[2017] UKFTT 486 (TC)

TC05940

Appeal number: TC/15/3943 and TC/15/4505

CAPITAL GAINS TAX –receiver's fees and legal fees in challenging receiver and claiming against bank – whether deductible expenses - no

FIRST-TIER TRIBUNAL
TAX CHAMBER

LIAQAT HAROON HANIF **Appellants**
-and-
RIFAQAT HAROON HANIF

- and -

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

TRIBUNAL: JUDGE Barbara Mosedale
Toby Simon

Sitting in public at the Royal Courts of Justice, the Strand, London on 20 April 2017

Mr S Usman, Solicitor, of Harvard Solicitors, for the Appellants

Mrs B Sanu, HMRC officer, for the Respondents

DECISION

1. Each appellant appeals against a review decision each dated 23 January 2015 and issued to each of them following a discovery assessment in respect of the tax year 2010/11. The review decision of 23 January 2014 upheld the discovery assessment on Mr Liaqat Hanif to the extent of £33,943.52, and a review decision of the same date upheld the discovery assessment on Mr Rifaqat Hanif to the extent of £27,709.90.

The facts

2. There was very little factually in dispute, but Mr Liaqat Hanif gave fairly extensive evidence which explained the background to the situation in which he and his brother had found themselves. We accept his evidence.

3. We find as follows. The appellant brothers were not, or at least were not treated as being, in partnership but owned 9 properties jointly. A tenth property was owned by R Hanif with his wife. Nine of the properties were let apart from one in which R Hanif and his wife lived.

4. The properties had been acquired piecemeal over time and had been subject to various loans from different lenders. At some point, the brothers decided to consolidate the loans into a single facility with the Bank of Scotland. The borrowers were the brothers and Mrs Hanif, although it appeared accepted by all parties that Mrs Hanif had no equitable interest in the properties or lettings business.

5. The brothers decided to sell 2 of the 10 properties, and did so with the bank's permission. They intended to use the proceeds of sale to reduce the loan but, for reasons Mr Hanif did not understand, the bank kept the proceeds of sale in a separate account and did not use them to reduce the amount of the loan. The bank then claimed that the Hanifs were in breach of the terms of the loan, as the rental income, once reduced by the sale of the two properties, dropped to less than a predetermined percentage of the interest.

6. The Hanifs were aggrieved by this as they had expected the sale proceeds to be applied to reduce the loan and thus keep the rental income above the predetermined percentage of the loan. In their view, the bank's decision to keep the proceeds of sale in a separate account created the situation in which they were put in breach of the conditions of the loan.

7. The bank appointed a receiver on 19 November 2009 because of the (alleged) breach of conditions by the Hanifs. The Hanifs instructed solicitors. They were advised that they would be unable to get an injunction to prevent the receiver selling the properties. We find that the disbursement for counsel's fees invoiced to the Hanifs by Cooks, detailed at §12(2)(a) below, was in respect of this advice.

8. The Hanifs instructed another firm of solicitors (Neumans LLP) in December 2009 to advise them on making a claim against the bank. Neumans invoiced them (see §12(2)(b) below) for their services in November 2010.

9. The receiver sold the properties in May 2010 and the appellants were given a summary of their loan position with the bank in December 2010. In particular, the bank deducted from the sale proceeds the amount of the loan and various expenses, including the receiver's fee (see §12(1) below). This left an amount of £113,378.04 which the bank claimed that the Hanifs owed to the bank, and the bank lodged a claim in the High Court against the appellants for this amount on 16 December 2011.

10. The Hanifs defended this claim and issued a counter-claim against the bank for damages arising from alleged mis-selling by the bank of the loan agreement. They instructed another firm of solicitors in September 2012, Sky Solicitors, to act for them and Sky continued to act for the Hanifs until an out of court settlement was reached with the bank in April 2014. Sky then invoiced the Hanifs for their services (see §12(2)(c) below).

11. The sale of the original two properties was declared on their tax returns but Mr L Hanif agreed that he and his brother had overlooked the need to declare the sales of the remaining eight properties in their tax return. This oversight was perhaps to some extent understandable in that those eight properties were sold by the receiver appointed by the bank and without the Hanifs' consent.

12. Following the discovery assessment, the brothers claimed that the calculation of their respective capital gains should have taken into account their share of the following expenses:

(1) Receiver's fee of £34,075.00. This figure was shown on the breakdown provided by the bank to the Hanifs in December 2010 (§9)

(2) The three sets of legal fees as follows:

(a) £1,725 counsel's fee (a disbursement incurred by Cook & Partners on the appellants' behalf in an invoice dated 5 January 2010) (§7);

(b) Neumans LLP's fee of £23,433.02. The invoice was dated 8 November 2010 and stated to be in respect of work from 8 December 2009 to the date of the invoice (§8).

(c) Sky Solicitors' fees £76,573.33; invoice dated 25 April 2014 and stated to relate to work undertaken from September 2012 to April 2014 (§10).

The dispute

13. It was accepted that the properties were capital assets belonging to the brothers in respect of which they ran a letting business and that the brothers should have declared the sale of properties on their tax returns for the relevant year. It was accepted that HMRC's calculation of the capital gain on each brother, as shown in the

review decisions dated 23 January 2015 was correct, save in respect of the disallowance of the four expenses set out at §12 above.

14. The appellants claimed that the three sets of legal fees were allowable as incurred in defending title to the eight properties. They accepted that their ownership of the property was not actually challenged but said that they were defending their equity in the properties. HMRC did not accept this on the basis, they said, the expenses were incurred after the properties were sold.

15. So far as the receiver's fee was concerned, HMRC considered that the appellants had not shown it was incurred wholly and exclusively in respect of the sale of the properties. There was no breakdown of the work carried out by the receiver. And it was clear that the receiver would have carried out other tasks than just selling the properties: he must have managed the properties for a few months pending their sale and in particular must have collected the rents which were due. Indeed, the breakdown provided by the bank (see §9) showed that some £31,000 was received in rent pending the sales.

The law

16. The point at issue in the appeal is therefore a very discrete one. Were all or any of those four expenses allowable in the calculation of the appellants' capital gains. The relevant law is in s 38 of the Taxation of Chargeable Gains Act 1992 and it provides:

> (1)Except as otherwise provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to the 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,
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> (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...the incidental costs to the person making the disposal of the acquisition of the asset or its disposal shall consist of expenditure wholly and exclusively incurred by him for the purposes of the acquisition or, as the case may be, 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 .....

17. We consider each expense in turn.

The receiver's fee

18. HMRC accepted that a part of this fee would have reflected time spent by the receiver on the sale of the properties. However, we agree with HMRC that the appellant has not shown that the fee was wholly and exclusively concerned with the sale of the properties: indeed, the evidence is that the receiver carried out other tasks as well, in particular collecting rents in the months before the properties were sold.

19. The receiver's fee was clearly not a cost to the brothers on acquiring the properties nor on enhancing the value of the properties: the only applicable subsection was s 38(1)(c) 'incidental costs of disposal'. This contained a 'wholly and exclusively' test and the receiver's fee failed that test as it was not shown to be wholly and exclusively a cost of disposal because it was more likely than not to have been in respect of more than just selling the properties. Moreover, the receiver's fee did not fulful the criteria that it was 'paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal adviser' as in fact the receiver acted for the bank and not for the brothers. So for both reasons, we find that the receiver's fee was not an allowable deduction.

20. We note that our decision on this is the same as that in another recent Tribunal decision (*James O'Donnell* [2017] UKFTT 347 (TC)) where the deductibility of a receiver's fee on the forced sale of properties was one of many issues the Tribunal considered: at [76] the Tribunal ruled that it could not be deducted as it was not shown to be wholly and exclusively in relation to the sale.

Legal fees in respect of litigation with bank

21. By far the largest of the fees was the amount paid to Sky for work carried out 2012-2014. This was clearly not within s 38(a) as an amount paid on the acquisition of the properties; nor was it an amount with s 38(1)(c) as a cost of disposal. The properties had been disposed of long before Sky was appointed and their services related to the Hanifs' litigation with the bank.

22. The appellants' case was that it fell within s 38(1)(b) as '...expenditure wholly and exclusively incurred ... in establishing preserving or defending ... title to, or to a right over, the asset'. We reject that claim. The properties were sold in 2010; the litigation in 2012 was not concerned with the brothers' title to the properties but their rights and liabilities under the loan agreement with the bank.

23. The appellants had earlier incurred fees with Neumans LLP in the period December 2009 to November 2010 in relation to a 'proposed claim against' the bank. We have no more detail than this. While the properties where sold during the period Neumans were acting, we do not accept that their fees were a cost of the disposal of the properties. Neumans did not have anything to do with the sale. We also do not accept that the expenditure fell within s 38(1)(b) as defending the brothers' title to the property: the brothers' ownership of the properties was not in dispute. As before, the fees appeared to be incurred with respect to advice on the brothers' rights and liabilities under the loan agreement and not their title to the properties.

Counsel's fee on appointment of receiver

24. This was incurred, we found, in seeking advice on obtaining an injunction to prevent the receiver selling the properties. It was clearly not incurred in respect of the acquisition of the properties (s38(1)(a)). It was also clearly not an incidental cost of disposal (s38(1)(c)): on the contrary the aim was to prevent disposal. The brothers' claim was that it was within s 38(1)(b).

25. We could see an argument that it might be said to be expenditure on 'enhancing the value' of the asset in the sense that it might reasonably be thought that preventing a forced sale by a receiver would enable the properties to be sold for a higher value later: however, that part of s 38(1)(b) is a two-stage test and to fall within it the appellants would have to show that the enhancement expenditure was actually reflected in the asset at the time of the disposal. Clearly, that has not been shown here: the expenditure was unsuccessful. The sale by the receiver went ahead.

26. The appellants consider that it was expenditure incurred in defending their title. While the brothers' ownership of the properties was not challenged, the appointment of a receiver undoubtedly prevented them exercising the rights of owner in the sense that they were not able to prevent the receiver selling the properties when they did not want them sold. Nevertheless, our view is that strictly the expenditure was not incurred in defending title: the brothers' title was never in issue. What was at issue was whether the receiver was acting lawfully within the terms of the loan agreement between the brother and the bank, not the brothers' title to the property.

27. Our conclusion is that the expense is not allowable as a deduction.

Income expense?

28. We note that in any event no expenses are deductible for capital gains purposes if the asset was fixed capital of the trade and the expense would have been deductible as the expense of that trade for income tax purposes: s 39(2) TCGA. Mrs Sanu did not draw the appellants' or tribunal's attention to this provision but it seems that it would in any event have prevented the above expenses being deductible in the *capital gains* computation.

29. Although we do not have to decide this point as we have decided that none of the expenses fell within s 38 TCGA in any event, it seems to us that the claimed expenditure was all of an income nature. The challenge to the appointment of the liquidator and the pursuit of a claim against the bank for alleged mis-selling of the loan agreement would not have been capital expenditure on the property because it does not alter or enhance the properties (see *Southern v Borax Consolidated Ltd* [1941] 1 KB 111 and *Linslade Post Office & General Store [2012] UKFTT 457 (TC))* On the contrary, it seems to us expenditure challenging the receivership and claiming damages from the bank for their actions which resulted in the loss of the brothers' letting business would have been income expenditure.

Income tax cases

30. Mr Usman referred the Tribunal to a number of cases on the deductibility of legal fees, in particular *Spofforth and Prince* 26 TC 310, *Sheppard* [1999] 3 All E R 491, and *Parry* [1973] STC 56. However, the cases were largely irrelevant as they concerned whether the particular legal fees concerned were deductible in computing the profits for the purposes of income tax; however, all of the cases contained guidance on the meaning of 'wholly and exclusively' but it did not assist the appellants, confirming as they did that the entire cost claimed (or an identified part of it) had to be exclusively for an allowable purpose. There was no possibility of apportionment.

Conclusion

31. For the reasons given above we do not consider that any of the four claimed fees in issue were deductible in the appellants' capital gains computation and the appeal is therefore dismissed.

32. 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: 12 June 2017