TC01582

Appeal numbers TC/2010/00610/11

Inheritance tax – discounted gift trust – valuation of retained interest to income stream – s160 IHTA 1084 – burden of proof – adequacy of comparables – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DAVID MERRILL WATKINS and CLIVE JONATHAN HARVEY

(executors of KATHLEEN MAY WATKINS decd)

Appellants

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (*inheritance tax*) **Respondents**

TRIBUNAL: Judge Malachy Cornwell-Kelly
Mrs Sonia Gable

Sitting in public in London on 5 & 25 October 2011

Mr Keith Watkins for the taxpayers

Mr Colin Ryder for the Crown

DECISION

Introduction

1 This is an appeal against a Notice of Determination issued on 15 September 2009 by the executors and trustees of the estate of the late Kathleen May Watkins who died on 18 March 2006 aged 91 years and one day. Mrs Watkins was predeceased by her husband Thomas Charles Watkins by two days. The case turns on the valuation of a retained interest in an income stream reserved from a discounted gift trust created by Mrs Watkins on 21 December 2004, when she was aged 89 years and 9 months, in favour of David Merrill Watkins and Keith Charles Watkins her two sons. The trust was a potentially exempt transfer, which in these events became chargeable.

2 The case for the appellants was argued by Mr Keith Watkins, authorised by his brother Mr David Merrill Watkins and the latter's co-executor Mr Clive Jonathan Harvey to represent the executors in the appeal. Mr Colin Ryder, Head of Inheritance Tax Litigation at HM Revenue and Customs, appeared for the Crown. Written and oral evidence was given by Mr David Merrill Watkins for the appellants and by Mr Brian Watson, as a valuation expert, for the Crown; we were also furnished with a substantial volume of additional documentary evidence bearing on the case.

3 The discounted gift trust in this case was effected by an instrument prepared and marketed by a company based in the Isle of Man called Royal Skandia Trust Company Limited. From abundance of caution, as the presiding member of the tribunal I declared to the parties at the outset that I had a number of personal connections with the Isle of Man and had served as clerk of the island's parliament (but had no connection with or interest in the business in question) and invited the parties to indicate whether they would prefer me to recuse myself from the case. Both parties said that they were content that the appeal should proceed before the tribunal as constituted.

4 The appeal comes to the tribunal under section 224 of the Inheritance Tax Act 1984 (the 1984 Act) as amended, which provides that the tribunal must confirm the determination appealed against unless the tribunal is satisfied that it ought to be varied or quashed.

The law

5 Section 3(1) of the 1984 Act provides:-

> (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.

6 The valuation of any property – as defined in section 272, see below – transferred is ascertained according to section 160 of the 1984 Act, which is as follows:-

> 160 Except as otherwise provided by this Act, the value at any time of any property shall for the purposes of this Act be the price which the property might reasonably be expected to fetch if sold in the open market at that time; but that price shall not be assumed to be reduced on the ground that the whole property is to be placed on the market at one and the same time.

7 The authority most immediately in point is the decision of Lewison J in *RCC v Bower & Anor.* [2009] STC 510. The case was heard on appeal from special commissioner Nowlan and concerned the value to be placed on the reserved rights to a life annuity under an estate planning bond or policy issued by AXA Isle of Man Limited to a lady of 90 years of age, Mrs Bower. Mrs Bower died five months after the issue of the policy to the trustees of a pre-existing trust of which Mrs Bower was the settlor for a premium of £73,000 paid by Mrs Bower herself; under it, she was entitled to a 5% life annuity equal to £304.16 a month.

8 The terms of this policy were that any of the assets allocated to it remaining unused at Mrs Bower's death would pass to the trustees; and that should the assets be exhausted while Mrs Bower was still alive the annuity would cease and AXA would have no liability. Medical evidence put Mrs Bower's life expectancy at between two and three years. According to AXA, the value of Mrs Bower's reserved annuity was £7,800, but the Revenue assessed it at £250 leaving the value of the gift as £72,750.

9 The Revenue's published position in such cases was that since life assurance in respect of the annuitant would be required by any person purchasing her rights, and since such assurance was not commercially available for a person aged 90 or over, the value of the annuity would be purely nominal. After rehearsing the well-established principles applicable to a notional sale of the annuitant's interest, the special commissioner went on to envisage the likely conduct of speculative buyers, essentially those willing in effect to bet on Mrs Bower's actual survival. The commissioner concluded with a valuation which he himself described as "little more than uninformed, but hopefully realistic, guesswork".

10 The decision was reversed on appeal on the ground that the commissioner had erred in law by envisaging potential purchasers for whom there was no evidence. The learned judge said at [12]:

> The special commissioner's method of calculation and valuation is not one that had been put forward by anyone and not put by him to any of the witnesses or parties for comment. This in itself is a breach of the rules of natural justice. But more important for present purposes is that it was not based on the evidence before the special commissioner. It flowed from the special commissioner's erroneous conclusion that he was required or entitled to populate the real market in which the hypothetical sale took place with hypothetical speculators who did not share the characteristics of real buyers.

11 Emphasising the relevance of the remarks of Hoffman LJ in *IRC v Gray* [1994] STC 360, at 371 to 372, Lewison J observed:

> [4] Mr Bretton QC for the executors stressed that part of the ruling [in *Gray*] that the hypothetical vendor and purchaser were prudent men of business negotiating seriously, but in my judgement the key point is that there is nothing hypothetical about the market in which the sale takes place. Thus, the hypothetical vendor and purchaser are serious prudent men of business of the kind who buy and sell the asset in question. If in the real world there are no speculators in the kind of asset under consideration, then in my judgment the statutory hypothesis does not require them to be invented.
>
> [6] Thus, although the whole world is in theory free to bid, there must be an inquiry into who is in the market. This is an inquiry, not an assumption, and in my judgment an inquiry is an inquiry into the facts.

12 The *locus classicus* in regard to the valuation criteria and their application to cases such as this is indeed the judgment of Hoffman LJ in *IRC v Gray,* which it is worth quoting at length since it sets the parameters for the task which we must undertake. At [1994] STC 371-372 he says this:

> The hypothetical vendor is an anonymous but reasonable vendor, who goes about the sale as a prudent man of business, negotiating seriously without giving the impression of being either over-anxious or unduly reluctant. The hypothetical buyer is slightly less anonymous. He too is assumed to have behaved reasonably, making proper inquiries about the property and not appearing too eager to buy. But he also reflects reality in that he embodies whatever was actually the demand for that property at the relevant time.
>
> It cannot be too strongly emphasised that although the sale is hypothetical, there is nothing hypothetical about the open market in which it is supposed to have taken place. The concept of the open market involves assuming that the whole world was free to bid, and then forming a view about what in those circumstances would in real life have been the best price reasonably obtainable. The practical nature of this exercise will usually mean that although in principle no one is excluded from consideration, most of the world will usually play no part in the calculation.

> The inquiry will often focus on what a relatively small number of people would be likely to have paid. It may have to arrive at a figure within a range of prices which the evidence shows that various people would have been likely to pay, reflecting, for example, the fact that one person had a particular reason for paying a higher price than others, but taking into account, if appropriate, the possibility that through accident or whim he might not actually have bought. The valuation is thus a retrospective exercise in probabilities, wholly derived from the real world but rarely committed to the proposition that a sale to a particular purchaser would definitely have happened.

13 One aspect of these general principles appears in a further decision of the Court of Appeal in *Walton v IRC* [1966] STC 68. That case involved a decision of the Lands Tribunal on the valuation for capital transfer tax purposes of the share of a partner in a farming partnership, one of whose assets was an agricultural tenancy. The case seems to us authority for the proposition that the intentions of a known potential purchaser of the interest to be valued should be taken into account, and is a matter of fact to be established by the evidence. Giving the judgment of the court, Peter Gibson LJ held, at 86:

> The open market hypothesis does not require as a necessary incident of it that the landlord [a potential purchaser] should be hypothetical. In my judgment the statute requires one to assume a sale but it should be assumed to take place in the real world.

14 In *Crossman v CIR* [1936] 1 All ER 762, the issue concerned the value to be put on shares for estate duty purposes where they were saleable in the open market, but only after pre-emption rights in favour of the existing shareholders at a reduced price had not been taken up. Following the Irish Court of Appeal in *Attorney-General v Jameson* [1905] 2 IR 218 and the Scottish Court of Session in *Salvesen's Trustees v. IRC* [1930] SLT 387, the House of Lords held, by a majority, that the value of the shares was the price they would fetch in the open market on the basis that the purchaser was entitled to be registered as the holder of them, but that he would be subject to the restrictions on sale which the company's articles provided for.

15 Finally, in so far as the authorities specifically on taxation are concerned, we note first the decision of the Court of Appeal in *Melville & ors. CIR* [2001] STC 1271 confirming that, for the purposes of the 1984 Act, the definition of "property" in section 272 is an inclusive definition which, subject to the context, can embrace (in that case) a power of appointment and, per Lightman J in the High Court, "anything which is capable of producing value, being realised and turned into money"; and second, the dictum of Danckwerts J in *Re Holt* [1953] 1 WLR 1488, at 1492 that the court "must firmly reject the wisdom which might be provided by the knowledge of subsequent events".

16 In regard to the law of evidence, we were referred to a number of authorities bearing upon the doctrine of judicial notice and what it would be appropriate for the tribunal to take into account, drawn from *Keane's Modern Law of Evidence* 8th edition. The only authority in that regard we found helpful to the context of this case was the decision of the House of Lords in *Brandao v Barnett* (1846) 12 Cl&Fin 787, which established that judicial notice might be taken of the custom of bankers' lien; and subsequent authorities showed that a similar course might be taken in regard to the professional practices of conveyancers, accountants and surveyors.

17 There is no category of general knowledge relevant to this appeal in regard to which we need to take account of the rules as to judicial notice, even if they are applicable. Rule 15 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009:

> 15(2) The Tribunal may-
>
> (a) admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom; or
>
> (b) exclude evidence that would otherwise be admissible where-
>
> . . .

(iii) it would otherwise be unfair to admit the evidence.

The facts

18 The essential facts of the case are not in dispute and our findings with regard to them are as follows.

19 Mrs Watkins died on 18 March 2006 aged 91 years and one day, her husband having predeceased her by two days. On 21 December 2004, when Mrs Watkins was aged 89 years and nine months, Mrs Watkins settled upon her two sons David and Keith in equal shares a Royal Skandia Collective Redemption Bond S4519/7 obtained for a premium of £340,000.[1] David and Keith were also the trustees of the settlement, which divided into two funds: the first called 'the Settlor's Fund' for the absolute benefit of the settler and a Residual Fund for the named beneficiaries, David and Keith.

20 It is the Settlor's Fund which is the subject of this appeal. The trust deed provided in clause 6:

> The trustees will pay or transfer capital of the Settlor's Fund to the Settlor . . . of the amount and at the frequencies stated in the third schedule.

The third schedule specified level payments of 10% p.a. of the single premium for the trust property (the Skandia bond), payable quarterly for the life of the settlor. In the event, this was quantified at £4,250 per quarter, or £53,273 over the actuarially reckoned life expectancy of Mrs Watkins of 3.1337 years. A medical report on Mrs Watkins dated 20 October 2004 was taken into account in the actuarial projection.

[1] Mrs Watkins alone is shown as the settlor in the deed of 21.12.04; the bond was jointly subscribed by Mr & Mrs Watkins; the latter's income stream was therefore 10% of the 50% of the fund attributable to her.

21 On 15 September 2009, the Revenue issued the Notices of Determination under appeal on the basis that the value of Mrs Watkins's retained rights in the settlement to an income stream of £4,250 each quarter was no more than one quarter's payment, namely £4,250. The appellants contend that it is approximately £49,033.

Evidence at the hearing

22 For the appellants, evidence was given by Mr David Watkins. Mr Watkins had carried out in 2009 what he described as "an informal survey of several organisations and people" to establish whether buyers of the type of interest retained by Mrs Watkins would be interested in purchasing her rights and how they would value them, with particular regard to the factor that the risk of her death before her actuarially estimated lifespan would terminate the income stream.

23 Mr Watkins's enquiries proceeded on the assumption that the person entitled to the income stream was aged 89, had a life expectancy of 3.1 years, could not obtain life assurance but was prepared to place the capitalised value of her rights (put at £53,000) into an escrow account to guarantee to the purchaser such part of the purchase price as he might lose if the grantor died before the 3.1 years had expired. The question asked was: could this kind of deal be done? It was made clear that the question was hypothetical.

24 Two sources were approached: first, a Mr Andrew Kyd, since 2000 a retired senior manager with HSBC, who had had a range of senior management responsibilities; the second was Mr Paul Clark, the manager of Lloyds TSB's branch at Sevenoaks in Kent. Mr Watkins also approached "a number of financial and insurance contacts", although these remain unidentified. Given that the Revenue had accepted in correspondence (as they did before us) that there was no evidence that discounted gift trust income streams were actually sold, Mr Watkins was asking to know whether such streams *could* be sold and on what terms, rather than assuming that the only useful basis of

comparison was the very limited market for the sale of life interests under existing trusts. As he put it:

> Only enquiry of real potential buyers in the wider market can give guidance as to the likely form of a hypothetical market for [discounted gift trust] sellers with assets because there is no specific market today, nor in all likelihood will there ever be.

25 The result of Mr Watkins's researches was a signed statement from Mr Kyd, and reported comments from Mr Clark. Mr Kyd's statement, made on 17 April 2010, was as follows:

> Discounted Gift Income streams are not generally sold in the financial markets today. I have been asked to comment on the HMRC hypothesis that in a market, if one should arise, for people aged 90 or more, it would be impossible to capitalise such a stream based on the actuarial life forecast because of the high risk of earlier death and the fact that commercial life assurance is not available at such an age to cover that risk. Such a hypothesis, in effect, states that such streams are not saleable and therefore valueless.
>
> However, as we know, it is quite common for financial institutions to secure such a risk of default in the payment of contractual streams (for which a capital advance has been made) by a charge over physical assets or secured by financial instruments.
>
> In my view, if a market for the purchase of [discounted gift trust income streams] were to arise, it is almost inconceivable that capitalisation would not be available somewhere in the financial system, especially if the risk were appropriately secured on physical or financial assets. Advancing capital against a contractual payment stream with asset security to compensate for any eventual shortfall at maturity is not an unusual approach within the banking industry.

26 Mr Watkins's report of Mr Clark's comments was as follows:

> I asked [Mr Clark] what the bank would say if someone asked them for a capital advance against a lifetime interest income stream. He said there was no reason why this would not be treated as a normal capital advance where the following things would be defined at the branch, although the final decision would be made centrally:

- How much was the income, was it assignable and for what period?

- What was the capital intended for? This was not usually of concern but a capital advance would not be made for gambling.

- Was there a sufficient financial or physical asset for the bank to take a charge on as security against death? He did not mention life insurance.

27 In a supplementary witness statement, Mr Watkins deposed that he had been both a Creative Director and a Financial Director at the consultancy Kinsley Lord, and before that at Procter & Gamble, and had had experience of the use of phased contractual payments as a means of making good obligations which, for one reason or another, it was not possible or desirable to discharge at one time. Many examples of that could be given, including mortgages to purchase houses. The features they all had in common was that there was no risk to the lender/seller, and the banks and building societies who facilitated such transactions assumed no risk to themselves by virtue of taking security, or by seeking third party guarantors.

28 In oral evidence, Mr Watkins urged that the Revenue's refusal to take any of these possibilities into account on the ground that there no evidence of actual sales was unreasonable since there was never any evidence of actual sales of discounted gift trust income streams and a market in them could only be hypothesised; the market in sales of life interests under a trust was materially different and, in any event, focussed as far as the Revenue were concerned in one particular area rather than, as the authorities required, ranging as widely as possible. The inheritance tax disadvantage of not selling the rights to an income stream meant that to hypothesise a specific market in their sale was clearly right, because there would now be an obvious incentive for such sales to take place.

29 In support of this argument, a calculation of the commercial value of the income stream was submitted which sought to show, by reference to quarterly payments of £4,250 over 3.1337 years using an interest rate of 5%, that it was worth a capital sum of £49,033. It was accepted that the calculation could need to be fine tuned.

30 A number of possible ways of achieving a sale of an income stream without the collateral of life insurance were suggested in the appellants' skeleton argument, which Mr Watkins adopted in amplification of his evidence. Examples were:

(i) security for the risk of early death could be given by a charge on assets, either of the settlor or the beneficiaries (this was described as "securitisation", evidently not of the kind currently associated with modern banking practice);

(ii) the price for the income stream could be paid by phased payments matching the release of income;

(iii) the beneficiaries could underwrite the purchaser's mortality risk;

(iv) the remaindermen under the trust (the beneficiaries in this case) could purchase the settlor's rights on their own account, thus advancing the retained income;

(v) the remaindermen could take the opportunity of the income stream being sold to sell with it all or the relevant part of their interest in the trust, thus acquiring capital early;

(vi) the purchase price could be deposited in an escrow account with instalments being released as income was received, any shortfall in the purchased stream returning to the buyer in the event of the early death of the settlor.

In all these examples, the mortality risk would effectively have been eliminated.

31 For the Crown, Mr Brian Watson gave expert evidence as to the valuation of life interests for sale in the auction market held by Foster & Cranfield of 25 Britton Street, London EC1.

32 Mr Watson is a fellow of the Institute of Actuaries and practises as an actuarial consultant; since 1999 he has been a consultant to Foster & Cranfield and has had access to the archives of this firm in preparing his evidence. Foster & Cranfield were established in 1843 as auctioneers and valuers of financial rights and interests.

33 Mr Watson's instructions were to provide (i) an analysis of the valuation of income streams in the open market based upon his expert opinion and knowledge of the market for such interests, (ii) an opinion with regard to the valuation of Mrs Watkins's income stream, (iii) an analysis of the appellants' valuation methodology and proposed values, and (iv) his observations on evidence of sales of interests such as the withdrawals or like contingent interests which supported (iii).

34 Mr Watson confirmed that as far as he was aware there was no market in the sale of income streams arising from discounted gift trusts, but that there was an established methodology for valuing interests derived from a trust whether life interests, absolute reversionary interests or contingent reversionary interests. The market for the sale of trust interests had declined significantly and Mr Watson's review of the evidence from Foster & Cranfield only went back to 1990, since when the market in such interests had been limited and did not allow him to infer the detail of the valuation bases used by investors.

35 The actuarial literature on the valuation of trust interests consisted of two papers produced in 1973 and 1977, and the lack of any more recent material was in Mr Watson's view probably the result of the decline in the market for such interests; the valuation of trust interests was indeed no longer part of the examination syllabus of the Institute of Actuaries. At the time these papers were written, there were reversionary companies owned by life insurers which specialised in the purchase of trust interests but even they – with the possibility of

pooling risk – were not willing to assume the mortality risk without life cover being included on the life of the life tenant.

36 The valuation of the interest therefore depended on the premium payable for the whole life policy, which in turn depended on the age, sex and state of health of the life tenant. The seller of such an interest would therefore need to cooperate in the effecting of such a policy.

37 Mr Watson presented an analysis of the sales recorded by Foster & Cranfield since 1990. It showed that, with two exceptions, in all life and contingent reversionary interests offered for sale either life insurance was in place to protect the purchaser against the mortality risk or terms for such insurance had been obtained and were quoted in the auction catalogue. The two exceptions involved a combination of life and reversionary interests, thereby reducing the mortality risk of a potential investor.

38 A single case in 2007 was instructive. It concerned the sale of a life interest with life assurance terms quoted in the sale catalogue, but after the sale it was found not to be possible to effect the life policy needed. Negotiations between the seller and buyer took place to resolve the problem but were unsuccessful and the matter was believed to have ended in the abandonment of the sale. Meanwhile, surveys confirm that life assurance for persons over 90 is a practical impossibility. Mr Watson's conclusions therefore were that no purchaser of Mrs Watkins's income stream would have proceeded without life insurance and that none would have been available.

39 Mr Watson distinguished the instant case from situations such as equity release and bank loans. The situation of equity releases was, he said, much more akin to the case of absolute reversions where the risk was inverted: the sooner the life of the owner expired, the sooner the investor recovered his capital and it was not surprising that owners aged 90 or more could obtain such an arrangement. In the case of a

mortgage loan, there would be no purchase of an income stream and, provided adequate security was taken, virtually no risk.

40 Mr Watson appended a list of the sales he had been able to research from Foster & Cranfield's records from March 1990 to June 2009. In these the buyers had usually been private investors and most of them did not concern life interests; nevertheless, contingent reversion cases shared the characteristic of involving a mortality risk and were therefore instructive.

41 While accepting that the kind of examples given in the context of the appellants' evidence would be possible, and the mortality risk thereby eliminated, Mr Watson contended that there would seldom if ever be a realistic incentive for anyone to undertake them and there was certainly no evidence that they were being undertaken. Asked whether he would necessarily know what was going on outside the conventional market place with which he was associated, Mr Watson conceded that there might be other markets or types of dealing of which he was unaware.

42 In the list of transactions exhibited by Mr Watson, between 1990 and 1991, there were five examples of life interests being sold with life cover either existing or available; there was one example, in May 2001, of a sale of five life interests in one lot with life cover included, and one further example of a life interest sold with life cover in January 2007. There was no example of a life interest *on its own* without life cover. All the sales of contingent reversions also included life cover.

Submissions

43 The appellants' case was in essence that the position adopted by the Revenue was unjustifiably rigid, in looking only to the Foster & Cranfield market for the sale of life interests as a comparator for the

notional sale of the discounted gift trust's income stream required to be hypothesised.

44 The evidence submitted showed clearly that other types of sale transaction were possible and avoided the problem of mortality risk, and therefore overcame the difficulty in this case that Mrs Watkins's life was uninsurable due to her age. Mr Watson had conceded that the suggested ways of structuring an income stream sale were possible and, since the Crown could no more offer a concrete example of an income stream sale than could the appellants, the upshot was necessarily that all reasonable and practicable hypotheses must be taken into account.

45 The examples suggested by the appellants were the subject of detailed debate as to the mechanisms by which they would operate; the Crown's expert witness accepted in principle that they were feasible, though he made the important reservation that he could see little business reason (apart, we add, perhaps from a taxation motive) why they should be found in practice. That is the essential point, and we mean no disrespect to the appellants' careful argument in saying that it serves no purpose to rehearse the possible advantages or disadvantages that might or might not be encountered with respect to their suggested further options.

46 Mr Watson's evidence was criticised on the basis that sales of life interests under trusts, and sales of contingent reversions even more, were materially different from the income stream in this case, and that the examples given were in any event so few that no reliable conclusion could be drawn from them. The situation in *Bower* was distinguished on the ground that there had been no evidence to support the conjectures adopted by the special commissioner, whereas in this appeal there was clear evidence put forward by Mr David Watkins that the options suggested were feasible and not mere conjectures. It was open to the tribunal to take account of the normal mechanisms of

financial affairs and to hypothesise the likely sales and the shape of the market in which they would be made.

47 An attempt was made in reply to Mr Ryder's submissions to introduce – for the first time – an argument that an income stream sale by means of "securitisation" would be a disposition within section 10 of the Act – exclusion of dispositions made at arm's length – and therefore is not risk mitigation. The argument was put forward, it was said, to show that it was reasonable for a valuer to take risk mitigation into account. As Mr Ryder pointed out, section 10 does not prevent there being a disposition but simply addresses its characterisation. (Apart from its being introduced as a new point too late in the proceedings, we cannot see the relevance of section 10 here and we make no further comment about it.)

48 Also after Mr Ryder's submissions had been made, Mr Keith Watkins applied to recall Mr David Watkins to give evidence that the brothers would have offered a guarantee to a buyer of Mrs Watkins's rights. Mr Ryder objected to this application on the grounds that he had had no notice of it, that it would now be evidence given with the benefit of hindsight having heard the Revenue's arguments and would be uncorroborated. We adjourned to consider the matter and ruled that it would be unfair, within the meaning of rule 15(2)(b)(iii), to admit such evidence because it had at no stage been part of the appellants' case, there had been ample opportunity to introduce it as part of the appellants' witness statement and it would effectively take Mr Ryder by surprise in the final afternoon of a two day hearing when there had already been a gap of three weeks between the two days.

49 For the Revenue, Mr Ryder submitted that we should take care to avoid the temptation to speculate where evidence of reality was lacking. The authorities clearly required the statutory hypothesis to be related to evidence of what was likely to happen, and the best evidence of that was what did happen in closely comparable situations

in the open market which none of the appellants' suggestions would be likely to involve. The circumstances of the case were virtually on all fours with *Bower*.

50 The various suggestions put forward for the appellants were not in fact supported by Mr David Watkins's research enquiries. The persons of whom he made these enquiries went no further than saying that the options suggested were feasible, but not that they had ever been realised. It would be quite inappropriate for the tribunal to draw on personal or generalised understanding of how financial business was conducted to supplement this.

51 Even in the instance of a special purchaser, *Walton* emphasised that the person envisaged must be a reality and not an artificial construct. The appellants had not put forward any evidence of such a person and the attempt to introduce evidence of what they themselves would have done as third parties had there been a sale, even if it had been admitted by the tribunal, would not have amounted to showing that a sale which they could facilitate would have found a purchaser to begin with.

52 The lack of commercial reality inherent in some of the proposed options was a further reason why no reliance should be placed on them. For example, the escrow option would involve the settlor receiving her quarterly payments from the escrow account exactly as she would have received them from the trustees. The 'purchaser' would lose the mortality risk if the settlor died earlier than predicted because the unused amount would revert to him, but the settlor would have received nothing more than she began with and the value to her of the new rights is therefore negligible.

53 Mr Ryder submitted that the value to the settlor would be much less than £49,000 in all the appellants' examples. Where the settlor received a lump sum outright, she would only do so by virtue of a guarantee of the income stream notwithstanding her premature death. Since the guarantee would come from a third party, its value could not

be part of the value of the rights retained. Thus, it was essential always to deduct the costs incurred in making the rights saleable in order to arrive at their value to the settlor and therefore the extent to which her estate was diminished by the sale.

Conclusions

54 It is clear from the authorities, and from *Bower* in particular, that we are required to conduct an inquiry into the factual existence of the open market a sale in which is to be hypothesised for the purpose of section 160 of the 1984 Act. The evidence adduced by the appellants shows no existing market, let alone what could be described as an open market, for the income stream to be valued, nor a market for any similar type of entitlement, save that for life interests under trusts shown by the Revenue's evidence.

55 It is important to recall the terms in which the two persons cited by Mr David Watkins stated their opinions. In the case of Mr Kyd, his statement said:-

> In my view, if a market for the purchase of [discounted gift trust income streams] were to arise, it is almost inconceivable that capitalisation would not be available somewhere in the financial system, especially if the risk were appropriately secured on physical or financial assets.

56 Mr Clark's comments were reported by Mr Watkins as follows:-

> I asked [Mr Clark] what the bank would say if someone asked them for a capital advance against a lifetime interest income stream. He said there was no reason why this would not be treated as a normal capital advance where the following things would be defined at the branch, although the final decision would be made centrally:

57 Both these statements make it clear that there is no actual experience of the transaction scenarios on which these gentlemen were asked to comment. Their views are speculations on what would be possible or even probable; they are no doubt well-informed on the

matters on which they opine, but there is cited no factual foundation in previous or similar transactions to refer to.

58 It is true that the evidence adduced by the Crown is limited, and not entirely on all fours with the facts of this case, but it shows a consistent pattern of behaviour over a significant period of time in regard to rights which are very similar to those in this appeal. We have very much in mind Lord Hoffman's reminder in *Gray* that:

> It cannot be too strongly emphasised that although the sale is hypothetical, there is nothing hypothetical about the open market in which it is supposed to have taken place.

59 Ingenious though the appellants' formulations may seem, they do not pass the test that they are identifiable with any type of open market that exists. The burden of displacing the valuation adopted by the Revenue lies on the appellants and it has not in our judgment been discharged. The appeal does not therefore succeed and we confirm the determinations.

Appeal rights

60 This document contains the full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal no later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

Malachy Cornwell-Kelly
Tribunal judge

Release date: 17 November 2011