in land ..., retention or assumption by the donor of actual occupation of the land or actual enjoyment of an incorporeal right over the land ... shall be disregarded if it is for full consideration in money or money's worth". Sections 102A and 102B each have their own "full consideration in money or money's worth" exceptions.[16]

Paragraph 6(1)(b) is expressly imported into the 1999 Code. See 3.2.

Paragraph 6(1)(c) applies to benefits which the donor obtained by virtue of any associated operations. It is by its nature applicable only to section 102, as the trigger condition in each of sections 102A and 102B is different.

Paragraph 6(2) provides that any question whether any property comprised in a gift was at any time enjoyed to the entire exclusion, or virtually to the entire exclusion,

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13 See 3A.2.

14 Section 102C(3).

15 See 5 for the substituted property provisions.

16 See section 102A(3) and section 102C(3)(c).

of the donor and of any benefit to him shall (so far as that question depends upon the identity of the property) be determined by reference to the property which is at that time treated as property comprised in the gift. Section 102C(4) and (5) deals with the corresponding question in rather different terms in relation to the 1999 Code. See 7.

The differences are in the trigger conditions which bring each of the sections into play. Under section 102, the condition is that "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".[17]

4 Section 102A Trigger Conditions

4.1 The Basic Rule

Section 102A comes into play if "at any time in the relevant period ... the donor or his spouse enjoys a significant right or interest, or is party to a significant arrangement, in relation to the land ..."[18]

So far as section 102 is concerned, the spouse of the donor is in principle irrelevant. The same is true of section 102B. At first blush, it would appear in the case of section 102A to be immaterial whether it is the donor or his spouse who enjoys a significant right or interest, or is party to a significant arrangement, in relation to the land. The definition of "significant" is such, however, that a benefit enjoyed by the donor's spouse might not bring the section into play whereas the same benefit enjoyed by the donor would. See 4.2.

By contrast with section 102, it is sufficient for the donor to enjoy some relevant right or benefit in relation to the land an interest in which was gifted. It is not necessary that the benefit should be referable to the interest gifted.

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17 Section 102(1). "The relevant period" is the 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.

18 Section 102A(2).

Like section 102, if the section applies, it is the interest in land gifted, not the donor's entire interest in the land, which is property subject to a reservation. It will be seen that section 102B operates in this respect in a way very similar to section 102A, rather than to section 102. See 5.

Can a donor "enjoy" a right which does not belong to him, e.g. if he is allowed to occupy land as the gratuitous licensee of another who has the legal right of occupation? In my view, he cannot.

The word "arrangement" is *prima facie* a word of very wide meaning.

When is a donor a "party" to an arrangement? In most cases, it will be obvious that he is. But suppose that an arrangement is set up by others, possibly without his knowledge, and then presented to him on a plate, e.g. he is then told that he is being given a gratuitous licence to occupy land?

4.2 "Significant"

Section 102A(3) provides:

> "Subject to subsections (4) and (5) below, a right, interest or arrangement in relation to land is significant for the purposes of subsection (2) above if (and only if) it entitles or enables the donor to occupy all or part of the land, or to enjoy some right in relation to all or part of the land, otherwise than for full consideration in money or money's worth."

This key provision – a masterpiece of inept drafting – is full of ambiguities. The terms "right or interest" are familiar enough. The word "interest" normally connotes a proprietary right, binding on third parties. The word "right" is wider and would include a purely personal right, such as a contractual licence.

If an arrangement "entitles" the donor, then it is difficult to see how he will not have a relevant right. Hence, "arrangement" is probably introduced to deal with the situation where the donor has no right or interest but obtains a *de facto* relevant benefit. It is a moot point whether it is necessary that the arrangement should have as one of its purposes that it should enable the donor to enjoy a relevant benefit.

The right, interest or arrangement must "entitle or enable ... the donor to occupy all or part of the land, or to enjoy some right in relation to all or part of the land". It is difficult to see how a "right" in relation to land could not entitle the donor to enjoy some right in relation to the land; unless, that is, the right the donor is entitled to enjoy must be a different right from that which entitles him to enjoy the first

right. Yet such an interpretation would make little sense.

What of an interest in relation to the land? Is it possible that it could not entitle the donor to enjoy some right in relation to the land? Perhaps, if the right is one not comprised in the interest. Does "right" in the expression "enjoy some right in relation to all or part of the land" exclude anything which is an "interest"? Normally, "intere st" would include "right". The employment of the phrase "right, interest or arrangement" at the beginning of the subsection may, however, be contrasted with the use of the single word "right" towards the end.

In the case of a right or interest in relation to the land, it would appear that the first test, that it should entitle or enable the donor to occupy all or part of the land, may be redundant, as any right or interest which did would also enable the donor to enjoy some right in relation to all or part of the land. This potential redundancy may be a reason for construing more narrowly "right" in the expression "enjoy some right in relation to all or part of the land".

The test of enabling would appear to come into its own principally in the case where the donor does not enjoy any right or interest, but is a party to an arrangement under which he is enabled to occupy all or part of the land without having any right to do so.

It would appear that where a donor is a party to an arrangement under which he is entitled to enjoy some benefit in relation to the land other than occupation but has no right to do so, then section 102A will not be in point. For example, he could have made a gift of the freehold of property subject to a lease at a rack rent and the donee could make him a voluntary allowance out of the rent. As far as the donor is concerned, this may be of little consequence, since in that case he will usually be caught by section 102. As far as benefits enjoyed by his spouse are concerned, the point could be a vital one, as he will not be caught under section 102 on that account.

If the right or interest in question is owned by the donor's spouse, will it be "significant"? It will not normally be so merely because it "entitles" the donor to occupy all or part of the land.[19] Yet it may arguably "enable" the donor to occupy all or part of the land" if he in fact "occupies" as his spouse's licensee. "Occupation" is a legal concept of some technicality. If I have children or domestic staff living in my home, I am nonetheless the sole occupier, even though they may all be resident there. The position where I have a spouse living with me may be

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19 The position might be different if the spouses are married under a community property regime.

more ambiguous.

If the donor is not able to occupy the land, it is difficult to envisage circumstances in which section 102A will come into play simply because his spouse is a party to an arrangement.

4.3 The Full Consideration Exception

The closing words of section 102A(3) are "otherwise than for full consideration in money or money's worth". What is the scope of this exception? If the donor first gives the donee his entire interest in the land and the donee then grants the donor the right to occupy the land for full consideration, whether in a capital or an income form, the section is clearly not in point. These circumstances are, in the case of section 102, covered by Finance Act 1986, Schedule 20, paragraph 6(1)(a).[20]

Suppose the donor buys a freehold for full consideration from a third party and then grants a reversionary lease of it to his son. The father continues to occupy by virtue of his freehold, for which he has paid full consideration. There is no requirement that the consideration should be given to the donee. I apprehend that this construction is one which would surprise the Capital Taxes Office and which it would be reluctant to accept.

What if the donor, having paid full consideration for his freehold, does exactly as Lady Ingram did, i.e. grants a 20-year lease to a nominee for himself, and then gifts the reversion expectant on that lease. The lease is merely part of the original freehold and carved out of it. Just as he acquired the whole for full consideration, so he acquired the part for full consideration. Whereas he previously had the right to occupy in perpetuity, he now has the right to occupy for only twenty years. True, the lease is a contract as well as a property interest, but provided it confers on him no right which would fall foul of section 102, it is difficult to see how the concluding words are not in point. I apprehend that this construction is one which would render the Capital Taxes Office livid if it were accepted and which it would oppose with all the emotion of which we know it to be capable.

What of the case where the donor has inherited his home and gifts it to the donee

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20 Schedule 20, paragraph 6(1)(a) does not in terms cover the case where the benefit the donor obtains consists of something other than actual occupation of the land or actual enjoyment of an incorporeal right over the land. It is a moot point whether, if the donor enjoys some other benefit for full consideration, there is in any event property subject to a reservation for the purposes of section 102. In my view, there is not, but my view is inconsistent with the decision of the Privy Council in *Chick v Commissioner of Stamp Duties of New South Wales* [1958] AC 435.

on condition that the donee grants a lease back to the donor? In *Lady Ingram's Executors*, the Revenue was still arguing that, on the authority of *Nicholls v IRC*, a gift of a freehold charged in Equity with an obligation on the donee to grant a lease back to the donor amounted to a transfer of the whole with something given back. If that analysis were correct, it would be difficult to see why the donor had not given (more than) full consideration for the lease back. There are two problems with reliance on *Nicholls*. Firstly, the majority of the Court of Appeal in Lady Ingram followed *Nicholls* but simply ignored the argument that the full consideration defence was available. Secondly, and more importantly, the House of Lords in Lady Ingram, overruled *Nicholls*. The true analysis in such a situation is that the donee only ever receives the freehold subject to an Equitable obligation to grant the lease and hence to an Equitable lease.

It is a moot point whether, if the donor were to transfer the freehold to the donee in return for a non-specifically enforceable obligation binding on the donee to grant a lease back, perhaps after a discreet interval, the full consideration exception would be in point, It seems to me that technically it would. So, too, would be the Schedule 20 paragraph 6(1)(a) exception, both in relation to section 102 and to section 120A (as well as section 102C), at least in so far as the benefit conferred on the donor consisted of occupation of the land. I apprehend that the Capital Taxes Office would resist such an argument.

4.4 The Section 102A(4)(a) Defence

Section 102A(4)(a) provides:

> "(4) A right, interest or arrangement is not significant for the purposes of subsection (2) above if –
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> > (a) it does not and cannot prevent the enjoyment of the land to the entire exclusion, or virtually to the entire exclusion, of the donor ..."

This is indeed enigmatic. What is meant by "the land"? Normally, in a taxing statute, it would mean the proprietary rights over or in respect of the physical land enjoyed by others. It is unlikely to bear that meaning here; partly because section 102A would have virtually no effect and partly because in the preceding subsections, "land" clearly means the physical land.

If "land" means "the physical land", of what right or interest vested in the donor could it not be said that it "cannot prevent the enjoyment of the land to the entire exclusion, or virtually to the entire exclusion, of the donor"? A lease vested in the

donor cannot qualify, at least if it is in possession. A reversionary lease is more questionable. If "cannot" includes "could not in future", then a reversionary lease cannot qualify.

What of a rent charge or right by way of security vested in the donor? If it is currently exercisable, can it be said that it cannot prevent the enjoyment of the land virtually to the entire exclusion of the donor? If the security is enforced, the interest over which it subsists will no longer be enjoyed by its owner in quite the same way. If the enforcement would be for the benefit of the donor, is that enough to prevent section 102A(4)(a) applying? Would the position be any different if the rent charge or right by way of security were not currently exercisable?

On one view, there is no right or interest which can be vested in the donor which cannot prevent the enjoyment of the land to the entire exclusion, or virtually to the entire exclusion, of the donor. That is unlikely to be the correct view, as it would render section 104(4)(a) otiose.

I suspect that what the draftsman had (hazily) in mind was the enjoyment of the land in a very popular and non-legal sense, namely enjoyment through occupation. That, however, is entirely a matter of speculation.

What if a right or interest is vested in the spouse of the donor? When will that be regarded as not "s ignificant" by virtue of section 102A(4)(a)? It would fail to prevent the enjoyment of the land virtually to the entire exclusion of the donor only if the spouse decided to confer some benefit on the donor. Yet that can hardly be the test. For anyone who was entitled to an interest in the land could in principle use it to benefit the donor. Does section 102A(4)(a) therefore ensure that section 102A never operates where only the spouse of the donor, and not the donor, enjoys a right or interest in or over land? One possibility is that a right or interest vested in the spouse of the donor does not bring section 102A into play so long as the land is in fact enjoyed virtually to the entire exclusion of the donor.

In conclusion, section 102A(4)(a) is so enigmatic that only the hardy would seek to rely on it except where any possibility of benefit to the donor was *de minimis*.

4.5 The Section 102A(4)(b) Defence

Section 102(4) further provides:

> "(4) A right, interest or arrangement is not significant for the purposes of subsection (2) above if –

> ...
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> (b) it does not entitle or enable the donor to occupy all or part of the land immediately after the disposal, but would do so were it not for the interest disposed of."

If the donor being, say, the freeholder, grants the donee a lease of the land to take effect in possession, the freehold will not be a "significant " interest in relation to the gift. This reflects the lack of concern of the Capital Taxes Office while arguing *Lady Ingram* with the position where the donor has to move out as a result of his gift.

Section 102A(4)(b) might also apply in some circumstances where the donor vests beneficially in the donee an equitable interest in possession in the donor's estate in the land. Again, the Capital Taxes Office is unlikely to be concerned about that situation.

It is difficult to see section 102(4) having any operation in relation to any other situation. It must be the interest disposed of which prevents the donor from being entitled to occupy all or part of the land immediately after the disposal. No interest other than a lease or an interest in possession will in principle achieve that.

Schemes based on taking advantage of section 104(4)(b) by ensuring that the donor is neither entitled nor enabled to occupy all or part of the land *immediately* after the disposal, but is so entitled or enable shortly thereafter, will, it seems, founder on the requirement that, but for the gift, the donor would be entitled to occupy all or part of the land.

If one has regard simply to the terms of the statute, if the property is already let so that the lease granted by the donor to the donee is a lease of the reversion, the exemption is not available. Yet the 1999 Budget Speech Press Release states:

> "4. The extended provisions will not apply where—
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> ...
>
> the donor may occupy the land or enjoy some right in relation to it only on the determination of the interest that he/she has given away; for example, the donor gives away a leasehold interest and retains the freehold reversion which entitles him/her to re-occupy the land when the lease expires."

4.6 The Section 102A(5) Defence

Section 102A(5) provides:

> "(5) A right or interest is not significant for the purposes of subsection (2) above if it was granted or acquired before the period of seven years ending with the date of the gift."

One suspects that what the draftsman had in mind was the "prior independent transaction" reference in *Nicholls*, which the House of Lords rejected in *Lady Ingram*. It would appear that if a donor were to grant a lease to a nominee for himself and wait for seven years, he could then gift the freehold without section 102A thereby coming into play. In other words, Lady Ingram's strategy still works provided one takes seven years longer over it.

The wording of the subsection in fact goes much wider. If I acquired a freehold interest more than seven years ago, whether or not for full consideration, it would appear that if, for example, I grant a reversionary lease over the property to my donee, section 102A will, surprisingly not be in point.[21]

It is crucial that the only interest I retain is in law the same interest as that which I acquired more than seven years ago. Care must be taken if a leasehold interest has been extended. Much may depend on the mechanics. The variation of the terms of an existing lease might produce a different result from the grant of a new lease in substitution for the old. The position where the interest has been gifted to a trust under which the donor or his spouse takes an immediate interest in possession also requires careful consideration on a case by case basis.

Suppose, having acquired a freehold interest more than seven years ago, I transfer the legal estate to a nominee, who grants a twenty-year lease back to me. If I then gift the beneficial interest in the freehold, subject to the lease, is the lease a " significant" interest? In my view, it is not. It is merely part of the donor's unencumbered freehold, provided it confers on the donor no right which he did not possess before it was granted and/or the freehold was gifted.[22] I apprehend, however, that many will not share my view which, superficially, is plumb wrong.

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21 It should be noted that there is no comparable provision in section 102B which, if it applies, does so to the exclusion of section 102A.

22 Compare the discussion at 4.3, in the context of the full consideration exception.

4.7 Timing of the Defences

The section 102A(4)(a) and 102A(5) defences must be satisfied from time to time. The section 102A(4)(b) defence, by contrast, need be satisfied only immediately after the gift is made. Care is therefore needed with planning after the making of the gift as well as before. Suppose, for example, a donor owns a leasehold interest in his home with sixty years unexpired which he acquired more than seven years ago. He grants out of it to a donee a reversionary lease. For the time being, the donor's interest is not "significant". If the donor subsequently acquires a longer leasehold interest, or the freehold, he will then own a significant interest which is not within section 102A(5). That will bring section 102A into play (unless some other exception or defence is in point).

4.8 Multiple Application of Section 102A

Section 102A(6) provides:

> "(6) Where an individual disposes of more than one interest in land by way of gift, whether or not at the same time or to the same donee, this section shall apply separately in relation to each interest."

This is an important provision which blocks some forms of tax planning. As section 102A operates to deem the interest gifted still to be comprised in the estate of the donor, it is only logical that it should apply separately to each interest gifted.

5 Section 102B Trigger Conditions

5.1 Disposal of an undivided Share of an Interest in Land

Section 102B, while shorter than section 120A, has been thought through no more clearly and many ambiguities lurk beneath its apparently straightforward surface.

Section 102B(1) provides:

> "(1) This section applies where an individual disposes, by way of gift on or after 9th March 1999, of an undivided share of an interest in land."

Where the section applies, section 102A does not apply. Why one should have needed a separate section dealing with the disposal of an undivided share in land (whatever is meant by that), I cannot tell.

An undivided share of an interest in land is the interest of a tenant in common, as opposed to the interest of a joint tenant.[23] My guess is that the typical case to which the section was meant to apply was where a sole owner creates a tenancy in common by the gift of an undivided share to a donee whilst retaining another undivided share himself. Yet its scope is far from clear. The Revenue is in some difficulty in accepting by way of concession that section 102B does not apply in a particular case. Unless it adequately protects itself, there would be nothing to prevent the taxpayer on the one hand taking advantage of the concession but on the other hand insisting that, because section 102B applies as a matter of law, neither section 102 nor section 102A can apply!

The first question is whether the donor must have owned an undivided share in an interest in land immediately before the gift. In my view, it is not possible to read in this limitation. I feel sure that the Revenue did not intend it.

The second question is whether, if the donor is a joint tenant before the gift, the section applies. In my view, it probably does if, as a result of the gift, an undivided share becomes vested in a donee. If a joint tenant gifts his entire share to a donee, that will involve severing the joint tenancy and creating a tenancy in common. It is possible for joint tenants to make a joint gift without bringing section 102B into play, as where husband and wife are joint tenants of a freehold and jointly gift it to their only son absolutely.

The third question is whether, if the sole owner of, say, a freehold, gifts it to his two children in equal shares absolutely, section 102B applies. This is much more difficult. While he at no point owns an undivided share, it is difficult in principle to distinguish this case from that where the donor gifts a one half share while "retaining" the other. One could construe the gift to the children in equal shares as two gifts of one undivided share each. By contrast, where the donor gifts the freehold to his two children as joint tenants and one of them, of his own volition, then severs the joint tenancy, so as to create a tenancy in common, section 102B does not apply.

A fourth question is whether the donor must immediately after the gift own an undivided share in the interest in which another undivided share has been gifted. While the Revenue may well have intended this limitation to apply, it cannot be spelled out of the words of the section.

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23 The difference between a joint tenancy and a tenancy in common is a question of English property law which is beyond the scope of this work. Tax advisers who are not lawyers are warned that it is a highly technical area.

A fifth question is whether the section applies, if, say, husband and wife own a property as tenants in common in equal shares and by the same instrument gift it to their daughter so that she becomes absolutely entitled to it. They have each given an undivided share but she has not received an undivided share. If they were to convert their tenancy in common into a joint tenancy before making a joint gift, it is clear that section102B would not apply.[24]

The position is more complex still where the gift is to a trust. Assuming the donor does not own an undivided share in land before the gift (and does not have to create one by severing a joint tenancy), then, if as a matter of law it is enough for the section to apply that an undivided share in the land has vested in someone, much may turn on the precise terms of the trust. Take the case where the donor is the sole owner of the freehold and conveys it to the trustees. If the trusts are for A for life remainder to B, the section does not apply. The position is not so clear if the trusts are to A for life remainder to B and C in equal shares absolutely; or to A and in equal shares during their lives, remainder to C. Does it make a difference that there is a trust for sale? Or that the beneficiaries entitled for an interest in possession do or do not have right to occupy the land?

5.2 The Defences in Outline

Section 102B(2) provides:

> "(2) At any time in the relevant period, except when subsection (3) or (4) below applies –
>
> > (a) the share disposed of is referred to (in relation to the gift and the donor) as property subject to a reservation; and
> >
> > (b) section 102(3) and (4) above shall apply."

It is irrelevant whether the donor or his spouse enjoys a significant right or interest, or is party to a significant arrangement, in relation to the land.

It will be noted that the three sets of conditions contained in section 102B(3) and (4), which in effect confer defences, can each apply at one time and cease to apply thereafter. As soon as none of them applies, the interest gifted becomes property subject to a reservation. If thereafter one of the conditions becomes satisfied, the donor will be deemed to make a potentially exempt transfer if he dies within the next

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[24] It is a moot point whether, if they had owned the freehold as tenants in common for more than seven years before the conversion, the section 102A(5) defence would apply.

seven years.

The three defences appear to be directed to the situations where

(a) the donor does not occupy the land at all

(b) the donor occupies the land but the donee does not occupy it at all and

(c) the donor and the donee both occupy the land.

These three cases are probably intended to deal with all possible permutations.

Difficulties can arise in identifying "the donee" where the gift is made to more than one person. If the donor gifts a one-quarter share in the freehold to each of his two children while retaining a one-half undivided share, on one view he has made two disposals by way of gift of an undivided share of an interest in land and one must apply section 102B separately in relation to each gift.

If the donor owns a one-half undivided share in land which he gifts to his son and the spouse of the son as joint beneficial tenants, there is only one disposal by way of gift. What is the position if the donor occupies the land jointly with one donee to the exclusion of the other donee? Is section 102B(3)(b) or (4) or neither potentially in point?

The position where the gift is made to the trustees of a settlement is more problematic still. All the learning on the predecessors of section 102 would suggest that it is not the trustees but the beneficiaries who are the "donees". If the trust is an interest in possession trust, does Inheritance Tax Act, section 49(1) operate to deem the gift to be made to the beneficiary entitled in possession? If so, what happens when his interest terminates?

5.3 Section 102B(3)(a) Defence

Section 102B(3) provides:

"(3) This subsection applies when the donor –

(a) does not occupy the land ..."

This is a very important exception. If the donor owns tenanted property, before the 1999 Budget Speech he could grant a lease to a nominee for himself and then gift

the freehold without bringing section 102 into play.[25] Since the 1999 Budget Speech, if he gifts the freehold, he may or may not bring section 102A into play. If he gifts merely an undivided share in the freehold, say, a 99% undivided share, section 102B will not apply provided he does not occupy the land but merely enjoys the rents. In my view, section 102A will not apply either.[26]

The situation is the same wherever (a) the donor gifts an undivided share in land but (b) the donor does not occupy the land. The donor could thus reserve an annuity charged on the land.[27]

It is in my view irrelevant that the donor has the right to occupy the land provided he does not in fact occupy it.

It is probably insufficient to bring section 102B(3)(a) that the donor is not the only person to occupy the land.

It is equally irrelevant that the spouse of the donor may occupy the land. Strategies which depend on the spouse of the donor occupying the land while the donor lives in the premises without occupying it, even jointly (e.g. as the licensee of the spouse) should work fine in principle but are likely to prove difficult in practice, especially where the property is the main conjugal home.

5.4 Section 102B(3)(b) Defence

Section 102B(3) goes on to provide:

> "(3) This subsection applies when the donor –
>
> ...
>
> (b) occupies the land to the exclusion of the donee for full consideration in money or money's worth."

What is meant by occupation of the land "to the exclusion of the donee"? In my view, it is tantamount to saying "and the donee does not occupy at all". If the

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25 Lady Ingram in fact did this as regards part of the land the freehold of which she gifted.

26 As to which, see 6.

27 The annuity may cause the property gifted to become settled property so that an appropriate proportion of its value would be brought into charge on the death of the donor: see Inheritance Tax Act, section 43(2)(c) and section 50.

donee does occupy, then the situation is dealt with either by section 102B(3)(a) or section 102B(4). One can envisage a situation where the donor is the sole occupier but the donee is a licensee. It is very unlikely that that situation is meant to be treated less favourably than one where the donee occupies and the donee is not a licensee.

What is "full consideration in money or money's worth"? If the donor pays a market rent to the donee, there can be no problem. In my view, full consideration can also be a capital consideration. The Revenue may not agree. See 4.3.

If the donor is the sole owner of an unencumbered freehold and gifts a one-half undivided share in it to a donee, what would constitute "full consideration in money or moneys worth"? Paying half a market rental would. It is true that as a matter of private law, if the donor does not exclude the donee, the donee does not have the right to demand any rent from the donor. In order to be sure of avoiding section 102B, it may be better for the donor to agree with the donee that he shall have exclusive occupation in return for paying the donee a sum equivalent to the appropriate proportion of a market rent. It may be that the parties will not wish the donee to be responsible for his share of what would be the landlord's obligations under a lease proper, e.g. the obligation to keep the premises in repair. If so, the amount payable could be adjusted accordingly.

For the difficulties of identifying "the donee" in certain cases, see 5.3.

5.5 Section 102B(4) Defence

Section 102B(4) provides:

> "(4) This subsection applies when –
>
> (a) the donor and the donee occupy the land; and
>
> (b) the donor does not receive any benefit, other than a negligible one, which is provided by or at the expense of the donee for some reason connected with the gift."

It may well be possible to satisfy the condition that both the donor and the donee occupy the land even though the donee is present on the land much less than the donor. For example, this would be the case if the donee works in town where he has a flat where he sleeps during the week and the land an interest in which has been gifted is in the country, where the donee sleeps only at weekends. It is a question of fact and degree what amounts to joint occupation.

What is a "benefit ... provided by or at the expense of the donee"? On one view, where the donor and the donee both occupy the land, section 102B adds nothing to section 102.

Difficulties of interpretation arise where the donor receives some benefit from the land which is arguably not referable to his retained interest. Let us consider some examples in increasing order of difficulty from the taxpayer's point of view.

Firstly, suppose (a) the donor and donee own the land in equal shares, (b) the donor uses the land much more than the donee, (c) the donor pays the donee a "rent" which reflects the greater use of the donor, and (d) the donor pays a share of the outgoings which reflects his use. In my view, it is impossible to say that the donor is thereby receiving a benefit provided by or at the expense of the donee.

Secondly, suppose (a) the donor and donee own the land in equal shares (b) the donor uses the land much more than the donee, and (c) both pay the outgoings in equal shares. While, in my view, the donor is not receiving a benefit provided by or at the expense of the donee, the contrary is not unarguable.

Suppose (a) the donor and donee own the land in unequal shares, the donee having the larger share, (b) the donor's use of the land, compared with the total use of the donor and the donee, is greater than his proportional interest in the land and, (c) both pay the outgoings in the same proportions as those in which they own it. Here, there is a greater risk that the donor is receiving a benefit provided by or at the expense of the donee.

For the difficulties of identifying "the donee" in certain cases, see 5.3.

5.6 The Section 102A(5) Defence

The section 102A(5) defence of acquisition of an interest more than seven years before the gift (as to which see 4.6) does not in terms apply in a section 102C situation. The 1999 Budget Press Release is totally misleading in this respect - unless, that is, it amounts to a published concession!

It is stated in the general section:

> "The new provisions will apply to gifts of interests in land where—
>
> ...
>
> the gift is made within seven years after the interest, right or

arrangement concerned is granted, acquired or entered into"

It is stated under "Details":

"4. The extended provisions will not apply where —

...

the gift is made more than seven years after the right, interest or arrangement concerned is created or entered into"

6 Section 102B as a Defence to the Application of Sections 102 and 102A

As observed at 3.1, if section 102B "applies ", it ousts section 102 and section 102B.[28] What is meant by "apply"? In particular, if the conditions mentioned in section 102B(1) are satisfied (i.e. that an individual disposes, by way of gift on or after 9th March 1999, of an undivided share of an interest in land), but section 102B(2) does not operate to deem the interest gifted to be property subject to a reservation (because section 102B(3) or (4) applies), does section 102B "apply"? In my view, it does. Section 102B(1) says so in terms. It is meant to be the only section which applies where there is a gift of an undivided share of an interest in land. If, in the circumstances, it expressly states that the interest gifted is not property subject to a reservation, then the Revenue cannot attempt to treat it as such by relying on one of the other two sections.

Such a construction accords with the literal interpretation. In my view, it is also the one which results from a purposive approach. For example, section 102B(3)(a) makes it clear that there is no property subject to a reservation where the donor does not occupy the land, without requiring any further condition to be fulfilled. It would be odd in the extreme if the Revenue could then rely on section 102A as treating the interest gifted as property subject to a reservation on the grounds that, in order for the donor's retained interest not to be significant, it is necessary not only that it "does not entitle or enable the donor to occupy all or part of the land immediately after the disposal", but also that it "would do so were it not for the interest disposed of" - a condition not imposed by section 102B.

The section 102B(4) condition is clearly meant to be less onerous than the section 102B(3)(b) condition. If the donee occupies the land in addition to the donor, it is enough to prevent the interest gifted being property subject to a reservation if the

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28 Section 102C(6).

donor "does not receive any benefit ... which is provided by or at the expense of the donee for some reason connected with the gift". If the donor occupies to the exclusion of the donee, it is necessary that he does so "for full consideration in money or money's worth". Consider the situation where both the donor and the donee occupy, the donor "does not receive any benefit ... which is provided by or at the expense of the donee for some reason connected with the gift" but the donor does not occupy "for full consideration in money or money's worth". Can it really be the case that the Revenue can in effect render the section 102B(4) defence useless by relying on section 102A and pointing out that for the donor's retained interest not to be "significant" he must show that it is not one which "entitles or enables the donor to occupy all or part of the land ... otherwise than for full consideration in money or money's worth", within the meaning of section 102A(3)?

7 Change in Property Gifted

7.1 The Problem

It is not entirely clear how the 1999 Code is intended to operate where there is a change in the identity of the property gifted. The only express guidance is given by section 102C which provides:

> " (4) The provisions of Schedule 20 to this Act, apart from paragraph 6, shall have effect for the purposes of sections 102A and 102B above as they have effect for the purposes of section 102 above; and any question which falls to be answered under section 102A or 102B above in relation to an interest in land shall be determined by reference to the interest which is at that time treated as property comprised in the gift.
>
> (5) Where property other than an interest in land is treated by virtue of paragraph 2 of [Schedule 20 of Finance Act 1986] as property comprised in a gift, the provisions of section 102 above shall apply to determine whether or not that property is property subject to a reservation."

7.2 No Gift of Interest in Land

Is it the case that, unless the interest actually gifted is itself an interest in land, neither section 102A nor section 102B can apply? Consider an example where the donor sells his home and gifts part of the proceeds to the donee and the donee (without being under any legally binding obligation to do so) buys one interest in a new home for the donor and the donor buys another, which together amount to the freehold. In this case, neither section can apply. The only section potentially in

point is section 102. Section 102C(5) clearly cannot operate to produce any different result. The substituted property provisions, in particular Finance Act 1986, Schedule 20, paragraph 2(1) (Substitutions and accretions) do not in any event apply where the "property disposed of by the gift ... (b) is a sum of money in sterling or any other currency".[29]

Vary the example. Suppose the donor gifts to the donee quoted securities which the donee in due course exchanges for an undivided share in the donor's new home, the donor buying the other share. Schedule 20, paragraph 2(1) provides:

> "2-(1) Where there is a disposal by way of gift and, at any time before the material date, the donee ceases to have the possession and enjoyment of any of the property comprised in the gift, then on and after that time the principal section and the following provisions of this Schedule shall apply as if the property, if any, received by the donee in substitution for that property had been comprised in the gift instead of that property (but in addition to any other property comprised in the gift)."

Applying those words literally, the interest in the home which the donee has purchased is deemed to have been comprised in the donor's original gift so that, if that gift was made after 8th March 1999, section 102A or section 102B could now apply to it.

Does one apply the words literally? Section 102C(4) would superficially suggest that one does. One argument to the contrary is that the requirement that "the provisions of Schedule 20" are to "have effect for the purposes of sections 102A and 102B above as they have effect for the purposes of section 102 above" involves reading paragraph 2(1) in its application to section 102A or section 102B as if it were amended by the addition of the italicised words:

> "2-(1) Where there is a disposal by way of gift of *[an undivided share off*[30] *an interest in land* and, at any time before the material date, the donee ceases to have the possession and enjoyment of any of the property comprised in the gift, then on and after that time the principal section and the following provisions of this Schedule shall apply as if the property, if any, received by the donee in substitution for that property had been comprised in the gift instead of that property (but in addition to any other property comprised in the gift)."

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29 Paragraph 2(2).

30 The words in square brackets are appropriate only in the case of section 102B.

Another argument to the contrary is that, while the substituted property provisions have effect to determine what is from time to time the property comprised in the gift, they do not have effect to determine the identity of "the land" mentioned in section 102A(1) or section 102B(1). That argument is not the strongest.

Vary the case yet again. This time, the donee transfers the securities or the proceeds thereof to his spouse who then uses them to buy the interest in the donor's new home instead of the donee. Schedule 20, paragraph 4 applies, which provides:

> "(4) Where, at a time before the material date, the donee makes a gift of property comprised in the gift to him, or otherwise voluntarily divests himself of any such property otherwise than for a consideration in money or money's worth not less than the value of the property at that time, then, unless he does so in favour of the donor, he shall be treated for the purposes of the principal section and sub-paragraph (1) above as continuing to have the possession and enjoyment of that property."

Hence, the 1999 Code cannot in any event operate in relation to the gift of the securities.

It should be borne in mind that if a gift in settlement, either by the donor or the donee, is involved, or the donee predeceases the donor, Schedule 20 contains separate rules which would need to be considered.

7.3 Donor's Interest in Land Disposed Of

Suppose the donor gifts an interest in land and retains another interest or right over or in relation to that land which he subsequently disposes of. Section 102A will in principle cease to apply if and in so far as its application depended on the ownership by the donor of that right or interest.[31] Of course, section 102A may still apply independently of ownership by the donor of some interest or right. Then again, if under the substituted property provisions the interest gifted is deemed to be an interest in some other land, it is possible that section 102A might still apply by virtue of an interest or right of the donor over, or relevant arrangement in relation to, that land.

7.4 Donee's Interest in Land Disposed Of

If the donee's interest in the land is disposed of and under the substituted property

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31 The position is more complicated where the donor gifts his retained right or interest to his spouse.

provisions the property gifted is deemed to be something other than an interest in land, it would appear that section 102A could not apply from that time forward. Of course, if the donee's interest were to be reconverted into an interest in land, section 102A could apply afresh.

The donee might sell the interest gifted or transfer it to a company in exchange for shares. Capital gains tax considerations and stamp duty would need to be borne in mind.