[2016] UKFTT 78 (TC)

TC04871

Appeal number: TC/2013/04291, TC/2013/04292 TC/2013/04293, TC/2014/01880 TC/2014/01885, TC/2014/01886

CAPITAL GAINS TAX – whether expenditure deductible in computing chargeable gain – whether entrepreneurs' relief available – whether HMRC could issue a discovery assessment – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

R T PATEL **Appellant**
D T PATEL
P R PATEL

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS
AMANDA DARLEY

Sitting in public at The Royal Courts of Justice, Strand, London on 14 January 2016

Nitin Amin of Amin, Patel & Shah, accountants, for the Appellant

Marie McGregor, Officer of HM Revenue & Customs, for the Respondents

© CROWN COPYRIGHT 2016

DECISION

1. This decision deals with six associated appeals which arise out of the same series of transactions. The appellants are Mr R T Patel ("Mr Patel"), his wife Mrs P R Patel ("Mrs Patel") and his mother, Mrs D T Patel ("Mrs Patel Senior"). The appeals relate to the capital gains tax ("CGT") that is due on disposals of seven flats in North London that took place in the 2008-09 and 2009-10 tax years.

2. There are three points at issue in this appeal:

(1) Whether the appellants can deduct the aggregate sum of £395,000 paid to Regent Lodge Hotel Ltd (the "Company"), a company which the appellants control, in circumstances set out more fully below, in calculating the chargeable gain on these disposals for CGT purposes.

(2) Whether the appellants are entitled to entrepreneurs' relief under the provisions of Chapter 3 of Part V of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992") so as to reduce the amount of CGT payable.

(3) Whether HMRC were entitled to raise discovery assessments for the 2008-09 tax year.

Evidence and procedural matters

3. The Tribunal's case management directions for this appeal required that both parties served witness statements by 18 May 2015. No witness evidence was served on behalf of the appellants whether by this deadline or at all. However, at the hearing, Mr Nitin Amin (who we will refer to by his full name throughout to distinguish him from Mr Dilip Amin, a witness who gave evidence) applied for permission for Mr Patel to give witness evidence on issues such as the history of the appellants' business and their dealings with the Company. He also requested permission for Mr Dilip Amin, the appellants' accountant who has advised them for many years, to give evidence on issues such as the way the appellants' tax returns had been prepared, the Company's previous tax compliance and the way that the payment of £395,000 to the Company had been treated for accounting purposes.

4. Officer McGregor initially opposed this application making the point that, if the appellants had wished to rely on witness evidence, they should have served witness statements by the due date and that HMRC ran the risk of being prejudiced by being asked to deal with evidence being presented for the first time at the hearing itself.

5. We considered that Mr Patel's evidence would be highly relevant since one of the central issues in this appeal is the precise nature of the payment of £395,000 to the Company. We considered also that Mr Dilip Amin's evidence had the potential to be relevant as it could shed light on the nature of the £395,000 payment and also the question of whether the conditions for making discovery assessments for 2008-09 were satisfied.

6. We regarded it as regrettable that the appellants had not complied with the direction regarding witness statements. However, we considered that the overriding objective set out in Rule 2 of the Tribunal Rules is to deal with cases fairly and justly. Therefore, rather than simply denying the appellants the opportunity to adduce any witness evidence because they had failed to comply with the directions, we decided that we would first hear the evidence of Mr Patel and Mr Dilip Amin. Having heard that evidence, we would then invite Officer McGregor to make submissions as to whether it should be excluded altogether, or whether some alternative course of action should be taken, such as adjourning the hearing for a short period to permit her to prepare cross-examination or adjourning the entire hearing to a different date if that evidence raised new issues.

7. In the event Mr Patel's oral evidence did not contain any great surprises for Officer McGregor, she made no application to exclude that evidence and she was able to proceed with cross-examination straight away. Similarly, Officer McGregor made no application to exclude Mr Dilip Amin's oral evidence, although we adjourned the hearing for a period to enable her to prepare her cross-examination.

8. We therefore had oral evidence from Mr Dilip Amin and Mr Patel. As set out in more detail below, that evidence was, in places, contradictory. While we have accepted most of Mr Patel's evidence, we have not been able to accept much of Mr Dilip Amin's evidence.

Background and facts not in dispute

Background to the disposals

9. In 1977, Mrs Patel Senior and her husband ("Mr Patel Senior") began trading in partnership (the "Partnership") as hoteliers. Their son, Mr Patel, became a partner on 6 April 1993 and Mrs Patel became a partner on 1 July 1994.

10. On 17 June 1996, the Partnership acquired the Regent Lodge Hotel which was located on a site in North London (the "Property"). The Partnership carried on a trade which involved providing bed and breakfast accommodation in the Regent Lodge Hotel to benefit claimants until 31 December 2002.

11. On 31 October 2002, the Company was incorporated. Each of the four family members was allocated one quarter of the issued share capital. The Company commenced trading on 1 January 2003, by acquiring the Partnership's business. However, the Property was not transferred to the Company and remained in the ownership of the family members. Therefore, from 1 January 2003, the Partnership ceased to carry on a business involving the Regent Lodge Hotel or the Property. Instead, the Company carried on that business and used the Property (owned by the four family members) in order to do so.

12. The accounts of the Company for the year ended 31 December 2003 (the accounting period in which it made the acquisition referred to at [11]) show a figure

of £395,000 as being the value of the goodwill that the Company acquired when it purchased the business of the Partnership.

13. From 2003, the Company continued to carry on a business at the Property that included the provision of bed and breakfast facilities to benefit claimants although, as noted in more detail below, that business experienced difficulties owing to changes in Government policy on the housing of benefit claimants in bed and breakfast accommodation. No written agreement was entered into that set out the terms on which the Company was able to use the Property.

14. Mr Patel Senior passed away in 2004. (Throughout this decision, we will use the expression "the family" to refer to the appellants and Mr Patel Senior until his death in 2004). His shares in the Company, and his interest in the Property, passed to the other three family members in equal shares.

15. Between 2006 and 2008 the Regent Lodge Hotel was demolished and a block of seven flats was built on the Property. The Company paid the costs of this redevelopment and it received 50% of the disposal proceeds when the Property and flats were ultimately sold. However, no written agreement setting out detailed terms of the redevelopment arrangements exists.

16. These flats were then sold on various dates between July 2008 and January 2010. At or around the times of these disposals, the Company and the appellants entered into an arrangement which resulted in the appellants agreeing to pay £395,000 to the Company. The precise nature of this arrangement was in dispute, but part of the appeal relates to the question of whether this £395,000 should be deducted when computing the chargeable gain accruing to the appellants on disposal of the Property (and the flats).

HMRC's enquiries into the 2009-10 tax year

17. The appellants submitted their tax returns for the 2009-10 tax year on 20 July 2010. In those tax returns, the appellants each claimed that their respective share of the £395,000 paid to the Company (as referred to at [16]), was deductible in computing their chargeable gains. They also claimed that entrepreneurs' relief was available. On 25 May 2011, HMRC validly opened an enquiry into the CGT aspects of those returns.

18. On 8 January 2014, HMRC issued each appellant with a closure notice which adjusted computation of CGT due for the 2009-10 tax year by not allowing any deduction by reference to the £395,000 paid to the Company and by denying each appellant entrepreneurs' relief.

Discovery assessments for the 2008-09 tax year

19. The appellants submitted their tax returns for 2008-09 on various dates in October 2009, well within the applicable time limits. In those tax returns, the appellants claimed a deduction for their respective shares of the £395,000 paid to the

Company and also claimed entrepreneurs' relief. Pursuant to s9A of the Taxes Management Act 1970 ("TMA 1970"), HMRC had until October 2010 to open an enquiry into the appellants' tax return for this tax year and no such enquiry was opened.

5 20. On 21 March 2013, HMRC issued the appellants with discovery assessments under s29 of TMA 1970. The effect of those discovery assessments was only to deny the appellants any deduction for their respective shares of the £395,000 paid to the Company. Unlike the closure notices issued for the 2009-10 tax year, these assessments did not seek to deny the appellants' claims for entrepreneurs' relief.

10 Points at issue

21. It was agreed that 50% of the consideration received on disposal of the Property and the flats should be allocated to the Company and should not form part of the computation of the appellants' chargeable gain. Therefore, it was agreed that, in principle, the appellants' CGT calculation should be performed as follows:

15 (1) Since the three appellants owned the Property in equal shares, each appellant should be treated as receiving one third of the 50% disposal proceeds that were not allocated to the Company. Therefore, each appellant should be treated as receiving one sixth of the disposal proceeds for CGT purposes.

(2) Each appellant should be treated as incurring one third of the aggregate 20 expenditure on the Property that the appellants between them incurred[1]. We did not have any details of the costs of redevelopment of the Property. However, since the parties were agreed that these were paid by the Company, we assume that the costs of redevelopment of the Property have been taken into account in the Company's CGT calculation.

25 (3) The difference between the amount of consideration allocated to each appellant under (1) and the amount of expenditure allocated to each appellant under (2) produces the amount of gain which is, subject to reliefs and exemptions, in principle subject to CGT.

22. However, the parties are not agreed on the figures that should enter these 30 calculations. The appellants argue that, at or around the time they disposed of the Property and the flats, they between them paid the sum of £395,000 to the Company and that, since this sum was paid for the purposes of enhancing the value of the Property prior to its sale, it should be deducted in the computation of the gain under s38(1)(b) TCGA 1992. However, HMRC do not consider that this expenditure 35 satisfies the requirements of s38(1)(b) TCGA 1992 and therefore should not be taken into account in computing any appellant's chargeable gain.

---

[1] The three appellants inherited Mr Patel Senior's interest in the Property when he passed away. Applying CGT principles, they are treated as having acquired that interest for its market value at the time of his death. There are separate discussions taking place between the appellants and HMRC as to the amount of that market value.

23. In addition, as noted, the appellants consider that entrepreneurs' relief is available, whereas HMRC disagree. While HMRC have sought to deny the appellants entrepreneurs' relief in the closure notices that they issued for the 2009-10 tax year, they have not denied entrepreneurs' relief in the discovery assessments that they made for 2008-09 and are, accordingly, requesting the Tribunal to increase those discovery assessments so as to deny the appellants entrepreneurs' relief on the disposals made in 2008-09.

24. The appellants dispute HMRC's ability to issue "discovery assessments" in relation to the 2008-09 tax year.

25. Officer McGregor submitted that HMRC had the onus of establishing that the conditions necessary to make a discovery assessment were satisfied and of establishing that the assessments for the tax year 2008-09 should be increased. However, she submitted that the appellants otherwise had the burden of establishing that the aggregate figure of £395,000 should be deducted in computing their chargeable gains and that they were entitled to entrepreneurs' relief in relation to the disposals taking place in 2009-10. Mr Nitin Amin did not disagree with those submissions and we have accepted them.

Findings of fact on matters that were not agreed

26. We have made the findings of fact set out at [27] to [54] in relation to matters that were not agreed.

The Company's acquisition of the business in 2003

27. Mr Dilip Amin gave evidence that the Company acquired the business of the Partnership for a consideration that was left outstanding as a debt due from the Company. Therefore, his evidence was that when the Company acquired the business, as an accounting matter it recorded a £395,000 debit in its accounts (which resulted in the purchased goodwill appearing on its balance sheet as an asset) and credited the directors' loan account[2] with £395,000 (reflecting the Company's liability to pay £395,000 consideration for the purchase of that goodwill). Therefore, he stated that the consideration for the acquisition of the business was not an issue of shares in the Company, but rather took the form of the Company agreeing to pay £395,000 to the family. That evidence was not challenged in cross-examination and we have accepted it.

28. We conclude that no professional advice was taken as to the market value of the business being purchased, but that what the family regarded as a "standard multiplier" was applied to the Partnership's annual profits in order to estimate its value. In those circumstances, we are not satisfied, on a balance of probabilities, that the market value of the goodwill that the Company acquired from the family in 2003 was £395,000.

---

[2] We assume the directors' loan account was credited because the directors of the Company were the same as the former partners in the Partnership to whom the Company owed the consideration.

The arrangement between the Company and the appellants in 2003

29. Mr Patel's evidence was that he could not remember many specifics of the arrangement under which the Company used the Property owned by the family from 2003 onwards. However, he said that the Company did not pay any rent to the family for use of the Property. The Tribunal asked Mr Patel about how profit that the Company generated from its business was distributed to the family. Mr Patel's evidence was that the Company did not make that much profit from 2003 onwards and did not pay dividends but that members of the family received nominal salaries from the Company, although he could not say whether all family members received a salary or how much precisely any salary was.

30. Mr Dilip Amin's evidence contradicted Mr Patel's to some extent. He said that there <u>was</u> an arrangement between the Company and the family for the Company to be charged rent for its use of the Property, even though that rent was not actually collected. He was not able to say, however, what rights of occupation he understood the Company to obtain in return for paying rent (for example, the right to occupy for a fixed period or the right only to use the Property for so long as the family permitted).

31. We were, therefore, faced with contradictory evidence on the nature of the arrangement between the Company and the family for the use of the Property. No written contract has been produced that documents the terms of this arrangement. Moreover, the evidence that we had consisted purely of Mr Patel's and Mr Dilip Amin's recollections given orally during the hearing. Aside from the accounts of the Company we were not referred to any contemporaneous documentation that might have shed any light on the nature of the arrangement.

32. We have not accepted Mr Dilip Amin's evidence that the Company and the family entered into an arrangement in 2003 that the Company would be charged rent for use of the Property. The principal reason for this is that Mr Dilip Amin's evidence was inconsistent with that of Mr Patel and, if Mr Patel did have an entitlement to rent, we would expect him (as the person having that entitlement) to be aware of it and to be aware of any arrangement under which he, and other family members, would defer their entitlement to receive rent. In addition, on a review of the accounts of the Company for the year ended 31 December 2003, there was no accrual for rent in the Company's profit and loss account whereas such an entry might be expected if rent was payable, even if the actual due date for payment of that rent was suspended. Finally, as noted at [46], in 2008, when the appellants agreed to pay the Company £395,000 there was no "truing up" of accumulated rent owed to the appellants whereas, if the Company did have an obligation to pay rent, we would have expected that to be taken into account in calculating the amount due from the appellants to the Company.

33. We have concluded that some arrangement was entered into in 2003 under which the Company was able to use the Property. The existence of such an arrangement can be inferred from the fact that the Company did not own the Property but needed to use it in its business. However, we do not consider that arrangement was complicated or sophisticated and we do not consider that it amounted to the creation of a lease that encumbered the Property. Nor do we consider that the

transaction in 2003 involved the Company acquiring both the business and a contractual right to occupy the Property rent-free in return for an aggregate consideration of £395,000. That is because, if the Company were being granted a contractual right to use the Property without paying rent, we would have expected the value of that rent-free period to be taken into account in computing the consideration that the Company paid. However, Mr Patel's evidence was that the £395,000 figure was derived by applying a "standard multiplier" to the Partnership's profits and he did not mention any value being attributed to the right to occupy the Property rent-free. We ourselves did not see how a "standard multiplier" of income could be used to calculate the value of rent-free occupation of the Property.

34. Therefore, we consider that the nature of the arrangement between the Company and the family in 2003 was that the Company could use the Property in its business, without payment, for as long as the family allowed. That may not even have amounted to a legally binding contract between the family and the Company (since it was not clear that the Company was giving any consideration for the promise to allow it to use the Property). A loose, informal arrangement such as this is consistent with the fact that it was not documented in writing.

35. Mr Patel also said that there was an arrangement between the family and the Company under which the family would compensate the Company should they wish to redevelop the Property and therefore prevent the Company using the Property in its business. That statement was not challenged in cross-examination and we have accepted it. We are satisfied that this arrangement did amount to a legally binding contract since it was one of the terms on which the Company agreed to purchase the business from the Partnership and, as such, was supported by consideration. An arrangement such as this is also consistent with the Company having a loose and informal arrangement to use the Property since, if the Company had robust and legally binding rights to use the Property, it might be better able to control any decision to redevelop the Property and, accordingly, less need of compensation should the Property be developed. However, while we are prepared to accept the existence of a legally binding obligation on the family to pay the Company compensation in certain circumstances, we do not consider that this obligation was particularly detailed, not least since the parties did not consider it necessary to set it out in writing. Therefore, we consider that the family agreed to pay the Company a reasonable amount in compensation should they decide to redevelop the Property and so prevent the Company from carrying on its business.

The Company's operation of the business after acquisition and the decision to redevelop the Property

36. While the Partnership carried on the business (until 2003), we accepted Mr Patel's evidence that it had a substantial turnover. However, right from the moment the Company acquired the business from the Partnership, the Company experienced difficulties with it. That was because, from 2003 onwards, changes in Government policy meant that benefit claimants were no longer housed in bed and breakfast accommodation (of the kind that the Company offered at the Regent Lodge Hotel) to the same degree. Therefore, we accepted Mr Patel's evidence that between 2003 and

2006, the business of the Company was only "ticking over" and the family started to consider whether the Regent Lodge Hotel should be redeveloped into serviced accommodation that could be made available to benefit claimants and not affected by the above changes in Government policy.

37. There was no dispute that, between 2006 and 2008, the Regent Lodge Hotel was demolished and self-contained flats built on the Property. However, the parties were not agreed as to when the demolition took place or whether, and if so, when, the demolition of the Regent Lodge Hotel resulted in a cessation of the Company's trade as a hotelier. The appellants seemed to consider that these questions are relevant to the issue of whether entrepreneurs' relief was available on disposal of the flats. For reasons we will explain later, we do not think that these questions are relevant to that issue. However, since the points were disputed, we will make findings on them.

38. We were shown a "Design and Access Statement" apparently prepared in April 2007 in connection with planning law aspects of the redevelopment. That statement recorded that planning permission was granted for seven flats on the site in December 2005 and that work commenced on the foundations and substructure in August 2006. Since we would regard it as difficult to work on the foundations and substructure of a new building if the old building is still standing, we have inferred that the structure of the Regent Lodge Hotel was demolished prior to August 2006.

39. Mr Patel said in his evidence that, while the seven flats were being built, the Company and the appellants were still considering the possibility of using those seven flats in a business of providing self-contained serviced accommodation for benefit claimants rather than selling them. Officer McGregor suggested to Mr Patel in cross-examination that, from the moment the Regent Lodge Hotel was demolished, the Company's business changed, and it was carrying on a property development business rather than a hotel trade, or a trade of providing serviced accommodation. In her closing submissions, she referred us to contemporaneous planning documentation which made no reference to the flats being used as serviced accommodation.

40. We have accepted Mr Patel's evidence that the Company was considering making the seven flats available to local councils as serviced accommodation for benefit claimants. We agreed with Mr Nitin Amin, that this was not inconsistent with the planning documentation to which we were referred. That documentation simply referred to the development as a residential development. Without having any evidence before us as to terms used in planning documents, we considered that serviced accommodation could fairly be described as "residential". We are, therefore, prepared to accept that demolition of the Regent Lodge Hotel did not result in an immediate cessation of the Company's trade, but rather resulted in the Company suspending its commercial operations for a period while the Property was redeveloped and the Company (and the appellants) evaluated their options. Mr Patel was clear in his evidence, however, and we have accepted that neither the Company nor the appellants at any point actually provided serviced accommodation to benefit claimants as they ultimately decided that this business would not be economically viable given the likely returns they could make from it.

The nature of the arrangement under which the appellants "repaid" £395,000 to the Company in 2008

41. In a letter to HMRC of 19 October 2011, Amin, Patel & Shah, the appellants' accountants enclosed a calculation setting out their view that a "credit given to the [Company] on the repurchase of goodwill" totalling £395,000 in aggregate should be deducted in computing the appellants' chargeable gain on disposal of the seven flats. We had differing evidence as to the precise nature of this "repurchase of goodwill".

42. Mr Patel's evidence was somewhat contradictory. At points in his evidence he said that the appellants had paid the Company £395,000 to compensate the Company for the loss it suffered as a result of the sale of the flats preventing the Company from carrying on its trade of providing accommodation to benefit claimants. However, he also said that the payment might have been made in return for the Company agreeing to vacate the Property so that the appellants could sell the flats.

43. Mr Dilip Amin said that the £395,000 was paid to the Company in 2008 in return for the Company agreeing to give up its right to occupy the Property, thereby enabling the appellants to sell the Property (and the flats on them).

44. Since we have concluded, at [34], that the Company did not have any rights to occupy the Property beyond the informal arrangement summarised in that paragraph, we have not accepted Mr Dilip Amin's characterisation of the payment. Since the appellants could terminate the informal arrangement at any time, they did not need to pay the Company £395,000 in order to induce it to vacate the Property.

45. Nor do we consider that the £395,000 was paid as consideration for the appellants re-acquiring the business that they had transferred to the Company in 2003. That is because, as noted at [36], after 2003, the Company's business was just "ticking over" whereas, prior to its transfer to the Company in 2003, it had "substantial turnover". Moreover, in August 2006, the Regent Lodge Hotel had ceased to exist so, until the construction of the flats was complete, the Company was not in a position to carry on any business at the Property at all. By 2008, the appellants had concluded that making the flats available as serviced accommodation to benefit claimants was not a viable business proposition. Therefore, we consider that the value of the Company's business in 2008 was materially lower than the value of the Partnership's business in 2003. Since the Company's business cannot have been worth £395,000 in 2008, we do not consider that the appellants paid £395,000 in order to acquire the Company's business in 2008.

46. We have concluded that the £395,000 was "paid" by means of book entries that were made in stages as the flats were sold and the appellants received consideration for those sales. The payment of £395,000 was intended as compensation to the Company for the fact that it would no longer be able to carry on a business at the Property pursuant to the arrangement outlined at [35]. We have concluded, as Mr Patel accepted in cross-examination that, rather than performing a rigorous analysis of the amount of compensation that should be paid to the Company (that took into account the deterioration in the fortunes of the Company's business since 2003), the parties fixed on the figure £395,000 simply because it was the same sum that had been

paid at the time of the 2003 transaction and had appeared in the Company's accounts in 2003. Since no witness mentioned rent due from the Company, which had accumulated but not been paid, being taken into account in computing the figure of £395,000, we have concluded that no accumulated rent was so taken into account.

47. We were not shown evidence that suggested that paying the £395,000 to the Company enabled the appellants to achieve a higher price on the sale of the flats or the Property than they would have received if no such payment had been made. We have concluded, therefore, that paying £395,000 to the Company did not have this effect.

Information and documents provided to HMRC relevant to the discovery assessment issue

48. There appeared to be some dispute between the parties as to what information had been included with the appellants' 2008-09 tax returns. We were shown a letter dated 3 February 2012 from Amin, Patel & Shah, that included the following paragraph:

> **2008/9**
>
> Capital Gains computation was enclosed with on line tax return. A copy print out of particular page 11 of 13 is enclosed which confirms "Summary of your enclosed computations"

49. Attached to that letter were pages 11 to 13 of one of the appellants' tax returns for 2008-09 (it was not clear which). Those pages recorded the making of a capital gain, showed the disposal proceeds received and the allowable costs and included an amount of entrepreneurs' relief (which operated to reduce the amount of chargeable gain). We accepted, therefore, that this tax return would have made it clear to an HMRC officer that entrepreneurs' relief was being claimed. However, we did not accept Mr Nitin Amin's submission that these pages would have made it clear that a deduction was being claimed for a share of the £395,000 payment referred to above, although they did make it clear that some deduction for allowable expenditure was being claimed. The pages 11 to 13 attached to the letter did not mention the £395,000 payment specifically, and still less did they set out what the nature of that payment was. Nor did they mention the arrangement between the Company and the appellants under which the appellants owned the Property and the Company used it in its business.

50. It was not clear to us whether the letter from Amin, Patel & Shah was suggesting that there was some other attachment to the particular tax return referred, or whether the capital gains computation referred to was that set out on the enclosed pages 11 to 13. The phrase "summary of your enclosed computations" which Amin, Patel & Shah quoted in their letter, appears on page 11 of enclosed tax return pages which suggests that the reference may have been to those pages rather than a different document. In a letter dated 10 February 2012, HMRC denied that any separate CGT computation had been attached to the tax return. Since the appellants did not put

forward any evidence of a separate attachment to a 2008-09 tax return submitted by any of the appellants, we have concluded that there was none.

51. Mr Nitin Amin submitted that, on 13 October 2009, accounts of the Company were filed both at Companies House and with HMRC. A form of those accounts was included in the hearing bundle. They were abbreviated accounts which were signed on 6 October 2009 and, while we strictly had no evidence for the proposition that they were submitted to Companies House or HMRC on any particular date, we were prepared to accept Mr Nitin Amin's submission that these accounts were submitted both to HMRC and to Companies House on 13 October 2009. However, despite showing a disposal of fixed assets of £395,000, these accounts made no specific reference to any transaction involving the appellants paying £395,000 to the Company (or any mention at all of a related party transaction) nor any reference to facts relevant to the appellants' claims for entrepreneurs' relief.

52. Other than those matters referred to at [49] to [51] above, we were not satisfied that the appellants provided any information on their CGT liability for 2008-09 to HMRC prior to October 2010 when, as noted at [19], HMRC ceased to be entitled to enquire into the appellants' 2008-09 tax returns.

53. On 25 May 2011, as noted at [17], HMRC opened an enquiry into CGT aspects of the appellants' tax returns for the 2009-10 tax year. By 19 October 2011 HMRC had seen a CGT computation for the 2009-10 tax year that made it clear that a deduction was being claimed by reference to the £395,000 figure in calculating the chargeable gain arising in that tax year.

54. On 28 October 2011, HMRC wrote to the appellants stating that they considered the allowable costs included in the CGT calculation were excessive and that HMRC would start the process of checking the amount of tax that should have been paid. That process continued for a period and on 21 March 2013, HMRC issued the discovery assessments referred to at [20] stating that they needed to act to "protect HMRC position before deadline of 5 April 2013".

Legislation

Section 29 of TMA 1970

55. Section 29 of TMA 1970 provides, so far as material, as follows:

> **29 Assessment where loss of tax discovered**
>
> (1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment--
>
> (a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
>
> (b) that an assessment to tax is or has become insufficient, or
>
> (c) that any relief which has been given is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

…

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above--

> (a) in respect of the year of assessment mentioned in that subsection; and
>
> (b) in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

…

(5) The second condition is that at the time when an officer of the Board--

> (a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or
>
> (b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if--

> (a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;
>
> (b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;
>
> (c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer; or
>
> (d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above--
>
> (i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or
>
> (ii) are notified in writing by the taxpayer to an officer of the Board.

56. From the above, it can be seen that, by virtue of s29(1) of TMA 1970, in order to be able to make a discovery assessment, an HMRC officer must first "discover" particular facts.

57. Since the appellants have delivered tax returns for the tax years in question, s29(3) TMA 1970 requires that one of two further conditions must be satisfied before a discovery assessment can be made. In the circumstances of this appeal, HMRC rely on the second condition, set out in s29(5) of TMA 1970.

Section 38 of TCGA 1992

58. Section 38 of TCGA 1992 provides, so far as material as follows:

> **38 Acquisition and disposal costs etc**
>
> (1) 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--
>
> (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the asset,
>
> (b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset,
>
> (c) the incidental costs to him of making the disposal.
>
> (2) For the purposes of this section and for the purposes of all other provisions of this Act, the incidental costs to the person making the disposal of the acquisition of the asset or of its disposal shall consist of expenditure wholly and exclusively incurred by him for the purposes of the acquisition or, as the case may be, the disposal, being fees, commission 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--
>
> (a) in the case of the acquisition of an asset, with costs of advertising to find a seller, and
>
> (b) in the case of a disposal, with costs of advertising to find a buyer and costs reasonably incurred in making any valuation or apportionment required for the purposes of the computation of the gain, including in particular expenses reasonably incurred in ascertaining market value where required by this Act.

Provisions relevant to entrepreneurs' relief

59. Entrepreneurs' relief is capable of applying to disposals effected on or after 6 April 2008 and this is potentially relevant to the sale of the flats which took place in tax years 2008-09 and subsequently.

5 60. Section 169H of TCGA 1992 provides for entrepreneurs' relief to be available on, inter alia, "a material disposal of business assets".

61. Section 169I of TCGA 1992 explains that concept and related definitions as follows:

> **169I Material disposal of business assets**
>
> 10 (1) There is a material disposal of business assets where--
>
> (a) an individual makes a disposal of business assets (see subsection (2)), and
>
> (b) the disposal of business assets is a material disposal (see subsections (3) to (7)).
>
> 15 (2) For the purposes of this Chapter a disposal of business assets is--
>
> (a) a disposal of the whole or part of a business,
>
> (b) a disposal of (or of interests in) one or more assets in use, at the time at which a business ceases to be carried on, for the purposes of the business…
>
> 20 (3) A disposal within paragraph (a) of subsection (2) is a material disposal if the business is owned by the individual throughout the period of 1 year ending with the date of the disposal.
>
> (4) A disposal within paragraph (b) of that subsection is a material disposal if--
>
> 25 (a) the business is owned by the individual throughout the period of 1 year ending with the date on which the business ceases to be carried on, and
>
> (b) that date is within the period of 3 years ending with the date of the disposal.

30 62. Section 169I(2)(c) of TCGA 1992 (which extends entrepreneurs' relief to situations involving the disposal of shares in, or securities of, a company) is not quoted above since the disposal on which the appellants claim entrepreneurs' relief was of the Property (and the flats on the Property) and not of any shares in, or securities of, a company.

35 63. For completeness, entrepreneurs' relief is also available in relation to "a disposal associated with a relevant material disposal" (a concept explained in s169K of TCGA 1992). However, in order for this provision to be relevant there must either be a disposal of an interest in assets of a partnership, or of shares in or securities of a company. That is not relevant here since, as noted at [11] while the Property was 40 partnership property until 31 December 2002, subsequent to that date the Property

ceased to be used for the purposes of a business carried on in partnership and was used for the purposes of a business carried on by the Company.

64. In order to be capable of qualifying for entrepreneurs' relief under s169I of TCGA 1992, therefore, the appellants must be making a disposal of "business assets". In addition, the disposal must be a "material disposal" which is defined in s169I(3) and s169I(4). Both of those sections require that the "business" referred to must be owned by the individual making the disposal during some specified period. We will deal with this point in more detail later in this decision but, at this point, simply note that the business relevant to this appeal was conducted by the Company, although the appellants owned an asset that was in use for the purposes of that business, namely the Property.

65. Finally, there is a specific definition of the term "business". That is defined in s169S(1) of TCGA 1992 in the following terms:

> **169S Interpretation of Chapter**
>
> (1) For the purposes of this Chapter "a business" means anything which--
>
> (a) is a trade, profession or vocation, and
>
> (b) is conducted on a commercial basis and with a view to the realisation of profits.

The Tribunal's power to increase assessments on appeal

66. Section 50(7) of TMA 1970 provides as follows:

> If, on an appeal notified to the tribunal, the tribunal decides
>
> (a) that the appellant is undercharged to tax by a self-assessment
>
> (b) that any amounts contained in a partnership statement are insufficient; or
>
> (c) that the appellant is undercharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be increased accordingly

Discussion

Whether the £395,000 paid to the Company should be taken into account as a deduction in the computation of the appellants' gain

67. In order to be deductible in computing the appellants' chargeable gain, the £395,000 paid to the Company must fall within the provisions of s38(1) TCGA 1992 which is outlined at [58].

68. There is no question of s38(1)(a) TCGA 1992 applying. The appellants did not pay the £395,000 in order to acquire the Property as they already owned it. Similarly, s38(1)(c) TCGA 1992 cannot apply as s38(2) TCGA 1992 sets out an exhaustive

definition of the "incidental costs" of making a disposal which does not cover payments such as the £395,000 paid to the Company.

69. Therefore, the relevant question is whether the payment to the Company falls within s38(1)(b) TCGA 1992. Since there is no evidence to support the conclusion that the appellants paid the £395,000 to the Company in order to establish, preserve or defend their title to the Property, all of the following conditions would need to be met before s38(1)(b) could apply:

(1) The £395,000 must be expenditure wholly and exclusively incurred on the asset which the appellants disposed of (being the Property and the flats on the Property);

(2) That expenditure must have been incurred for the purposes of enhancing the value of the assets being disposed of;

(3) That expenditure must be reflected in the state or nature of the assets at the time of disposal.

70. We do not consider that the first condition referred to at [69(1)] is satisfied. Given the findings of fact we have made at [46], we have concluded that the £395,000 was not wholly and exclusively incurred on either the Property or the flats on them. Rather, we consider that the payment was made in discharge of the appellants' obligation to compensate the Company if they chose to redevelop the Property with the result that the Company could no longer use it in its business.

71. Mr Nitin Amin argued in his skeleton argument that the intention of the appellants in making the £395,000 payment was "to enhance the value of their business premises which were used by the company since 1 January 2003". He also argued that the payment achieved an enduring benefit and that, "without the agreement to make that payment, the partners would not have been able to obtain the vacant possession of their business premises for the redevelopment for the purposes of enhancing its value".

72. However, Mr Nitin Amin's submissions are not borne out by the facts. We were not satisfied that the payment was made for the purpose of enhancing the value of the Property or the flats given that we have concluded that the payment was made for the purposes of discharging the appellants' contractual obligation to the Company referred to at [35]. In addition, we were not satisfied that the payment of this sum was capable of having any effect on the value of the Property or the flats. That can be readily seen by considering what would have happened if the appellants had, in breach of their obligation to the Company, not made any payment of compensation. In that case, the Company might well have a claim against them (although for the reasons set out at [45], that claim might be for a sum considerably less than £395,000 since the business of which the Company was being deprived was not worth £395,000). However, no evidence was presented that suggested that this would have any effect on the value of the Property or the flats. In particular, it was not suggested that the Property would be encumbered by any obligation the appellants owed to the Company and, given our conclusion that the appellants did not grant any lease of the

Property to the Company, we do not consider that such an argument could have succeeded even if it had been made.

73. In addition, given the findings we make at [44], we do not agree that it was only by paying the Company £395,000 that the appellants were able to obtain vacant possession of the Property. Rather the appellants could at any time have obtained vacant possession by terminating their informal arrangement with the Company. We do not, therefore, consider that either of the conditions referred to at [69(2)] or [69(3)] is satisfied.

74. In correspondence with HMRC, though not at the hearing itself, the appellants referred to the decision of the High Court in *Chaney v Watkis* 58 TC 707. In that case, a taxpayer owned a property which was occupied by his mother-in-law as a protected tenant The taxpayer agreed to build an extension to his own house in which his mother-in-law could live in return for her agreeing to vacate the property so that he could sell it with vacant possession. The dispute concerned the amount of expenditure that was allowable under what is now s38(1)(b) TCGA 1992 in respect of the costs of building that extension. It was agreed between the taxpayer and the Revenue (see paragraph 711 of the reported decision) that payment of a sum of money to a protected tenant in order to obtain vacant possession, and thereby increase the value of the landlord's interest, could be expenditure falling within what is now s38(1)(b) of TCGA 1992, so the High Court did not actually decide this point. However, we have concluded that the appellants' payment of £395,000 did not enable them to obtain vacant possession (see [44]). We have also concluded (see [47]) that the payment did not increase the value of the Property. Therefore, the payment the appellants made had neither of the features of the kind of payment referred to in *Chaney v Watkis*.

75. For all of those reasons, we do not consider that the conditions referred to at [69] are satisfied. We have therefore concluded that none of the conditions necessary for s38(1)(b) of TCGA 1992 to apply are satisfied and the result is that the £395,000 paid to the Company is not deductible in computing the appellants' chargeable gain.

Entrepreneurs' relief

76. We do not consider that the disposal of the Property falls within s169I(2)(a) of TCGA 1992 referred to at [61] above. When they disposed of interests in the Property, the appellants were not disposing of the "whole or part of a business" since any business that was being conducted was being carried on by the Company and not the appellants. In particular, we have found at [45] that the arrangements between the Company and the appellants in 2008 did not involve the appellants re-acquiring the business so that they could be said to be themselves carrying on the business in 2008.

77. Section 169I(3) TCGA 1992 makes it clear that, in order for a disposal falling within s169I(2)(a) to be a "material disposal", the "business" must be owned by the individual making the disposal throughout the period of one year ending with the date of the disposal. As we have said, we do not consider that the appellants owned the business for such a period. Moreover, even if the appellants had reacquired the business from the Company in 2008 (which they did not), there was no evidence

before us that would enable us to conclude that they owned that business for a complete one year period before making their disposals of interests in the Property.

78. Mr Nitin Amin suggested that it was enough that the appellants had an intention to operate a business and pointed to the evidence to the effect that the appellants and the Company were considering, even as the flats were being built on the Property, using those flats for the provision of serviced accommodation to benefit claimants. However, in order to constitute a "business" as defined in s169S TCGA 1992, the operations in question would need to be "conducted on a commercial basis with a view to the realisation of profits". We were not satisfied that the appellants, at any point after 31 December 2002, "conducted" the relevant business: at most they considered conducting that business before deciding that it would not be economically viable.

79. That, therefore, deals with the question of whether the appellants made a "material disposal" falling within s169I(2)(a) and s169I(3) of TCGA 1992. It is next necessary to consider whether they made a "material disposal" falling within s169I(2)(b) and s169I(4) of TCGA 1992.

80. The conditions of s169I(2)(b) might be satisfied. At some point the business of the Company ceased to be carried on. At the point that business ceased to be carried on, the Property might have been "in use" for the purposes of the Company's business. We say "might" because it seems to us that there is room for doubt on this issue. The Company at no point used the Property to make serviced accommodation available to benefit claimants after the flats were built. Therefore, it is debatable whether the Property was "in use" at any point after 2006, although this might not be a problem if it is concluded that the Company's business ceased in 2006.

81. However, even if the conditions of s169I(2)(b) were satisfied, those set out in s169I(4) must be satisfied as well. For reasons that we have set out above, the "business" was not owned by the appellants throughout the period of 1 year ending with the date on which the business ceased to be carried on. Whether it is concluded that the "business" ceased in 2006 or subsequently, the fact remains that at no point after 31 December 2002 was it owned by the appellants. Therefore, the condition set out in s169I(4)(a) cannot be satisfied.

82. For all of the reasons set out at [76] to [81], there was no "material disposal" falling within s169I(3) or s169I(4) and the conditions necessary for entrepreneurs' relief to be available are not satisfied. HMRC were accordingly correct to refuse the appellants' claim for entrepreneurs' relief in their closure notices relating to the 2009-10 tax year. By virtue of s50(7)(c) of TMA 1970, we have the power, and indeed the duty, to increase the amount of the assessments for 2008-09 if the discovery assessments issued undercharge the appellants to tax and we will do so.

Discovery assessment issue

83. In *Commissioners for Her Majesty's Revenue & Customs v Charlton and others* the Upper Tribunal [2012] UKUT 770 (TCC), the Upper Tribunal considered what

could amount to a "discovery" for the purposes of s29 TMA 1970. Their conclusion, set out at [37] was:

> All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment

5 84. That requirement is clearly met. On or around 28 October 2011, as noted at [54], officers of HMRC, having seen the detail of the appellants' CGT calculations for 2009-10 formed the view that their calculations for 2008-09 were wrong. They made enquiries, discussed the position with the appellants and their accountants and ultimately concluded that the appellants' calculations were wrong. The requisite 10 "discovery" took place.

85. That then leaves the question of whether the requirements of s29(5) of TMA 1970 were met. As *Charlton* makes clear, that question is to be addressed by determining what information falling within s29(6) of TMA 1970 was provided to an officer of HMRC and then considering whether a hypothetical officer, receiving that 15 information and having the level of knowledge and understanding that would reasonably be expected in an officer considering that information, would have been aware that the appellants had paid insufficient tax.

86. Section 29(5) requires us to consider only information that HMRC received up until October 2010, when HMRC ceased to be able to open an enquiry into the 20 appellants' tax returns for the 2008-09 tax year. Mr Nitin Amin submitted that, if HMRC had asked for a CGT computation for 2008-09 earlier, such a computation would have been provided. But that is not the statutory test: s29(6) directs attention only at particular categories of information, not all information that HMRC could reasonably be expected to obtain if they made enquiries. Therefore, only the 25 information referred to at [49] to [51] is potentially relevant to the question posed by s29(5).

87. We are not satisfied that the accounts of the Company fall within s29(6) TMA 1970. There was no evidence before us to suggest that those accounts were enclosed with the appellants' returns (so as to fall within s29(6)(a)) or referred to in any claim 30 made by the taxpayers (so as to fall within s29(6)(b)). Since no enquiry into the appellants' 2008-09 tax return was opened, s29(6)(c) cannot be relevant. While we are prepared to accept that the Company's accounts were sent to HMRC, we do not consider that is enough to bring the accounts within s29(6)(d) since there was no evidence that the appellants told HMRC that the Company's accounts contained 35 information relevant to their CGT liability. Moreover, as noted at [51] above, the accounts did not in fact contain any information regarding the nature of the fixed asset of £395,000 that the Company disposed of or that there had been a payment to the Company from a related party and contained no information relevant to their claim for entrepreneurs' relief either. Even if a reasonable officer of HMRC had read the 40 accounts in detail, he would not have realised that the appellants were claiming a deduction for their respective shares of the £395,000 payment to the Company. Still less would that officer have realised that the deduction claimed failed the conditions of s38(1)(b) of TCGA 1992. Nor would the accounts have revealed that the appellants

did not actually own the business at the relevant times with the result that they were not entitled to entrepreneurs' relief.

88. It follows, therefore, that the test set out in s29(5) TMA 1970 can be applied only by reference to information set out in the appellants' tax returns themselves. As we have found at [49] and [50], the tax return to which Mr Nitin Amin referred us did not contain any information on the £395,000 payment to the Company. They could not, therefore, have alerted a hypothetical officer to the fact that the £395,000 payment did not meet the requirements of s38(1)(b) of TCGA 1992. Moreover, those tax returns contained no mention of the factors that prevented the appellants from being entitled to entrepreneurs' relief (including the fact that the appellants were not themselves carrying on any relevant business). Therefore, we have concluded that a hypothetical officer receiving the relevant information could not have concluded that the appellants were paying insufficient tax. All requirements necessary for the making of a discovery assessment were satisfied.

Conclusion

89. Accordingly, our decision is:

(1) The appellants are not entitled to any deduction for their respective shares of the £395,000 paid to the Company in the computation of their chargeable gains on disposals of the flats and the Property in 2008-09 or 2009-10.

(2) Entrepreneurs' relief is not available on those disposals.

(3) The discovery assessment for 2008-09 was validly issued.

(4) The Tribunal is obliged, under s50(7) of TMA 1970 to increase the assessments for the 2008-09 tax year so as to deny the appellants entrepreneurs' relief.

90. The appeal is dismissed.

91. 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.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 9 FEBRUARY 2016