GETTING LOST IN THE WORLD OF DEEMED REALITY

By Laurent Sykes QC

The effect of s28 TCGA 1992

Every now and again a bit of common sense needs to be injected into the tax system by higher courts. s28 TCGA seems to have generated more need for this than many other provisions.

On its face, the effect of s28 TCGA is simple: it provides that the time of a disposal and related acquisition will be the time of entering into an unconditional contract, rather than completion of that contract (if different). The House of Lords explained the limited effect of s28 in *Jerome v Kelly* [2004] STC 887 per Lord Hoffmann at [11]:

> "It is hard to see why the abolition of Case VII (which needed a provision to fix the time of the acquisition and disposal) should have made it necessary to introduce one for the capital gains tax, which did not depend on the time of disposal. The rules for the two taxes are quite distinct. Whatever may be the explanation, it seems to me clear that the paragraph was intended to deal only with the question of fixing the time of disposal and not with the substantive liability to tax. It does not deem the contract to have been the disposal as the 1962 Act had done…" [underlining added]

Lord Hoffmann is clear in his approach; the effect of s28 is no broader than dictating the timing of a disposal. In particular, it should not affect the substantive calculation of the gain. The narrow point was that, where there was no ultimate disposal in the ordinary sense, s28 could not apply to deem one into existence.

The Upper Tribunal's decision in *The Commissioners for Her Majesty's Revenue and Customs v Desmond Higgins* [2018] UKUT 280 was therefore surprising. The Upper Tribunal explained at [27] that the effect of *Jerome v Kelly* did not preclude the deeming effect of s28 from treating the taxpayer as owning the off-plan property he had contracted to purchase at a time when it had not yet been built (with a consequent reduction in principal private residence relief). This would have tax consequences beyond the mere timing of the disposal, and affect the computation of the gain:

> "In our judgment, the FTT was wrong to say at [6(5)] that "a deeming provision must give way where it is dealing with an ancillary issue and not the substantive liability to tax". It is not a question of whether a deeming provision "gives way" as such. It is necessary to identify what is deemed to be the case and in what circumstances. *Jerome v Kelly* is authority for the proposition that section 28 is concerned solely with fixing the time of disposal by a person whose identity is to be ascertained by other means. It is the ultimate disposal of an asset which engages capital gains tax and that is why Lord Hoffmann stated that section 28 did not deal with the substantive liability to tax. <u>We do not read that statement as meaning that section 28 can never have any substantive effect on the incidence or computation of the tax so that it cannot apply to determine the period of ownership for the purposes of section 222</u>." [underlining added]

The Upper Tribunal decision was reversed by the Court of Appeal in *Higgins v RCC* [2019] EWCA Civ 1860 which held that ownership meant what it said and the period of ownership did not start until completion. But there are still other ways in which the scope of s28 causes confusion.

Value

The Upper Tribunal assumed in *Higgins* (and neither party argued the point) that market value for the purposes of s17 TCGA would be the market value of the asset at the time of contracting, rather than completion (see [16]). This seems like more of the same confusion.

The emphasis is on what is received (or deemed to be received) in return for the asset and therefore value and market value should be ascertained at completion. The point is more stark when what is received does not exist at the time of the contract but only exists at completion, for instance on the transfer of an asset in return for newly issued shares. *Stanton v Drayton* [1983] 1 AC 501 illustrates this point. The shares did not exist at the time of the contract. Lord Fraser said: "In my opinion, the consideration was the Drayton shares. That is, I think, how any businessman would have seen the transaction, and it is the commercial reality. Counsel for Drayton argued that the correct legal analysis was not for businessmen, but for lawyers, and I agree, subject to this, that the lawyer must have regard to the businessman's view. From the lawyer's point of view, it seems plain beyond argument that what Eagle Star received as consideration for its portfolio was the Drayton shares." It is impossible to see one how can value something which does not exist – at best one is speculating. In *Stanton v Drayton* it was never suggested by HMRC that the value should be the market value of the to-be-issued shares at the time of the contract as that would have been impossible to determine. Their argument was that it should be the market value of some sort of credit under the agreement relating to the future issue which was the consideration and which therefore fell to be valued. That was rejected by the House of Lords.

This illustrates the wider point that the value at completion is likely to be what is relevant, regardless of whether the asset exists at the time of the contracting. Any other view would result in tax on "arithmetical differences", rather than on what business people would consider to be gains, which is not in accordance with the purpose of the legislation.

The effect on the availability of PPR

The Court of Appeal decision in the *Higgins case* mentioned above concerns an off-plan purchase of a dwelling where there is a contract for its acquisition. Suppose the dwelling is being built by the taxpayer? There is no contract in such a case and one would not expect to have to treat the period of ownership of the dwelling as beginning in a period where the dwelling did not exist. But that is not what HMRC appear to think.

Extra-statutory concession D49 is explained in the Manuals at CG65003:

> "ESC D49 sets out three circumstances in which you should allow relief for a period between the acquisition of land, including land on which a dwelling house stands, and the beginning of residence in a dwelling house on that site. Those circumstances are:
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> - <u>where the delay in taking up residence is because a dwelling house is being built on that land,</u>
> - where the delay in taking up residence is because of the continuing occupation of the previous residence while arrangements are made to sell it,
> - where the delay in taking up residence is because alterations or redecorations are being carried out.
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> The concession allows relief for a period up to 12 months, although where there are good reasons for the period exceeding 12 months which were outside the individual's control the period may be extended up to 2 years. The extended period which can qualify for relief in these circumstances is explained at CG65009. The effect of these provisions is explained at CG65013."

ESC D49 suggests that where no dwelling has yet been constructed, the taxpayer only has 12 (or 24) months from the acquisition of the land to inhabit a dwelling on the land before the right to full PPR relief will begin to dissipate. This assumes that the period of ownership begins with the time the land was acquired, not when the dwelling came into existence.

The FTT make the same error in *Andrew White and Melanie White v The Commissioners for Her Majesty's Revenue and Customs* [2019] UKFTT 659 in which no attention is given to when the dwelling first existed; the operative point in time was considered to be the acquisition of the land.

This is all quite odd. s222(1)(a) applies to "a dwelling-house or part of a dwelling-house which is, or has at any time in [the taxpayer's] period of ownership been, his only or main residence". This naturally refers to the period of ownership of the dwelling-house – which, surely, requires that it exists.

s222(7) provides a definition of the "period of ownership" but this applies only where different interests in the dwelling-house are acquired at different times and therefore does not provide a general definition of the concept of "period of ownership" (so the natural meaning should prevail, as above). s222(7) states:

> "In this section and sections 223 to 226, "the period of ownership" where the individual has had different interests at different times shall be taken to begin from the first acquisition taken into account in arriving at the expenditure which under Chapter III of Part II is allowable as a deduction in the computation of the gain to which this section applies".

The "different interests" are clearly different interests "in" the dwelling-house (where the relief is sought under s222(1)(a)), which presupposes there is a dwelling-house and not simply land. So the prior ownership of land is not relevant since the acquisition of land on which the dwelling-house is to be built is not the acquisition of an interest in the dwelling-house. In *Higgins* Newey LJ said at [26] in relation to s222(7):

> "The subsection is directed at a situation in which a person acquires successive interests: first, say, a lease and later the freehold. If the acquisition of an earlier interest is to be taken into account when calculating deductible expenditure, the "period of ownership" must likewise encompass that in which the earlier interest was held: a taxpayer cannot have it both ways. Section 222(7) does not purport to deal with whether someone who has done no more than contract to purchase a property has relevant "ownership" or stipulate that section 28 (which is to be found in chapter II of part II, not chapter III) applies when determining "period of ownership"."

HMRC's approach to own-built properties, like their approach in *Higgins*, seems ripe for a reality check.