Analysis

Slade: land owning dispute costs not allowed

Speed read

In *J M Slade and another v HMRC*, the First-tier Tribunal ruled that the legal expenditure incurred defending rights to a number of assets collectively was not an allowable deduction for CGT purposes when one of those assets was sold alone. The case concerned two parcels of land which were transferred to the appellant and his son, one of which was sold, believing it to form part of the farmland left to him and his son. Some of the family asserted that the parcels formed part of the residuary estate in which they had an interest. As the asset in question had been sold by the time the expenditure was incurred, the expenditure had not been in defending title to the asset but in defending title to the proceeds of sale of the asset. The FTT also ruled that there is no provision for apportionment of sums paid which are not wholly and exclusively incurred for that purpose since the expenditure was incurred on one parcel of land only. The case highlights that legislation can be rigid and prevent a deduction which taxpayers may assume that they will get, and that strong technical representation is necessary where the subject is complex.

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The fact that joint landowners can dispute over relatively minor (and major) points is well known. Likewise, beneficiaries to a will may also fight over its content, detail and emotional impact. Here, we look at a case which sets out the additional costs that can arise from such disputes.

The facts of the case

The case under the spotlight is *J M Slade and another v HMRC* [2022] UKFTT 227 (TC). The First-tier Tribunal (FTT) found the legal expenditure incurred defending rights to a number of assets 'collectively' was not an allowable deduction for CGT purposes when one of those assets was sold alone.

In her will, Dora (the mother) had left some farmland to her son, Jonathan James Slade (JJS), who was the sole executor at the relevant time. JJS assented to two parcels of land (the 'northern parcel' and the 'southern parcel') being transferred to himself and his son, Jonathan Mark Slade (JMS), believing that the parcels formed part of the farmland left to him. They subsequently sold the southern parcel for some £221,000 net of costs. The northern parcel was worth about £86,000. Some of the family asserted that the parcels did not form part of the farmland left to Jonathan, but formed part of Dora's residuary estate, in which they had an interest. The claim was settled out of court on terms that they paid the claimants £240,000 (including their costs), with their own costs amounting to circa £41,000.

Dispute over split of proceeds and possible breach of fiduciary duties

The dispute arose in relation to the split of the proceeds of the sale of the southern parcel between the appellants, JJS and JMS, and other members of the family – arguably a common occurrence in the management of estates. It was claimed that the estate had been managed in breach of fiduciary duties in respect of both the southern and northern parcels. The case had to go to the High Court by way of a consent order which led to costs and payments being made to other members of the family totalling some £240,000, as stated above.

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Deductible expenditure

A person disposing of an asset may, in computing a capital gain, deduct (inter alia) 'expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset'. When it came to the settlement costs, JJS and JMS believed these fell under that definition: was that not precisely what they had spent £281,000 on? Surely these expenses, or at least most of them, were deductible in computing any capital gain on the disposal of the southern parcel? The appellants therefore claimed a CGT deduction in their computations for the payments which were made to other members of the family, as well as the associated legal costs.

A non-existent gain?

The issue before the FTT therefore concerned the amount that was tax allowable and could be deducted in calculating the chargeable gain on the disposal of the land. In particular, whether JMS and JJS were entitled to deduct the payments which they made to the other family members under a consent order, together with the costs of the High Court proceedings. In essence, the father and son said that they made no gain when they disposed of the land. They were of the view that virtually all the proceeds were paid to the other family members by way of damages and costs and it could therefore be argued that it was unfair that they should then be taxed on a non-existent gain.

The FTT clarified that it seemed that the High Court claim was to agree the split of the proceeds of sale of the land. The claimants were asserting an interest in the proceeds of the sale, which derived from their case that JJS had held the land on the residuary will trust. By the time the expenditure

in question was incurred, the asset in question had been sold. Thus, the expenditure had not been incurred in defending title to the asset but in defending title to the proceeds of sale of the asset. To defend that claim, JMS and JJS asserted that they had title to the land before the disposal.

Expenses not incurred wholly and exclusively in respect of the southern parcel

It had to be taken into account that the sums paid concerned not only the southern parcel but also the northern parcel. It therefore could not be said to fall within the legislation which required it to be incurred wholly and exclusively for the establishing, preserving or defending their title to or rights over the asset disposed of, i.e. the southern parcel. There were no legislative provisions which would enable the expenditure to be apportioned and a deduction claimed accordingly and, as a result, JMS and JJS lost out. The FTT stated: 'it cannot be said that the sums paid by JJS and JMS were wholly and exclusively incurred by them in establishing, preserving or defending their title to the southern parcel. They were partly paid in relation to the northern parcel. There is no provision for apportionment of sums paid which are not wholly and exclusively incurred for that purpose.'

JMS and JJS were wrong to say they were being taxed on a non-existent gain. They were being taxed because they made a chargeable disposal which gave rise to a chargeable gain and they were unable to prove the costs were allowable. Many would consider that at least the legal costs should have been allowable and with strong legal and tax advice the lack of provision of apportionment in the legislation could have been planned for in advance. In this case, JMS and JJS were unrepresented and this may have had a bearing on the outcome. It will be fascinating to see if there will be an appeal.

The FTT decision was short, but possibly wrong. If I buy two separate assets for a single aggregate price, nothing will have been paid 'wholly and exclusively' for either asset: does that mean that my base cost for the assets is nothing at all? Of course not: the Act provides that 'any necessary apportionments shall be made of any consideration or of any expenditure and the method of apportionment adopted shall, subject to the express provisions of this chapter, be just and reasonable'.

High Court claim after the disposal of the land

The fact that the High Court claim followed the disposal of the land obviously created a problem in this instance. Had it preceded the sale, the claim would have probably sought declaratory relief that JMS and JJS held the land on a will trust. There was a counterclaim by JMS and JJS for declaratory relief that they held the land as beneficial owners. The expenditure incurred would then have been deductible when the land was sold.

The appellants asserted that the family members were themselves liable to CGT on the amounts paid to them, either because the amounts were derived from their purported interest in the northern and southern parcels or because there was no underlying asset and the damages were subject to CGT in full (albeit that by extra-statutory concession D33 damages up to £500,000 may be treated as exempt). The corollary to this, they said, was that 'the payments were deductible by the appellants as they related to the same underlying asset.'

It was decided by the FTT that the existence of a gain had to be determined by reference to TCGA 1992 s 38. It was 'generally irrelevant' how the proceeds of the sale were used. Referring to *Blackwell v HMRC* [2017] EWCA 232, the FTT said the wording of s 38 'acquisition and disposal costs' was 'couched in cautiously restrictive terms'. This shows generically that all CGT disposals must be reviewed carefully, especially with the costs of sale moving forward. It was explained that another FTT recently applied this principle (in *Tedesco v HMRC* [2022] UKFTT 171 (TC)), when it held that a repayment of debt before a disposal of company shares was not deductible.

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In this respect, the FTT adopted HMRC's reserved but correct answer (even if to a layman it may sound like not dealing with the problem): 'the tax treatment of damages in the hands of the other family members is irrelevant to the tax treatment of the appellants' disposal of the southern parcel.'

Rigid rules

This case highlights that legislation can, at times, be rigid and prevent a deduction which taxpayers may, based on grounds of fairness and economics, assume that they will get.

There is much that farmers and potential beneficiaries can learn from this case; perhaps the first lesson is to avoid any dispute because it costs money. In reality, if this is unavoidable, they must consider any tax planning around the course of action. Where the subject is as complex as in this case, appellants should consider strong technical representation. ■