

GIFTS BY ASSOCIATED OPERATIONS

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1 Scope of the Article²

The Inheritance Tax Act 1984³ contains an extremely wide definition of "associated operations". In this article, an argument is put forward which, if correct, suggests that the terrors of dispositions or transfers of value by associated operations are very much exaggerated by the Revenue, as there is a fundamental flaw in the drafting of the legislation.

2 The Paradigm Case

Consider the case where a husband makes a gift of property to his wife on the understanding, not legally enforceable, that she will in due course make a gift of the property to their son and she in due course does make that gift. The husband may do this as part of an estate equalisation exercise or because his life expectancy is less than that of his wife so that any potentially exempt transfer she makes is less likely to become chargeable by her death within seven years. A variant on this strategy, which is in my view less exposed to attack under *Furniss v Dawson*, is for the husband to make a gift in settlement under which his wife takes an initial interest in possession, with a fixed or discretionary remainder to the son.

The Revenue will contend that the husband has made a potentially exempt transfer to the son on the occasion of the gift of the property by the wife. In this article, I argue that even if that is so, the value transferred is nil. The argument holds good for most transfers of value by associated operations.

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² I am grateful to Mr Brian Green of Wilberforce Chambers for an intense discussion which helped clarify the ideas expressed in this article.

³ In this article, all statutory references are to this Act.

3 Associated Operations

3.1 The Definition

The definition of "associated operations" is contained in section 268(1):

"In this Act "associated operations" means, subject to subsection (2) below,⁴ 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."

3.2 Width of Definition

This *definition* is extremely wide indeed. Two operations can be associated with each other which occur many years apart and have in reality nothing whatsoever to do with each other. A sells land to B in 1950, B gifts it to C in 1960, A gives the proceeds of the 1950 sale to D in 1970, the property passes on C's death to E in 1990. Each of these operations is associated with the other. Section 268 is, however, merely a definition. There is no doctrine of associated operations as such. Section 268 has no bite unless and until it is brought into play by some other provision in the Inheritance Tax code.

3.3 Disposal by Associated Operations

3.3.1 The Statute

One such provision, which, on the Revenue view, is by far the most important in practice, is section 272 of the 1984 Act, which provides that "disposition" includes a disposition effected by associated operations, so that a transfer of value, as defined by section 3(1), is thus "a disposition, *including a disposition effected by associated operations*, made by a person (the transferor) as a result of which the

⁴ Which deals with the grant of a lease for full consideration.

value of his estate immediately after the disposition is less than it would be but for the disposition".

3.3.2 Judicial Authority

There is no further definition of "disposition by associated operations". In *Inland Revenue Commissioners v Brandenburg* [1982] STC 555, which involved an unsuccessful scheme to make a non-taxable gift using exempt gilts owned by an offshore company, Nourse J thought it undesirable to express any view on the disposition by associated operations point, although "a question of great general importance".

The Special Commissioners did express a view. They stated:

"13. We now come to the 'associated operations' provisions. It is admitted on behalf of the taxpayer that these six operations were all 'associated operations' within the meaning of the capital transfer tax legislation, but it is contended that their being so associated has no effect in this case. Counsel for the taxpayer⁵ says that one has to ask: 'What is the significance of operations being associated?' We agree with that proposition. There are two principal respects in which it is significant, for capital transfer tax purposes, that operations are 'associated'. First,⁶ ... Secondly, section [272] provides that ' "disposition" includes a disposition effected by associated operations'. It is on that provision that the Crown principally relies in this case.

"14. Counsel for the taxpayer submitted that, because the definition of 'associated operations' is so wide (including, as it is clearly capable of doing, two operations affecting the same property which were not part of any plan and occurred many years apart), the expression 'disposition by associated operations' should be given a narrow meaning. Otherwise, he submitted, the provision would be of incredibly wide application and would produce insuperable problems in connection with timing and subject matter. The contention of counsel for the taxpayer was that, to avoid this, the definition in section [272] should be confined to cases where, but for that provision, there would be no disposition; for example where a person diminished his estate by failure to act instead of by a disposition. The Crown contends that the definition in section [272] covers any collection of associated operations as a result of which (taken together) the transferor's estate is diminished, whether or not the individual operations are dispositions. Having considered the arguments carefully, we find

⁵ Mr Robert Walker, now a Chancery judge.

⁶ The first case is not relevant to the present discussion.

ourselves unable to accept the contention of counsel for the taxpayer on this point. In our view, there is no sufficient warrant for giving the expression in section [272] such a narrow meaning. It may be that problems will arise, but we have to construe the words used. In our opinion, the expression 'a disposition by A' denotes a transaction carried out by A whereby something passes from the ownership of A into the ownership of B. In our judgment, the phrase 'a disposition by A effected by associated operations' means any two or more transactions, or operations (which are associated in the statutory sense) *put in train by A*⁷ whereby something leaves the estate of A and passes, eventually, into the estate of B, having been through the hands of other persons in between and/or having changed its nature in the course of the operations being carried out. In our view it is immaterial whether, or not, those transactions or operations are themselves dispositions. It seems to us that the problem of the time when the transfer of value effected by the associated operations is treated as taking place is dealt with by section [268(3)].

15. That leaves the more difficult question: what is to be regarded as the subject matter of the extended disposition where, as here, the subject matter changes as the associated operations proceed?"⁸

Thus, the Special Commissioners rejected the wider argument of the taxpayer that an earlier disposition could not form part of a later disposition by associated operations, yet did require the two operations to be "put in train" by the person making the disposition. That, with respect, is the minimum requirement for a disposition by associated operations. If A disposes of property to B, his wife, intending her to keep it for her own benefit and she then immediately gifts it to her secret lover, A has made no disposition by associated operations in favour of the lover.

3.3.3 Result of Judicial Authority

The Revenue can thus plausibly argue, on the basis of the Special Commissioners' decision, that where the husband does put in train an absolute gift of property to his wife with the intention that she should make a further gift of it to their son and she does so, then he has made a potentially exempt transfer to their son on the date of his wife's gift. Of course, there is obviously wide room for argument as to what degree of predestination there should be for the two associated operations to constitute a disposition by the husband to the son and the strategy using a trust would be much more difficult for the Revenue successfully to attack.

⁷ Italics supplied.

⁸ This point is immaterial to the present discussion.

3.3.4 Disposition by Associated Operations and *Furniss v Dawson*

One reason why we have no doubt heard so little of associated operations in recent years is the doctrine of *Furniss v Dawson* which seemed for a long period to cover the same ground and more. Yet it is clear from *Craven v White*⁹ that a very high degree of predestination is needed in order for the doctrine to operate, and it is clear from *Countess Fitzwilliam*¹⁰ that even a totally preordained artificial tax avoidance scheme, described by Lord Templeman as one which "trembled on the brink of a sham", is not enough unless one can say of the steps that "realistically they constituted a single and indivisible whole in which one or more of them was simply an element without independent effect and [it] is intellectually possible so to treat them." Ironically enough, after the enormous restriction on the scope of *Furness v Dawson* by these two House of Lords authorities, it is possible that dispositions by associated operations may allow the Revenue to collect tax where *Furniss v Dawson* would not!

4 Value Transferred by Disposition by Associated Operations

4.1 No value transferred

Even if it could be said that the husband, in addition to the actual disposition which he made to his wife, made a further disposition by associated operations, so that he had in principle made a second, potentially exempt, transfer of value, nevertheless, no value would be transferred by the transfer by associated operations. A transfer of value is a disposition as a result of which the value of a person's estate is diminished: see section 3(1). In the case of a transfer of value made by associated operations carried out at different times, it is treated as made at the time of the last of them: see section 268(3). The value transferred is the amount by which the value of the transferor's estate immediately after the disposition is less than it would be but for the disposition: see section 3(1). Yet the husband's estate is not diminished by the disposition by associated operations. It had already been fully diminished by the original actual disposition. Even if the disposition by associated operations had never occurred, there could have been no further diminution in his estate. Hence, the value transferred by the disposition by associated operations was nil. Nor would it make any difference if the gifted property had appreciated in value during the period of its ownership by the wife.

⁹ [1988] STC 476.

¹⁰ [1993] STC 502.

4.2 Section 268(3) objection

What, it might be objected, of the second limb of section 268(3), which provides that where a transfer of value is made by associated operations carried out at different times and 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 is to 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. I fully accept that because the original operation was an exempt transfer of value by virtue of section 18, the husband cannot rely on the second limb of section 268(3) as reducing the value transferred by the transfer by associated operations. Yet he does not need to do so. The value transferred is, by virtue of section 3(1) standing alone, nil, so that there is no need for any further reduction.

4.3 Related property rules objection

What, it might be further objected, of the related property provisions;¹¹ do not they require the estates of husband and wife to be aggregated and does not value pass out of their joint estate at the time of the disposition by associated operations? The short answer is that husband and wife each have separate estates for inheritance tax purposes and their estates are aggregated only for determining the value of the estate of each of them. In determining the value of the husband's estate immediately before the disposition by associated operations one does not take into account the property which he has gifted to his wife.

5 Conclusion

The above argument will apply with equal force in many situations where the Revenue would wish to contend, correctly or not, that there has been a transfer of value by associated operations. Suppose a father has granted to his son a tenancy of English agricultural land for agricultural purposes for full consideration in money and the value of his estate has thereby been reduced, but 100% agricultural relief was not available. That in itself is not a transfer of value, no matter how great the gratuitous intent: see section 16. Suppose that a year later the father gifts the freehold reversion to his son. The Revenue will claim that he has made a disposition of the unencumbered freehold by associated operations at the date of the gift of the encumbered reversion. Yet if the above argument is correct it avails them nothing. Moreover, section 268(2) of the Act, a relieving provision, which provides that the granting of such a lease is not to be taken to be associated with

¹¹ Section 161.

any operation effected more than three years after the grant, would appear to be redundant.

Hence, unless there is a flaw in the argument, it is difficult to conceive of any situation where the existence of a disposition by associated operations will result in more inheritance tax being payable. Of course, the Revenue *might* be able to invoke *Furness v Dawson* instead of associated operations to achieve the result they would desire, but that will be no easy matter after *Fitzwilliam*, especially if the trust route is used.