

[2017] UKUT 103 (TCC)



Appeal reference UT/2015/0184

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

BAKHTIAR KHAN

Appellant

- and -

MUDASAR ZAFAR

Respondent

TRIBUNAL: Tribunal Judge Elizabeth Cooke

Sitting in public in Manchester on 15 November 2016

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DECISION

Introduction

- 5 1. On 19 April 2010 the Appellant, Mr Bakhtiar Khan, executed a deed transferring leasehold property (“the property”) – an industrial estate in Manchester - to himself and the Respondent Mr Mudasar Zafar. Title to the property was registered under title number GM456572. The deed was in form TR1 and I shall refer to it as “the TR1”. The TR1 has never been registered and Mr Khan remains sole registered proprietor of the property. Mr Zafar has had a unilateral notice entered on the register to protect his interest in the property.
- 10 2. I have to digress at once to note that that entry is a puzzle. An unregistered transfer takes effect in equity pending registration; unless the TR1 is void Mr Khan must hold the property upon trust for himself and Mr Zafar pending registration of the TR1, and section 33 of the Land Registration Act 2002 states that no notice may be entered on the register in respect of an interest under a trust of land. I come back to this puzzle at the conclusion of my decision, at paragraph 79 below.
- 15 3. Mr Khan applied to HM Land Registry on 20 September 2012 to cancel the notice. Mr Zafar objected to that application, and the dispute was referred to the Land Registration Division of the First-tier Tribunal (“the LRD”). Mr Zafar was the Applicant in those proceedings because it was for him to prove that he had an interest that could be protected by the notice. Mr Khan’s application to cancel the unilateral notice was made on the basis first that the TR1 was not completed, having been delivered by him in escrow, and second that if it was completed the TR1 contained a mistake in that it should have been a transfer of part only.
- 20 4. In the course of the proceedings in the LRD Mr Khan made an application of his own. The LRD has the same jurisdiction as the High Court to rectify or set aside documents that (to paraphrase section 108 of the Land Registration Act 2002) will lead to registration, and Mr Khan applied to set aside the TR1 if it was found to have been completed. Accordingly the judge of the LRD had to determine first whether the transfer of 19 April 2010 was valid and effected a transfer of the property into the joint names of Mr Khan and Mr Zafar and second, if it was valid, whether it should be set aside.
- 25 5. The reference was heard by Judge David Taylor on 20 – 22 April 2015. He decided that the transfer was valid and refused to set it aside; by his decision 14 July 2015 he directed the Chief Land Registrar to cancel the Respondent’s application, with the result that the unilateral notice remains on the register
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protecting Mr Zafar’s interest. This is an appeal against that decision of the LRD.

- 5 6. The appeal was listed for a date in June 2016, but I gave permission for that date to be vacated and the hearing re-listed once the decision of the Supreme Court in *Patel v Mirza* [2016] UKSC 42 had been handed down. I heard the appeal on 15 November 2016 at Alexandra House in Manchester. At that hearing Mr Khan was represented by Mr Reay of counsel and Mr Zafar by Mr Moss of counsel, and I am grateful to both for their helpful arguments at that hearing and in written submissions afterwards. At the hearing I asked some questions about the scope of what is known as the illegality defence; it was agreed that I should allow Mr Reay to make written submissions in response to the points I had raised and Mr Moss to reply, which is why this decision is given some weeks after the hearing.
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- 15 7. For the reasons that I now explain the appeal fails. In the paragraphs that follow I first summarise the facts as found by the LRD, by way of background, and then set out the decisions of law made by the LRD. I then consider the grounds of appeal, under two headings: the illegality question and the sham transaction question.

The facts found by the LRD

- 20 8. There is no appeal from the findings of fact that Judge Taylor made, and I summarise them by way of background to this appeal.

The negotiations leading to the TR1

- 25 9. The learned judge found that Mr Khan acquired the property in 2007 for £375,000; around £260,000 of that price was a mortgage advance from the Yorkshire Bank. Mr Khan’s evidence was that it was worth about £1 million, but the judge found that the £375,000 “more or less” reflected its value. He also found that in early 2010 Mr Khan was in some financial difficulty. He was having trouble making mortgage payments and needed to ease his cash-flow problems. There were negotiations between Mr Khan and Mr Zafar Iqbal, who was Mr Zafar’s father and acted as his agent, for the sale of some or all of the property.
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- 35 10. In making findings of fact about those negotiations the judge was hampered by Mr Khan’s evidence; he changed his story a number of times and, the judge said at his paragraph 18, in his documentary evidence “has re-written history in order to try to advance a case for an outcome that he considers would be fair in the circumstances”. Nevertheless, the judge found, his oral evidence at the hearing “had the ring of truth”. The judge found, in line with the evidence that Mr Khan eventually gave at the hearing, that agreement was reached between Mr Khan and Mr Iqbal that Mr Zafar would buy “Block B”, which was about

half of the industrial estate by area, and that it was “probable that Mr Khan expected that he would eventually receive payments totalling £520,000, by a series of instalments” (and of which £131,000 would be a mortgage advance). The judge called this the parties’ “true agreement” or “underlying agreement”, but he did not find that it was a contract.

The preparation of the TR1

11. The TR1 departed from the parties’ agreement in two respects – the price paid, which was stated to be £130,000, and the actual transaction, which was not a sale of half but a transfer of the whole into joint names. The judge traced the way those two differences came about, starting with the instructions given to HSK Solicitors (“HSK”), who acted for both Mr Khan and Mr Zafar.
12. HSK’s attendance note of 9 February 2010 stated that their two clients gave instructions that Mr Zafar wanted to buy, and Mr Khan to sell, half the property, and that while £130,000 would be paid by Mr Zafar, a mortgage advance of £131,000 would be made by the Yorkshire Bank to both Mr Khan and Mr Zafar. The judge found that HSK were unaware that £520,000 was to be paid. The attendance note of 9 February 2010 recorded that the Yorkshire Bank was happy to lend on this basis and ended with the words:

The transaction will therefore be a transfer by Mr BA Khan from his sole name into the joint name of himself and Mr Zafar and will be for one half of the land and buildings owned.
13. Mr Khan’s evidence, which the judge accepted, was that it was on Mr Iqbal’s instructions that the figure of £130,000 was inserted in the transfer, rather than the £195,000 (being the cash plus half the liability for the mortgage debt) that HSK knew that Mr Khan was to receive or the £520,000 that the parties had agreed was payable, and that this was done in order to stay below the threshold for Stamp Duty Land Tax, which is £150,000; and indeed £130,000 was the consideration recorded in the SDLT return dated 5 May 2010.
14. That accounts for the difference in price between the “underlying agreement” and the TR1. The difference in price is the illegality which has been the focus of this appeal, because the price was under-stated so that Mr Zafar would not have to pay Stamp Duty Land Tax. Since there was no contract for the payment of £520,000 it appears that the illegality was the under-statement of the consideration by the £65,000 that was paid (being half the mortgage liability) rather than by the £390,000 which the judge found was agreed; which it was is immaterial to these proceedings but I mention in it in case it becomes important in another context.
15. As to the transaction itself, the judge found (at his paragraph 79) that HSK probably advised the parties that a mortgage of part would be difficult to negotiate, and that that was why the parties instructed HSK to prepare a transfer that made them joint owners of the whole, and therefore had the effect

of transferring 50% of the beneficial interest in the whole property to Mr Zafar rather than selling half the land to him as they had originally instructed.

16. The judge also accepted (at his paragraphs 18 and 79) Mr Khan's oral evidence that he did not understand the difference between a transfer of whole into joint names, and an outright transfer of Block B, although he found as a fact that Mr Iqbal "most probably understood the distinction". Mr Khan, the judge found (his paragraph 79), "was happy for HSK to get on and do whatever was necessary to ensure that he received the funds which he urgently required."

Events after the TR1

17. The judge found (his paragraphs 67 and 88) that on 19 April 2010 the parties executed a new legal mortgage over the property to secure a loan of £131,000, and that that sum was used (along with the cash payment of £130,000) to redeem Mr Khan's existing mortgage. The new charge to the Yorkshire Bank cannot have been registered because the mortgagors were not yet, and still are not, registered as joint proprietors.

18. No more has been paid. Mr Zafar did pay to HSK on 18 February 2011 an instalment of £137,800 which was later refunded to him; there is no finding in the LRD decision as to why that was. It was Mr Khan's case that Mr Zafar was unable to come up with the final instalment of approximately £130,000 to complete the transaction.

19. The judge noted evidence of subsequent negotiations or dealings between the parties which he said (at his paragraph 72) demonstrated that there was "something more to the agreement between the parties" than the deal recorded in the attendance note of 9 February 2010 and in the TR1 itself. One piece of evidence was a document dated 23 February 2011 headed "Agreement" in which Mr Iqbal acknowledged indebtedness of £363,000 to Mr Khan. The judge took that evidence as being "supportive of the view that some wider agreement had been reached between Mr Khan and Mr Iqbal" (the latter having been found to have been acting throughout as Mr Zafar's agent).

20. Another was a draft contract on HSK's file, disclosed during the proceedings, together with correspondence from 2014 which together indicated that Mr Zafar had agreed to purchase the property, together with the superior leasehold title, for £137,000. The judge accepted Mr Reay's argument, for Mr Khan, that it was evidence that Mr Zafar knew that he had not already acquired a 50% share in the whole property.

21. The TR1 appears to have made – and indeed has made, as I find in refusing this appeal – Mr Khan the joint owner of the whole property, having parted with half his interest in it for around £195,000 (being the cash payment and half the mortgage advance). Whether that was a good or a bad deal is not

known in the absence of any valuation evidence, but at any rate it is not the deal that Mr Khan now wants.

The decisions of law made in the LRD

5 22. As I have said, the TR1 has not been registered; the LRD did not make any finding of fact as to why it has not. Having failed to register it Mr Zafar has had a unilateral notice entered on the title to the property to protect his interest under the TR1. The judge in the LRD directed the registrar to cancel Mr Khan's application to remove Mr Zafar's unilateral notice. He found that the transfer in 2010 was effective and he declined to set it aside; therefore Mr
10 Khan failed both in the reference under section 73 of the Land Registration Act 2002 and in the rectification application under section 108 of the same. He did so for the following reasons.

23. First, he rejected Mr Khan's argument that the transfer was ineffective because it was delivered as an escrow and not as a deed.

15 24. Where a document is delivered as an escrow, it is executed by one party and handed over, typically to a legal representative, on the basis that it cannot take effect until a particular condition is met. Mr Khan argued that the transfer was an escrow that was not to take effect unless and until Mr Zafar executed it (which he did not). There was in fact no need for Mr Zafar to execute it, since
20 the purchase did not involve either the giving of covenants by the purchaser or the making of a declaration of trust, and Mr Khan's argument was rejected. The judge said, at his paragraph 88:

... the purpose of the transaction was to enable the Respondent to raise funds with which to repay his debt to the Yorkshire bank. This would
25 be achieved by (a) Mr Zafar's payment of £130,000, and b) new borrowing from Yorkshire Bank of £131,000. Mr Zafar paid the £130,000, and on 19th April 2010 [Mr Khan] (together with Mr Zafar) executed a new legal mortgage over the property in favour of Yorkshire Bank to secure the new borrowings of £131,000. The funds
30 raised as a result were used to repay Mr Khan's original mortgage debt to Yorkshire Bank, As a result of this series of transactions, Mr Khan's mortgage interest payments were halved. Mr Khan was quite clearly fully aware of the financial result of the series of transaction which had taken place. Can it really lie in the mouth of Mr Khan, in
35 circumstances in which he plainly wanted the transaction to proceed, and in circumstances in which it did proceed and he benefitted from it, to say that the deed was delivered as an escrow?¹

¹ In quoting the decision of the LRD, here and elsewhere, for clarity in the present context I have substituted the names of the parties for their designation as "Applicant" and "Respondent" in the LRD.

25. There is no appeal against this aspect of the LRD’s decision. I have quoted the judge’s findings as to what Mr Khan wanted to happen and did happen because they are relevant when I come to consider the question whether the TR1 was a “sham”, below.
- 5 26. Second, it was argued for Mr Khan on the authority of *Tinsley v Milligan* [1994] 1 AC 340, that Mr Zafar could not rely upon the TR1 to assert a beneficial interest in the property because in doing so he would be relying on an illegality, namely the mis-statement of the consideration and consequent underpayment of Stamp Duty Land Tax.
- 10 27. The judge considered the law as it then stood, and concluded:
... it seems to me that Mr Zafar, in the present case, does not need to rely upon the unlawful evasion of stamp duty in order to assert that, by virtue of the completion of the transfer, he has acquired a beneficial interest in the property. He is entitled simply to refer to the fact of the transfer in order to establish that interest.
- 15 28. That finding is appealed, and I discuss the two grounds of appeal under the heading “The illegality question” below.
29. Third, it was argued for Mr Khan that the transfer was of no effect because it was a sham. Judge Taylor found that Mr Khan could not make that argument, because in doing so he would have to rely on the illegality in the transfer. He was saying that it was a sham precisely because it contained an illegality, and he could not rely upon that illegality to impugn the document. It was argued that the purpose of the illegality had not in fact been carried into effect, and that therefore the principle in *Tinsley v Milligan* need not to be applied, but
- 20 25 Judge Taylor rejected that argument. The decision that Mr Khan could not argue that the TR1 was a sham is appealed, and I discuss the two relevant grounds of appeal under the heading “The sham transaction question” below.
- 30 30. Fourth, it was argued that Mr Khan held an unpaid vendor’s lien over the property – in other words, a charge arising from non-payment of the purchase price – and that that lien defeated Mr Zafar’s beneficial interest. That argument too was rejected, and there is no appeal from that decision.
31. Accordingly Judge Taylor found that the transfer was effective and that although it has not taken effect in law for want of registration (section 27(1) of the Land Registration Act 2002) it has taken effect in equity.
- 35 32. He then went on to consider whether the transfer should be set aside. Mr Khan’s case was that the transfer was a mistake. It was supposed to transfer half of the property by area, but as we have seen it did not, and we have seen why (my paragraph 14 above). Judge Taylor said:
In the light of my factual findings, it is quite clear that there is no possibility of Mr Khan succeeding in his argument that the TR1 should be set aside on the ground of mistake. This is for the simple reason that
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there was no mistake. Although the parties' underlying agreement was very different to that which was recorded in the TR1, this was not the result of any error but rather because it suited their various purposes to present the transaction in the way in which they did.

5 33. There is no appeal against the decision on rectification.

34. I now turn to the two questions that arise on this appeal.

The illegality question

The grounds of appeal

10 35. It is argued for Mr Khan that the R1 did not confer an interest in the property upon Mr Zafar because of the doctrine of illegality. I begin with a brief explanation of the law.

The illegality defence

15 36. The doctrine of illegality is a defence. It prevents certain claims from being made. Typically a claimant brings an action in contract or restitution, or – as in *Tinsley v Milligan* – asserts an interest under a trust, and the defendant's answer is that the claim cannot be made because of an illegality.

20 37. Before the decision in *Patel v Mirza* the leading case was *Tinsley v Milligan* [1994] 1 AC 340. Miss Tinsley and Miss Milligan bought a house together; both contributed, and they agreed that it would belong beneficially to both. But the legal title was held by Miss Tinsley alone so that Miss Milligan could make false benefit claim from the Department of Social Security by hiding her property.

25 38. Later the two fell out and Miss Tinsley brought possession proceedings. Miss Milligan counterclaimed for a declaration that the house was held on trust for them both in equal shares. She succeeded, and both the Court of Appeal and the House of Lords dismissed Miss Tinsley's appeal. Miss Milligan was able to prove that she had an equitable interest by pleading the contribution and the common intention; because she did not need to plead the illegal purpose the illegality defence failed.

30 39. It is well-established that the law as stated in *Tinsley v Milligan* generated some arbitrary results. The development of the law and the problems with it are set out in the Supreme Court's decision in *Patel v Mirza*, which introduced a new way of looking at the defence. The defence is no longer a mechanistic one, successful if the claimant has to plead the illegality and not otherwise. Instead, the court is to consider whether the enforcement of the claim would be contrary to public policy by considering three factors. Lord Toulson, in *Patel v Mirza* at paragraph 101, said:

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40 ... one cannot judge whether allowing a claim which is in some way tainted by illegality would be contrary to the public interest, because it would be harmful to the integrity of the legal system, without (a) considering the underlying purpose of the prohibition which has been

transgressed, (b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and (c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality.

5 *The grounds of appeal relating to illegality*

40. Two of Mr Khan’s four grounds of appeal (grounds 1 and 3) relate to the illegality defence. The basis of both grounds is that the illegality – namely the under-statement of the consideration – in the TR1 means that no equitable interest arises in Mr Zafar’s favour. To quote the Grounds of Appeal:

10 The equitable interest which *prima facie* arises does so directly from the instrument of illegality and is conditional upon there being a transaction to transfer the legal title capable of enforcement, which is absent.

41. The argument is that the TR1, which does not operate at law because it is not registered, cannot operate in equity because of the illegality. An instrument that fails to operate at law can operate in equity, but only insofar as it amounts to an enforceable contract to grant a legal estate; the TR1 is tainted by illegality and therefore cannot be enforced; accordingly the TR1 has no effect in equity.

42. The argument is also put another way: the TR1 can confer an equitable interest only on the basis that it will in due course be registered and will create a legal interest; the illegality in the TR1 means that “the Courts and the Tribunal could not ever allow that legal title to be registered”, and therefore “the equitable interest must also fall away because the equitable interest rests on the premise that there is a legal interest to be acquired” (I quote from Mr Khan’s application for permission to appeal).

43. As I said above, there are in fact two grounds of appeal relating to illegality, both supporting the argument that no beneficial interest has been created.

44. Mr Khan’s first ground of appeal was drafted before *Patel v Mirza* was decided and therefore relied upon the authority of *Tinsley v Milligan*. The argument was that the TR1 was unenforceable because Mr Zafar would have to rely upon the illegality in order to make a claim on the basis of the TR1. That was the argument rejected by Judge Taylor.

45. Ground 3, added after the decision in *Patel v Mirza*, supplements Ground 1. *Patel v Mirza* changed the law by moving away from the mechanistic approach of *Tinsley v Milligan*. The question now to be asked is not simply whether the claimant can make his or her case without relying upon the illegality. Instead a more rounded approach is substituted, which seeks to do justice between the parties and to take a proportionate rather than a mechanistic approach to the illegality – see paragraph 39 above. It is argued for Mr Khan that if this new approach is taken then, again, the TR1 falls foul

of the illegality defence, cannot be enforced as a contract, and therefore does not create an interest for Mr Zafar. Alternatively, putting it the other way round as in paragraph 42 above, the TR1 could not be registered because of the illegality and therefore, since it cannot create a legal interest, it cannot create an equitable interest either.

Discussion of the illegality question

46. If title to the property had not been registered, the transfer deed would have conferred a legal estate upon Mr Zafar. There would have been no scope for any “defence”, whether of illegality or otherwise. On execution and delivery the deed would simply have done what it was supposed to do, namely transfer the legal estate from Mr Khan alone to Mr Khan and Mr Zafar together.

47. The proposition that where title to the property is registered a deed of transfer might fail to take effect, not only at law but also in equity, because of an under-statement of consideration is startling.

48. Of course, the TR1 has not transferred the legal estate in the property, but that is only because section 27(1) of the Land Registration Act 2002 states that it shall not take effect at law until it is registered. It is well-established, however, that pending registration a transfer of registered land takes effect in equity. Can the doctrine of illegality be said to prevent that? If I have understood correctly, the argument made by Mr Reay is that the TR1, deprived of legal effect by the statute, is reduced to the status of a contract and confers a beneficial interest because it is specifically enforceable. It is said that the equitable interest of the purchaser pending registration is the same as that of a purchaser pending completion of a contract for sale of land (Mr Reay’s supplemental skeleton argument, paragraph 38). The doctrine of illegality prevents specific performance, and therefore the TR1 cannot create a beneficial interest.

49. In my judgment the argument is misconceived because it treats the TR1 as an executory contract – that is, an obligation to create or confer a legal estate in the future. It is not: insofar as it is a contract it is an executed contract leaving nothing to be performed by the transferor. Mr Khan has made the transfer by executing the TR1; there is nothing else he is obliged to do. In this sense the beneficial interest of a purchaser under a completed but unregistered TR1 is very different from that of a purchaser under an uncompleted contract for the sale of land. An order for specific performance would be meaningless.

50. I take the view that the TR1 has conferred (in the absence of a prior contract) a beneficial interest pending registration, the latter being the only further step needed to create a legal estate. To say that the illegality defence could prevent the registration of the deed, or could prevent the TR1 from conferring an equitable interest pending registration, would be a novel idea, for which there is no precedent, and which does not in my view make conceptual sense.

51. I noted above (paragraphs 42 and 45) the alternative way in which the argument was put, namely that the deed could not be registered because of the illegality and that therefore it cannot confer an equitable interest, the equitable interest arising only on the basis that a legal estate will eventually be conferred. Yet in the absence of objection nothing would stand in the way of the registration of a deed that under-stated the consideration, and no doubt such registration has happened countless times. True, if an objection were made then the matter would be referred to the Tribunal or court proceedings would be commenced; and there would then be a need to consider, as I am doing, whether the illegality could prevent the operation of the deed, at law or in equity. So that alternative argument does not take matters any further.
52. At the hearing in November 2016 I asked counsel for both the parties if there was any case in which the doctrine of illegality had prevented the operation of a deed of transfer of land. They agreed that there was none, and neither has produced any such precedent in their written submissions. Whatever the purpose behind it, the parties' deed remains their deed and it is not possible to see that any illegal purpose or side-effect of that deed could prevent its operation in equity or at law.
53. Indeed, the use of the illegality defence in this way would create a circularity; it would mean that a transfer containing an under-statement of consideration would be void, and therefore that no liability to stamp duty land tax would arise, and therefore that there could be no illegality. It would be perverse to construe the law so as to produce such a contradiction.
54. If I am wrong about that, and there is a possibility of the illegality defence preventing the creation of an equitable interest by a deed of transfer, then in any event it does not do so here whether under the law as it stood at the time of the hearing in the LRD or as the law now stands. Looking first at the *Tinsley v Milligan* approach, the judge found there was no need for Mr Zafar to rely upon the under-statement of the consideration to establish that he had an equitable interest. He needed only the executed deed, without reference to the consideration stated within it. It is argued for Mr Khan that that is wrong, and that Mr Zafar has to rely upon the "instrument of illegality" to show that he has a beneficial interest in the property; but that is to mischaracterise the transfer. The TR1 itself was not illegal; it was perfectly proper for Mr Khan to make the transfer. The illegality was the evasion of Stamp Duty Land Tax, which happened when the return was filed and was facilitated by the statement of the consideration in the TR1.
55. Nor would the law as it now stands, post-*Patel v Mirza*, have the effect for which Mr Reay argues. Looking at Lord Toulson's three considerations (see paragraph 39 above):

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- a. Certainly there is a public policy requiring the payment of stamp duty land tax, but
 - b. there is also the policy that transactions in land are to be secure and the register is to be relied upon. Above all
 - c. for the transfer to be ineffective where the consideration is understated would be a disproportionate response to the illegality. The obligation to pay tax is enforced by the civil and criminal penalties that follow from under-reporting and under-payment. To enforce it by preventing the operation of the TR1 would be overkill, and would result in a significant injustice in that Mr Khan would have received consideration of £261,000 in return for nothing.

56. Accordingly, even if it is conceptually possible for the illegality defence to present the TR1 from conferring an equitable interest upon Mr Zafar, in my judgment it does not do so here.

15 **The sham transaction question**

The decision in the LRD

20 57. It was argued for Mr Khan in the LRD that the TR1 was a sham. At paragraph 96 of his decision the learned judge says that the argument was made on the basis that the TR1 under-stated the consideration; and that appears to be the argument made by Mr Reay in his written submissions to the LRD (which I have as part of the appeal papers). At paragraph 98 of his decision the judge goes on to say that the TR1 misrepresented the parties' true agreement in two respects, namely the price and the interest to be transferred, and his discussion of whether the TR1 was a sham focuses both on the under-statement of the consideration and on the "misrepresentation" of the "true agreement" which was that Block B should be transferred to Mr Zafar rather than a half share in the whole property.

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30 58. The learned judge went on to express the view that the parties (Mr Zafar through the agency of Mr Iqbal) shared a common intention that the TR1 should misrepresent their true agreement. However, he held that Mr Khan could not argue that the TR1 was a sham because he had to rely on the illegality (the under-statement of the consideration) in order to do so. He rejected the idea that the illegal purpose had not been carried into effect – which would have allowed Mr Khan to make the argument despite the intended illegality – because the Stamp Duty Land tax Return had indeed been submitted, returning a figure of £130,000, and no tax had therefore been paid.

35 *The issues in the appeal*

40 59. On appeal, it is said that the learned judge in the LRD found that the TR1 was a sham. Mr Khan's appeal is against the judge's finding that he could not show that it was a sham because to do so he would have to rely upon the illegality, namely the under-statement of consideration. Ground 2 of Mr

5 Khan's grounds of appeal, framed before the decision in *Patel v Mirza*, is that the consideration paid was in fact £130,000, that there was no contract for the payment of £520,000, and that there is therefore no illegality that Mr Khan would have to rely upon to show that the transaction is a sham. The unlawful purpose has not been carried out and will not be, and nothing is lost by HMRC.

60. How that is consistent with grounds 1 and 3 of the appeal I do not understand. Nor do I understand how it is consistent with the judge's finding that the parties took on a joint mortgage for £131,000, so that Mr Khan benefited from Mr Zafar's liability, so that the consideration actually paid on 19 April 2010 was £261,000 (whatever the position as to who paid the mortgage instalments thereafter, which might be a matter for equitable accounting). It certainly involves a shifting of ground in that it must mean that Mr Khan's only basis for saying that the document is a sham must be not the mis-statement of the consideration (as was argued to the LRD) but the fact that the TR1 transferred the whole property into joint names when the "true agreement" was to sell just Block B to Mr Zafar.

61. Second, in the amended grounds of appeal, ground 4 is that the law has now changed and that on the basis of the considerations set out in *Patel v Mirza* Mr Khan is no longer precluded from arguing that the document is a sham.

The doctrine of sham

62. What is a sham transaction? A sham is a document that creates a smoke screen to hide what is really happening. Typically this is done to evade a tax liability by hiding consideration, as in *Stone v Hitch* [2001] EWCA Civ 63, or to hide assets in divorce proceedings by transferring an asset to a company that is in truth wholly owned and controlled by the transferring spouse – see the discussion in *A v A* [2007] EWHC 99 (Fam). In that case at paragraph 28 of his decision Munby J, as he then was, quoted Lord Wilberforce in *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 who said, at page 323,:

It is for the fact-finding [tribunal] to find whether a document, or a transaction, is genuine or a sham. In this context *to say that a document or transaction is a "sham" means that while professing to be one thing, it is in fact something different*. To say that a document or transaction is genuine, means that, in law, it is what it professes to be, and it does not mean anything more than that.

63. The emphasis there is mine, as it is crucial to what has to be decided here. It is well-established that a sham is of no effect and that the court is able to "go behind" the document that expresses the sham so as to see what was really going on.

64. The leading decision on sham transactions is *Snook v London & West Riding Investments Ltd* [1967] 2 QB 786, where Lord Diplock said at p 802

As regards the contention of the plaintiff that the transactions between himself, Auto-Finance, Ltd. and the defendants were a "sham", it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities ... that for acts or documents to be a "sham", with whatever legal consequences follow from this, *all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.*'

65. Again the emphasis is mine.
Was the TR1 a sham?
66. It was suggested to me at the hearing in November, by Mr Reay, and reiterated in his written submissions after the appeal hearing, that Judge Taylor had made a finding that the TR1 was a sham and that the Upper Tribunal could not go behind that.
67. Judge Taylor did not make a finding that the TR1 was a sham. He considered Mr Khan's argument to that effect, and he made clear his view that the TR1 was a sham, but held that it was not open to Mr Khan to make that argument, because to do so he would have to rely on the illegality, namely the mis-statement of the consideration. Accordingly no finding was made in response to Mr Khan's argument, and there was nothing that Mr Zafar could have appealed.
68. Accordingly for Mr Khan's appeal to succeed on this point there must be a finding by the Upper Tribunal that the TR1 is a sham. It is clear to me that it was not.
69. First, a mis-statement of the consideration does not by itself make a deed a sham. To hold that a deed which mis-stated consideration was a sham and of no effect would be a startling proposition, and would also mean that no liability to Stamp Duty Land Tax arose at all in such circumstances, because of the same circularity that I mentioned at paragraph 53 above.
70. For a deed to be a sham something much more fundamental must be wrong with it. As Lord Wilberforce said, it must be the case that while professing to be one thing it is in fact something different. A mis-statement of consideration alone does not make it a sham – and indeed it would appear that it is now Mr Khan's position that the consideration was not mis-stated. Instead he must

base his argument upon the finding that the parties' "true agreement" was that Mr Zafar would acquire Block B rather than joint ownership of the whole of the property.

- 5 71. The judge made no finding that there was a contract for the purchase of Block B by Mr Zafar. What appears, on the basis of the learned judge's findings of fact, to have happened is that the parties initially wanted to buy and sell Block B alone but that their solicitors pointed out that a sale of part would not be acceptable to the Yorkshire Bank which held a charge over the whole. The parties therefore decided to take that advice and make a transfer of whole, by deed, from one to both.
- 10 72. Does that make the TR1 a sham? Clearly not. It is commonplace for parties to re-structure a deal, or change their minds about the deal, on the basis of legal advice. I have struggled to understand how such a change of mind could be said to make the TR1 a sham.
- 15 73. The judge found that the parties had a wider deal than that which was set out in the TR1, namely for the payment of rather more consideration – although there was no contract to that effect. He also found that there were subsequent negotiations, and even a draft contract in 2014. But I do not accept that it follows from his findings of fact that the TR1 was a sham. The situation was very different from the facts of *Hitch v Stone* [2001] EWCA Civ 62, where an agreement was found to be a sham because it was essentially a fiction. It was an executory contract, and crucial obligations within it were never performed – in particular the grant of a lease, the assignment of the benefit of the agreement, and a valuation. It was drafted in order to mask a complex web of transactions designed to evade tax. The sham agreement in *Hitch v Stone* was a nullity; it was an executory contract and there was no intention to perform it. The TR1 in this case, by contrast, was a completed transaction which left nothing to be performed save for registration (so that there was nothing left to be performed on the transferor's part).
- 20 25 30 35 40 74. It is not clear to me whether what is really being said on Mr Khan's behalf is that the parties executed the TR1 without any intention of registering it and with no intention that it should take effect in equity. Is it said that the TR1 was a smoke-screen to persuade the Yorkshire Bank to lend money, on the basis of a transfer and then of a mortgage deed, neither of which was going to be registered? No argument has been addressed to me about that although I wonder if that was the conclusion I was invited to draw. If so, I decline to do so. Certainly there is no doubt that the mortgage deed, executed by both parties, makes both liable for the deed and has taken effect as an equitable mortgage already, so that the bank has security for its loan. Moreover, the judge found that Mr Khan did not understand the difference between a transfer of whole into joint names and a transfer of Block B only to Mr Zafar alone;

that is not consistent with the idea that Mr Khan did not intend the TR1 to have effect. Indeed, the finding that I quoted above, at my paragraph 24, from paragraph 88 of the LRD's decision make it clear that Mr Khan did intend the transaction of 19 April 2010 to take effect:

5 Mr Khan was quite clearly fully aware of the financial result of the series of transaction which had taken place. Can it really lie in the mouth of Mr Khan, in circumstances in which he plainly wanted the transaction to proceed, and in circumstances in which it did proceed and he benefitted from it, to say that the deed was delivered as an
10 escrow?

75. It cannot, and similarly it is not plausible for him now to say that it was a sham. Indeed, I suggested at the hearing in November 2016 that Mr Khan was in any event estopped from denying his deed. The doctrine of estoppel by deed rests on ancient precedent and Mr Zafar might well have pleaded it. But he did
15 not, and estoppels must be pleaded, so that point cannot be taken further. But his argument on this point is implausible, and is also inconsistent with the findings of the LRD just quoted.

76. The TR1 was not a sham. On the basis of legal advice Mr Khan made a transfer of the whole property from himself as sole owner to himself and Mr Zafar. That is the effect of the deed. It is not a matter of choosing to present, or
20 to misrepresent, the transaction in the TR1 in a particular way (and to that extent I respectfully disagree with the learned judge, who described it thus). The deed is not a description of the transaction; it *is* the transaction.

77. That being the case I do not need to make any findings as to whether Mr Khan could argue that it was a sham. The issue at first instance was whether he could do so, despite the need to rely on the illegality, and he argued that he could because the illegal purpose had not been carried into effect. The illegality doctrine was operating as a defence to the claim that the TR1 was a sham. The *Tinsley v Milligan* approach with its emphasis on reliance is now
25 gone, and if the document were a sham there would have to be an analysis, using the principles in *Patel v Mirza*, of whether it was proportionate to allow Mr Khan to show that the TR1 was a sham despite his participation in the illegality. I am not going to explore that question, because the TR1 was not a
30 sham and could only be a sham if it was of a completely different nature and in a much more complex factual context; I am not going to carry out an
35 exercise that would be both hypothetical and imaginary.

Conclusion

78. Accordingly this appeal must fail. The decision of the LRD stands, as does the direction to the registrar to cancel Mr Khan's application to remove the
40 unilateral notice.

79. There remains a puzzle. The notice has been entered, apparently, to protect Mr Zafar's beneficial interest in the property; yet a notice cannot be used to protect an interest under a trust of land. Title registration is designed to protect legal title and not equitable interests. It is possible to enter a restriction so as to ensure that equitable interests are over-reached, and such a restriction can operate as an indirect protection to the beneficiary because a purchaser is likely to want to have it removed before proceeding rather than being content to rely on the over-reaching mechanism. But the Land Registration Act 2002 does not offer direct protection for equitable interests, and so there is something of a mystery as to how the unilateral notice came to be entered. I do not need to explore that because no application was made to cancel the notice on that basis. I do not know what was said to the registrar in the application for the notice, just as I do not know why the TR1 has not been registered. I do not have enough information to make any comment on the entry of a notice in these circumstances; I mention the point only to ensure that this decision is not taken as a precedent for the use of a notice purely to protect an interest under a trust of land, nor as an attempt to go behind the words of the statute.

80. Mr Zafar is entitled to his costs of the appeal. If either party wishes to make an application about costs he may do so within 28 days of the date of this decision, and I will then give directions.

TRIBUNAL JUDGE ELIZABETH COOKE

RELEASE DATE: 7 March 2017