Pre-incarnated dwellings

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consider the application of main residence relief to situations where a taxpayer has acquired a dwelling and demolished it to erect a new residence.

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We recently advised a couple who had disposed of land which they had acquired with a residence on it which they had demolished in order to build a new home. In this article we consider how main residence relief applies in such circumstances.

Relevant legislation

TCGA 1992, s 223(1) provides: 'No part of a gain to which s 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.'

Similar provisions are made in s 223(2) in respect of dwelling houses which have been the disponer's main residence only for part of his period of ownership.

TCGA 1992, s 222(1) provides:

'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.'

Key points

- Strictly, one does not own a dwelling-house but only an interest in the land on which it sits.
- It is argued that the period of ownership cannot include a time when the dwelling-house did not exist.
- The First-tier Tribunal decision in *Lee* in favour of the taxpayer supports the normal usage construction of period of ownership.
- HMRC has appealed the *Lee* decision to the Upper Tribunal.

On the authority of *Paul Gibson* (TC3021), it is likely that, in such circumstances as those we are considering, the original dwelling and the new dwelling are not the same dwelling-house for the purposes of main residence relief and, therefore, that the dwelling-house referred to in s 222 and s 223, is the new dwelling alone.

Period of ownership

How is the phrase the 'period of ownership' to be construed for the purposes of s 222 and s 223?

Neither s 222 nor s 223 says expressly to what gains s 222 applies but it is surely implicit that it applies to a gain arising on the disposal of an asset, falling within the descriptions in s 222(1) which meets the conditions of s 223(1) or (2). That asset 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 falling within s 222(1)(b). The trouble with this description is that, strictly, one does not own a dwelling-house but only an interest in the land on which it sits. It is by virtue of the ownership of that interest in 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.

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 main residence relief, 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? As a matter of ordinary English usage no one would say that he did.

The natural construction of the period of ownership is, therefore, that it is 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. We call this construction the 'normal usage construction'. We call the contrary construction, that the period of ownership is 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'.

Relevant case law

If there were no relevant case law on the matter, therefore, we should conclude that the normal usage construction is certainly the correct one. There are four cases, however, which are of direct or indirect relevance to the period of ownership issue.

Henke

Mr and Mrs Henke (SpC 550) concerned a couple who purchased the freehold of bare land in 1982 with outline planning permission for a house to be built on the land. For various reasons, they only began construction of a new dwelling-house ('Old Oak House') in 1991 and took up residence in it on its completion in 1993. They continued to reside in it at the time the case was heard.

The case concerned disposals by Mr and Mrs Henke of two plots of the land with planning permission to build further residences which, at the time of the relevant disposal, formed part of the garden and grounds of Old Oak House. These disposals were part disposals of the freehold.

One of the issues in dispute in respect of the amount of main residence relief was the period of ownership. HMRC asserted that the special usage construction applied.

The period of ownership was 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.

HMRC's primary argument was: '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 TCGA 1992, s 28 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 of ownership of the asset in question, which here was the land.'

The Special Commissioner summarised Mr Henke's main argument in response as follows: '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.'

The Special Commissioner rejected this argument and accepted HMRC's primary argument stating:

> '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 TCGA 1992, s 288(1), 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 it have regard only to the period for which the dwelling-house has been in existence?'

Having stated the matter in this way, he then implicitly reformulated the question at issue by saying: '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.'

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 of ownership of the land and to further identify the part of that period during which this ownership conferred rights in respect of the dwelling-house concerned. Clearly that can only be the period during which the dwelling-house existed.

McHugh

McHugh (TC6605) is a case which might be said to be of indirect relevance to the period of ownership issue. It concerned a couple who bought freehold land in 2004 and then began building a dwelling-house on the land. On its completion in 2007 they took up residence in it continuing to occupy it as their main residence until its sale in 2010.

HMRC asserted that, because the freehold of the land had been held since 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 of the chargeable gain arising on the disposal of the freehold was relieved by main residence relief.

The principal question at issue between the parties was not what was the period of ownership but whether extra-statutory concession D49 applied to reduce the chargeable gain. It was implicit, therefore, that the period of ownership included the period before the dwelling-house existed. The parties and the First-tier Tribunal proceeded on this assumption without argument being advanced on the issue. Implicitly, therefore, they adopted the special usage construction.

Higgins

In *Higgins v CRC* [2019] STC 2312, Mr Higgins entered into a contract to take a 125-year lease of an apartment from Manhattan Loft St Pancras Apartments Limited on 2 October 2006. 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 First-tier Tribunal's words, 'a space in a tower'.

Mr Higgins only acquired a right of occupation when the contract was completed, in January 2010.

HMRC asserted that, because TCGA 1992, s 28 treats a disposal as taking place when a binding contract for the disposal is made, Mr Higgins' period of ownership started when he contracted to acquire the apartment in 2006 and not when that contract was completed in 2010.

Newey LJJ in the Court of Appeal said that HMRC's argument defeated the purposes of main residence relief, was contrary to ordinary English usage and extended the application of s 28, which is a deeming provision, beyond the purposes for which it was enacted so that: 'Mr Higgins' "period of ownership" of the apartment … did not begin until his purchase was completed.'

It is not clear that the decision was based on an assumption that the special usage construction was correct. It seems reasonable to assume that the external walls of the St Pancras Hotel existed for all the periods relevant to the case so this was not necessarily a case in which a new building was erected but might well be one in which an existing building continued to exist but was extensively altered. Even if the normal usage construction were adopted, therefore, if HMRC's argument in respect of s 28 were correct, the period of ownership might still have started on the date of the purchase contract.

Lee

The case of *Lee* (TC8502) is the second case which is of direct relevance to the period of ownership issue. Like *Henke*, it was a decision of the First-tier Tribunal and therefore only of persuasive authority. Unlike *Henke* determining the period of ownership was the only matter at issue in the case and the appellant was represented by senior counsel, so that the arguments for the application of the normal usage construction were clearly and fully set out to the tribunal.

In 2010 Mr and Mrs Lee jointly bought a freehold interest in an area of land on which stood a dwelling-house. The original house was demolished and a new house was built in which Mr and Mrs Lee took up residence in 2013. They completed a sale of the freehold in 2014.

HMRC adopted the special usage construction and asserted that the relevant period of ownership began when Mr and Mrs Lee acquired the freehold. Mr and Mrs Lee adopted the normal usage construction and contended that their period of ownership began on the completion of the new house.

HMRC repeated its primary argument advanced in *Henke*.

The tribunal judge noted that she was not bound by the decision in *Henke*. She did not agree 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.'

The judge continued: 'The natural construction of the legislation is that "period of ownership" refers to period of ownership of the dwelling house. 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".'

In finding for the taxpayers the tribunal judge concluded:

> '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.
>
> 'We do not think that there is a clear definition of period of ownership.
>
> '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.
>
> 'We do not consider there are compelling reasons to depart from the natural reading of the legislation.'

Conclusion on the case law

The only directly relevant case before *Lee*, therefore, *Henke*, supports the special usage construction. That case, however, is only persuasive and it is of weak authority. That is because the arguments for the normal usage construction were not fully set out by the appellant so that the Special Commissioner did not have the benefit of a considered presentation of the arguments which might be made in favour of that construction and he did not identify those arguments himself.

The subsequent cases of *McHugh* and *Higgins* were only indirectly relevant to the period of ownership Issue. *McHugh* was also of only persuasive authority and was of weak persuasiveness. The case of *Higgins*, as a decision of the Court of Appeal, is binding but it was not binding in respect of the period of ownership issue which was not part of the *ratio decidendi* of the case.

Lee, although it was also only a persuasive decision, is directly relevant to the period of ownership issue and, by contrast to *Henke*, is of strong persuasiveness. That is 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 and made a substantial consideration of the arguments of both parties.

It is likely, therefore, that future decisions will follow *Lee* rather than *Henke*.

Welcome appeal?

It might seem paradoxical that we welcome the fact that the well-reasoned decision in favour of the taxpayer in *Lee* is to be the subject of an appeal by HMRC. The appeal will, however, be an opportunity for the Upper Tribunal to confirm the First-tier Tribunal's decision and to create a precedent which is binding and not merely persuasive. ●

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