[2020] UKFTT 0037 (TC)

TC07543

Capital Gains – deduction of mortgage redemption costs in calculation – penalties for careless inaccuracy

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/00023

BETWEEN

DANIEL UNGER **Appellant**

-and-

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

TRIBUNAL: JUDGE ABIGAIL MCGREGOR
NOEL BARRETT

Sitting in public at Taylor House on 1 November 2019

The Appellant appeared in person

Mr Williams, presenting officer of HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This was an appeal against HMRC's assessment of capital gains on the disposal of a property and the associated penalties for careless inaccuracies. The taxpayer sought to argue that the repayment of a mortgage out of the disposal proceeds should reduce the disposal proceeds used as the starting point for the capital gains calculation.

PRELIMINARY ISSUE – GROUND OF APPEAL ALREADY STRUCK OUT

2. The appellant had included in his notice of appeal an argument related to the question of whether he had in fact made a full and final settlement with HMRC on the capital gain in question. In directions given on 30 May 2019 by Judge Poole, this ground of appeal was struck out on the grounds that the First-tier Tax Tribunal (FTT) does not have jurisdiction to adjudicate on the existence or effect of the supposed settlement agreement. The directions had explained the reasons for coming to that conclusion and made it clear that this strike out was without prejudice to Mr Unger's right to argue the existence of such an agreement in any recovery proceedings before the courts.

3. Mr Unger sought to revisit this decision at the beginning of the hearing. HMRC drew our attention to the directions given on 30 May 2019 that this argument had been struck out for lack of jurisdiction. Mr Unger's argument was that it seemed to him to be unfair to have two sets of proceedings when the question of the settlement could dispose of everything.

4. Although we understand Mr Unger's frustration, we cannot alter the fact that the FTT is a creature of statute that is bound by the powers granted to it, which do not extend to the question of whether a settlement has been reached with HMRC. In addition, the directions given had highlighted the opportunity for Mr Unger to make an application to challenge the directions within 14 days of the issue of the directions. No such application was made.

PRELIMINARY ISSUE – APPLICATION FOR STRIKE OUT OF RESPONDENT'S CASE

5. The appellant made an application for the respondent's case to be struck out on the basis of a series of failings by HMRC in the process of the case, namely:

(1) The failure by HMRC to deal with Mr Unger's arguments relating to his contention that he had already made a final settlement of the case with HMRC in its statement of case;

(2) A delay of 6 days in receiving HMRC's statement of case;

(3) A delay of 11 days in HMRC notifying the appellant that HMRC would not be producing any witnesses;

(4) A delay of 1 week in receiving the document bundles from HMRC; and

(5) A delay of from Friday to Monday in receiving the authorities bundle.

6. The first two issues had already been addressed by Judge Poole in directions given on 30 May 2019 in which he had stated that they did not fall within the circumstances in which the FTT can strike out HMRC's case.

7. HMRC did not dispute that these delays had occurred, but submitted that part of the reason for the delay in the delivery of the authorities bundle had been due to the same delay (i.e. due on Friday but not received until Monday) in the receipt of Mr Unger's skeleton argument.

8. We considered the delays that had been occasioned by HMRC's failures and our powers under the Tribunal Procedure Rules. Where a person has failed to comply with a requirement

in the Rules, the Tribunal can, under Rule 7(2)(c), exercise its power to strike out but this is subject to the detailed provisions on strike out in Rule 8 and Rule 2 (the overriding objective).

9. The directions given in this case were not unless orders and therefore Rule 8(1) was not relevant. Similarly, there was no suggestion that Rule 8(2) was in point (which deals with jurisdiction). Rule 8(3) provides the FTT with a discretion (but not obligation) to strike out a party's case for non-compliance with directions. The overriding objective of the Tribunal un rule 2 obliges the FTT to act fairly and justly, including seeking flexibility in proceedings and avoiding delay (provided it does not jeopardise proper consideration of the matter).

10. Mr Unger did not present any evidence at the hearing that he had been prejudiced by any of the short delays, save for suggesting that it had delayed his ability to plan his appeal.

11. After the hearing Mr Unger sent in further representations (unsolicited and without the agreement of the FTT) adding in a further complaint that HMRC had not replied to his question as to whether the witness was to be cross-examined until the very last minute and suggested that this had resulted in prejudice because the witness had not had any opportunity to review their files and authorities. This had not been raised at the hearing by Mr Unger or the witness and, in our view, the evidence presented by the witness would not have been affected by any such delay, given the limited nature of his evidence.

12. Clearly it is not acceptable for either party to delay consistently in complying with directions and HMRC admitted that these delays had occurred. However, in our view, given the lack of prejudice to Mr Unger, it would be an unfair consequence in this case to prevent HMRC from further participating in the case.

13. We gave this response during the hearing and then proceeded to hear the substantive case.

EVIDENCE

14. We heard evidence from Mr Unger and from Mr Peters, a representative from the firm of accountants engaged by Mr Unger to assist with the enquiry.

15. Both were cross-examined by HMRC.

16. We also had extensive bundles of documents showing the exchange of correspondence between HMRC and Mr Unger over the course of the enquiry.

LAW

17. The main substantive issue was the calculation of a capital gain under section 38 of the Taxation of Chargeable Gains Act 1992, in particular:

(1) The amount of the consideration or disposal proceeds; and

(2) The sums allowable as deductions from the consideration

in the computation of the chargeable gain.

18. In addition, HRMC had assessed a penalty for an inaccuracy that was careless under Schedule 24 to Finance Act 2007.

FACTS

19. There was no dispute over the following facts:

(1) The property in question is 112 Portsea Place;

(2) Mr Unger's father inherited the property in April 2006 from his late partner, at which point it was valued at £375,000, which was used as the probate valuation;

(3) In May 2007, a deed of variation of his father's partner's will was effected, under which his father became the bare trustee of Portsea Place, holding the property on bare

trust for beneficiaries – 50% to Mr Unger and the remaining 50% shared between other family members;

(4) Both parties accept that this deed of variation was valid and effective;

(5) Mr Unger's father remained living in Portsea Place until he died;

(6) Mr Unger's father took out a mortgage over Portsea Place, with the consent of the beneficiaries, in August 2009;

(7) The mortgage funds were used:

(a) £325,000 to acquire an extension of the lease of Portsea Place; and

(b) The remainder to fund Mr Unger's father's living and care costs;

(8) After Mr Unger's father's death, Portsea Place was sold to an independent third party, for £1.3million in September 2013;

(9) The undisputed allowable costs on the disposal were:

(a) The probate value of the property: £375,000

(b) The cost of the lease extension: £325,000

(c) SDLT on the lease extension: £9,750

(d) Costs of acquisition and disposal (e.g. legal fees): £33,306

(e) Other allowable costs: £703.

(10) Mr Unger did not include the disposal of the property on his tax return for 2013-14;

(11) HMRC opened an enquiry into the 2013-14 tax return on 13 May 2015;

(12) After extensive correspondence and sharing of information, on 26 July 2017 HMRC issued a closure notice stating that additional tax of £71,620.60 was due;

(13) On 31 October 2017, HMRC raised a penalty assessment of £13,428.86;

(14) On 9 February 2018, Mr Unger requested a review;

(15) Following extensive further correspondence and more information, on 20 November 2018, HMRC issued their review conclusion letter, upholding the earlier decision;

(16) On 19 December 2018, Mr Unger filed his appeal with the FTT.

PARTIES ARGUMENTS ON THE SUBSTANTIVE QUESTION

Appellant's arguments

20. During the course of the enquiry, Mr Unger accepted that a capital gain should have been included in his 2013-14 tax return.

21. He submitted that he had not included it on the return because he was relying on advice received from professional advisers, namely an associate at the solicitors who were dealing with the conveyance, that no tax was due on the disposal. This advice had been verbal and he had not followed up to get it in written form.

22. Mr Unger also conceded that the repayment of the mortgage and the mortgage interest accrued was not an allowable deduction in calculating the gain under TCGA 1992, s 38.

23. However, he argued that the amount used to repay the mortgage should be excluded from the consideration included as the starting point for the calculation of the capital gain. The reasons given for this assertion were not based in law but rather an idea of fairness, namely:

(1) The circumstances of this disposal were not normal ones;

(2) Mr Unger's father had in fact borrowed the money, not Mr Unger;

(3) The mortgage funds had been used to pay for the lease extension and to fund his father's living and care costs towards the end of his life; and

(4) The repayment of the mortgage had reduced the amount of money the beneficiaries had received.

24. Mr Unger also argued that he was entitled to set off brought forward capital losses of £4,168 against the capital gain.

HMRC arguments

25. HMRC submit that the question to be asked is "what did the purchaser give or give up in return for what the Appellant and any other beneficiaries received"? The answer to that question should form the starting point for the calculation for capital gains tax on the disposal of Portsea Place. HMRC submit that the answer is the £1,300,000 paid by the purchaser and received by the appellant's solicitors.

26. The fact that the beneficiaries needed to use those funds to redeem a mortgage (including interest that had rolled up into it) is not relevant to the disposal proceeds because that is not within the power of the purchaser.

27. On the question of deducting the cost of the mortgage, HMRC submitted that:

(1) Section 38 of TCGA 1992 allows certain specific costs to be deducted from the consideration paid by the purchasers:

(a) Incidental costs paid in respect of the acquisition of the property;

(b) Expenditure wholly and exclusively incurred for the purposes of enhancing the value of the property (where that enhancement is reflected in the asset at the time of disposal); and

(c) Incidental costs in respect of the disposal;

(2) Incidental costs are further defined in section 38(2) to include, for example, the fees of professional surveyors. Section 38(3) provides that payment of interest shall never be allowable under section 38 except as provided by section 40; and

(3) TCGA 1992, s 40 only provides for interest to be deductible if it has been incurred by a company (subject to a number of other conditions).

28. HMRC therefore submitted that, because the cost of the mortgage and the interest are not incidental costs; and the interest was not payable by a company, the costs of mortgage redemption and interest payments were not allowable in calculating the capital gain on Portsea Place.

DISCUSSION ON THE SUBSTANTIVE QUESTION

Initial consideration of extra-statutory concession D39

29. The cost of the lease extension was allowed by HMRC under extra-statutory concession D39. It is outside the powers of the FTT to consider the application of extra-statutory concessions by HMRC. However, in this case, HMRC have applied the concession to allow the cost of the lease extension and its allowance is clearly in the taxpayer's favour. Therefore, we are not considering the application of the concession, it is recorded as an undisputed fact.

Findings of fact

30. On the question of the availability of unused capital losses brought forward:

(1) Mr Peters' evidence was that he had searched his archives and found a pre-self-assessment tax return from 1993-94 which contained capital losses of £4,168 - this return was not submitted in evidence;

(2) Mr Unger said he had no recollection of using the losses and therefore they should be available; and

(3) HMRC submitted that they had done a search of their archives and found the 1997-98 return had been amended in 2004 to incorporate brought forward losses to set against gains in that year, and a gain in 2006-07 against which no capital losses were set.

31. We find that there was no evidence of the capital losses brought forward.

Consideration of the calculation of capital gain

32. Mr Unger accepted that there was nothing within section 38 TCGA 1992 that would enable the funds used on the redemption of the mortgage and its rolled-up interest to be deducted as an allowable expense in the calculation of the gain; and there were no other statutory provisions which would so allow.

33. This conclusion is in agreement with HMRC's submissions; and we concur that that is the case.

34. On the question of whether the funds used to redeem the mortgage and rolled up interest should reduce the amount treated as the proceeds of disposal, Mr Unger (and Mr Peters) could not point to any legal proposition to support their arguments, rather a question of fairness.

35. It is a curious feature of TCGA 1992 that it does not set out a step by step process to calculate a capital gain, but rather it is be deduced from the words used and the exceptions applied. TCGA 1992, s 2 states that a person is subject to capital gains tax on his chargeable gains. TCGA 1992, s 15 states that the amount of the gain shall be computed in accordance with the provisions in TCGA 1992, Part II and that all gains are chargeable gains unless otherwise expressly provided.

36. TCGA 1992, s 38(1) starts as follows:

> "Except as otherwise expressly provided, the sums 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:"

37. It is deduced from section 38 TCGA 1992 that the starting point is the 'consideration'. Consideration is not further defined and therefore it must take its natural meaning, which is the value given by a person in exchange for the receipt of something. HMRC submitted that the question was what had the buyer given up. We would concur with that approach.

38. It does not seem to us to have been in dispute that the value given by the purchaser was £1,300,000.

39. We find nothing in the legislation that would mean the consideration should be reduced by the amount of the mortgage redemption payment.

40. It simply cannot be the case that a taxpayer can reduce their potential capital gains tax liability on sale by mortgaging the property, and effectively withdrawing cash from it (save for the circumstances where those mortgage monies are then used wholly and exclusively for the purposes of enhancing the value of the property and that enhancement is reflected in the asset at the time of disposal, in which case it is not really the mortgage that reduces the capital gain, but the expenditure).

41. Although the circumstances of this particular mortgage are relatively unusual, having been taken out for the benefit (at least partly) of the bare trustee of the property to cover his care costs, those unusual circumstances do not alter the fact that mortgage debts are the debts of the property owners (which at the time of disposal were Mr Unger (as to a 50% share in the property) and his other family members (who were beneficially entitled to the other 50% share in the property) and the need to repay those debts is not related to the amount of consideration given by the purchaser. By analogy if the proceeds of sale had been insufficient to cover the mortgage costs, Mr Unger and his family members would have been responsible for paying the excess. While that may result in a tax charge on the property in circumstances where the disposal does not give rise to any residual funds for the sellers (what some might call a dry tax charge), that would be in line with the purpose of the legislation, which is to tax gains in the value of assets held. The asset held is the property and where there is a gain in the value of the property during the period of ownership, that gain is chargeable to capital gains tax (subject to any exemptions and allowances). The bare trustee, Mr Unger's father, retained no further beneficial interest in the property after entering into the Deed of Variation in 2007. The mortgage advance would seemingly therefore belong to the beneficiaries in equal shares. Whether they then chose to save or invest those mortgage monies, or spend those mortgage monies upon Mr Unger's father's care costs, or indeed anything else, was purely a matter for them.

42. Therefore, we find that the costs of the mortgage redemption and rolled up interest are not to be deducted from the disposal proceeds or as allowable costs.

43. On the question of the availability of capital losses, it is for a taxpayer to claim available losses and therefore the burden is on Mr Unger to provide evidence of the losses available to set off against his gain. We find that Mr Unger has not met that burden as no evidence has been provided.

THE PENALTY FOR CARELESS INACCURACY

44. Under Finance Act 2007, Sch 24, para 1, a penalty is payable by a person where that person has given a document to HMRC that contains an inaccuracy:

(1) That leads to (among other things) an understatement of liability to tax; and

(2) That is careless (or deliberate) on the part of the taxpayer.

45. We are concerned only with the question of careless (and not deliberate) inaccuracies in this case. Careless is defined in FA 2007, Sch 24, para 3 as where the inaccuracy arises as a result of a failure to take reasonable care.

46. The standard amount of the penalty is defined in FA 2007, Sch 24, para 4 as 30% of the potential lost revenue, where the penalty relates to a careless inaccuracy on a domestic matter (i.e. not involving offshore assets).

47. The potential lost revenue is defined in FA 2007, Sch 24, para 5 as the additional amount due or payable in respect of tax as a result of correcting the inaccuracy (subject to some additional rules which are not relevant in this case).

48. However, the standard amount of the penalty can be reduced as a result of the disclosure of the inaccuracy to HMRC (para 10), with the amount of the reduction dependent on the quality of the disclosure. The minimum amount of the penalty where the disclosure has been prompted is 15%.

49. Under FA 2007, Sch 24, para 9(1) a taxpayer discloses a matter by:

(1) Telling HMRC about it;

(2) Giving HMRC reasonable help in quantifying the inaccuracy, and

(3) Allowing HMRC access to records for the purpose of ensuring that the inaccuracy is fully corrected.

50. Under FA 2007, Sch 24, para 9(2), a disclosure is unprompted if it is made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy. All other disclosures are prompted.

51. Under FA 2007, Sch 24, para 9(3) the quality of disclosure includes its timing, nature and extent.

52. Under FA 2007, Sch 24, para 13, HMRC must assess the penalty, notify the person and state in the notice the tax period in respect of which the penalty is assessed. The time limit for making such assessment is within 12 months of the end of the appeal period for the decision correcting the inaccuracy.

HMRC's arguments on the penalty

53. HMRC submits that Mr Unger's 2013/14 tax return did not contain any details of the disposal of Portsea Place and that this was an inaccuracy that led to an understatement of his liability to capital gains tax.

54. HMRC further submits that this error was careless on the basis that although Mr Unger was not a professional with tax experience, he had made capital gains and losses in prior years and included them on his tax returns (with or without the help of agents) and therefore should have sought out proper advice at the time of the disposal of Portsea Place to ensure that the correct position was included in his return, particularly given the advice at the time of the variation of his father's will, which should have prompted him to follow up to check the capital gains position on the property.

55. HMRC did not accept Mr Unger's argument that he had been given advice, orally, at the time of disposal that he did not need to include the gain on his tax return.

56. HMRC submit that Mr Unger did make disclosures to HMRC, but only after the enquiry had commenced and therefore they were all prompted disclosures.

57. HMRC has allowed the following reductions for the disclosure:

(1) Telling: HMRC allowed a 10% reduction (out of a maximum of 30%) on the basis that although Mr Unger did provide the majority of the information, there were a series of extensions to deadlines required and an information notice was issued to require a response, such that the process of obtaining all the necessary information took a long period;

(2) Helping: HMRC allowed a 35% reduction (out of a maximum of 40%) because Mr Unger had been cooperative throughout the enquiry, save for the issue of consistent delays; and

(3) Giving: HMRC allowed a 30% reduction (out of a maximum of 30%) because Mr Unger had supplied all the information that HMRC requested.

58. HMRC therefore allowed a total reduction of 75%.

59. HMRC submit that there are no special circumstances that could apply to reduce the penalty and that it was not an appropriate set of circumstances for suspending the penalty because the inaccuracy arose from a mistake, not a systemic problem.

60. HMRC submit that it complied with the statutory requirements for raising the assessment:

(1) Issuing a notice of penalty assessment on 31 October 2017 which identified the period for which the penalty was assessed (i.e. tax year 2013/14)

(2) Issuing the notice within 12 months of the appeal window for the decision correcting the inaccuracy:

(a) The decision correcting the inaccuracy was issued on 26 July 2017

(b) The penalty assessment was notified on 31 October 2017 which was well within the 12 month period.

Appellant's arguments on the penalty

61. Mr Unger submitted that he did not include the capital gain in his tax return because he was advised, at the time of the disposal, that he did not need to include the capital gain in his tax return and that he therefore did take reasonable care in submitting his return.

62. Mr Unger did not submit any arguments on the technicalities of the assessment for the penalty or the method of reduction, save to say that he did not recall delays in responding to any of HMRC's requests for information and if there were any, he always forewarned HMRC that he was going to be late with responding to the requests.

DISCUSSION ON THE PENALTY

63. It is HMRC's burden to show that it has correctly assessed the penalty, within the appropriate time limits. We find that HMRC has met that burden and that the notice of assessment issued was compliant.

64. Mr Unger would have a defence against the penalty if he could show that he had taken reasonable care in submitting his return without including the disposal in the section on capital gains.

65. There are circumstances on which reliance on an agent can constitute reasonable care. In this instance Mr Unger states that he uses an accountant to submit his tax return every year (including the year in question), but in relation to 2013/14 he did not tell his accountant about the disposal. He therefore cannot claim that the error was made as a result of the actions of the agent who prepared and submitted his return.

66. However, Mr Unger argues instead that he sought advice from the associate at the firm of solicitors who were dealing with the disposal of the property about the tax consequences of the transaction and was advised that no tax was due. Mr Unger submits that he obtained that advice orally over the phone. No evidence was submitted that supported the existence of this telephone call and Mr Unger stated in correspondence with HMRC that he had not been sufficiently diligent in follow up.

67. This advice around the time of disposal contrasts with advice given at the time of the deed of variation that there would be capital gains tax to pay on disposal, even if the details were not then explored.

68. We do not need to find, as a matter of fact, whether Mr Unger had the stated telephone call, since we find that, in the context of the wider circumstances and the level of attention that was given to the tax position at the time of the deed of variation and probate and his own level of knowledge, even if he did have that phone conversation it was not reasonable for Mr Unger to rely on oral advice only and not to follow up for formal written advice from the solicitors to confirm the position or provide details of the disposal of the property to the agent preparing his return. Mr Unger has not shown that he took reasonable care in the preparation of his tax return for 2013/14.

69. Therefore, we find that the penalty has been validly assessed and Mr Unger does not have a defence against it for reasonable care.

70. In considering HMRC's reductions in the penalties, we find that the disclosures by Mr Unger were prompted since they all followed the opening of the enquiry.

71. With regards to the reductions for telling, helping and giving, we set out our reasoning for each matter in turn.

72. On telling, HMRC sought to suggest that they had been forced to issue an information notice in order to elicit information and that there had been long delays; whereas Mr Unger suggested that there were no delays on his part that he did not forewarn HMRC about. We find the position on telling is part way between the two parties' positions. It was clear from the correspondence that the use of the information notice was not one where the taxpayer had been unresponsive, but rather it was used to formalise the process and to give Mr Unger a firm deadline. Mr Unger had, persistently, requested extensions of deadlines in order to comply with the requests and HMRC regularly had to follow up the initial response with a further request to capture the information that had been left out as well as further information arising as a result of the initial response. HMRC had applied a 10% reduction (out of a maximum of 30%), we conclude that this should have been 15%.

73. On helping, we agree that the tenor of the correspondence was one of generally trying to help, but the persistent deadline extension frustrated this somewhat and therefore agree that 35% is appropriate.

74. On giving, HMRC have given the maximum reduction, which is certainly fair and therefore we uphold it.

75. As a result, the reduction in the penalty should be 80%, rather than 75%.

76. On suspension and special reduction, we find that there are no circumstances in this case that would lead to suspension or special reduction being appropriate.

DECISION

77. For the reasons set out above, we:

(1) Dismiss the taxpayer's appeal on the calculation of the capital gain, finding that the mortgage redemption costs and rolled up interest could not be taken into account in calculating the capital gain;

(2) Affirm the decision of HMRC that a penalty for careless inaccuracy is payable; but

(3) Substitute our own decision for that of HMRC on the amount of the penalty, so that the penalty is reduced by 80%, not 75%.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

78. 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.

ABIGAIL MCGREGOR
TRIBUNAL JUDGE

RELEASE DATE: 22 JANUARY 2020