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Buzzoni v HMRC and *Lady Hood v HMRC*: a reservation too far?

Introduction

Buzzoni and others v HMRC; In re the Estate of Kamhi, decd (*Buzzoni (CA)*)[1] and *Viscount Hood (Executor of the Estate of Lady Diana Hood) v HMRC* (*Lady Hood (CA)*)[2] are two important inheritance tax cases that consider in greater detail the difficult second limb of sub-section 102(1)(b) of the Finance Act 1986 (FA 1986) and the practical application of the reservation of benefit rules. They are the first major cases on reservation of benefit since *Ingram and another (executors of the estate of Lady Ingram, deceased) v IRC* (*Ingram (HL)*)[3] and *IRC v Eversden*.[4]

If a donor dies having reserved a benefit in gifted property, that property is treated for the purposes of inheritance tax (IHT) as remaining comprised in the donor's estate. However, this deeming provision does not apply for capital gains tax (CGT) purposes. Hence there is no step up to market value on death and no possibility of main residence relief on a disposal. Furthermore, the donee can still be subject to IHT on death. In short, the reservation of benefit rules are penal anti-avoidance provisions as the donor's estate can be worse off than if the gift had never been made at all.[5]

For section 102 FA 1986 not to apply, either or both of the tests in sub-section 102(1)(a) FA 1986 (condition A) or in sub-section 102(1)(b) FA 1986 (condition B) must be met in the period seven years prior to the donor's death (the relevant period).

Condition A requires that possession and enjoyment of the gifted property is bona fide assumed by the donee. There have been few reported cases on this head and it is not considered further here.[6]

[1] *Buzzoni and others v HMRC; In re the Estate of Kamhi, decd* [2013] EWCA Civ 1684; [2014] 1 WLR 3040.
[2] *Viscount Hood (Executor of the Estate of Lady Diana Hood) v HMRC* [2018] EWCA Civ 2405; [2018] STC 2355.
[3] *Ingram and another (executors of the estate of Lady Ingram, deceased) v IRC* [1999] STC 37 (HL). See E. Chamberlain, "Ingram and the Finance Bill - a case of sour grapes" [1999] BTR 430.
[4] *IRC v Eversden* [2002] EWHC 1360 (Ch); [2002] STC 1109.
[5] HMRC also deny spouse exemption on reservation of benefit property although this point is open to debate.
[6] See *Commissioner of Stamp Duties of New South Wales v Perpetual Trustee Co Ltd* [1943] AC 425 (Privy Council (Australia)) where the donor settled shares to which he retained legal title in trust for his son's benefit for the trustees to apply during the son's minority the whole or any part of the income or capital as the trustees thought fit for the son's maintenance and advancement and on the son attaining 21 to transfer the capital and all accumulations of income to him. No part of the dividends or income were paid to the son during his minority. The settlor died before the son reached 21 and the Revenue argued that possession and enjoyment had not been assumed by the donee. The Privy Council held that the donee was the recipient of the gift whether the son alone was the donee (or the son and the body of trustees) and "the son was (through the medium of the trustees) immediately put in such bona fide beneficial possession and enjoyment of the property comprised in the gift as the nature of the gift and the circumstances permitted"

Condition B has two limbs:

1. Is the gifted property in fact enjoyed to the entire exclusion of the donor (limb 1)?
2. Is there any benefit to the donor by contract or otherwise (limb 2)?

Limb 1 requires that the donor is excluded from any enjoyment of the gifted property. With one exception, the fact the donor may receive no actual benefit (for example because he or she pays full consideration) is immaterial.[7] The one statutory exception relates to land and chattels. Actual occupation or enjoyment is disregarded if the chattel or land is enjoyed for full consideration in money or money's worth.[8] However, giving cash to an individual who then lends it back to the donor charging interest would, in HMRC's view, be caught by limb 1.[9]

Limb 2 of Condition B requires three conditions to be satisfied:

First, the donor's benefit must be by virtue of and referable to the property he or she has given away. This was decided in *Ingram (HL)* when Lord Hoffmann noted:

> "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: see Lord Simonds in [*St Aubyn v Attorney General*]…."[10]

This is sometimes called the referability concept and means that if the donor carves out and retains certain rights and gives away property shorn of those retained rights, there is no reservation; the benefit is not referable to the property given but to the property retained. As Lord Hoffmann noted in *Ingram (HL)*:

> "The theme which runs through all 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."[11]

Secondly, the benefit to the donor must consist of some advantage which the donor did not enjoy before he or she made the gift. This was decided by Millett LJ in the Court of Appeal[12] in his dissent in the judgment which was appealed in *Ingram (HL)* and it was endorsed by Moses LJ in *Buzzoni (CA)*[13] and by Henderson LJ in *Lady Hood (CA)*.[14]

Thirdly (and this was finally confirmed in *Buzzoni (CA)*), there must be detriment to the donee (something not required under limb 1).

(at 440 per Lord Russell of Killowen). In *Lyon's Personal Representatives v HMRC* [2007] STC (SCD) 675 it was held that the way in which the trust was run meant that the donor not the donee had control over the gifted property.

[7] See *Chick v Commissioner of Stamp Duties of New South Wales* (*Chick*) [1958] AC 435 (Privy Council (Australia)).

[8] See FA 1986 Sch.20 para.6(1)(a).

[9] As well as another anti-avoidance provision in FA 1986 s.103.

[10] *Ingram (HL)*, above fn.3, [1999] STC 37 at 41: *St Aubyn v Attorney General* (*St Aubyn*) [1952] AC 15 (HL).

[11] *Ingram (HL)*, above fn.3, [1999] STC 37 at 41.

[12] *Ingram and another (Executors of the Estate of Lady Ingram, deceased) v IRC* (*Ingram (CA)*) [1997] STC 1234 (CA).

[13] *Buzzoni (CA)*, above fn.1, [2013] EWCA Civ 1684; [2014] 1 WLR 3040 at [51].

[14] *Lady Hood (CA)*, above fn.2, [2018] EWCA Civ 2405; [2018] STC 2355 at [63].

The *Buzzoni* case

The facts

The deceased (Mrs Kamhi) died in Turkey in 2008. On 5 June 1996 she had acquired a lease for 100 years less a day of a London flat. That lease contained covenants:

1. against assigning unless the assignee first covenanted with the landlord to pay the rent and observe the terms of the lease; and
2. against underletting unless the undertenant entered into a covenant with the landlord to observe all the covenants and obligations of the tenant in the head lease.

Covenants to be observed by the deceased under her head lease included keeping the property in good repair, paying the service charge and ground rent and indemnifying the landlord against outgoings.

The following year (in November 1997), the deceased obtained a licence to underlet from her landlords[15] and on the same day granted an underlease to an offshore trust for the benefit of her two sons. Crucially the underlessee was a party to the licence to underlet and covenanted directly with the landlord to observe and perform the same covenants and conditions (other than the payment of rent) as were contained in the head lease.

The underlease was to commence on 24 November 2007. It was a reversionary lease. The underlease expired on 22 March 2094 (being two days before the deceased's head lease was then due to expire). There were positive covenants in the underlease itself including a covenant to pay the service charge, keep the premises in repair, etc. mirroring those in the head lease.

On the death of Mrs Kamhi in 2008 the head lease which she retained was valued at £50,000 as the under lease had already taken effect in possession. Without the underlease her interest would have been worth £2.1 million. HMRC contended that the underlease (being the gifted property) was reservation of benefit property falling within sub-section 102(1)(b) FA 1986 and so was taxed as part of her estate when she died.

The decision

The First-tier Tribunal (FTT)[16] and Upper Tribunal (UT)[17] found in favour of HMRC broadly for the following reasons:

1. The argument that the obligation in the subtenancy to observe the covenants in the head lease was an essential feature of the grant of a subtenancy and effectively the donee took the sub-lease subject to the covenants was rejected. Proudman J noted:

> "Mrs Kamhi granted a limited property interest in land which was in effect conditional upon fulfilment of the covenants. Such a benefit is either a benefit

[15] So this was prior to the anti-*Ingram* legislation in FA 1999 s.104, which inserted FA 1986 ss.102A–102C, although reversionary leases can still in certain circumstances work.

[16] *Buzzoni (executor of Kamhi, deceased) and others v HMRC* (*Buzzoni (FTT)*) [2011] UKFTT 267 (TC); [2011] SFTD 771.

[17] *Buzzoni (executor of Kamhi, deceased) and others v HMRC* (*Buzzoni (UT)*) [2012] UKUT 360 (TCC); [2013] STC 262.

referable to the property given or it is referable to the property reserved. The nature of a lease is not such that the obligations under the lease can be said to be part of the property given. Payment of rent and service charges is not an essential feature of a lease; the only essential feature is the grant of a right to exclusive possession for a finite period. It is possible to grant a lease without covenants. The covenants themselves do not constitute an interest in land."[18]

2. The Judge concluded that HMRC's case was consistent with authority:

"In *Ingram* Lord Hoffmann said…:

'…a lease is a contract as well as an estate. It involves obligations between the parties enforceable in contract or by virtue of privity of estate. It cannot therefore be regarded as the mere reservation of property like a life interest. This is true and if, *in addition to the leasehold estate which she reserved, Lady Ingram had obtained by covenant any additional benefits, as in Re Nichols decd*[…], *they would have been benefits reserved*.[…]'

Thus the House of Lords in Ingram acknowledged the distinction between on the one hand, the grant of an estate in land while reserving another estate, which they held to be a grant of a limited interest rather than the grant of a larger interest with reserved benefit, and, on the other hand, the grant of an interest in land with reserved covenants.

…the important point about the covenants in the present case is not that similar (not of course the same) covenants were contained in the head lease but that the covenants had (and I quote from the judgment of Millett LJ in the Court of Appeal in *Ingram* [1997] STC 1234 at 1268, '…the effect of transferring to the trustees [the donee] a liability which would otherwise have been borne by [the donor].'"[19]

Which limb of sub-section 102(1)(b) FA 1986 was relevant? Proudman J commented:

"…[I]n the present case it has not been made entirely clear (and it is not common ground) whether the case is said to come within the first or the second limb of s 102(1)(b), namely whether the gifted property is said not to have been enjoyed to the exclusion of the donor or whether it is said that there is a benefit to the donor by contract or otherwise. It seems to me that potentially it is both.

The covenants must logically either be comprised in the property retained or in the property given away. In this case…the covenants were an integral part of the relationship

[18] *Buzzoni (UT)*, above fn.17, [2012] UKUT 360 (TCC); [2013] STC 262 at [14].
[19] Writer's italics. *Buzzoni (UT)*, above fn.17, [2012] UKUT 360 (TCC); [2013] STC 262 at [15]–[22]; *Ingram (HL)*, above fn.3, [1999] STC 37 at 41; *Nichols v IRC* (*Nichols*) [1975] STC 278 (CA); *Ingram (CA)*, above fn.12, [1997] STC 1234 at 1268.

> between Mrs Kamhi and the trustee [the donee] rather than some incidental benefit which was only tangentially referable to the gift."[20]

Proudman J held that there was a new benefit to the donor from the gift as

> "the benefit to Mrs Kamhi of the trustee [donee] owing her covenants [mirrored] the covenants which she owed under the head lease: see paragraph 73 of the [FTT decision]".[21]

The decision of the Court of Appeal

An uncertainty before the UT was which limb of sub-section 102(1)(b) FA 1986 HMRC were relying on. Before the Court of Appeal HMRC accepted that it was limb 2 so that the only question was whether the positive covenants in the underlease involved a reserved benefit by Mrs Kamhi.

Giving the only reasoned judgment of the Court of Appeal, Moses LJ rejected the carve out argument put forward by the taxpayers on the basis that the rights conferred by the covenants given by the donee were obtained by virtue of the underlease, the subject of the gift, and not by virtue of the reversion retained by Mrs Kamhi. Unlike the facts found in the *Ingram* case, where the gift of the freehold interest subject to the retained lease merely included a covenant of quiet enjoyment for the benefit of the leaseholder, this sub-lease contained positive covenants which constituted a new benefit to the donor.

However, the question was not merely whether the donor had obtained a benefit from the gifted property but whether the donee's enjoyment of the property remained exclusive. If the (new) benefit to the donor did not impact on the donee's enjoyment of the property then the third condition cited above was not satisfied. There was no detriment to the donee. In this case the covenants in the sub-lease made no difference to the donee's enjoyment of the underlease because the donees in the licence to sublet had already entered into covenants with the head lessor which mirrored those contained in the underlease. In the light of those covenants entered into directly between the donee trust and the head landlord, the covenants with Mrs Kamhi under the sub-lease did not detract anything further from the enjoyment by the donees of the underlease. Moses LJ referred to the speech of Lord Radcliffe in *St Aubyn v Attorney General* (*St Aubyn*)[22] which considered section 43(2)(a) of the Finance Act 1940, and which Moses LJ noted "differed from section 102(1)(b) of the 1986 Act in form but not in substance".[23] Moses LJ noted the requirement in *St Aubyn* that regard must be had to whether the benefit given to the donees "[trenches] upon the possession and enjoyment of the property in which the interest has been surrendered".[24] Moses LJ also observed:

> "The second limb of section 102(1)(b) of the 1986 Act requires consideration of whether the donee's enjoyment of the property gifted is to the exclusion of any benefit to the donor.

[20] *Buzzoni (UT)*, above fn.17, [2012] UKUT 360 (TCC); [2013] STC 262 at [19] and [32]; *Buzzoni (FTT)*, above fn.16, [2011] UKFTT 267 (TC); [2011] SFTD 771.
[21] *Buzzoni (UT)*, above fn.17, [2012] UKUT 360 (TCC); [2013] STC 262 at [29].
[22] *St Aubyn*, above fn.10, [1952] AC 15.
[23] *Buzzoni (CA)*, above fn.1, [2013] EWCA Civ 1684; [2014] 1 WLR 3040 at [34].
[24] *Buzzoni (CA)*, above fn.1, [2013] EWCA Civ 1684; [2014] 1 WLR 3040 at [36]: *St Aubyn*, above fn.10, [1952] AC 15 at 47.

> The focus is not primarily on the question whether the donor has obtained a benefit from the gifted property but whether the donee's enjoyment of that property remains exclusive. The statutory question is whether the donee enjoyed the property to the entire exclusion or virtually to the entire exclusion of any benefit to the donor. If the benefit to the donor does not have any impact on the donee's enjoyment, in my view, then the donee's enjoyment is to the entire exclusion of any benefit to the donor."[25]

In short, the fact that the donor enjoyed a new benefit as a result of the gift is a necessary condition of limb 2, but may not in all cases be a sufficient condition. Here the obligations in the underlease did not in any way detract from the enjoyment of the underlease because the obligations imposed by those covenants did not in any way add to the obligations already imposed by the licence. If Mrs Kamhi enjoyed a benefit not previously enjoyed it was not obtained at the expense of the donee's enjoyment of the underlease.

> "To persist in the possibly over-baked metaphor, the size of the cake remained unaffected, because the portion the deceased is said to have eaten had already been consumed by the head landlord."[26]

The other members of Court (Black and Gloster LJJ) agreed with the trenching argument and were careful not to express any view on what Gloster LJ termed the "interesting question"[27] of the carve out argument.

In fact, until *Buzzoni (CA)* the detriment argument was doubted by many commentators to remain valid under the IHT legislation. Even under estate duty, the Privy Council in *Chick v Commissioner of Stamp Duties of New South Wales*[28] had doubted the trenching argument first raised in *Oakes v Commissioner of Stamp Duties of New South Wales*.[29] One reason why the detriment or trenching argument was thought not to exist is the statutory let out referred to earlier regarding full consideration being provided by the donor: there would be no need for the full consideration let out to apply to both limbs of sub-section 102(1)(b) FA 1986 if in fact detriment was required for the donee. The donee would suffer no detriment if they received full consideration.

However, the answer to this may be that the statutory let out is still required for limb 1 (where no benefit to the donor as such is required, merely enjoyment of the gifted property) and the draftsman saw no reason to limit the full consideration let out in Schedule 20 FA 1986 specifically to limb 1.

The *Lady Hood* case

Here the facts were similar but the taxpayer failed because there was no prior covenant between the sub-lessee and the freeholder. The carve out argument was again raised but rejected wholesale

[25] *Buzzoni (CA)*, above fn.1, [2013] EWCA Civ 1684; [2014] 1 WLR 3040 at [50].
[26] *Buzzoni (CA)*, above fn.1, [2013] EWCA Civ 1684; [2014] 1 WLR 3040 at [57].
[27] *Buzzoni (CA)*, above fn.1, [2013] EWCA Civ 1684; [2014] 1 WLR 3040 at [59].
[28] *Chick*, above fn.7, [1958] AC 435 at 450.
[29] *Oakes v Commissioner of Stamp Duties of New South Wales* [1954] AC 57 (Privy Council (Australia)) at 73–75.

by Henderson LJ in the Court of Appeal in a wide-ranging judgment on the scope of section 102 FA 1986.

The facts

Lady Hood died on 15 March 2008. She owned a long lease on a property in Chelsea Square, London, SW3 and in 1997 (again before the anti-*Ingram* legislation) had granted a reversionary sub-lease over it to her sons. The creation of the sub-lease involved a potentially exempt transfer by Lady Hood which she had survived by seven years (so that it had become an exempt transfer). The sub-lease commenced on 25 March 2012 and ended shortly before the termination of Lady Hood's head lease. (Unlike the facts in *Buzzoni* the sub-lease had not commenced in possession prior to the donor's death.)

The sub-lease was made "upon the same terms and subject to the same covenants provisos and conditions as are contained in the Head Lease".[30] The covenants were in standard form and included an obligation to pay rent and repair. Lady Hood's head lease contained a covenant not to sublet without the previous consent in writing of the freeholder. Accordingly, a licence to sublet was duly obtained. Unlike the facts seen in *Buzzoni* the sons (the sub-lessees) were not party to the licence and did not enter into direct covenants with the freeholder. Lady Hood remained in occupation of the property at the time of her death by virtue of the long lease; the reversionary lease was only to take effect some four years later.

As a result of the covenants for her benefit contained in the gifted sub-lease, HMRC successfully argued that Lady Hood had reserved a benefit within the second limb of sub-section 102(1)(b) FA 1986: during the relevant period the property was not enjoyed to the entire exclusion or virtually to the entire exclusion of the donor and of any benefit to the donor by contract or otherwise. HMRC were successful at all levels including the Court of Appeal.

As with all reservation of benefit cases, the first point was to determine what property had been gifted: was it a gift of a leasehold interest out of which the benefit of the covenants to the donor was reserved (so that there was a reservation of benefit) or was it the gift of an interest in effect subject to certain restrictions and burdens (namely the head lease and the requirement to perform covenants) so being a type of "shearing" arrangement which avoided a reservation?

At the FTT, Judge Berner concluded:

> "There is in my view no scope for, and certainly no authority for, the proposition that a proprietary interest gifted by way of a sub-lease must be dissected, and the donated property regarded as being what is left after carving out the burdens on the sub-lessee which are inherent in the sub-lease."[31]

In the Court of Appeal, Henderson LJ considered whether a gift consisting of the grant of an underlease which always contained covenants from the donee in favour of the donor (of which the donor did not have the benefit before the gift) was caught by sub-section 102(1)(b) FA 1986. He concluded it was so caught, irrespective of whether the sub-lease and covenants were one interest. In that context, Henderson LJ said:

[30] *Lady Hood (CA)*, above fn.2, [2018] EWCA Civ 2405; [2018] STC 2355 at [9].
[31] *Viscount Hood (Executor of the Estate of Lady Diana Hood) v HMRC* [2016] UKFTT 59 (TC); [2016] SFTD 351.

"In considering these submissions, I would accept that it is necessary to begin by identifying the true subject matter of Lady Hood's gift to her sons. That subject matter is the 'property' to which the provisions of s 102 have to be applied. I would also agree with Mr Taube that the 'property' which Lady Hood gave to her sons can only be identified as the sub-lease of the Property, which has to be regarded as a whole. I do not think that any sensible distinction can be drawn, at this preliminary stage, between the legal estate in land which she created by the sub-demise, on the one hand, and the mutual covenants into which the parties entered in the sub-lease, on the other hand. Both the estate in land and the covenants formed part of a single transaction, and it would be artificial to distinguish between them because neither would have come into existence without the other. Put another way, the gift made by Lady Hood was a gift of an interest in land subject to, and with the benefit of, the obligations which the parties agreed to undertake in the sub-lease. Any other analysis would in my view involve a formalistic departure from reality, in a context where, as Lord Hoffmann emphasised in *Ingram*, form should not be allowed to prevail over substance…."[32]

However, he then went onto consider the benefits to the donor:

"[60] …it is necessary to pay close attention to the wording of s 102(1)(b), and in particular to its second limb. The property, that is to say the sub-lease viewed as a whole, will be property subject to a reservation in Lady Hood's estate unless it was enjoyed by the donee, that is to say her sons, to the entire exclusion, or virtually to the entire exclusion, of any benefit to her by contract or otherwise. How, I ask, can this condition be satisfied, when Lady Hood, in her capacity as the intermediate or mesne lessor of the Property, now had the benefit of the positive covenants given by her sons, including the obligation to observe and perform the provisions of the head lease throughout the term of the sub-lease? True, those benefits were future ones, in the sense that they would only come into force when the sub-lease fell into possession in March 2012; but they would then enure for the benefit of Lady Hood (or her estate after her death) until 2076 or the prior termination of either the head lease or the sub-lease. This was undoubtedly a benefit to Lady Hood of real, and more than minimal, value; and, crucially, it had no prior existence before the grant of the sub-lease. How, then, can it be said that the grant of the sub-lease did not involve the reservation by Lady Hood of a benefit by way of contract?

[61] In my view, it is no answer to this question to say that the positive covenants which give rise to the benefit formed an integral part of the original gift. So they did, but that is a separate question from whether the enjoyment of the gift by the sons (and their successors entitled to the sub-lease) was free of any benefit to the donor. On the facts of a case such as this or *Buzzoni*, the benefit to the donor was inseparable from the gift, but that only goes to show the closeness of the connection between the gift and the benefit. Incidentally, it also obviates the need for any separate enquiry as to whether the benefit was referable to, or trenched upon, the gift, because (as I have said) one could not have existed without the other. Indeed, the connection could hardly have been closer.

[32] *Lady Hood (CA)*, above fn.2, [2018] EWCA Civ 2405; [2018] STC 2355 at [59]; *Ingram (HL)*, above fn.3, [1999] STC 37 at 44–45.

> [62] The fact that the sons' [donees'] covenants had no prior existence is in my judgment of critical importance for at least two reasons. First, it leaves little, if any, room for an argument that the benefit was something retained by the donor, or otherwise separate from the gift which she made. Rather, the benefit was an inherent part of the gift itself. Secondly, it distinguishes cases of the present type from ones such as *Ingram* or *St Aubyn*, where the donor takes advantage of the sophisticated nature of English land or trust law so as to define the property given away in such a manner that any benefits retained by the donor never formed part of the gift at all.
>
> [63] For these reasons, I think that the first ground of decision by this court in *Nichols* was, in essence, correct, quite apart from the fact that it is in any event binding on us. In particular, the court was right to emphasise that the donor's right to have the mansion house and outbuildings repaired under the covenant did not exist before, 'and therefore could not be something simply not given'. Similarly, I am in respectful agreement with the observations of Millett LJ in his dissenting judgment in *Ingram*, where he clearly took the view that the second limb of s 102(1)(b) would have applied if the lease had contained 'covenants which would have the effect of transferring to the trustees a liability which would otherwise be borne by Lady Ingram', and that 'the benefit must consist of some advantage which the donor did not enjoy before he made the gift'. So too, I agree with the unqualified statement by Lord Hoffmann in *Ingram*…, that:
>
> > '…if, in addition to the leasehold estate which she reserved, Lady Ingram had obtained by covenant any additional benefits, as in [*Nichols v IRC*], they would have been benefits reserved.'"[33]

Unlike *Buzzoni*, in the *Lady Hood* case the "trenching" or detriment argument could not apply as the sub-lessees gave no direct covenants to the head lessor: the only positive covenants were given to Lady Hood and therefore did adversely affect their enjoyment of the property. Whilst accepting that regard must be had to the substance and not to conveyancing form the Tribunal did not accept that the case was "economically equivalent"[34] to that in *Buzzoni*.

Conclusions and comments

The *Lady Hood (CA)* judgment given by Henderson LJ is a magisterial survey of the existing case law, including discussion of important estate duty cases such as *St Aubyn*[35] which are often overlooked. The fact that the lease covenants had no prior existence before the gift of the sub-lease was seen as critical by the Court.

However, some may consider the distinction between *Buzzoni* and *Lady Hood* as something equivalent to angels dancing on a pinhead. After all, in *Buzzoni* the licence between donee and head landlord was done on the same day as the subsequent gift. Can form over substance really

[33] *Lady Hood (CA)*, above fn.2, [2018] EWCA Civ 2405; [2018] STC 2355 at [60]–[63]; *Nichols*, above fn.19, [1975] STC 278 at 285; *Ingram (CA)*, above fn.12, [1997] STC 1234 at 1268; *Ingram (HL)*, above fn.3, [1999] STC 37 at 45.
[34] *Lady Hood (CA)*, above fn.2, [2018] EWCA Civ 2405; [2018] STC 2355 at [42].
[35] *St Aubyn*, above fn.10, [1952] AC 15 (HL).

make such a difference? In reality the two sub-leases do seem economically identical. In *Ingram (HL)* Lord Hoffmann seemed to reject such a formalistic approach:

> "For my part, I do not think that a theory based upon the notion of a scintilla temporis can have a very powerful grasp on reality…If one looks at the real nature of the transaction, there seems to me no doubt…that the trustees and beneficiaries never at any time acquired the land free of Lady Ingram's leasehold interest."[36]

Henderson LJ saw as critical the fact that the benefits received by the donor were new and therefore the carve out argument was largely irrelevant. But is this correct? Let us suppose that it could be argued that the sons never acquired the sub-lease free of the covenants favouring the donor, that is, what was gifted was a lease subject to the carrying out of the obligations under the lease and therefore there *was* a valid carve out. There may then be two responses to Henderson LJ's judgment. First, is there in fact any detriment to the donee if the donee never takes the gifted interest free of the covenants? Secondly, did the covenants in favour of Lady Hood actually provide her with any tangible benefit?

On the first point, is a gift of a lease subject to existing covenants any different from a sale of a lease at an undervalue? In the latter case, HMRC do not argue that the consideration paid for the lease is a benefit to the donor and therefore there is a reservation of benefit in the undervalue but simply that the gift element is limited to the undervalue. On the same view one could say in *Lady Hood* the gift element was limited to the value of the sub-lease subject to those covenants.[37] Would it have made any difference if instead Lady Hood had granted a sub-lease free from any burden of the covenants but instead the donees had paid some consideration at the point of grant equivalent economically to the value of those covenants? On HMRC's analysis at IHTM14316[38] there would have been no reservation of benefit. Would Henderson LJ have taken the same view? Suppose X grants a sub-lease worth £1 million in consideration of £200,000 cash paid upfront by the donee. The lease does not impose any covenants on the donee. This would not be regarded as a gift with reservation (GWR). The gifted property is effectively valued at £800,000. Suppose instead X grants a sub-lease for no consideration but imposes covenants on the donee. The imposition of the covenants is found to devalue the gift to the donee to £800,000. In these circumstances there would apparently be a reservation. But is there really any economic difference between the two?

Secondly, was there in reality actually any material benefit for the donor? All she did was protect herself from ongoing liabilities owed to the freeholder once she ceased to be able to obtain any benefit from the land when the reversionary sub-lease fell in. This point does not seem to have been discussed.

These two cases show the difficulty of applying the GWR legislation to specific factual situations. Perhaps for this reason HMRC guidance essentially comprises examples rather than

[36] *Ingram (HL)*, above fn.3, [1999] STC 37 at 41.
[37] See an analysis of this argument in C. Whitehouse, "Inheritance tax: Lady Hood in the Court of Appeal (Case Comment)" [2019] *Private Client Business* 105.
[38] HMRC, Internal Manual, *Inheritance Tax Manual* (published 20 March 2016; updated 14 April 2020), IHTM14316, "Lifetime transfers: gifts with reservation (GWRs): the gift: sales for less than full consideration".

clear statements of principle. Henderson LJ's judgment in *Lady Hood (CA)* sets out the principles but, as can be seen above, leaves some key questions unanswered. ☙

Emma Chamberlain

☙ Gifts; Inheritance tax; Leasehold covenants; Reservation of benefit; Reversionary leases; Underleases