[2014] UKUT 0165 (TCC)

Capital Gains Tax – Relationship between Enterprise Investment Scheme relief and Taper Relief in relation to properties that had been used for both business and non-business purposes, either concurrently or at different times, in the period of ownership by the taxpayer – Appeal allowed

IN THE UPPER TRIBUNAL **Appeal no: FTC/42/2012**
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

-and-

MARK STOLKIN

Respondent

Tribunal: Mr Justice David Richards

Sitting in public in London on 8 October 2013

Aparna Nathan, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants
Michael Sherry, counsel, instructed by Shipleys LLP, for the Respondent

Introduction

1. This appeal concerns the relationship between two reliefs against capital gains tax, Enterprise Investment Scheme (EIS) relief and taper relief, on the disposal of an asset which has been used for both business and non-business purposes (a mixed-use asset). Taper relief was abolished in 2008, so that the issue has no relevance to any disposal occurring since then.

2. Briefly summarised, the issue is whether a taxpayer can elect to claim EIS relief on that part of the gain accruing on the disposal of a mixed-used asset referable to its non-business use, and so enable the taxpayer to take advantage of the more generous taper relief available in respect of gains occurring on the disposal of business assets.

3. The First-tier Tribunal (Judge Nowlan and Sheila Cheesman), in their decision given on 24 November 2011, allowed the taxpayer's appeal. This reduced the taxpayer's liability to capital gains tax from almost £1.256 million on HMRC's case to about £775,000. Judge Nowlan gave permission to appeal, observing that the case involved only points of law and the decision was finely balanced.

Facts

4. The tax return of the taxpayer respondent, Mark Stolkin, for 2005/06 included chargeable gains in respect of several properties. Some of the properties had

been used wholly for business or wholly for non-business purposes but two of the properties were mixed-use properties. The two mixed-use properties were Flat 3, Observatory Gardens, London W8, of which the taxpayer owned 50%, and Lanterns Court, Millharbour, London. The un-tapered gain resulting from these disposals was £11,374,910. The taxpayer made a claim for EIS relief in the sum of £3,499,999, and it is agreed that the claim was valid and the relief was due. In his tax return, the taxpayer divided the gain arising on the disposal of the two mixed-use properties between business and non-business use in accordance with the statutory provisions dealings with taper relief. He sought to apply EIS relief against the full amounts of the non-business gains on the two properties, so eliminating those gains as chargeable gains in that year of assessment, and applying taper relief to the business gains, so far as not relieved by the balance of the EIS relief.

5. It is the contention of HMRC that the taxpayer was not entitled to divide the gain accruing on the disposal of the mixed-use properties into business and non-business gains but was required to apply the EIS relief on the undivided gain accruing on each disposal and then applying taper relief to the balance remaining. For that purpose, the balance of the gains stood to be apportioned between business and non-business use in accordance with the statutory taper relief provisions. It is this difference of approach which accounts for the difference of over £480,000 in the respective computations of the parties of the taxpayer's liability for capital gains tax.

Capital gains tax: general points

6. It is helpful to start with some of the basic features of capital gains tax, which then as now was governed by the Taxation of Capital Gains Act 1992, as amended from time to time (TCGA). Section 1(1) provides that tax is charged in accordance with the TCGA in respect of "chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets." Section 2(1) provides that, subject to any exceptions provided by the TCGA, a person is chargeable to capital gains tax "in respect of chargeable gains accruing to him in a year of assessment." Section 2(2) provides that the tax is charged "on the total amount of chargeable gains accruing to the person chargeable in the year of assessment" after deducting allowable losses.

7. The effect of these provisions is that capital gains tax is payable in respect of chargeable gains that accrue to a person in the year of assessment. If no chargeable gains accrue in the year of assessment, no capital gains tax is chargeable in respect of that year.

EIS relief

8. EIS relief was introduced by the Finance Act 1995. It has the effect of deferring the tax otherwise payable on chargeable gains arising on the disposal of any asset to the extent that investment is made within a qualifying period in shares meeting the conditions of the Enterprise Investment Scheme.

9. The detailed provisions are contained in schedule 5B to the TCGA. Paragraph 1(1) provides that the schedule applies where, among other conditions:

> *"(a) there would (apart from paragraph 2(2)(a) below) be a chargeable gain ("the original gain") accruing to an individual ("the investor") at any time ("the accrual time") on or after 29 May 1994."*

10. The effect of a successful claim to EIS relief is therefore that, to the extent of the claim, no chargeable gain accrues in respect of the disposal of the original asset in the year of its disposal. The gain is deferred to a subsequent year of assessment. The deferred gain does not therefore satisfy the basic requirement of sections 1 and 2 of the TCGA, that, in order to give rise to chargeable gains in a year of assessment, the gain must accrue in that year. The deferred gain is therefore outside the capital gains tax provisions for the year in which the disposal occurred.

11. In relation to the issue arising on this appeal, it is to be noted that EIS relief may be claimed in respect of the gain arising on the disposal of any type of asset. No distinctions are made between different types of asset, for example between assets held for business or non-business purposes.

12. It is common ground that, by virtue of paragraph 2(1) of schedule 5B, the taxpayer is entitled to decide against which gain, arising on the disposal of which asset, he wishes to claim EIS relief. In the period during which taper relief was available, it therefore made sense for a taxpayer to claim EIS relief against the gains arising on the disposal of assets characterised as non-

business assets for the purposes of taper relief, thereby maximising the benefit of taper relief on assets characterised for such purposes as business assets.

Taper relief

13. Taper relief was introduced by the Finance Act 1998 with effect from the year 1998/99. Its purpose was to reduce the amount of chargeable gains, net of allowable losses, accruing in a year of assessment by applying taper relief to the chargeable gains eligible for the relief. The relevant provisions are contained in section 2A of, and schedule A1 to, the TCGA.

14. These provisions create an important distinction between business assets and non-business assets. Section 2A(3) provides:

> *"Subject to the following provisions of this Act, a chargeable gain is eligible for taper relief if –*
>
> *(a) it is a gain on the disposal of a business asset with a qualifying holding period of at least 1 year; or*
>
> *(b) it is a gain on the disposal of a non-business asset with a qualifying holding period of at least 3 years."*

Taper relief operates to reduce the percentage of the gain which is chargeable to tax, but on a very much more generous scale in the case of business assets, than in the case of non-business assets: section 2A(4) and (5).

15. The detailed provisions concerning taper relief are contained in schedule A1 to the TCGA. Section 2A(7) provides:

> *"Schedule A1 shall have effect for the purposes of this section."*

Paragraph 1 of schedule A1 provides:

"(1) Section 2A shall be construed subject to and in accordance with this Schedule.
(2) The different provisions of this Schedule have effect for construing the other provisions of this Schedule, as well as for construing section 2A."

16. The conditions for determining whether an asset, other than shares or an interest in shares, was at any time a "business asset" for the purposes of taper relief are contained in paragraph 5 of schedule A1.

17. The central provisions of schedule A1 for the purposes of this appeal are paragraphs 3 and 9.

18. Paragraph 3(1) concerns business assets:

"(1) Subject to the following provisions of this Schedule, a chargeable gain accruing to any person on the disposal of any asset is a gain on the disposal of a business asset if that asset was a business asset throughout its relevant period of ownership."

19. Paragraph 3(2)-(5) concerns assets which have been used for business purposes for parts of the period of ownership and for non-business purposes for other parts of such period:

"(2) Where –
(a) a chargeable gain accrues to any person on the disposal of any asset,
(b) that gain does not accrue on the disposal of an asset that was a business asset throughout its relevant period of ownership, and
(c) that asset has been a business asset throughout one or more periods comprising part of its relevant period of ownership,
a part of that gain shall be taken to be a gain on the disposal of a business asset and, in accordance with sub-paragraph (4) below, the remainder shall be taken to be a gain on the disposal of a non-business asset.
(3) Subject to the following provisions of this Schedule, where sub-paragraph (2) above applies, the part of the chargeable gain accruing on the disposal of the asset that shall be taken to be a gain on the disposal of a business asset is the part of it that bears the

same proportion to the whole of the gain as is borne to the whole of its relevant period of ownership by the aggregate of the periods which –

(a) are comprised in its relevant period of ownership, and

(b) are periods throughout which the asset is to be taken (after applying paragraphs 8 and 9 below) to have been a business asset.

(4) So much of any chargeable gain accruing to any person on the disposal of any asset as is not a gain on the disposal of a business asset shall be taken to be a gain on the disposal of a non-business asset.

(5) Where, by virtue of sub-paragraphs (2) to (4) above, a gain on the disposal of a business asset accrues on the same disposal as a gain on the disposal of a non-business asset –

(a) the two gains shall be treated for the purposes of taper relief as separate gains accruing on separate disposals of separate assets; but

(b) the periods after 5th April 1998 for which each of the assets shall be taken to have been held at the time of their disposal shall be the same and shall be determined without reference to the length of the periods mentioned in sub-paragraph (3)(a) and (b) above."

20. Paragraph 9 concerns assets which have concurrently been used for business and for non-business purposes:

"(1) This paragraph applies in the case of a disposal by any person of an asset where the asset's relevant period of ownership is or includes a period ("a mixed-use period") throughout which the asset –

(a) was a business asset by reference to its use for purposes mentioned in any provision of paragraph 5 above; but

(b) was, at the same time, being put to a non-qualifying use.

(2) The period throughout which the asset disposed of is to be taken to have been a business asset shall be determined as if the relevant fraction of every mixed-use period were a period throughout which the asset was not a business asset.

(3) In sub-paragraph (2) above "the relevant fraction", in relation to any mixed-use period, means the fraction which represents the proportion of the use of the asset during that period that was a non-qualifying use.

…

(6) Where a mixed-use period is a period in which –

(a) the proportion mentioned in sub-paragraph (3) above has been different at different times, or

(b) different attributions have to be made for the purposes of sub-paragraphs (4) and (5) above for different parts of the period,

this paragraph shall require a separate relevant fraction to be determined for, and applied to, each part of the period for which there is a different proportion or attribution.

(7) In this paragraph –
"non-qualifying use", in relation to an asset, means any use of the asset for purposes which are not purposes in respect of which the asset would fall to be treated as a business asset at the time of its use; and "non-qualifying part" and

"relevant income" have the same meanings as in paragraph 8 above."

The present case

21. One of the properties disposed of by the taxpayer in the present case, Observatory Gardens, had been used wholly for business purposes during part of its period of ownership and wholly for non-business purposes during the rest of the period. Accordingly, paragraph 3 of schedule A1 applies to the chargeable gain arising on its disposal. Another property, Lanterns Court, had been used for both purposes throughout its ownership by the taxpayer, so engaging paragraph 9. The taxpayer's case in short is that, for the purposes of claiming EIS relief, he is entitled to distinguish between the gain on the disposal of the properties attributable under schedule A1 to their business use and the gain so attributable to their non-business use, and to elect under schedule 5A to claim EIS relief primarily against the gain attributable to non-business use, so maximising the value to him of taper relief.

22. HMRC submit that EIS relief may be claimed only in respect of the total gain arising on the sale of a single asset and that no authority exists for apportioning for EIS relief purposes the gain arising on the disposal of a single asset into separate gains attributable to its use as a business asset and as a non-

business asset. Such a distinction and apportionment is deemed by section 2A and schedule A1 to exist only for the purposes of taper relief.

23. The taxpayer accepts that a claim for EIS relief lies in respect of a gain before the application of taper relief. This was decided in *Daniels v HMRC* [2005] STC 684. EIS relief results in the chargeable gain being deferred, so that to the extent of the relief no chargeable gain accrues in the year of disposal. As the special commissioner said at [38] as regards taper relief:

> *"Section 2A is dealing with accrued chargeable gains as mentioned in section 2(2). Those chargeable gains do not include ones where accrual has not taken place. The only chargeable gains relevant for section 2A in a given year of assessment are those which have accrued to the chargeable person in the year of assessment."*

At [50], he said:

> *"On the clear construction of the 1992 Act following the Finance Act 1998, chargeable gains in a given year of assessment were, to the extent that they were relieved under schedule 5B, not gains accruing in the year of assessment."*

The special commissioner expressed his conclusion at [54]:

> *"I decide this appeal in the sense contended by the Revenue, namely that the available deferral relief is to be deducted from the chargeable gains accruing in the year of assessment* ***before*** *taper relief is applied. In a sentence, this is because taper relief only applies to chargeable gains that the 1992 Act treats as accruing in the particular year of assessment."*

24. The decision and reasoning in *Daniels v HMRC* are not challenged by the taxpayer on this appeal and appear to me to be clearly correct.

25. On this basis, the taxpayer's claim fails, unless he can point to a statutory authority, applicable to claims for EIS relief, for treating the single gain

arising on the disposal of a single mixed-use asset as two gains arising on the disposal of two assets, referable to the asset's business and non-business use.

26. No such authority exists in the provisions for EIS relief or generally in the provisions for the identification and computation of chargeable gains. The taxpayer submits that this is nonetheless the effect of paragraphs 3 and 9 of schedule A1 which, he submits, apply not only for the purposes of taper relief but also for the purposes of claiming EIS relief.

The decision of the First-tier Tribunal

27. The First-tier Tribunal accepted the taxpayer's case.

28. The Tribunal's approach is summarised in its Decision at [11]:

> *"We consider that this dispute was very finely balanced. Indeed, purely in interpreting the wording, we incline to the view that the Respondents have the marginally stronger case, and that there is a tenable view that EIS relief has to be set, in one single calculation against the single gain on an asset, treated as a mixed use asset for taper relief purposes. The point of interpretation is not unambiguous, however, and we allow this appeal because of situations where we consider that the results of the Respondents' contention would lead to significant anomalies."*

29. Referring to paragraphs 3 and 9 of schedule A1, the Tribunal said at [17]:

> *"…both categories of mixed-use lead to the drafting fiction of their being deemed disposals of separate assets, and two deemed gains for taper relief purposes."*

30. The Tribunal accepted at [24] as "reasonably compelling" HMRC's reliance on the statement in paragraph 3(5) of schedule A1 that the two deemed gains arising on the disposal of a mixed-use asset are to be treated "for the purposes of taper relief" as separate gains accruing on separate disposals of separate

assets. But at [27] the Tribunal went on to set out a counter-point which had occurred to the Tribunal and has been adopted by the taxpayer on this appeal. They observed that, unlike paragraph 3(5), paragraph 3(2) contains no words limiting the deemed creation of two separate gains to taper relief purposes. At [28], they said:

> *"For present purposes, the conclusion that we reach, that we find to be of considerable significance, is that the deemed separate asset notion is occasioned by paragraph 3(2), not by paragraph 3(5), and it is only paragraph 3(5) that is expressed to be for taper relief purposes. That certainly makes entire sense when applying sub-paragraph 3(5)(b), and quite what sub-paragraph 3(5)(a) achieved that had not already been achieved by the earlier sub-paragraphs appears to us to be a bit of a mystery. We certainly say that paragraph 3(5) cannot be read to qualify paragraph 3(2), and to deem the deeming notion of paragraph 3(2) to have been narrower than it initially seemed. That could and should have been achieved by inserting the four simple words, "for taper relief purposes" in paragraph 3(2), had that been intended to be how the deeming notion of paragraph 3(2) should operate."*

31. In reaching their conclusion in favour of the taxpayer, the Tribunal relied principally on the following points. First, it relied on its point of construction just noted, that paragraph 3(2) of schedule A1 does not expressly limit its deeming effect to taper relief. Secondly, it considered that, in a broad sense, the taxpayer's allocation of EIS relief to the non-business portion of the gain was made for the purposes of taper relief, because the purpose of the allocation was to enable the taxpayer to take advantage of the more generous taper relief available for gains on business assets. Thirdly, it considered it to be very odd for the legislation to permit EIS relief to be set against gains on chosen assets, and thus most obviously against gains on non-business assets, but for a different rule to apply where an asset is a mixed-use asset for taper relief purposes.

Discussion

32. In my judgment, the Tribunal was wrong to conclude that the deeming provisions of paragraphs 3 and 9 of schedule A1 have any application outside the provisions for taper relief, and specifically have any application to claims for EIS relief.

33. The restricted ambit of these deeming provisions is made clear both by their context and by express provision. They appear in a schedule which is concerned solely, as its heading makes clear, with the application of taper relief. The entire contents of the schedule are directed to taper relief. This would, in my view, be enough but the express terms of section 2A(7) and paragraph 1 of schedule A1 make clear the purpose and limited application of the provisions of the schedule. There is in my judgment no basis for giving them any wider application.

34. If it had been intended, on the introduction of taper relief in 1998, to alter the application of the existing provisions for EIS relief so as to deem the disposal of a single asset to be the disposal of two separate assets, one business and the other non-business, this would have been done in terms. The absence of any amending provision in schedule 5B or of any provision in schedule A1 extending the application of paragraphs 3 and 9 of schedule A1 to EIS relief points to the lack of any such intention.

35. The distinction which the Tribunal saw in the terms of paragraphs 3(2) and 3(5) of schedule A1 does not assist. Paragraphs 3(2)-(5) are dealing with a single subject matter and must be read together. Paragraph 3(5)(a) makes clear that the treatment of the two gains, deemed by paragraph 3(2) to exist, as separate gains accruing on separate disposals of separate assets was for the purposes of taper relief. Paragraph 3(2) did not have an effect independent of paragraph 3(5). They took effect together. If, as the Tribunal thought, paragraph 3(5)(a) was strictly unnecessary, and merely repeated the effect of paragraph 3(2), it made clear that the effect of paragraph 3(2) was limited to taper relief. If, as I consider, paragraph 3(5)(a) is an integral part of paragraph 3(2)-(5) designed to give effect to the concept of the two deemed gains and disposals, its express effect is likewise to limit the deeming effect of those provisions to taper relief.

36. The Tribunal saw force in the taxpayer's submission that because he sought to allocate EIS relief to the non-business part of the gain in order to use taper relief to better advantage, the allocation was made for taper relief purposes. With respect to the Tribunal, the issue is not the purpose of the taxpayer in seeking to make this election but the purpose of the legislative provisions. The issue is whether there is anything in the legislation which deems for the purposes of EIS relief the gain on the disposal of a single mixed-use asset to be two separate gains. In my judgment, there is not, for the reasons given above.

37. The Tribunal was influenced by its perception that it would be "very odd" to permit a taxpayer to elect to claim EIS relief against the gain made on the disposal of an asset which was, for taper relief purposes, a non-business asset without also allowing the taxpayer to make such an election against different parts of a single gain arising on the disposal of a single asset. Such considerations may be relevant to resolving any real ambiguity in the terms of particular provisions, but in this case it does not appear to me that there exists any ambiguity in the provisions for EIS relief and taper relief.

38. Accordingly, I allow the appeal by HMRC.

Mr Justice David Richards

Release date 9 April 2014