

Home run!

Tribunal finds that taxpayer who bought and sold three properties in quick succession was not trading, writes Harry Smith

Taxpayer purchasing, renovating and selling properties allowed private residence relief on capital gain and held not to be trading as property developer for tax purposes, a tribunal has ruled.

Gary Ives (the Appellant), who had trained as a plasterer and had also carried out work as a general builder and painter and decorator, bought and sold, in quick succession, three residential properties, having made substantial improvements to each. The sale of each property took place shortly before the purchase of the next. In consequence of the improvements made to the properties (which included basement conversions and turning one of the properties, which had previously been converted into flats, back into a single house), the Appellant made substantial capital gains. During the building works, he and his son had lived in the properties, in some cases effectively camping in them without adequate facilities while building work was in progress.

The Appellant claimed private residence relief (PPR) from capital gains tax in respect of the sale of each of the three properties. HMRC enquired into the Appellant's tax returns and concluded that he had been trading in residential properties, and issued closure notices on the basis that the gains on the sales of each of the properties constituted trading profits and were therefore taxable as income. HMRC also raised assessments in relation to historic rental income said to have been received by the Appellant in relation to another property. The Appellant appealed to the FTT.

The legislation

Section 222, Taxation of Chargeable Gains Act 1992 (TCGA), exempts from CGT a capital gain arising on a disposal of, or an interest in, a dwelling-house which is, or has at any time in the taxpayer's period of ownership, been his only or main residence.

Section 224(3), TCGA, provides that PPR is not available if the acquisition of (or of the interest in) the dwelling-house, or part thereof, was made wholly or partly for the purpose of realising a gain from its disposal.

The FTT decision

Save for tax payable in respect of a small amount of rental income, the appeals were allowed.

The following main issues were before the FTT:

- the trading issue;
- the PPR issue; and
- the rental income issue.

The trading issue

A great deal of witness evidence was placed before the FTT and it noted in this regard that as HMRC had not suggested to any of the Appellant's witnesses (including the Appellant

himself) that their evidence was not truthful (despite HMRC's arguments being effectively predicated on this proposition), the Appellant's witness evidence must stand.

In coming to its decision, the FTT examined several of the badges of trade identified in *Marson v Morton* [1986] STC 463:

(1) Pattern of similar transactions

The FTT determined that, while there were three very similar transactions (which would suggest that the Appellant might have been trading), he had an explanation for each of them. In essence, he had been trying to establish a family home in each of the properties, but forces of circumstance (financial in one case, parking and noise issues in the second, and a change of family circumstances in the third) had prevented him from doing so.

(2) Relationship with existing trade

The Appellant's existing trade was that of a builder. However, the FTT considered that his business was really more in the nature of a plasterer and odd-job man, rather than a trader carrying out substantial home redevelopments. He had no prior history as a property developer. In the circumstances, the FTT considered that carrying out the works to the properties did not constitute a natural extension to his existing business.

(3) Subject-matter of transactions

It had not been put to the Appellant that the properties were wholly unsuitable for use as a family home and then sold on at a profit. The FTT considered that a party acquiring a home solely with a view to living in it while renovating it and then selling it at a profit and with no real intention to make it their settled home would almost certainly not be occupying it as a residence for the purposes of PPR relief from CGT, but it did not consider that that was the case here.

(4) Resemblance to trading activity

The FTT noted that, at least superficially, the transactions did resemble typical property development/trading activity. Property was purchased, with significant debt, planning permission was obtained promptly and significant work was carried out. The property was then disposed of in short order. However, the Appellant had an explanation for the history of the transactions.

(5) Finance

There was a significant level of debt used to finance the transactions. This was characteristic of a property development trade. However, the Appellant was not asked in cross-examination how he intended to finance the debt or its terms, and HMRC did not suggest to him in cross-examination (or to the FTT in submissions) that its size would pressure the Appellant to sell the properties.

(6) Resale in a different condition from acquisition

The FTT considered it clear that significant work was carried out on all three properties.

(7) Motive/intentions

The FTT discussed the Appellant's evidence as to his intention to live in each of the properties as a family home at length, and noted that, at least for some time, the evidence suggested that he and his family moved into the properties which were fully-furnished and enjoyed as homes.

Weighing everything up in the round, the FTT considered that while there were some indicia of trade, they could be explained by the plausible narrative presented by the Appellant. No evidence had been led by HMRC as to any intent by the Appellant to sell the

properties quickly, and HMRC had not suggested that he was not (or his other witnesses were not) telling the truth. In the circumstances, the FTT concluded that the transactions were not trading in nature. It accordingly allowed the appeal on this issue.

The PPR issue

As a matter of procedure, the FTT noted that the closure notices had only stated that the Appellant was trading, and had not sought to disallow PPR in the event that his proceeds from the sale of the properties proved to be capital in nature. The FTT determined that it was open to HMRC to pursue arguments in relation to PPR since the scope of the 'matter in question' was to determine the correct tax liability in relation to the property transactions.

On the substantive issue of PPR, the FTT noted that while the Appellant had, on his evidence, moved into all of the properties as soon as they were acquired, he had also claimed exemption from council tax for lengthy periods in relation to the properties. The Appellant's explanation was that he had understood, based on a discussion with a council officer, that if property did not have ordinary functioning kitchens and bathrooms, exemption from council tax was available despite the fact that the property was being lived in. On the basis that on the evidence before the FTT the Appellant was in actual occupation of each of the properties, the FTT considered that all three properties were actively occupied by the Appellant as his residence.

The FTT therefore held, allowing the appeal in this respect, that PPR was available to exempt the gains on disposal for all three of the properties.

The rental income issue

HMRC had raised assessments in respect of two properties in which the Appellant had received relatively small amounts of rental income.

In May 2017, HMRC raised assessments against the taxpayer under sections 29 and 95, Taxes Management Act 1970, in relation to under £2,000 of rental income received in respect of Hamilton House (a property not referred to above) for years 2003/04 to 2006/07. The FTT noted that given the passage of time between the tax years concerned and the raising of the assessments, HMRC had to demonstrate that the loss of tax was brought about deliberately. There was, the FTT noted, no contemporaneous evidence of the Appellant's intent when he filled the relevant tax returns. His evidence was that he had thought that deductible expenditure had always exceeded rental income in the years when it was received. The FTT considered that the Appellant had been careless, but there was no evidence before it to show that he had been deliberate and accordingly it determined that these assessments were out of time and the relevant appeals were allowed.

HMRC also assessed the Appellant in respect of a little under £3,000 of rental income received from his son's girlfriend, who lived at Fullbrooks (another property not referred to above) during 2010/11. The FTT held that rent-a-room relief under Chapter 1, Part 7, Income Tax Act 2007, was not available to the Appellant as Fullbrooks was not his sole or main residence during this year (as it had shifted to the other properties that were the subject of this decision). It accordingly determined that his share of the profit of this limited rental activity was taxable and left it to HMRC and the Appellant to determine the quantum.

Comment

Although each case will of course turn on its own facts, in coming to its decision, the FTT carefully examined several of the badges of trade (as identified in Marson) and this decision should therefore be considered by anyone who has purchased, renovated and sold a number of properties in relatively quick succession, where HMRC is claiming that they are trading in property.

It is also notable that the FTT criticised HMRC's preparation for the hearing and in particular the quality of the hearing bundle. The FTT noted that the hearing had already been deferred from April 2022 due to "inadequate marshalling of evidence" by HMRC and commented that "in a case where the total amount in dispute is nearly £1 million, we would expect HMRC to take more care in preparing the hearing bundle and making sure that it contains all relevant material properly arranged, particularly so when their failings had already been pointed out to them some months previously by a judge of this Tribunal".

The fact that the Appellant prepared for the hearing and adduced documentary evidence and witness evidence appears to have assisted him greatly in convincing the FTT that his appeals should be allowed.

The decision can be viewed at <https://tinyurl.com/4unwp644>

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