Briefing

Private client review for November

Speed read

This month, we look at two taxpayer victories in CGT cases: concerning principal private residence relief (in *Lee*) and CGT on the disposal of a property between separating spouses (in *Wilmore*), the latter indicating that the tribunal may be sympathetic to events preceding the recent rule change in this context. *Breen* considers case management issues in a domicile claim scenario. Two cases, *Chisnall* and *Kay*, both involve share valuation disputes with HMRC, where differing conclusions were reached. *White Breeze Ltd* makes it clear again that ill-health will not be considered a reasonable excuse for the late filing of a (corporation) tax return. Finally, *Modha* continues the trend of robust denial of SDLT mixed-use claims by the tribunal.

Edward Reed
Macfarlanes
Edward Reed is a partner in the private client team at Macfarlanes. He advises internationally mobile families on their asset structuring, personal tax and succession planning, wills, trusts and personal tax planning. Email: edward.reed@macfarlanes.com; tel: 020 7849 2568.

Helin Gurel
Macfarlanes
Helin Gurel is an associate in the private client team at Macfarlanes. She advises on a broad range of private client matters, including personal taxation, asset structuring, governance, estate and succession planning, trusts and wills. Email: helin.gurel@macfarlanes.com; tel: 020 7849 2904.

Taxpayer successes in CGT cases

Two recent taxpayer victories involving CGT provide interesting insight into the operation of reliefs on the disposal of property.

In *HMRC v G Lee and another* [2023] UKUT 242 (TCC), the Upper Tribunal (UT) considered principal private residence relief (PPR) (TCGA 1992 ss 222–226B).

The facts of the case were straightforward. The taxpayers bought a plot of land in October 2010 and demolished the existing house on it. They then built a new house on the land which they moved into in March 2013, before selling it in May 2014, claiming PPR on the resultant gain.

The dispute between HMRC and the taxpayers arose not over the availability but over the extent of the available relief. HMRC's position was that 'period of ownership' referred to the length of ownership of the plot of land rather than of the new dwelling-house (as the taxpayers argued, and the FTT held). Accordingly, HMRC said that only partial relief was available, specifically for the period March 2013 to May 2014.

Dismissing HMRC's appeal, the UT upheld the decision of the FTT that 'period of ownership' of a dwelling-house meant the period during which the relevant house was in existence, and did not include a longer period of ownership of the land before the house was built.

The decision provides helpful clarity on the definition of 'period of ownership', the previous case law which had often resulted in decisions that were difficult to reconcile. With HMRC since announcing that it will not appeal, the case now sets a precedent, and it will be interesting to see if it will prompt further claims for refunds from developers who have been refused PPR by HMRC on similar grounds.

In *Wilmore v HMRC* [2023] UKFTT 858 (TC), the FTT considered the applicability of TCGA 1992 s 58 to the division of matrimonial assets following a separation, which has long been a controversial subject, particularly as the relief is less generous than the spouse exemption for inheritance tax.

Under s 58, transfers of assets between spouses (or civil partners) are made on a no gain/no loss (NGNL) basis in any tax year in which they are living together. Importantly, this treatment had historically only been available on disposals in the remainder of the tax year in which the separation occurred; after that, transfers were treated as normal disposals for CGT purposes, creating an insurmountable challenge for spouses separating in (say) March.

Here, the taxpayer separated from her former spouse in September 2015; they reached an informal agreement in December 2015 that he would become the sole owner of the relevant property. It was subsequently sold in September 2016. HMRC issued a discovery assessment relating to the disposal.

> The decision in *Lee* provides helpful clarity on the definition of 'period of ownership'

The taxpayer's legal interest in the property had not transferred to her spouse by 5 April 2016. However, the principal question was whether her *beneficial interest* in the property was so transferred by that date for s 58 to apply.

Allowing the taxpayer's appeal against the discovery assessment, the UT concluded that due to the December 2015 agreement, a constructive trust arose whereby the taxpayer was a joint owner of the legal title, but had no beneficial interest in the property. The species of constructive trust was based on the 'common intention' and 'mutual understanding', established by 'the 'agreement, arrangement or understanding' actually reached between the parties'. The taxpayer had therefore transferred all her beneficial interest in the property. Accordingly, s 58 applied to the transfer.

The case is a classic example of the challenge which separating spouses have historically faced where there were delayed decisions on splitting assets. After lengthy lobbying by the professions, changes were introduced to s 58 by F(No.2) A 2023 s 41. Separating spouses now have up to three years to make NGNL transfers of assets between themselves when they cease to live together. NGNL treatment will also apply to assets that separating spouses or civil partners transfer between themselves as part of a formal divorce agreement.

Two become one: case management in a domicile claim context

Now to an HMRC victory: the background to *HMRC v Breen* [2023] UKUT 252 (TCC) related to a dispute over the taxpayer's domicile (following a trend highlighted in previous columns of HMRC's increasing focus on domicile).

The taxpayer had appealed the decision, but following a series of delays in his providing information, and an ultimate failure to comply with an 'unless direction' within the specified timeframe, the appeal was struck out.

The taxpayer applied to the FTT to reinstate his appeal and a third judge accepted the application.

HMRC appealed on two grounds, namely that (i) the decision was perverse because the FTT failed to take full account of the taxpayer's previous non-compliance; and (ii) the FTT erred in considering an irrelevant factor and/or misdirected itself in law, by allowing the application because the burden of proof in the underlying appeal lay upon HMRC.

The UT upheld HMRC's appeal. In remaking the FTT's decision, the UT applied the three-stage *Martland* test ([2018] UKUT 178 (TCC)) and struck out the taxpayer's appeal.

The UT was particularly critical of the FTT for considering the burden of proof as a material factor in assessing whether the taxpayer's appeal should be reinstated and found the 'abbreviated' reasoning it provided as to why it was relevant to its decision 'unsatisfactory'; indeed, the UT's view was that this was not a relevant factor since it effectively considers only one component of the strength of the taxpayer's defence.

Interestingly, in the judgment's final paragraph, the UT also went on to encourage the publication of decisions on strike-out appeals so that the public, and indeed other judges, can understand the decision-making process.

It's a question of values

Two cases – *Chisnall v HMRC* [2023] UKFTT 857 (TC) and *Kay v HMRC* [2023] UKFTT 861 (TC) – shed light in cases involving gifts of shares to charity on the FTT's approach to assessing the valuation of AIM shares. Both involved appeals against closure notices issued by HMRC reducing the amount of income tax relief available to the appellants under ICTA 1988 s 587B regarding a gift of shares to charity.

This legislation provides that a deduction is available in calculating a taxpayer's total income (for income tax purposes for the year in which the disposal was made) for the market value of the qualifying investment at the time of the disposal. Therefore, the point in issue in both cases was the market value of the shares at the time of the gift.

The appellants in both cases had calculated the relevant shares' market value, and hence the amount of tax relief available, solely by reference to the price that the shares traded for on AIM (being a higher amount than that included in HMRC's closure notices).

In *Kay*, whilst the FTT accepted the appellant's view that AIM trades may be relevant to a reliable market valuation, they drew from *Netley v HMRC* [2017] UKFTT 442 (TC) that the price at which small volumes of shares were traded cannot, without more, be viewed as a reliable proxy for the open market value of those shares. The FTT in *Kay* agreed with HMRC's expert evidence that the prudent purchaser would have considered other publicly available information such as Companies House data and prospectus details. Accordingly, the appeal was dismissed and the FTT accepted the lower share valuation advanced by HMRC.

Contrastingly, in *Chisnall,* the FTT concluded on the evidence that the prices at which shares traded on AIM held greater evidential weight than HMRC's valuations, although it described both parties' positions as 'unsatisfactory'. The FTT found that, although the expert evidence from HMRC was admissible, despite the individual being an HMRC employee, its evidential weight was seriously diminished not least because HMRC had failed to clarify why the current valuations they were relying on were more reliable than earlier valuations they had previously used, relating to the same shares. The FTT also took account of the expert's limited expertise concerning AIM-listed companies. Consequently, the FTT held that the prices that the shares traded for on AIM carried greater evidential weight than HMRC's expert valuation and the appeal was upheld in favour of the appellants. However, this case should be treated with caution given that the FTT found that it was 'unfortunate that there are not other options available' and their decision was made based on the 'unusual circumstance[s]' outlined above. *Kay* is perhaps the more indicative of the way similar cases will usually play out.

Ill health continues not to be a reasonable excuse

In *White Breeze Ltd v HMRC* [2023] UKFTT 862 (TC), the FTT agreed with HMRC that the ill health of a company director was not found to be a 'reasonable excuse' for the late filing of corporation tax returns for the periods ended 31 July 2013 to 2015.

Here, the appellant contended that the ill-health of one of its principal directors, who was suffering from dementia, and who subsequently died in 2017, constituted a reasonable excuse for the three tax returns' late filing. The FTT considered the four-stage test in *Perrin v HMRC* [2018] UKUT 156 (TC) as to whether the company had a reasonable excuse in the circumstances.

The FTT agreed with HMRC that it was not objectively reasonable for the appellant not to submit the corporation tax returns for so many years, notwithstanding the ill-health of a director and the inability to receive clear instructions from him.

It was clear that another director was, in effect, running the company and it was not reasonable to allow the non-submission of the returns, particularly given that the operations of the business were continuing and there were two other company officers. In any event, the FTT found that any such reasonable excuse was not remedied without unreasonable delay since the information required to submit the tax returns was clearly available in January 2017, but the tax returns were not submitted for another 18 months.

Similarly, in *Harrison v HMRC* [2022] UKUT 216 (TCC) (covered previously in this column), albeit in the context of the late filing of personal tax returns, the UT found that the appellant's ability to carry out complex work-related tasks, notwithstanding his depression, suggested he should have been able to remedy the late filing sooner. The tribunal clearly takes a similar view on this issue in both personal and corporate tax-related cases.

SDLT: closing thoughts

Readers may recall our discussion of the rare taxpayer victory in *Suterwalla v HMRC* [2023] UKFTT 450 (TC) relating to SDLT mixed-use rates. In that case, the property which warranted the finding of mixed-use was a paddock.

In *Modha v HMRC* [2023] UKFTT 783 (TC), however, HMRC were able to reclaim their winning streak. The case had a similarly equestrian theme; the property included a five-bedroomed house, garages, stables, tack-room, garden and paddock. It was agreed between the parties that these were all residential. The property also included an eight-acre field used under an informal grazing agreement. The FTT considered, amongst other factors, the proximity and extent of the field, and that it had no function unconnected with the dwelling. It concluded that the field's use under this agreement did not make the house mixed-use and so subject to the lower SDLT rates for mixed-use properties. Instead, the field was held to be part of the dwelling's grounds. As such, the SDLT higher rates were applicable. HMRC therefore look to be back on track in this arena. ■

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