The Importance of *Henke*

Julie Butler discusses a recent case on PPR and to what extent a garden qualifies

A recent case before the Special Commissioners, *Henke and another v HMRC* SpC 550, (heard in March and published in May 2006), could be a timely reminder for tax planners on what is required to achieve the tax efficient disposal of a large garden.

The housing shortage

The chronic shortage of houses in the UK has allowed many taxpayers to look to utilisation of the large garden for development opportunities. There has been an assumption that this gain will be subject to 'principal private residence' (PPR) relief under s 222, Taxation of Chargeable Gains Act 1992 (TCGA 1992).

The facts of *Henke*

In the case of *Henke* various principal private residence issues arose. In 1982 the Henkes bought a 2.66 acre plot of land with planning permission for one house to be built. Work did not start on the house until February 1991 and was finished by June 1993. Oak House comprised 4,500 sq ft of accommodation and 1,000 sq ft of garage in the same curtilage. The Henkes having lived elsewhere moved into Oak House and have lived there ever since. In July 1995 they obtained detailed planning permission for two separate houses to be built on part of the same plot, with each sub-plot comprising of 0.54 acres. Both plots were sold, in 1999 and 2001 respectively, and the two houses were built. The Henkes used the proceeds of the first sale to repay the mortgage on Oak House. Until the sales, each sub-plot had been maintained as part of the garden and grounds of Oak House.

Size and character

PPR relief is restricted to half a hectare or such an area as the Commissioners concerned may determine on being satisfied that, regard being had to the size and character of the dwelling house, a larger area is required for reasonable enjoyment of the house as a residence (s 222(3), TCGA 1992). The garden and grounds have to be for the owner's own occupation and enjoyment.

The curtilage, garden and grounds

HMRC have historically adopted the dictionary definition of curtilage: 'a small courtyard or piece of ground and forming one enclosure with it'. For the purposes of s 222 the garden takes its everyday meaning, ie an enclosed piece of ground devoted to the cultivation of flowers, vegetables or fruit. Grounds merely extend this definition to 'enclosed land surrounded or attached to a dwelling house or other building serving chiefly for ornament or recreation'.

The permitted area

It is generally accepted that this is the most potentially contentious area of PPR relief and this proved to be the case in *Henke*. If the garden and grounds do not exceed half a hectare (which does not include the site of the dwelling house) relief for the whole of the garden or grounds is given automatically. Section 222(4), TCGA 1992 states that if the area of garden and grounds is greater than the permitted area then the part that is 'chosen' as the permitted area for s 222, TCGA 1992 is the part most suitable for the occupation and enjoyment of the residence.

Period of ownership before the house became PPR

The question was raised as to whether an apportionment was required to exclude the period before the house became Mr and Mrs Henke's PPR. This might not seem obvious but the garden can only qualify for PPR when the house does, ie after 1993 and not before.

Reasonable enjoyment

If the garden and grounds exceed half a hectare, relief will only be available for a larger area if that area is required for the 'reasonable enjoyment' of the property having regard to the size and character of the dwelling house.

Required

In the case of *Sharkey v Secretary of State for the Environment and South Buckinghamshire District Council* 45 EG 113 at para 126, 'required' was held to mean something more than 'considered necessary'.

The Valuation Office Manual gives an indication as to how the District Valuer would approach the objective test.

To judge what is the 'required' area the most obvious evidence to consider is the other properties in the local area of a similar size and character and the grounds which they enjoy. This will obviously depend upon the closeness of sufficient comparables to give a fair idea. Of course today gardens tend to be smaller because of cost and convenience and houses in built-up areas generally have smaller gardens than in rural districts.

Houses which were built many years ago may not strictly require the amount of grounds which they occupy. The grounds attached to comparable properties is evidence of requirement. Where there are larger areas, these can be due to historic reasons. It should be sufficient to show that there are some closely comparable houses with 0.5 of a hectare or more.

Arguments by the taxpayer and the District Valuer in *Henke*

The Henkes argued that PPR relief was due on the sale of the two sub-plots. HMRC disagreed and the District Valuer concluded that the plots sold were not part of the 'permitted area' of Oak House as they were not necessary for the reasonable enjoyment of Oak House as a residence (s 222(3), TCGA 1992). Looking at comparable properties in the area, the permitted area was said to be 2.03 acres.

The decision

On the issue of the period of ownership and PPR the Special Commissioner, John Clark, held that as Mr and Mrs Henke did not own the house until 1993 but had owned the land since 1982, an apportionment was necessary under s 223(2), TCGA 1992 to limit the PPR relief due because they did not meet the 'throughout the period of ownership' condition in s 223(1).

There was to be only one period of ownership of the single asset consisting of the land and a house which might be built on it during that period. Where, as in the Henke case, land was held for a period and subsequently a house was built on it and occupied as the Henkes' PPR, an apportionment was required. This was deemed to be very clear.

On the question of permitted area the Commissioner found in favour of HMRC, being only the second decision on the permitted area issue (*Longson v Baker* being the other). It is worth noting that the house and the comparables used were all modern properties.

The 'permitted area' test in s 222(1)(b) was to be applied by reference to what was required in the particular situation at the time of the disposal, and so is an objective one. A house and a garden are subject to two individual tests.

For a house, the test for only or main residence was 'at any time'. The test for land was whether it was a garden or grounds at the time of disposal. The garden would not qualify where a house stopped being an only or main residence. At the time of disposal, if the house and garden satisfied the tests, the grounds would qualify whatever their previous use. In the *Henke* case the permitted area was on both occasions 0.82 of a hectare (2.03 acres). Before the sale of the sub-plots the total plot exceeded this, afterwards it was less than 2.03 acres. Thus the sales were partly covered by the PPR relief and the sales proceeds of the plots should be apportioned on the basis of the respective non-exempt and exempt areas.

Longson v Baker

In the case of *Longson v Baker* [2001] EWCA Civ 364 the taxpayer claimed that the permitted area amounted to 7.56 hectares including a farmhouse, stables and an outhouse all facing a central courtyard. Although the parties agreed that the stables accommodating 12 horses were part of the dwelling, the claim failed. The Inspector argued that 'required' meant close to essential. The permitted area was reduced to 1.054 hectares – being exactly the same area that the previous owner protected. This appears to set a precedent in that, where the issue has cropped up in the past HMRC may look at any earlier disposals of the property since 1965.

What is the 'required' amount of grounds? The use of it raises a question of fact. While it is agreeable and convenient to have open space round the house, it does not follow that open space is required for the convenience of the house. 'Required' does not mean merely that the occupiers of the house would like to have it, or that it would be missed it if they lost it, or that any potential purchasers would think less of the house without it. 'Required' means that without it there will be such a lack of facilities or convenience that such grievance would be done to the occupier and that depends totally upon the facts.

In this case could alternative advice have been given? The stable size was large. Could Business Assets Taper Relief be claimed on the gain? Was there, or could there be, any potential for business activity?

HMRC may well look at conveyance documents on a property's previous disposal so any history with regards to the size of the garden may be used as a precedent.

Expert evidence

It is possibly more than unfortunate that the Henke family (who represented themselves) did not call upon any expert evidence. Compare this to say the two *Antrobus* cases (see *TAXline* January 2006 page 8 and March 2006 page 12). The production of expert evidence here, for example of 26 similar farmhouses, was to be commended.

There are arguments to say that a 2.66 acre plot can historically be shown to be 'required' by a residence of 4,500 sq ft of accommodation and 1000 sq ft of garage. It would appear that what might have been missing here is expert evidence.

Planning for the future

Any clients who have large gardens with potential development for the future should put a number of safeguards in place such as:

1. The history of the specific garden and grounds (with reference to previous disposals).

2. The history of the local gardens – what is standard required area? How much is required for enjoyment?

3. 'Injury done to the property'. What would happen if the required garden was reduced?

4. Evidence of garden and grounds enjoyed. What evidence is there that the permitted area is:
   - 'enjoyed';
   - for the purpose of recreation;
   - not restricted by unnecessary boundaries (eg fences)?

Clearly these matters must be planned in advance, and tax advisers should work with their clients towards this aim.

Oh yes, and s 776

In *Henke* the history of ownership goes back to 1982 and the status of PPR to 1993. Some developments such as these are over a shorter period of time and with a different motive – development profit.

Development is not defined by statute. The HMRC interpretation is any physical adaptation or preparation for new use of land. Essentially if the land, eg the 2.66 acre plot in *Henke*, had been purchased with a view to the realisation of profit then the gain on Oak House would be trapped as assessable to income tax under s 776, ICTA 1988. This was not the case in *Henke* but HMRC could question the motive and look to PPR relief being used as a possible false shelter for development profit.

Conclusion

The definition of gardens and grounds will be developed in the years ahead. The tax planning key is to try and ensure maximum PPR relief is achieved. Lessons could be learnt about the apparent lack of expert evidence for the permitted area. The apportionment question is one of fact and something that clients must be warned about and planned for in advance.

Julie Butler FCA is managing partner of Butler & Co, Alresford, Hampshire and can be contacted on 01962 735544 or j.butler@butler-co.co.uk

Can taxpayers sue HMRC for damages?

Robin Williamson discusses a recent High Court case

The case of *Neil Martin Ltd v Commissioners of HM Revenue and Customs* [2006] EWHC B1 (Ch) is the first to reach trial in which it has been argued that HMRC are liable to pay damages for breach of a private law obligation. It is interesting not only in demonstrating how difficult it is to argue successfully that the revenue authority owes a liability in private law, or a duty of care, to taxpayers, breach of which may found a claim in damages; but also in testing how far HMRC may be prepared to go in offering compensation under their code of practice on complaints, COP1.

The facts

Neil Martin established a business of contracting and sub-contracting in the construction industry in February 1988, operating with a sub-contractor's tax certificate. By 1999 the business had grown considerably and employed over 30 people. Following advice from his accountant, Mr Martin decided to transfer his business to a limited company. The claimant company, Neil Martin Limited, was duly incorporated on 26 February 1999.

It was of great importance for the new company to secure a sub-contractor's certificate; and it was here that the claimant's problems began. The claimant submitted an application for a certificate to its local tax office at Barrow-in-Furness in May or June 1999 (there was some dispute about precisely when), but the certificate was not received until September of that year. The claimant alleged that because of the delay, it lost new business and its cash flow was badly affected.

The trial judge, Andrew Simmonds QC, subsequently found that the Inland Revenue (the Revenue) had made a number of mistakes in processing the application, which resulted in a delay of well over a month in issuing the certificate. They had initially refused to process the application because sole trader accounts were offered in support, the newly-formed company having no company accounts. They had allowed Mr Martin to leave the office without signing certain forms that he had completed; they had processed the forms as an application for a registration card, not a certificate; and they had sent the certificate when issued to the wrong address.

On 26 November 1999, Mr Martin made a formal complaint under the Revenue's internal complaints procedure, based on the then current version of COP1. The Regional Director rejected his complaint, and his subsequent referral to the Adjudicator's Office was also rejected. That may seem surprising, but note that at this stage the Revenue were maintaining – and had so informed the Adjudicator – that their officer was not obliged to accept Mr Martin's