[2016] UKFTT 0243 (TC)

TC05019

Appeal number: TC/2014/05750

Capital gains tax – disposal of business by sole trader – extent of costs allowable in computation of gain on disposal of goodwill – costs previously included as revenue expenses in accounts – extent of allowable deduction for expenditure allegedly incurred on provision or enhancement of goodwill disposed of – sections 38 and 39 TCGA considered – appeal dismissed, subject to allowance of £500 of disposal costs omitted from HMRC's calculations in error

FIRST-TIER TRIBUNAL
TAX CHAMBER

KEVIN MULLOY **Appellant**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
JOHN WILSON FCA

Sitting in public in Nottingham Justice Centre on 17 and 18 December 2015

The Appellant appeared in person

Philip Oborne, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns a dispute about the extent of costs allowable in computing the chargeable gain accruing on the appellant's disposal of his business in 2010. Most of the costs concerned had previously been included in the appellant's accounts in previous years as revenue expenses and as a result of this HMRC had refused to allow a deduction for them in computing the appellant's chargeable gain.

2. This decision therefore mainly explores the issues surrounding the allowability of such expenses generally. At the hearing, it was envisaged that we would be issuing a "decision in principle", leaving some matters of detail to be agreed or determined later on the basis of guidance contained in our decision; in fact, however, because of the views we have taken on certain key issues, this decision finally disposes of the appeal.

The facts

3. We received an extensive bundle of documents and heard some oral evidence from the appellant. We find the following facts.

<u>The establishment and running of the appellant's business</u>

4. The appellant established himself in business as a combined property managing agent and estate agent/mortgage adviser on 1 September 2004 under the trading style "122 Property" (also known as "122property.co.uk"). The business was a new venture; he established it himself from scratch, funded largely by an inheritance from his first wife's estate.

5. As part of setting up the business, in addition to taking a lease of trading premises at Bulwell in the northern part of Nottingham, the appellant incurred various expenditure on what he regards as set up costs. The accounts in our bundle up to 31 March 2005 (the appellant's first accounting period) were incomplete, but by reference to the subsequent year's accounts, it can be seen that the appellant incurred expenditure which was treated in the accounts as capital expenditure of £676 and £120 under the headings of "Tools and Equipment" and "Furniture and Fittings" respectively (to which depreciation at the rate of 25% was applied, resulting in net book values at 31 March 2005 of £597). All other expenditure (totalling £69,499 and under a heading "Overheads") was treated as revenue expenditure in the accounts for the period up to 31 March 2005. No capital allowances were claimed for that period. The gross income in the period to 31 March 2005 was £9,316 (mainly fees, but including interest of £81) and accordingly the net loss for the period was £60,382 (for tax purposes, the trading loss shown on the appellant's tax return was £59,445).

6. The appellant now claims that £29,050 of the total £69,499 expenses shown in the accounts for the period was capital in nature and should be treated as allowable in his CGT computation on the later sale of his business. The key headings under which he makes this claim are as follows:

(1) £12,675 of advertising costs of "the business" (as opposed to advertising costs in relation to particular properties), including costs of entry into directories, local paper advertisements and distribution costs for 35,000 promotional leaflets inserted into a local paper (plus a further £175 for the printing of the leaflets).

(2) £11,272 of what the appellant describes as "legal and professional" costs. These relate to training for the appellant to permit him to practise as a mortgage adviser, various software licences (both specific to the business – e.g. products called "MortgageLINK" and "Property Pro" – and generic, such as Microsoft Office suites) and miscellaneous expenditure such as the set up costs of the business website and design work on display boards.

(3) £1,869 of "technical equipment", including a laptop computer, printer, camera equipment, ASDL router and laser measuring instruments.

(4) £1,315 of "non-technical equipment", comprising largely furniture and other fittings for the shop.

(5) £889 on pre-launch training for himself on the proprietary software and by the National Association of Estate Agents.

(6) £855 for building work at the shop premises.

7. In the late summer of 2005 the appellant moved the business from its original premises at 122 Main Street Bulwell to the adjacent (double sized) shop at 118-120 Main Street.

8. In November 2005, the appellant's second wife formed a partnership with an unconnected third party to operate a business similar in many respects to the appellant's business, and trading under the name "122property Carlton". The appellant permitted the "122" trading style to be used without payment. The two businesses operated independently (and their accounts were kept separate) but they provided technical support and advice to each other. They both benefited from the enhanced market profile resulting from the two businesses trading from separate premises in distinct areas of Nottingham, appearing to prospective customers to have the extra critical mass of two offices rather than one.

9. In the year to 31 March 2006, the gross income of the appellant's business was £51,279 (mainly fees but including £79 that appears to be commission and £348 interest). The revenue expenses shown in the accounts (under Overheads) total £97,718. After some adjustments (including the claiming of £502 of capital allowances, though no depreciation was included in the accounts), the trading loss for the year for tax purposes (as shown on the appellant's tax return) was £45,407. The accounts reflect an additional £1,083 of capital expenditure on "tools and equipment" and £833 on "fittings and furniture" during the year, as well as disposals of "tools and equipment" with an original cost of £676 (i.e. all the tools and equipment bought in the first seven months) at a profit of £468.

10. The appellant now claims that £13,368 of the total £97,718 revenue expenses shown in the accounts for the period was capital in nature and should be treated as allowable in his CGT computation on the later sale of his business. The key headings under which he makes this claim are as follows:

(1) £4,982 in respect of improvements to the trading premises following the move.

(2) £2,191 in respect of advertising specific to the business (rather than any particular properties).

(3) £2,113 in respect of "technical equipment", including a Dell computer server and some more camera equipment.

(4) £1,496 for further software licences relating to the specific business software and a 360-degree camera.

(5) £939 for printing of business-specific advertising material.

(6) £850 in respect of "non-technical equipment", including some surveying equipment and more furniture and heating equipment for the premises.

(7) £475 for proprietor's training – mainly CPD courses and tests of the NAEA.

(8) £322 of professional fees, comprising £72 client money protection levy and £250 for software programming to permit uploading of "virtual tours" of properties.

11. In the year to 5 April 2007 (the gap in the accounts from 31 March to 5 April 2006 was not explained), the gross income increased to £92,733 (mainly fees, but including interest of £2,328). The total of revenue expenses, under Overheads, was £103,527 and the total including interest paid was £103,529. The loss shown on the accounts was £10,775 (without adjusting for a small arithmetical error) and after some adjustments (though no depreciation or capital allowances were claimed), the trading loss for tax purposes for the year was £9,525 (as shown on the appellant's tax return).

12. The appellant now claims that £7,103 of the total £103,527 expenses was capital in nature and should be treated as allowable in his CGT computation on the later sale of his business. The key headings under which he makes this claim are as follows:

(1) £3,740 of "business only" advertising.

(2) £1,099 of "business only" printing (promotional leaflets and business cards).

(3) £912 for “legal and professional”, including £392 annual renewal fees for mapping and postcoding software and £210 joining/membership fees for the Estate Agents’ Ombudsman scheme.

(4) £691 for “non-technical equipment”, chiefly some signs and displays and some other minor office equipment.

(5) £281 for some further training for the appellant.

(6) £214 for some further display equipment and a key cabinet at the shop.

(7) £166 for a display screen and calculator.

13. In the year to 5 April 2008, the gross income increased to £125,657 (including interest of £2,770). The total revenue expenses were £123,910 (Overheads £123,850 and interest £60). After some adjustments (including capital allowances of £1,579, though no depreciation was claimed), the trading profit for tax purposes for the year was £4,510 (as shown on the appellant’s tax return).

14. The appellant now claims that £5,777 of the total £123,910 expenses was capital in nature and should be treated as allowable in his CGT computation on the later sale of his business. The key headings under which he makes this claim are as follows:

(1) £2,841 in respect of “legal and professional”, comprising £1,300 for transfer of paper records to computer, £1,056 for proprietary software licences, £235 for ombudsman’s fees and £250 trademark fees.

(2) £1,471 in respect of “technical equipment”, comprising a computer server, an external hard drive and a hammerdrill to fix sale/letting boards,

(3) £909 in respect of improvements to the shop.

(4) £386 in respect of “business-only” printing (for some kind of transportable banner advert)

(5) £170 for a leather visitors’ settee for the shop.

15. The appellant’s wife’s partner left the 122property Carlton partnership and her business was not doing well. At some point in 2008 or early 2009 it was agreed to transfer the management contracts for the 18 properties managed by her into the appellant’s business, along with a few “for sale” properties also on her books, effectively closing down that business. One employee came over the appellant’s business on the transfer. The appellant made no payment for the transfer.

16. In the year to 5 April 2009, the gross fee income fell to £112,710 (the total income including interest was £114,663). The total revenue expenses (Overheads) was £109,025. The trading profit for tax purposes for the year was £5,638 (as shown on the appellant’s tax return).

17. The appellant now claims that £4,117 of the total £109,025 expenses was capital in nature and should be treated as allowable in his CGT computation on the later sale of his business. The key headings under which he makes this claim are as follows:

(1) £1,726 in respect of "business only advertising", £1,449 of which related to production of 1,000 "6-page folding 'custom' folders", £111 related to 1000 colour compliments slips, £94 related to a yellow pages advertisement and £72 related to a polycarbonate advertising board.

(2) £1,398 in respect of "legal and professional", £1,300 for further data transfer and the remaining £98 for post coding software.

(3) £833 for "technical and non-technical equipment", comprising a further computer for the network (£485), a laminator (£100), 4 leather visitors' chairs (£120), a banknote speed checker (£21), a self-inking rubber stamp (£78) and an electric radiator (£29).

(4) £160 for fitting some shelving and key cabinets in the shop.

18. In late 2009 or early 2010, the appellant began to consider selling his business. He made the decision to do so in about March 2010 and started to negotiate with a potential purchaser. This process took some time, and in the meantime he had another prospective purchaser who was also interested.

19. In the year to 5 April 2010, the "sales" (presumed to be fee income) increased to £132,902 (less unexplained "purchases" of £673). The total expenses were £119,418 (excluding depreciation of £1,391 and bank charges of £1,986). The trading profit for tax purposes for the year was £10,142 (as shown on the appellant's tax return). This figure was after adding back depreciation but deducting capital allowances of £683.

20. The appellant now claims that £4,979 of the total £119,418 expenses was capital in nature and should be treated as allowable in his CGT computation on the later sale of his business. The key headings under which he makes this claim are as follows:

(1) £3,286 in respect of "legal and professional". This included £1,477 consultancy fees paid to a former employee who carried out work for the business to counteract the activities of a manageress who attempted to entice away the appellant's customers when it became apparent the business might be up for sale (thus, in the appellant's submission, protecting his goodwill); £950 paid for a compulsory audit of client account for the National Federation of Property Professionals; £325 paid for energy certificates for 5 newly built houses in order to secure the management contract for them; £250 for enhanced computer software, £115 for Anti-Money Laundering registration and £69 for a software licence to use Oyez legal forms.

(2) £908 in respect of "business only advertising", £683 for Google advertising, £125 for Yell.com and £100 for an entry in the Nottingham Business Directory.

(3) £670 in respect of "equipment". £644 of this was for a colour laser printer and the remainder was for a digital card reader and USB hub.

(4) £115 for enhancements to the shop (installation of white boards and security chain).

21. In total, therefore, the appellant claims to have incurred capital expenditure totalling £64,394 in the years 2004-05 up to 2009-10, which he seeks to set against his subsequent disposal proceeds on the sale of the business.

<u>Sale of the appellant's business and arrangements leading up to it</u>

22. In the summer of 2010, the appellant's second marriage was in difficulty. He drafted a "Deed of Separation" without involving lawyers, which set out the basis upon which he and his wife agreed to separate and, ultimately, divorce. This Deed (signed on 11 September 2010) dealt with a number of matters, and included the following section in relation to the appellant's business:

> "<u>Scheme of division of assets between the parties regarding 122property</u>
>
> The business is wholly owned by [the appellant] and it is accepted that the funding for setting up this business came wholly from the estate of [the appellant's first wife]. However it is accepted by both parties that [the appellant's second wife] made a contribution to the business not compensated for by receipt of money by her alone. Therefore it is agreed that until the sale of the business [the appellant's second wife] shall receive twenty per cent of any net profits of the business starting with business year 2010-11. Also that upon the sale of the business, [the appellant's second wife] shall receive twenty per cent of the sale value of the business with the value being capped at a maximum of £145,000 this being the asking price at the time of [the appellant's second wife] curtailing involvement in the business.
>
> Profits from 122property in business year 2009-10. It is agreed that [the appellant's second wife] should receive one half of these profits after making offsetting provisions for (1) net amounts already transferred by [the appellant] into the joint account and (2) provision for [the appellant] to purchase such goods and chattels necessary to furnish a 2-bed house (less some white goods etc already held at Basford). The net sum to be transferred to [the second appellant's wife] is £4,310."

23. The appellant sought to persuade us that his second wife beneficially owned 20% of the business as a result of the earlier transfer of her lossmaking business into it and financial and other contributions she had made to it (both directly and indirectly). We reject this submission – see [47] below.

24. The appellant finally entered into a contract to sell the business to Castlegates Estates and Lettings Limited on 1 November 2010. The agreement for sale (which was conditional upon the purchaser completing satisfactory due diligence and arrangements being settled with the landlord for assignment or subletting of the trading premises) was in reasonably routine form for a simple business sale agreement and included the following features:

(1) The appellant was party to it as the sole seller of the business.

(2) Essentially all the assets of the business were sold (including, specifically, the goodwill and leasehold trading premises), other than the book debts and cash.

(3) Certain liabilities were excluded from the sale, most notably creditors and pre-sale trade and tax liabilities.

(4) The sale price was £139,000, subject to a reduction of $1/175^{th}$ for each property by which the number of landlord's properties under active management by the business was found to be below 175. The purchase price was to be paid to the appellant.

(5) The appellant agreed to contribute £500 towards the purchaser's legal fees.

(6) There was no agreed allocation of the purchase price amongst the assets being sold. There were only six or seven months before the property lease expired and the purchaser only decided to take it at the last minute, after the overall sale price had already been agreed. We infer that a nil value is attributable to the disposal of the lease.

25. Pursuant to his agreement with his then wife, the appellant made arrangements for £27,800 of the sale price for the business to be paid to her direct. Our bundle included a copy of a cheque drawn by a Mr P J Mitchell (who appears to have been a director of the purchasing company) in favour of Mrs Frances Mulloy for that sum, dated 1 November 2010, together with a copy of a receipt for that cheque signed by the appellant, stated to be "in part payment for purchase of 122 property by Castlegate Estate and Lettings Ltd under the contract dated 1st November 2010 at 2120 hours".

26. The sale of the business was completed on 17 November 2010, when the balance of the purchase price (net of the £500 contribution to legal fees) was paid to the appellant. There appears to have been no reduction in the purchase price as a result of any shortfall in the number of properties under active management.

<u>Subsequent events</u>

27. On 6 January 2012 the appellant's self-assessment tax return for the tax year 2010-11 was delivered. This return included a sum of £130,736 in respect of gains qualifying for Entrepreneurs' Relief (it is common ground that the sale of the business was the only relevant disposal during the year). This figure could not be explained to

us, but it is common ground that the final taxable capital gain figure arising from the return was £33,756, resulting in capital gains tax of £3,375.60 (payable at the 10% Entrepreneurs' Relief rate). Attached to the return, however, were some computations showing how the £33,756 figure was arrived at, as follows.

28. The disposal proceeds were shown as £138,500, all qualifying for Entrepreneurs' Relief. Further unspecified losses of £94,644 were claimed as a deduction against the disposal proceeds, reducing the gain to £43,865. The annual exempt amount of £10,100 was then deducted, resulting in a final taxable gain of £33,756 and a consequential liability to capital gains tax of £3,375.60.

29. At no stage does the appellant appear to have provided a clear explanation of the £94,644 figure for losses claimed, though it appears to bear some approximate relationship to the aggregate net trading losses of the business during its life and/or the amount of the appellant's "investment" in the business (both of which have been referred to by the appellant, at various stages, as justifying a deduction).

30. On 30 October 2012, HMRC wrote to the appellant and his then accountants, opening an enquiry into his 2010-11 return, specifically the capital gains tax aspects. One of the questions they raised was the origin and nature of the £94,644 of losses claimed in the CGT computation.

31. In his reply, the appellant did not respond directly to this question. In the absence of any justification for the losses claimed (beyond an allowable capital loss of £3,364 brought forward from 2000-01, which HMRC established by checking back on the appellant's earlier returns, no mention of it having been made by the appellant), HMRC wrote to the appellant on 17 January 2013 explaining that they would be disallowing all but £3,364 of losses brought forward.

32. Further correspondence followed, and a meeting in November 2013. In essence, the appellant was seeking to persuade HMRC that a deduction should be available in respect of what he regarded as his lost investment in the business, whether by reference to the accumulated net losses or his unpaid capital account and other loans to the business shown in its balance sheet.

33. For present purposes, the only relevant outcome of that correspondence was HMRC's acceptance, in a letter dated 27 June 2013, that £4,900 of the consideration received on the sale of the business ought properly to be attributed to the sale of assets other than goodwill (mainly office equipment and software), falling outside the scope of capital gains tax.

34. Ultimately, HMRC did not accept any further arguments in relation to the losses claimed and accordingly on 4 February 2013 issued a closure notice in respect of their enquiry, disallowing the losses claimed except to the extent of the carried forward loss. Their computation of the liability was based on a disposal of goodwill for £134,100 (i.e. the total sale price of £139,000 less the £4,900 which they accepted should be attributed to the sale of assets outside the scope of CGT); against those disposal proceeds they were prepared to allow the brought forward capital loss of

£3,364 and the annual exemption of £10,100, resulting in a chargeable gain of £120,636 and a CGT liability (after Entrepreneurs' Relief) of £12,063.60 (applying the 10% rate). For some reason, they appear not to have allowed a deduction for the £500 of costs paid by the appellant in relation to the sale and purchase; as they did not specifically take issue with that deduction at any stage, we assume this to have been an oversight on their part. Mr Oborne confirmed at the hearing that HMRC did not dispute its availability.

35. Following a formal appeal by the appellant, this decision was ultimately confirmed by a statutory review dated 26 September 2014. In their letter, HMRC recorded that "some of the expenditure which you incurred during the lifetime of your business appears to have been capital in nature. Such expenditure should have been excluded from your profit-and-loss accounts and, had that action been taken, it would now be available to allow in the computation of the capital gain accruing to you on the disposal of the business." They went on to say that, as a result of the inclusion of the relevant expenditure as revenue in the trading accounts, its deduction for capital gains purposes was specifically excluded by virtue of section 39(1) Taxation of Chargeable Gains Act 1992 ("TCGA"). Any attempt now to re-write those accounts and amend the returns to exclude the expenditure as revenue deductions (thus potentially making them available as deductions in the CGT computations) would by then be out of time, so that route was not open to the appellant. They also rejected any suggestion that the £28,700 paid to the appellant's wife should be excluded from his disposal proceeds; it was clear that this payment was as a result of a separate private arrangement between the appellant and his wife (set out in the deed of separation) and was not as a result of his wife selling any share in the business.

36. The appellant's notice of appeal to the Tribunal was dated 21 October 2014 and received on 22 October 2014.

Arguments of the parties before the Tribunal

37. In his notice of appeal (which, with its annexures, ran to some 450 pages), the appellant set out two basic grounds of appeal:

> (1) First, he argued that he was a long term creditor of or investor in the business whose debt/investment had not been (and would not be) repaid and that some or all of that lost debt/investment should be allowed as a deduction from the disposal proceeds.
>
> (2) Second (if his first argument failed), he argued that on a close analysis, much of the expenditure he had incurred during the life of the business was capital in nature and therefore ought to be allowed as a deduction in computing any chargeable gain.

38. At the hearing, the appellant also argued that the amount of his disposal proceeds on the sale of the business should be reduced by £27,800, being the amount paid over directly to his wife by the purchaser of the business in accordance with the

deed referred to at [22] above. This was an argument that had previously been raised and dismissed by HMRC (see above).

39. Mr Oborne essentially maintained the line that had been followed by HMRC in their review letter.

The law

The appellant as a debtor of the business

40. The first point to clarify (as we did at the hearing) is that as the appellant carried on the business as a sole trader, there was no separate legal entity carrying on the business. He and the business were, in legal terms, one and the same entity. As such, he could not legally be owed anything by the business – it is legally impossible to owe a debt to yourself; and the accounting entries showing him to have an investment in (or amount due from) the business by way of capital or current account or as a creditor did not create or reflect any entitlement of the appellant to a separate asset recognised by law, they merely arose from the process of presenting the financial affairs of the business for accounting purposes as separate from the appellant's other financial affairs. This was a matter of presentation, so as to make the financial state of the business clear on the face of the accounts; it could not alter the underlying legal reality that the appellant was not in law owed anything by "the business".

41. As a result of this legal analysis, any attempt on the sale of the business to claim as a deduction the value of the appellant's "lost" investment in it is misconceived and doomed to fail. Before any relief can be available for the loss of an asset, that asset must exist in law. We therefore do not consider it necessary to explore any further what reliefs might have been available if the appellant had suffered the loss of an actual investment in some third party.

42. We should say in passing that the same legal analysis would also have prevented any attempt to structure the sale and purchase agreement so as to allocate the relevant part of the price to repaying the appellant's investment in (or loan to) the business rather than to goodwill. "The business" (being, in law, the same legal entity as the appellant) was not legally capable of owing the appellant any money and therefore even if the sale and purchase agreement had purported to attribute some part of the consideration to the repayment of the appellant's investment in the business (whether characterised as loan, capital account or in any other way), that purported attribution could have no legal effect. In the absence of any other asset being sold to which the consideration was properly attributable, it could only properly be attributed to goodwill.

The status of the payment to the appellant's wife

43. It is common ground that the appellant acted alone in selling the business. We understood him to be seeking a deduction for the amount paid to his wife by the purchaser in one of two ways: either on the basis that he was acting on behalf of his wife in selling her part share of the business (therefore, strictly, making no disposal

himself for CGT purposes of that part share) or, if we were not attracted by that analysis, on the basis that the amount paid to his wife was an expense of the sale giving rise to an allowable deduction under the general rules considered below. As to the first of these alternatives, section 60 TCGA provides as follows:

> "**60 Nominees and bare trustees**
>
> (1) In relation to property held by a person as nominee for another person, or as trustee for another person absolutely entitled as against the trustee, or for any person who would be so entitled but for being an infant or other person under disability (or for 2 or more persons who are or would be jointly so entitled), this Act shall apply as if the property were vested in, and the acts of the nominee or trustee in relation to the property were the acts of, the person or persons for whom he is the nominee or trustee (acquisitions from or disposals to him by that person or persons being disregarded accordingly).
>
> (2) It is hereby declared that references in this Act to any property held by a person as trustee for another person absolutely entitled as against the trustee are references to a case where that other person has the exclusive right, subject only to satisfying any outstanding charge, lien or other right of the trustees to resort to the property for payment of duty, taxes, costs or other outgoings, to direct how that property shall be dealt with."

44. The law applicable to the second alternative (expense of sale) is considered below.

Deductibility of expenditure claimed

45. The dispute in this area revolves around sections 38 and 39 TCGA, which provide (so far as relevant) as follows:

> "**38 Acquisition and disposal costs etc**
>
> (1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to —
>
> > (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the asset,
> >
> > (b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in

establishing, preserving or defending his title to, or to a right over, the asset,

(c) the incidental costs to him of making the disposal.

(2) For the purposes of this section and for the purposes of all other provisions of this Act, the incidental costs to the person making the disposal of the acquisition of the asset or of its disposal shall consist of expenditure wholly and exclusively incurred by him for the purposes of the acquisition or, as the case may be, the disposal, being fees, commission or remuneration paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal adviser and costs of transfer or conveyance (including stamp duty or stamp duty land tax) together —

(a) in the case of the acquisition of an asset, with costs of advertising to find a seller, and

(b) in the case of a disposal, with costs of advertising to find a buyer and costs reasonably incurred in making any valuation or apportionment required for the purposes of the computation of the gain, including in particular expenses reasonably incurred in ascertaining market value where required by this Act.

…

39 Exclusion of expenditure by reference to tax on income

(1) There shall be excluded from the sums allowable under section 38 as a deduction in the computation of the gain any expenditure allowable as a deduction in computing the profits or losses of a trade, profession or vocation for the purposes of income tax or allowable as a deduction in computing any other income or profits or gains or losses for the purposes of the Income Tax Acts and any expenditure which, although not so allowable as a deduction in computing any losses, would be so allowable but for an insufficiency of income or profits or gains; and this subsection applies irrespective of whether effect is or would be given to the deduction in computing the amount of tax chargeable or by discharge or repayment of tax or in any other way."

Discussion and decision

Relief for loss of the appellant's investment or attribution of disposal proceeds to repayment of such investment

46. For the reasons summarised at [40] to [42] above (and already stated to the appellant at the hearing), we consider the appeal must fail insofar as it seeks to rely on either (a) some kind of relief for the supposed loss of the appellant's investment in (or loan to) the business, or (b) the attribution of some or all of the consideration to the

repayment of such supposed investment/loan rather than to the goodwill of the business.

Relief in respect of the payment to the appellant's wife

47. So far as the payment to the appellant's wife is concerned, we agree with HMRC that this amounted to a partial redirection of the appellant's sale proceeds in respect of a business entirely owned by himself (in the context of an agreed division of assets on separation), rather than a payment to his wife for a beneficial part share in the business owned by her. All the evidence pointed to this, including the terms of the separation deed itself and of the sale agreement for the business. The appellant does not, in our view, satisfy the requirements of section 60 TCGA, because no evidence was produced to us giving any material support to the suggestion that he owned a part share in the business as nominee or trustee for his wife. The very first sentence of the deed of separation set out at [22] above makes it quite clear that, on the contrary, the appellant was very definite about his own personal ownership of the business and his wife accepted this. The fact that the payment was clearly motivated to some extent by recognition of her financial and other contributions to the business is insufficient to satisfy section 60 TCGA.

48. The alternative argument was that the payment to the appellant's wife should be treated as part of "the incidental costs… of making the disposal" under section 38(1)(c) TCGA.

49. Given the terms of section 38(2) TCGA set out above, we do not see any basis for this argument. The agreement to pay £27,800 to his wife was an entirely separate matter, reflecting an attempt at an equitable sharing of assets with a view to an impending divorce. The payment in our view falls entirely outside the scope of section 38(2) as an incidental expense of the disposal.

50. For completeness, we should also say that we can see no basis on which the payment could be said to fall within any other part of section 38. There was no evidence to suggest that the appellant was, by agreeing to make the payment, incurring expenditure within section 38(1)(a) TCGA on the acquisition of any part of the goodwill which was subsequently sold along with the business. It was clear, on the evidence, that he was the 100% beneficial owner of the business, including its goodwill, at all times up to its sale, and had paid nothing for the transfer of his wife's lossmaking business. The payment would not satisfy the conditions to be treated as "enhancement expenditure" under section 38(1)(b) TCGA: his purpose in incurring the expenditure was wholly or largely to achieve an amicable separation from his wife rather than to enhance the goodwill in any way. We do not see how the payment could be said to be "reflected in the state or nature" of the goodwill at the time of sale, nor was there any suggestion before us that the payment was agreed and made to any extent in "establishing, preserving or defending his title to" the goodwill.

Allowable expenses generally

<u>Preliminary points</u>

51. The bulk of the argument before us was around this point. Subject to the points mentioned above, it is clearly the case that the goodwill of the business was disposed of as part of the sale in November 2010, and the consideration attributable to the goodwill on the sale was the total sale price of £139,000 less the amount of £4,900 agreed by HMRC in their letter dated 27 June 2013 to have been properly attributable to other assets outside the charge to CGT. We are therefore concerned with disposal proceeds on the sale of the goodwill of £135,100. What expenses may be set against these proceeds?

52. As a secondary point, the appellant did dispose of his leasehold trading premises (albeit for no consideration). As some of the expenditure incurred by the appellant was claimed to be capital expenditure on improvements to the premises, this opened up the possibility of that expenditure giving rise to an allowable loss on his disposal of the lease, which would be available to offset in part the gain arising on the disposal of the goodwill (subject to potentially severe limitations by reason of the wasting assets rules applicable to short leases). In the event, we have decided this possibility is not in fact open to the appellant. This is because he did not claim to have incurred any capital expenditure on the <u>acquisition</u> of the lease of the second shop, and any <u>enhancement</u> expenditure would only be allowable pursuant to section 38(1)(b) TCGA if it had been "wholly and exclusively incurred… for the purpose of enhancing the value of" the asset in question, namely his leasehold interest. Given that his lease was to expire in the summer of 2011 without (so far as we were informed) any entitlement to reimbursement for expenditure on improvements, the "asset" in question would have entirely vanished at that point, making it impossible rationally to assert that any expenditure had, as its purpose, an enhancement in the value of the asset. Even if one takes a broader view of what constituted "the asset" for these purposes, to include the physical property of the shop rather than just the bundle of rights and obligations comprised in the lease, a similar point applies: by adapting the property better to suit his business, the appellant might have made it more useful to the business, but there is no indication that he enhanced its value, still less that he had incurred the expenditure "wholly and exclusively" in order to do so.

53. HMRC accept that the appellant's £500 contribution to the purchaser's legal costs should be treated as an incidental cost of the disposal under section 38(1)(c) and accordingly allowable as an expense. We concur.

<u>Deduction of revenue expenses – section 39 TCGA and the capital/revenue case law</u>

54. It is quite clear from section 39 TCGA that any expenditure "allowable as a deduction in computing the profits or losses of a trade, profession or vocation for the purposes of income tax…" cannot also be allowed as a deduction in computing a capital gain.

55. We note that section 39 uses the word "allowable", rather than "allowed". Mr Oborne's submission, that any expenditure actually <u>claimed</u> in the accounts as a deduction in computing trading profit or loss must be excluded from the capital gains computation, cannot therefore be accepted. In principle, if sums were wrongly claimed as "revenue" deductions when they were in fact capital in nature then they were not properly "allowable" in computing the profits or losses of the trade and are therefore not precluded by section 39 from being deducted in any capital gains computation. (This might result in a necessary reappraisal of the level of trading profit or loss, but in the present case this does not appear to be a practical issue, due to the overall levels of trading losses.)

56. Thus, if any of the expenses summarised above are found to be capital in nature (and therefore to have been incorrectly deducted in computing the trading profit/loss), there is no objection in principle to them being taken into account as deductions in the capital gains computation, subject to the rest of the normal rules and restrictions applicable to the availability of such deductions.

57. It is important however to bear in mind that simply because some item of expenditure is capital in nature, that does not mean it is available as a deduction in computing the chargeable gain or loss on a disposal of the goodwill of the business (or indeed of any other asset); it is intrinsic in the scheme of the legislation that there are some types of capital expenditure for which no relief at all is available – no deduction in computing trading profit (because of the capital nature of the payment) and no deduction for capital gains purposes (if the expenditure falls outside the quite limited scope of allowable deductions under the CGT code).

58. To establish which (if any) of the expenditure was capital in nature, the historic case law concerning the distinction between capital and revenue would be relevant. It has been made clear on many occasions that there is no simple test to fix the dividing line. The classic starting point for the authorities is the House of Lords case of *British Insulated and Helsby Cables Ltd v Atherton* (1925) 10 TC 155, where Viscount Cave said:

> "When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such expenditure as properly attributable not to revenue but to capital."

<u>The limitations on allowable expenditure in section 38 TCGA</u>

59. Before considering the detailed application of the capital/revenue divide to the facts of the present case, however, it is appropriate to consider whether there is any claimed expenditure which would clearly be non-allowable under the rules set out in section 38 TCGA. By doing so, it will be possible to narrow the scope of the "capital/revenue" examination which is required, or eliminate it altogether.

60. The appellant set the business up from scratch himself and therefore did not claim to have incurred any expenditure on the "acquisition" of the goodwill as

mentioned in section 38(1)(a). He is clearly correct in this. The basis of his claim appears to have been that the expenditure he had identified was all either (a) wholly and exclusively incurred in "providing" the goodwill in accordance with section 38(1)(a) TCGA, or (b) enhancement expenditure falling within section 38(1)(b) TCGA.

61. We do not consider it could properly be said that any of the expenditure for which the appellant claims a deduction could be said to have been wholly and exclusively incurred by the appellant in "providing" the goodwill of the business for himself. We consider that the concept of "providing an asset" (in the context in which it appears in section 38(1)(a) TCGA, as an adjunct to the wording concerning acquisition of the relevant asset) contemplates a situation where the asset in question is provided by the taxpayer for himself, whilst incurring expenditure in doing so. The text books refer to examples such as the creation of a copyrighted work or a registered patent. Another example might include the building of a factory using bought in materials. It seems to us, however, that the goodwill of a business is something that is acquired with the business (in the case of a going concern) and/or is built up over time as a result of the successful operation and promotion of the business. Arguably in the circumstances of this case, goodwill did not exist at all until the business was sold for more than the aggregate value of the assets and liabilities otherwise identified. In any event, we do not consider that goodwill is something which can be "provided" by a taxpayer by expenditure on other assets (tangible or intangible) that are to be used in (or in the promotion of) the day to day trading activities of the business, still less could it be said that expenditure on such assets was incurred "wholly and exclusively" in "providing" goodwill.

62. Nor do we consider it realistic to suggest that the appellant's payment of £27,800 to his wife (even though a one-off payment of a larger amount) was so incurred.

63. As to enhancement expenditure, potentially allowable under section 38(1)(b) TCGA:

(1) the section only gives relief for "expenditure wholly and exclusively incurred on the asset… for the purpose of enhancing the value of the asset". In this case, the "asset" we are concerned with is the goodwill of the business. Whilst it might be accepted that the appellant could have considered the enhancement of his goodwill to be part of his purpose in incurring the expenditure he claims to deduct, it is quite clear that the expenditure was actually incurred on training, publicity, software and various tangible assets which were all actively used in the normal way in the day to day running of the business. Clearly therefore none of the expenditure can, in our view, properly be said to have been incurred wholly and exclusively for the purpose of enhancing the value of the goodwill.

(2) the section also requires that the expenditure must be "reflected in the state or nature of the asset at the time of the disposal". This phrase has been considered by the Inner House of the Court of Session in *Aberdeen*

Construction Group Ltd v IRC [1977] STC 302, where Lord Emslie said (at p 311):

> "what [the predecessor provision to section 38(1)(b) TCGA] is looking for is, as the result of relevant expenditure, an identifiable change for the better in the state or nature of the asset, and this must be a change distinct from the enhancement of value [of the asset disposed of]"

64. Applying this test, we do not see how any of the expenditure claimed by the appellant, even if found to be capital in nature, could be said to have resulted in an "identifiable change for the better in the state or nature" of the goodwill ultimately sold by him, as opposed to a possible simple enhancement of its value.

65. Accordingly, we find that none of the expenditure claimed by the appellant is available for deduction from the disposal proceeds of the goodwill as enhancement expenditure under section 38(1)(b) TCGA.

66. In the light of this finding, we do not consider it necessary to go on to consider the extent to which the individual items (or general headings) of expenditure incurred by the appellant were capital or revenue in nature, as they would in our view not be allowable as deductions even if found to be capital. In passing, we would observe that whilst most of the expenditure appears at first sight to us to be revenue in nature rather than capital (in particular, the various advertising costs), a number of the items of expenditure (such as the costs of training the appellant in the necessary skills for the business from scratch, as distinct from training to update or improve skills which he already possessed) would clearly have been capital in nature; but we find this does not assist the appellant.

Conclusion

67. We consider there is no bar in principle to the appellant claiming relief in his CGT computation for expenditure which has been incorrectly claimed as a revenue expense in drawing up his accounts (and, therefore, in computing his profit and loss for income tax purposes) – see [55] and [56] above.

68. We do not consider any relief to be available to the appellant under section 38(1)(a) TCGA for expenditure supposedly "wholly and exclusively incurred by him in providing" the goodwill which he disposed of – see [61] above.

69. We do not consider that any of the expenditure for which he claims relief could, under section 38(1)(b) TCGA, properly be said to have been "wholly and exclusively incurred" on the goodwill by him or on his behalf "for the purpose of enhancing the value" of the goodwill, nor do we consider any such expenditure to be "reflected in the state or nature" of the goodwill at the time of its disposal. Accordingly, no relief is available for such expenditure – see [63] to [65] above.

70. It follows that even if some of the expenditure he incurred was capital and not revenue in nature, it would still not be allowable as a deduction in computing his chargeable gain on the disposal of the goodwill.

71. We do not consider any allowable loss to have arisen from the appellant's disposal of his leasehold premises on sale of the business, so as to be available to set against the chargeable gain arising on his disposal of the goodwill – see [52] above

72. Subject to the necessary adjustment to give relief for the £500 incurred by the appellant as an incidental cost of the disposal of the goodwill, we therefore DISMISS the appeal.

73. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 13 APRIL 2016