

Capital taxes update (Lecture P1437 – 18.37 minutes)

Sale of garden to a property developer

Summary – The deemed disposal of part of a garden to trading stock crystallised a gain that was eligible for principal private residence relief.

In 1995 Andrew Nunn bought a property in Oxfordshire for £120,000 which he lived in as his main residence. Its garden was less than 0.5 of a hectare.

In 2015, he agreed to sell part of garden to a property developer for £295,000, who obtained planning permission in April 2015 to build two houses on the land.

By 2 June 2016 formal contracts for sale had still not been agreed but the developer was keen to begin work, in order to make progress during good weather. At that time, Andrew Nunn signed a letter from the developer agreeing that construction work could commence. The builder erected a fence to partition the land from the remaining garden and began construction work.

A formal contract of sale was signed and completed on 7 September 2016. The agreed terms of the sale were that £195,000 would be paid immediately and a further £100,000 on the completion of the sale of the second house to be built on the land.

By 7 September 2016 the foundations of the houses had been poured and brick walls built sufficiently high that scaffolding had been erected for the construction of the second storey.

In 2018, Andrew Nunn submitted his 2016/17 Self Assessment tax return, declaring sale proceeds of £195,000 and allowable costs of £222,000, resulting in a loss of £27,220.

On 18 December 2018, HMRC opened an enquiry into the 2016/17 tax return, later issuing a closure notice denying any loss relief. HMRC stated that the disposal date for CGT was 7 September 2016 and by that date the land was a building site, no longer part of the garden. Consequently, HMRC sought to collect CGT of £72,634 on the basis that principal private residence relief was denied.

Andrew Nunn appealed, arguing that disposal of the 'garden' took place on 2 June 2016, when the land was part of his garden that formed part of the permitted area of his main residence.

Decision

The First Tier Tribunal found that the letter that was signed on 2 June 2016 was not a contract for sale. Rather it simply allowed the developer to commence work on the development on the new houses. The Tribunal noted that there was nothing in it which showed a definite intention to bring about the immediate disposal of the land.

The Tribunal found that under normal circumstances, the CGT date of disposal was 7 September 2016, the date on which Andrew Nunn no longer owned the property.

However, the First Tier Tribunal found that as a result of the 2 June 2016 letter and the construction work commencing, Andrew Nunn was no longer using the land as part of his garden. The Tribunal stated that Andrew Nunn 'did not dig the foundations or lay the bricks himself' but he was carrying out development activities, through an agreement with a professional property developer. If the sale had fallen through, he 'would likely need to find a buyer' and was willing to take the risk of development works being begun in order to enable the reward of realising a profit on the sale of the land.

Consequently, there had been a deemed disposal of the property to trading stock (s.161 TCGA 1992). As the land was still a garden and not separated from his house at that time, Principal Private Residence relief applied. The Tribunal noted that 'Any further disposal of that land would normally be subject to tax as a trading transaction.'

Andrew Nunn v HMRC (TC09127)

Negligible value claim

Summary – Shares were acquired at a time when they were already of negligible value, meaning that the taxpayer's subsequent negligible value claim was denied.

Kleos (Holdings) Ltd was incorporated on 19 December 2013 with two directors, Abigail Tan and Dr. Valeria Cinaglia. Two ordinary shares were allotted, one to each director.

On 30 September 2017 Abigail Tan applied for 150,000 Ordinary shares of £1.00 each in the company, stating in writing "I hereby confirm that payment for the aforementioned shares shall be capitalisation of the director's loan account." This was approved at a board meeting on 30 September 2017.

The company's Annual report and Unaudited Financial Statement for the year ended 31 December 2017 stated:

"The principal activity of the company was to be that of Licensed restaurants which was closed down in November 2017."

The Notes to the Financial Statements in relation to Going Concern stated:

"The company meets its day to day working capital requirements through the shareholder providing the funds."

In July 2019 Silver Levene filed a DS01 (strike off) form with Companies House for the company. There was no evidence that the company went through any form of insolvency procedure.

Abigail Tan submitted her tax return for 2017/18 on 1 August 2018, arguing that her shares had become of negligible value and claiming a negligible value loss of £150,000.

HMRC denied the claim believing that the company had ceased trading on 30 September 2017 and that at this date Abigail Tan's shares already had no value. HMRC stated:

"The £150,000 shares subscribed for do not meet the conditions for a negligible value claim as they were worthless at the time of acquisition on 30/09/2017 when the loan conversion took place. S251(3) of TCGA 1992 limits the acquisition cost of the shares subscribed for to their market value at the time of the loan conversion."

Abigail Tan argued that when the capital sums were introduced, the company was solvent and hence the share value would be at £1 each, and one had to look at the company's position not as at 30 September 2017 but when the £150,000 capital was introduced.

Decision

The First Tier Tribunal found that the earliest date at which she could have owned the shares was 30 September 2017, when the company resolved to allot them.

However, as at that date, the shares were already of negligible value, as the company was insolvent and so the shares could not "become" of negligible value whilst owned by the Appellant."

The appeal was dismissed.

Abigail Tan v HMRC (TC09112)

Entrepreneurs' relief and rectification

Summary – Rectification for an error would be allowed, meaning that entrepreneurs' relief was available.

On 26 February 2019 Jonathan Cooke disposed of his entire shareholding in ISG Holdings Limited to a third party, realising a chargeable gain of about £600,000.

At that time, entrepreneurs' relief was available on gains arising on a share disposal provided certain conditions were met, including that the person making the disposal had held at least 5% of the "ordinary share capital" in the company for a period of one year prior to the disposal.

Jonathan Cooke explained he had known the founders of ISG Holdings Limited since 2012. For a number of years, he had acted as 'friendly adviser' to them, helping them grow the business by giving them the benefit of his expertise in the property industry and also introducing them to his industry contacts.

In 2017 he became a formal investor in the company by acquiring shares in the company, with the agreement made with the founders stating that he was to buy 5% of the business for £500,000.

Jonathan Cooke was very focussed on the 5%, as he was well aware of the benefits of entrepreneurs' relief, should he sell his shares in the future. Indeed, he requested an anti-dilution clause to be included in the documents so his shareholding would not fall below 5%.

Following the share sale in 2019, Jonathan Cooke declared on his tax return that the sale qualified for entrepreneurs' relief.

However, following an enquiry by HMRC, he became aware for the first time that his holding of 245,802 D shares in ISC Holdings Limited was one share short of 5% of the ordinary share capital of the company. This was a mistake that had occurred due to the fact that a spreadsheet was used to calculate the number of shares acquired, but this spreadsheet rounded the percentage from 4.99998% to 5%. On this basis, HMRC denied the relief.

Jonathan Cooke appealed, arguing that he should be entitled to entrepreneurs' relief relies as if appropriate proceedings were brought in the High Court, it would order the rectification of documents to secure that he had held at least 5% of the ordinary share capital for the required

period. He argued that the First Tier Tribunal should proceed as if such rectification had been ordered.

Decision

The First Tier Tribunal found that the taxpayer's intention was to transfer "a minimum of 5%" and that this "was a clear red line for Mr Jonathan Cooke, due to the fact that he wanted to qualify for entrepreneurs' relief. The fact he asked for (and received) an anti-dilution clause in the shareholders' agreement further points to this fact."

In the case *Lobler v Revenue and Customs Commissioners* [2015] UKUT 152 (TCC) it was found that:

"although the FTT did not itself have power to order rectification, it could determine that if rectification would be granted by a court who does have jurisdiction to grant it, Mr Lobler's tax position would follow as if such rectification had been granted."

Consequently, in this case the Tribunal considered that it did have the jurisdiction to consider what the High Court would do, were it to be asked for rectification.

- The Tribunal found that the parties had a common intention to transfer a 5% holding which was clearly shown in various documents including the Heads of Terms and confirmed in oral evidence by all parties. The Tribunal found that the High Court would treat this matter as one that was capable of rectification.
- There was little delay between finding out that the problem existed and taking action to remedy this problem. It was very clear that all parties acknowledged and accepted that small cash adjustments would be necessary to effect the rectification.
- The Tribunal found that if rectification was allowed, no other third party would be left in an unjust position and that it was "highly unlikely that the High Court would consider them to be anything but neutral in this situation."

For these reasons, the First Tier Tribunal considered that the High Court would, if asked to consider the matter, grant rectification of these documents. As a result, the conditions for entrepreneurs' relief would then have been met.

The appeal was allowed.

Jonathan Cooke v HMRC (TC09118)

Property bought by brother

Summary - An individual who bought a property on behalf of his bankrupt brother was holding it on resulting trust. As legal, but not beneficial owner, he was not subject to tax on its disposal to his sister-in-law.

Rasiah Raveendran had owned the leasehold of a property since 1989 from which his brother, Mr Indraraj, traded from.

In 2005, his brother was approached by the freeholder who wanted to sell the property but, having been declared bankrupt in 2004, Mr Indraraj could not obtain a loan to buy it. As a result, Rasiah Raveendran bought the property for £300,000 with the bulk of the purchase price paid from a loan

taken out in Rasiah Raveendran's name. Mr Indraraj did contribute a sum, roughly the equivalent to 10% of the purchase price, to pay for further improvements in the property.

In 2014, with the loan affecting his credit score, the property was sold to his sister-in-law for £350,000 and the loan was repaid. At this time, the property was valued at £1,080,000.

HMRC enquired into Rasiah Raveendran's tax return for 2014/15 but found no mention of the property sale. HMRC started from the position that as Rasiah Raveendran was the legal owner of the property, he should be assumed to be the beneficial owner of the property in the absence of evidence to the contrary. There was no trust deed to show beneficial ownership held by Mr Indraraj. HMRC raised a valid discovery assessment for £191,974.

Rasiah Raveendran appealed, arguing that he was only the legal owner of the house, not the beneficial owner, who was his brother. It was understood that he was holding the property on trust for his brother. When asked why £350,000 was paid, rather than the original purchase price of £300,000 he claimed that the extra was to compensate him for the stamp duty land tax paid.

Decision

The First Tier Tribunal found that the evidence provided showed that:

- It was entirely plausible that Mr Indraraj could obtain no credit due to his bankruptcy;
- The entire mechanism of the purchase had been arranged for the brother, with the transaction described by Rasiah Raveendran as 'my brother using my name';
- From the outset, there was a clear understanding by both parties that the property was held for Mr Indraraj.

Despite there being no trust deed to show beneficial ownership, all of the evidence pointed towards his brother having beneficial ownership of the property. Costs were funded by Mr Indraraj via direct contribution or by paying the mortgage. The only funds contributed by Rasiah Raveendran were the loan, which was repaid when the property was transferred to the sister-in-law in May 2014.

The Tribunal stated:

"There is no evidence, in our opinion, that points to the original transaction being anything other than a resulting trust."

With the entire purchase price funded by Mr Indraraj, he was the sole beneficial owner of the property and the appeal was allowed.

Rasiah Raveendran v HMRC (TC09119)

Annexe under construction

Summary – A garage converted to a self-contained unit was not a dwelling and so multiple dwellings relief was denied.

On 7 June 2021, Yisroel Dreyfus exchanged contracts to buy a property in London and at the same time agreed a "key undertaking" document allowing him to convert the garage into a self-contained unit.

On 22 June 2021, he completed on the £1.8 million purchase; this was the effective date of the transaction for SDLT purposes.

The week before, various works had been carried out to create a door, to introduce a cold-water supply pipe and a soil pipe for waste.

Yisroel Dreyfus submitted his SDLT return and paid tax, claiming multiple dwellings relief. He argued that on the effective date for SDLT, the annexe was in the process of being constructed, meaning it was a second dwelling facilitating his claim.

HMRC rejected the multiple dwellings relief claim and increased the SDLT payable by £74,750.

The taxpayer appealed, maintaining that the property included two self-contained dwellings, with each including “all the amenities required for everyday living”. Further, each dwelling had its own supply of electricity and gas which could be used independently of the other dwelling.

Decision

Both parties agreed that the appeal centred around the interpretation of paragraph 7(2)(b) Schedule 6B FA 2003 which explains 'what counts as a dwelling'.

It states:

- (2) A building or part of a building counts as a dwelling if—
 - (a) it is used or suitable for use as a single dwelling, or
 - (b) it is in the process of being constructed or adapted for such use."

The Tribunal considered the work planned and undertaken before and after purchase, concluding that these did not provide sufficient evidence of construction or adaptation stating that:

“The minimal work referred to ... does not provide sufficient evidence of construction or adaptation”.

After two years, the annexe was complete but still not let. Water, light and heat were all shared with the main property; there were no separate meters. No council tax was being paid in respect of the annexe and there was no evidence to prove that the annexe had a lockable door.

Concluding that the annexe was not usable as a single dwelling, the appeal was dismissed.

Yisroel Dreyfus v HMRC (TC09113)

Unused woodland

Summary – 3.4 acres of woodland were found to be part of the grounds of a property bought in a semi-rural location. SDLT was payable at the residential rates.

On 12 March 2018, the couple bought a property in Potters Bar for £1.5 million, submitting the SDLT return on the basis that the property was 'residential'.

The property was located in a semi-rural location and consisted of a five-bedroomed house, attached double garage, a garden set in approximately half of an acre and 3.4 acres of woodland.

Nearly a year later, their agent sent HMRC a letter requesting that the return be amended on the basis that there was non-residential property, woodland, included in the purchase, which was not being used.

Following an enquiry, HMRC issued a closure notice concluding that the "woodland" was residential property.

The couple appealed to the First Tier Tribunal arguing that neither they nor the previous owners used the woodland, which was overgrown and inaccessible.

Decision

The First Tier Tribunal used the "pointers" in *Faiers v HMRC* that set out the principles, derived from various SDLT cases, to use when considering whether a particular piece of land can be said to be grounds "of" a dwelling.

- Historic use - there was no suggestion that the Woodland had been used otherwise than as woodland;
- Layout/proximity - The Woodland was at the top of the garden but contiguous with it and could be seen from the house, enhancing the rural character of the Property;
- Extent - 3.4 acres was considered to be appropriate for a dwelling of this size in a semi-rural location, being consistent with properties in the area;
- Legal factors/constraints – on purchase, there were no legal factors or constraints preventing the use of the Woodland with the house and the garden;
- Connection - the Woodland was connected directly with the garden;
- Common ownership - the Woodland was in common ownership;
- Contiguity - The Woodland was contiguous to the garden.
- Functionality - the Woodland gave a degree of security and privacy to the property;
- Unconnected purpose - the Woodland was not used or occupied for a purpose separate from and unconnected with the garden.

Having considered all of these factors, the First Tier Tribunal dismissed the appeal.

Mihalakis and Dora Michael v HMRC (TC09130)