RUDGE REVENUE REVIEW

ISSUE XXX

DISPUTED SUCCESSION

McKie & Co LLP
Rudge Hill House
Rudge
Somerset
BA11 2QG

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HOW DOES MAIN RESIDENCE RELIEF APPLY WHERE A BUILDING HAS BEEN DEMOLISHED?

1.1 It is not uncommon when an individual acquires a new home for him to make substantial improvements to it. Sometimes the improvements are so substantial that only a minor part of the original structure remains. Sometimes it proves cheaper to demolish the original structure and to build an improved one than to improve the original structure. How does Main Residence Relief[1] apply in such circumstances?

THE EXAMPLES

2.1 In this Review we explore this question in respect of four alternative examples which are simplified versions of a real situation on which we have recently advised.

[1] Relief under Taxation of Chargeable Gains Act ('TCGA 1992') s.223. We also refer to this relief as 'MRR'. See Appendix I

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EXAMPLES[2]

EXAMPLE A

In August 2012, Mr A entered into a contract (the ‘Purchase Contract’[3]) to purchase, for £3 million, the unencumbered freehold (the ‘Freehold’[4]) of 1.2 acres of land (the ‘Land’[5]). On 225yd^2 (the ‘Original Plot’[6]) of the Land stood a residential building (the ‘Original Structure’[7]) in which Mr A took up residence on completion of his purchase (the ‘Purchase Completion’[8]) in October 2012. He lived in the Original Structure until August 2015 when he moved into temporary accommodation (the ‘Temporary Accommodation’[9]) whilst the structure underwent extensive building works.[10] These Building Works cost £3 million. The Original Structure was, because of the Building Works, uninhabitable during the period when Mr A occupied the Temporary Accommodation.

Mr A moved into the improved structure (the ‘Revised Structure’[11]) in August 2016 and he continued to reside there until the Sale Completion in October 2022 (see below).

The Revised Structure stood on land (the ‘Revised Plot’[12]) of 360yd^2. 200yd^2 of the Original Plot formed part of the Revised Plot. 25yd^2 of the Original Plot, therefore, did not form part of the Revised Plot and 160 yd^2 of the Revised Plot had not formed part of the Original Plot.

60% of the Original Structure incorporated into the Revised Structure and 40% had been demolished. 66% of the Revised Structure was entirely new.

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2 See Appendix I
3 See Appendix I
4 See Appendix I
5 See Appendix I
6 See Appendix I
7 See Appendix I
8 See Appendix I
9 See Appendix I
10 We refer to the works in Examples A, B, C and D which the acquirer engaged in each example after the Purchase Completion as the ‘Building Works’. We refer to these examples as the ‘Examples’. See Appendix 1
11 See Appendix I
12 See Appendix I

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Mr A entered into a contract (the 'Sale Contract'[13]) to sell the Freehold for £10 million in August 2022 which was completed (the 'Sale Completion'[14]) in October 2022.

He resided in the Revised Structure at least from August 2016 until the Sale Completion. In the period from October 2012 to October 2022 there was no building in which he could be said to have resided which was not constituted by the Original Structure, the Revised Structure or the Temporary Accommodation.[15]

EXAMPLE B

Mr B entered into transactions which were the same as Mr A's in all relevant ways except that only 10% of the Original Structure formed part of the Revised Structure, 95% of the Revised Structure was entirely new, the purchase price of the Freehold was £2 million and the Building Works cost £4 million.

EXAMPLE C

Mr C entered into transactions which were the same as Mr B's in all relevant ways except that the Original Structure, including its foundations, was demolished and the demolished materials were removed from the site so that the Revised Structure was entirely new.

[13] See Appendix I
[14] See Appendix I
[15] Which is not to beg the question of what dwelling-house constituted his residence within TCGA 1992 s.222 in the period October 2012 until August 2016 and whether that building or those buildings were the same dwelling-house for this purpose as the Revised Structure

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EXAMPLE D

Mr D entered into transactions which were the same as Mr C's in all relevant ways except that the Revised Structure was on a different part of the Land so that no part of the Original Plot formed part of the Revised Plot.

THE RELEVANT LEGISLATION

3.1 TCGA 1992 s.223(1) and (2) provide that:

'(1) No part of a gain to which section 222 applies shall be a chargeable gain if the dwelling-house or part of a dwelling-house has been the individual's only or main residence throughout the period of ownership, or throughout the period of ownership except for all or any part of the last 9 months of that period.

(2) Where subsection (1) above does not apply, a fraction of the gain shall not be a chargeable gain, and that fraction shall be—

(a) the length of the part or parts of the period of ownership during which the dwelling-house or the part of the dwelling-house was the individual's only or main residence, but inclusive of the last 9 months of the period of ownership in any event, divided by

(b) the length of the period of ownership.'

3.2 TCGA 1992 s.222(1) and (2) provide that:

'(1) This section applies to a gain accruing to an individual so far as attributable to the disposal of, or of an interest in—

(a) a dwelling-house or part of a dwelling-house which is, or has at any time in his period of ownership been, his only or main residence, or

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(b) land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area.

(2) In this section "the permitted area" means, subject to subsections (3) and (4) below, an area (inclusive of the site of the dwelling-house) of 0.5 of a hectare.'

THE ELEMENTS OF MRR

4.1 Main Residence Relief may, at first sight, appear to be straightforward. The more one considers its application to particular circumstances, however, the more difficult it seems to become. Many of the difficulties stem, in the Authors' opinion, from the fact that, whereas property interests are interests in land the extent of which is defined by reference to the land's surface, the relief is given by reference to the function and use of a building which stands on the land. The draftsman has not rigorously kept in mind the distinction between the two.

4.2 A freehold is more exactly described as a fee simple estate. The land in which such an estate subsists includes anything affixed to the land[16] and, subject to numerous common law and statutory exceptions, everything above the land and below the land.[17]

4.3 It is clear, that immediately before the Sale Completion, Mr A had an interest in the Revised Structure by reason of his owning the Freehold. On the Sale Completion he made a disposal, of the Freehold on which a capital gain accrued[18] and that disposal disposed, *inter alia,* of his interest, under the Freehold, in the Revised Structure. The Revised Structure was clearly a dwelling-house which at least from August 2016 was his only residence.[19]

[16] Under the old common law principle *quicquid plantatur solo, solo credit* which loosely means, in English, 'whatever is attached to land is part of the land'

[17] Under the old common law principle *cuius est solum eius est usque ad caelum ad inferos* which loosely means, in English, 'he who owns the surface owns everything up to the heavens and down to the infernal regions'

[18] Of £4,000,000 (£10,000,000 - £3,000,000 - £3,000,000)

[19] All that is said in this paragraph of Mr A, could also be said of Mr B, Mr C and Mr D

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4.4 We have seen that TCGA 1992 s.222(1) which defines the gain to which the relief applies, refers to a *'disposal of, and of an interest in, a dwelling-house …'* whereas the interest concerned will actually be, directly, an interest in land on which a dwelling-house stands and, therefore, only indirectly by virtue of the interest in land, an interest in the building which constitutes the dwelling-house.

4.5 Section 222(1) requires one to identify the:

(a) 'time of disposal';
(b) 'dwelling-house';
(c) 'period of ownership'.

THE TIME OF DISPOSAL

5.1 Where a contract for the sale and purchase of an asset is to be completed after the time when the contract is made, the disposal only takes place if the contract is completed. If it is completed, the disposal, and the purchaser's acquisition, is treated under TCGA 1992, s.28 as taking place when the contract became unconditional.[20]

5.2 The disposal referred to in s.222(1), therefore, is deemed to take place when the unconditional contract for the disposal is made although the disposal actually takes place on completion. In respect of all our Examples, the disposal is treated as taking place in August 2022 although it actually takes place in October 2022.

5.3 As we shall see,[21] this seems to have the rather paradoxical effect that the disposal is treated as taking place before the end of the disponer's Period of Ownership in respect of the dwelling-house concerned.

[20] See *Jerome v. Kelly* [2004] UKHL 25
[21] See para. 7.55 below

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THE ‘DWELLING-HOUSE’

6.1 What is a ‘dwelling-house’ to which reference is made in s.221(1)? In Example A the Revised Structure stands on most of the Original Plot and most of the Original Structure is incorporated into the Revised Structure. On the other hand, there is 44% of the Revised Plot on which no part of the Original Structure stood and 66% of the Revised Structure is entirely new. Did the Original Structure constitute the same dwelling-house for this purpose as is now constituted by the Revised Structure?

6.2 There is little case law on the question of whether a dwelling-house which has had a large part of the original structure of a dwelling-house substantially incorporated into it is the same dwelling-house as the original structure or is a different one. There is, however, one MRR case in which a situation which was not dissimilar to Example C considered by the First Tier Tribunal (the ‘FtT’).[22]

Gibson v. HMRC

6.3 It is the case of *Gibson v. HMRC*[23] which concerned a taxpayer who purchased land on which stood, in 2003, a residential property.[24] He took up residence in this property.[25] In 2004 the taxpayer completely demolished the original structure and constructed an improved structure on substantially the same area of land as that on which the original structure stood.[26] The taxpayer disposed of his interest in the revised structure without having resided in it.[27]

6.4 The original structure had been called ‘*Moles House*’ as was the new structure after it was built. The judgment refers to the original structure as ‘*Moles House One’* and the new structure as ‘*Moles House Two*’. In reading the judgment one has to be careful not to allow this terminology to prejudice one’s understanding of the question at issue. Recognising that danger, we nevertheless adopt the judgement’s terminology.

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22 See Appendix I
23 *Paul Gibson v. HMRC* [2013] UKFTT 626 (TC). See Appendix I
24 *Gibson v. HMRC* at para. 2
25 *Gibson v. HMRC* at para. 30
26 *Gibson v. HMRC* at para. 2
27 *Gibson v. HMRC* at para. 76

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6.5 HMRC contended that *Moles House One* and *Moles House Two* were not the same dwelling-house and that MRR did not apply to the taxpayer's disposal of his interest in the land on which *Moles House Two* stood because *Moles House Two* had not been the taxpayer's residence. It pointed to the fact that *Moles House Two* was a substantially larger structure than *Moles House One*:

> *'The newly constructed house had 5 bedrooms, 4 bathrooms, 3 floors, a garage attached to the house, a family room and a study, in addition to the kitchen, dining room and drawing room. The original house had 4 bedrooms, one bathroom and a WC, 2 floors, a detached garage, kitchen, living room and dining room, but no family room or study. The two were different in size and layout. The old house was completely demolished, and the bricks were taken away and not used in the new house.'*[28]

6.6 HMRC went on to submit that:

> *'… Moles House Two was a different dwelling-house …. The old house was completely demolished, and no materials from the original house were used in the construction of the new house. The new house had a very different size and layout to the original house.'*[29]

6.7 It went on to assert that:

> *'45. The difference between the present case and one where an existing house is fundamentally remodelled and renovated is that in the present case there were two houses, and in the latter type of case there would be only one house. Had Moles House One been renovated and remodelled, then the tax consequences may well have been different and private residence relief may have applied.'*[30]

6.8 The Tribunal summarised HMRC's arguments on this matter as follows:

> *'55. First, HMRC argue* [sic] *… that [Moles House One and Moles House Two] … were very different in size and layout …,*[31] *and substantially different in*

[28] *Gibson v. HMRC* at para. 17
[29] *Gibson v. HMRC* at para. 30
[30] *Gibson v. HMRC* at para. 45
[31] See para. 6.5 above

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appearance and value. The Tribunal is not persuaded by that argument, for the simple reason that HMRC accepted that if an existing dwelling house was fundamentally remodelled and renovated, it could still be the same dwelling house. Following fundamental remodelling and renovation, a dwelling house may well have a very different size and layout to what it had before, as well as a very difference [sic] *appearance and value. This cannot therefore be determinative.*

56. Secondly, HMRC argue that Moles House was completely demolished, and none of the materials from Moles House One were used in the construction in Moles House Two.'[32]

6.9 The Tribunal went on to note that:

'57. In its post-hearing directions, the Tribunal requested the parties to refer the Tribunal to any case law dealing with the application of s 222(1) TCGA in circumstances where a dwelling house is demolished in order for a new dwelling house to be immediately erected in the same place. Neither party was able to refer to any. The Tribunal notes that the decision of the Court of Appeal in Ellis & Sons Amalgamated Properties, Limited v Sisman [1948] 1 KB 653 might be said to have some similarities. However, this was not a tax case and is not directly on point, and given that neither of the parties has addressed this case in argument, the Tribunal does not take it into account.'[33]

6.10 In considering the party's arguments on this matter the Tribunal accepted:

'… that, as a matter of ordinary language, it would be said that in such circumstances, the existing house had ceased to exist, and that an entirely new house had been erected in its place. Thus, HMRC point to the fact that even the Appellant himself in his own witness statement refers to "the new house".'[34]

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[32] *Gibson v. HMRC* at paras. 55 & 56

[33] *Gibson v. HMRC* at para. 57. *Ellis v. Sisman* does not throw any significant light on the issue

[34] *Gibson v. HMRC* at para. 58

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6.11 The Tribunal went on to say:

'59. There are, however, a number of arguments that might be made contrary to the relevant provisions of the TCGA being given this interpretation.

60. The Appellant's evidence, which the Tribunal does find to be plausible on this point, was that in order to create a house of a certain size and layout, it was cheaper to demolish the existing house and to rebuild it from scratch than to achieve the same end result by remodelling and renovating the existing house. It is arguable that there is no reason for ascribing different tax consequences to the end result, merely because different means were employed to achieve that same end result.

61. It is also arguable that there may be difficulties in distinguishing between the two cases in practice. For instance, it may be difficult to determine whether a house has been remodelled and renovated, or whether one house has been demolished and a new one constructed in its place, if a house is razed to its foundations but the existing foundations are used in the reconstruction, or if some of the materials from the existing house are used in the reconstruction.

62. Furthermore, it might arguably be unjust to apply a different tax treatment in cases where the demolition of the original house is not due to the owner's choice, such as where the original house is completely destroyed by fire.'[35]

6.12 HMRC had cited a passage in the case of *Sansom v Peay*[36] to the effect that Parliament's purpose in enacting MRR was that:

'…when a person sells his home he frequently needs to acquire a new home elsewhere. The evil of inflation was evident even in 1965. It must have occurred to the legislature that when a person sells his home to buy another one, he may well make a profit on the sale of one home and lose that profit, in effect, when he buys his new home at the new, inflated price. It would not therefore be surprising if Parliament formed the conclusion that, in such circumstances, it

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[35] *Gibson v. HMRC* at paras. 55 - 62

[36] *Sansom v Peay* [1976] 1 WLR 1073; 52 TC 1

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would be right to exempt the profit on the sale of the first home from the incidence of capital gains tax so that there is enough money to buy the new home.'[37]

6.13 Applying this view of the purpose of MRR, HMRC had submitted that:

'…the Appellant has not disposed of his home in order to fund the purchase of a new home.'[38]

6.14 The Tribunal was, understandably, unpersuaded by this argument commenting that:

'…, *the Tribunal finds that, regardless of what might have been said in Sansom v Peay about the justification for private residence relief, it is not a requirement of the legislation that the proceeds of sale be used to fund the purchase of a new home.*

Relying on this quote, HMRC also argue that the increase in the value of the property in this case was due to the construction works rather than the effect of inflation. The difficulty with this argument is that the same could be said in circumstances where an existing dwelling house is fundamentally remodelled and renovated, yet HMRC accept that there could be a single dwelling house in such circumstances.'[39]

6.15 As a decision of the FtT, *Gibson v. HMRC* is not a binding authority but is merely persuasive. Its persuasiveness is, however, reduced by the fact that the presiding Tribunal Judge and Tribunal Member were deadlocked. The Tribunal Judge resolved the deadlock by exercising his casting vote:

'67. The Tribunal Judge is of the view that despite the considerations above, the words of the relevant provisions of the TCGA, read in the context of the statute as a whole, must be given their plain meaning unless this would lead to "an inconsistency, or an absurdity or inconvenience so great as to convince the court that the intention could not have been to use them in their ordinary signification, and to justify the court in putting on them some other signification,

[37] *Gibson v. HMRC* at para. 63
[38] *Gibson v. HMRC* at para. 64
[39] *Gibson v. HMRC* at paras. 64 & 65

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which, though less proper, is one which the court thinks the words will bear" (River Wear Comrs v Adamson (1877) 2 App Cas 743, 764–765 Lord Blackburn, quoted for instance in Yarl's Wood Immigration Ltd v Bedfordshire Police Authority [2009] EWCA Civ 1110 at [68]). The Tribunal Judge considers that the ordinary meaning of the words "dwelling house" refer to the building itself (and may include, as a secondary matter, the land upon which it is situated), rather than refer to the land (and, as a secondary matter, any building that may be situated upon it). If one house is completely demolished and a new house erected in the same location, then the new house is not the same "dwelling house" as the one that previously stood on that site. The considerations referred to above[40] are not sufficient to justify a conclusion that the intention could not have been to use the words in their ordinary meaning. The Tribunal Judge therefore concludes that Moles House Two was not the same house as Moles House One.

68. On the other hand, the Tribunal Member is of the view that that the considerations above, especially those at paragraphs 59-62[41] above, lead to the conclusion that where a house is demolished and then reconstructed in order to achieve the same end as extending and remodelling the existing house, only by more cost effective means, the new construction should be regarded as the same dwelling house as that which originally existed.

69. As the Tribunal is not unanimous, the Tribunal Judge has the casting vote pursuant to article 8 of the First-tier Tribunal and Upper Tribunal (Composition of Tribunal) Order 2008. The Tribunal accordingly finds, by majority, that Moles House Two was not the same dwelling house as Moles House One."[42]

Applying *Gibson v. HMRC* to the Examples

6.16 It is by no means clear, therefore, that a differently constituted Tribunal would follow the presiding Tribunal Judge's decision in *Gibson v. HMRC* and not the more purposive construction of the dissenting Tribunal Member. If it were to follow the Tribunal Judge's

[40] See para. 6.11 above
[41] See para. 6.11 above
[42] *Gibson v. HMRC* at paras. 67 - 69

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decision it is clear that the Revised Structures in Examples C and D would not constitute the same dwelling-house as the Original Structures in those Examples:

> *'If one house is completely demolished and a new house erected in the same location, then the new house is not the same "dwelling house" as the one that previously stood on that site.'*[43]

6.17 If a later tribunal were to follow the Tribunal Judge's decision in *Gibson v. HMRC* it is also likely that it would find the Original Structure and the Revised Structure in Example A to constitute the same dwelling-house for the purposes of MRR and, to a lesser degree of likelihood, the same is likely to be true of the Original and Revised Structures in Example B:

> *'First, HMRC argue [sic] … that [Moles House One and Moles House Two] … were very different in size and layout (see paragraph 17 above), and substantially different in appearance and value. The Tribunal is not persuaded by that argument, for the simple reason that HMRC accepted that if an existing dwelling house was fundamentally remodelled and renovated, it could still be the same dwelling house. Following fundamental remodelling and renovation, a dwelling house may well have a very different size and layout to what it had before, as well as a very difference* [sic] *appearance and value. This cannot therefore be determinative.'*[44]

THE PERIOD OF OWNERSHIP

Ownership of what asset?

7.1 We have seen[45] that ss.222 and 223 apply by reference to the 'period of ownership'.[46] That phrase must bear the same meaning wherever it is used in these sections and it must therefore refer to ownership of the same asset. We have also seen[47] that TCGA 1992 s.222 provides that:

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[43] *Gibson v. HMRC* at para. 67. See para. 6.15 above

[44] *Gibson v. HMRC* at para. 67. See para. 6.8 above

[45] See paras. 3.1 and 3.2 above

[46] We use the phrase the 'Period of Ownership' to refer to the phrase as it is used in TCGA 1992 ss.222 – 226B and the phrase the 'Period of Ownership Issue' to refer to the question as to how that phrase is to be construed. See Appendix I

[47] See para. 3.1 above

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> *'(1) This section applies to a gain accruing to an individual so far as attributable to the disposal of, or of an interest in—*
>
> > *(a) a dwelling-house or part of a dwelling-house which is, or has at any time in his period of ownership been, his only or main residence, or*
> >
> > *(b) land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area.'*

7.2 It will be seen that neither s.222[48] nor s.223[49] says expressly to what gains s.222 applies but it is surely implicit in those sections that it applies to a gain arising on the disposal of an asset, or an interest in an asset, falling within the descriptions of s.222(1) which meets the conditions of s.223(1) or (2). The asset described in s.222(1) is '*a dwelling-house or part of a dwelling-house which is, or has at any time in … [the disponer's] … period of ownership been, his only or main residence'* and garden or grounds meeting the description in s.222(1)(b). The trouble with this description is that, as we have seen,[50] strictly one does not own a dwelling-house but the land on which it sits. It is by virtue of the ownership of that land that one has rights over the dwelling-house. The reference to the dwelling-house in s.222(1) must be to the interest in land by virtue of which the disponer has an interest in the dwelling-house which has been his main residence.

7.3 Where that dwelling-house has not been in existence for the entire period during which the disponer owned the interest in the land can he be said, for the purposes of MRR, to have had an interest in land which conferred an interest in the dwelling-house during the period when the dwelling-house did not exist? Does the relevant 'period of ownership' include a period when the dwelling-house did not exist? Can it be said that one owns a dwelling-house or an interest in it when one owns an interest in land on which a dwelling-house does not presently stand but on which a dwelling-house will stand in the future? As a matter of ordinary English usage no one would say that one did.

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48 See para. 3.2 above
49 See para. 3.1 above
50 See para. 4.2 above

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7.4 It might have been clearer if s.222(1) had been worded:

> *'(1) This section applies to a gain accruing to an individual so far as it is attributable to the disposal of an interest -*
>
> *(a) in land on which stands a dwelling-house or part of a dwelling-house which is, or has at any time in his period of ownership been, his only or main residence; or*
>
> *(b) in land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area'*[51]

and the period of ownership had been defined as;

> *'the period during which the individual has owned the interest in land referred to in s.222(1) and the dwelling-house referred to in that sub-section has stood on that land.'*

7.5 Applying ordinary English usage, however, the actual words used in s.222(1) can fairly bear the same construction.

7.6 In the Authors' view, therefore, the natural construction of the Period of Ownership (the 'Normal Usage Construction') is that it refers to the period during which the disponer owned an interest in land which conferred rights in respect of the dwelling-house concerned with the result that that period cannot include any period during which the dwelling-house did not exist.[52]

7.7 It can be seen that if we apply the Normal Usage Construction to Examples C and D, Mr C's and Mr D's relevant Periods of Ownership only began when the Revised Structures came into existence so that, except perhaps during the period when the Revised Structures were in the course of construction but sufficiently developed to

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[51] Compare the legislation set out at para. 7.1 above

[52] We call the contrary construction, that the 'Period of Ownership' refers to the period during which the disponer has owned the interest in land by virtue of which he had an interest in the dwelling-house concerned immediately before the disposal, the 'Special Usage Construction'

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constitute dwelling-houses, they were the disponer's main residences throughout the relevant Periods of Ownership.

Relevant case law

7.8 If there were no relevant case law on the matter, therefore, we should conclude that the Normal Usage Construction is certainly the correct one.

7.9 There are four cases, however, which are of direct or indirect relevance to the question of how one determines the Period of Ownership in the MRR.

Henke v. HMRC

7.10 *Henke v. HMRC*[53] concerned a couple, Mr and Mrs Henke, who purchased the freehold (the 'Henke Freehold'[54]) of 2.66 acres of bare land (the 'Henke Land'[55]) in August 1982 with outline planning permission for one house to be built on the land.[56] Having had a design made by an architect and, one presumes, obtaining detailed planning permission, they began construction of a new dwelling-house ('Old Oak House'[57]) in February 1991.[58] Mr and Mrs Henke took up residence in Old Oak House on its completion in June 1993 and continued to reside in it at the time the case was heard.[59]

7.11 The case concerned disposals (the 'Henke Disposals'[60]) by Mr and Mrs Henke of two plots of the Henke Land both of which, at the time of the relevant disposal, formed part of the garden and grounds of Old Oak House.[61] Mr and Mrs Henke had obtained planning permission in July 1995 for two houses to be built on these plots and the plots were disposed of with the benefit of those permissions.[62] The Henke Disposals were part disposals of the Henke Freehold.[63]

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[53] *Anthony John Henke and Alice Joyce Henke v. HMRC;* SpC 550 [2006] STC (SCD) 561. See Appendix I
[54] See Appendix I
[55] See Appendix I
[56] *Henke v. HMRC* at para. 3
[57] See Appendix I
[58] *Henke v. HMRC* at paras. 4 & 5
[59] *Henke v. HMRC* at para. 5
[60] See Appendix I
[61] *Henke v. HMRC* at para. 7
[62] *Henke v. HMRC* at paras. 7 & 8
[63] *Henke v. HMRC* at para. 8

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7.12 The matters at issue in the case included various administrative issues as to returns, assessments and time limits and substantive issues as to the calculation of the chargeable gains arising on the disposals.[64] It was accepted by HMRC that MRR applied to the Henke Disposals but the amount of the relief was in dispute between the parties. One of the issues in dispute in respect of the amount of MRR was the Period of Ownership Issue. HMRC contended that Mr and Mrs Henke's Period of Ownership commenced when the Henke Freehold was acquired by them in August 1982. Mr and Mrs Henke contended that their Period of Ownership commenced when Old Oak House was first available for their occupation in June 1993.[65]

7.13 The Period of Ownership Issue was, therefore, only one of many issues considered in the case. As a decision of the Special Commissioners the case is not a binding authority but is only persuasive. The persuasiveness of the decision is reduced by the fact that Mr Henke represented himself and his wife at the hearing and the arguments he advanced were not expressed with the clarity one would have expected had Counsel been instructed.[66]

7.14 The Special Commissioner recorded that:

> *'39. Mr Henke argued that the adjustment based on a time prior to completion of the dwelling-house was inconsistent with the requirements of s 222(1)(a) and (b) TCGA 1992 and the planning permission. Sub-s (1)(a), Varty v Lynes, and the HMRC Capital Gains Manual CG64377–64378 all specified that the land test for a private residence relief claim needed consideration only at the time or moment of disposal. The time test for the dwelling-house was conditional on both ownership and residency (ie the use of the dwelling-house). He challenged HMRC on the basis that an ownership/residency event which did not happen until June 1993 was incorrectly applied to August 1982 (when land was*

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[64] *Henke v. HMRC* at paras. 116 - 125

[65] *Henke v. HMRC* at paras. 39 & 69. In effect, HMRC adopted the Special Usage Construction. It is not quite clear to what extent Mr and Mrs Henke adopted the Normal Usage Construction. See paras. 7.14 & 7.15 below

[66] At least this appears to be the case judging by the summaries of his arguments given in the case report. Those who have experience of litigation will be aware that summaries of the taxpayer's arguments in recorded decisions often vary considerably from the arguments actually advanced

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purchased without the house), and the Henkes had chosen to leave the land fallow until they were ready to build. Their right to do this was claimed through s 57(2) TCPA 1990. Mr Henke asked for a finding that the downward adjustment of principal private residence relief due to the purchase of land having preceded the Henkes' occupation of the dwelling-house should be disallowed.'[67]

7.15 This argument seems to confuse[68] the question of at what time one identifies the garden and grounds to the dwelling-house concerned under TCGA 1992 s.222(1)(b) with the question of how one identifies the period of ownership of the dwelling-house for the purposes of TCGA 1992 ss.222(1)(a) and s.223(1) and (2).[69] We shall see,[70] that this confusion led to further confusion in the Special Commissioner's consideration of Mr Henke's argument later in the judgment.

7.16 HMRC began its consideration of the Period of Ownership Issue with an appeal to common sense, a sense which rarely has much application to fiscal matters:

'67. The question was whether private residence relief needed to be apportioned to exclude relief for the period before Old Oak House became Mr and Mrs Henke's residence. Surprisingly, this question was not as straightforward as might be expected. It seemed to be very much a matter of common sense that one could not have the relief for a period before a residence was built; a purposive construction of the legislation was necessary to avoid an absurd result.'[71]

7.17 HMRC's primary argument ('HMRC's Primary Argument in *Henke*[72]) was that:

'70. It had been agreed that there was only one asset, namely the land and any buildings on that land. For capital gains tax purposes, the date on which that asset was acquired was determined by s 28 TCGA 1992 as the time of contract, which was August 1982. A dwelling-house was not a separate asset which could be "owned", so when TCGA 1992 spoke of "period of ownership" it meant period

[67] *Henke v. HMRC* at para. 39
[68] Certainly as it is recorded in the decision of the Special Commissioner.
[69] In dealing with the other provisions of the MRR
[70] See paras. 7.28 – 7.33 below
[71] *Henke v. HMRC* at para. 67
[72] See Appendix I

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of ownership of the asset in question, which here was the land. Consequently s 223(1) did not apply because Old Oak House was not the Henkes' residence throughout the period of ownership of the land and relief fell to be time apportioned under s 223(2).'[73]

7.18 HMRC then bolstered this primary argument in *Henke* with four subsidiary ones.[74]

7.19 HMRC's First Subsidiary Argument was that:

> *'(1) Extra Statutory Concession D49 … referred to the case of an individual acquiring land on which he had a house built which he then used as his only or main residence. Such an individual was allowed a period of twelve months (longer in some cases) without having to lose relief. If Mr Henke's interpretation of the "period of ownership" was correct, this Concession would be completely redundant …'*[75]

7.20 This is surely an extraordinary argument to advance. Extra Statutory Concessions are concessions by HMRC and are therefore necessarily based on HMRC's view of the construction of the relevant statute. It is clearly a circular argument for a department of Government to support an argument as to the construction of a statute by reference to that department having previously construed the statute in that way.

7.21 HMRC's Second Subsidiary Argument was that:

> *'(2) Section 222(7) defined the period of ownership, in a case where an individual had had different interests at different times, as beginning with the first acquisition giving rise to allowable expenditure for capital gains tax purposes. (The sub-section did not apply to the Henkes, as they had only ever had one interest in the land at Houghton.) If an individual who had bought a leasehold interest in some bare land later purchased the freehold, retained it for a number of years and then built a house, he would have had different interests*

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[73] *Henke v. HMRC* at para. 70

[74] 'HMRC's Subsidiary Arguments in *Henke'.* We refer to each of 'HMRC Subsidiary Arguments in *Henke*' as 'HMRC's First Subsidiary Argument', 'HMRC's Second Subsidiary Argument', etc. See Appendix I

[75] *Henke v. HMRC* at para. 71

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in the land at different times so that the sub-section would apply. That defined the start of the period of ownership by reference to the time of purchase of the leasehold interest, taking into account the cost of acquisition. On Mr Henke's interpretation the individual's period of ownership would begin when the house was completed. This absurd result would be avoided by accepting the Crown's interpretation of "period of ownership".'[76]

7.22 This argument is also remarkably beside the point. TCGA 1992 s.222(7) provides that:

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

7.23 Before one can apply that section one must identify the thing in which different interests might exist for these purposes. If one applies the Normal Usage Construction, that thing is land on which a dwelling-house sits not land on which a dwelling-house does not sit.

7.24 HMRC's Third Subsidiary Argument was that::

'(3) If Mr Henke's view prevailed, then in any case where land was purchased, held for a time, built on and the house occupied as the only or main residence, the pre-build gain would (subject to any permitted area considerations) be covered by private residence relief. Mr Kelly found it hard to accept that this result had been the intention of Parliament.'[77]

7.25 One might regard the result of the Normal Usage Construction as an anomalous but, as we shall see,[78] there are other examples in the direct tax system of similar anomalies.

7.26 HMRC's Fourth Subsidiary Argument was that:

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[76] *Henke v. HMRC* at para. 71
[77] *Henke v. HMRC* at para. 71
[78] See para. 7.71 below

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'(4) It would be rather odd if Mr and Mrs Henke could obtain private residence relief to cover the gain arising on the land during a time when they were not only resident elsewhere but also able to claim private residence relief in respect of the two homes which they sold before moving into Old Oak House. This result would go against the principle of an individual only being able to have one "only or main residence" at one time.'[79]

7.27 Again, this begs the question. Applying the Normal Usage Construction would not have resulted in Mr and Mrs Henke *'obtaining private residence relief* [sic] *to cover the gain arising on the land during the time when they were not only resident elsewhere but also able to claim private residence relief in respect of the two homes which they sold before moving into Old Oak House'.* It would have resulted in gains which arose at particular points in time being relieved by reference to the use of Old Oak House during the period between its coming into existence and the times those gains were made.

7.28 It is unfortunate, if indeed it was the case, that Mr Henke advanced the rather confused argument that the Special Commissioner summarised in para. 39 of his decision.[80] The Normal Usage Construction does not depend upon a consideration only of the position of the land and buildings as at the 'moment of disposal' and yet the Special Commissioner spent three of the seven paragraphs in which he considered the Period of Ownership Issue in addressing that argument and it further coloured his consideration of HMRC's Primary Argument in *Henke*.

7.29 So the Special Commissioner stated:

'119. On one interpretation of Mr Henke's argument, it would not be quite the same as in Mr Kelly's description. Mr Henke referred to the position of the land and buildings as at the moment of disposal; as I understand this reference, he was contending that if a piece of land has a dwelling-house on it which is used as a principal private residence as at the time of disposal of that land with the house on it, this governs the position whatever the previous history of the land

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79 *Henke v. HMRC* at para. 71

80 See paras. 7.14 & 7.15 above

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and house. In effect, this would be to treat the circumstances prevailing at the time of disposal as it [sic] *they had applied throughout the period of ownership. On this basis, it would not be correct to sub-divide the period of ownership into two parts consisting of the period while there was no house on the land and the period while Old Oak House was on the land. In a way, this argument would be a "mirror image" of his earlier argument concerning the permitted area being fixed from the beginning; in this case, the use of the house at the time of disposal would govern the treatment throughout the period of ownership.*

…

121. I therefore do not accept the argument that the test under s 223(1) is solely directed to the state and condition of the dwelling-house and land at the point of disposal. However, this deals only with part of the general submission which Mr Henke made, that he did not consider an apportionment to be appropriate. He argued that "ownership" in s 222(1)(a) together with the word "disposal" in s 222(1) must convey a meaning of controllership in the use of the dwelling-house during its period of availability, ie June 1993 to the disposal dates. "Ownership" of the dwelling-house had not existed outside these dates.'[81]

7.30 The Special Commissioner went on from here to accept HMRC's Primary Argument that the Period of Ownership must be the period of ownership of an asset and the only asset which the Henkes' owned was an interest in land which they had acquired in 1982:

'122. In relation to this argument, the difficulty is that highlighted by Mr Kelly. Section 223(1) refers to the period of ownership. Buildings cannot (at least in normal circumstances) be owned separately from the land on which they are situated. By s 288(1) TCGA 1992, for the purposes of the Act, "land" includes houses and buildings of any tenure. Mr Kelly confirmed the Crown's acceptance that Mr and Mrs Henke owned one asset, the land and buildings at Houghton. Thus the ownership of the single asset has subsisted since 1982, with subsequent changes to that asset, these changes consisting of the construction of the buildings, the disposal of Plot 1 and the disposal of Plot 2. Is the test relating to the "period of ownership" to be applied to that single asset, or should

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[81] *Henke v. HMRC* at paras. 119 - 121

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it have regard only to the period for which the dwelling-house has been in existence?'[82]

7.31 He went on to comment:

'It is not specifically provided anywhere within the Act that an individual can be regarded as having a period of ownership of a dwelling-house separate from his period of ownership of the land. Given the definition of "land" in s 288(1), this is not surprising.'[83]

7.32 The Normal Usage Construction, however, does not involve an assumption that an individual can be regarded as having a period of ownership of a dwelling-house separate from his *'period of ownership of the land'.* It requires one to identify the period during which the disponer owned an interest in land which conferred rights in respect of the dwelling-house concerned. Clearly that can only be a period in which the dwelling-house existed.

7.33 HMRC's, and the Special Commissioner's, construction did not give due attention to the actual words of the statute. The statute does not refer to the disposal of land, or an interest in land, but to *'the disposal of, or of an interest in … a dwelling-house'*. That formulation may not be one of a precision to satisfy a property lawyer but, in the context, it clearly refers to an interest in land which confers rights in respect of a dwelling-house. The Period of Ownership must therefore be the period during which such an interest was owned. A person does not own an interest in land which confers rights in respect of a dwelling-house in a period in which no such dwelling-house exists.

7.34 Having been led astray by Mr Henke's formulation of the argument, or perhaps by his own summary of Mr Henke's formulation, the Special Commissioner confirmed his conclusion by reference to HMRC's arguments from absurdity and as to purpose:[84]

'I accept Mr Kelly's arguments as to the consequences, in terms of anomalies and absurdities, of an interpretation that would permit the ownership of a dwelling-house to be looked at separately from the ownership of the land. In my

[82] *Henke v. HMRC* at para. 122
[83] *Henke v. HMRC* at para. 123
[84] See paras. 7.18 – 7.27 above

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view the Parliamentary intention behind the legislation is clear; there is to be only one period of ownership, of the single asset consisting of the land and any buildings which may be erected on it during that period. It follows that an apportionment is required where land is held for a period and subsequently a house is built on it and occupied as the individual's only or main residence.'[85]

7.35 In accepting HMRC's Subsidiary Arguments in *Henke* in this way the Special Commissioner failed to subject them to sustained analysis and therefore seems not to have considered the rather obvious counter arguments set out above.[86] That appears to have been another unfortunate consequence of Mr and Mrs Henke not being represented by Counsel.

McHugh v. HMRC

7.36 *McHugh v. HMRC*[87] is a case which might be said to be of indirect relevance to the Period of Ownership Issue. It concerned a couple who purchased freehold land at some time on or before 30th November 2004.[88] On that date, Mr and Mrs McHugh began constructing a dwelling-house on the land.[89] On its completion in December 2007 they took up residence in it continuing to occupy it as their main residence until the completion of a contract for its sale in September 2010.[90]

7.37 At the relevant times, Extra Statutory Concession D49 ('ESC D49') provided that:

'D49. This Concession applies:

- *where an individual acquires land on which he has a house built, which he then uses as his only or main residence*
- *where an individual purchases an existing house and, before using it as his only or main residence, arranges for alterations or redecorations or completes the necessary steps for disposing of his previous residence.*

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[85] *Henke v. HMRC* at para. 123
[86] See paras. 7.18 – 7.27 above
[87] *Mr George McHugh and Mrs Mary McHugh v. HMRC* [2018] UKFTT 403 TC (TC06605). See Appendix I
[88] *McHugh v. HMRC* at para. 2
[89] *McHugh v. HMRC* at para. 2
[90] *McHugh v. HMRC* at para. 2

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In these circumstances, the period before the individual uses the house as his only or main residence will be treated as a period in which he so used it for the purposes of Sections 223(1) and 223(2)(a) TCGA 1992, provided that this period is not more than one year. If there are good reasons for this period exceeding one year, which are outside the individual's control, it will be extended up to a maximum of two years.

Where the individual does not use the house as his only or main residence within the period allowed, no relief will be given for the period before it is so used. Where relief is given under this Concession it will not affect any relief due on another qualifying property in respect of the same period."[91]

7.38 HMRC took the view that because the freehold of the land had been held at least since 30th November 2004 and there was no building on it which was Mr and Mrs McHugh's main residence until December 2007, s.222(2) applied and only a fraction, and not the whole, of the chargeable gain arising on the disposal of the freehold was relieved by MRR.[92]

7.39 It is implicit in that view that the Period of Ownership included the period before the dwelling-house existed. The parties and the Tribunal proceeded on the assumption that was the case without any argument being advanced on the issue.[93] Implicitly, therefore, they adopted the Special Usage Construction.[94]

7.40 The principal question at issue between the parties was whether ESC D49 applied to reduce the chargeable gain.[95] HMRC argued that it did not because on its terms, where the period between the acquisition and the house to which the Concession

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[91] *McHugh v. HMRC* at para. 14
[92] *McHugh v. HMRC* at para. 15
[93] Unsurprisingly, in view of the fact that the Period of Ownership Issue was not the subject of argument by the parties, *Henke v. HMRC* was not cited in the case
[94] *McHugh v. HMRC* at para. 11
[95] *McHugh v. HMRC* at para. 11

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refers first being used as a main residence exceeds two years, the conditions for the application of the Concession will not be satisfied and so no relief will be given.[96]

7.41 The Authors consider that to be the correct construction of ESC D49. The Tribunal found, however, that although:

> *'… the Concession could be read as introducing a proviso to the effect that the concession can and will only apply if the building or refurbishment works are completed within one year, [or the longer period of two years for which the Concession provides in some circumstances].*[97]

7.42 It was:

> '… *equally capable of being read as expressing the intention that the period for building and/or refurbishment works should not be open ended and should, for capital gains tax purposes, be limited to 12 months or, if there are good reasons beyond the control of the taxpayer, to a maximum of 24 months.'*[98]

7.43 The Tribunal found that the latter construction was to be preferred on the grounds that it gave better effect to the purpose of the Concession.[99]

7.44 On its own, *McHugh v. HMRC* is only weak authority for rejecting the Normal Usage Construction of the 'Period of Ownership'. That is because the issue of the phrase's construction was not argued before the Tribunal and the Tribunal's construction of the phrase is only implicit in the judgment and is not explicitly stated.[100]

7.45 In the Finance Act 2020,[101] however, a statutory version of ESC D49 was enacted to replace it and was inserted in TCGA 1992 as s.223ZA. The section only applies where:

> *'during the period beginning with the individual's period of ownership and ending with the moving-in time a qualifying event occurred.'*[102]

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[96] *McHugh v. HMRC* at para. 15
[97] *McHugh v. HMRC* at para. 17
[98] *McHugh v. HMRC* at para. 17
[99] *McHugh v. HMRC* at paras. 18 - 20
[100] If the matter had been argued the taxpayer would one presumes, have had the opportunity to advance the arguments set out in para. 7.1 – 7.7 above
[101] Finance Act 2020 s.24
[102] TCGA 1992 s.223ZA(1)(d)

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7.46 TCGA 1992 s.223ZA(2) provides that:

'The following are qualifying events—

(a) the completion of the construction, renovation, redecoration or alteration of the dwelling-house or the part of the dwelling-house mentioned in subsection (1);

(b) the disposal by the individual of, or of an interest in, any other dwelling-house or part of a dwelling-house that immediately before the disposal was the individual's only or main residence.'

7.47 The Notes on the Finance Bill 2020 explained:

'Subsection 4 adds a new section 223ZA which legislates ESC D49. Broadly this section applies where an individual acquires land on which they build a dwelling and which they then occupy as a main residence, or purchases an existing dwelling and delays occupation until alterations or redecoration is completed, or until they complete the disposal of their previous residence. New section 223ZA allows the period of non-occupation between acquisition and the occupation of the dwelling to be treated as a period of occupation of the house as the individual's main residence, provided that the period between acquisition and occupation as main residence does not exceed two years and no other person has used the property as a residence during that time.'[103]

7.48 It might be argued that the reference in s.223ZA(2)(a) to *'the completion of the construction … of the dwelling-house … '*[104] would be redundant if the phrase *'period of ownership',* referred only to ownership during which the dwelling-house concerned actually existed and that, therefore, the enactment of that sub-section demonstrates Parliament's intention that the 'Special Usage Construction' should apply to the phrase 'Period of Ownership' in the MRR.

7.49 Two counter arguments might be made.

[103] Finance Bill 2020 Explanatory Notes. Notes on Clause 23: relief on disposal of private residence. Note 8

[104] See para. 7.46 above

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7.50 First, that the phrase *'period of ownership'* has been used in the MRR legislation, including the predecessor sections in TCGA 1992 s.222ZA and s.223, since it was originally enacted in the Finance Act 1965 and that Parliament's implicit understanding of its construction in 2020 can cast no light on Parliament's intention in enacting the provisions 55 years previously.

7.51 Secondly, because it is possible for a dwelling-house to be habitable as such even before it is completed, the reference in s.223ZA(2) to 'the completion of the construction' would not be redundant even if the Normal Usage Construction applied, because, in such a situation, s.223ZA(2)(a) would be necessary to give relief for the period between the time the building became habitable as a dwelling-house and a later time when the construction had been completed and the owner took up occupation.

Higgins v. HMRC

7.52 In the case of *Higgins v. HMRC*:[105]

> *'[2] On 2 October 2006, Mr Higgins entered into a contract to take a 125-year lease of an apartment ("the Apartment") from Manhattan Loft St Pancras Apartments Limited ("Manhattan"). The Apartment was to be in the former St Pancras Station Hotel, which Manhattan was converting. At the date of the contract, the area which was to become the Apartment was, in the FTT's words, "a space in a tower".'*[106]

7.53 The contract was only completed, and Mr Higgins only acquired a right of occupation of the Apartment, on 5th January 2010.[107]

7.54 HMRC asserted that, by virtue of TCGA 1992, s.28 which treats a disposal as taking place at the time a binding contract for the disposal is made and not when that contract is completed, Mr Higgins period of ownership started when he contracted to acquire

[105] *Desmond Higgins v. HMRC* [2019] EWCA Civ 1860. See Appendix I
[106] *Higgins v. HMRC* at para. 2
[107] *Higgins v. HMRC* at para. 7

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the Apartment on 2nd October 2006 and not when that contract was completed on 5th January 2010.[108]

7.55 Newey LJJ, delivering the leading judgment in the Court of Appeal, concluded that HMRC's argument defeated the purposes of MRR,[109] was contrary to ordinary English usage[110] and extended the application of s.28, which is a deeming provision, beyond the purposes for which it was enacted[111] so that:

> *'Mr Higgins' "period of ownership" of the Apartment for the purpose of section 223 of the TCGA did not begin until his purchase was completed.'*[112]

7.56 Does *Higgins v. HMRC* indicate that the Normal Usage Construction is wrong and that the Special Usage Construction is correct so that the Period of Ownership in respect of a dwelling-house for the purpose of the MRR can include a period before the dwelling-house existed? Not necessarily. The application of the Normal Usage Construction was not argued before the Court of Appeal or the lower courts.[113] What is more, it seems reasonable to assume that the external walls of the St Pancras Hotel existed for all the periods relevant to the case. The report does not record how much of the original structure was incorporated into the new structure or at what stage the whole building might have been properly described as a dwelling-house or a collection of dwelling-houses even if they were not currently habitable. So this was not a case in which a new building was erected but one in which an existing one was altered and is not, therefore, a direct authority on determining the Period of Ownership of a newly constructed building for the purposes of the MRR.

Lee v. HMRC

7.57 The case of *Lee v. HMRC*[114] is the second case which is of direct relevance to the Period of Ownership Issue. It is, as was *Henke v. HMRC*, also a decision of the FtT

[108] *Higgins v. HMRC* at para. 16
[109] *Higgins v. HMRC* at para. 17
[110] *Higgins v. HMRC* at para. 21
[111] *Higgins v. HMRC* at paras. 24 - 25
[112] *Higgins v. HMRC* at para. 29. It follows that his period of ownership ended for this purpose when his contract to sell the Apartment was completed and not when that contract was made
[113] Unsurprisingly, in view of the fact that the Period of Ownership Issue was not the subject of argument by the parties, *Henke v. HMRC* was not cited in the case
[114] *Gerald Lee and Sarah Lee v. HMRC* [2022] UKFTT 175 (TC) TC08502. See Appendix I

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and therefore only of persuasive authority. In contrast to *Henke v. HMRC,* however, determining the Period of Ownership was the only matter at issue in the case and the appellant was represented by Senior Counsel, Laurent Sykes QC. The result of that was that, unlike in *Henke v. HMRC*, the arguments for the application of the Normal Usage Construction were clearly and fully set out to the Tribunal.

7.58 The relevant facts are straightforward.

7.59 In October 2010 the appellants, Mr and Mrs Lee, jointly purchased a freehold interest (the 'Nuns Walk Freehold'[115]) in an area of land (the 'Nuns Walk Land'[116]) on which stood a dwelling-house (the 'Original Nuns Walk Structure').[117] Between October 2010 and March 2013 the Original Nuns Walk Structure was demolished and a new structure (the 'Revised Nuns Walk Structure'[118]) was built[119] and Mr and Mrs Lee took up residence in it on 19th March 2013.[120] They completed a sale of the Nuns Walk Freehold on 22nd May 2014 (the 'Nuns Walk Freehold Disposal'[121]).[122]

7.60 As we have said,[123] the only matter at issue between the parties was the Period of Ownership Issue.[124] HMRC adopted the Special Usage Construction and asserted that the relevant Period of Ownership for determining MRR on the Nuns Walk Freehold Disposal began on 26th October 2010 when Mr and Mrs Lee acquired the Nuns Walk Freehold.[125] Mr and Mrs Lee adopted the Normal Usage Construction and contended that the Period of Ownership began on the completion of the Revised Nuns Walk Structure on 19th March 2013.[126]

7.61 HMRC cited *Henke v. HMRC* and repeated the HMRC Primary Argument advanced in that case contending:

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[115] See Appendix I
[116] See Appendix I
[117] *Lee v. HMRC* at para. 2
[118] See Appendix I
[119] *Lee v. HMRC* at para. 3
[120] *Lee v. HMRC* at para. 4
[121] See Appendix I
[122] *Lee v. HMRC* at para. 5
[123] See para. 7.57 above
[124] *Lee v. HMRC* at para. 17
[125] *Lee v. HMRC* at para. 38
[126] *Lee v. HMRC* at para. 30

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’42. … that the Appellants acquired, owned and disposed of a single asset, being an interest in land, and that they made changes to that asset by demolishing the house which was part of that interest in land at the time of acquisition, and constructing a new house.

43. HMRC say that in order to succeed in his appeal the Appellants would somehow need to demonstrate that the interest in land acquired in October 2010 was in some way a different asset or interest to the dwelling house subsequently built on it so that the period of ownership of the dwelling-house (or rather, more accurately, land including the dwelling-house) is then different to the period of ownership of the interest in land originally acquired. HMRC contend that, the relevant provisions of the TCGA 1992 cannot be construed in such a way as to regard the Appellant as having a period of ownership of a dwelling-house separate from his period of ownership of the land. Indeed, HMRC contend the legislation points in the opposite direction with Section 288(1) TCGA 1992 stating ' “land” includes messuages, tenements, and hereditaments, houses and buildings of any tenure;”

44. HMRC say absent any provision in the PPR legislation allowing a dwelling-house to be treated as a separate asset to the land on which it is situated, HMRC submit that the natural meaning of the phrase the “period of ownership” used in s.223 TCGA 1992 can only be construed as the period of ownership of the single asset consisting of the Appellants' interest in land and any buildings which may be erected on it.’[127]

7.62 In response to this the Appellants’ arguments in the case were focused on the actual words used in the relevant statute and on their meaning in ordinary English usage:

’26. The Appellants say that “period of ownership” in s222(1) and s223(1) and (2) TCGA 1992 is not defined.

27. S222(7) is not a definition (as was recognised by the Court of Appeal in Higgins v Commissioners for HMRC … at s26 and as was argued by HMRC in

[127] *Lee v. HMRC* at paras. 42 - 44

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Henke and accepted by the Special Commissioner, at s71(2) and s123). "Period of ownership" should therefore take its ordinary meaning and the wording of each of these provisions clearly refers to the ownership of the dwelling-house.

28. The asset disposed of is the legal interest in the land but the Appellants' case is that what attracts relief is that part of the asset which corresponds to dwelling house in s222(1)(a) and those grounds which are in s222(1)(b). This is why apportionment of consideration may be required – as mentioned in s222(10).

29. The Appellants say that if "dwelling house" was to mean "land" then there would be no need for s222(1)(b) because all the land within the title would be already included within the "dwelling house" wording of s222(1)(a).

30. In any event, the Appellants argue that no asset can comprise or include a dwelling house until the dwelling house has been built.'[128]

7.63 The Tribunal Judge noted that she was not bound by the decision in *Henke v. HMRC*. She went on to say that she did not agree:

'51. … with HMRC that "dwelling house" should be read to include land. The fact that the definition of "land" includes dwelling houses upon that land does not operate in reverse to mean that "dwelling house" should be read to include the land. The fact that "dwelling house" is used in the legislation means it is capable of being treated for some purposes separately to land within the same title.

52. We agree with the Appellant that that the natural construction of the legislation is that "period of ownership" refers to period of ownership of the dwelling house.

[128] *Lee v. HMRC* at paras. 26 - 30

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53. In every part of the legislation concerned, "period of ownership" would appear to attach to the "dwelling house" where the taxpayer may or may not reside. No mention is made of the land in reference to "period of ownership".'[129]

7.64 As it had done in *Henke v. HMRC*,[130] HMRC supported its primary argument by reference to the purpose of the MRR legislation and the anomalies which, HMRC asserted, would arise from the Normal Usage Construction.

7.65 First, HMRC repeated the argument in relation to TCGA 1992 s.222(7) which it had advanced[131] in *Henke v. HMRC:*

'45. HMRC also say that if the ownership of the dwelling-house could somehow be treated as separate from the ownership of the land originally acquired then this would mean that the Appellants had had different interests at different times; being the interest in land acquired and subsequently an interest in a dwelling-house (or, more correctly, the land including the dwelling-house) which replaced the interest in land originally acquired. In that case s.222(7) TCGA 1992 would apply, HMRC say, to set the period of ownership at the beginning of the first acquisition taken into account in the computation of the gain to which s.222 TCGA 1992 applies. The first acquisition taken into account in the computation of the gain to which s.222 TCGA 1992 applies would be the acquisition of the land in October 2010. In turn, this would mean that the period of ownership would commence at the time of the acquisition of that land.'[132]

7.66 In rejecting this argument the Tribunal Judge did not set out her reasoning in any detail merely saying:

'73. We do not agree with HMRC on this point. We agree that a single asset was purchased and then subsequently sold. We therefore do not think that s222(7) is in point as there is no question that this is not a case where separate interests (e.g. leasehold and freehold) were owned at different times. But we do

[129] *Lee v. HMRC* at paras. 51 - 53
[130] See paras. 7.18 – 7.27 above
[131] See para. 7.21 above
[132] *Lee v. HMRC* at para. 45

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not agree that simply because we are dealing with one asset, the legislation for the relief has to operate on the period of ownership of that one asset.'[133]

7.67 As to HMRC's arguments on purpose and anomalies the Tribunal Judge commented that the parliamentary draftsman of the provisions was unlikely to have had in mind situations such as that involved in *Lee v. HMRC:*

> *'59. We do not consider that this case, which is clearly unusual on its facts, will have been considered one way or the other very carefully when the legislation was drafted.'*[134]

7.68 HMRC had pointed:

> *'62. … to the fact that someone could own a dwelling house and simultaneously own a plot of land, which has risen considerably in value during their ownership. They could then build on the land, sell their dwelling house (with full PPR exemption), move into the newly built house, and in due course sell that with full exemption.'*[135]

7.69 In reply the Appellant had pointed out:

> *'63. … if the building of the house was in order to mask the gain on the land, PPR exemption would be denied by virtue of s224(3) TCGA 1992.*
>
> *64. … it would be unfair, in a similar case … where there was no gain on the land prior to the building of the house, that part of any gain on the house should be denied because of the ownership of the land.'*[136]

7.70 In respect of these arguments the Tribunal Judge concluded:

> *'65. The legislation for apportionment has always contained "anomalies" from the outset by apportioning based on time rather than based on valuations at specific points in time.*

[133] *Lee v. HMRC* at para. 73
[134] *Lee v. HMRC* at para. 59
[135] *Lee v. HMRC* at para. 62
[136] *Lee v. HMRC* at paras. 63 & 64

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66. We do not consider that anomalies on either side point convincingly to the requirement to read the legislation any way than its natural reading.'[137]

7.71 The Tribunal Judge also observed:

'76. The Appellant pointed to other examples in Capital Gains Tax legislation where conditions that have been satisfied for a short period of time have an effect over the whole of the gain on an asset even if the period of ownership was longer than the period of time for which the conditions have been satisfied, for example Entrepreneur's relief (as it used to be called) s169H – s169V TCGA 1992 and the substantial shareholding exemption in Schedule 7AC TCGA 1992. Whilst these are in no way determinative, it is possible both conceptually and as the Appellant points out, actually in practice to have legislation that operates this way.'[138]

7.72 Finally, HMRC had raised the same argument in respect of ESC D49 that it had raised in *Henke v. HMRC*;[139] that the Extra Statutory Concession was based on the assumption that the Special Usage Construction applies and that this, in some way, indicated that was the correct construction of the Period of Ownership. It updated the argument by referring to the subsequent enactment of TCGA 1992 s.223ZA(2).[140] In respect of this the Tribunal Judge simply said:

'81. We agree with the Appellant that the legislation must be looked at on its own an [sic] *the existence or not of an Extra Statutory Concession has no bearing on how the legislation should be interpreted.'*[141]

7.73 In the light of her discussion the Tribunal Judge concluded:

'82. We consider that in the absence of definitions, the legislation should be read with its natural construction, unless doing so would lead to a clear anomaly contrary to the wishes of Parliament.

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[137] *Lee v. HMRC* at paras. 65 & 66
[138] *Lee v. HMRC* at para. 76
[139] See paras. 7.19 & 7.20 above
[140] See paras. 7.45 – 7.51 above
[141] *Lee v. HMRC* at para. 81

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83. We do not think that there is a clear definition of period of ownership.

84. For the reasons given above, we consider that the natural reading of the legislation is that "period of ownership" means the period of ownership of the dwelling house that is being sold.

85. We do not consider there are compelling reasons to depart from the natural reading of the legislation.

86. We therefore ALLOW this appeal.'[142]

Conclusion on the relevant case law

7.74 The only directly relevant case before *Lee v. HMRC*, therefore, *Henke v. HMRC*, supports the Special Usage Construction. That case, however, is only persuasive and it is of weak authority because the arguments for the Normal Usage Construction were somewhat garbled by the appellant,[143] so that the Special Commissioner did not have the benefit of a considered presentation of the arguments which may be made in favour of that construction and did not identify those arguments himself.[144]

7.75 The subsequent cases of *McHugh v. HMRC* and *Higgins v. HMRC* were only indirectly relevant to the Period of Ownership Issue.[145] *McHugh v. HMRC* was also of only persuasive authority and was of weak persuasiveness.[146] The case of *Higgins v. HMRC*, as a decision of the Court of Appeal, is binding but it was not binding in respect of the Period of Ownership Issue because a consideration of that issue was not part of the *ratio decidendi* of the case.[147]

7.76 *Lee v. HMRC*, although it was also not a binding, but only a persuasive, decision, is of direct relevance to the Period of Ownership Issue and by contrast to *Henke v. HMRC*

[142] *Lee v. HMRC* at paras. 82 - 86
[143] Who appeared in person. At least they were garbled as summarised in the Special Commissioner's decision
[144] See paras. 7.10 – 7.35 above
[145] See paras. 7.36 – 7.56 above
[146] See paras. 7.10 – 7.35 above
[147] See paras. 7.52 – 7.56 above

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is of strong persuasiveness because the Tribunal had the benefit of full argument of the taxpayer's case by a well-respected QC who is a specialist in revenue law, the case was solely concerned with the Period of Ownership Issue and contains a substantial consideration of the arguments of both parties.[148]

7.77 It is likely, therefore, that a future tribunal or a court will follow *Lee v. HMRC* on the Period of Ownership Issue rather than *Henke v. HMRC*.

7.78 It remains open, therefore, in any future case for a taxpayer to argue that the Normal Usage Construction is the correct one.

'So far as attributable to the disponer'

7.79 We have seen,[149] that HMRC argued both in *Henke v. HMRC* and in *Lee v. HMRC* that it is anomalous that a taxpayer's gains in such situations would, under the Normal Usage Construction, be wholly relived by MRR as those gains might well reflect the increase in value of the relevant areas of land between their acquisition and the building of a new dwelling-house. Even if one assumes that the Normal Usage Construction is correct, however, there is another way in which MRR might be restricted in these circumstances.

7.80 Section 222(1) applies to a gain *'so far as attributable to the disposal of, or of an interest in … a dwelling-house or part of a dwelling-house'* falling within s.222(1)(a).[150] If one applies the Normal Usage Construction to s.222(1)(b) might it be that a part of the gain on the disposal of an interest in land on which a dwelling-house has been built during the disponer's ownership of the land could be said not to *be 'attributable to the disposal of, or of an interest in, a dwelling-house or part of a dwelling-house'* so that some sort of allocation is necessary to determine which part of the gain is attributable to the dwelling-house and which part is not?

7.81 Such an argument might well be made by HMRC in a future case but the Authors think that it is, on balance, incorrect.

[148] See paras. 7.57 – 7.73 above
[149] See paras. 7.18 & 7.24 above
[150] See para. 3.2 above

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7.82 That is because s.223(2)[151] is plainly designed to restrict MRR by reference to periods when the dwelling-house has not been used as the disponer's main residence. It would be odd if the draftsman had decided to include a detailed formula to achieve this in s.223 whilst further restricting the relief under s.222 but without providing a detailed formula to do so.

7.83 There is a general apportionment provision in the MRR legislation, TCGA 1992 s.222(10), but it applies to apportion consideration and not gains.

ONLY A FUTURE CASE WILL RESOLVE THESE UNCERTAINTIES

8.1 So the application of MRR to dwelling-houses which have been built during the disponer's period of ownership of the interest in land on which they stand raises rather complex issues as does the application of MRR in many other circumstances. Only a future case is likely to resolve these particular uncertainties. It may be paradoxical to hope that the well-reasoned decision in favour of the taxpayer in *Lee v. HMRC* should be the subject of an appeal by HMRC, but if it were it would be an opportunity for the Upper Tribunal to confirm the FtT's decision creating a precedent which is binding and not merely persuasive.

[151] See para. 3.1 above

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APPENDIX I

GLOSSARY OF WORDS AND PHRASES

In this Review we use various words and phrases in special senses which we define in this Appendix. This Appendix lists those words and phrases and gives their definitions and the paragraphs in which they are first used.

DEFINED WORD OR PHRASE	DEFINITION	PARAGRAPH OF THE PAPER IN WHICH THE DEFINED WORD OR PHRASE IS FIRST USED
Building Works	The works on the structures in the Examples which were undertaken after the Purchase Completions	2.1
Examples	Example A, Example B, Example C and Example D together	2.1
Freehold	A freehold interest acquired under the Examples	2.1
FtT	First Tier Tribunal	6.2
Gibson v. HMRC	The case of *Paul Gibson v. HMRC* [2013] UKFTT 626 (TC).	6.3
Henke v. HMRC	The case of *Anthony John Henke and Alice Joyce Henke v. HMRC*; SpC 550 [2006] STC (SCD) 561	7.10
Henke Disposals	The disposals if the gains arising on which were the subject of *Henke v. HMRC* and which are referred to in paras. 7 – 9 of that case	7.10

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Henke Freehold	The freehold referred to in *Henke v. HMRC* at para. 3 of that case	7.10
Henke Land	The land subject to the Henke Freehold referred to in *Henke v. HMRC* at para. 3 of that case	7.10
Higgins v. HMRC	The case of *Desmond Higgins v. HMRC* [2019] EWCA Civ 1860	7.52
HMRC's First Subsidiary Argument in *Henke*	HMRC's first subsidiary argument in *Henke v. HMRC* set out in para. 7.19	7.18
HMRC's Fourth Subsidiary Argument in *Henke*	HMRC's fourth subsidiary argument in *Henke v. HMRC* set out in para. 7.26	7.18
HMRC's Primary Argument in *Henke*	HMRC's primary argument in *Henke v. HMRC* set out in para. 7.17	7.17
HMRC's Second Subsidiary Argument in *Henke*	HMRC's second subsidiary argument in *Henke v. HMRC* set out in para. 7.21	7.18
HMRC's Subsidiary Arguments in *Henke*	HMRC's subsidiary arguments in *Henke v. HMRC* which are set out in paras, 7.18 – 7.19, 7.21, 7.24 and 7.26	7.18
HMRC's Third Subsidiary Argument in *Henke*	HMRC's third subsidiary argument in *Henke v. HMRC* set out in para. 7.24	7.18
Land	Land which is the subject of a Freehold under the Examples	2.1
Lee v. HMRC	The case of *Gerald Lee and Sarah Lee v. HMRC* [2022] UKFTT 175 (TC) TC08502	7.57
Main Residence Relief	Relief under TCGA 1992 s.223	1.1

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McHugh v. HMRC	The case of *Mr George McHugh and Mrs Mary McHugh v. HMRC* [2018] UKFTT 403 TC (TC06605)	7.36
MRR	Main Residence Relief	1.1
Normal Usage Construction	The construction of the phrase ‘period of ownership’ in the MRR legislation as referring to the period during which the disponer owned an interest in land which conferred rights in respect of the dwelling-house concerned with the result that that period cannot include any period during which the dwelling-house did not exist	7.6
Nuns Walk Freehold	The freehold interest which is referred to in *Lee v. HMRC* at para. 2 of that case	7.59
Nuns Walk Freehold Disposal	The disposal of the Nuns Walk Freehold which is referred to in *Lee v. HMRC* at para. 5 of that case	7.59
Nuns Walk Land	The land which is the subject of the Nuns Walk Freehold which is referred to in *Lee v. HMRC* at para. 2 of that case	7.59
Original Nuns Walk Structure	The dwelling-house which stood on the Nuns Walk Land the demolition of which is referred to in *Lee v. HMRC* at para. 3 of that case	7.59
Old Oak House	The dwelling-house built on the Henke Land and completed in June 1993 referred to in *Henke v. HMRC* at paras. 4 & 5	7.10
Original Plot	Land on which stood an Original Structure under the Examples	2.1
Original Structure	A structure which stood on the Land when the Purchase Completions took place under the Examples	2.1

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Period of Ownership	The phrase ‘period of ownership’ as it is used in TCGA 1992 s.222 – s.226B	7.1
Period of Ownership Issue	The question of how the phrase the ‘Period of Ownership’ is to be construed	7.1
Purchase Completion	The completion of a Purchase Contract under the Examples	2.1
Purchase Contract	A contract made in 2012 to purchase a Freehold under the Examples	2.1
Revised Nuns Walk Structure	The dwelling-house standing on the Nuns Walk Land the construction of which is referred to in *Lee v. HMRC* at para. 3 of that case	7.59
Revised Plot	Land on which stood a Revised Structure under the Examples	2.1
Revised Structure	A structure which stood on the Land at a Sale Completion under the Examples	2.1
Sale Completion	The completion of a Sale Contract under the Examples	2.1
Sale Contract	A contract for the sale of a Freehold made in August 2022 under the Examples	2.1
Special Usage Construction	The construction of the phrase ‘period of ownership’ in the MRR legislation, under which the phrase refers to the period during which the disponer has owned the interest in land by virtue of which he had an interest in the dwelling-house concerned immediately before the disposal	7.6
TCGA 1992	Taxation of Chargeable Gains Act 1992	1.1
Temporary Accommodation	Accommodation in which Mr A, B, C or D lived from August 2015 to August 2016 under the Examples	2.1

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