[2018] UKFTT 0549 (TC)

TC06724

Appeal number: TC/2017/05100
TC/2017/05105

Capital gains tax – sale of land - whether property owned jointly – yes – enhancement expenditure - whether expenditure incurred by associated company is to be treated as incurred by landowners - no –whether amount assessed should be increased under section 50 Taxes Management Act 1970 –no - appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

ROBERT DAVID SIDEBOTTOM **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S **Respondents**

JANE ELIZABETH PICKETT **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S **Respondents**
REVENUE & CUSTOMS

TRIBUNAL: JUDGE IAN HYDE
TERENCE BAYLISS

Sitting in public in Birmingham on 9 May 2018

Mr Sawyer for the Appellant

Mrs Checkley, officer, for the Respondents

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DECISION

1. This appeal concerns whether the appellants are entitled to enhancement expenditure for capital gains tax purposes for services carried out on the appellants' land by Mainstone Properties Limited ("MPL"), a company owned by the appellants.

The facts

2. Mr Sidebottom, one of the appellants, and Mr Stuart Unsworth, an officer of the Respondents, gave evidence. We find the facts in this appeal as set out below.

3. The appellants were at the relevant time husband and wife but are now divorced. Mr Sidebottom ran several businesses at various times, including farming and a pub and brewery.

4. In July 2002 Silurian Mill, being disused factory premises and connected land in Powys, was acquired for £170,000. Initially the purchase was in Mr Sidebottom's name but shortly afterwards it was transferred into the joint ownership of the appellants. As with the other businesses Ms Pickett, then Mrs Sidebottom, was a joint owner but took no active part in the day to day decision making in respect of Silurian Mill. The purchase price was financed in the short term by a mortgage secured on the appellant's pub by a loan from Carlsberg Tetley and some funds made available by HSBC.

5. The appellants' purpose in purchasing Silurian Mill was to redevelop it or at least obtain planning permission and sell it at a profit. Mr Sidebottom was persuaded that for presentational purposes it would be better if a company were seeking planning consent rather that the appellants as individuals. There was also some convenience in having expenses being paid through a company so that it was kept separate from the appellants' other businesses. A new company, MPL, was therefore established in June 2003 with the appellants each as equal shareholders but Mr Sidebottom as sole director. MPL's sole customer was and remained the appellants.

6. On 18 June 2003 the appellants and MPL entered into a short agreement ("the Development Agreement") the principal operative parts of which were as follows;

> "...the Owners…have contracted with the Company for the Company to develop the property for residential use. It is agreed that the Company will explore development potential and provide all necessary services and amenities required to obtain planning permission for the most profitable development to be agreed between the Owners and the Company.
>
> The intention is that the Owners will either sell the property with the benefit of planning permission or will develop the site themselves or using contractors.
>
> The consideration payable to the Company for work carried out by the Company to secure the agreed development will be 5% of the final agreed sales

price of the property or 5% of its value at that time, being the value of the property with the new development potential as agreed by Halls Estate Agents (the Fee)…the Fee shall be exclusive of VAT…

This contract shall terminate and the Fee shall become payable at the first happening of one of the following events:

1) The Sale of the Property

2) The obtaining of the permission and receipt of the valuation from Halls has instigated by the Company or the Owners

3) The agreement by the Company and the Owners that the contract shall terminate for a fee agreed by both parties…"

7. All of the expenditure incurred in relation to Silurian Mill was incurred by MPL. A number of bank loans were taken out with National Westminster Bank ("NatWest") both to replace the Carlsberg Tetley loan and also to finance the development expenditure on Silurian Mill. These loans were taken out in the name of Mr Sidebottom but secured on other properties jointly owned by the appellants.

8. The funds obtained by these loans were paid into an HSBC account in Mr Sidebottom's sole name, and described by Mr Sidebottom as the property loan account. The property loan account was used by Mr Sidebottom as a general business account, the funds in which were used to fund all of his businesses as required by the transfer of lump sums to the relevant accounts for each business. It was not used for day-to-day expenses, whether of the businesses or the appellants' living expenses. As far as Silurian Mill was concerned, Mr Sidebottom advanced lump sums from the property loan account to MPL's bank account and MPL used those funds to defray all the costs of contractors, advisers and so on required to carry out the business ventures and planning applications made in respect of Silurian Mill.

9. The advances made by Mr Sidebottom were treated in the accounts of MPL as a director's loan. No advances by Mr Sidebottom were ever repaid by MPL. In the unaudited accounts as at 30 June 2008, the last set of accounts for MPL, the director's loan account stood at £283,227. The accounts also showed "work in progress" of £350,000 and "turnover" of £100,983. Mr Sawyer agreed that, apart from some £5,000 of income from tyre storage received in respect of Silurian Mill and credited to MPL, there had been no sales and explained that the "work in progress" was an estimate of the expected fee plus reimbursed expenses from the Development Agreement and "turnover" broadly the increase in work in progress from the previous year, the 2007 work in progress being £250,000. The £283,227 represents the full cost to MPL of implementing Mr Sidebotham's designs and business initiatives in respect of Silurian Farm. Notwithstanding the loose terminology we accept Mr Sidebottom's explanation of the figures in the accounts.

10. Mr Sidebottom's initial attempts to exploit and develop Silurian Mill included reviving its previous use as a used tyre storage and recycling centre (from which £5,000 of income was derived and credited to MPL) and obtaining planning consent

for conversion of the disused mill into flats. However, the principal objective was obtaining residential planning consent for the whole site and this involved a significant amount of remedial work on the land and buildings and extensive professional advice. However, planning permission was obtained in April 2007 for the development of 36 houses. The planning consent was subject to a number of conditions, including the carrying out of an extensive site survey. Mr Sidebottom engaged WSP to carry out the survey but instead of taking the expected 12 weeks it took nearly a year, finishing in March 2008.

11. The appellants started marketing the land once planning permission had been obtained in April 2007 and soon had offers culminating in an offer of £1.75m from some developers which was accepted. However, the sale could not proceed because the survey had not been completed and by March 2008, the financial crisis having hit, the buyer's bank withdrew its funding offer and the sale fell through.

12. In the course of the hearing we asked Mr Sawyer as to the position under the Development Agreement once the planning permission was obtained in April 2007. Mr Sawyer agreed that the fee payable under the Development Agreement was payable once planning permission was obtained but accepted it was never charged or invoiced. It was also accepted that it was implicit in the agreement that the 5% would be chargeable over and above a reimbursement of the costs incurred by MPL. Thus, based on the offer of £1.75m a fee of £87,500 plus reimbursement of £283,227 of costs would have been payable by the appellants to MPL. Had MPL done so a VAT liability would have arisen and MPL would in broad terms have paid corporation tax on the fee less any allowable expenses.

13. In 2008 the appellants' bank accounts with NatWest were transferred from the local branch in Powys to the Royal Bank of Scotland and its Global Restructuring Group ("RBS"). Mr Sidebottom gave extensive evidence as to how he was treated by RBS and made reference to recent publicity about the practices of its Global Restructuring Group. Whilst the conduct of RBS is the subject of strongly held views by Mr Sidebottom, these matters are beyond the jurisdiction of this Tribunal and to a large degree irrelevant to the tax matter in this appeal. However, we find as fact that the revaluations required by RBS caused the appellants to be in breach of their loan covenants and forced the appellants to sell their land and businesses.

14. In 2008 WSP sought payment from MPL of their fee for carrying out the extensive survey required by the planning consent, being some £78,000. Mr Sidebottom resisted payment on the basis that WSP had taken so long carrying out the survey that it had lost him the buyer. WSP sought to enforce payment but in 2010 accepted Mr Sidebottom's argument that MPL did not have the funds to pay and stopped demanding payment. At this time it was agreed that MPL should be wound up. Whilst the appellants were unable to produce any evidence or Mr Sawyer provide any explanation as to what happened we find that Mr Sidebottom or Mr Sawyer on his behalf applied to Companies House to strike off MPL and it was struck off on 16 February 2010.

15. MPL was registered for Value Added Tax throughout the relevant period up to it being struck off in February 2010. Throughout that period MPL reclaimed as input tax VAT incurred on costs incurred. The £283,227 figure for the loan account therefore represents the net of VAT expenditure by MPL.

16. In the course of the hearing neither Mr Sidebottom nor Mr Sawyer as his accountant could explain the position of MPL on being dissolved and therefore deregistered for VAT. Further, on being questioned by Mr Bayliss, whilst Mr Sawyer believed that a final corporation tax form CT 600 was completed, he could not recall with any accuracy the final corporation tax position.

17. In March 2011 the appellants sold land forming part of Hill End farm for £317,000.

18. In March 2011 RBS appointed receivers and sold Silurian Mill for approximately £400,000.

19. In tax years 2011-12 and 2012-13 other parcels of land were sold by the appellants.

20. Neither appellant disclosed to HMRC the disposal of any of the above properties.

21. On January 2014 HMRC opened a compliance check into the 2010-11 self-assessment tax return for Mr Sidebottom under section 29 Taxes Management Act 1970 as HMRC had become aware of the potential understatement of tax due to a failure to notify the disposal of Hill End Farm. In March 2014 HMRC opened a compliance check into Ms Pickett's 2010-11 tax position for failure to notify HMRC of the disposals, Ms Pickett not having filed a return for the year 2010-11.

22. There then followed a series of correspondence between Mr Sawyer on behalf of the appellants and HMRC covering issues that have now been abandoned or resolved and concerning facts that have since been either corrected or otherwise determined by this Tribunal. Specifically it was at one stage asserted on behalf of Mr Sidebottom that he was entitled to relief for a loss on director's loan account but he does not now do so. Further, ownership of Silurian Mill was the source of debate but HMRC at the hearing and in light of evidence presented, now accept that on the balance of probabilities Silurian Mill was owned jointly by the appellants. There were also issues concerning disposals in later tax years which are not the subject of this appeal.

23. On 13 February 2017 HMRC issued notices of assessment to the appellants in respect of the disposals of part of Hill End farm in 2011 and the sale by receivers of Silurian Mill, the amount of tax payable by Mr Sidebottom being £26,036.54 and by Ms Pickett £36,640.20. HMRC's assessments were based on there being a chargeable gain in respect of the sale of Hill End farm and that as regards Silurian Mill, the expenditure incurred in respect of obtaining planning and other improvement work was not incurred by the appellants and so did not qualify as enhancement expenditure for CGT purposes. Accordingly, according to HMRC, the sale of Silurian Mill also

produced a chargeable gain rather than, as the appellants argued, an allowable loss to set against the gain on Hill End farm.

24. On the same date HMRC advised Mr Sidebottom that penalty notices would be issued under Schedule 24 Finance Act 2007 for £3,904.48 (as amended) for errors in a return based on failure to take reasonable care with maximum disclosure reduction of 100%. HMRC also issued a penalty notice to Ms Pickett under schedule 41 Finance Act 2008 for £7,328.04 for failure to notify, again with maximum disclosure reduction.

25. On 8 March 2017 Mr Sawyer appealed the assessments and penalties on behalf of the appellants and requested reviews of the decisions.

26. On 10 April 2017 HMRC issued a formal penalty notice to Mr Sidebottom in respect of tax year 2010-11 and acknowledged that the penalty notice for Mr Sidebottom had not been properly notified but would treat the appeal as effective.

27. On 24 May 2017 the original decisions were upheld on review but the amount of tax payable by Mr Sidebottom increased to £46,996.78 and the amount payable by Ms Pickett reduced to £15,705.16 on the basis that the officer believed that Mr Sidebottom was the sole owner of Silurian Mill. The appellants appealed those decisions.

Legislation

28. Section 38 Taxation of Chargeable Gains Act 1992 ("TCGA") provides, so far as relevant;

> "(1) except as otherwise provided, the sum allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to-
>
> (a) …
>
> (b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving all defending his title to, or to a right over, the asset
>
> (c) …"

29. Section 39(2) TCGA provides, so far as relevant;

> "(2) without prejudice to the provisions of subsection (1) above, there shall be excluded from the sums allowable under section 38, as a deduction in the computation of the gain any expenditure which, if the assets, or all of the assets to which the computation relates, were, and at all times had been, held or used

as part of the fixed capital of the trade the profit or gains of which were (irrespective of whether the person making the disposal is a company or not) chargeable to income tax would be allowable as a deduction and computing profits or gains or losses of the trade for the purposes of income tax"

Issues in the appeal

30. There were originally a number of issues in this appeal but they have been narrowed considerably to the question as to whether by virtue of the relationship between the appellants and MPL the appellants are entitled to enhancement expenditure pursuant to section 38(1)(b) TCGA. If the appellants succeed then the sale of Silurian Mill would generate an allowable loss which would be available to relieve the gain on the sale of Hill End. If they lose this point then the sale of Silurian Mill would have been at a gain and the gain on Hill End would be unrelieved.

31. The appellants have claimed enhancement expenditure of £283,227 being an amount equal to the director's loan account. No evidence was adduced beyond a list of expenditure and general descriptions by Mr Sidebottom as to the nature of the costs included in that amount. HMRC expressly reserved their position on the nature of that expenditure and whether it was "qualifying" for the purposes of section 38. In the absence of detailed evidence at the hearing as to the nature of the expenditure, it was agreed that rather than make a decision based on the superficial evidence available, the appeal would decide the issue of principle as to whether the appellants have "incurred" the expenditure, leaving the parties to determine if necessary what elements of that expenditure are "qualifying" for the purposes of section 38(1)(b).

32. The appellants did not challenge the amount of the penalties, merely that they should be discharged if there were not tax payable.

The Appellants' argument

33. The appellants argued that they have incurred the expenditure because the funds that financed MPL were obtained by bank loans taken out on the security of the appellants jointly owned properties. As a result of the financial crash and the winding up of MPL the appellants never received these moneys back. In economic terms the work was done, the appellants have incurred the expenditure and they should therefore obtain tax relief for that expenditure.

HMRC's argument

34. HMRC argued that MPL was funded by a director's loan. A director's loan is not expenditure. In any event it was a loan by Mr Sidebottom and not by the appellants jointly even if secured on jointly owned property. At the very least Ms Pickett is not entitled to any relief based on a loan she did not make.

35. MPL never charged the appellants for the work under the Development Agreement. Had they done so then the appellants would have incurred the expenditure but they did not.

36. The only person to incur expenditure was MPL, a separate legal person to the appellants. Furthermore, section 39(2) excludes from section 38 allowable expenditure, any expenditure which, had the assets been fixed assets of a trade, would have been allowable as a deduction in calculating trading profits. MPL's expenditure would have been so allowable and so the appellants are not entitled to enhancement expenditure under section 38.

Decision on allowable expenditure

37. We agree with HMRC that the appellants have a central difficulty in that MPL never charged them for the work under the Development Agreement. As was accepted by Mr Sawyer in the hearing and we have found, MPL's fee under the Development Agreement was payable once planning permission was obtained in April 2007. Had the fee and associated cost reimbursement been charged to the appellants then MPL would have been in a position to repay Mr Sidebottom the director's loan. However, this was never done.

38. We accept that during this period the appellants were under considerable financial strain but to the extent we have been able to determine the facts concerning the winding up of MPL, it appears simply to have been wound up without any thought to the consequences. Neither Mr Sidebottom nor Mr Sawyer as his long time adviser could assist with a coherent explanation.

39. The appellants argue that even though no invoice was raised they have in substance paid for the works through the director's loan which became irrecoverable upon the winding up of MPL. We find that there was a loss but it was a loss on director's loan account and that it accrued to Mr Sidebottom as a director. However, a loss on director's loan account generates its own form of relief and it cannot be conflated with enhancement expenditure for capital gains tax purposes even if the economic consequences might be the same. Accordingly, the appellants as joint landowners did not incur the expenditure of paying MPL for its services under the Development Agreement.

40. For completeness, we do not accept HMRC's argument that section 39(2) applies which, without any significant argument on the points, appears to us to be aimed at the allocating expenditure by the same taxpayer as between reliefs through the capital gains tax and income tax systems. It is not aimed at dealing with third party expenditure. In the event we find that the appellants have not "incurred" the expenditure on general principles without recourse to section 39(2).

Decision on the effect of joint ownership

41. Finally, we note that, HMRC having conceded in the hearing that Silurian Mill was owned jointly, the quantum of the assessments as adjusted in the 24 May 2017 review are in principle wrong and the original assessments of 13 February 2017, based on an assumption of joint ownership are the correct numbers. The amount in Mr Sidebottom's original February 2017 assessment of £26,036.54 was increased on review in May 2017 to £46,996.78. However, Ms Pickett's original assessment of

£36,640.20 was reduced to £15,705.16. In short based on a finding of joint ownership Mr Sidebottom's assessment is excessive and Ms Pickett's too low. Mr Sidebottom's appeal should therefore be allowed in part to reduce the tax chargeable to £26,036.54. However, Ms Pickett has been under assessed and the amount she appealed to this Tribunal is too low. The question arises as to whether this Tribunal has the power to increase the tax payable on appeal and if it does whether it should do so.

42. Section 50 Taxes Management Act 1970 provides that a Tribunal may on appeal increase the tax payable above the amount assessed;

> "(7) if, on an appeal notified to the tribunal, the tribunal decides
>
> (a)…
>
> (b)…
>
> (c) that the appellant is undercharged by an assessment other than a self-assessment
>
> the assessment or amounts shall be increased accordingly
>
> (7A)…
>
> (8) where, on an appeal notified to the tribunal against an assessment other than a self-assessment which-
>
> (a) assesses an amount which is chargeable to tax, and
>
> (b) charges to tax on the amounts assessed
>
> The tribunal decides as mentioned in subsection (6) or (7) above, the tribunal may, unless the circumstances of the case otherwise require, reduce or, as the case maybe, increase only the amount assessed, and where any appeal notified to the tribunal is so determined the tax charge by the assessment shall be taken to have been reduced or increased accordingly."

43. This point was not considered in the hearing and the parties were asked to make written submissions. The appellants in their submissions maintained that, as Ms Pickett had appealed the May 2017 review, that is the amount that should be treated as due. HMRC argued that the February 2017 assessments were the ones HMRC were seeking to be determined. Beyond those short positions neither party addressed the wider issues inherent in this point.

44. In considering this issue we take it as read that the relationship between the appellants is irrelevant and would be even were they still married. Ms Pickett's tax position should be considered in isolation.

45. We find HMRC's argument unpersuasive insofar as HMRC are seeking to maintain the February 2017 assessment for Ms Pickett but are content to take the tax

due under the May 2017 review for Mr Sidebottom. However, HMRC's position has the benefit of resulting in the right amount of tax being payable.

46. The appellants' position, whilst not expressed as such, has the attraction that taxpayers should only pay the lower of the amount of tax due and the amount finally assessed by HMRC.

47. Having considered the circumstances we decline to exercise our power under section 50 to increase the tax payable by Ms Pickett beyond that calculated in the May 2017 review. HMRC made a mistake in the review and decided, indeed contrary to the appellants' arguments, that the appellants did not own the property jointly. On that basis they wrongly increased Mr Sidebottom's assessment and reduced Ms Pickett's. Had they wished to preserve their position on this point we assume that they could have done so. This issue is ultimately no more than the relatively common circumstance where HMRC take a view as to the correct amount of tax and it proves to be insufficient. Whilst it is attractive to see increasing Ms Pickett's tax liability as correcting the tax payable to the true amount, this would in substance be treating Mr Sidebottom and Ms Pickett as joint taxpayers where the tax can simply be shifted from Mr Sidebottom to Ms Pickett. As we have said Ms Pickett's tax position should be seen independently of Mr Sidebottom, whether they are married or not.

48. Ms Pickett appealed on the basis that her risk was £15,705.16 and whilst the true amount of tax due is £26,036.54, we do not think in the circumstances HMRC should have that mistake corrected by the Tribunal.

49. Accordingly, subject in both appeals to quantification as to the amount of expenditure that should be treated as "incurred", Mr Sidebottom's appeal is allowed in part, reducing the tax payable to the amount of the original February 2017 assessment. Ms Pickett's appeal is dismissed but the amount of tax payable maintained in principle at the amount in the May 2017 review.

50. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

IAN HYDE
TRIBUNAL JUDGE

RELEASE DATE: 21 September 2018