

Mark Buzzoni (Executor of the estate of Mrs Lia Kamhi, deceased), The Legis Trust Limited, Vili Hayin (or Hayati) Kamhi, Cefi Kamhi v The Commissioners for Her Majesty's Revenue and Customs

Appeal number: TC/2010/988

First-Tier Tribunal Tax

21 April 2011

[2011] UKFTT 267 (TC)

2011 WL 1151804

Tribunal: Mrs B Mosedale (Tribunal Judge) Mr J Stafford (Tribunal Member)

Release Date: 21 April 2011

Sitting in public at 45 Bedford Square, London WC1 on 3 March 2011

Representation

Mr R Matthew QC , instructed by Bracher Rawlins LLP , for the Appellant.

Mr M Slater , counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents.

Decision

Mrs B Mosedale

1 This is an appeal against Notices of Determination issued to the four Appellants on 15 October 2009 under the [Inheritance Tax Act](#) that a disposal by way of gift by the deceased Mrs Lea Kamhi was subject to a reservation of benefit with the effect that the gifted property should, for inheritance tax purposes, be treated as property to which she was beneficially entitled immediately before her death.

2 The first Appellant is Mrs Kamhi's executor; the second is the trustee of the settlement into which she gifted the property at issue in this appeal; the third and fourth Appellants are her sons who are the beneficiaries of the trust.

The Law

3 By [Section 1 of the Inheritance Tax Act 1984](#) ("IHTA"), inheritance tax is chargeable on chargeable transfers as defined. By Section 2 a chargeable transfer is a transfer made by an individual which is not an exempt transfer. Transfers within the lifetime of a person can be potentially exempt transfers by s101 and [Schedule 19 of the Finance Act 1986](#) .

4 This does not apply to disposals by way of a gift with a reservation as defined in [s102 and Schedule 20 of the Finance Act 1986](#) . A gift with a reservation is deemed to form part of the donor's estate up until the point the reservation ceases:

102 Gifts with reservation

(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-

(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;

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.

(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

(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.

(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 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.

(5) [not relevant]

(6) [not relevant]

(7) [not relevant]

(8) [Schedule 20](#) to this Act has effect for supplementing this section.

5 The question for this Tribunal is whether the property gifted by Mrs Kamhi to the trust was, as per [s102\(1\)\(b\)](#), at any time in the relevant period “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”. Although nothing turned on it in this appeal, the relevant period (as defined by [s102\(1\)](#)) was the seven years to 2 May 2008 being the date of Mrs Kamhi's death.

6 It was the Appellant's case that the property was enjoyed to the entire exclusion of Mrs Kamhi or it was enjoyed *virtually* to the entire exclusion of Mrs Kamhi.

Findings of Fact

7 The facts were not in dispute. There was an agreed statement of facts and a witness statement by Mr Mark Buzzoni. He was not called to give evidence as Counsel for HMRC indicated that they had no questions for him. His evidence was therefore undisputed. We find the following facts as agreed by the parties or as given in evidence by Mr Buzzoni:

8 On 5 June 1996 Parkside Knightsbridge Ltd (“the Superior Landlord”) granted to Mrs Kamhi a lease (“the Headlease”) of Flat 32 Parkside, 28–56 Knightsbridge, London for a term of 100 years less one day commencing on 25 March 1994. The premium charged was £250,000.

9 On 21 November 1997 the Superior Landlord consented by Licence to Underlet to Mrs Kamhi granting an underlease (“the Underlease”) of Flat 32 to Ovalap Nominees Limited. The parties to the Licence to Underlet were the Superior Landlord, Mrs Kamhi and Ovalap.

10 The Licence to Underlet was negotiated at arms length between the Superior Landlord and Mrs Kamhi. Mr Buzzoni's evidence, which was unchallenged and which we accept, was that it contained the usual covenants for such a Licence to Underlet and that without such covenants there would have been no realistic prospect of the Licence being granted.

11 On the same day, Mrs Kamhi granted the Underlease to Ovalap for approximately 86½ years commencing on 24 November 2007 and expiring on 22 March 2094 (ie two days before the head lease would expire). The Underlease was granted without rent or premium being payable.

12 Also on the same day (21 November 1997) Mrs Kamhi created by deed a settlement. The trustee was Legis Trust Limited and the trust property was the Underlease. Ovalap entered into the Underlease as bare nominee for Legis Trust Limited. It was agreed between the parties that nothing turned on the fact it was Ovalap who was named as underlessee rather than Legis. Ovalap is part of the Legis group and Mr Buzzoni believed that the Legis group decided for reasons of internal administration that the legal title be held by a nominee for the trustee.

13 Mr Buzzoni is a solicitor and advised Mrs Kamhi on the transactions which are the subject of this appeal. Mrs Kamhi entered into the Licence to Underlet, Underlease and creation of the trust at the same time. Mr Buzzoni's evidence, which we accept, was that Mrs Kamhi considered the three transactions to be a single composite arrangement.

14 On 24 March 2004 Parkside (Knightsbridge) Residents Limited then granted Mrs Kamhi a new lease over Flat 32 for a term of 999 years commencing 1 April 2003. No premium was charged and the rent was one peppercorn if demanded. It was agreed between the parties that this grant of a longer headlease made no difference to the point at issue in this case, and we agree with them and do not refer to it again.

15 Mrs Kamhi died in Turkey on 2 May 2008. The Headlease was valued as at the date of death of Mrs Kamhi to be £50,000. This valuation took into account that the Headlease with vacant possession would have been worth in the region of £2,100,000 but because of the Underlease the Headlease (in reversion) was worth the much lower figure of £50,000.

16 The Notices of Determination referred to in paragraph 1 stated that “having regard to the provisions of [Section 102 Finance Act 1986](#) the creation of the sub-lease was a disposal by way of gift by the Deceased of property subject to a reservation which falls to be treated as property to which she was beneficially entitled immediately before her death.” The trustee and life tenants were said to be liable for the resulting inheritance tax. On 11 November 2009 the four Appellants lodged an appeal with HMRC and on 18 December 2009 referred them to the First-tier Tribunal.

17 We were also provided with many documents including all the deeds referred to above and from reading these we make the further findings of fact.

18 The Headlease contained a term for payment of rent (commencing at £1,000 per term and ultimately increasing to £8,000 per year after 2069). From 2004 when the new Headlease was granted no rent was payable. There was a service charge of “3%” and by 2008 when the valuation was carried out this amounted to some £9,000 per annum. The tenant Mrs Kamhi covenanted to pay both rent and (as additional rent) the service charge and advance service charge.

19 There were many other covenants by the tenant in the Headlease, such as to keep the property in repair; to clean the premises and its windows; to indemnify landlord on outgoings (eg taxes, utilities charges); to keep Flat 32 decorated; and to pay a proportion of the costs of maintaining, lighting, and cleaning all common areas.

20 There was also a covenant not to assign the Headlease unless the assignee first covenanted with the Superior Landlord to pay the rent and observe the terms of the lease.

21 There was a covenant not to underlet the Headlease unless the “undertenant shall first enter into a covenant with the Landlord to observe all the covenants and obligations on the part of the Tenant contained in this Lease from the commencement, and for the residue, of the term granted by the underlease”. The Superior Landlord had to consent to the underletting such consent not to

be unreasonably withheld. The terms of the underlease had to be for not less than six months; prohibit further subletting; and be granted on terms no more favourable than the Headlease.

22 The terms of the Licence to Underlet included covenants by Mrs Kamhi and Ovalap. Mrs Kamhi covenanted with the Superior Landlord to enforce the covenants given by the undertenant in the Underlease. Ovalap covenanted with the Superior Landlord to observe Mrs Kamhi's covenants in the Headlease.

23 The Underlease contained about 11 pages of covenants on the undertenant. We find that these covenants on Ovalap reflected the covenants on Mrs Kamhi in the Headlease. They were intended to and did mirror the covenants in the Headlease apart from the prohibition on sub-letting and that rent was not payable.

24 Although the Underlease did not require Ovalap to pay rent, Ovalap did covenant to pay Mrs Kamhi an amount equal to the amount of service charge that she had to pay under the Headlease to the Superior Landlord. There were many other covenants, as there were in the Headlease, such as covenants to keep the property in repair and decorated. There was a general covenant:

“to observe and perform the covenants and conditions on the lessee's part contained in the Headlease except only the covenant for payment of the rent reserved by the Headlease but including for the avoidance of doubt the covenants for payment of rates and service charges reserved by clause 4.1.2 of the Headlease and to keep the Landlord indemnified against all damages claims costs and expenses in any way relating to the covenants contained in the Headlease.”

The Property

25 The parties did not dispute that the “property” for S102 was not Flat 32 but the Underlease which Mrs Kamhi granted to the trust. That this is correct in law follows from the House of Lords decision in *Ingram* [2000] 1 AC 293. Lord Hoffman at page 304 said:

“... ‘property’ in [section 102](#) is not something which has physical existence like a house but a specific interest in that property, a legal construct, which can coexist with other interests in the same physical object. [Section 102](#) does not therefore prevent people from deriving benefit from the object in which they have given away an interest. It applies only when they derive the benefit from that interest.”

26 So it is not relevant to this appeal that Mrs Kamhi remained with the legal right to possession of Flat 32 until 24 November 2007. This follows because she gave away a future underlease (in other words an underlease which would not commence until a date in the future, in this case in 2007), and was entitled to remain in possession of the property meanwhile under the terms of her the Headlease. At first impression one would say she retained a benefit — as did Lady Ingram in *Ingram* — but as Lord Hoffman explained the property is not the physical land but the legal interest in that land.

27 The effects of the decision in *Ingram* — but not the legal basis for it — were to some extent negated by the later enactment in the [Finance Act 1999 of s102A Finance Act 1986](#) with effect from 27 July 1999. This section is irrelevant to this appeal as the date of the disposition by Mrs Kamhi was 21 November 1997, as explained below.

Date of transfer

28 From the point of view of inheritance tax, it is of importance whether the gift to the trust took place when the Underlease was granted in November 1997 or when the term of it commenced ten years later in November 2007. This is because it is the Appellants' case that the transfer was potentially exempt from inheritance tax under s3A IHTA and as Mrs Kamhi died in 2008 this only benefits them if the transfer took place in 1997.

29 HMRC did not suggest at the hearing that the transfer took place in 2007 when the Underlease fell into possession. Nevertheless, we have considered this point as the date of the disposition underlies the whole basis of the claim to relief from inheritance tax.

30 S3 IHTA provides that a transfer of value is:

“a disposition made by a person (the transferor) 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”

31 A potentially exempt transfer is defined as a transfer of value which fulfils various requirements (chiefly that it is made during the lifetime of the transferor). The definition of “disposition” in [s 272](#) is unhelpful on this point: it merely says that it includes “disposition effected by associated operations”.

32 Disposition suggests a positive action (or even perhaps a deliberate omission) taken by the disposer. The only positive step Mrs Kamhi took was to grant the future lease. She did nothing further: when it fell into possession in 2007 it did so because of the terms of the deed dated 21 November 1997. We think the disposition took place on 21 November 1997. It would be very strange if this were not the case as the effect of Mrs Kamhi's grant of the future lease must have been to immediately significantly devalue her leasehold interest. It is true that the value of her leasehold interest would have continued to reduce as the commencement date of the future lease approached: but that was due to the operation of the terms of that lease and not to any act or omission by Mrs Kamhi.

33 Similarly where [s102](#) talks of the “date of the gift” we think that this must be the date of the disposition as the section applies where someone “disposes of any property by way of gift” and therefore the date of gift for [s 102](#) is the date of the disposition. The disposition was the grant of the future underlease.

34 In conclusion, we think HMRC were right not to raise this as an issue as it is clearly the law that the date of the disposition of a future underlease is the date of the grant and not the date the underlease actually commences.

Reservation of benefit

35 Mrs Kamhi gave away a future underlease in Flat 32. The question for this Tribunal is whether the property gifted by Mrs Kamhi to the trust was at any time in the relevant period “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”

36 It was the Appellant's case that the property was enjoyed to the entire exclusion of Mrs Kamhi or it was enjoyed *virtually* to the entire exclusion of Mrs Kamhi.

37 We note that until the term of the Underlease commenced on 24 November 2007, the undertenant (the trustee) had no immediate liability on the covenants. But from that date the trustee was liable on the covenants, including the covenant to pay the service charge to Mrs Kamhi. Whether or not in law the future nature of the lease might have made a difference, it does not on the facts because the “relevant period” for [s102\(2\)](#) was “at any time” in the 7 years prior to Mrs Kamhi's death and she died on 2 May 2008. So at the time of her death, the underlease had already commenced and so had the trustee's liability to Mrs Kamhi on the covenants.

38 Was the underlease enjoyed to the entire (or virtually the entire) exclusion of Mrs Kamhi? The Appellant's arguments seem to us to be threefold:

- (issue 1) The underlease including the covenants was a single property and this was what Mrs Kamhi transferred: the covenants were not reserved, they were part of the leasehold estate;
- (issue 2) Even if not, the nature of the covenants in reflecting those of the headlease

meant Mrs Kamhi was entirely excluded from enjoyment of the property;

- (issue 3) And if not, the benefit was of such a nominal nature that she was *virtually* entirely excluded.

39 Both sides were agreed that this is a question of fact following *Chick v Commissioner of Stamp Duties* [1958] AC 436 where Viscount Simonds said “the sole question is one of fact — was the donor excluded?”. However, we think at least Mr Matthew's first point is one of law: what is the nature of a lease? And we discuss this below.

Nature of a lease

40 In *Ingram* the deceased gave away the freehold reversion. In this case Mrs Kamhi gave away an underlease. In both cases the deceased created and gave away an interest in the land in which she had (originally) a greater interest. The distinction between the two cases is that the interests in land given away were different and in Mrs Kamhi's case the gift was subject to covenants.

41 A normal covenant on the grant of a lease is rent. If Mrs Kamhi's transfer of the property to the trustee was in return for a covenant to pay the full market rent then it would not have been a gift at all and this hearing would not have taken place. She did not reserve full market rent or indeed any rent (in the narrow sense) at all. The underlease was granted at a very substantial undervalue: it was a gift.

42 But the gift was qualified by covenants. Under the terms of the Underlease the trustee was obliged to pay to Mrs Kamhi the service charge and advance service charge, to keep the property in repair and obey various other covenants running to some 11 pages of the Underlease.

43 Does a reservation of covenants, and in particular one for payment (such as payment of an amount equal to the service charge under the Headlease), mean that the trust does not enjoy the Underlease to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to her by contract or otherwise?

44 HMRC's view is that Mrs Kamhi could not grant an underlease and avoid reservation of benefit unless she gave away a bare underlease, an underlease without any covenants in favour of Mrs Kamhi.

45 The first question for us, therefore, is whether the covenants were a property interest which could be reserved, as explained by Lord Reid in *Oakes v Commissioner of Stamp Duties New South Wales* [1954] Appeal Cases 57 at page 79:

“The contrast is between reserving a beneficial interest and only giving such interests as remain on the one hand, and on the other hand reserving power to take benefit out of, or at the expense of interests which are given, and for reasons already stated their Lordships are of opinion that the present case is within the latter class.”

In that case the reservation of income out of gifted property was found to be a reservation at the expense of an interest that was given away.

46 The legal definition of a lease is contained in the [Law of Property Act 1925](#) at [s 205\(1\)](#) where it says that a term of years absolute (a lease) is:

“a term of years (taking effect either in possession or in reversion whether or not at a rent) with or without impeachment for waste, subject or not to another legal estate, and either certain or liable to determination by notice, re-entry, operation of law, or by a provision for cesser on redemption, or in any other event (other than the dropping of a life, or the determination of a determinable life interest)”

47 To be a lease therefore it is essential that the right to possession is granted (albeit it might be in reversion to an inferior interest) and that the right is granted for a finite time not merely the life of someone. Rent is specifically stated not to be essential. Reservation of rent is therefore a choice and not an incident of the lease.

48 Mr Slater also cited Knight's Case (1588) 5 Co Rep 54b at 55a and [R v Collett \(1823\) Russ & Ry 498](#) as authority that rent is not an essential feature of a lease. We do not need to rely on these cases for that proposition as it is clear rent is not an essential feature of a lease from the [Law of Property Act](#) cited above. Nor did we understand Mr Matthew to disagree with this proposition: he disagreed with the conclusion drawn from these cases that covenants to pay rent, (or service charge) are therefore reserved benefits.

49 We find as a matter of law it is not essential for a lease to have a covenant to pay rent (or any other covenant). It is possible as a matter of law to create a lease without covenants. Our view is that a lease is a grant of a legal estate in land: it gives the tenant the right to occupy the land to the exclusion of anyone else (other than a sub-tenant or licensee) and in particular to the exclusion of the landlord.

50 The *rent* or any other covenant is merely the consideration for the grant in the same way that the price is the consideration for the sale of a freehold. The rent is not inherently part of the right to occupy: if rent is not paid the lease does not automatically terminate. On the contrary, the landlord if he chose to do so would have to take proceedings for forfeiture. The rent does run with the lease, so that a subsequent tenant must pay it to avoid forfeiture even though he does not have a contractual relationship with the landlord: the rent is merely a term on which the lease was granted, as are the other covenants.

51 On the other hand, we find the right to receive rent is not a *property* interest that can run apart from an interest in the land (it might be enforceable in contract law of course). The right to rent is not itself a term of years absolute or any other interest in real estate. If Mrs Kamhi had granted the same lease but without reserving any covenants at all she would have granted the identical *property* interest to the one she actually granted: a future underlease for a term of years absolute. The distinction between that hypothetical lease and the actual underlease is that the latter was subject to covenants. And covenants are not beneficial interests in property.

52 In *Ingram* the deceased granted an estate in land (the freehold reversion) and reserved an interest in land (the lease). The Lords held this was a grant of a limited interest and not a grant of a larger interest with reserved benefit. Mrs Kamhi's case is quite different. She granted an interest in land (the underlease) and reserved covenants which were not an interest in land.

53 That this is the correct interpretation of the law is reinforced by the view of Lord Hoffman in *Ingram* at page 304 where he says:

"...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 [in re Nichols, decd \[1975\] 1 WLR 534](#), they would have been benefits reserved. But in a case such as this, when she in fact received no such benefits, the contractual nature of the lease seems to me a matter of conveyancing theory rather than substance."

54 Unlike Lady Ingram, Mrs Kamhi did not merely grant a limited interest in land: she granted a limited property interest in land conditional upon fulfilment of covenants in favour of herself.

Antecedent reservation

55 Mr Matthew asked us to consider the case of [Munro v Commissioners of Stamp Duties \[1934\] Appeal Cases 61](#). The deceased farmed land in partnership with his children under a partnership agreement in 1909. In 1913 he gave them a share in the land. The Privy Council held that the partnership had either a tenancy over the land or a licence coupled with an interest. So the subsequent gift of land by the donor was subject to the pre-existing lease. The Privy Council

found the deceased had not reserved benefit out of his gift because his interest in the land arose under the partnership agreement and not from the gift.

56 Mr Matthew suggested that Munro might apply to Mrs Kamhi's gift. He suggested that the effect of the Licence to Underlet was to create the Underlease as a single entity or property interest which Mrs Kamhi then gave away. It is true that the draft Underlease was annexed to the Licence to Underlet, as one would expect, as the Superior Landlord was only giving consent for the grant of an underlease on the exact terms of the draft.

57 We find that this is really another way of putting his argument, which we have disposed of above, that the lease with covenants was a single, limited interest in property which was given away and that the covenants were part and parcel of the grant and not reserved by the donor. We do not agree with it. Firstly, as a matter of law the Licence to Underlet did not create the Underlease. It merely gave Mrs Kamhi the power to grant the Underlease without being in breach of the Headlease. Secondly, this case is not comparable to Munro. Mrs Kamhi's right to the service charge and other covenants were not independently granted to her by the trust, antecedent to the gift by her of the Underlease. The covenants were a condition of the Underlease, and, as we have already said, were not independent property interests even capable of being granted separately to the lease. This contrasts with Munro where the donor was given an antecedent property interest of either a lease or licence coupled with an interest.

58 We resolve issue 1 from paragraph 38 above against the Appellant for the reasons given. We move on to consider the other two issues: despite the reservation of normal covenants, was Mrs Kamhi excluded from all (or virtually all) enjoyment of the property?

Meaning of exclusion from enjoyment of the property

59 We consider what exclusion from enjoyment of the property actually means. The Appellant says that we cannot look at it in this simple way and cites to us Oakes (above). This was a decision of the Privy Council and therefore strictly not binding on us but neither party suggested to us that it was in any way wrongly decided and being a decision of the Privy Council, it is highly persuasive.

60 In that case, the testator gave away his property on trust the terms of which included that he (the trustee) was to be paid remuneration for managing the property. It was assumed by the Privy Council that the remuneration was reasonable and not excessive. The income from the property, now held in trust for the testator's children, to defray the expenses of them while minors. The estate duty law in New South Wales at that time provided that for a lifetime gift to be free of tax the property gifted must be enjoyed "to the entire exclusion of the deceased, or of any benefit to him of whatsoever kind or in any way whatsoever enforceable at law or in equity or not ...". Although the wording is not identical, the Privy Council said that it was not materially different in meaning to the [Finance Act 1940](#) which it considered (and which itself was the precursor to the provisions this Tribunal is considering).

61 The Privy Council concluded that spending the money on maintenance and education of his children was in their best interests and the fact the donor indirectly benefited from this by being relieved of the need to make this provision out of his own pocket was not relevant. This did not amount to a reservation of benefit.

62 However, the remuneration (assumed to be at a reasonable level) was found to be a reserved benefit. As already mentioned, the Privy Council found that the reservation of remuneration was the reservation of something that was not itself a property interest and therefore it was at the expense of the property interest that was gifted.

63 The Appellant's point in this case is that they see the covenants as being of the same indirect benefit to Mrs Kamhi as the payments for maintenance of children in the Oakes case. In that case the father (the donor) would have to pay the children's maintenance out of his own pocket if the trust had not: in this case Mrs Kamhi would have to pay the service charge if the trustee did not.

64 We cannot agree. It was not a condition of the grant of the property interest in Oakes that the trust would pay for the children's maintenance. On the contrary in this case, it was a term of the underlease that the tenant would pay Mrs Kamhi an amount equivalent to the service charge in

the Headlease. The reservation of the service charge by Mrs Kamhi was equivalent to the reservation of remuneration by Mr Oakes.

65 We think it might be different if it was merely that under the terms of the Licence to Underlet the donee covenanted with the Superior Landlord to pay the service charge direct to the Landlord. This would (indirectly) benefit Mrs Kamhi as much or almost as much as a direct payment to herself of the equivalent amount which she could then use to pay the service charge. But the distinction with the facts of this case is that Mrs Kamhi *reserved* this benefit when she made her gift of the Underlease. She could enforce the covenant against the trustee whereas she could not do so if the covenant were just between the Superior Landlord and the trustee.

66 We were also referred to the Court of Appeal's decision in [In re Nichols \[1975\] 2 All E R 120](#) . In this case the deceased gave the freehold in the land away to his son, and his son leased back the land on a 5 year lease with covenants by the son to carry out all repairs. It was found that that the son was given the freehold subject to the obligation to grant back a leasehold interest. The question (under legislation which was the precursor to that in this case) was whether the reservation of the leasehold was a reservation of benefit or was the gift merely of a freehold minus the leasehold interest? Goff LJ indicated that they thought the reservation of the lease was reservation of benefit but reached no final view on this as it was clear the gift failed to avoid inheritance tax because there was reservation of benefit on other grounds. Those were that the donee was made liable for repairs and to pay some tithes. This liability was imposed on the donee — the freeholder and landlord of the lease — under terms of the lease.

67 The finding of the Court of Appeal was that a covenant to carry out repairs and pay tithes was a benefit to the donor. On this authority it is difficult to see how the reservation of covenants for payment of service charge and repair of Flat 32 could be otherwise than a benefit to Mrs Kamhi.

68 We were also referred to the case of [Attorney General v Earl Grey \[1898\] 2 QB 534](#) in which the donor gave away the freehold in land subject to an annual rent charge to be paid to him. The Court of Appeal, on the legislation in force then which referred to the donee having "enjoyment...to the entire exclusion of the donor or of any benefit to him by contract or otherwise", found that the donor was not entirely excluded *and* that there was benefit to the donor under contract.

69 HMRC say that the Grey case shows that reservation of rent brings the reservation of benefit provisions into play and Nichols shows that a repairing covenant does so. In HMRC's view, this case is clearly within the charge to tax as there was a covenant to pay service charge and to carry out repairs. Mr Matthew considered it would be wrong on the basis of these cases to conclude against his client as (he said) in reality the covenants were of no benefit to Mrs Kamhi; the terms would have been implied even if she had not reserved them; and such an interpretation of the law would lead to absurdity.

Of no benefit to Mrs Kamhi

70 Mr Matthew said that the reserved covenants were of no benefit to Mrs Kamhi as she was liable to Superior Landlord on identical covenants. She did nothing more than protect her interests under the Headlease. By this we understand Mr Matthew to mean that Mrs Kamhi had the benefit of occupation of Flat 32 under the Headlease but subject to certain covenants, and all she did when creating the Underlease was to give the right of occupation to her trust subject to the same covenants.

71 The Appellant said the covenants were not of *benefit* to Mrs Kamhi: it was just reimbursement of a detriment (because she was liable to pay the service charge to the Superior Landlord.) He says the tenant was not liable to pay any rent, just to reimburse Mrs Kamhi an amount equal to the service charge she had to pay to the Superior Landlord. Rent is rent says Mr Matthew, service charge is merely payment by the tenant for the use of facilities. It is not, he says, the same thing.

72 Similarly, Mr Matthew was of the view that the various covenants including the one to keep the property in repair were not of benefit to Mrs Kamhi as they merely discharged her liability to the Superior Landlord. We had no evidence that the undertenant (the trustee) had actually incurred any expense under these covenants: but from the when the lease fell into possession on

24 November 2007 until her death six months later Mrs Kamhi could have enforced the covenants if the undertenant was in breach.

73 We do not find that this means that Mrs Kamhi was excluded from benefit of the property. We agree that Mrs Kamhi held Flat 32 under the Headlease subject to the many covenants in that grant. However, it was clearly of benefit to her that after the grant of the Underlease, the trustee now owed her the same covenants. While we can see that vis-à-vis the Superior Landlord, the trustee and Mrs Kamhi now had joint and several liability on the covenants, the former under the Licence to Underlet and the latter under the Head Lease, nevertheless Mrs Kamhi could, under the terms of the Underlease, pass her liability on to the trustee. This has to be of benefit to her.

74 A related point Mr Matthew made was that Mrs Kamhi remained liable on the covenants in any event. And, for the reasons explained in the previous paragraph, we agree that this is the case but we do not agree that this means Mrs Kamhi took no benefit. Yes, she remained liable on the covenants under the Headlease but after the grant of the Underlease, she could now force the trustee to underwrite her liability. Nor do we agree that it makes any difference in theory that a service charge rather than rent was reserved. Irrespective of the fact it was calculated to mirror the service charge in the Headlease, the payment was due to her under the terms of the Underlease and was therefore rent by whatever name called or however or by whomever calculated.

Terms would be implied in any event

75 Another point made by Mr Matthew is that if the underlease did not contain mirror covenants, then such terms would be implied by law in any event. He cited *Cosser v Collinge* (1832) 40 ER 108 as authority for this. In that case the lease contained some terms that were unusual in 1832 such as a covenant on the tenant to insure. The court implied these terms into the underlease on the basis the undertenant had had the opportunity to inspect the headlease and should be taken to know its terms (and in fact did know its terms) and therefore a successor to the original undertenant was bound by these implied mirror covenants too.

76 The law on this was set out by Tomlin J in the case of *Melzak v Lilienfeld* [1926] Ch 480 where he said:

“in a contract for...the grant of a sub-lease out of a leasehold interest, in each of which cases the proposed grantee has notice of the lease, the law is this: that in the absence of any term in the contract to the contrary, and in the absence of any evidence that the proposed grantee has in fact been made acquainted with the actual terms of the lease, the contract must be read and construed as in the one case a contract for the assignment of a lease containing the usual covenants, and in the other case, as a contract for the grant of a sub-lease out of a leasehold interest containing the usual covenants.”

77 Our understanding is that normal covenants will be implied in the absence of an agreement to the contrary, and indeed covenants mirroring those in the headlease will in addition be implied where the proposed undertenant was shown a copy of the headlease.

78 Mr Matthew's point is that he considers that mirror covenants would have been implied into the grant by Mrs Kamhi even if she had not reserved them. We do not agree that the authorities show this. The cases cited by Mr Matthew do not involve underleases that were intended as gifts: on the contrary they were commercial leases. The point about implied terms is that they are terms that the parties must have intended to apply to their dealings. It is far from obvious that a person would intend to reserve mirror covenants in a lease intended as a gift and we do not think that they would for this reason be implied.

79 In any event, the parties could choose to exclude implied covenants by an express term to this effect (and indeed Tomlin J says this as he says “in the absence of any term in the contract to the contrary ...”). Therefore it is not the case that had Mrs Kamhi not expressly reserved the mirror covenants, they would have been implied in any event. The lease could have had a term to the contrary effect.

80 Thirdly, we do not agree that it makes any difference to [s 102](#) whether the reserved benefit was expressly reserved or arose by implication. [S102](#) refers to enjoyment to “the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise”. It does not on the plain words of [s 102](#) make any difference whether the contractual or lease term, for instance, is express or implied. The question is whether there is benefit.

81 Lastly, Mrs Kamhi did expressly reserve these mirror covenants and therefore a hypothetical situation is not relevant. In conclusion, we do not consider the point on implied terms is of any assistance to the Appellant.

Impracticability of literal interpretation

82 Mr Matthew said that in practical terms it would be impossible to grant such underleases as Mrs Kamhi had without reserving covenants which mirrored those in the Headlease as the Superior Landlord would not consent to an underletting on unusual terms.

83 For what it is worth, we do not agree with Mr Matthew on this. We note that the Headlease required, as a precondition to the grant of an underlease, that the Superior Landlord's consent was obtained and that the undertenant had to first enter into a covenant with the Superior Landlord to obey the Headlease. This requirement was fulfilled by the trustee's covenant to the Superior Landlord given in the Licence to Underlet. Of more relevance to Mr Matthew's point is clause 4.10.3 which says that that a permitted underlease should “be granted on terms no more favourable to the Lessee than those contained in the Lease”. This suggests Mr Matthew is right and unless Mrs Kamhi reserved these mirror covenants she could not grant the underlease. However, we note two things. Firstly, as a matter of fact the Superior Landlord did not insist on this clause being fulfilled to the letter in that the Headlease reserved rent and the Underlease did not. And secondly, it is clearly open to a superior landlord to waive such a covenant. And we see no reason why a superior landlord would not be prepared to waive such a covenant: his concern will be the direct covenants the prospective undertenant gives him in the Licence (which he can enforce) and not the terms of the Underlease itself (which he cannot enforce).

84 More significantly we consider that the *reason* for the reservation of benefit is not relevant. [S102](#) simply asks the question whether the property interest given away is “enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise”. It does not ask, if not, why?

85 Mr Matthew argues for a purposive interpretation of the legislation. A literal interpretation of the Act he says makes any grant of an underlease (whether a future underlease designed to avoid inheritance tax or one taking effect immediately in possession) ineffective as a potentially exempt transfer. In other words, Lady Ingram could make a potentially exempt transfer as she owned the freehold, but, Mr Matthews suggests, on a restrictive reading of [s 102](#) Mrs Kamhi could not as she only owned a leasehold interest in Flat 32 and must reserve covenants.

86 Mr Matthew's suggested purposive interpretation would be that covenants in an underlease which mirror those in the headlease are not benefits enjoyed by the donor. He cited [Commissioner of Inland Revenue v Levy \[1982\] STC 442](#) in which Nourse J interpreted “settlement” to exclude commercial transactions which had no element of bounty because otherwise *any* transaction would be caught which was clearly not intended by the legislation. His point is that if the Tribunal considers that all reserved covenants are reservations of benefit, no grant of *any* underlease could ever be a potentially exempt transfer for inheritance tax.

87 We do not agree that it is right to give the interpretation argued for by Mr Matthew. A normal reading of the legislation does not lead to an absurd result and is we think closer to Parliament's intention. Firstly, the legislation itself refers to “virtually” being excluded so there is already a margin for de minimis matters to be disregarded. We think it possible that some covenants might be of so minor a nature as to mean the lessor is “virtually” excluded from benefit: whether the covenants in this appeal were of a de minimis nature we address in the next section.

88 Secondly, it was open to Mrs Kamhi or any other holder of a long lease wishing to make a potentially exempt transfer of it to *assign* the lease rather than grant an underlease. We see no reason why an assignment should contain reserved covenants as, vis-à-vis the Superior Landlord, the donee becomes the tenant and liable on the covenants in the lease; and as far as

the donor is concerned they intend a gift. (We note that the donor, even if it has the liability of an original tenant, indirectly benefits because the donee by becoming tenant also becomes liable on the lease covenants. The landlord might choose to pursue the donee rather than the donor for any non-observance of covenants. But, under the authority of *Oakes* and the point on maintenance of the children, this is not a reservation of benefit contained in the grant of the assignment and is not relevant to [s 102](#).) It was also open to her if she could obtain the consent of the Superior Landlord to grant an underlease without reserved covenants.

89 Thirdly, the grant of a future underlease is likely to be very unusual. HMRC did not choose to challenge Mrs Kamhi's motives in granting a future underlease (although it seems Mr Buzzoni would have been in a position to explain them as he was her adviser) so we make no finding on the motive in this case but merely note that -under the law as it stood at the time — if we decide in the Appellants' favour, a future underlease would seem to be effective at reducing inheritance tax while allowing the donor to live in the property. An ordinary reading of [s 102](#) avoids this absurd result.

90 In conclusion, we do not see any distinction between Mrs Kamhi's case and the binding cases of *Grey* (reservation of rent) and *In re Nichols* (covenant to do repairs and pay tithes) or the persuasive decision of the Privy Council in *Oakes*. We do not think the fact that the covenants in this case mirrored those in the headlease makes any difference. They were still of benefit to Mrs Kamhi. Mr Matthew's suggestion amounted to saying we should “see through” the headlease as if it were not there and see the trustee as owing the covenants direct to Superior Landlord. This would have been the effect if Mrs Kamhi had assigned her lease but she did not. And as she did not, we cannot look through the underlease and pretend it did not exist.

91 The reservation of service charge and the other covenants we find means that the trust as tenant and donee could not enjoy the lease to the entire exclusion of the donor: far from it, the service charge had to be paid to Mrs Kamhi and the covenants obeyed or the property (the Underlease) could be forfeited. That decides the second point referred to in paragraph 38 against the Appellant so we turn to consider the last which was whether Mrs Kamhi was virtually entirely excluded from benefit.

Virtually entirely excluded?

92 Counsel was unable to point us to much authority on what “virtually” means. Although the point was not at issue in *Ingram*, Lord Hoffman referred to “virtually” as *de minimis*:

“For one thing, it is in one sense a penal section. Not only may you not have your cake and eat it, but if you eat more than a few *de minimis* crumbs of what was given, you are deemed for tax purposes to have eaten the lot.”

93 The meaning of “virtually” was considered in *Eversden & Eversden* [\[2002\] EWHC 1360 \(Ch\)](#). The Deceased created a trust of which her husband was life tenant and thereafter she among a class of others was a discretionary beneficiary. Although she was far from certain to benefit, there was a real possibility of her benefiting very substantially from the trust fund and Lightman J held that she was neither excluded nor virtually excluded from benefit. This was not doubted on appeal: [\[2003\] STC 822](#) at paragraph 13 per Carnwath LJ.

94 Similarly in *Lyon and the Trustees of the Alloro Trust* *SPC 00616* the Special Commissioner found that where the settlor was one of a number of potential beneficiaries of a discretionary trust, he was neither excluded nor virtually excluded from the trust.

95 What is the meaning of “virtually”? The Shorter English Oxford dictionary contains this definition:

“As far as essential qualities or facts are concerned. In effect. Practically; to all intents; as good as.”

96 We think “virtually” is a very high test. To be virtually excluded is to be as good as excluded; to be excluded for all practical purposes. An exceedingly remote chance of benefit or where the

benefit is real but very slight might mean a settlor is “virtually” excluded but not otherwise. As Lord Hoffman said (albeit obiter) more than a few de minimis crumbs is too much.

97 S102 is concerned with the possibility of benefit and not whether Mrs Kamhi actually did benefit. We do not know whether the trustee ever did make payments of service charge to Mrs Kamhi. Indeed, Mr Matthew pointed us to a letter written by a solicitor acting for his client which said no payments were made by the undertenant but as she was not called to give evidence we place no weight on this. In any event, the significant point is that from the moment the underlease fell into possession, the trustee was obliged to pay an amount equal to the service charge charged under the Headlease to Mrs Kamhi, as well as obey various other covenants. Whether Mrs Kamhi died before any payments were made is not relevant: it is the potential for benefit that matters.

98 The service charge was, in absolute terms, substantial, some £9,000 per annum. The other covenants also had a real potential to involve the trustee in expenditure of significant sums of money, such as the covenants to decorate and repair the property, expenditure which the tenant (Mrs Kamhi) would have had to incur except that the terms of the grant of the underlease made the trustee liable to do it. Even if “virtually” should be measured by comparison to the size of the gift, the Appellant has failed to satisfy us that the service charge and other covenants were practically insignificant. We think it would be a real burden to anyone, who has given away the right to occupy the property, to carry on paying a service charge of very much more than a nominal amount. And we find £9,000 per annum is far from a nominal amount.

99 We do not find that Mrs Kamhi was *virtually* excluded from benefit.

100 We dismiss the appeal.

101 This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to [Rule 39 of the Tribunal Procedure \(First-tier Tribunal\) \(Tax Chamber\) Rules 2009](#) . The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

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