Briefing

Private client review for July

Speed read

This month we look at the FTT's recent decision in *Lee,* which could enable taxpayers who have built or redeveloped their own houses to claim private residence relief in full on a subsequent sale of the property. There is a warning for advisers in *Johnson*: white space disclosures (even if made in good faith) are not a bar to a finding of carelessness. The decision in *Paul* once again shows the UT's strict approach to reopening points that either were or should have been considered at FTT level. *Kavanagh*, where a taxpayer was one share short of entrepreneurs' relief applying, serves as a reminder for taxpayers to consider carefully the tax implications of their commercial decisions as it may well be 'tough luck' for those who make errors. Finally, HMRC's recent success in challenging MDR claims continues in the case of *Dower*.

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Private residence relief: an encouraging decision for self-builders

One of the most widely known features of the UK's CGT regime is private residence relief, which exempts from tax capital gains on the sale of an individual's main residence. The idea is that, in a rising property market, people should be able to replace their existing home with a property of a similar value – which they could not do if the uplift in value of their own property were subject to tax.

To engage the relief, various requirements must be satisfied which have been a fertile source of court decisions. In particular, there must have been a 'dwelling', which narrows down the qualifying land; that dwelling must have been occupied by the taxpayer as their main residence throughout (roughly) their entire 'period of ownership'. Any time in the period of ownership during which it was not so occupied can result in a pro rata loss of tax relief.

These requirements were examined recently by the First-tier Tribunal (FTT) in *Lee v HMRC* [2022] UKFTT 175 (TC). The taxpayers bought a plot of land with a house on it, which they immediately demolished, to build a new one. The building took three years, after which the taxpayers moved in. A year later, they sold the new house at a substantial gain.

HMRC sought to restrict the application of the relief, arguing that the 'period of ownership' in the legislation referred to the land, not the dwelling – and since the taxpayers had only occupied the dwelling for the period after it was built, tax should be charged in respect of the three years during which construction was taking place. (Note that, at the relevant time, an extra-statutory concession (now incorporated into the CGT legislation) applied to taxpayers who were initially unable to occupy their new home due to the renovation or construction of the dwelling; however, this had a strict 24-month time limit so did not apply here.)

The FTT disagreed with HMRC, ruling that the 'period of ownership' actually refers to the dwelling. Accordingly, provided the taxpayers occupied the dwelling as their main residence throughout the period *during which it was a dwelling*, any prior period when there was no dwelling still qualified for the relief.

This is an encouraging decision for taxpayers who have built or redeveloped their own houses, as it may well enable them to claim full relief on any subsequent sale of the property. However, it remains to be seen whether HMRC will appeal or whether another court will reach a different conclusion (as FTT decisions do not set a precedent), so taxpayers should continue to watch this space.

Discovery assessments: hedging your bets through white space disclosure not enough

Continuing a recurring theme in recent cases, discovery assessments were again in the spotlight in *Johnson & another v HMRC* [2022] UKFTT 156 (TC), with the FTT confirming that white space disclosures (even if made in good faith) are not a bar to findings of carelessness against tax advisers.

The case involved a compensation payment received by the taxpayers, in connection with an investment in an interest rate hedging product. In preparing the taxpayers' returns for the year in question (2013/14), their tax adviser consulted HMRC guidance before concluding that the payment was not taxable as it was connected with a 'non-business loan'. The underlying loan had been taken out by the taxpayers to buy a rental property from which they received rental income, but the tax adviser did not equate the rental income with business income. Nonetheless, there was an element of doubt about this conclusion, so the tax adviser included a white space disclosure in the taxpayers' 2013/14 returns providing details of the payment.

HMRC enquired into the returns in 2018, determining ultimately that the compensation payment was taxable and issuing assessments and carelessness penalties to the taxpayers (later cancelled on review). The taxpayers appealed to the FTT.

The case turned on whether the adviser had failed to take reasonable care when deciding to omit the payment from the taxpayers' taxable income in their returns.

The FTT found in HMRC's favour, noting both that the tax adviser should have known that receiving rental income amounted to a property business for income tax purposes, and that the tax adviser should have enquired further into the facts to confirm that the underlying loan had actually been used to buy the rental property (the tax adviser did not seem sure on this point).

Notably, the FTT rejected an argument that the loss of tax was caused by HMRC failing to enquire into the returns sooner, having been put 'on notice' by the white space disclosure. Although the FTT was sympathetic to the tax adviser's position (the disclosure was included in good faith and there was an element of uncertainty as to the taxability of such compensation payments at the time), the loss of tax was caused by the tax adviser failing to take reasonable care in investigating the facts and applying the law properly – not HMRC's subsequent actions as part of the enquiry.

Tribunal procedure: HMRC unsuccessful in raising estoppel argument

In line with other cases previously mentioned in this column, the decision in *Paul v HMRC* [2022] UKUT 116 (TCC) once again shows the UT's strict approach to reopening points that either were or should have been considered at FTT level.

The sole issue on appeal to the UT in *Paul* was one of procedure: namely, whether a notice of enquiry which had not been posted to the taxpayer's address (but had been received by his tax advisers) was properly served in accordance with TMA 1970 s 115.

HMRC raised a new argument (not heard before the FTT) that the taxpayer should be estopped by convention from challenging the validity of the enquiry, following the Supreme Court's decision in *Tinkler v HMRC* [2021] UKSC 39, where the Supreme Court found in HMRC's favour on similar facts, confirming both that estoppel by convention was an effective bar to procedural challenges to enquiries, and that engaging with an invalid enquiry could be treated as an implicit affirmation of validity if HMRC relies on it to their detriment.

The taxpayer argued (unsurprisingly) that HMRC could not raise this point, since it had not been argued before the FTT.

The UT found in the taxpayer's favour, noting that HMRC had failed to demonstrate that it was 'fair and just' to admit the estoppel argument. Although the argument would not necessitate new evidence before the UT, allowing it to be heard would (the UT concluded) have resulted in the hearing being conducted differently at FTT level. For example, the taxpayer might not have forgone his right to an oral hearing (the case was decided on the papers) and would likely have cross-examined the HMRC officer giving evidence on HMRC's behalf.

Importantly, the UT emphasised that this outcome was not at odds with the decision in *Tinkler*. Even if the facts in the two cases were similar, the question before the UT was not whether the estoppel argument should succeed, but whether it should be heard in the first place. On this point, HMRC had failed.

Paul is therefore noteworthy for taxpayers, tax advisers and HMRC alike. *Tinkler* should still be kept in mind when dealing with enquiries, but appellants to the UT (taxpayers included) should not expect to be able to raise before the UT any arguments not previously introduced before the FTT.

Precision is key: one share short for entrepreneurs' relief to apply

Entrepreneurs' relief (now known as business asset disposal relief) can be a valuable relief for taxpayers, operating to reduce the rate of CGT due on 'qualifying business disposals'.

In *Kavanagh v HMRC* [2022] UKFTT 173 (TC), Mr Kavanagh sought to apply entrepreneurs' relief to the disposal of his shareholding in an estate agency business. For the relief to apply, he needed to hold at least 5% of either the ordinary share capital or voting rights in the company. The company had four shareholders (including Mr Kavanagh) and there were numerous mergers and acquisitions over time which altered the shareholding proportions amongst them. In 2006, following an acquisition and share exchange, it was recorded in a share purchase agreement that Mr Kavanagh owned 1,842 A ordinary shares, giving him a percentage ownership of 4.997285706531% in the company. In 2017, Mr Kavanagh sold all of these shares.

HMRC contended that Mr Kavanagh had not made a 'qualifying business disposal' to which entrepreneurs' relief applied because he did not hold at least 5% of the ordinary share capital or voting rights in the company (whether as registered owner or as beneficial owner).

Mr Kavanagh argued that the other shareholders held the remaining 0.002714293469% of the shares (equivalent to less than one share) on trust for him. However, despite the three other shareholders confirming that they had always worked on the assumption that Mr Kavanagh held 5%, the FTT concluded that there was no agreement or understanding that any shares not registered in Mr Kavanagh's name were held by the other shareholders on his behalf. Accordingly, Mr Kavanagh did not hold the required 5%, meaning that entrepreneurs' relief would not apply on the disposal of his shares.

In this column, we have previously commented on various cases which illustrate the mechanistic way in which CGT is calculated, with 'fairness' being irrelevant. This case serves as a further reminder of this point and the importance for taxpayers always to consider carefully the tax implications of their commercial decisions as it may well be 'tough luck' for those who make errors.

SDLT: HMRC's success in challenging MDR claims continues

Multiple dwellings relief (MDR) can be a very useful relief for property buyers, applying to qualifying purchases of more than one dwelling and fixing the SDLT rate by reference to the average chargeable consideration for multiple purchases of dwellings, rather than the aggregate chargeable consideration (subject to a minimum rate of 1% of the total consideration). However, as noted in their consultation on SDLT, published in November 2021, HMRC are concerned that the current rules are 'leading to potentially unfair outcomes, incorrect claims or abuse of the rules'.

In this column earlier this year, we commented on HMRC's recent success in challenging taxpayers' MDR claims in the courts. The FTT's decision in *Dower v HMRC* [2022] UKFTT 170 (TC) is the latest in a string of wins for HMRC.

Here, the taxpayer was appealing against HMRC's closure notice denying MDR in respect of the sale of a property and an annexe. MDR is only applicable to properties which are 'suitable for use as a dwelling' and, whilst this was undisputed in relation to the property, the position was less clear in relation to the annexe.

Applying the multi-factorial test set out in *Fiander v HMRC* [2021] UKUT 156 (TCC), the FTT gave particular weight to two factors. Firstly, the annexe had rudimentary facilities and, although it was self-contained (with its own boiler, central heating system, alarm and bathroom), the FTT held that this was insufficient to render it 'suitable as a dwelling'. For example, the kitchen facilities comprised only a microwave and a slow cooker which made the annexe unsuitable to live in with a degree of permanence. Secondly, the FTT focused on the question of whether the annexe could have been sold separately as a residential property in its own right 'at the effective date'. At the time, there was a planning restriction in place which permitted the use of the annexe only in connection with the main house. Therefore, the court held that the annexe could not have been sold as a separate property 'at the effective date' and was therefore not 'suitable for use as a dwelling'. Accordingly, MDR could not apply.

Over the last few years, some taxpayers (and advisers) have developed a 'have a go' attitude in making MDR claims. However, *Dower* reminds us of the importance of context and of proceeding with caution in this area; advancing potentially spurious MDR claims is likely to fail. ■

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- Gotcha! *Tinkler* and estoppel (D Whiscombe, 5.8.21)
- SDLT MDR: multiple multiple dwellings appeals (M Schofield, 4.11.21)