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JOINT TENANTS – ENTERING A FICTIONAL WORLD

Michael Firth wrote a fascinating article in the *GITC*, entitled the 'Taxation of Jointly Owned Property'. It led to the following exchange of correspondence between us on the valuation for Inheritance Tax purposes on a death of an interest in a joint bank account:-

'**Dear Michael**

I was reading your really excellent article 'The Taxation of Jointly Owned Property' in the July edition of the GITC Review. You say on page 21 that:-

> '... the fact that the joint tenant is about to die does not affect the value of the joint share ... the joint tenancy could be severed in the instant before death, meaning that the deceased's interest's descent into worthlessness is not inevitable.'

I wondered, however, whether you had considered the following argument.

The requirement of IHTA 1984 s.4 is to value the interest immediately before death. At the instant immediately before death the tenancy is a joint tenancy. If it were to be severed at that instant, the severed tenancy could only be sold on or after the death and that is not the point in time at which the valuation is to be made.

Further, what is the nature of the asset which is the subject of the hypothetical sale? It must be the joint tenancy of the deceased not a new joint tenancy of the purchaser. So we must envisage a purchaser who buys a joint tenancy of a person whose death the next instant is predictable and which the purchaser would not have time to sever.

I have to say that I find valuation for IHT purposes extraordinarily enjoyable because it is so completely artificial.

Yours sincerely
Simon McKie'

'**Dear Simon**

You raise a really interesting point. If I've understood correctly (and please correct me if I haven't!), your argument is that in order for the joint interest to have value, there must be sufficient time for two events to occur:

1) The sale
2) The severance

In the first formulation of your argument you consider the analysis that would apply if the severance happens first (followed by the sale). Your conclusion is that because we are only permitted a single instant (due to this happening "immediately" before death), even if the soon-to-be-deceased severed his interest in that instant, there would be no time to sell it. It follows that we cannot extract value from the interest by that route, and I agree with you.

In the second formulation, you consider the analysis that would apply if the sale happened first. Your conclusion is that the purchaser buys the joint tenancy in the single, available instant, but there is no time to sever it.

I would suggest that the answer to this is that sale of a joint tenancy interest automatically severs that interest. From this it follows that if we use the single instant available to sell the interest (or buy, depending on your viewpoint), we achieve both sale and severance at the same time. That a sale automatically severs the joint interest follows from the fact that a joint tenancy requires the four unities to be present. Of particular relevance here is the unity of title which requires all joint tenants to derive their title from the same immediate source. Following a sale, the new interest holder's title derives from the sale, whereas the other interest holders' titles derive from an earlier transaction. The lack of unity of title breaks the joint tenancy.

I wonder if I have come close to persuading you? I do, also, entirely agree with your comment about this being a fascinating area, full of unexpected results (and traps!).

Best wishes
Michael'

'**Dear Michael**

I have thought about this a bit more. Section 4 says that tax is charged as if, immediately before the death of the individual concerned "he had made a transfer of value and the value transferred by it had been equal of the value of his estate immediately before his death".

That requires you to value the taxpayer's estate immediately before his death. His estate of course, under Section 5, is the aggregate of all the property to which he is beneficially entitled subject to various exceptions. In the case of a joint bank account, immediately before the deceased's death, he possesses an interest in the account as joint tenant. That is a different thing to an interest in the account as a tenant in common. In reality, he is unable to sell that interest. Any transaction which purports to do so will actually lead to the extinction of the joint interest and the coming into being of a beneficial tenancy in common held by the purchaser.

Section 160 tells us that the value at any time of any property is 'the price which the property might reasonably expect to fetch if sold in the open market at that time' and poses the question of what one does when a sale is impossible. *Crossman v Re Lynall* is authority for the proposition that the restrictions preventing a sale must be ignored to the extent necessary for a sale to take place but that in arriving at the valuation of the asset one must assume the acquirer will acquire the actual asset subject to the restrictions on sale.

Applying that to a joint interest, therefore, one might think that the acquirer would be treated as acquiring a joint tenancy of which he was a joint tenant even though it is actually impossible for him to do so. Because the hypothetical acquirer would know that immediately on its acquisition he would be able to sever the joint tenancy the amount which he would be willing to pay for it would not be very different to the monetary balance in the account divided by the number of joint tenants. So that argument gets us to the same position as yours but by a different route.

It doesn't seem entirely satisfactory, however, because the asset which is the subject of the hypothetical sale is one which includes the right to the whole account in the event of the death of the other joint tenants before the death of the vendor if the joint tenancy isn't severed before then and it appears to be a different asset to the one which is acquired which is a joint tenancy which includes the right to the whole amount in the event of the death of the other joint tenants before the death of the acquirer. We appear to have sold a different asset to the one which the acquirer has purchased. This is a very different situation to the sort of asset considered in *IRC v Crossman*, being shares, the nature of which was not changed by the identity of the holder.

One might make a comparison with an annuity which contained a prohibition on assignment. It is clear that there one wouldn't assume that the acquirer acquired an annuity on his own life. One would simply ignore the prohibition on Assignment to the extent that it prevented the hypothetical sale under s.160. The acquirer would be deemed to acquire immediately before death an annuity on the life of a person who was about to die.

When one looks at the cases on joint accounts (*O'Neill and Otrs v HMRC* [1998], *Sillars and Anr v HMRC* [2004], *Taylor and Anr v HMRC* [2008], *Smith and Otrs v HMRC* [2009]) they take for granted the nature of the asset which is being valued and seem to assume that its value is equal to a simple right to the account balance. They talk in terms of the 'property in the account' or of 'the balance' but a bank account is merely a chose in action constituted by a debt according to its terms and quantified by the rendering of an account. There is

no underlying asset consisting of the ‘money’ in that account. That is just a loose non-technical description of the arrangement.

I often find that things that people have always taken for granted are the most difficult to understand when you start to consider them from first principles ...

Kind regards.
Simon’

‘**Dear Simon**

...

Fundamentally, I think that you are right - a joint tenant is not, by any means, able to transfer his or her precise interest. Instead, disposal of the interest effects a process of extinguishing the joint tenancy interest and the creation of a tenancy in common interest (for all remaining joint owners).

Reassuringly, to some extent, we are not the first to grapple with these difficulties. There is an article by Barry Crown in the Law Quarterly Review 117 LQRR 477 where the author comments:

> “The fact that a joint tenancy can be severed by alienation presents considerable logical difficulties. Neither joint tenant owns a separate interest in the land. Each joint tenant holds everything yet holds nothing. If so, what property does he have to alienate to a third party? One might have thought, therefore, that the only way in which severance could take place would be by some form of agreement between all the joint tenants. In fact, however, severance is effected by the unilateral act of alienation by one of the joint tenants. What appears to happen is that the alienor disposes of an interest that he does not actually have and this “transfer” creates the very interest which was supposedly the subject-matter of the transfer in the first place.

> It is possible to dismiss the logical difficulties involved in understanding how a joint tenancy can be severed by alienation as mere academic quibbling. There is a rule of law that a joint tenancy is severed by alienation. This rule has been accepted for centuries and that is all that matters for practical purposes. However, problems arise when one is faced with a novel situation. Suppose a question arises as to whether or not a certain act amounts to a form of alienation sufficient to sever a joint tenancy. If this precise point is not covered by case law, the normal course of action of a lawyer would be to try to draw a logical deduction from those rules of law which have been clearly established by the courts. It is difficult to do this, however, if those rules themselves are based on a what is actually a logical fallacy. Where logical deduction is impossible, it is tempting instead to appeal to authority. This may perhaps explain a notable feature of the 20th century cases on common law severance, which is the extent to which so many of these modern judgments are embellished with quotations from Coke upon Littleton."

I can think of three possible ways to solve this problem. The first is the one you have set out: to enter the fictional world where the impossible is possible and thus a joint tenant's interest can be assigned.

If I've understood correctly, you find this unsatisfactory because "we appear to have sold a different asset to the one which the acquirer has purchased". I would suggest that once we are into the fictional world we must refrain from comparisons with the real world because the very reason why we went into the fictional world in the first place was that the real world does not allow us to answer the statutory question properly.

Thus, for example, in *Crossman*, one can say that the hypothetical purchaser would acquire, in reality, something different from what we have sold - namely, nothing (because of the restrictions on sale). That is not a reason, however, to question the fiction. Similarly, once we decide to assume that the joint tenant can sell his or her full interest, we should not question that by comparison with the reality (in which the purchaser acquires a tenancy in common interest).

What makes this confusing in cases of joint tenants as compared to *Crossman*-type cases is that the reality is that the purchaser does actually acquire something, rather than nothing.

The second alternative, in cases where the purchaser does actually acquire something, is to try and make some sense of the reality. The closest I have come to this is to say that the joint tenant has a bundle of rights and powers which must be analysed separately. Thus, for the purposes of enjoyment and survivorship, the traditional notion that each joint tenant is entitled to the whole applies. For the purposes of alienation, however, joint tenants are in a similar position to tenants in common - each does have a "share" which he or she can alienate. Some support for this view can be derived from *Wright v Gibbons* 78 CLR 313 at 330 where Dixon J quotes Richard Preston as summing up the result:

> "In two places Richard Preston summed up the result: "Joint tenants are said to be seised per my et per tout. They are in under the same feudal contract or investiture. Hence livery of seisin from one to another is not sufficient. For all purposes of alienation, each is seised of, and has a power of alienation over that share only which is his aliquot part": Essay on Abstracts of Title, (1824), vol. 2, p. 62. "The real distinction is, joint tenants have the whole for the purpose of tenure and survivorship, while, for the purpose of immediate alienation, each has only a particular part"; On Estates, 2nd ed. (1820), vol. 1, p. 136."

Assuming that we need a right (or power) which can be transferred for the purposes of IHT valuation, the power of alienation could feasibly fulfil this role as it is (at least functionally) the same right in the hands of the joint tenant and the tenant in common. Such a power would, as far as I can see, have the same value as the fictional transfer of the joint tenant's interest. This would be so whenever one carries out the valuation (i.e. even if the vendor's death was not imminent) because an open market purchaser would place no real value on the possibility of survivorship given that the other joint tenant could, at any time, sever the joint tenancy.

Finally, if one takes a broader view of "sold in the open market" so as to include any method of turning a right to account through an open market transaction, the conceptual difficulties of severing a joint tenancy do not arise as part of the IHT analysis.

...

Best wishes
Michael'

'**Dear Michael**

Thank you so much for your very full and very interesting reply on this matter. I find all you say persuasive but I should just make the following comment.

You say that:

> "...in *Crossman v Crossman*, one can say that the hypothetical purchaser would acquire, in reality, something different from what we have sold – namely, nothing (because of the restrictions on sale)."

I don't think that this is quite as I would express it. The individual concerned has an actual asset, his interest as joint tenant in the bank account. It is impossible to sell that asset. For the purposes of Inheritance Tax, however, in order to value the asset we have to hypothesise a sale. Crossman tells us that for the purposes of that hypothetical sale we have to assume that it is possible for the sale to be made. It also tells us, however, that the asset which the individual is to be treated as selling is the exact asset which he owns so that the hypothetical purchaser is treated as acquiring the rights of which the asset consists and subject to the same restrictions to which it is subject in the hands of the individual. The argument I made was that the exact asset which the individual owns is his interest as joint tenant and not an interest of the

purchaser as joint tenant. Thus we have to hypothesise a purchaser who acquires a right which, for example, will be extinguished by the individual’s death. Valuing that right immediately before the individual’s death, it is plain that it would be as good as valueless. That, of course, is not the way the Courts have approached the matter but then the argument I have advanced has never, as far as I know, been argued in a case.

...

Many thanks for this fascinating exchange.

Simon McKie’