



INHERITANCE TAX – deceased granted reversionary sub-lease to sons out of her head leasehold interest – licence to sub-let given by head landlord to deceased – sub-lease provided for same covenants, including repairing covenants, as in head lease – whether property disposed of by way of gift was subject to a reservation under s 102 FA 1986 – application of second limb of s 102(1)(b) – identification of donated property – whether benefit ‘trenched upon’ donees’ enjoyment of the donated property - Buzzoni considered

[2017] UKUT 0276 (TCC)
UT/2016/0053

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

VISCOUNT HOOD **Appellant**
EXECUTOR OF THE ESTATE OF LADY DIANA HOOD

- and -

THE COMMISSIONERS FOR HER MAJESTY’S
REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: MRS JUSTICE ROSE, CHAMBER PRESIDENT
JUDGE BISHOPP PRESIDENT OF THE FIRST-TIER
TRIBUNAL TAX CHAMBER

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 15 and 16 May 2017

Simon Taube QC, instructed by Penningtons Manches LLP, for the Appellant

Jonathan Davey QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. This is an appeal against the decision of First-tier Tribunal (Judge Berner) released on 2 February 2016 ([2016] UKFTT 59 (TC) ('the Decision'). The appeal is brought with the permission of Judge Berner granted on 6 April 2016. It is brought by Viscount Hood as executor of the estate of his mother the late Lady Diana Hood who died on 15 March 2008. The estate challenged a notice of determination issued by HMRC on 13 June 2014 relating to the grant by Lady Hood to her three sons of a sub-lease of premises at 67 and 67a Chelsea Square London SW3 ('the Premises'). HMRC had determined that the creation of the sub-lease was a disposal by way of gift by Lady Hood of property subject to a reservation and that it therefore fell to be treated as property to which she was beneficially entitled immediately before her death. If that is right, the estate is liable for inheritance tax ('IHT') on the value of her sons' sub-leasehold property interest in the Premises because it is deemed to form part of her estate on her death.

2. The facts are not in dispute. The sub-lease granted by Lady Hood to her sons was granted out of a lease dated 21 September 1979 of which Lady Hood was the head-lessee and Viscount Chelsea was the head-lessor. Other parties to the head-lease were Chelsea Land & Investment Company Ltd and Cadogan Holdings Company ('Cadogan'). The term of the head-lease was due to expire on 25 December 2076.

3. The head-lease contained a covenant by Lady Hood not to assign, transfer or part with possession of the Premises without the consent in writing of Cadogan, such consent not to be unreasonably withheld. On 17 June 1997 Cadogan granted a written licence to Lady Hood to enter into a reversionary sub-lease of the Premises to her three sons. The parties to that licence were Cadogan and Lady Hood. The proposed sub-lessees were not party to the licence and the sub-lease was not appended to or referred to in the licence. The sub-lessees did not enter into any direct covenants with the head-lessor or with Cadogan; no such direct covenants were required under the head-lease. The sub-lease was granted by Lady Hood to her sons on 19 June 1997. The term of the sub-lease commenced only some 15 years later, on 25 March 2012 and lasted until 22 December 2076, three days before the term of the head-lease was due to expire.

4. The sub-lease was made upon and subject to the same terms, covenants, provisos and conditions as were contained in the head-lease. Lady Hood as sub-lessor and her sons as sub-lessees respectively covenanted to perform and observe those provisions as if they had been repeated in the sub-lease. The head-lease included the following covenants which were incorporated mutatis mutandis into the sub-lease ('the Company' being Cadogan Holdings and 'the Lessor' being Viscount Chelsea):

'(3) AT the Lessee's own expense throughout the said term well and substantially to repair maintain and keep the demised premises and all erections and buildings that shall for the time being be erected or built upon the site of the demised premises and all landlord fixtures which at

any time during the said term shall be erected fixed or fastened upon or to the demised premises in good and substantial repair and condition and to clean the windows of the demised premises at least once a month during the said term and properly to stock cultivate and keep in good order and condition throughout the said term the gardens of the demised premises

(4) IN the year One thousand nine hundred and eighty and in every succeeding third year and in the last three months of the said term (whether determined by effluxion of time or otherwise) to paint with not less than two coats of good quality paint in colours first be approved by the Company the whole of the outside wood iron stucco or cement and other work heretofore or usually painted of the demised premises

(5) IN the year One thousand nine hundred and eighty four and in every succeeding seventh year and in the last three months of the said term (whether determined by effluxion of time or otherwise) to paint with not less than two coats of good quality paint and paper all the inside parts of the demised premises respectively heretofore or usually painted or papered And at the expiration or sooner determination of the said term peaceably and quietly to leave surrender and yield up to the Lessor the demised premises together with all landlord's fixtures which at any time during the said term shall be erected fixed or fastened upon or to the demised premises so well and substantially repaired maintained painted and papered and kept as aforesaid.'

5. The head-lease also contained a right to forfeit for non-payment of rent or for failure to perform any of the lessee's covenants:

'4(B) If the rent hereby reserved or any part thereof shall be unpaid for twenty one days after becoming payable (whether formally demanded or not) or if any covenant on the Lessee's part herein contained shall not be performed or observed it shall be lawful for the Lessor or the Company at any time thereafter to re-enter upon the demised premises or any part thereof in the name of the whole and thereupon this demise shall absolutely determine but without prejudice to the right of action of the Lessor or the Company in respect of any breach of the Lessee's covenants herein contained.'

35 **The legislation**

6. The notice of determination was made by HMRC by reference to section 102 of the Finance Act 1986 ('section 102'). Section 102 is part of the overall scheme of IHT. The principal Act in relation to IHT is the Inheritance Tax Act 1984 ('IHTA'). IHT is charged on the value transferred by a chargeable transfer (see sections 1 and 2 of IHTA). Subject to the provisions of the IHTA, a transfer of value is a disposition made by a person as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition, and the amount by which it is less is the value transferred by the transfer (section 3(1)). For the

5 purposes of the IHTA, a person's estate is the aggregate of all the property to which he is beneficially entitled, except that the estate of a person immediately before his death does not include excluded property (section 5(1)). On the death of any person, IHT is charged as if, immediately before his death, he had made a transfer of value and the value transferred had been equal to the value of his estate immediately before his death (section 4(1)).

10 7. Section 114(5) of the Finance Act 1986 provides that Part V of that Act, which includes section 102, is to be construed as one with the IHTA. The effect of section 102 is that the estate of a person immediately before his death is deemed to include additional property which would not otherwise form part of his estate for IHT purposes, if it amounts to 'property subject to a reservation' as that term is defined in section 102. Section 102 provides, so far as is material, as follows:

15 '(1) Subject to subsections (5) and (6) below, this section applies where, on or after 18th March 1986, an individual disposes of any property by way of gift and either—

20 (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;

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

30 (2) If and so long as—

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

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

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

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

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

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8. Section 102 re-enacted, although not in precisely the same words, similar provisions about the reservation of benefits that had applied under estate duty legislation until it was repealed by the Finance Act 1975.

9. It was common ground before us, as it was before the FTT, that the grant of the sub-lease by Lady Hood was a disposal of property, namely of a sub-leasehold estate in the Premises, and that it was a disposal by way of gift. It was also accepted by HMRC that possession and enjoyment of the property was bona fide assumed by Lady Hood’s sons so that section 102(1)(a) did not operate to make the gift subject to a reservation. It is also accepted that the sons enjoyed the property to the entire exclusion of Lady Hood so that the first limb of section 102(1)(b) is not satisfied. The area of dispute between the parties was whether the second limb of section 102(1)(b) applied because:

‘(b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of ... **any benefit to him by contract or otherwise;**’

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10. Within that second limb, there is no dispute about the ‘relevant period’. The dispute is as to whether the terms of the sub-lease conferred on Lady Hood a benefit by contract or otherwise which prevented her sons from enjoying the property to the entire exclusion or virtually the entire exclusion of Lady Hood.

11. HMRC’s case is that the sub-lease did confer a benefit on Lady Hood which meant that the property she gave them was not enjoyed by her sons to the entire or virtually entire exclusion of any benefit to her. This benefit was the benefit of the repair and maintenance covenants contained in the sub-lease under which the sub-lessees took on obligations towards Lady Hood as sub-lessors. HMRC argued that these covenants effectively indemnified Lady Hood for the performance of her own obligations owed under the head-lease to keep the building in good repair. HMRC submitted that this benefit meant that the gift was property subject to a reservation and so fell to be treated as part of her estate.

12. The estate contends that there was no reservation here and that the repair covenants in the sub-lease do not operate to prevent Lady Hood’s sons from enjoying the property she gave them to the exclusion of any benefit to her. They argue broadly that:

(a) The FTT erred in failing to identify accurately the property comprised in the gift. The donated property was not the bare sub-leasehold interest free of the obligations under the sub-lessees’ covenants but the sub-lease incorporating, or, as Mr Simon Taube QC, appearing before us for Viscount Hood, put it,

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‘imprinted’ with the sub-lessees’ covenants. There was therefore no reservation from the property that was gifted to them.

5 (b) The case law establishes that in order for section 102(1)(b) to be triggered, the donee’s enjoyment of the property must be impaired or trenced upon by the benefit reserved to the donor. In the present case there was no such impairment or trenching that prevented the sons from enjoying the property gifted to them exclusively and the FTT erred in finding that there was.

Section 102 as applied in the case law

10 13. The application of section 102(1)(b) was considered recently by the Court of Appeal in *Buzzoni and others v Revenue and Customs* [2013] EWCA Civ 1684 (*‘Buzzoni’*). That case was central to the FTT’s decision in this case and key to the submissions made to us by the parties. In *Buzzoni* the donor, Lia Kamhi, was the lessor of a property in Knightsbridge under a lease. She had covenanted to the head-landlord not to underlet unless the under-lessee first entered into a covenant with the head-lessee to observe all the covenants and obligations imposed on the donor in the head-lease. In 1997 the donor granted a sub-lease of the property to a nominee for the trustee of a settlement (referred to as Legis) for her two sons. The grant of the sub-lease was pursuant to a licence to underlet granted to her by the head-landlord and under the sub-lease the under-lessee covenanted to observe and perform the covenants and obligations other than the payment of rent contained in the head-lease. The under-lessee was also party to the licence to underlet and had undertaken to the head-landlord to comply with the covenants in the head-lease.

25 14. Moses LJ who gave the lead judgment in *Buzzoni* identified the issues as the same issues which arise in the instant case, namely whether the positive covenants in the under-lease constituted a benefit taken back by the donor from the property she had given so that section 102(1)(b) applied because the donee did not enjoy the under-lease to the exclusion of a benefit to the donor. This resolved into two issues. The first was the source of the alleged benefit, namely was the benefit of the positive covenants in the under-lease something that the donor *received back* from the donee or did she enjoy the benefit because she had *retained it* by virtue of her reversionary interest in the head-lease? The second issue was whether, if the source of the benefit was the under-lease and so was something she received back from the donee, was it a benefit within the meaning of section 102(1)(b) because she enjoyed it *at the expense* of the donees’ enjoyment of the under-lease?

35 15. As regards the first issue of the source of the benefit, Moses LJ referred to the speech of Lord Hoffmann in *Ingram v IRC* [2000] 1 AC 293, which we discuss further below. Moses LJ accepted that the reversion of the under-lease was never gifted to the donees so that the gift created two separate interests in the head-lease, the reversion and the under-lease. The donor had gifted only the under-lease. The question was therefore whether ‘those positive covenants should be regarded as rights which Mrs Kamhi enjoyed by virtue of her reversionary interest which was never comprised in the gift, or whether they were enjoyed by virtue of the interest, the underlease, of which she did make a gift’ (para 22). Although he accepted that

the covenants became attached to the proprietary interest that the donor retained in the head-lease and took on ‘a proprietary character’, he held that it did not follow that the benefit derived from the reversion rather than from the interest she gifted. He held that the benefit of the positive covenants was enjoyed by virtue of the under-lease and not by virtue of the reversion the donor retained.

16. As regards the second issue, Moses LJ considered whether the donor was right to contend that in order for a benefit to fall within section 102(1)(b) it had to impair to more than a minimal extent the donee’s enjoyment of the gifted property. Moses LJ examined earlier case law and held that the authorities did not ‘carry the appellants as far as they wished to go’ (para 49). However, he held that there was sufficient support for the donor’s contention to be found in the wording of the subsection itself:

‘50. ... The second limb of section 102(1)(b) requires consideration of whether the *donee*’s enjoyment of the property gifted is to the exclusion of any benefit to the donor. The focus is not primarily on the question whether the donor has obtained a benefit from the gifted property but whether the donee’s enjoyment of that property remains exclusive. The statutory question is whether the donee enjoyed the property to the entire exclusion or virtually to the entire exclusion of any benefit to the donor. If the benefit to the donor does not have any impact on the donee’s enjoyment, in my view, then the donee’s enjoyment *is* to the entire exclusion of any benefit to the donor.

51. ... As I have said, the subsection, in its focus on the exclusivity of the donee’s enjoyment of the gifted property, may demand further enquiry as to whether the benefit has any impact upon the donee’s enjoyment. If the benefit is irrelevant to such enjoyment it does not “trench upon” the exclusivity of donee’s enjoyment.’

17. Moses LJ held that it was therefore necessary to enquire whether the benefit the donor obtained from the positive covenants affected the donee’s enjoyment of the flat. He held that it did not because the donees were already under an obligation to the head-lessor as set out in the licence to underlet and that obligation precisely matched those obligations into which they entered with the donor:

‘56. Accordingly, I consider it is necessary to enquire whether the benefit Mrs Kahmi obtained from the positive covenants affected Legis’ enjoyment of the flat. In my view, it made no difference whatsoever to the Underlessees’ enjoyment of the Underlease. The Underlessees were already under obligations, in the Licence to Underlet, to the Head Lessor which precisely matched those obligations into which they entered with Mrs Kahmi (save that the Underlessees were under no obligation to pay rent). The obligations in the positive covenants 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. It is true they were entered into with a different party, but performance of one set of obligations, for example, those contained in the

Licence, would have fulfilled the obligations in the positive covenants in the Underlease and vice-versa. Even if it may be said that Mrs Kahmi obtained a benefit she had not previously enjoyed, it was not obtained at the expense of the donees' enjoyment of the Underlease. It neither added
5 to nor subtracted from their enjoyment in the light of the obligations into which they had already entered with the Head Landlord.'

18. He therefore held that the appeal should be allowed. Gloster and Black LJ agreed that the appeal should be allowed but limited their concurrence to the reasoning on the second issue, agreeing that there was no trenching on the donees' enjoyment. They did not express any view on the question whether the benefit of the
10 positive covenants in the Underlease was referable to the reversionary interest retained by Mrs Kahmi in the head-lease or to the under-lease which she had given to the donees.

19. Moses LJ's decision on the first issue – the source of the benefit of the positive obligations – is therefore obiter. It contrasts, as Moses LJ recognised, with the decision of the House of Lords in *Ingram v IRC* [2000] 1 AC 293 ('*Ingram*'). In that case Lady Ingram had conveyed the freehold of her home to her solicitor to hold as her nominee. The following day the solicitor granted her a lease of the house for 20 years rent free with no covenants except the covenant for quiet enjoyment. The day
20 after that the solicitor conveyed the reversion of the house to trustees to hold on trusts declared in a separate document for the benefit of her children and grandchildren. The Inland Revenue Commissioners made a determination when Lady Ingram died less than two years later that section 102 applied and that the value of her estate was deemed to include the value of the unencumbered freehold of the property. There was a separate issue that does not arise here, namely whether the
25 initial lease granted by Lady Ingram's solicitor to her was void because a nominee cannot grant a lease to his beneficiary. If that was right, then HMRC argued that the grant of the leasehold interest to Lady Ingram only became possible after the trustees had taken the unencumbered freehold. The leasehold was therefore a benefit derived from the property which had been given to the trustees and not an item of property that Lady Ingram had never given. The first instance judge (Ferris J) held that the initial grant of the lease by the solicitor had been invalid but that the lease was binding in equity on the trustees so should be treated as having been granted by them. The lease therefore only came into effect when the reversion was transferred
30 to the trustee of the family settlement. However, he held that the freehold interests were enjoyed by the trustees to the entire exclusion of any benefit to Lady Ingram. The Court of Appeal agreed that a nominee could not grant a lease to his principal. They also agreed that the trustees, as volunteers with notice of Lady Ingram's intention, took the freehold subject to an obligation in equity to grant the lease. But they disagreed with Ferris J's conclusion on the application of section 102 in these
40 circumstances. They held further that it was conceptually impossible for a lease to come into existence before the lessor had acquired the freehold interest – the disposition of the freehold interest had to be complete before the lease back could be granted. It followed, they held, that the gift of the reversion to the settlement must have been a gift of the unencumbered freehold interest and the lease to Lady Ingram
45 must have been a benefit reserved out of it.

20. The House of Lords unanimously allowed the appeal. Lord Hoffmann (with whom Lords Clyde, Browne-Wilkinson and Steyn agreed, Lord Hutton delivering a concurring speech) emphasised the need to identify carefully the proprietary interest gifted away, having regard to the multiplicity of legal and beneficial estates that ‘the highly sophisticated English land law’ recognises can exist simultaneously in respect of a single plot of land. He referred to earlier authorities on section 102 and its predecessors noting that: (page 303A-B)

‘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. 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* [1952] AC 15, 22-23.’

21. Lord Hoffmann held that there was no bar to the grant of a lease by a nominee to his principal and that the initial grant of the lease by the solicitor had been valid. But this did not, in his opinion, affect the result because if one looked at the real nature of the transaction the donee of the freehold, the trustees and beneficiaries, never at any time acquired the freehold interest in the land free of Lady Ingram’s leasehold interest. He held that the policy of section 102 required people ‘to define precisely the interests which they are giving away and interests, if any, which they are retaining’. Once they have given away an interest they may not receive back any benefits from that interest.

22. In *Ingram*, the only covenant granted by the settlement donee to Lady Ingram was the covenant of quiet enjoyment. That was not a sufficient benefit to trigger the operation of section 102 because, Lord Hoffmann said, such a covenant ‘is no more than an incident of the leasehold estate’ (page 303B-C). He contrasted this with the position in the earlier case of *In re Nichols, deceased* [1975] 1 WLR 534 (*‘Nichols’*). In that case Sir Philip Nichols had conveyed his country house and estate to his son Francis by way of gift subject to the son’s agreement to grant him a lease back. The Court of Appeal in *Nichols* expressed the view that a grant of the fee simple subject to and with the benefit of the lease back, where such a grant is made by a person who owns the whole freehold free from any lease, is a grant of the whole fee simple with something reserved out of it, and not a gift of a partial interest leaving something in the hands of the grantor which he has not given. However the Court of Appeal in *Nichols* considered that it was not necessary to reach a final conclusion on the point because the son had given covenants in the lease as to repairs and the payment of the tithes redemption annuity which amounted to benefits unrelated to any interest previously enjoyed by Sir Philip. There was no way in which they could be said to be property which he had separated from the gift and retained.

23. Lord Hutton in *Ingram* made it clear that the opinion of the Court of Appeal on the nature of the lease back from the gift of the freehold in *Nichols* was not correct. He referred to the decision of the House in *St Aubyn v Attorney General* [1952] AC 15 (*‘St Aubyn’*) where Lord Simonds had said that ‘by retaining something which he

has never given a donor does not bring himself within the mischief of the section'. In the case before their Lordships in *Ingram*, 'there never was a time when, in equity, the donees held the property free from the donor's leasehold interest'. The gift made by Lady Ingram was the freehold shorn of the leasehold interest so that section 102 did not apply.

The decision of the FTT

24. The FTT in the present case considered the same two issues that had been considered by Moses LJ in *Buzzoni*. On the first issue as to the scope of the donated property, the FTT was not persuaded that it should depart from the conclusion reached by Moses LJ in *Buzzoni* or the reasoning by which that conclusion was reached. Judge Berner accepted that where parallel proprietary interests exist in property simultaneously, as they do when a sub-leasehold interest is created out of a head-lease, then one such interest may form the subject matter of a gift while the other is retained. But Judge Berner went on:

15 'It is the proprietary interest which is gifted, carrying with it both benefits and burdens. 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.'

25. He rejected the estate's argument that the decisions in *Nichols* and *Ingram* were limited to their own facts. He held that there can be no principled distinction between the contractual covenants given by the donee of a freehold interest in a lease back to a donor and such covenants given by a lessee or sub-lessee to a donor in a lease or sub-lease gifted by that donor.

26. On the second, 'trenching', issue the FTT considered itself bound by the decision in *Buzzoni* that there was this additional element of the section 102 test. It was necessary to determine whether the obligations owed by Lady Hood's sons under the sub-lease made any difference to their enjoyment of the property gifted to them. Judge Berner distinguished the present case from *Buzzoni* on the facts because in the present case Lady Hood's sons were not party to the licence to underlet granted by the head-landlord and in contrast to the position in *Buzzoni* they gave no direct covenants to the head-lessor: see [37]. Judge Berner rejected the argument of the estate that the circumstances of this case were 'economically equivalent' to those in *Buzzoni* because of the sub-lessees' obligation by virtue of *Henderson v Squire* (1869) LR 4 QB 170 to deliver up the property at the expiry of the sub-lease. He held that there was a world of difference between obligations to which a sub-lessee might be subject by way of direct covenant to a head-lessor and the actions that might have to be taken in practice by a sub-lessee to avoid or obtain relief from forfeiture in the event that the lessee failed to observe covenants in the head-lease and the head-lessor took steps to forfeit the head-lease. He therefore held that the estate's trenching argument also failed and dismissed the appeal.

Ground One: is the benefit of the covenants retained or received back?

27. In our judgment, the gift by Lady Hood of the sub-lease estate in the Premises is the gift of the whole sub-lease estate and the benefit of the covenants entered into by her sons was a benefit she received back from them and not something that was carved out of the estate which she granted to them. We have arrived at that conclusion for the same reasons as Judge Berner in the FTT in this case and Moses LJ in *Buzzoni*. We recognise, as Mr Taube submitted, that the defining character of a lease is that the sub-tenant has exclusive possession as against the landlord: see *Street v Mountford* [1985] 1 AC 809. In the present case the sons did enjoy exclusive possession of the property as against Lady Hood; that is why HMRC accepted that the first limb of section 102(1)(b) was not satisfied. But we respectfully agree with Moses LJ that it does not follow from that that they also enjoyed the property to the exclusion of **any benefit to** Lady Hood. The existence of the covenants was such a benefit and did cause the property to fall within section 102.

28. Viscount Hood relies in particular on the decision of the Court of Appeal in *City of London Corporation v Fell and others* [1993] QB 589 (*'Fell'*). This case was not referred to by Moses LJ in *Buzzoni*. In *Fell*, the defendants negotiated a 10 year lease of premises that were owned by the plaintiffs. The defendants covenanted to pay the annual rent during the contractual term. Part way through the term the defendants assigned the unexpired term of the lease to a company which remained in occupation after the expiry of the term pursuant to section 24(1) of the Landlord and Tenant Act 1954. The company went into liquidation owing unpaid rent to the landlord. The landlord commenced proceedings against the defendants as the original tenants for the outstanding rent. The Court of Appeal held that since an original tenant who had assigned his tenancy before the end of the contractual term no longer held the demised premises and could not properly be described as the tenant the contractual obligations of the original tenant to the landlord were not continued after the expiry of the contractual term. The original tenant who had covenanted to pay rent only during the contractual term could not be held liable for rent payable after that date. Nourse LJ, with whom Evans LJ and Sir Michael Kerr agreed, restated what he described as 'some elementary propositions in the law of landlord and tenant' (page 603H):

'A lease of land, because it originates in a contract, gives rise to obligations enforceable between the original landlord and the original tenant in contract. But because it also gives the tenant an estate in the land, assignable, like the reversion, to others, the obligations, so far as they touch and concern the land, assume a wider influence, becoming, as it were, imprinted on the term or the reversion as the case may be, enforceable between the owners thereof for the time being as conditions of the enjoyment of their respective estates. Thus landlord and tenant stand together in one or other of two distinct legal relationships. In the

first it is said that there is privity of contract between them, in the second privity of estate.’

29. The question that Nourse LJ was addressing in *Fell* was a different question from the one arising in this appeal. We do not agree that because the covenants are imprinted on the leasehold estate so that they bind the assignee of the tenancy, that must mean that they are part of the estate retained by the landlord rather than an obligation given back by the tenant and his assignee to the landlord. The covenants are enforceable as against the assignee regardless of the answer to the question we need to decide.

30. Mr Taube argues that the value of the sub-leasehold interest is diminished by the existence of the covenants to repair and maintain and hence in a different context the rent would be reduced to reflect this. Similarly if the sub-tenants wished to assign the sub-lease for a premium they would get a lower sum for it since the assignee would take on the obligation to comply with those covenants directly to Lady Hood. This demonstrates, he submits, that the estate granted is the estate with the obligations imposed by the covenants already present - the bundle of rights and obligations conferred on the sub-lessees is a bundle which includes the obligation to repair. However, again, we do not see that this indicates the answer to the question whether that diminution arises because the estate conferred by the gift was the estate already subject to the obligations to repair and maintain. Those obligations undoubtedly exist, whether they are retained by the donor or received back from the donee and they diminish the value of the estate, as compared with a sub-lease that did not confer any such obligations.

31. Mr Taube also argues that the cases where the relevant disposition of property is a disposition of the freehold by the donor and the donee grants back a lease to the donor is fundamentally different from the present case. That is because the donee landlord in those other cases is excluded from possession of the property for the benefit of the donor. The nature of the freehold interest in land is that, as a matter of property law, all inferior estates must be carved out of that superior estate. He therefore submits that both *Nichols* and *Ingram* were concerned with different fact patterns where there were multiple consecutive dispositions, there had been a prior gift of the freehold by the donor and a subsequent lease back by the donee and in *Nichols* but not *Ingram*, the donee gave beneficial covenants to the donor.

32. We do not agree that those authorities are distinguishable as a matter of principle even though the estate gifted by the donor was different from the sub-leasehold gifted by Lady Hood. In *Ingram Ferris J* and the Court of Appeal agreed that the initial grant of the lease by the solicitor had been invalid and that the lease only came into effect when the reversion was transferred to the trustee of the family settlement. But they disagreed about the effect of this for the application of section 102. The House of Lords held, as we have said, that the freehold estate was gifted already shorn of the Lady Ingram’s leasehold interest because the trustees and beneficiaries took the freehold subject to an equitable obligation to grant the lease to Lady Ingram. This was precisely because Lord Hoffmann rejected the relevance of the supposedly consecutive dispositions, holding that the Revenue could not rely on

the scintilla temporis which must elapse between the conveyance of the freehold to the donee and the creation of the leasehold interest in favour of the donor: see page 303F. He therefore held that even though there were consecutive actions, Ferris J had been right in saying that the trustee had never at any time acquired the land free of Lady Ingram's leasehold interest. There is nothing in the House of Lords' speeches that limits the principles enunciated there to a freehold/leasehold disposition rather than a leasehold/sub-leasehold disposition. The passages cited from *St Aubyn* by Lord Hutton in his speech in *Ingram* are expressed in general terms as regard limited equitable interests.

33. Mr Taube criticises paragraph 60 of the FTT's decision where Judge Berner said that a benefit to a donor which arises from a condition of a gift is 'a benefit referable to the gift' and does not cut down the nature of the donated property itself. He contends that the application of a test to the effect that section 102 is satisfied if the benefit obtained is referable to the gift is wrong and contrary to the decision of the House of Lords in *St Aubyn*. However, it is clear from a fair reading of the FTT's judgment as a whole that that was not the test that was applied; the FTT was well aware that the issue was whether the benefit of the covenants was part of the estate retained by Lady Hood or was received back by her from the donees. The FTT did not conclude that section 102 was satisfied merely because the covenants were referable to the gift.

34. We therefore hold that the FTT was right to follow the dicta of Moses LJ in *Buzzoni* and to hold that the donated property was the sub-lease of the property and not the sub-lease with the obligations of the covenants carved out of it.

35. Mr Taube argues that there is a parallel between a case such as this and an example, given in HMRC's own IHT Manual, of the gift of a business by a mother to her daughter, the daughter undertaking personal responsibility for any business liabilities incurred by and due from her mother. The manual states 'That undertaking would not be regarded as a reservation. The transaction would be treated as a gift of the net assets.' We do not accept that there is a parallel between the two situations. As the Manual says, in that case there is a gift of the net assets of the business. In economic terms what is given is equivalent to a sale of the business in exchange for a price equal to the outstanding debts, a crystallised liability which the donor then proceeds to discharge. In either case the diminution in value of the donor's estate is the same, namely the excess of assets over liabilities. Here, there is a gift of the sub-leasehold estate, with a reservation represented by the continuing obligation imposed on the sub-lessees to perform covenants for the *future* and correspondingly indeterminate benefit of the donor.

Ground two: did the covenants 'trench upon' the donees' enjoyment of the gift?

36. The estate submits that the FTT in this case was wrong to find that the covenants entered into by Lady Hood's sons trenched upon their enjoyment of the sub-lease of the Premises. The term 'trench upon' seems to come from the speech of Lord Radcliffe in *St Aubyn* although the Court of Appeal held in *Buzzoni* that this element of the test derives more from the wording of section 102(1)(b) itself: see paragraph

50 of Moses LJ's judgment. Moses LJ held that the focus of the subsection is not primarily on whether the donor has obtained a benefit from the gifted property but on whether the donee's enjoyment of that property remains exclusive. That aspect of the decision in *Buzzoni* is binding on us as it was on the FTT.

5 37. Mr Taube puts forward two reasons why the covenants here did not trench upon Lady Hood's sons' enjoyment of the sub-lease. The first appears to us to be a recasting of the argument put forward on the first ground, namely that because the covenants are imprinted on the estate and so are not part of the gift, no benefit that
10 Lady Hood enjoyed from the covenants can be enjoyed to the detriment of the enjoyment by her sons of the limited estate gifted to them. We reject that argument for the same reasons as we rejected it in relation to ground one. The covenants are benefits given by the donees to Lady Hood, not benefits retained by her in the interest she retained in the head-lease.

15 38. The second reason put forward by the estate is that FTT was wrong to distinguish the facts here from the facts in *Buzzoni* on the grounds that here there was no direct covenant between the sub-lessees and the head landlord. Mr Taube refers to *Henderson v Squire* [1869] QB 170 which establishes that in a sub-lease there is an implied obligation on the tenant to deliver up the property at the end of the term. Here the term of the sub-lease expired three days before the expiry of the
20 head-lease, a distinction which was made in order to prevent the sub-lease from operating as an assignment: see *Milmo v Carreras* [1943] KB 46.

25 39. Mr Taube argues that had the sub-lessees not performed the covenants set out in the head-lease, the head-landlord could have determined or forfeited their sub-leasehold estate. Thus, even if there had been no express covenants in the sub-lease to perform the tenant's covenants in the head-lease, the landlord could have forfeited
30 the head lease and destroyed the sub-lease if the sub-tenants had failed to ensure that the covenants in the head-lease were performed. To put it another way, if the head-lease had been forfeited because Lady Hood had failed to comply with her obligations under the head-lease and her sons had applied for relief from forfeiture, that relief may well have been granted only subject to the condition that they
35 perform the covenants and make good any existing breach. That being the case, the estate argues, the mere fact that the sub-tenants' covenants in the sub-lease were expressly given to Lady Hood and not to Cadogan or Viscount Chelsea had no material impact on the sub-tenants' enjoyment of their proprietary estate. Given that section 102 is a penal provision with drastic tax consequences, the estate submits that it is not appropriate that its impact should turn on the fine distinction between this case and the facts of *Buzzoni*.

40 40. This point raises two separate issues. The first is whether the existence of the obligations of the head-lessee under the covenants in the head-lease from which the sub-lease is granted means that performance of the covenants is an incident of the sub-lease in the same way that the covenant for quiet enjoyment was an incident of the lease granted to Lady Ingram. The second is whether the risk of forfeiture means that Lady Hood's sons in effect owed direct duties to Viscount Chelsea to perform

the covenants just as Mrs Kahmi's donee owed direct covenants to Parkside Knightbridge Ltd, the head-landlord in *Buzzoni*.

41. On this point we entirely agree with the decision of Judge Berner that there is a substantial difference in practical as well as legal terms between the obligations of Lady Hood's sons arising from the covenants they entered into vis à vis her and the potential burdens arising from the grant of a sub-lease where the sub-landlord has its own obligations to the head-landlord, breach of which might cause both the lease and the sub-lease to terminate. We agree with the submission of Mr Jonathan Davey QC on behalf of HMRC that whether in a given case a landlord chooses to exercise its right to forfeit in the event of a breach by the head-lessee of the covenants in the head-lease will depend on a host of fact sensitive issues. It is not inevitable that the sub-tenant will be called upon to comply with the covenants or remedy past breaches as the price for obtaining relief from forfeiture.

42. In *Ingram* the House of Lords did not have to consider the effect of any covenants entered into by the donee to the donor because the trustee, as holder of the freehold reversion of the premises, entered only into the covenant of quiet enjoyment. But *Ingram* did not, in our judgment, cast doubt on the reasoning of the Court of Appeal in *Nichols* that the full repairing covenant entered into by Sir Philip's son was sufficient benefit to trigger the application of section 102. Mr Taube argues that there is a qualitative difference between the covenants in *Nichols* and the covenants here. First, the donee in *Nichols* had taken the freehold reversion and then as landlord granted a lease back to his father including a landlord's obligation to repair. That was an obligation which was a valuable benefit because the son was promising to repair the house where his father was living. That, Mr Taube says, is well within the mischief at which section 102 is aimed. Conversely, the arrangements here do not offend against those principles. We reject this argument. There is no basis in either the wording of section 102 or in the case law for the tribunal to undertake an assessment of the value of the covenants or how burdensome they are likely to be for the donee to perform. The position in *Ingram* was very particular because the express covenant of quiet enjoyment was really no covenant at all – the right to quiet enjoyment is an incident of the estate conferred. As Lord Hoffmann said in *Ingram*, as long as covenants given by the donee are 'more than a few de minimis crumbs of what has been given' the donor is treated as having retained the whole cake. It cannot be argued here that the obligations under the repair and maintenance covenants in the sub-lease are de minimis and we see no basis on which this case can be distinguished from *Nichols*.

43. Goff J, giving the judgment of the Court of Appeal in *Nichols*, described the covenant entered into by the son as 'a covenant for the benefit of the donor, at the expense of the donee, and one which he was as a condition of the gift obliged to enter into and for the protection and better enjoyment of the property by the donor'. We recognise that the situation here is different in that in *Nichols* it was the party who was being granted the entitlement to live in the premises (Sir Philip) who had the benefit of the full repair covenant from his son in respect of the premises whereas here, at least once the term of the sub-lease commences, it is the future occupants of the Premises, Lady Hood's sons, who are undertaking to her to keep

the premises in repair. But the principle remains the same; their obligations to her are for the protection and better enjoyment by her of her retained interest in the head-lease because they provide greater protection for her than she would have enjoyed had she simply remained subject to her own covenants in the head-lease without imposing any corresponding obligation on her sub-tenants. Conversely, the obligations taken on by Lady Hood's sons by the mirroring obligations in the sub-lease of the Premises are more onerous than the implied obligations to which they would have been subject if the sub-lease had been silent about who was going to clean the windows, paint the inside and outside of the Premises and keep the gardens in good order.

44. We therefore reject the arguments put forward by the estate and dismiss the appeal.

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MRS JUSTICE ROSE DBE

JUDGE COLIN BISHOPP

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**UPPER TRIBUNAL JUDGES
RELEASE DATE: 7 JULY 2017**