[2017] UKUT 4 (TCC)

Appeal numbers: UT/2014/0051
UT/2014/0053

INHERITANCE TAX – whether transfer of funds to a personal pension plan was a transfer of value – Inheritance Tax Act 1984, s 3(1) and s 10 – whether deceased's omission to take lifetime pension benefits was to be treated as a disposition and transfer of value – s 3(3) IHTA

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Appellants and Cross-Respondents**
- and -	
(1) RICHARD WILLIAM JAMES PARRY HENRY FRANCIS ALEXANDER PINEY TOBY ANTHONY STAVELEY (as personal representatives of Rachel Frances Staveley, deceased)	
(2) HENRY FRANCIS ALEXANDER PINEY	**Respondents and Cross-Appellants**
(3) TOBY ANTHONY STAVELEY	

TRIBUNAL: MR JUSTICE BARLING
JUDGE ROGER BERNER

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 on 14 and 15 December 2016

Elizabeth Wilson, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants/Cross-Respondents

David Rees, instructed by Farrer & Co LLP, for the Respondents/Cross-Appellants

DECISION

1. This appeal and cross-appeal concern notices of determination to inheritance tax made by HMRC in respect of two alleged lifetime transfers of value by the late Mrs Rachel Frances Staveley, who died on 18 December 2006.

2. The alleged transfers of value arose out of the transfer, in November 2006, by Mrs Staveley of funds out of one registered pension scheme ("the s 32 policy") into another ("the AXA PPP"), and the omission of Mrs Staveley during her lifetime to take any lifetime benefits from the AXA PPP. The determinations were made on Mrs Staveley's personal representatives, and on her two sons, Mr Piney and Mr Staveley, who were the beneficiaries of the death benefit paid out of the AXA PPP after the death of Mrs Staveley.

3. The personal representatives, and Mr Piney and Mr Staveley in their capacities as beneficiaries appealed to the First-tier Tribunal ("FTT") against those determinations. The FTT (Judge Mosedale and Mr Menzies-Conacher) allowed the appeals in respect of the transfer of funds to the AXA PPP, but dismissed the appeals so far as they concerned the omission by Mrs Staveley to take lifetime benefits. HMRC appeal, with permission of the FTT and of this tribunal, in respect of the first issue; the personal representatives and Mr Piney and Mr Staveley as beneficiaries cross-appeal, with the FTT's permission, on the second issue.

The facts

4. The findings of fact of the FTT are set out at [6] to [40]. We can summarise them quite shortly.

5. The s 32 policy had derived from the transfer, in July 2000, of funds out of Mrs Staveley's share of a company pension scheme, the AXA Morayford Executive Pension Plan, established by Morayford Limited ("Morayford"), a company set up by Mrs Staveley with her ex-husband. The transfer from that scheme into the s 32 policy had followed an acrimonious divorce and advice received by Mrs Staveley that her only transfer option was into the s 32 policy, and that she would not be able to transfer into a personal pension plan ("PPP") until 10 years after her departure from the company.

6. Mrs Staveley had also been advised that any surplus in the s 32 policy would be returned to Morayford. The significance of that was that her pension was over-funded in respect of her level of salary. Otherwise, it was provided by the s 32 policy that if Mrs Staveley died without taking lifetime benefits, the trustees would pay such death benefits as there were to her personal representatives. The minimum age for accessing the pension was 50, and as Mrs Staveley was 50 years of age in 2000 she could have accessed the pension under the s 32 policy at any time after that.

7. Mrs Staveley remained very concerned that the pension fund could revert, in whole or in part, to the benefit of her ex-husband or his new family. The FTT found,

at [16], that preventing Morayford receiving benefit from the pension fund was very important to Mrs Staveley, but that it was also very important to her that her sons would benefit from her estate. The FTT rejected the assertion that Mrs Staveley would rather her sons had received nothing than her ex-husband would benefit in any way.

8. Mrs Staveley sought advice with respect to her pension on a number of occasions between 2002 and 2006, both as regards accessing the pension and, when possible, transferring the fund into a PPP. In 2004, she was advised by C Hoare & Co that a forthcoming legal change, introduced by the Finance Act 2004 ("FA 2004") but having effect in April 2006, would make it possible for her to transfer the pension fund to a PPP from that date without waiting for the 10-year period to expire.

9. In 2004 Mrs Staveley was diagnosed with ovarian cancer. Following treatment, she was advised, in July 2005, that she was in complete remission. In 2005 Mrs Staveley made her will, by which her estate was to be divided equally between her two sons, Mr Piney and Mr Staveley, on trust to pay the income in their lifetime and with power for the trustees to advance capital.

10. Unfortunately, in 2006 Mrs Staveley's symptoms returned, and she commenced another round of treatment. During that treatment, and following a meeting with Mrs Staveley, C Hoare & Co wrote her a further letter of advice on 20 June 2006. According to that letter, the sole issue on which Mrs Staveley had sought advice at that time was whether to access the s 32 policy. The letter was concerned only with that issue. The risks of doing so were identified as being, first, that taking a high present income would erode income in old age, and secondly that it would provide lower death benefits in the event of premature death. The FTT found the overall tone of the letter was that the author of it was opposed to the immediate accessing of the fund, instead advising that it was more tax efficient to use other sources of money (such as a bond) before accessing the pension fund.

11. The June 2006 letter also discussed death benefits under the s 32 policy in the event that Mrs Staveley did not access her pension in her lifetime. The change effected by FA 2004 from April 2006 was confirmed, the advice being that the whole of Mrs Staveley's fund would go to her named beneficiaries (her sons), and that none would revert to Morayford. However, as the FTT recorded at [27], the letter went on to say:

> "This is new legislation and may be challenged by your former husband.
>
> In order to remove all the concerns which you have about this matter you could transfer your s 32 policy to a Personal Pension Plan … and this would completely sever any link with the company. You could do this without needing to take any tax-free cash or income."

12. Despite treatment, by mid-October 2006 Mrs Staveley had been advised and had understood that her prognosis was terminal.

13. C Hoare & Co wrote again to Mrs Staveley on 31 October 2006. The FTT found, at [28], that it was evident from this letter that Mrs Staveley had told C Hoare & Co that she had decided not to access the pension fund. According to the letter the only remaining issue was to ensure that Mrs Staveley's ex-husband would not benefit from the fund. The advice was that this objective could be achieved by transferring the funds in the s 32 policy into a PPP. It was also advised that the death benefits should not form part of Mrs Staveley's estate for inheritance tax purposes.

14. The FTT made a particular finding with regard to the following passage in the October 2006 letter:

> "Under both arrangements, in the event of your death prior to taking pension benefits, the full value of the fund up to the present Lifetime Allowance of £1.5 million may pass to your beneficiaries and should be free of inheritance tax …"

Rejecting HMRC's argument that this sought to compare a stakeholder pension (which had been referred to only at the start of the letter) with a PPP, the FTT held that it had – albeit wrongly – equated the inheritance tax treatment of death benefits under the s 32 policy and the PPP.

15. Although the letter from C Hoare & Co giving advice with regard to the transfer of funds into a PPP is dated 31 October 2006, Mrs Staveley signed a request for such a transfer from the s 32 policy on 30 October 2006. On 3 November 2006 she applied for the funds from the s 32 policy to be transferred into the AXA PPP. As part of that application, and as required by the form, she completed an expression of wishes by requesting that the death benefits be paid equally to her two sons.

16. The AXA PPP commenced on 9 November 2006. Although the terms of the policy entitled Mrs Staveley to access lifetime benefits from the age of 50, she did not do so. Mrs Staveley died on 18 December 2006.

17. Under the AXA PPP policy, as the FTT found at [39], the scheme administrator had a discretion to pay death benefits to all or any of the following:

- The persons nominated by Mrs Staveley (that is, Mr Piney and Mr Staveley)
- Mrs Staveley's grandchildren
- Mrs Staveley's personal representatives

18. In the event, in mid-2007 the scheme administrator exercised its discretion and paid the lump sum death benefit to Mr Piney and Mr Staveley in equal shares.

The law

19. Unless otherwise stated, all references are to the Inheritance Tax Act 1984 ("IHTA").

20. Inheritance tax is charged on the value transferred by a chargeable transfer (s 1, IHTA). Except for exempt transfers (which are not relevant in this case), a chargeable transfer is "a transfer of value which is made by an individual" (s 2, IHTA).

21. So far as material, s 3 IHTA defines both actual and deemed transfers of value in the following way:

> "(1) Subject to the following provisions of this Part of this Act, 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.
>
> (2) ...
>
> (3) Where the value of a person's estate is diminished, and the value—
>
> (a) of another person's estate, or
>
> (b) of any settled property, other than settled property treated by section 49(1) below as property to which a person is beneficially entitled,
>
> is increased by the first-mentioned person's omission to exercise a right, he shall be treated for the purposes of this section as having made a disposition at the time (or latest time) when he could have exercised the right, unless it is shown that the omission was not deliberate…"

22. Section 3 is thus subject to s 10, which provides:

> "**10 Dispositions not intended to confer gratuitous benefit**
>
> (1) A disposition is not a transfer of value if it is shown that it was not intended, and was not made in a transaction intended, to confer any gratuitous benefit on any person and either—
>
> (a) that it was made in a transaction at arm's length between persons not connected with each other, or
>
> (b) that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other.
>
> (2) ...
>
> (3) In this section—
>
> 'disposition' includes anything treated as a disposition by virtue of section 3(3) above;
>
> 'transaction' includes a series of transactions and any associated operations."

23. The extension of "transaction" in s 10 to "associated operations" requires consideration of the definition of that term in s 268 IHTA:

> "(1) In this Act 'associated operations' means, subject to subsection (2) below, any two or more operations of any kind, being—
>
> (a) operations which affect the same property, or one of which affects some property and the other or others of which affect property which represents, whether directly or indirectly, that property, or income arising from that property, or any property representing accumulations of any such income, or
>
> (b) any two operations of which one is effected with reference to the other, or with a view to enabling the other to be effected or facilitating its being effected, and any further operation having a like relation to any of those two, and so on,
>
> whether those operations are effected by the same person or different persons, and whether or not they are simultaneous; and 'operation' includes an omission.
>
> (2) ...
>
> (3) Where a transfer of value is made by associated operations carried out at different times it shall be treated as made at the time of the last of them; but where any one or more of the earlier operations also constitute a transfer of value made by the same transferor, the value transferred by the earlier operations shall be treated as reducing the value transferred by all the operations taken together, except to the extent that the transfer constituted by the earlier operations but not that made by all the operations taken together is exempt under section 18 above."

The first issue: Was the transfer from the s 32 policy to the AXA PPP a transfer of value?

24. It was common ground, both before the FTT and before us, that the transfer of the fund from the s 32 policy to the AXA PPP was a disposition for the purpose of s 2 IHTA and that it gave rise to a diminution in the value of Mrs Staveley's estate. This was explained by reference to the meaning, in s 5 IHTA, of a person's estate; it includes not only the property to which the person is beneficially entitled but also, by s 5(2), property over which that person has a general power of disposition. The s 32 policy conferred a right on Mrs Staveley to dispose of the death benefit under that contract, which would form part of her estate on her death. Following the transfer to the AXA PPP, and the completion by Mrs Staveley of the expression of wishes, she no longer had that right; instead the matter was one of discretion for the scheme administrator.

25. A disposition which reduces the value of a person's estate is a transfer of value, subject to s 10. There are a number of elements to that provision. First, it is for the taxpayer to show that the disposition, namely the transfer to the AXA PPP, was not itself intended to confer any gratuitous benefit on any person. Secondly, it must be shown that the disposition was not made in a transaction (including either a series of transactions or any associated operations) intended to confer such a benefit. Thirdly, it must be shown either that it was itself made in an arm's length transaction between

unconnected persons or, if not, that it was such as might be expected in such a transaction.

26. The FTT held that s 10 did apply to the transfer. That conclusion is the subject of HMRC's appeal. Miss Wilson, for HMRC, put the case in two broad ways. First, she submitted, the FTT had misconstrued s 10 and had misapplied it to the facts as found. It was argued that had the FTT applied the correct legal test to the facts found, it could not have reached the conclusion it did. But secondly, and in the alternative, Miss Wilson also submitted that the FTT had made findings of fact that were not open to it as a matter of law and for that reason also misapplied s 10.

The transfer not intended to confer any gratuitous benefit

27. The FTT found that the transfer itself was not intended to confer any gratuitous benefit on any person; in particular it was not intended to confer such a benefit on Mrs Staveley's two sons. The key finding of the FTT in this regard was that at [48], which is worth reproducing in full:

> "We find on the evidence that [Mrs Staveley's] sole motive in making the transfer was to sever all ties with Morayford. She had clearly been very aggrieved, not surprisingly, that, while her part of the pension fund was supposed to come to her absolutely following the divorce, the terms of the s 32 policy and the effect of the law prior to April 2006 meant that a substantial part of the fund might revert to Morayford for the benefit of her ex-husband. She was consistent in her desire to thwart this outcome during the last six years of her life following her divorce. While it is not clear why in June 2006 she was considering accessing her s 32 policy in her lifetime, by October 2006 it was clear she was only seeking advice on severing her pension fund's links with Morayford (§28). While her transfer of funds to the PPP may have been based on a risk that was by then more perceived than real, she had been advised that there was such a risk (see §27), and the perceived risk was the reason why she acted as she did."

28. The FTT went on to consider the argument of HMRC that Mrs Staveley could have had a dual motivation, in that not only was she concerned to ensure that her ex-husband did not benefit from the sums in the pension fund, but also to ensure the death benefits passed to her sons. The FTT rejected, at [49], the submission that Mrs Staveley had intended by the transfer that the death benefits should pass to the sons free of inheritance tax. It also rejected the submission, disregarding inheritance tax, that there was an intention that the death benefits should pass to the two sons.

29. The reason given by the FTT, at [50], for rejecting that argument is the subject of criticism by HMRC. The FTT said that it could not see how the signing by Mrs Staveley of the expression of wishes in the AXA PPP could be an intention to confer a gratuitous benefit. It reasoned that because her two sons were named already as beneficiaries under her will (and would therefore have benefited from the death benefits under the s 32 policy as part of Mrs Staveley's estate), no new benefit had been created. That could not therefore have been part of the motivation for Mrs Staveley. Rejecting the argument for HMRC that a benefit could be conferred

notwithstanding that the sons would have benefited in any event, the FTT said, at [52]:

> "… The entire premise of s 10 is that benefit is conferred. It presupposes that the benefit did not exist before and is newly conferred. If Miss Wilson [for HMRC] was right, a transfer from one PPP to another PPP for commercial reasons (perhaps to get a better rate of return) without any change in beneficiaries, would be caught. We do not think that this was intended by Parliament."

30. We agree with Miss Wilson that, as a matter of law, the mere fact of an existing putative benefit under a will of a person into whose estate certain assets will pass on death cannot prevent a disposition in lifetime from conferring a benefit, even if the benefit is to the same beneficiaries, and is substantially identical to that which would be conferred by the will. The example given by the FTT at [52] is inapt. Not only would a mere transfer from one PPP to another without any change in beneficiaries be unlikely to result in any transfer of value, the presence of commercial reasons (and no other reasons) would enable s 10 to apply.

31. On the other hand, the nature of any benefit and the surrounding circumstances are relevant to the question of intention. The fact that Mrs Staveley's two sons would benefit under her will was a relevant factor in assessing the true motive of Mrs Staveley in making the transfer from the s 32 policy to the AXA PPP. The finding of the FTT was that the sole motive was to sever all ties with Morayford, and to guard against the risk perceived by Mrs Staveley, on advice, even after April 2006 that surplus funds in the s 32 policy could revert to Morayford and thus to her ex-husband.

32. Miss Wilson submitted that, had the FTT properly construed s 10, it would have been compelled to conclude that Mrs Staveley made her disposition with the intention of doing several things, one of which was to confer a gratuitous benefit on the sons. We do not accept that submission. To the extent that the FTT was in error in deciding that the replacement of the testamentary benefit to the sons by the benefit conferred as beneficial objects of the discretion of the scheme administrator of the AXA PPP could not in law amount to the conferring of a benefit, that was not the basis for the FTT's conclusion as to the sole motive of Mrs Staveley. That was a decision of the FTT on the facts, which properly included the nature of the benefit in question.

33. Miss Wilson did not shrink from submitting that the FTT's decision on the facts was itself an error of law. Although Mr Rees reminded us of the constraints imposed on such an argument, the principles are well-known and it is not necessary for us to say very much about them. The classic exposition is that of Lord Radcliffe in *Edwards v Bairstow* [1956] AC 14, where at [36] he held that a finding of fact would be an error of law where the facts found were such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. Furthermore, the question of motive or intention is one requiring a multi-factorial assessment by the fact-finding tribunal with which an appeal tribunal should be slow to interfere (*Proctor & Gamble UK v Revenue and Customs Commissioners* [2009] STC 1990, per Jacob LJ at [9]).

34. Miss Wilson drew our attention to other findings of fact by the FTT. Thus, at [16], the FTT found that, as well as being very important to her that her ex-husband did not benefit, "it was also very important to her that her sons did benefit from her estate". The FTT expressly rejected the evidence of Mr Staveley that Mrs Staveley would rather the sons received nothing than her ex-husband benefit from the pension fund in any way. At [149], when considering Mrs Staveley's continuing decision not to access her pension at any time between June 2006 and her death (during which period the transfer from the s 32 policy to the AXA PPP had taken place), the FTT found as a fact that conferring on her sons a greater benefit than otherwise was one of the factors in her decision not to access her pension fund, and that "[t]here was an intent in June 2006 to confer gratuitous benefit even if there was other intent too." Finally, when dealing with a particular argument on s 12(2A) – (2G) IHTA (which is not in issue on this appeal), the FTT, at [167], confirmed its finding that Mrs Staveley's intention in omitting to take lifetime benefits was in part to confer a gratuitous benefit.

35. In our judgment none of those findings of the FTT can come close to satisfying the hurdle imposed by *Edwards v Bairstow*. A finding by the FTT that Mrs Staveley's omission to take lifetime benefits from her pension was, at least in part, intended to confer a gratuitous benefit on her sons does not mandate a similar finding with respect to the transfer to the AXA PPP itself. That fact would of course have been relevant to the FTT's multi-factorial assessment, but it cannot be supposed that the FTT ignored its own finding in that respect when it was considering Mrs Staveley's intention with respect to the transfer itself.

36. Nor can the finding of the FTT that Mrs Staveley regarded it as important that her sons benefited from her estate compel a conclusion that the transfer to the AXA PPP was intended to confer a gratuitous benefit on them. The reference to the sons benefiting, at [16] of the FTT's decision, can in our judgment be understood simply as the other side of the coin to Mrs Staveley's actual motive in seeking to make sure that the identified risk of her ex-husband becoming entitled to any of the pension fund was avoided. Mr Piney and Mr Staveley were intended beneficiaries under Mrs Staveley's will, and any risk to her estate was a risk to their inheritance.

37. Miss Wilson submitted that the FTT made no finding of fact that Mrs Staveley would have made the transfer to the AXA PPP so as to exclude her ex-husband had the result been to exclude her sons from benefiting from the death benefits. But no such finding was necessary for a conclusion as to Mrs Staveley's motive in making the transfer. What the FTT concluded was that Mrs Staveley's sole motive in doing so was to exclude the possibility of her ex-husband benefiting. The finding that that was her sole motive can also be understood as a finding that, but for that risk, Mrs Staveley would not have made the transfer, but would have allowed the status quo to endure, and for her sons to benefit, as she had planned, under her will.

38. In our judgment, therefore, the FTT was entitled on the evidence to find, as it did at [55], that the disposition by the transfer of funds from the s 32 policy to the AXA PPP was not intended to confer a gratuitous benefit on any person. The FTT did not, contrary to Miss Wilson's submission, shut its eyes to the desired destination

of the death benefits; to the contrary it clearly took that factor into account. To the extent that the FTT was in error in finding that it was necessary for a benefit to be a "new" benefit, and that the existing benefit of the sons under Mrs Staveley's will precluded the benefit under the AXA PPP from being such a new benefit, that did not in our judgment vitiate the FTT's conclusion, at [48], that Mrs Staveley's sole motive was to prevent surplus pension funds reverting to Morayford and thus to the benefit of her ex-husband.

Transaction and series of transactions

39. As Miss Wilson submitted, s 10 IHTA is not confined to examination of cases where the disposition itself is said not to be intended to confer a gratuitous benefit. Section 10 widens the possible enquiry into cases where the disposition is made in a transaction or series of transactions, neither of which can be intended to confer such a benefit.

40. In this case, it was common ground that no distinction could be drawn between the disposition, comprising the transfer into the AXA PPP in all its aspects, including Mrs Staveley's completion of the expression of wishes, and a wider transaction. It is clear that the FTT regarded the disposition itself as comprising all those aspects. The conclusion of the FTT in that respect, which we have found is not vitiated by any error of law, is equally unimpeachable when the disposition is considered as part of a transaction to that extent.

41. Miss Wilson, on the other hand, submitted that the FTT had misinterpreted the expression "series of transactions" in s 10. The view taken by the FTT, at [58], was that the omission by Mrs Staveley to take a pension could not be one of a series of transactions because an omission was not a transaction at all. "Transaction", found the FTT, implied a positive act involving at least two persons. The IHTA carries no extended meaning of transaction (beyond, we should add, the extension to associated operations), and on that basis the FTT concluded that Mrs Staveley's omission to take pension benefits could not be described as a transaction or series of transactions.

42. In the context of this case, the debate on the meaning of transaction or series of transactions is a sterile one. The real question, as we shall describe, is whether the disposition by the transfer to the AXA PPP was part of a transaction including associated operations, and whether that extended transaction was intended to confer a gratuitous benefit. But as the point was argued we should say that we agree with the FTT. The expression "transaction" must be construed by reference to its context. As Mr Rees submitted, Parliament has taken great care with the language employed in the IHTA, drawing a distinction between dispositions, transactions and operations. The definition of "operation", in the context of associated operations in s 268(1), is extended to include an omission. That indicates that, without such an express inclusion, an operation would not normally include an omission. Operation is a word of wider import than transaction or disposition, the meaning of neither of which is so extended. Although in certain circumstances s 3(3) IHTA treats a person's omission as a disposition, that is not an extension of the meaning of "disposition"; it reinforces

that a disposition does not without more include an omission. Properly construed, therefore, we do not regard "transaction" as capable of encompassing omissions.

Associated operations

43. By contrast, as we have described, an omission is, by s 268(1) IHTA, included within the meaning of "operation" and can therefore be an associated operation, and thereby part of a transaction for s 10 purposes.

44. Miss Wilson argued that the findings of the FTT with respect to Mrs Staveley's omission to take lifetime benefits from her pension from June 2006 to the date of her death necessarily led to the conclusion that the omission was an associated operation with the transfer to the AXA PPP, within s 268(1)(a); they were both operations that affected the same property. She reiterated that the decision not to take the pension had been found to have been an ongoing choice (FTT, [87]), and that the intention not to access the pension had been to confer a gratuitous benefit on the sons. In particular, the FTT found, at [148], that "… omitting to take life time benefits would increase the funds available to her sons in the event of her death and that she knew that and had discussed it with her adviser and had been advised about it …".

45. Section 268 is not a charging provision but one of definition. Its relevance in this case is in the extension of the meaning of "transaction" in s 10. Its practical operation is comparatively limited. As Park J observed in *Rysaffe Trustee Co (CI) Ltd v IRC* [2002] STC 872, at [27], referring to *Countess Fitzwilliam v IRC* [1993] STC 502:

> "It is not some sort of catch-all anti-avoidance provision which can be invoked to nullify the effectiveness of any scheme or structure which can be said to have involved more than one operation and which was intended to avoid or reduce inheritance tax."

46. It was not suggested in this case that Mrs Staveley had entered into a scheme to avoid or reduce inheritance tax. But it is equally clear that, where it is relevant, s 268 can apply to ordinary cases where no avoidance is involved.

47. The scope of the associated operations provision, at that time contained in s 44(1) of the Finance Act 1975, was considered by the House of Lords in *IRC v Macpherson* [1989] 1 AC 159. In that case settled property on discretionary trusts included certain valuable pictures. Those pictures were kept in houses owned by one of the beneficiaries under an agreement with the trustees whereby the beneficiary undertook the custody, care and insurance of the pictures and paid £100 a year for the enjoyment of them. The agreement was terminable on three months' notice.

48. Following a court-approved arrangement whereby the beneficiary was excluded from beneficial interest in the settled property, on 29 March 1977 the trustees entered into a new agreement with the former beneficiary which varied the earlier agreement, providing for limitation of the former beneficiary's liability in respect of insurance and loss, reducing the annual payment to £40 and providing for a longer term not terminable on three months' notice. That resulted in a diminution in the value of the

settled property by reference to the pictures, because the date on which they could be sold in the open market had been deferred.

49. On 30 March 1977 the trustees executed a deed of appointment whereby they appointed the pictures, subject to and with the benefit of the agreements, on trusts under which the former beneficiary's son took a protected life interest. The question for the court was whether a disposition, namely the new agreement in relation to the pictures, had been made in a transaction intended to confer a gratuitous benefit on a person. It was held that the disposition constituted by the 29 March 1977 agreement had been a contributory part of a scheme comprising the agreement and the appointment of 30 March 1977, that the agreement and the appointment had been associated operations and the disposition had been made in a transaction, including the appointment, intended to confer a gratuitous benefit on the son.

50. Despite the apparent width of the wording of what is now s 268 IHTA, in *Macpherson* the Crown accepted (and Lord Jauncey, with whose speech all the other law lords agreed, considered rightly accepted) that some limitation must be imposed. As a matter of the statutory language, Lord Jauncey, at p 175H, found that it was clear that the intention to confer gratuitous benefit qualifies both transactions and associated operations. He went on to say (at pp 175H – 176A):

> "If an associated operation is not intended to confer such a benefit it is not relevant for the purpose of the subsection [now s 10 IHTA]. That is not to say that it must necessarily per se confer a benefit but it must form a part of and contribute to a scheme which does confer such a benefit."

51. The FTT found that the transfer to the AXA PPP and the omission by Mrs Staveley to take lifetime benefits were separate in the sense that they were not linked by motive. It held, at [64], that whatever the intent behind that omission, it was not linked with the transfer to the AXA PPP in Mrs Staveley's mind, and her intent with respect to the transfer itself was solely to break the connection with Morayford. There was no intent linking the two matters. The decision not to take lifetime benefits was taken independently of the decision to transfer funds to the AXA PPP (FTT, [69]).

52. Miss Wilson submitted that the FTT misunderstood what Lord Jauncey said in *Macpherson*. She argued that Lord Jauncey had not stipulated that each and every operation must be shown to have been entered into by a transferor with the subjective intention of conferring a gratuitous benefit. She submitted that the test of an operation being associated was that it should form part of and contribute to the gift, an objective test, and that the gift should be made with the relevant subjective intent.

53. In our judgment what Lord Jauncey was saying was that, if it does not itself confer a benefit, an operation must at least objectively form part of and contribute to a scheme that does. But there is also a subjective element which is not limited to a discrete element or elements of the scheme; the scheme, comprising all its elements, must also be intended to confer the benefit. In this case, the necessary intention must be shown for the combination of the transfer to the AXA PPP and the omission to take

lifetime benefits. As the FTT had found that there was no common intention with respect to the transfer and the omission, that was sufficient for the transfer not to be an associated operation with the omission.

54. It is the case that in *Macpherson* it had been conceded by the Crown that the 1977 agreement of itself had not been intended to confer a gratuitous benefit on anyone (see p 173F-G). That did not prevent Lord Jauncey finding, at p 176B-C that:

> "In this case it is common ground that the appointment conferred a gratuitous benefit on Timothy. It is clear … that the appointment would not have been made if the 1970 agreement had not been varied by that of 1977. It follows that the 1977 agreement was not only effected with reference to the appointment but was a contributory part of the scheme to confer a benefit on Timothy. So viewed there can be no doubt that the 1977 agreement, being the disposition for the purposes of [what is now s 10], was made in a transaction, consisting of the agreement and the appointment, intended to confer a gratuitous benefit on Timothy."

55. What was found in *Macpherson*, therefore, was that although when viewed singly the 1977 agreement did not have the necessary intention, it was part of an overall scheme, comprising both the 1977 agreement and the appointment, which viewed in combination did. The difference in this case is that the transfer, and the motivation for it, were found to be entirely separate from the omission to take lifetime pension benefits, and any intention in that respect. Even if the omission had been intended to confer a gratuitous benefit, the transfer was not part of any scheme with the omission which had that collective intention. On that basis, we can find no error of law in the FTT's approach to the question of associated operations, or in its conclusion. In our judgment, there was evidence on which the FTT could properly conclude that the transfer and the omission were unconnected, and not part of any scheme to confer benefit on Mrs Staveley's two sons. Accordingly, the FTT's conclusion with regard to associated operations was in our view correct in law.

Arm's length transaction

56. Having come this far, it remains to consider the question whether the disposition, namely the transfer from the s 32 policy to the AXA PPP was, in the terms of s 10, made in a transaction at arm's length between persons not connected with each other, or if it was not whether it was such as might be expected to be made in such a transaction.

57. We regard this as a straightforward issue. Once it has been determined that the transaction in question is the transfer to AXA PPP, including the surrender of the s 32 policy and the completion by Mrs Staveley of the expression of wishes, and that it is not extended to any omission to take lifetime benefits, the answer appears to us to be plain. As the FTT found at [74] – [77], the parties to the transfer (and indeed the surrender of the s 32 policy) were Mrs Staveley and AXA; they were unconnected parties. The surrender and transfer themselves and the AXA PPP were unexceptional;

as the FTT found, the expression of wishes in the AXA PPP was a feature of an arm's length transfer into a pension of that nature.

58. Before the FTT, and again before us, Miss Wilson argued that the expression of wishes was a feature that, having regard to the gratuitous intent it evidenced, had the effect that the transaction could not be regarded as at arm's length. We do not agree. Although it is necessary to have regard to the transaction as a whole in determining whether it is at arm's length, and it would be wrong to conclude that a transaction which merely included some arm's length elements but which was overall not at arm's length or not between unconnected persons, was nonetheless an arm's length transaction, there is nothing in the transaction at issue here that is not at arm's length and between persons who are unconnected.

59. Although we accept, as Miss Wilson submitted, that s 10 does not use the expression "parties", but talks of persons not connected with each other, it is not the case that the mere presence or reference to connected persons will prevent the test in s 10(1)(a) from being met. The relevant test is whether the transaction, as identified, is "between" unconnected persons. That is the critical link. In this case, although Mrs Staveley's two sons were named in the expression of wishes, it could not be said that any part of the relevant transaction was between Mrs Staveley and her sons, or indeed that any part of the transaction was between persons who were connected with each other.

Conclusion on the first issue

60. Agreeing with the FTT, therefore, we find that it has been shown that the disposition by the transfer of funds to the AXA PPP was not intended, and was not made in a transaction intended, to confer gratuitous benefit on any person, and that it was made in a transaction at arm's length between persons not connected with each other. The transfer was accordingly, by virtue of s 10 IHTA, not a transfer of value for the purpose of s 3 IHTA.

61. We dismiss HMRC's appeal.

The second issue: Was the omission to exercise the right to take lifetime pension benefits properly treated as a transfer of value?

62. The FTT found, at [114], that it was not satisfied that the increase in the estates of Mrs Staveley's sons was not caused by her omission to take lifetime pension benefits. That was so, notwithstanding that those benefits had not been caused solely by that omission, but also by the exercise of discretion by the AXA PPP scheme administrator. The FTT held, at [113] – [114], that it was common knowledge that a pensions administrator will normally, and perhaps invariably, exercise its discretion in accordance with a deceased's statement of wishes, and that accordingly it would be wrong to regard such a discretion as a break in "the chain of causation when it was virtually inevitable that [it] would honour [Mrs Staveley's] wishes and pay the money directly to her sons."

63. The FTT also found, at [127], that Mrs Staveley's omission had been deliberate. That meant that the FTT found that the conditions in s 3(3) IHTA had been met, and accordingly that Mrs Staveley's omission to exercise her right to take lifetime pension benefits was treated as a disposition immediately before her death. In light of that finding, the FTT went on to consider the possible application of s 10. It found, at [127], as a fact, that one of the factors in Mrs Staveley's decision not to access her pension fund was the conferring on her sons of a greater benefit than would otherwise be the case. The existence of that factor immediately before Mrs Staveley's death was sufficient, the FTT found, to prevent s 10 applying.

64. In this appeal there is no challenge to the FTT's finding that Mrs Staveley's omission to take lifetime pension benefits was deliberate, nor to its findings with respect to s 10. The error which the estate, and Mr Piney and Mr Staveley, submit was made by the FTT, was in finding that the omission satisfied the requirements of s 3(3) so as to amount to a disposition for the purposes of s 3(1).

65. Leaving aside the question whether the omission was deliberate, there are in this case two relevant conditions for an omission to exercise a right to be treated as a disposition. The first, with respect to which there is no dispute, is that the value of a person's (P's) estate is diminished. The second is that the value of another person's estate is increased by P's omission to exercise a right. It is with the application of that second condition that we are concerned in this appeal.

66. Mr Rees put his case on appeal by reference to what he described as two key arguments. The first, described as the timing argument, was that for an omission to exercise rights to amount to a disposition for the purposes of s 3, the diminution in value of the estate of the person omitting to exercise the right and the increase in the other person's estate must take place at the same time. The second, the causation argument, is that both the diminution in value of the estate of the person omitting to exercise the right and the increase in value of the other person's estate must be caused by the omission. It is submitted that, on the facts of this case, neither of those requirements has been met.

The timing argument

67. Mr Rees' timing argument centred upon the use of the present tense "is" in s 3(3) both in "the value of a person's estate *is* diminished" and "the value of another person's estate *is* increased". Whilst he accepted that the respective values of the decrease and increase need not be identical, he argued that the use of the present tense carried with it the implication of a single moment in time in relation to both the diminution and increase such that it requires the two events to occur at the same time.

68. Mr Rees emphasised that he was not seeking to make an argument based on scintilla temporis, a reference to the finding by the First-tier Tribunal in *Fryer and others (personal representatives of Arnold (deceased)) v Revenue and Customs Commissioners* [2010] SFTD 632, at [45], that the fact that the omission in that case to take lifetime pension benefits had caused the value of settled property to increase only after the death of Mrs Arnold did not prevent the s 3(3) condition being satisfied.

69. We do not accept Mr Rees' timing argument. The use of the present tense in s 3(3) cannot bear the weight that Mr Rees seeks to ascribe to it. In our judgment, agreeing in this respect with the FTT at [92] and with the tribunal in *Arnold*, there is no temporal requirement imposed by s 3(3). The use of "is" merely describes a state of affairs, which is capable of being objectively measured. Attractive as Mr Rees' see-saw analogy was, it cannot be supported by the proper construction of s 3(3). The legislation does not support a requirement that there must be a see-saw effect of simultaneous diminution and increase in value, or as he put it "pushing down on one side causes the other to rise".

The causation argument

70. It was apparent, both from Mr Rees' skeleton argument, and his oral submissions, that his timing argument was largely symbiotic on the causation argument. The argument that Mrs Staveley's failure to draw down lifetime benefits did not lead to a corresponding increase in the estates of her sons did not rest solely on the six-month period that elapsed before the AXA PPP scheme administrator exercised its discretion in favour of the sons, but also on what was submitted to have been the entirely separate and independent decision by the scheme administrator.

71. Mr Rees argued that, in deciding that the increase in the sons' estates was caused by Mrs Staveley's omission, the FTT failed to give proper weight to the existence of the independent discretion exercised by the scheme administrator. In particular, Mr Rees criticised the findings of the FTT, at [113] – [114] to the effect that a pensions administrator would "normally" and "perhaps invariably" exercise its discretion in accordance with a statement of wishes, and that it was "virtually inevitable" that Mrs Staveley's wishes would be honoured. He argued that there was no evidence before the FTT that could have supported such a finding, that the finding was not one that was open to the FTT and that it was not a matter of which the FTT was entitled to take judicial notice.

72. Miss Wilson did not seek to support the FTT's findings in this respect. We consider that the FTT was wrong to rely on what appears to have been its own perception. There was no evidence before the FTT as to the general practice of administrators of the AXA PPP, or the practice of scheme administrators generally. The FTT was not entitled to make a finding contrary to such evidence that it did have, namely the terms of the transfer-in application in respect of the AXA PPP itself on which discretion was conferred on the scheme administrator.

73. At section C of the transfer-in application, under the heading "How would you like us to pay your death benefits?" there appears the following:

> "The Scheme Administrator will decide how the cash sum benefits [excluding any protected rights benefits] should be paid to your dependants or any other beneficiaries the scheme rules allow. To help us make this decision, please fill in the 'Expression of wish' form that follows."

The following declaration was made by Mrs Staveley to the scheme administrator:

> "I understand that the Scheme Administrator will pay the cash sum benefits under the scheme at their discretion. I would, however, like the Scheme Administrator to consider paying the benefits to the people named below."

The named persons were, as we have described, Mr Piney and Mr Staveley.

74. We agree with Mr Rees' submission that, absent any submission or evidence that the discretion conferred on the AXA PPP scheme administrator was a sham, it was open to the FTT to find only that there was a genuine exercise of discretion by the scheme administrator and that the most that Mrs Staveley could have expected from her completion of the expression of wishes was that a diligent administrator would take those wishes into account as a relevant factor in the exercise of its discretion.

75. The FTT found, at [106], that the immediate cause of the increase in the sons' estates was the exercise of the scheme administrator's discretion in their favour. Mr Rees submitted that, once the FTT's error in finding that it was "virtually inevitable" that the scheme administrator would comply with Mrs Staveley's wishes was recognised, the only proper finding was that the proximate cause of the increase was not the omission by Mrs Staveley to exercise her right to take lifetime pension benefits, but the exercise of the scheme administrator's discretion. The sons' estates were not increased *by* the omission, and s 3(3) did not apply.

76. Miss Wilson, while not seeking to support the FTT's finding of virtual inevitability, argued that there was no requirement in s 3(3) for the causal link to be immediate. She submitted that it was sufficient if there was any causal link between the increase in the other person's estate and the omission which caused the diminution in the first person's estate. In this case, although there was an exercise of discretion, that was merely an administrative act, or the machinery of payment, which completed the gift to the sons which Mrs Staveley had intended by completing the expression of wishes in their favour.

77. In support of that argument, Miss Wilson referred us to *Drummond v Collins* [1915] AC 1011, a case concerning the source for income tax purposes of income of a trust derived from foreign possessions which was remitted by the trustees, under a discretionary power, to the mother of the minor beneficiaries in England for their maintenance and education. It was held that the remittances were subject to income tax as being receipts from the foreign possessions.

78. In rejecting an argument that, although the sums in question arose from the foreign possessions, they were not "income" of the children, because they were voluntary payments by the trustees, Lord Loreburn said, at pp 1017-1018, in a passage particularly relied upon by Miss Wilson:

> "… it is enough to say that these were not voluntary payments in any relevant sense. They were payments made in fulfilment of a testamentary disposition for the benefit of the children in the exercise of a discretion conferred by the will. They were the children's income in fact."

79. The position is more fully explained by Lord Wrenbury, at pp 1019-1020:

> "… the first matter is to investigate upon the provisions of the will what the remittances in question are. In the events which have happened the trustees are by the will directed to hold the trust estate and to apply the net income for the use and benefit of the children. So far I find a direct and unfettered gift of the income in favour of the children. There follows a direction that out of the net income of the proportionate share held in trust for any child the trustees make such provision from time to time as they in their uncontrolled discretion think necessary or advisable for the maintenance and education of the child until he is entitled under provisions after contained to receive the income directly from the trustees. This provision may be paid to the child or to the guardian of the child. Subject to the above directions the income of the shares is to be accumulated until dates which have not yet arrived—at which dates payments are to be made to the children direct. In all this I find nothing contingent. The gifts are each one of them in favour of the children, but the dates for payment to the children are fixed with reference to the exercise by the trustees of their discretion or the ages from time to time of the children. At the time with which your Lordships have to do there could be no payment except by exercise of the discretion vested in the trustees, but so soon as their discretion is exercised in favour of the child the resulting payment seems to me upon the language of the will to be a payment of income to which the child is entitled by virtue of the gift made by the testator. I cannot see any ground upon which such income is not subject to income tax."

Lord Wrenbury went on to consider the position if the children's interest had been contingent, holding in that event that once the trustees had exercised their discretion the interest ceased to be contingent and became vested, and was therefore income of the child.

80. Not only were the facts in *Drummond v Collins* very far from those in this case, the statutory question was different. In *Drummond v Collins* the question concerned whether the receipt was a receipt of income. That was held to be so whether the children's rights were at all times vested or were contingent until the exercise of the trustees' discretion. Notwithstanding the exercise of discretion, the income had as its source the foreign possessions.

81. Miss Wilson's argument is that this illustrates that where, as in this case, funds are entrusted to a third party for distribution amongst a class of persons potentially entitled to the funds, the exercise of the discretion is merely the machinery of payment. We do not agree. We do not accept that *Drummond v Collins* can have any application to the issue of causation that arises under s 3(3) IHTA. The question of source is different from that of causation. It may well be concluded that the ultimate source of the benefit which in the event accrued to the sons' estates was the omission by Mrs Staveley to take lifetime benefits from the AXA PPP, but that is not the statutory question in this case.

82. Section 3(3) does not require identification of the source, which may be found irrespective of any intervening actions, but the proximate cause of the increase in a person's estate. That is the effect of the use of the word "by" in the expression "another person's estate … is increased by … [the] omission to exercise a right". Where such an immediate and proximate cause exists, a more remote reason why an estate is greater than it otherwise would have been is unlikely to satisfy the statute. An effective intervening event without which the person's estate would not be increased will in most cases be sufficient to break the necessary causative link with the original omission. In our view in the present case the scheme administrator's exercise of its genuine discretion was clearly the immediate and proximate cause of the increase in the sons' estates, and sufficient to break the chain of causation.

83. We do not accept that the discretion of the scheme administrator in this case could be characterised merely as the machinery of payment or as an administrative act. The sons had no vested interest in the death benefits payable under the AXA PPP. They were merely two among a larger class of potential beneficiaries permitted by the AXA PPP scheme rules, including Mrs Staveley's grandchildren and her estate generally. Mrs Staveley's expression of wishes was no more than that; it did not deprive the scheme administrator of an effective discretion, and did not reduce the role of the scheme administrator to one of mere paymaster.

84. There is no question, as was suggested by Miss Wilson in her skeleton argument, that the right to the death benefits in this case was settled property for inheritance tax purposes. Nor can the position of the scheme administrator be assimilated to that of a trustee of settled property so as to mandate the same result as would obtain if the death benefits had been settled property. In such a case, it would be the increase in the value of the settled property itself that would be in issue (see s 3(3)(b)). The position of a discretion exercisable outside the confines of settled property is different. Although Miss Wilson argued that the only difference between this case and that of *Arnold*, where there was a discretionary trust of the pension plan, including the death benefits, and thus settled property whose value had increased by the omission to take lifetime benefits, was one of legal form, we regard the difference as one of substance. The cases cannot properly be compared. *Arnold* concerned the application of a specific provision concerning the increase in the value of settled property; this case does not.

85. Nor, in our judgment, does s 3(3) apply where the increase in question is not of an estate of an identifiable person. Miss Wilson argued that it was immaterial how the scheme administrator exercised its discretion; however the discretion was exercised there would be an increase in the value of *some person's* estate. We do not consider that to be a tenable argument having regard to the terms of s 3(3)(a) itself. What is required is that the be an increase in *another person's* estate. It must accordingly be possible to identify, by reference to the required causal link, a particular estate or estates that has or have been increased by the omission. Were that not to be the case, it would be possible for s 3(3)(a) to apply to a class of discretionary beneficiaries under a trust. That such an outcome was considered not to be possible is evident from the inclusion, in s 3(3)(b), of special provision for an increase in the value of the settled property itself. Absent such special provision for a class of

discretionary beneficiaries outside of settled property, it is not possible to construe s 3(3)(a) to the same effect.

Conclusion on the second issue

86. It follows that we find that the FTT made an error of law in deciding that the discretion of the scheme administrator in this case did not break the chain of causation between the omission by Mrs Staveley to exercise her right to take lifetime pension benefits. We set aside the FTT's decision in that regard and re-make it.

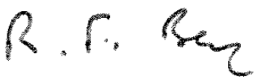
87. In our judgment, the proximate cause of the increase in the estates of Mr Piney and Mr Staveley was the exercise of the discretion of the scheme administrator. Their estates were increased "by" the exercise of that discretion, and not by the omission of Mrs Staveley to exercise her right to take lifetime benefits. There would have been no increase in the value of the son's estates but for the omission to take those benefits, but the test is not a "but for" test and it was not the omission which had the effect of increasing the sons' estates; it was the exercise of the scheme administrator's discretion. It follows, therefore, that the conditions of s 3(3) are not satisfied with respect to Mrs Staveley's omission, and that omission cannot be treated as a disposition or as a transfer of value within s 3(1).

88. We allow the appeal of the estate and Mr Piney and Mr Staveley.

Decision

89. We dismiss the appeal of HMRC with respect to the first issue. We allow the appeal of the executors and Mr Piney and Mr Staveley with respect to the second issue.

MR JUSTICE BARLING



UPPER TRIBUNAL JUDGE ROGER BERNER

RELEASE DATE: 10 January 2017