TC04780

Appeal numbers: TC/2015/435, 441 and 442

INCOME TAX – share loss relief – whether company which made it profits from building new housing on land which it purchased with the benefit of planning consent was a property developer - yes – whether it failed the gross assets test when its liabilities exceeded its assets – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PHILIP BROWN **Appellants**
-and-
JONATHAN COOK
-and-
GRAHAM CUNNINGHAM

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE Barbara Mosedale

Sitting in public at the Royal Courts of Justice, the Strand, London on 7 December 2015

Mr G Taylor, Chartered Tax Adviser, for the Appellants

Mr A Hall, HMRC officer, for the Respondents

DECISION

1. There were three appeals joined for hearing on the basis that each appeal involved exactly the same legal issue and (so far as relevant) exactly the same facts. Each appellant had purchased shares in the year 2007/2008 and each made a claim for 'share loss relief' to be allowed against their income in the tax year 2009/2010. HMRC opened enquiries into each appellant's tax return, and denied the share loss relief in the closure notices. The amendments to the tax returns was upheld in the respective review letters issued in around December 2014 and January 2015. The appellants appealed.

The issues

2. The parties were effectively agreed on all matters save for two. In other words, HMRC accepted that the appellants met all the necessary qualifications to obtain the claimed relief except for two: HMRC considered that that the company in which the shares were issued carried on an excluded activity and failed the gross assets test.

3. I was asked only to rule on these two issues. If I ruled in favour of the appellants on both issues, they would win the appeal; if I ruled against them on either issue, they would lose the appeal.

The facts

4. Some of the facts were agreed and in addition the Tribunal heard evidence from Mr Graham Cunningham. Mr Cunningham commenced working with the CALA group of companies in 2006 as a land director of one of the regional subsidiaries; in 2007 he became Managing Director of it. Later, he became regional chairman of CALA Management Ltd and now sits on its Board. I accept his evidence. While he was asked quite detailed questions, his relevant evidence can be summarised quite shortly.

5. I find that the structure of the group of companies was that CALA Group Ltd was the holding company. The trade was carried on in its subsidiary company, CALA Management Ltd. There were about 10 or so regional subsidiaries but these represented a regional management structure and in practice held no assets and entered into no contracts and did not trade. In law, the structure was not really material. As explained below, the law looks at the trade of the corporate group as a whole and below I will refer to the corporate group as CALA.

6. CALA is an old established corporation originating in Scotland (CALA stands for City of Aberdeen Land Association) which had become nationwide. It described itself in 2008 as a leading provider of high quality homes and commercial property solutions in the UK although the next year it chose to become a residential only developer. While in various documents it described itself as both a house builder and property developer, the evidence was that CALA only built houses on land in which it had an interest. It did not build homes on land belonging to other entities.

7. Mr Cunningham explained that CALA, like its competitors, had four ways of acquiring land on which to build, but the fourth method had never been used by the CALA companies for which he had responsibility in the nine years he had been with CALA. Those methods were:

(1) CALA might buy land which already had the benefit of planning permission and therefore had to pay a price for it which reflected its value with the planning permission;

(2) CALA might contract to buy land on a conditional contract, the terms of which were that the contract would complete if and when planning permission was obtained and an a price under which the increase in the land value due to obtaining the planning consent was paid to the vendor;

(3) CALA would take an option to buy land at open market value at the time of sale: they would exercise the option if planning consent was obtained and pay the then open market value which would necessarily reflect the increase in value due to obtaining the planning consent.

In summary, whichever of the above methods was used to buy the land on which CALA built its new homes, the increase in land value due to the grant of planning consent was realised by the original owner of the land and not by CALA.

8. The fourth method of obtaining land was to buy land speculatively without planning consent and in the hope of obtaining it: this was risky and if it happened, the value of obtaining the planning consent would accrue to CALA. But I disregard this option as relevant as I accept the evidence that CALA either never did this or only vary rarely. In reality, on my view of the law as explained below, it would make no difference to the outcome whichever of these four options was the predominate method CALA used for obtaining land.

9. I accept, as Mr Cunningham said, CALA intended to make a profit by constructing new build properties on the land it obtained, such that the monies realised by the sale of the land with the newly built properties would exceed its costs, including, of course, the cost of buying the land and constructing the buildings.

10. The accounts show that in 2008/9 that although CALA had very substantial assets of about £275million, it also had very substantial liabilities which equalled or exceeded its assets. It was agreed that the appellants acquired shares in CALA Group Ltd in the year ended 2008 which had become of negligible value as at 6 April 2010.

The law

11. HMRC accepted that the shares had become of negligible value as at 6 April 2010 and that the appellants were entitled to claim a capital loss for the purposes of capital gains tax: they did not accept that the appellants fulfilled the requirements to set the capital loss against income.

12. All parties were agreed that the relevant legislation was s 131 Income Tax Act 2007 ("ITA") and that to qualify for this relief the appellants had to show that the

shares were shares in a qualifying trading company (EIS relief not being applicable). S 134 ITA sets out four conditions (A-D) that had to be met for a company to be a qualifying trading company.

13. In summary, HMRC accepted these conditions were met save that they did not accept that the company met the trading requirement (s 131(2)(a)(i)) at any time and certainly not at the relevant times and therefore did not accept that conditions A or B overall were met; nor did HMRC accept that the company met the gross assets requirement of Condition C. They did accept Condition D was met so I do not refer to it again.

The group

14. Before looking at the conditions, I mention that both parties were agreed that I should consider the activities of the group of CALA companies. The shares were purchased in the holding company. S 137 permitted relief where the shares were in a holding company but only where:

> **S137 The trading requirement**
>
> (1) (a) [not relevant]
>
> (b) the company is a parent company and the business of the group does not consist wholly or as to a substantial part in the carrying on of non-qualifying activities.

The 'business of the group' was defined in (3) as:

> (3) For the purpose of subsection (1)(b) the business of the group means what would be the business of the group if the activities of the group companies taken together were regarded as one business.

A group company was defined in 137(7) as the parent or any of its subsidiaries; non-qualifying activities were defined as:

> (a) excluded activities, and
>
> (b) [not relevant]

'Excluded activities' were defined as having the meaning given in s 192 read with sections 193-199.

15. In other words, the group structure did not alter the basic requirement that the holding of shares had to be in a company or corporate group which did not carry on (or substantially carry on) excluded activities.

Excluded activities

16. The definition of excluded activities in s 192(1) included a long list of activities, the only relevant ones of which were:

> (a) dealing in land…..

(g) property development

17. In practice, nothing was said in the hearing about dealing in land. I am inclined to think on the evidence that CALA did not deal in land but this is irrelevant, as I decide, for the reasons given below, that its only or primary activity was that of property development.

18. In the hearing the submissions rightly centred on the meaning of "property development". S 196, with which s 192 should be read, provided a definition of 'property development' as follows:

> **S196 Excluded activities: property development**
>
> (1) This section supplements section 192(1)(g)
>
> (2) 'Property development' means the development of land –
>
> (a) by a company which has, or at any time has had, an interest in the land, and
>
> (b) with the sole or main object of realising a gain from the disposal of an interest in the land when it is developed.
>
> (3) For this purpose, 'interest in land' means, subject to subsection (4) –
>
> (a) any estate, interest or right in or over land, including any right affecting the use or disposition of land, or
>
> (b) any right to obtain such an estate, interest or right from another which is conditional on the other's ability to grant it.
>
> (4) References in this section to an interest in land do not include –
>
> (a) the interest of a creditor (other than a creditor in respect of a rentcharge) whose debt is secured by way of mortgage, an agreement for mortgage or a charge of any kind over land or
>
> (b) in the case of land in Scotland, the interest of a creditor in a charge or security of any kind over land.

19. The common law has always regarded land as including anything fixed to the land and there is a whole body of case law devoted to when something is sufficiently fixed to the ground to become a fixture such that it is then a part of the land: buildings are clearly fixtures. This is put beyond doubt by the Interpretation Act 1978 which provides in Schedule 1:

> "land" includes buildings and other structures….

For instance, it is not possible to sell a building in situ without selling the land on which it stands: and any sale of land automatically includes the buildings on it. This reflects practical reality: buildings can not be picked up and moved away from the land on which they stand. And unless it is very small, and without foundations, a building can't be removed from the land on which it stands unless it is demolished.

20. Nevertheless, the appellants' case was that they did not carry out property development because (they said) they obtained no gain from the increased value of

the underlying land. The facts were, as I have said that the increase in the land value which resulted from obtaining planning permission went wholly back to the original landowner from whom CALA purchased the land. CALA made its profit from selling new build houses on the land for more than they cost to build, including the cost of the land. CALA's case was that because it did not benefit from the increase in land value attributable to the planning consent, it did not benefit from an increase in land value and did not therefore develop the land.

21. It seems to me that at root the appellants' case is based on a fundamental misunderstanding of the meaning of "land". While they saw the grant of planning permission as something which increases the value of the land by development, they did not see that the construction of a building on land is also something that increases the value of the land by development. Fundamentally, they saw the 'building' being distinct from the 'land'. But that is wrong. Any building is a part of the land: by building a new house on a site, CALA increased the value of the land on which that building was situated. CALA depended on this increase in value of the land to make its profit: the original property owner got the increase in value which resulted from obtaining planning permission; CALA got the increase in value of the land which resulted from building new houses on the land. That was its business model.

22. CALA clearly carried on property development. It owned an interest in the land from the moment it purchased the land, or, if earlier, from the moment it was given an option to buy it. Its main (indeed only) object was to realise a gain from selling its interest in the land once it had been developed by the construction of new build homes.

23. Mr Taylor said that CALA ought to be compared to a manufacturer of boots. Such a manufacturer would buy in the necessary raw materials, make the boots, and then sell the boots with the intention of selling them at a price in excess of what they cost to make. CALA bought in the raw materials, eg land and bricks, built the houses, and sold them with the intention of making a profit.

24. But this is not a useful analogy. Both CALA and the boot manufacturer traded: but the relevant distinction is that one traded in boots and the other in land. CALA constructed houses on land. It did not sell the houses distinct from the land: it sold the land with the houses constructed on it. It had no choice but to do so as by law (reflecting practical reality) a building fixed to the land cannot be sold other than as part and parcel of the land it stands on. So while CALA undoubtedly traded, nevertheless its trade was in property development and that was an excluded activity.

25. The appellant also said that it derived its income from the design, construction and sale of the properties it built, and I accept that. However, it went on to compare these activities to those of an architect, house-builder and estate agent and said that none of these activities would, individually, be 'property development' (which I accept) so the appellant did not understand why, when combined into one operation, these activities amounted to property development. But this shows again a fundamental misunderstanding of the situation. CALA might well act as an architect in designing homes and as a builder in constructing homes, but it did not act as an

estate agent. An estate agent introduces a buyer to a seller: CALA, on the other hand, owned the houses which it sold. It was the vendor. It was not, like an estate agent, an intermediary between vendor and buyer. And it is the act of selling the houses (in reality the land on which the houses stand) that makes it a property developer because it is making its profit from a gain in the value of the land which it had brought about by constructing houses on the land which it owns.

26. CALA was an arch-typical example of a property developer: the appellants' submissions to the contrary appeared to be based on a failure to appreciate that land, both in law and practical reality, comprises not only the soil but the buildings in and on the soil. Constructing new houses increased the value of the land: CALA made its profits in this way. It therefore carried on the trade of property development.

27. I was asked to give these provisions a 'purposive' interpretation on the basis that Parliament would not have intended to exclude a company like CALA which clearly traded. But, on the contrary, I think the provisions are very clearly intended to exclude from income tax relief shares in a company whose trade was property development, like CALA's. S 192(1)(g) and s 196 could not really be clearer in showing an intention to exclude shares in companies like CALA from relief. Nor can it be said that the plain meaning of the statutory language gives rise to an absurdity: property development is often seen as a safer investment than many others and it would be quite rational for Parliament to decide that it did not need to encourage investment in that sector by giving it an income tax relief. I think the purpose of the relevant sections is shown in the literal wording, and applying that purpose and the literal wording, CALA undertook an excluded activity and Conditions A and B are therefore not met.

Gross Assets test

28. That conclusion makes it unnecessary for me to consider the gross assets test, but as I was addressed on it, and in case these appeals go further, I will record my decision.

29. Condition C was set out in s 142(1):

> **S 142 gross assets test**
>
> (2) The gross assets requirement in the case of a parent company is that the value of the group assets –
>
> (a) must not exceed £7million immediately before the shares in respect of which the share loss relief is claimed are issued, and
>
> (b) must not exceed £8 million immediately afterwards.
>
> (3) The value of the group assets means the sum of the values of the gross assets of each of the members of the group, ignoaring any that consist in rights against, or shares in or securities of, another member of the group.

30. The definitions in subsection (4) made it clear that the value that was relevant for Condition C was the combined total of the gross assets for each of the subsidiaries and the holding company in CALA.

31. It was accepted that CALA's gross assets were at all times well in excess of the £7 and £8 million ceiling. In the relevant accounting period (July 2007 to June 2008) they were £275 million.

32. The appellants accepted that the normal meaning of gross was, like its dictionary meaning, the total of assets without any deductions for liabilities.

33. The appellant's case was that I should give this provision some kind of 'purposive' interpretation on the basis that Parliament could not have intended to disqualify from relief investments in company which were risky in the sense that the company had a nil or negative net value.

34. CALA's liabilities at this stage equalled or exceeded its assets in that it owed its bank over £300million, all of which was secured on the property it owned which comprised the greater part of its assets. Moreover, it was all repayable 'on demand' so its creditor could at any time have brought its ability to trade to a standstill.

35. While I accept that the appellant is right to say that the company was actually valueless at the time in question, I am unable to agree that the legislation could be interpreted to bring CALA into qualifying under Condition C. I think that Parliament used the word 'gross' quite intentionally and with the object of limiting the relief to small and medium sized companies. A company with such a large asset base as CALA's is a large company, even if its liabilities exceed its assets. Parliament clearly intended to exclude shares in such companies from relief, and the 'purpose' of the gross assets test was revealed in the literal meaning of the words used. Gross was intended to mean gross. A purposive interpretation in this case is a literal interpretation.

36. Therefore, I find that CALA also failed the gross assets test in Condition C and the appeal must fail for this reason too.

37. I dismiss the appeal.

38. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

Barbara Mosedale
TRIBUNAL JUDGE
RELEASE DATE: