RUDGE REVENUE REVIEW

ISSUE XXXIII

PRE-EXISTING DWELLINGS?

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INDEX

INTRODUCTION

An old relief still posing difficulties

1.1 Main Residence Relief ('MRR')[1] has been a feature of CGT[2] since it was introduced in Finance Act 1965.[3] In spite of its age, however, very common situations continue to raise difficult questions of construction in respect of it.

Demolition and rebuilding instead of refurbishment and improvement

1.2 A previous issue of the Rudge Revenue Review (Issue XXX) considered the not uncommon situation where a purchaser of a residence finds that, rather than refurbishing the existing structure, it is more economic to demolish it and to build a new one. In that issue of the Rudge Revenue Review we considered some of the difficult issues such a transaction poses in applying MRR.

Opposing decisions of only persuasive authority

1.3 Those issues included determining the relevant 'Period of Ownership'[4] of the relevant interest within TCGA 1992[5] s. 222(1). This period is used in calculating MRR where the dwelling-house which is the subject of the disposal has not been the individual's main residence throughout this period.[6]

1.4 That issue was considered in the cases of *Henke v. HMRC*[7] (a decision of the Special Commissioners) and *Lee v. HMRC*[8] (a decision of the FtT).[9] The decision of the Special

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1 See Appendix I
2 See Appendix I
3 See Finance Act 1965 s. 29
4 The period of ownership referred to in TCGA 1992 s. 222(1)(a). See Appendix I
5 Taxation of Chargeable Gains Act 1992. See Appendix I
6 TCGA 1992 s. 223. See para. 3.2.below
7 *Anthony John Henke and Alice Joyce Henke v. HMRC* SpC 550 [2006] STC (SCD) 561
8 *Gerald Lee and Sarah Lee v. HMRC* [2022] UKFTT 175 (TC) TC08502) We refer this decision as the '*Lee* FtT Decision'. See Appendix I
9 The First-Tier Tribunal (Tax). See Appendix I

Commissioners in *Henke v. HMRC*, made by a single commissioner, was in favour of HMRC and found that the relevant Period of Ownership was that of the interest in land on which, subsequent to its acquisition by the taxpayers concerned, the new structure was built.[10]

1.5 In the *Lee* FtT Decision, the FtT declined to follow the Special Commissioner's decision in *Henke v. HMRC* and found that the relevant Period of Ownership began on completion of the new structure which constituted the dwelling-house and which became the taxpayers' residence.[11]

1.6 Decisions of the FtT and, before their supersession by the FtT, the Special Commissioners are not of binding, but are only of persuasive, authority.[12] As we said in Issue XXX of the Rudge Revenue Review, the *Lee* FtT Decision was more persuasive than the decision in *Henke v. HMRC*. That was because in *Henke v. HMRC* the taxpayer represented himself and, in spite of his best efforts, rather garbled the relevant arguments. Furthermore, determining the Period of Ownership was only one of the issues in dispute in the case and the issue was given only scant consideration by the single Special Commissioner. In contrast, in the *Lee* FtT Decision the Tribunal had the benefit of a full presentation of the arguments for the taxpayers by a well-respected QC who was a specialist in Revenue Law and the decision was solely concerned with the Period of Ownership issue, contained a substantial consideration by the Tribunal of the arguments of both parties on the issue and was a unanimous decision of a tribunal comprising a Tribunal Judge and a Tribunal Member.

[10] We call this construction the 'Land Interest Construction'. See Appendix I
[11] We call this construction the 'Dwelling-House Interest Construction'. See Appendix I
[12] Simons Taxes Part A2 para. A2.106

The UT Decision

1.7 The issue of the relative persuasiveness of the two decisions has, however, ceased to be of relevance because *Lee v. HMRC* has now been heard[13] by the Upper Tribunal (the 'UT')[14] and its decision in favour of the taxpayer is binding on the FtT having priority over the Special Commissioner's decision in *Henke v. HMRC*.[15]

THE FACTS IN *LEE v. HMRC*

2.1 The facts in *Lee v. HMRC* were straightforward.

2.2 In October 2010 the appellants, Mr and Mrs Lee, jointly purchased a freehold interest (the 'Nuns Walk Freehold')[16] in an area of land (the 'Nuns Walk Land')[17] on which stood a dwelling-house (the 'Original Nuns Walk Structure').[18] Between October 2010 and March 2013 the Original Nuns Walk Structure was demolished and a new structure (the 'Revised Nuns Walk Structure')[19] was built.[20] Mr and Mrs Lee took up residence in the Revised Nuns Walk Structure on 19th March 2013[21] and it is implicit in HMRC's formulation of its case that it accepted that it was the Lees' main residence from that date until its disposal. They contracted to sell the Nuns Walk Freehold some time after 6th April 2014[22] and completed the sale on 22nd May 2014[23] (the 'Nuns Walk Freehold Disposal').[24]

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13 *HMRC v. Gerald Lee and Sarah Lee* [2023] UKUT 00242 (TCC). We refer to this decision as the *Lee* UT Decision
14 See Appendix I
15 See Simons Taxes Part A2 para. A2.106
16 See Appendix I
17 See Appendix I
18 *The Lee* FtT Decision at para. 2 and the *Lee* UT Decision at para. 10
19 See Appendix I
20 The *Lee* FtT Decision at para. 3 and the *Lee* UT Decision at para. 10
21 The *Lee* FtT Decision at para. 4 and the *Lee* UT Decision at para. 10
22 The *Lee* FtT Decision at para. 6
23 The *Lee* FtT Decision at para. 5 and the *Lee* UT Decision at para. 10
24 See Appendix I

THE RELEVANT LAW

3.1 At the time of the Nuns Walk Freehold Disposal,[25] TCGA 1992 s. 222(1) provided 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*
>
> *(b) land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area.'*[26]

3.2 Section 223 provided 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 18 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 18 months of the period of ownership in any event, divided by*
>
> *(b) the length of the period of ownership'*[27]

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[25] In this Review, where we give, or refer to a text from TCGA 1992, that text is as it was in force in 2014/15, the UK fiscal year in which Mr and Mrs Lee made the disposals which were the subject of *Lee v. HMRC*

[26] The *Lee* UT Decision at para. 4

[27] The *Lee* UT Decision at para. 5

THE UT'S SUMMARY OF THE MATTERS AT ISSUE

4.1 In the *Lee* UT Decision, the UT summarised the matter at issue in the following way:

> *'There is no dispute here that s222(1) is engaged by the fact the new house was the Lees' main residence. The dispute revolves around the length of the "period of ownership" in the apportionment provision in s223(2)(b); does the denominator in the fraction which is used for apportionment, refer to the length of ownership of the new dwelling house the Lees built (as the taxpayers, the Lees argue, and the FTT held) or to length of ownership of the plot of land on which had once stood the old house which was demolished (as HMRC argue).'*[28]

4.2 It explained:

> *'Although HMRC put their appeal on the basis of eight grounds, the central question at issue is a short one of statutory interpretation …*[29]
>
> *…*
>
> *'As Mr Pritchard, who appeared for HMRC, helpfully acknowledged in his written and oral submissions, the eight grounds HMRC raise are essentially sub-grounds of the central question of statutory interpretation, and we address them in the course of dealing with HMRC's fundamental case that the FTT erred in deciding the "period of ownership".'*[30]

[28] The *Lee* UT Decision at para. 6
[29] The *Lee* UT Decision at para. 3
[30] The *Lee* UT Decision at para. 12

THE POSITIONS OF THE PARTIES

5.1 HMRC adopted the Land Interest 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.[31] On this basis, HMRC claimed that gains of £541,821 had been omitted from the self-assessment returns of Mr and Mrs Lee.[32] One assumes, that this was because, under the Land Interest Construction, the Revised Nuns Walk Structure was Mr and Mrs Lee's main residence for only approximately 42% (18 (29 months + 14 months) x 100)[33] of their Period of Ownership and their MRR was restricted to this percentage of their total gain on their disposals.

5.2 Mr and Mrs Lee adopted the Dwelling-House Interest Construction and contended that their Period of Ownership began on the completion of the Revised Nuns Walk Structure on 19th March 2013.[34] Under that construction, the Revised Nuns Walk Structure was, therefore,[35] Mr and Mrs Lee's main residence for their entire Period of Ownership and so their MRR was not restricted at all.

A TWO STAGE APPROACH

6.1 The UT approached the issue in two stages.

6.2 First it considered what it called the *'matter of straightforward textual interpretation'*.[36] On this it concluded that:

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31 The *Lee* FtT Decision at para. 38 and the *Lee* UT Decision at para. 10
32 The *Lee* FtT Decision at para. 11 and the *Lee* UT Decision at para. 2
33 See TCGA 1992 s. 223(2)
34 The *Lee* FtT Decision at para. 4 and the *Lee* UT Decision at para. 10
35 See para. 2.2 above
36 The *Lee* UT Decision at para. 21

' …, the answer is clear: the taxpayers' interpretation, with which the FTT agreed, is the correct one.'[37]

6.3 Then it considered:

' … whether there is anything to suggest the provision ought to be read differently.'[38]

THE *'MATTER OF STRAIGHTFORWARD TEXTUAL INTERPRETATION'*

The purpose of MRR

7.1 In reaching its conclusion on the *'matter of straightforward textual interpretation'*,[39] the UT started by considering the purpose of the MRR:

'It is directed to the classic case where someone buys a house, lives it in [sic] *as their main residence, and then sells it at a gain. Brightman J's articulation of the purpose in Sansom v Peay … (to which HMRC's submissions and the FTT Decision both refer) noted that "the justification for the exemption is that when a person sells [their] home [they] frequently need to acquire a new home elsewhere…it 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."*

The apportionment provisions will, on the interpretation of both parties, operate so as to relieve only part of the gain where a person does not use the house as their only or main residence, for instance because they live somewhere else.'[40]

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37 See the *Lee* UT Decision at para. 23
38 See the *Lee* UT Decision at para. 23
39 See para. 6.2 above
40 See the *Lee* UT Decision at paras. 15 & 16

The question of statutory construction

7.2 The UT then posed the question which must be answered in any matter of statutory construction:

> *' … how do the words of the legislation, construed in accordance with the established principles of statutory construction, apply to the given facts?'* [41]

'Dwelling-House' is the only asset referred to in s. 222(1)

7.3 It went on to point out that:

> *'"Period of ownership" is not defined in the legislation. HMRC highlight that the phrase is silent in particular as to what asset is referred to.'* [42]

7.4 This is certainly true but, as we have seen,[43] TCGA 1992 s. 222(1)(a), where the phrase 'period of ownership' is first used, refers only to one asset:

> '*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'.*

7.5 In the absence of any statutory definition of the Period of Ownership and of any provision applying it to any other asset in the MRR legislation it is difficult to see that any other asset could be referred to other than the dwelling-house referred to in the very sentence in which the phrase 'period of ownership' appears. The draftsman might have put the matter beyond doubt by adding, after 'period of ownership', the words, 'of that dwelling-house' but it is well within the normal conventions of English usage for the draftsman to have relied upon the absence of any reference to any other asset in the sentence to make it obvious that it is the 'period of ownership' of the 'dwelling-house or part of a dwelling-house' to which s. 222(1)(a) refers.

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41 The *Lee* UT Decision at para. 17
42 The *Lee* UT Decision at para. 18
43 See para. 3.1 above

7.6 As the UT said:

> *'Mr Pritchard* [Counsel for HMRC] *emphasised the statute was silent as to the asset which was owned. But sometimes drafting is silent for the simple reason that its meaning is considered obvious. Having regard to the immediate surrounding context we consider it plain that the "period of ownership" can only refer to the ownership of the dwelling house. It is true the drafter has not specified the asset, but that simply reflects that the natural reading of the provision refers the period of ownership back to the preceding reference of "dwelling house", and that as a matter of language use terms are not repeated on or elaborated where their intended sense is clear. There is not a concept of ownership of anything else referred to in the section.'*[44]

7.7 As the UT went on to say:

> *'The fundamental difficulty with HMRC's interpretation, and their reliance on statutory context, is that there is no reference at all in the immediate context to any asset other than the dwelling house. The term "period of ownership" already requires reading in words. HMRC's interpretation requires not only reading in words, but reading in words which are not to be found in the section, nor indeed relevantly in any of the other provisions relating to PRR.*[45] *In contrast, as mentioned, the whole focus of the provision is on there being a dwelling house. In fact, when the term "land" is mentioned, it refers specifically to land for the person's occupation and enjoyment of the dwelling house.'*[46]

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[44] The *Lee* UT Decision at para. 21

[45] The UT used this term as an acronym for Private Residence Relief to refer to MRR although 'private residence' is not a phrase found in the relevant statutory provisions which refer throughout to 'main residence' but only in their headings

[46] The *Lee* UT Decision at para. 22

IS THERE ANYTHING TO SUGGEST THAT THE PROVISION OUGHT TO BE READ DIFFERENTLY FROM THE *'STRAIGHTFORWARD TEXTUAL INTERPRETATION'*?

8.1 Having decided, very firmly, for the taxpayers on the *'matter of straightforward textual interpretation'*,[47] the Tribunal went on to consider HMRC's wider arguments that, as the Tribunal characterised them, *'the provision ought to be read differently'* from the reading which results from the straightforward textual interpretation. The Tribunal had previously said that HMRC had put its appeal *'on the basis of eight grounds'*[48] but it did not list those eight grounds and it seemed to deal with rather more arguments than eight. We shall simply consider the Tribunal's consideration of the most important of HMRC's arguments in turn.

'**A dwelling-house is not capable of ownership separately from the grounds which it stands'**

8.2 The first of HMRC's wider arguments which the Tribunal considered was one which had represented the core of its arguments in the *Lee* FtT Decision. The UT recorded that:

> *'HMRC make much of the proposition that a dwelling house is not capable of ownership separately from the ground on which it stands.'*[49]

8.3 That is surely beside the point. Under the Dwelling-House Interest Construction a gain must arise which is *'attributable to the disposal of, or of an interest in … a dwelling-house or part of a dwelling-house'*.[50] Nothing in the section requires the interest to be solely in the dwelling-house. So the statutory question to be answered is whether the interest in land which is the subject of the disposal on which a gain has arisen includes an interest in a dwelling-house or part of a dwelling-house.

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47 See para. 6.2 above
48 The *Lee* UT Decision at para. 3
49 The *Lee* UT Decision at para. 24
50 See para. 3.1 above

8.4 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[51] and, subject to numerous common law and statutory exceptions, everything above the land and below the land.[52] Clearly if the interest disposed of is a freehold of land on which a dwelling-house sits that dwelling-house is affixed to the land so that the freehold interest includes an interest in the dwelling-house.

8.5 It is clear, therefore, that immediately before the Nuns Walk Freehold Disposal, Mr and Mrs Lee had interests in the Revised Nuns Walk Structure by reason of their owning the Nuns Walk Freehold.

8.6 In dismissing HMRC's argument on this point the Tribunal said:

> *'From the perspective of English land law, the dwelling house is itself "land". But the notion of a separate interest in the building, as distinct from the ground on which it stands,*[53] *is not, we think, what the provision envisages, nor what the taxpayers' interpretation entails. The interest in the dwelling house here means (at least as regards a house) not only the building but also the ground on which it stands. That reflects that in the mainstream case of a house intended to be captured by the relief, the building and the ground upon which it is situated are envisaged to be, and will be, one and the same dwelling house. The crucial and straightforward feature which distinguishes an ownership interest in a dwelling*

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[51] 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'

[52] 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'

[53] The Tribunal made an interesting additional point here stating:

> *'We do not agree, not least because the term "dwelling house" must be construed to include flats as well as houses – and the title to an individual flat will rarely include the ground on which the block of flats stands.'*

In respect of a leasehold interest in a flat other than a ground floor flat the leaseholder has an interest in a dwelling which consists of part of a building and that part is not affixed to any land but to another part of the building, in which he does not have an interest, which is, in turn, affixed to the land. The freeholder's interest is in the land on which the building stands and in the building itself

house in this context from an ownership interest in real property more generally (which will cover ownership of any building on it), is that an ownership interest in a dwelling house requires that a dwelling house exists.'[54]

Argument from s. 222(8)

8.7 Section 222(8) extends MRR in certain circumstances where an individual resides in job-related living accommodation. It provided:

'If at any time during an individual's period of ownership of a dwelling-house or part of a dwelling-house he—

(a) resides in living accommodation which is for him job-related and

(b) intends in due course to occupy the dwelling-house or part of a dwelling-house as his only or main residence,

this section and sections 223 to 226 shall apply as if the dwelling-house or part of a dwelling-house were at that time occupied by him as a residence.'

8.8 HMRC argued that because s. 222(8) specifically qualifies the 'period of ownership' as being 'of a dwelling-house' in s. 222(8):

'… if Parliament had intended that "period of ownership" in s223(1)[55] *to similarly refer to a dwelling house it would have said so. In Mr Pritchard's submission, there is good reason for a reference to ownership of the dwelling house there, because otherwise the provision would deem there to have been ownership of a main residence for a period, for example, where the taxpayer just had a bare plot and was yet to build a house.'*[56]

8.9 The Tribunal was surely right in its conclusion on this argument:

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[54] The *Lee* UT Decision at para. 25

[55] It seems odd that HMRC should have made this point by reference to s. 223(1) rather than to the main condition of MRR in s. 222(1)

[56] The *Lee* UT Decision at para. 26

'We do not think that can be right, as s228(b) would not be satisfied as there would not be a dwelling house in relation to which the taxpayer could have the requisite intention. Moreover, we do not see the reference to "period of ownership of a dwelling house" as seeking to introduce a new concept in contradistinction to a different period of ownership elsewhere – rather it serves as a reminder that the period of ownership in question is that of the dwelling house. If it was meant to be used in contradistinction, we would have expected to see the preceding references to "period of ownership" to state the relevant asset to which the ownership referred.'[57]

8.10 Further, far from s. 222(8) supporting the Land Interest Construction adopted by HMRC the Tribunal found that it provided a further argument in favour of the Dwelling-House Interest Construction:

'The reference in s222(8) to "period of ownership of a dwelling house" also illustrates that there is no difficulty in a dwelling house being "owned", as this is specifically contemplated by the legislation. Similarly, it is implicit in the reference to an interest in a dwelling house being acquired in s224(3) … that a dwelling house can be "owned" – if something is capable of being acquired, it follows that it must be capable of being owned.'[58]

HMRC's argument from s. 222(7)

8.11 TCGA 1992 s. 222(7) provided:

'In this section and sections 223 to 226, "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

[57] The *Lee* UT Decision at para. 26
[58] The *Lee* UT Decision at para. 26

under Chapter III of Part II is allowable as a deduction in the computation of the gain to which this section applies, …'.

8.12 HMRC argued:

'… if the taxpayers' and FTT's interpretation were correct, the "period of ownership" could only begin when the house was completed, thus conflicting with the terms of s222(7). According to HMRC the provision operates as follows: if a person buys a leasehold interest in bare land, then later buys the freehold and then builds and moves into the house, the "period of ownership" starts with the leasehold purchase - whereas on the taxpayers' interpretation it would only start with the completion of the house.'[59]

8.13 Again this argument appears to be misconceived. If the Dwelling-House Interest Construction is correct, s. 222(7) is necessary to deal with such situations as one where an individual has had an interest in a dwelling-house as a leaseholder which for a period has not been his main residence, the interest is subsequently enlarged to a freehold and at some point during the individual's ownership either of the leasehold or of the freehold the dwelling-house has become his main residence.

8.14 The Tribunal made a similar assessment of HMRC's argument in respect of s. 222(7) but with a slightly different emphasis:

'The conflict HMRC rely on only arises if it is assumed that the relevant acquisition is of different interests in real property, as opposed to different interests in the dwelling house (being interests in land on which a dwelling house stands). But whether that is the case (i.e., whether for the purposes of PRR, acquisition of the thing owned captures bare land, or is concerned with

[59] The *Lee* UT Decision at para. 27

acquisition of the land interest which encompasses a dwelling house) is the very point in issue.'[60]

HMRC's arguments by reference to the structure of other provisions in TCGA 1992 using the phrase 'period of ownership'

8.15 HMRC argued that:

' … separating the statutory phrase "period of ownership" from the period of owning the asset/interest being disposed of runs contrary to other provisions in the TCGA that use the same, or similar phrases to describe the asset being sold.'[61]

8.16 In making this point HMRC referred to TCGA 1992 ss. 14F, 47A and 152.[62]

8.17 The Tribunal rejected this argument on the grounds that these sections to which Counsel for HMRC referred simply show that in them:

' …, the period of ownership relates to the asset because of the words used. What these examples do not demonstrate is that there is, absent context specific to the provision, a structural assumption that the period of ownership will relate to the asset being sold. In fact, the other provisions that he references in his skeleton serve to reinforce that where the particular asset disposed of is meant to be referred to, then this is made clear. Thus, if it were intended that the ownership in the PRR relief was to refer to the asset, as distinct from the ownership of the dwelling house, then we consider this would have been spelled out.'[63]

8.18 In a further argument from the structure of the provisions HMRC asserted that:

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60 The *Lee* UT Decision at para. 28
61 The *Lee* UT Decision at para. 31
62 The *Lee* UT Decision at para. 32
63 The *Lee* UT Decision at para. 33

' … the FTT erred in treating the "reliefs" part of TCGA separately to the "gain calculation" parts. The FTT, in effect, rejected a submission that the generic function of the provisions informed their interpretation; the words fell to be interpreted on their own terms. The FTT also noted that it was conceptually possible, and possible in practice, for legislation to give relief over the whole of the gain on an asset, even if the period of ownership of the asset was longer than the period of time for which the conditions had to have been satisfied - giving the example of entrepreneur's relief and substantial shareholder exemption. HMRC do not take issue with that as a proposition, but say the FTT erred in placing reliance on those reliefs, given their very different conditions and purposes as compared to PRR.'[64]

8.19 The Tribunal found, however, that in making this argument HMRC misrepresented the points made by the FtT on this issue:

' … we do not consider the FTT was placing reliance on these provisions; it was simply explaining that reliefs fall to be interpreted according to their terms, and there was no structural bar to the PRR provision operating in the way the taxpayers suggested.'[65]

HMRC's arguments from unintended consequences

8.20 HMRC then argued that if the Dwelling-House Interest Construction were correct there would be various consequences which Parliament could not have intended.[66]

8.21 In particular it argued that it could not have been Parliament's intention to allow what it called 'double relief' in a situation where a taxpayer buys land with a dwelling-house on

64 The *Lee* UT Decision at para. 34
65 The *Lee* UT Decision at para. 34
66 The *Lee* UT Decision at para. 35

it and, at the same time, bare land, lives in the dwelling-house while building a new dwelling-house on the bare land and then takes up residence in the new dwelling-house. In such a case, HMRC said, if the Dwelling-House Interest Construction were correct, MRR would apply in respect of the period during which the taxpayer lived in the first dwelling-house on gains arising on disposals of both interests and Parliament could not have intended to give double relief in his way.[67]

8.22 In rejecting HMRC's argument on this point the Tribunal usefully considered the correct approach to purposive interpretation:

> *'In our view these points push past the limits of a purposive interpretation. The legislative purpose is discerned by the words used. HMRC's submissions in relation to double relief make assumptions about the nature of the relief which are not reflected in the operation of the legislation. The relief is on a gain which arises on a disposal – a single event. The legislation is not interested in what gains accrue at different points, but looks at the gain that arises on disposal, albeit apportioning the amount by reference to the period of time the property is the person's main residence. In that sense it is misconceived to think of a "pre-build gain" that is being double relieved."*[68]

8.23 The UT also pointed out that:

> *'In any case the concept of a "double-relief" is already embedded within the legislative scheme because of the rule in s223 that the last 18 months of ownership are included within the term of main residence …. That represents a period where a taxpayer may be able to benefit from two dwellings in respect*

[67] The *Lee* UT Decision at para. 36
[68] The *Lee* UT Decision at para. 38

of the same period of ownership. Its presence suggests there is not a structural flaw with the taxpayers' and the FTT's interpretation which HMRC suggest."[69]

8.24 The UT then drew an overall conclusion on HMRC's arguments from the structure of the legislation:

'We find that there is no reason to suppose, from the scheme of the legislation and the words it uses, that they disclose any particular intention on the part of Parliament as to the differing circumstances of renovators and demolishers. There is certainly nothing to suggest a legislative preference for relieving cases of renovation over demolition. The legislation's focus is on the typical situation, mentioned in Brightman J's dicta, of a disposal of a property where the dwelling existed throughout. If there is any disparity in treatment, that is simply the effect of the words chosen when applied to fact patterns which Parliament did not necessarily have in mind when legislating."[70]

Inconsistencies with case law

8.25 HMRC also argued that the FtT's acceptance in the *Lee* FtT Decision of the Dwelling-House Interest Construction was inconsistent with case law, in particular with the Court of Appeal's decision in *Higgins v. HMRC.*[71] The issue in that case involved the acquisition of a leasehold interest in an apartment which had not been formed at the time the contract for the lease was made, where completion took place after the apartment was ready for occupation and the apartment then became the taxpayer's main residence. Arguably, therefore, it was implicit in the Court of Appeal's decision that the Ownership Period began with the completion and not with the exchange of contracts, that the Ownership Period was determined by reference to the ownership of the leasehold interest and not the existence of the dwelling. On this point the UT concluded:

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69 The *Lee* UT Decision at para. 38
70 The *Lee* UT Decision at para. 39
71 *Higgins v. HMRC* [2019] EWCA Civ 1860

> *'We acknowledge the distinction the Court of Appeal drew does indicate an assumption on their part that the period of ownership would start with the purchase of the plot of the land. But that question was not before the court and, as Mr Pritchard correctly recognised in his oral submissions, the view expressed was obiter. Nevertheless, Mr Pritchard argues the point was highly persuasive. However, as Mr Sykes points out, the point was not one that was argued before the Court of Appeal. Given those circumstances we agree the FTT did not err in law by not addressing the distinction Newey LJ had drawn at* [para. 22 of the judgment in *Higgins v. HMRC*].'[72]

Other points

8.26 HMRC also raised further points in support of the Land Interest Construction including in respect of the difficulty of determining the precise date when an interest in a dwelling-house is owned,[73] and of the enactment, subsequent to the transactions which were the subject of *Lee v. HMRC,* of TCGA 1992 s. 223ZA (which concerns MRR where a taxpayer takes up residence of a property after the completion of the construction, renovation, redecoration or alteration of the property).[74] The UT found little difficulty in rejecting HMRC's arguments in respect of these points.[75]

8.27 On the practical question of determining the precise date when an interest in a dwelling-house is owned, the UT did not provide any specific guidance but suggested, by implication, that the Lees' use of the date on which the builders issued a certificate of practical completion was reasonable.[76]

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[72] The *Lee* UT Decision at para. 47
[73] The *Lee* UT Decision at para. 54
[74] The *Lee* UT Decision at paras. 60 - 62
[75] The *Lee* UT Decision at paras. 55 & 63 & 64
[76] The *Lee* FT Decision at para. 57

Risk of abuse

8.28 HMRC also argued that the Dwelling-House Interest Construction could be abused in a way which would not be prevented by the anti-avoidance provisions of TCGA 1992 s. 224(3)[77] in circumstances:

> *' … where a gain on land was "masked" by building a property on it – perhaps a cheap shack- in order to access the PRR over all of the land gain that has accrued.'*

8.29 The UT found that HMRC's construction of the application of s. 224(3) to these circumstances was unlikely to be correct but that, in any event:

> *'As a general proposition it cannot be ruled out that correct interpretation of one part of some provisions means there is a gap in the anti-avoidance provision. There is not a particular reason to strain the interpretation so as to avoid the abuse when the other possibilities, that the anti-avoidance provision might be read more broadly, or if it cannot, that it must be accepted there is a gap in the anti-avoidance legislation which it is for Parliament to plug, might equally be true. … For present purposes it is sufficient to note that the fear of abuse does not suggest the taxpayers' interpretation of s224(3), which as we have noted, reflects the natural reading of the provisions, is wrong.'*

[77] Which provides that s. 223:

> *' … shall not apply in relation to a gain if the acquisition of, or of the interest in, the dwelling-house or the part of a dwelling-house was made wholly or partly for the purpose of realising a gain from the disposal of it, and shall not apply in relation to a gain so far as attributable to any expenditure which was incurred after the beginning of the period of ownership and was incurred wholly or partly for the purpose of realising a gain from the disposal.'*

RECOVERY OF OVERPAID TAX

HMRC not to appeal

9.1 An article appeared in the Daily Telegraph on 23rd October 2023,[78] in which it was stated that HMRC has said that it will not appeal against the *Lee* UT Decision. It appears, therefore, if the article is correct that the *Lee* UT Decision is final.

Taxpayers who have overpaid tax

9.2 It is quite likely that there will have been a number of taxpayers who have either self-assessed on the basis of HMRC's erroneous view of the law on the Ownership Period or have decided not to appeal against an assessment made by HMRC on the basis of that erroneous view and will, therefore, have paid CGT which was not chargeable under the law.

9.3 A further article on the case published in the Daily Telegraph on 28th October 2023,[79] stated that 63,662 self-build projects have been registered by individuals and couples since 2016 and that the Joseph Rowntree Foundation estimates that approximately 15,000 self-build homes were completed annually in the period 2010 - 2019.

TMA 1970 s. 33 and Sch. 1AB

9.4 The recovery of overpaid CGT is governed by TMA 1970[80] s. 33 and Sch. 1AB. These provisions include an exclusion preventing the repayment:

> *' … where—*
>
> *(a) the amount paid, or liable to be paid, is excessive by reason of a mistake in calculating the claimant's liability to income tax or capital*

[78] *'Capital gains rules were wrongly applied for 58 years – how refunds could be on the way'* (Daily Telegraph – 23rd October 2023)
[79] *'We fought the taxman and won £158,000 – here's how'* (Daily Telegraph – 28th October 2023)
[80] Taxes Management Act 1970. See Appendix I

gains tax (other than a mistake in a PAYE assessment or PAYE calculation), and

(b) liability was calculated in accordance with the practice generally prevailing at the time.'[81]

9.5 It may be that HMRC will assert that this condition was satisfied in respect of tax overpaid on the basis of HMRC's erroneous understanding of the Period of Ownership because it is clear from HMRC's Guidance[82] that HMRC took the view that the Period of Ownership began with the acquisition of the interest in the land concerned and that this view was in accordance with the practice which prevailed generally before *Lee v. HMRC* was heard by the FtT.

9.6 Even if HMRC does not make this assertion, or is unsuccessful in doing so, many taxpayers may be prevented from making a claim by the time limit imposed by TMA 1970 Schedule 1AB para. 3 which provides:

'A claim under this Schedule may not be made more than 4 years after the end of the relevant tax year.

In relation to a claim made in reliance on paragraph 1(1)(a), the relevant tax year is—

(a) where the amount paid, or liable to be paid, is excessive by reason of a mistake in a return or returns under section 8, 8A or 12AA of this Act, the tax year to which the return (or, if more than one, the first return) relates, and

(b) otherwise, the tax year in respect of which the payment was made.'

[81] TMA 1970 Sch 1AB para. 2(8)

[82] See Capital Gains Tax Manual para. CG65003

ESC B41

9.7 The harshness of this provision is modified by Extra Statutory Concession B41 which provides:

> *'Under the Taxes Management Act [TMA 1970], unless a longer or shorter period is prescribed, no statutory claim for relief is allowed unless it is made within 4 years from the end of the tax year to which it relates.*
>
> *However, repayments of tax will be made in respect of claims made outside the statutory time limit where an over-payment of tax has arisen because of an error by the Inland Revenue or another Government Department, and where there is no dispute or doubt as to the facts.'*

9.8 In spite of the unequivocal terms of this Concession, HMRC in its Guidance says:

> *'If a late claim or election forms part of a scheme or arrangement, the main purpose or one of the main purposes which is the avoidance of tax (including the payment of tax), you may take this into account when deciding whether to accept the late claim or election."*[83]

9.9 Although HMRC may invoke this exclusion in an attempt to resist making repayments of taxpayers overpayments it seems to the Authors that it is unlikely that very many cases of overpayments due to the taxpayer concerned accepting HMRC's erroneous view of the Ownership Period will fall within its terms. It is highly unlikely that, in designing tax avoidance transactions, a taxpayer will have assumed that the view of the law taken in the *Lee* UT Decision would prevail, so it is likely that, in most circumstances where tax had been overpaid due to HMRC's erroneous view of the Ownership Period being

[83] Self-Assessment Claims Manual para. SACM10040

accepted, the transactions relevant to the matter will not have been entered into for tax avoidance purposes.

9.10 In any event, according to the Telegraph article of 23rd October,[84] in stating that it would not appeal against the *Lee* UT Decision, HMRC referred to its guidance on how to claim a tax refund and to its Self-Assessment Claims Manual para. SACM10040 which deals with HMRC's acceptance of late claims and elections. It may be, therefore, that HMRC will be reasonable in applying ESC B41 to such overpayment claims.

AN UNCONSCIONABLE DECISION TO LITIGATE

10.1 In the *Lee* UT Decision, therefore, the UT roundly rejected every one of HMRC's arguments in favour of the Land Interest Construction in finding the Dwelling-House Interest Construction to be the correct one and the one which emerges from a *'straightforward textual analysis'.*

10.2 One sometimes wonders by what process HMRC selects cases to be the subject of litigation. Could it really have thought that the Land Interest Construction is a natural reading of this provision or expected that it could have persuaded the Tribunals that the

[84] See para. 9.1 above

phrase ‘Period of Ownership’ in s. 222(1) referred to an asset which was not actually mentioned in that section?[85]

10.3 We have said that it is not uncommon for purchasers of bare land to build a dwelling-house on it even in circumstances where there is an existing dwelling-house which must first be demolished.[86] Where the taxpayers concerned have obtained planning permission for building on what was previously bare land the gains could be very substantial. One wonders, however, whether the aggregate amount of tax at stake on such transactions can be of such consequence as to make it appropriate for HMRC to take such a case as *Lee v. HMRC*.

10.4 By doing so it embroiled the unfortunate Mr and Mrs Lee in litigation at two judicial levels, litigation which might have proceeded further to the Court of Appeal and the Supreme Court. HMRC subjected the Lees to seven years of uncertainty, inconvenience and the expenditure of time for which they will receive no compensation. In order to resist paying £158,000 which was not due under the law they incurred professional charges of £100,000, most of which will not be recoverable from HMRC because they were incurred in respect of HMRC’s enquiries and the appeal to the FtT.[87] It is not surprising that they are quoted in the *Telegraph* article of 28th October as saying *‘If we could wind back the clock, would we do it again? Probably not. And that’s totally wrong.’* HMRC subjected

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[85] Of course, the only case which had considered the issue before the *Lee* FtT Decision was *Henke v. HMRC* in which the Special Commissioner had accepted the Land Interest Construction and we have already set out in para. 1.6 above why that decision was of the weakest persuasiveness. It is also true that in *MrGeorge McHugh and Mrs Mary McHugh v. HMRC* [2018] UKFTT 403 TC (TC06605), and *Paul Gibson v. HMRC* [2013] UKFTT 626 (TC) the FtT, and in *Desmond Higgins v. HMRC* [2019] EWCA Civ 1860, the Court of Appeal had accepted arguments which seemed implicitly to assume that the Land Interest Construction was correct. As we explained in Issue 30, however, in all three decisions the Land Interest Construction was not explicitly formulated and accepted and no arguments were advanced by the parties in respect of it. What is more, the Court of Appeal case of *Higgins*, was not a case concerned with the building of a new dwelling but with the extensive alteration of an existing building in which, although the interior was extensively remodelled to create apartments which had not previously existed, the exterior of the building remained essentially unchanged. These decisions, therefore, do not provide a justification for HMRC’s advance in *HMRC v Lee* of the Land Interest Construction in defiance of what the UT characterised as a ‘*straightforward textual analysis’*

[86] See para. 1.2 above

[87] *The Telegraph* 28th October 2023

the Lees to this injustice simply in order to establish a construction of the legislation which is clearly unnatural, contrary to ordinary English usage and highly artificial.

10.5 We do not argue that HMRC should not litigate unless it is certain to be successful but rather that a great department of state has a moral duty to make realistic appraisals of its chances of success in litigation and to take into account the injustice it imposes on taxpayers if it gets that judgement wrong.

10.6 If HMRC considered, as a matter of policy, that it was appropriate to restrict MRR in these circumstances it could have done so for the future by persuading ministers to make changes to the legislation.

10.7 What made HMRC think this case was a suitable one to litigate?

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 REVIEW IN WHICH THE DEFINED WORD OR PHRASE IS FIRST USED
CGT	Capital Gains Tax	1.1
Dwelling-House Interest Construction	A construction of TCGA 1992 s.222(1) in respect of the acquisition of land followed by the building of a new dwelling-house which becomes the taxpayers' residence under which the period of ownership referred to in that subsection begins on the completion of the new structure which becomes the taxpayer's main residence	1.5
FtT	The First-Tier Tribunal (Tax)	1.4
Land Interest Construction	A construction of TCGA 1992 s.222(1) in respect of the acquisition of land followed by the building of a new dwelling which becomes the taxpayers' residence under which the period of ownership referred to in that subsection begins on the acquisition of the interest in land on which the new dwelling-house is built	1.4
Lee FtT Decision	The decision of the FtT in the case of *Gerald Lee and Sarah Lee v. HMRC* [2022] UKFTT 175 (TC) TC08502	1.4
Lee UT Decision	The decision of the UT in the case of *HMRC v. Gerald Lee and Sarah Lee* [2023] UKUT 00242 (TCC)	1.7

DEFINED WORD OR PHRASE	DEFINITION	PARAGRAPH OF THE REVIEW IN WHICH THE DEFINED WORD OR PHRASE IS FIRST USED
MRR	Main Residence Relief under TCGA 1992 ss. 222 - 226B	1.1
Nuns Walk Freehold	The freehold interest which is referred to in the *Lee* FtT Decision at para. 2 of that case	2.2
Nuns Walk Freehold Disposal	The disposal of the Nuns Walk Freehold which is referred to in the *Lee* FtT Decision at para. 5 of that case	2.2
Nuns Walk Land	The land which is the subject of the Nuns Walk Freehold which is referred to in the *Lee* FtT Decision at para. 2 of that case	2.2
Original Nuns Walk Structure	The dwelling-house which stood on the Nuns Walk Land the demolition of which is referred to in the *Lee* FtT Decision at para. 3 of that case	2.2
Period of Ownership	The period of ownership referred to in TCGA 1992 s. 222(1)(a)	1.3
Revised Nuns Walk Structure	The dwelling-house standing on the Nuns Walk Land the construction of which is referred to in the *Lee* FtT Decision at para. 3 of that case	2.2
TCGA 1992	Taxation of Chargeable Gains Act 1992	1.3
TMA 1970	Taxes Management Act 1970	9.4
UT	Upper Tribunal	1.7