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**Insights**

# CLAIMING A CAPITAL LOSS FOR ABORTIVE EXPENDITURE ON A PROPERTY ACQUISITION – ON HOLIDAY WITH THE LLOYD-WEBBERS

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## SUMMARY

In *Lord and Lady Lloyd-Webber v HMRC* the First-tier Tribunal decided that the taxpayers could claim capital losses on expenditure incurred under contracts to acquire properties off-plan when they never ultimately acquired the properties.  The expenditure included both the initial deposit and payments made against various stages of completion of building the properties.

## Facts

The facts were that in 2007 Lord and Lady Lloyd-Webber entered into contracts to acquire the properties, two villas in Barbados, once they were built.  Construction stopped and the Lloyd-Webbers terminated their rights under the 2007 contracts in return for rights under contracts entered into in 2011.  The 2011 contracts allowed them to recover some monies assuming the development proceeded successfully and the villas were sold on.  At the time of acquisition their rights under the 2011 contracts had negligible value.  The Lloyd-Webbers claimed capital losses in their 2011-2012 tax returns.

The taxpayers faced various challenges in bringing their claim.  We look at them in turn below.

### Did the Lloyd-Webbers acquire an asset that was disposed of for a loss?

A potential problem here was the case of *Hardy*, in which an Upper Tribunal decided that a taxpayer could not make a claim for a capital loss for a deposit he had paid to buy a property that was never acquired.  The Upper Tribunal decided that the taxpayer had not acquired an asset.  However, both HMRC and the taxpayers agreed that *Hardy* was wrongly decided on this point (it had not cited the Court of Appeal decision in *Underwood*) and that the taxpayers had acquired rights under the 2007 contracts.  Those assets were disposed of when they were terminated in exchange for the 2011 contracts.

## What did the Lloyd-Webbers spend their money on – land or acquiring rights under the 2007 contracts?

It was not enough to get a capital loss that the Lloyd-Webbers had acquired rights under the 2007 contracts. They also needed to make their payments wholly and exclusively to acquire those rights and for the purpose of enhancing the value of them within s38 TCGA 1992. In considering this question – was the money paid for the land or the rights – the Tribunal considered whether this was a subjective or objective test. Concluding that it was an objective test, the Tribunal had no difficulty in deciding that the money was paid for the contractual rights.

## What would have happened to their base cost if the Lloyd-Webbers had completed the acquisition?

This question was briefly considered by the Tribunal. If the position was that the Lloyd-Webbers had spent the money acquiring the rights in the interim, what would have happened if they had subsequently acquired the land? Would the base cost for the contracts have been lost and unusable for the land itself? In other words could the expenditure count twice? The Tribunal offered a solution to this issue by referring to a little used provision, s43 TCGA. This section allows expenditure incurred on an asset that merges into, or changes its nature into, another asset to be used against the subsequent asset. What is necessary is that the subsequent asset derives its value from the first asset. The Tribunal thought the conditions were met for s43 to apply and therefore for the base cost in the contractual rights to pass into the land – if the land had been acquired. Essentially, the 2007 rights would have merged or changed in nature to become the completed property. Problem solved.

## Was the provision for forfeited deposits in s144(7) TCGA relevant?

Under this provision a forfeited deposit of purchase money or other consideration money for a prospective purchase which is abandoned is treated as if it was an abandoned option, i.e. as if there is no disposal of an asset. Consequently, this provision denies a capital loss where a deposit alone is paid for a prospective purchase and the deposit is forfeited. The Tribunal referred to this provision briefly and said that if Parliament thought that a capital loss should be denied in the Lloyd-Webbers' case, provision could have been made in the legislation as it was by s144(7) for forfeited deposits.

## Comment

This decision is a fair outcome for the Lloyd-Webbers. They had an economic loss arrived at under normal business principles. Consequently, the decision is consistent with two cases the judge quotes in his decision: *Aberdeen Construction* and *Ramsay.* In those cases the judges said that the purpose of capital gains tax is to tax gains and make allowances for capital losses arrived at upon normal business principles: it's a tax on gains not on arithmetical differences. So this is an unusual situation where the common sense business outcome has played in the taxpayer's favour rather than against the taxpayer.

The case brings to light a number of difficult areas of tax law and issues where it is challenging to find coherence in the law.  The s43 analysis – the concept of base cost in rights to acquire property passing into base cost for the property itself on an subsequent acquisition – is interesting.

A taxpayer in a similar position to the Lloyd-Webbers, where an off-plan property has not been built and won't be, may (depending upon the facts) want to consider making a negligible value claim. Alternatively, like the Lloyd-Webbers, they could consider terminating their contract to acquire the property in return for new rights so that they can establish a disposal of an asset.

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**Anne Powell**

London

anne.powell@bclplaw.com
+44 (0) 20 3400 2162


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