

CAKE AND EAT IT – UNCONDITIONAL SALE CONTRACT WITH POWER TO RESCIND – CAPITAL GAINS TAX

by Patrick Soares

What is Sought

Taxpayers may want to enter into unconditional contracts to dispose of land in a particular year, to ensure that when completion takes place in the future, the disposal date is treated as taking place when the unconditional contracts were entered into. They may also want the power to rescind. This can be achieved.

Legislation

TCGA 1992 s.28 states thus:-

“Time of disposal and acquisition where asset disposed of under contract

- (1) ...where an asset is disposed of and acquired under a contract the time at which the disposal and acquisition is made is the time the contract is made (and not, if different, the time at which the asset is conveyed or transferred).
- (2) If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied.”

Date of Disposal

It is thus clear that if the taxpayer enters into an unconditional contract to dispose of land and the contract is not completed (ie there is no conveyance or transfer), there will be no disposal of the land for CGT purposes. If completion (legal completion) does take place, then the disposal will occur on the legal completion, but *that disposal is deemed to take place at the time when the unconditional contract was entered into.*

Rescission

Problems arise, however, if the vendor or the purchaser want to be in a position in certain circumstances to rescind the contract and want that right built into the contract. Is there a danger that the power to rescind may make the contract conditional, so that only when the power no longer applies will there be an unconditional contract to dispose of the property?

Case Law

Jonathan Parker J, as he was then, in *Hatt v. Newman* [2000] STC 113 dealt with a case where contracts were entered into subject to a condition precedent: the legal completion ultimately took place in a different tax year. On page 118 the Judge stated:-

“In any event, even if on a true analysis the contract was not a conditional contract within the meaning of TCGA 1992 s.28(2) (on the

footing that the condition in relation to planning permission was a condition subsequent, which did not prevent contractual obligations arising when the contract was concluded), the appropriate date would have been the date of the contract.”

In that particular case the taxpayer had a problem, whether the contract was a conditional one, or an unconditional one because in either event the disposal would have taken place in the wrong year. He needed to establish that completion was the disposal date and that it had no retrospective effect. He was unable to establish that, but the Judge made the point that had the grant of the planning permission been drafted as a condition subsequent, the contract would have been an unconditional one.

The second case giving guidance is *Jerome v. Kelly* 76 TC 147, where A contracted to sell property to B and B had the right to rescind if planning permission was not obtained. Park J at 164E stated:-

“Counsel (for both parties) agreed, and so do I, that the contract for the sale of (the land) to B was an unconditional contract. *The power of B ... to rescind the contract if planning permission was not obtained did not mean that it was a conditional contract within s.28(2).*” (my italics)

Cake and Eat It

It is thus perfectly possible for a taxpayer to unconditionally contract to sell land, and if, for one reason or another, completion does not take place on a particular date for example (the “longstop date”) one could have an appropriate condition subsequent: if that condition is not satisfied each party could have the power to rescind the contract and the contract would nevertheless have been an unconditional one for capital gains tax purposes.

One has to be careful in this day and age of the courts deciding to look at the substance and determining that in truth and reality the contract was a conditional one, i.e. conditional on not exceeding the longstop date (Riberio PJ in *Collector of Stamp Revenue v Arrowtown* (2003) HKCFA 46 at 35). However, if in reality the parties wanted to complete by the longstop date and anticipated that that may be the case, then there is no reason why the courts should not respect the legal documentation (*Spectros v Madden* 70 TC 349 at 375 and *Aberdeen Construction v IRC* (1978) AC 885 at 897DD).

Precedents

The sorts of clauses one would expect near the beginning of the contract are thus:-

- “(1) completion of this contract shall take place on or before the longstop date;
- (2) the contract to sell and purchase the Property is not subject to any conditions precedent.”

With regard to the ability to rescind, this would come near the end of a document and may be along the following lines:-

“The requirement that completion shall take place on or before longstop date is a condition subsequent to this contract. If that

condition is not fulfilled either the seller or purchaser may rescind this agreement by giving the other party written notice to that effect whereupon this contract shall be rescinded and such rescission shall be without prejudice to any claims that one party may have against the other in respect of any breach of the terms and conditions of this contract.”