"REAL VALUES" (2)
The Aggregation of Interests when Valuing an Individual's Estate for the Purposes of Inheritance Tax

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This article is the continuation of a piece which appeared in the first issue of the *Personal Tax Planning Review* which was a digest of *in re Lady Fox* before the Lands Tribunal. Simply put, the case considered the correct approach to be taken to the valuation of real property in a situation where there were different units of property which the Inland Revenue purported to value as a composite whole. The Inland Revenue was attempting to value Lady Fox's share in a farming partnership together with the value of her freehold interest in the land farmed. The fundamental question therefore was whether or not the Inland Revenue was entitled to deal with these two items of property on the basis that together they were more valuable than when apart. The aim of this second half of the article is to address two questions arising from that case report:

1. The correct approach to be taken to valuing property in the light of the Privy Council decision in *Mackie v Attorney-General of Ceylon*; and

2. The jurisdiction of the Lands Tribunal.

The Relevant Law

Lady Fox died in 1981, as stated above, and therefore the provisions of the Finance Act 1975 apply to the valuation of her estate for the purposes of Capital Transfer Tax.

Statute

S.22(1) 1975 Act provides:

> "On the death of any person after the passing of this Act tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death..."

By s.23(1) 1975 Act:

> "For the purposes of this Part of this Act, a person's estate is the aggregate of all the property to which he is beneficially entitled..."

The provision which governs the process of valuing a deceased's estate is s.38 1975 Act:

> "Except as otherwise provided by this Part of this Act, the value at any time of any property shall for the purposes of capital transfer tax be the price which the property might reasonably be expected to fetch if sold in the open market at that time; but the price shall not be assumed to be reduced on the grounds that the whole property is to be placed on the market at one and the same time."

The Revenue issued its notice of determination under the purview of Schedule 4 paragraph 6 of the 1975 Act. The relevant provisions are:

> "(1) Where it appears to the Board that a transfer of value has been made or where a claim under this Part of this Act is made to the Board in connection with a transfer of value, the Board may give notice in writing to any person who appears to the Board to be the transferor or the claimant or to be liable for any of the tax chargeable on the value transferred, stating that they have determined the matters specified in the notice.
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> (2) The matters that may be specified in a notice under this paragraph in relation to any transfer of value are all or any of the following...
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> (b) the value transferred and the value of any property to which the value transferred is wholly or partly attributable..."

The appeal was brought under the auspices of Schedule 4 paragraph 7:

> "(1) A person on whom a notice under paragraph 6 above has been served may, within thirty days of the service of the notice, appeal against any determination specified in it by notice in writing given to the Board and specifying the grounds of appeal."

The Terms of the Notice

The notice of determination purported to aggregate Lady Fox's freehold interest in the property with her share of the partnership business "as a single unit of property for the purposes of s.38 Finance Act 1975".

The "relevant amount" was therefore the sum of the two interests, being the vacant possession value of the property together with the partnership interest (£6,125,000), less an amount representing the shares in the partnership of Lady Fox's partners (£560,625): being £5,565,000. The "relevant amount" was then apportioned according to a mathematical formula set out in the notice between the partners according to their partnership shares. The value to be attributed to the freehold interest was stated, in the notice of determination, to be £4,280,768.

The terms of the partnership deed were, briefly, as follows:

Lady Fox agreed to grant the partnership a tenancy from year to year upon the terms and conditions set out in a draft attached to the original partnership deed. The capital of the partnership was to be £5,600 which was subscribed in cash as to £5,000 by Lady Fox and then as to the remainder in equal shares by Major Fraser and Mr Crees.

Any additional capital required by the partnership from time to time was to be provided by Lady Fox alone. Major Fraser and Mr Crees were to be under no obligation to subscribe any such sums. All the losses of the partnership were to be borne by Lady Fox over a ceiling of £300 placed on Major Fraser and Mr Crees' liabilities in any accounting year.

In the years ended 31st March 1980 and 31st March 1981 the partnership made pre-tax profits of £140,197 and £127,440 respectively.

The House of Lords' Approaches

Two well-known House of Lords decisions were referred to in the Tribunal's decision.

IRC v Maclean Crossman [1937] AC 26.

This was a case on the valuation of shares. The most useful dicta for these purposes concerns the decision of the majority of the House that no account should be taken of any special value to a particular purchaser but rather that an open market price should be taken. The Lands Tribunal concentrated on the decision in the *Buccleuch* case, as discussed below, which, for the reasons I outline later, is of more use to us here.

Duke of Buccleuch v IRC [1967] AC 506.

The Inland Revenue were seeking to value the assets of a company. There were a number of separate pieces of land but one such was taken before the Lands Tribunal, at first instance, to ascertain the correct approach for the valuation of the remaining pieces of land. The chosen estate had been divided into 532 separate units by the Revenue for the purposes of valuation. An aggregate market value for the 532 units was fixed at £868,129 on the basis that each unit had been sold separately at the date of the deceased's death. The Revenue took no notice of whether or not it would have been possible to put all of the property onto the market or of succeeding in placing all of the units with purchasers at that time.

The deceased's personal representatives argued that because only a proportion of the units would be capable of sale within a reasonable time, that portion should be calculated as to their aggregate market value, with a value paid by a hypothetical purchaser being assigned to the remainder on the basis that such price would necessarily be less than the unit price.

Lord Reid had a three-limbed approach:

1. The deceased's entire estate was not envisaged by the statute's valuation provisions but rather any part of it which it would be proper to treat as a separate unit for valuation purposes. The entire estate had to be taken in its form at the deceased's death.

2. Generally, the estate would consist of easily identifiable, natural units and there could be no justification for requiring elaborate subdivisions.

3. One had to have in mind a hypothetical sale of the actual unit on the day on which death occurred, after having taken such steps as were reasonable to attract as much competition as possible for the particular piece of property.

If the cost of selling the large portion of the property was disproportionately greater than that of selling the individual units, this was held to be evidence that the large portion of property was an unnatural unit and therefore should not be used in the calculation of value for inheritance tax purposes.[1]

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[1] per Lord Reid *ibid* at page 530E-531A.

The Privy Council decision not mentioned in the Lands Tribunal decision was:

Attorney-General of Ceylon v Mackie [1952] 2 All ER 775.

The share capital of the company concerned comprised 19800 eight per cent cumulative preference shares and 5,000 management shares. The company dealt in rubber, buying it and then grading it for resale. The deceased owned 9201 preference shares and all of the management shares. The Singhalese Estate Duty Ordinance 1938 provided that the value of any property for estate duty purposes was the price it would fetch if sold in the open market at the date of the deceased's death. Under the Articles of Association, the holders of nine-tenths of the shares in the company could call for a transfer of any other shares at a fair value, such fair value to be fixed by the company's auditors. It was admitted that no purchaser would pay full value for the shares unless he was able to obtain a large enough block of preference shares to give him a majority of votes and thus mitigate the effect of the Articles of Association.

The personal representatives argued that the value of the management shares and that of the preference shares should be considered separately. Without the voting rights of the preference shares, the management shares would clearly have been worth considerably less than they would have been if taken as a composite unit.

The Revenue authorities argued that in ascertaining the resale value of the shares the deceased's representatives must be taken to act in the way which would obtain the highest value for the shares. The obtaining of such high value would necessitate the bringing together of the management and preference shares to give the intending purchaser security against any possible effects stemming from the Articles of Association.

Lord Reid, delivering the judgment of the board, held that the latter interpretation was correct. The management and preference shares together would constitute the most natural unit of property. The only difficulty then would be in finding a purchaser for such a large block of shares at the deceased's date of death.

The most important principle to be taken away from this case is that one must take the greatest possible value of a shareholding by putting it together with such other holdings owned by the deceased as would increase its value.

The Question of Valuation

The question in the appeal relating to Lady Fox's estate was whether or not the freehold reversion and the partnership share should be treated as one unit of property for the purposes of s.38 1975 Act. The taxpayer argued that land cannot be aggregated with property other than land for the purposes of s.38. Consequently, the Revenue could not make a determination under Schedule 4 paragraph 6 which lotted together Lady Fox's freehold interest and her share in the partnership.

The Revenue argued that, by dint of s.23(1) 1975 Act, an individual's estate is the aggregate of all property to which she is beneficially entitled. Accordingly the Tribunal would be compelled to proceed on the basis that all of Lady Fox's beneficially-owned property was on the market at one and the same time.

Further, the Revenue argued that Lady Fox's partnership share was itself an interest in land, further to the Court of Appeal decision in *Cooper v Critchley* [1955] 1 Ch 431.

The decision of the Tribunal is unequivocal:

> "We do not accept that Lady Fox's share in the partnership was itself an interest in land. The tenancies were assets of the partnership but it does not follow that a share in the partnership was anything other than personalty or a chose in action. Accordingly, we agree with Mr. Bramwell that the freehold interest and the share did not constitute a single unit of property for the purposes of s.38 of the Act and that as a matter of law the Commissioners of Inland Revenue had no power to lot the two together in the notice of determination."

The Tribunal agreed further with the taxpayer that the freehold interest and the partnership did not constitute a natural unit of property within the meaning of the speeches in the House of Lords in *Duke of Buccleuch v IRC*. It was found that there was no reason to suppose that a purchaser of the property would have paid more than the agreed investment value of the freehold reversion. In fact, a purchaser would be likely to pay less because a lot made up of the freehold interest *and* the partnership share would not appeal to any identifiable sector of the market. On this basis, the Tribunal's decision must be in line with the dicta of Lord Reid in *Buccleuch* to the effect that extra cost or difficulty involved in the disposal of a composite piece of property implies that such a composite unit is not a natural unit of property.

If the interests could have been lotted together, the Tribunal accepted that s.38 required that the single unit be valued as a single unit and that the apportionment in the notice of determination was neither admissible nor appropriate.

However, it was found, as a matter of fact, that there had been no analogous case known to any of the witnesses in which a share in a farming partnership had been sold together with the freehold land.

Therefore the Tribunal decided that the value of Lady Fox's freehold interest was to be ascertained by reference to its investment value, being the agreed sum of £2,751,000.

The question therefore is what application the principle in *Mackie* should have in relation to this case. It is clear that, were Lady Fox's partnership interest and her freehold interest to be lotted together, the value of her estate would be markedly

increased. Lord Reid is quite clear in *Mackie* in his approval of the notion that one must take the highest possible return for the property owned at the date of death. The taxpayer's argument in this appeal centred very much on the contention that it is wrong to take land and personalty together for the purposes of valuation. However, in neither of the House of Lords decisions is there any dissent from the basic principle that one must look to all the property and interests owned which could increase the value of the holding. Therefore, there is no difficulty with the basic principle of looking to any interest, other than ownership of the principal unit of property[2], held by the deceased at the date of death which would increase the value of that principal property.

On the basis of the Lands Tribunal decision here one is lead to the inevitable conclusion that there is one rule for a holding of shares and another for a holding of land. While that rule might be easy to conceptualise, it is more difficult to justify. If one starts from the basic proposition, as the Lands Tribunal appears to have accepted, that land possesses some quality which should preserve it from the taint of amalgamation with other forms of proprietary right (one which I find logically elusive), then one must ask oneself a separate question: Why should land, even if it is to be separated from other forms of property, not have its value reflected in all of the possible types of circumstance which generally affect property values, as envisaged by Lord Reid in *Mackie* with reference to shares?

Simply as a matter of the valuation of land, it must be wrong to value it without reference to factors like planning permission, dangers of subsidence, location, amenities and so forth. Therefore, there must be a leap in logic at some point which allows one to say that the value of a share in a partnership which farms land is of no relevance to fixing the value of the land itself. In principle, the existence of a profitable partnership, a business interest of the deceased, which enhances the value of land **from the point of view of the deceased** should be reflected in the loss to the deceased's estate. The deceased has not only the value of land in his estate but also the valuable business user of that same land, which enhances the former interest.

I stress that this view is founded on the legal principle underpinning this case. On the facts, it appears to be quite another matter. Where it is found as a fact that Lady Fox would not have been able to sell the business interest together with the land on the date of her death had she lived, there cannot be a loss to her estate of that aggregated amount.

The other point of note is that the two items of property were held as a consequence not to be natural units as contemplated in *Buccleuch*. Much appears to have turned on the facts of this case and the difficulty in finding a purchaser prepared to take on a joint farming partnership and freehold interest.

This argument ties in neatly with Lord Reid's other observation in *Buccleuch* to the effect that, if there is extra difficulty and cost involved in selling a unit of property in one form rather than in another unitary form, then the former is unlikely to be a natural unit. On the facts, therefore, it would appear that the Lands Tribunal came to the correct decision by an alternative route.

The Jurisdiction of the Lands Tribunal

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[2] here the freehold interest.

Appeal against a notice of determination is brought under Schedule 4 paragraph 7 of the 1975 Act. The several jurisdictions of judicial and quasi-judicial bodies to hear such appeals are governed by sub-paragraphs (2) to (5). As is apparent from the issues for determination listed above, there are complex questions as to which body should hear the appeal. While the matter is fundamentally one of valuation, there are clearly points of legal principle to be decided.

Paragraph 7 provides:

> "(2) Subject to the following provisions of this paragraph the appeal shall be to the Special Commissioners ...
>
> (4) Neither the Special Commissioners nor the High Court shall determine any question as to the value of land in the United Kingdom on any appeal under this paragraph, but on any such question the appeal shall be to the Lands Tribunal..."

On an analogy with *Edwards v Bairstow and Harrison* [1956] AC 14 you must decide whether you are faced with a question of law or of fact. Where the matter can be said to be a matter solely of determining value, that is clearly a problem for the Lands Tribunal to solve. However, on these facts the Tribunal was faced with the more complex matter of which items of property, in which Lady Fox had beneficial interest, should be aggregated together to determine the value of her estate. Given that the House of Lords has been troubled by this question before, we can admire the pluck of a Lands Tribunal which is prepared to face the issue. The President of the Tribunal answered this initial question in this way:

> "We too have had doubts as to whether the Lands Tribunal has jurisdiction in this appeal, because, on its face, the notice of determination appears to lot together land and personalty. However, we have accepted the assurances of counsel that the Tribunal has jurisdiction and have done so because the purpose of the notice of determination, in the end, is to determine a value for the land and nothing but land."

There is, of course, a sense in which this begs the question. However, the matter had first been before the Special Commissioner, Mr R H Widdows. He had been unable to see any clear answer to the problem in his written observations on jurisdiction.

The Revenue argued that the value of Lady Fox's freehold interest and of her 92.5% partnership share was a question "as to" the value of land[3] and therefore within the Lands Tribunal's competence. This would have enabled the Tribunal to take the aggregate of the two interests regardless of the submissions which had been made concerning the jurisdiction of the Tribunal. However, for the reasons I have given, I feel that this simply begs the question.

Conclusion

In the light of the extreme complexity of the issues, the question of the existence of a different test for land from that for shareholdings, as impliedly countenanced by the

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[3] Schedule 4 paragraph 7(4) Finance Act 1975.

Lands Tribunal's failure to take the *Mackie* case into its ruminations, clearly demonstrates, in my opinion, that this question is something which undoubtedly requires the consideration of a court of law.