



TC05821

Appeal number: TC/2013/3016

CAPITAL GAINS TAX – Computation of gain – allowable expenses, order of application of relief under s 222, deductibility of loss on mortgage finance.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

JAMES O'DONNELL

Appellant

- and -

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

**TRIBUNAL: JUDGE CHARLES HELLIER
 SIMON BIRD**

Sitting in public in Bristol on 29 March 2017

The Appellant in person

Simon Foxwell for the Respondents

DECISION

1. Mr O'Donnell appeals against amendments to his self-assessment for 2008/9.
5 These amendments incorporated a capital gain on the disposal of four houses. He also appeals against a penalty.

The nature of our jurisdiction.

2. A number of Mr O'Donnell's submissions related to what HMRC may or may not or should have agreed or done. This decision does not address those issues. We
10 are a tribunal established by statute to hear appeals in relation to matters described by the statute. In the present context those matters include an appeal against the amendment of a self-assessment and against a penalty. We have no jurisdiction in relation to contractual agreements between HMRC and a taxpayer (which would have to be litigated in the County or High Court) or in relation to complaints that HMRC
15 acted outside its powers or unfairly (which would have to be litigated in the High Court or addressed to the Ombudsman).

The Evidence.

3. Mr James O'Donnell, and his father Tony O'Donnell gave oral evidence. Mr James O'Donnell produced a statement. There was a bundle of documents and a
20 further supplementary bundle. These documents consisted principally of correspondence between the parties and documents produced by Mr O'Donnell in that correspondence. We should say that we found Mr O'Donnell a clear, measured, helpful and articulate presenter and witness. We find as follows.

Background Facts.

4. At the beginning of 2008 Mr O'Donnell owned a number of properties. Among
25 them were 2 Assarts Lane (where his parents lived, his grandparents had lived and where, at certain times after his acquisition of it, he lived) and three houses in Woodstock Road, Worcester. He had purchased these properties with the benefit of a loan from Singer and Friedlander (which at some stage was replaced as lender by
30 Kleinwort Benson). This loan was secured by a charge over the four properties.

5. The nature of Mr O'Donnell's liability under the loan was unusual. The loan, we understand, was drawn down in Sterling but the liability could be, or be treated as, redenominated in, or translated into, any one or two of seven major currencies at intervals (with changes often taking place at intervals of about a week or less). The
35 redenomination was managed by The ECU Group plc with some form of consultation with Mr O'Donnell. Interest was calculated by reference to the prevailing interest rates for the currency or currencies in which the loan was treated as denominated from time to time.

6. The fluctuations in the exchange rates of the currencies against sterling and the
40 related interest rates could mean a higher interest rate was borne on the outstanding

debt but the sterling value of the principal diminished. It could also mean that the sterling value of the liability could become greater than it would have been had it been a straightforward sterling loan. The result would depend upon the fluctuations of the exchange rates and the skill or ability of ECU in moving between currencies.

5 7. Kleinwort Benson was owned by an Icelandic bank. It was adversely affected by the 2008 banking crisis. We understood that in 2008 (for reasons which were not explained to us) it called for immediate repayment of its loans to Mr O'Donnell and that it appointed a receiver under Law of Property Act 1925 to enforce repayment or to sell the four properties pursuant to the terms of the charge.

10 8. On his appointment or shortly thereafter the receiver had told Mr O'Donnell that unless he paid £950,000 within a couple of weeks the properties would be sold at auction.

15 9. This visited several misfortunes on Mr O'Donnell: (i) at the time of the call for payment the sterling value of his liability to Kleinwort Benson was more than £100,000 greater than the amount of the initial advance, (ii) his parents lived in 2 Assarts Lane and he did not want them to have to move home, (iii) a forced sale of the four properties would be likely to raise less than the amount which would be expected to be realised on a measured sale: he would lose some of his accumulated equity in the properties, and (iv) he did not have readily available funds to meet his liability
20 under the loan.

10. Mr O'Donnell set about finding alternative funds. He approached several lenders offering them the security of a charge over the properties. Each lender required a valuation. Mr O'Donnell paid for a number of valuations. But he was unable to raise the funds in time.

25 11. Then a knight in shining armour appeared in the form of Peter Smith, Mr O'Donnell's uncle. Mr Smith was a property developer and had bank facilities under which he could borrow sufficient to cover Mr O'Donnell's liability to Kleinwort Benson. He was willing to help and to come to an arrangement under which, in broad economic effect, he became a lender secured on the four properties.

30 12. The terms of the arrangement were the subject of negotiation with the receiver, Kleinwort Benson, Mr Smith and Mr O'Donnell. Solicitors were appointed: DF Legal LLP for Mr O'Donnell, and Lattey & Dawe for Kleinwort Benson and the receiver. Each side incurred costs.

35 13. Under this arrangement: (i) Mr Smith arranged to buy the properties for a payment of £1,400,000 and to charge them to his lender as security for additional borrowing of £1,090,000, (ii) the balance of £310,000 was to be met by a payment by Mr O'Donnell to Mr Smith, (iii) Mr Smith entered into trust deeds expressed to be supplemental to the purchase of each the property under which he constituted himself trustee of the properties, or the proceeds of sale, for Mr O'Donnell's parents as tenants
40 in common, after repaying the moneys secured by the charge, and (iv) Mr O'Donnell agreed to pay Mr Smith's costs.

14. In pursuance of this arrangement: (i) the receiver conveyed, or agreed to Mr O'Donnell conveying, the properties to Mr Smith on 13 June 2008, (ii) Mr Smith paid the receiver £1.4 million, (iii) Mr O'Donnell paid Mr Smith some £362,000 and (iv) Mr Smith executed the trust deeds.

5 15. Mr O'Donnell told us, and we accept, that his accountant conducted some calculations before submitting Mr O'Donnell's tax return for the 2008/9 year. These calculations showed that Mr O'Donnell had made a capital loss on the disposals. As a result, Mr O'Donnell said, his accountant said that he did need to disclose the disposals of the houses in his 2008/9 tax return.

10 16. We did not see this calculation. It must, in our view, for the reasons which follow later in this decision, have been inept. We believe that it did not treat the disposal value consideration of the properties as £1.4 million but, as £950,000, and that it may have taken into account the loss suffered by Mr O'Donnell on the Kleinwort Benson loan. Further Mr O'Donnell indicated that he had been given the
15 impression that there was no point in claiming a capital loss for the year since it could not be carried forward - a proposition contrary to section 2(2) Taxation of Chargeable Gains Act 1992 ("TCGA") (although the occasions on which he could use any loss might be limited because of the connection between Mr O'Donnell and Mr Smith – see below)..

20 17. Following a conversation between Mr O'Donnell and HMRC's Mrs Hammami in the course of the VAT visit, she opened an enquiry into Mr O'Donnell's tax return for 2008/9 in September 2011. (Since the return had been made on 26 July 2011 the enquiry was within the time limits specified by section 8(2)(b) TMA 1970).

25 18. There was then a period of correspondence between Mr O'Donnell, his advisers and HMRC. We shall return to the progress of that correspondence later in the context of the penalty. On 29 June 2012 HMRC wrote to Mr O'Donnell giving notice of (1) the closure of their enquiry into his 2008/9 return and, (2) amendments to his self-assessment to include a capital gain of £453,774 on the disposal of the houses – with additional tax payable of £79,951, (3) the reasons for these adjustments and (4) a
30 penalty assessment, based on a conclusion that Mr O'Donnell's omission of the capital gains from his return had been deliberate, of 52.5% of the additional tax.

35 19. Mr O'Donnell appealed and there was then further correspondence. He sought a review. The conclusion of the review was to uphold the amendments to Mr O'Donnell's 2008/9 assessment and to reduce the penalty to 30% of the potentially lost tax on the basis that his conduct was careless but not deliberate.

40 20. Mr O'Donnell appealed to the tribunal and there followed a period in which he supplied further information to HMRC and the pursuit of the appeal before the tribunal was delayed. Towards the end of this period there was an Alternative Dispute Resolution meeting with HMRC on 17 July 2014 (the "ADR meeting") in which settlement was discussed. Mr O'Donnell waived any privilege which might attach to that meeting.

21. In the correspondence between HMRC and Mr O'Donnell in the period after the notice of closure of HMRC's enquiry and the time shortly after the ADR meeting, Mr O'Donnell provided HMRC with information relating to the costs of improving the four properties and the expenses associated with his disposals. He also raised a contention in relation to the method of computation of any gain, and argued that the loss he made on the Kleinwort Benson loan should be set against any such gain.

22. Following these discussions and exchanges Mrs Hammami wrote to Mr O'Donnell on 9 April 2015 with amended calculations and proposed a revised assessment of the additional tax of £31,928. That letter set out the matters which were agreed.

23. The fact of disposals, the original acquisition costs, the allowable expenses of the acquisitions, and the periods in which Mr O'Donnell had resided in any of the properties were not in dispute before us.

The Issues to be Determined in the Appeal against the amendments to the self assessment

24. The issues which we have to resolve in order to determine the 2008/9 assessment are the following:

(1) what was the consideration for the disposal of the four properties - and in particular whether, and if so how, this question was affected by the actions of the receiver and the trust declarations;

(2) what improvement expenditure should be deducted in calculating the gains;

(3) what incidental expenses in relation to the disposals should be deducted in computing the gains;

(4) how should the computation of the gains be made in the light of the provisions of section 222 TCGA in relation to principal private residence relief; and

(5) whether, an allowable loss was deductible in relation to the Kleinwort Benson loan.

Discussion – the disputed components of the calculation of the gain

25. Section 15 TCGA provides that the amount of any gain accruing on a disposal of an asset shall be computed in accordance with Part 5 of that Act. However, despite those words, the Act does not spell out the computation which must be done. Instead it contains provisions which determine the consideration which must be treated as the consideration for a disposal and limitations on the amounts which are allowable as deductions. The intent and effect however is clear: namely that the gain is to be computed as the consideration (as determined under the Act) less the expenditure which is so allowed.

(1) The consideration for each disposal.

26. Section 101ff Law of Property Act 1925 (“LPA”) gives (subject to variation by the mortgage deed) a mortgagee power to sell mortgaged property once the mortgage money has become due and to appoint a receiver of the income of the property. The power may be exercised only after notice requiring payment has been given or
5 payment is in arrears or there has been a breach of that the term of the mortgage. The mortgagee is required by section 105 to account to the mortgagor for the proceeds of sale after deducting his costs and expenses and the monies due under the mortgage. Section 109 permits a mortgagee with the power of sale to appoint a receiver to act for him. Section 109(6) provides that the receiver shall be entitled to reclaim his costs and
10 expenses and commission at a rate not exceeding 5% of the monies received.

27. Mr O'Donnell gave us the impression that the appointment of a receiver by Kleinwort Benson was without notice and a surprise. That might indicate that the receiver's actions were not authorised by the Act or by the mortgage. However Mr O'Donnell was advised by solicitors in the period after the receiver had taken
15 possession (indeed he told us that his solicitors had made a compromise agreement with the receiver's solicitors), and we find it is likely that the receiver was duly appointed and was exercising the powers of the mortgagee given by the Act.

28. Section 26(2) TCGA provides that where a person entitled to assets by way of security or to the benefit of a charge "deals with the asset for the purposes of
20 enforcing or giving effect to the security ... his dealings with it shall be treated ... as if they were done through him as a nominee for the person entitled to the assets subject to" the encumbrance; and that this applies to the dealings of any person appointed as receiver as it applies to the person holding the security.

29. Therefore the dealings of the receiver with the properties must be treated for
25 capital gains tax purposes as dealings by Mr O'Donnell: a sale and conveyance by the receiver is to be treated as a sale and conveyance by Mr O'Donnell, and the costs incurred by the receiver in dealing with the property as costs incurred by Mr O'Donnell.

30. Mr O'Donnell showed us two completion statements dated 13 June 2013 dealing with the sale and purchase of the four properties. One dealt with the sale (showing a total receipts of £1.4 million) and the other with the purchase. The first was addressed to Mr O'Donnell, the second to Mr Smith.

31. We take from this that the receiver was content for Mr O'Donnell to act or be
35 treated as the vendor of the properties. Indeed it appears from the Trust Declarations that Mr O'Donnell was the named transferor of the properties rather than the receiver.

32. It seems to us that it is likely that the first completion statement, addressed to Mr O'Donnell in respect of sale was for the sale by the receiver and transfer of the four properties to Mr Smith. From that we conclude that for the purposes of the Act Mr O'Donnell transferred the properties for £1.4 million.

40 33. The second statement, addressed to Mr Smith, indicated a purchase price of £1.4 million, associated aggregate funding totalling £1,090,000 from two lenders, and a

balancing payment of some £346,000 due from Mr Smith. The statement bears a "draft" stamp but we find it likely that Mr Smith did borrow from those lenders, did receive the transfer of the properties and did grant charges to the lenders. We also find it likely that Mr Smith did pay the £346,000 and that Mr O'Donnell paid Mr Smith a sum which embraced that amount together with amounts in respect of Mr O'Donnell's costs.

34. In Declarations of Trust (we saw only two but accept that the others are in the same form), dated with the same date as completion of the sales, namely 13 June 2008, having recited that the declaration was "supplemental to a transfer" of the property of the same date whereby the property was transferred to Mr Smith "subject to a first legal charge", Mr Smith declares that he holds the relevant property or the net proceeds of sale after repayment of any charges "in trust for" Mr O'Donnell's parents "as tenants in common in equal shares".

35. Mr O'Donnell had obtained professional valuations of the properties. There was no dispute as to their market values which in aggregate amounted to £1.4 million.

36. Section 17(1) TCGA provides that a person's disposal of an asset shall for the purposes of the Act be deemed to be for consideration equal to the market value of that asset -

“(a) where he ... disposes of the asset otherwise than by way of a bargain made at arms length, and in particular where he ... disposes of it by way of a gift or transfer into settlement by a settlor ...”.

37. Section 18 TCGA provides that if the person acquiring and the person disposing of an asset are connected, they shall be treated as acting otherwise than at arms length: thus bringing into effect section 17. Section 286 describes what is meant by "connected". Mr O'Donnell and his uncle Mr Smith were not, as individuals, "connected" as defined in that section, but section 286 (3) provides that a person "in his capacity as trustee of a settlement is connected with any individual who in relation to the settlement is a settlor", and incorporates the meaning of "settlement" found in section 620 ITTOIA for these purposes, namely, as including "any disposition, trust, covenant, agreement, arrangement or transfer of assets".

38. In our judgement the arrangement under which Mr Smith came to hold the properties on the terms of the declaration of trust was a settlement for the purposes of section 286. The properties were transferred by Mr O'Donnell to Mr Smith (either by Mr O'Donnell himself or by the receiver but deemed by section 26 to be by Mr O'Donnell). Mr Smith was the trustee of that settlement and in our judgement Mr O'Donnell was the settlor since he transferred the benefit to the trustee. Mr Smith and Mr O'Donnell were therefore connected persons for the purposes of the transfers and therefore the transactions were to be treated as being at market value. That is to say for an aggregate £1.4 million.

39. If the arrangement was a settlement but we are wrong in our conclusion that as a result Mr Smith and Mr O'Donnell are to be treated as connected by virtue of section

18 , then we would find that the transfer fell within section 17(1)(a) because it was a transfer into settlement by a settlor.

40. If we were wrong in our conclusion that this was a settlement we would find that the conveyance to Mr Smith, considered as a transaction separate from the Declaration of Trust was a bargain at an arms length under which the consideration for the disposal was £1.4 million. That is because, if the later payment to Mr Smith is to be treated as a separate transaction, the amount paid and received was £1.4m

41. If we are wrong and finding that the transaction between Mr Smith and Mr O'Donnell viewed on its own was an arms length transaction for £1.4m we would find that because the properties were conveyed for considerably less than their market value, the transaction was not at arm's length. In that case the effect of section 17 is that the consideration for Mr O'Donnell's disposal is to be taken as market value namely £1.4 million.

42. We conclude that for the purposes of the Act the consideration for the disposals was £1.4 million in total, divided between the properties as shown on the relevant completion statements.

43. In passing we note that this conclusion does not, as Mr O'Donnell suggested it might, give rise to a double charge in relation to any increase in value of properties between their acquisition and their value at £1.4 million. That is because on any later disposal of the properties - for example by Mr Smith to Mr O'Donnell - Mr Smith would have a CGT base cost of £1.4 million and it would only be any gain in excess of that on the transfer which would be taxable. Further any purchaser from Mr Smith would normally acquire a CGT base cost equal to the amount paid to Mr Smith for the properties (assuming that to be an arm's length amount).

25 (2) What improvement expenditure should be deducted?

44. Section 38(1) TCGA limits deductions in respect of amounts of expenditure to: (a) that on the acquisition of the assets, (b) that on enhancing the value of the assets and (c) the incidental costs of disposal. The discussion in this part of this decision relates to the restrictions on expenditure on enhancing the value of an asset ("improvement expenditure").

45. In relation to expenditure on enhancing the value of an asset, para (b) of section 38(1) limits the deductible expenditure to that which: (i) has been incurred, (ii) has been incurred on the asset wholly and exclusively for the purposes of enhancing the value of the asset, and (iii) is reflected in the state or nature of the assets of the time that disposal.

46. Mr O'Donnell contended that in aggregate expenditure of £450,000 should be deductible under this head. HMRC accepted that in total £350,000 expenditure qualified for deduction.

47. In an appeal against an amendment to a self-assessment, the onus lies of the appellant to provide evidence supporting his view of the facts which is sufficient to convince the tribunal that his view of the facts is the more likely.

5 48. Mr O'Donnell offered no oral or written evidence other than that which he had already offered to HMRC and was recorded in the copy correspondence before us. We deal that evidence separately relation to (a) the three rented properties and (b) 2 Assarts Lane.

(a) The three rented properties.

49. The evidence before us consisted principally of the following:

10 (1) Mr O'Donnell's statements that at the time of his acquisition each of the three let properties required extensive improvements to enable them to be let as houses in multiple occupation, that these improvements were carried out, and that these changes were reflected the state or nature of property at disposal;

15 (2) certificates of accreditation from Worcestershire County Council which supported Mr O'Donnell's statement that the properties had been brought up to the relevant standard;

(3) a letter from an electricity contractor stating that he had substantially rewired the properties;

20 (4) lists prepared by Mr O'Donnell of the work carried out with his estimates of the cost for each property;

(5) statements by Mrs Hammami recorded in the note of the 17 July 2014 ADR meeting that some of the estimated costs exceeded the costs quoted to her by others or paid by Mr O'Donnell to others for seemingly similar items; and

25 (6) Mr O'Donnell's comment in his written statement for the tribunal that most of the improvements were done by direct labour rather than large contractors. This appeared to concentrate on the current value of the improvements rather than the amount actually expended.

30 50. We did not find this evidence sufficient to convince us that the amount expended on the improvements was that for which Mr O'Donnell contended, or greater than the amount treated as allowable by Mrs Hammami in her letter of 9 April 2015.

35 51. Mr O'Donnell said that he no longer had the records to support payments he had made. That made his case less easy to pursue. However, if he had provided estimates from builders, builders' merchants or labourers of the costs which would now be incurred and had it been possible to find an index to index that cost back to the time of the making of the expenditure, that would have gone a long way to get him over the threshold of proving what he had expended at the relevant time. But he did not.

(b) 2 Assarts Lane.

52. HMRC did not dispute that a number of improvements and alterations had been made to this property. Mr O'Donnell had supplied photographs of the changes, Mrs Hammami had inspected them. We find that the changes asserted by Mr O'Donnell were undertaken and the works were reflected in the state and nature of the property at the time of disposal.

53. What is at issue is the amount expended on those changes. Mr O'Donnell claimed expenditure of £300,206. This was, in part based on a estimate obtained by Mr O'Donnell in August 2013 from a builder of £193k for the current cost of some of the works which had been done, and in part on Mr O'Donnell's estimate of £90k for other works not included in that estimate.

54. In her revised computation following the ADR meeting Mr Hammami had agreed to a deduction of £230,000 for the cost of these works. In correspondence she points out that the builder's estimate was for the current cost, not the cost as it would have been when the works were incurred, and that the rate of VAT at the relevant time would have been less. We also note the suggestion made by Mr O'Donnell that some works were not carried out by contractor but with direct labour. That suggests that their cost may have been less than the amount which would have been paid to a contractor. On the other hand we also note Mr O'Donnell's evidence that materials costs were now lower than they were at the time of the works.

55. We note that the deduction permitted by section 38 is for the actual expenditure, not the current value of the works done.

56. The onus is on the appellant to provide evidence to convince us that HMRC are wrong. We do not find the evidence before us permits that conclusion. We conclude that the allowable improvement expenditure should be limited to £230,000.

Conclusion - improvement expenditure

57. We find that no adjustment should be made to the allowable deductible improvement expenditure in the revised computations of 9 April 2015.

(3) Incidental expenses of disposal.

58. Section 38(1) (c) permits the deduction of "incidental costs to [the taxpayer] of making the disposal". This phrase is defined in subsection (2), and thus such costs are limited to:

“(2) ...expenditure wholly and exclusively incurred by him for the purposes of the ... disposal, being fees, commissions, or remuneration paid for the professional services of any surveyor or valuer, or auctioneer or accountant, or agent or legal adviser and costs of transfer or conveyance (including stamp duty or stamp duty land tax)

together... with the costs of advertising to find a buyer and costs reasonably incurred in making any valuation...required for the computation of the gain,,,”

59. Thus for an expense (other than a valuation or advertising expense) to be deductible as an incidental expense, the expense must be: (i) incurred, (ii) incurred for the disposal, (iii) incurred wholly and exclusively for the purposes of the disposal, and (iv) be those of a specified person or the costs of the transfer. Nothing else can be deducted as an incidental expense (other than a valuation or advertising expense within the limitations of the tailpiece).

60. This statutory background is important since Mr O'Donnell rightly described certain expenses which he had incurred being connected to the sale. But that is not enough to make them deductible - they must be incurred for the purposes of the disposal, and wholly and exclusively for that purpose.

61. Mr O'Donnell claims deductions for the following fees and expenses in relation to the transactions (spread generally rateably across the properties according to their sale price): -

	Valuation and Broker fees	11,629.00
15	KB* Legal costs (receiver and bank fees)	55,447.65
	DF Legal's fees	<u>48,987.00</u>
	Total	<u>116,033.65.</u>

*KB: Kleinwort Benson

62. In her revised assessment of 9 April 2015 Mrs Hammami accepted that incidental fees and £80,000 would be deductible spread rateably across the four properties.

63. There was only limited documentary evidence before us of the extent of the work which had been done for these fees. The onus was on Mr O'Donnell to show us that the expenses had been incurred by him wholly and exclusively for the purpose of the disposal to Mr Smith. His failure to provide substantial detailed documentary evidence weakened his case.

64. There was no doubt that Mr O'Donnell had "incurred" expenses equal to the amounts claimed either by paying them directly, or, in the case of costs incurred by Mr Smith, by paying them indirectly in the single payment he made to Mr Smith. The first of the requirements mentioned in [59] above was satisfied.

65. Mr O'Donnell adduced a letter from his solicitors DF Legal which confirmed that the fees in the completion statements related to the transactions and had been borne by Mr O'Donnell. The existence of that connection is, however, not enough for deductibility.

66. We turn to consider each of the costs claimed:

(1) Valuation and Broker fees £11,629.

67. A schedule attached to a letter from Mr O'Donnell of 23 July 2012 shows brokers fees of £5,330 and valuation fees of £6,299 (which amounts sum to £11,629).

68. That schedule also indicates that some other valuation fees may have been paid by Mr O'Donnell which were not included in these amounts. We have recorded that Mr O'Donnell told us that when the receiver took possession of the property he sought replacement finance. The lenders he contacted required valuations. He obtained them. All in all he said that he got bills for some five sets of fees. The expenses of these valuations were in our view incurred, not for the purposes of the disposal but for the purposes of retaining the properties. Any such additional valuation fees were therefore not allowable.

69. On balance we concluded that the valuation fees in the schedule related to obtaining a valuation for the purposes of arranging the sale to Mr Smith rather than for the purposes of retaining properties. In the circumstances of the disposals we accept that they were the fees of a valuer incurred wholly and exclusively for the purposes of the sale to Mr Smith. We therefore accept that they are properly deductible in determining the gain within the main part of section 32(2): they were not such valuation fees as are described in the tailpiece as being limited to those of a valuation for the purpose of the computation of the gain.

70. We understood that the brokers fees were paid to mortgage brokers. Those fees in our judgement could only have been incurred for the purposes of retaining rather than disposing of the four properties. They are therefore not allowable in completing the gains.

71. As a result we concluded only £6,299 of the amount claimed under this heading is deductible.

(2) *Kleinwort Benson Legal costs £55,447.*

72. These appear to be the fees and expenses of the receiver. We could not find a breakdown of the amount in the papers before us although the following documents explained the composition of approximately similar figures.

73. Lattey & Daw had acted as solicitors to Kleinwort Benson. In a letter of 9 June 2008 Lattey & Daw set out the make up of some of £977,049 which it seems was at that stage Kleinwort Benson's claimed from Mr O'Donnell, and their agreement that this would be settled by a payment of £950,000 to Kleinwort Benson on 13 June 2008 (a payment which was noted in the sales completion statement as having been made). The claim of £977k was comprised of the balance of outstanding loans and accounts, together with:

- (1) £35,521 of legal and receivership fees,
- (2) £18,412 described as the balance of receivership fees and estate agent commission,
- (3) £7,398 being the balance of litigation fees, and

(4) £1,233 being the legal fees of sale.

All in all that came to £62,564.

74. A fax to Mr O'Donnell from DF Legal of 9 June 2013 indicates that the fees element of the amount to be settled on 13 June 2008 was £58,000 made up of:

5	(1) Receiver's fees	30,500
	(2) Receiver's solicitors' costs	16,093
	(3) agency fees on the sale	<u>11,500</u>
	Total	<u>58,093.</u>

75. A letter from DF Legal to Mr O'Donnell on 26 March 2014 repeats the immediately preceding breakdown and suggests that the relevant costs borne by Mr O'Donnell might be determined by abating the total by 950/977 by reason of the negotiated settlement.

76. It seems to us that the receiver's costs and expenses cannot be described as having been incurred by Mr O'Donnell wholly and exclusively "for the purposes of the disposal". They were incurred because the loan had fallen due and the receiver was setting about taking possession of land selling the properties. They may have been incurred by the receiver in part for the disposals but they were also incurred to protect the bank's position, and thus not exclusively for the purposes of the disposal to Mr Smith. Mr O'Donnell did not pay the expenses only in order to effect the disposals to Mr Smith but also because he was liable to pay them as a result of his obligation to the bank.

77. A note made by Mrs Hammami of a telephone call on 22 June 2013 contains a comment, we believe originating from Mr O'Donnell that the receiver's legal fees include barrister's fees in an action under the "Housing Acts" (we think this is probably a misprint for the Law of Property Act, given what follows), and that the sale at auction or privately could not have taken place without incurring his charges.

78. There was no detailed evidence before us of the progress of any litigation between Mr O'Donnell and the receiver or the precise detail of the issues litigated. It was clear to us that at least some part of the the receiver's charges must have been incurred for the purposes of protecting the bank's position. On the evidence before us we could not conclude that any of the expense incurred by Mr O'Donnell in paying the receiver's costs had been incurred by him wholly and exclusively for the purpose of the disposal to Mr Smith.

79. So far as concerns the agency fees will be think it likely that these refer to estate agents' fees in advertising for a buyer. We accept that these fees are deductible under the tailpiece of section 38(2).

80. The breakdown provided by Lattey & Daw included £1,233 of conveyancing costs. On balance we think it likely that these were the costs incurred by the bank in assenting to the conveyances to Mr Smith. On that basis these sums are allowable.

81. We conclude that it has been shown that no more than £12,733 of KB's costs are deductible being £11,500 of estate agency costs and £1,233 of conveyancing costs.

(3) *DF legal fees £48,957.*

5 82. These are made up of:

	(1) DF Legal's fees	10,164
	(2) DF Legal's conveyancing fees	1,213
	(3) Stamp duty /SDLT	36,499
	(4) land registry fees	<u>1,080</u>
10	Total	<u>48,956.</u>

83. The letter from DF Legal of 26 March 2014 describes the £10,164 of their fees as "related to the negotiation and conclusion of the deal struck with the Bank and the LPA Receiver", and £1,213 as representing their costs of the actual conveyancing.

15 84. The negotiation and conclusion of the deal struck with the receiver, as we understand it, enabled the properties to be sold to Mr Smith. The expense might therefore be said to have been incurred for that purpose. But it is deductible only if it was incurred wholly and exclusively for that purpose.

20 85. Mr O'Donnell was clearly aware that a quick auction sale by a receiver would be unlikely to raise as much as the properties would realise in a more measured sale, and in such a sale and therefore reduce the amount he would receive after repayment of the loan. The sale to Mr Smith at non-forced open market value preserved the value of Mr O'Donnell's equity in the properties. This therefore appeared to be a second purpose of the pursuit of an agreement with the receiver. We had no evidence before us which would enable us to come to a conclusion that the exclusive purpose of the negotiations and the costs was a sale to Mr Smith. We concluded it was not shown
25 that the £10,164 was deductible.

30 86. The conveyancing fees were clearly deductible in so far as they related to the work done for Mr O'Donnell or the receiver on the sale. We understood however that they also embraced the costs of the conveyancing work done for Mr Smith but paid directly by Mr O'Donnell. They were thus incurred by Mr O'Donnell and were the fees of a legal adviser. We thus find that £1,213 was deductible.

35 87. The costs of the SDLT on the purchase and the land registry fees were costs which were primarily attributable to Mr Smith. At first sight they were not "incurred" by Mr O'Donnell. But Mr O'Donnell told us, and we accept, that he agreed with Mr Smith that in return for Mr Smith's participation in the transaction Mr O'Donnell would pay his costs. And we accept that such payment was made.

88. It seems to us that the reimbursement of the cost of Mr Smith's legal work, his SDLT liability and the land registry fees was thus incurred wholly and exclusively for the purposes of the disposal.

89. Whilst SDLT and the Land Registry fees were not "fees and commissions, or remuneration paid for the professional services of any surveyor or valuer or auctioneer or accountant or agent or legal adviser", they are in our opinion properly described as "costs of the transfer or conveyance (including...[SDLT])". Even though what was paid was not SDLT but an amount equal to Mr Smith's SDLT liability, it was a cost of the transfer. As a result we conclude that only £1,213 + £1,080 + £36,499 = £38,792 of these costs is deductible.

Conclusion – incidental costs of disposal

90. Of the claimed costs of £116,033 we find only £6,299 + £11,500 + £38,792 = £56,591 was shown to be deductible under section 38. Mrs Hammami had allowed £80,000. That allowance must therefore be reduced.

15 **4. The computation of gain in the light of section 222 TCGA.**

91. 2 Assarts Lane was for part of the period of Mr O'Donnell's ownership his only or main residence. For a different period another of the properties, 85 Woodstock Road, was his only or main residence.

92. Section 223 (3) provides that where a dwelling house has been an individual's only or main residence for part only of his period of ownership "a fraction of the gain shall not be a chargeable gain and that fraction shall be -

(a) the length of the ... period of ownership during which [it] was the individual's only or main residence [we call this period R] ... divided by

(b) the length of the period of ownership [we call this P]."

93. In the computation of the amended assessment HMRC calculated the chargeable gains on 2 Assarts Lane and 85 Woodstock Road as

$$R/P \times \text{the gain}$$

where the gain was the consideration for the sale (SP) less cost of acquisition (C) less allowable improvement costs (I) less incidental expenses (E) That is to say,

$$\text{Gain} = SP - C - I - E.$$

Thus the chargeable gain was taken as :

$$(R \times (SP - C - I - E))/P$$

94. Mr O'Donnell argues that in his circumstances this is wrong. He says the chargeable gain should be computed thus:

$$R \times (SP - C - E)/P - I$$

95. That, he says, is because the relief for the improvement expenditure should not in effect be abated by the effect of the period of his occupation as a main residence. He advances several arguments in favour of this approach and of its consistency with the principle of ordering reliefs to give the best results to the taxpayer.

5 96. This is a hopeless argument. The statute is clear. The gain is calculated first, and the fractional abatement is then applied to the gain. There is no room for changing the order of the elements of the calculation prescribed by the statute.

5. The loss on the Kleinwort Benson loan.

10 97. Mr O'Donnell argues that an allowable loss arose on the mortgage loan which should be offset against any gain arising in the year loss was realised.

98. Section 1 (1) TCGA provides:

“1 (1) Tax shall be charged in accordance with this Act in respect of capital gains, that is to say chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets.”

15 99. Section 2(2) and provides that capital gains tax shall be charged on the total amount of chargeable gains accruing to a person in the year after deducting allowable losses accruing to that person in the year and, in so far they have not been allowed in relation to previous years, allowable losses accruing to any person in a previous year of assessment.

20 100. Section 15 provides:

“(1) The amount of the gains accruing on the disposal of assets shall be computed in accordance with this Part subject to the other provisions of this Act.

25 (2) Every gain shall, except as otherwise expressly provided, be a chargeable gain.”

101. Section 16 provides:

30 (1) Subject to sections 261B, 261D and 263ZA and except as otherwise expressly provided, the amount of a loss and accruing on the disposal of an asset shall be computed in the same way as the amount of the gain accruing on a disposal is computed.

35 (2) Except as otherwise provided, all the provisions of this Act which distinguish gains that are chargeable gains from those which are not, or which make part of the gain a chargeable gain and part not, shall apply also to distinguish which losses are allowable losses from those which are not, and to make part of a loss in allowable loss and parts not; and the references in this Act to an allowable loss shall be construed accordingly.

102. As the underlining added above shows, all these provisions concern assets. Mr O'Donnell was a borrower. The account with Kleinwort Benson was a liability, not an

asset. The provisions of the Act do not apply to liabilities. The loss on the liability is not an allowable loss for the purposes of the Act. It may not be deducted.

Conclusion – the assessment

103. We dismiss the appeal against the assessment.

- 5 104. The assessment is determined as that which set out in Mrs Hammami's letter of 9 April 2013 adjusted (upwards) in respect of our conclusion in relation to allowable incidental expenses of disposal - see paragraph [90] .

Penalties.

105. HMRC assessed a penalty of 30% of the additional tax.

- 10 106. Sch 24 Finance Act 2007 provides that a penalty is payable by a person who gives HMRC a tax return that contains an inaccuracy which leads to an understatement of tax. In circumstances where that inaccuracy was “careless” the prescribed penalty is 30% of the potential lost revenue, but the percentage may reduced by reference to the quality of any disclosure made to HMRC. A penalty may
15 also be reduced if there are “special circumstances”.

107. Mr O’Donnell’s failure to disclose the disposals of the properties and the gains arising in his tax return was in our view an inaccuracy in that return.

108. An inaccuracy is “careless” if it was due to a failure to take reasonable care. In our view, given the amounts involved and the complexity of the transactions it would
20 have been reasonable at the least to take serious formal competent advice as to whether a gain arose and to question seriously any advice which suggested that a gain should not be returned. We therefore regard the inaccuracy as careless.

The Quality of Mr O’Donnell’s disclosure

109. HMRC wrote to Mr O’Donnell:

- 25 (1) On 12 September 2011 telling him of the opening of the enquiry into his return.
(2) On 17 November 2014 indicating that a gain may have been omitted in his return and inviting computations;
30 (3) On 13 December 2011 indicating the information HMRC held on acquisition and disposal figures and giving notice of the impending closure of the enquiry.

110. Mr O’Donnell’s first response to these letters was on 26 January 2012 when he said that the receiver’s seizure of the four properties meant that he had made no gain, and offering inspection of the documents at his offices by appointment.

- 35 111. HMRC replied on 6 February asking for copies. Mr O’Donnell replied on 21 February that he was seeking advice from his accountant and solicitor.

112. No further correspondence seems to have occurred until 29 June 2012 when HMRC issued closure notices.

113. On 23 July 2012 Mr O'Donnell wrote with some details of the costs he had incurred in the disposals. No further details were provided. In March 2013 HMRC wrote a very detailed review letter, and during 2013 and 2014 Mr O'Donnell provided more detail and more figures in relation to improvement expenditure and other costs.

114. This correspondence led us to the conclusion that Mr O'Donnell's disclosure to HMRC had been slow and limited. He was polite and clear but unhelpful.

115. At the hearing Mr O'Donnell told us that his ability to make full disclosure had been limited by a non disclosure agreement made with KB as a part of the agreement for the settlement of his outstanding liabilities in 2008. At our direction he provided a copy of this agreement after the hearing.

116. In the agreement Mr O'Donnell undertakes that he will not make any disclosure of any particulars of, or in any way relating to the loans and charges, the negotiations over the operation of the loan account, or their settlement unless required by law.

117. In our judgment this agreement did not prevent Mr O'Donnell disclosing the disposals of the properties, the improvement expenditure, or the details of the transfer to Mr Smith to HMRC. It provides no excuse for the failure to provide those details at an earlier stage.

118. Nor did the terms of the agreement prevent Mr O'Donnell telling HMRC that he was bound by the terms of a confidentiality agreement from disclosing certain information to them. Such a disclosure would have assisted HMRC in deciding whether to exercise their statutory powers to require disclosure.

119. However, it would have been reasonable for Mr O'Donnell to have been loathe to do anything which would breach the terms of his undertaking.

120. Nevertheless we conclude that such proper reluctance does not affect the "quality" of the disclosure which Mr O'Donnell made, and thus cannot affect the level of the penalty.

121. We considered whether the circumstances of the disposals and in particular the non disclosure agreement were special circumstances which could warrant the making of a reduction in the penalty under para 11 Sch 24. In our view the non disclosure agreement was a circumstance special to Mr O'Donnell in relation to some of the information he could have given HMRC. HMRC did not consider this issue and in that respect their decision may be treated as flawed with the result that we may make a decision on the issue.

122. Overall we regard the restrictions flowing from the non disclosure agreement as minor, and, given our earlier findings, as warranting a reduction in the penalty percentage by 2.5% to 27.5%.

Conclusion – the Penalty

123. We conclude that the penalty must be set at 27.5% of the additional tax.

Rights of Appeal

5 124. 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
10 “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)”
which accompanies and forms part of this decision notice.

CHARLES HELLIER

15

TRIBUNAL JUDGE
RELEASE DATE: 26 APRIL 2017