

A 'tax nothing' (Lecture P1302 – 21.41 minutes)

'Tax nothings' occur where there is no relief for expenditure incurred by a taxpayer. They turn up in various parts of the tax system. The recent First-Tier Tribunal decision in *Drake v HMRC* (2022) provides a good example of this anomaly under the CGT legislation.

In July 2014, the taxpayer (D) entered into a contractual agreement under which, on completion, he was to be granted a lease of a London property – still under construction – in return for the payment of a premium of £2,200,000.

A deposit was payable by D on the date of the contract, followed by a stage payment due one year later, i.e. in July 2015. D paid the deposit, but, because of difficulties in the property market (the value of the lease was thought to be less than the agreed premium so that D had difficulty in raising the necessary finance), he was unable to make the stage payment.

This allowed the vendor to say that D had repudiated the contract, the main consequence of which was that the other party was entitled to retain D's deposit (£220,000). The contract was never completed.

In his 2015/16 tax return, D claimed relief for an allowable loss of £220,000 which HMRC refused. They said that the deposit was not an asset and so there was no disposal for CGT purposes. This was upheld on a review. D appealed to the First-Tier Tribunal.

The judge confirmed that HMRC's ruling was correct, but the real interest of this case lies in the discussion of judicial precedent. In the past, tax issues regarding forfeited deposits have come before the Courts and Tribunals on several occasions and there have been significant differences in the way in which the law has been interpreted.

Three earlier cases were cited here:

1. *Hardy v HMRC* (2016)

This Upper Tribunal case dealt with an off-plan purchase of a leasehold property where a deposit was paid on entering into the contract. However, the taxpayer was unable to complete the transaction and so he lost his deposit. The benefit of the contract was not assignable.

2. *Lloyd-Webber v HMRC* (2019)

The taxpayer (LW) contracted to purchase two plots of land in Barbados, together with villas to be constructed thereon. Large payments were made as the construction progressed. The developers, with whom LW dealt, suffered serious cash flow problems which ended with the building of the villas being abandoned, but not before LW was out of pocket to the tune of nearly \$11,500,000. This was a First-Tier Tribunal hearing.

3. Underwood v HMRC (2009)

The Court of Appeal had to decide whether the taxpayer (Mr Underwood) had realised an allowable loss on the disposal of land to a person (B). In the event, before completion, Mr Underwood contracted to repurchase the land and sell it to someone else (C). On completion, the land was never actually transferred to (and from) B. Instead, it was conveyed directly to C. Mr Underwood merely paid B what turned out to be the excess of the repurchase price over the sale price.

Although the facts in Drake sound similar to those in the Hardy case, a fundamental difference is that the contract in Hardy was non-assignable. The taxpayer in Hardy was not held to own an asset which he could sell and therefore the loss was disallowed), whereas, in the present case, D argued that he did have rights which he could turn to account. These were fully marketable and so, under S21 TCGA 1992, they constituted an asset for CGT purposes. D's rights were extinguished on rescission of the contract and he suffered a real monetary loss of £220,000. S24 TCGA 1992 confirms that the extinction of an asset is treated as a disposal under the CGT legislation.

D said that Hardy had failed to consider the ratio decidendi of the Underwood case (indeed, Underwood v HMRC (2009) was not mentioned in either of the Hardy hearings, despite being a Court of Appeal decision which predated Hardy by several years). The rationale was that, where a taxpayer has two contracts with the same person, one to sell and the other to repurchase an asset and settles those contracts by a payment of the excess of the repurchase price over the sale price, no allowable loss for CGT purposes can arise to the taxpayer on the sale, given that there is no disposal of the asset. This principle seems fair enough.

D then pointed out that, in Lloyd-Webber (which the taxpayer won), the Hardy decision was stated to be per incuriam, i.e. that it resulted from a judicial oversight of an important point, although no explanation was given in Lloyd-Webber as to why this was the case. However, Judge Zachary Citron in Drake v HMRC (2022) pronounced himself unable to agree that Hardy had been decided per incuriam.

He closed by saying:

'The principal factual difference between this case and Hardy is that the benefit of the contract in Hardy was not assignable in any circumstances, whereas, in this case, the appellant was entitled to assign the benefit of the contract after payment of the deposit and the stage payment.

However, this factual difference does not justify distinguishing Hardy from this case, as:

- (i) the decision in Hardy expressly considered the issue of assignability and determined that it was not a significant factor, i.e. the analysis applied equally to assignable and unassignable contracts; and
- (ii) in fact, the benefit of the contract never became assignable, (given that) the stage payment was never paid.

I conclude that Hardy is binding authority in this case and so this appeal must be dismissed, as the rescission of the contract, by reason of the taxpayer's repudiatory breach, did not constitute a disposal of an asset for capital gains purposes.'

Thus D was unsuccessful in his appeal.

As can be seen, the judge had to navigate his path through the various antecedent rulings and decide which represented binding precedents on him and which had been given per incuriam. Tax advisers dealing with legal disputes will find much to muse on in this case.

Contributed by Robert Jamieson