CAPITAL GAINS TAX - INCOME TAX - Execution by the owner of farm land likely to be the subject of a housing development of a Trust Deed constituting a bare trust in his favour - Subsequent execution by the owner of the land of Deeds of gift of shares in the net proceeds of sale to arise from the said land in favour of the owners' children - Subsequent grant of an option to purchase the said land to a developer - Subsequent exercise of the option to purchase the said land by developers - Receipt of part of the proceeds of sale by the Appellants - Whether a hold over election alleged to be signed by the Appellants is genuine or a forgery - Whether a clause contained in a legal charge executed by one of the developers exonerated the Appellants from liability to pay capital gains tax - Whether the Appellants were liable to be assessed to income tax on sums which they received from the developer after the development had commenced - Section 46(1) Capital Gains Tax Act 1979 - Section 776(2) Income and Corporation Taxes Act 1988

THE SPECIAL COMMISSIONERS

ROGER DENIS NEWMAN Appellant

- and -

DEREK JOHN PEPPER

(HM INSPECTOR OF TAXES) Respondent

COLIN JOHN NEWMAN Appellant

- and -

KENNETH MORGAN

(HM INSPECTOR OF TAXES) Respondent

Special Commissioner: MR T H K EVERETT

Sitting in Bristol on 8, 9 and 10 May 2000

Mr Colin John Newman appeared in person and also appeared on behalf of his brother Mr Roger Denis Newman

Mr Michael Furness of Counsel, instructed by the Solicitor of Inland Revenue appeared for each of the Respondents

DECISION

Mr Roger Denis Newman ("Roger") appeals against the following assessments

Year Number Description Amount Date

1985/86 262/GC/16337/8702 Chargeable gains £ 60,000 9.12.86

1985/86 262/DC/16337/8901 Transactions in land £ 50,000 18. 5.89

1986/87 262/GC/16337/8801 Chargeable gain £ 20,000 9. 2.88

1988/89 262/DC/16337/9001 Transactions in land £100,000 4.11.89

1989/90 262/DC/16337/9002 Transactions in land £ 10,000 27.11.89

1990/91 262/DC/16337/9401 Transactions in land £ 21,000 1.10.93

Mr Colin John Newman ("Colin") appeals against the following assessments

Year Number Description Amount Date

1985/86 218/GZ/59970/8801 Chargeable gain £150,000 13.10.87

1986/87 218/GZ/59970/8803 Chargeable gain £ 20,000 12. 1.88

1988/89 218/OZ/59970/9002 Transaction in land £100,000 1.11.89

1989/90 218/OZ/59970/9401 Transaction in land £ 8,178 18. 8.94

1990/91 218/OZ/59970/9402 Transaction in land £ 20.313 18. 8.94

On 20 August 1996 the Presiding Special Commissioner made an order that the appeals of both taxpayers should be heard at the same time before the Special

Commissioners.

I received in evidence two bundles of documents prepared and put before me by the Inland Revenue. In addition I heard the sworn testimony of Colin and that of Ian Marr Paterson, a retired inspector of taxes. I also received expert evidence from Dr Audrey Giles, an acknowledged expert in the scientific examination of documents and handwriting.

A copy of Dr Giles' report and of Mr Paterson's witness statement are available to the Court should these appeals proceed further.

From the evidence before me I find the following facts:

1. Mr Denis Newman, the father of Roger and Colin, acquired Manor Farm, Up Hatherley, near Cheltenham in or about the year 1963. The value of the farm is agreed between the parties as at 1963 and also as at 6 April 1965 in the sum of £7,000.

2. Mr Denis Newman had five children. In addition to Roger and Colin he had three daughters namely Irene Mary Tomlin, Marion Anne Newman and Daphne Molly McGovern.

3. Until 7 July 1982 Mr Denis Newman owned Manor Farm freehold. It comprised 42.14 acres.

4. On 7 July 1982 Mr Denis Newman executed a Trust Deed in which he conveyed to trustees all the land comprising Manor Farm with the exception of the farmhouse and a small area of land surrounding it. The two trustees were Roger and Colin. The land was to be held on trust for sale for Mr Denis Newman absolutely.

5. Also on 7 July 1982 Mr Denis Newman made gifts of the net proceeds to arise from sale of the land comprised in the Trust Deed as follows:

Roger one-eighth

Colin one-eighth

Irene Mary Tomlin one-eighth

Marion Anne Newman one-eighth

Daphne Molly McGovern one-eighth

Mr Denis Newman retained the remaining three-eighths of the sale proceeds

6. The land comprised in the Trust Deed was stated to be subject to "an option agreement of even date herewith and

made between [Denis Newman] of the one part and Westbury Estates (Severnside) Ltd of the other part". That option was not produced at the hearing and is not relevant to these appeals.

7. On 9 July 1982 Mr Denis Newman, Roger and Colin granted an option to purchase the greater part of the land comprised in the Trust Deed, forming part of Manor Farm, to Wates Built Homes (Blakes) Ltd ("Wates").

8. The option agreement included covenants by Wates to:

"Use all reasonable endeavours to obtain the inclusion of the subject land or as much thereof as [Wates] shall reasonably consider practicable in any relevant local plan or planning policy document for the area as land suitable for residential development" (Clause 1(1)) and

"Obtain (at the discretion of [Wates]) outline or detailed planning permission for residential development" (Clause 1(2)).

9. It is common ground in these appeals that the date of the formation of the first intention to develop the land was the date of the option, namely 9 July 1982.

10. The option agreement also contained a provision that Wates would appeal against any refusal of planning permission or unacceptable conditions unless a counsel specialising in planning law advised against such an appeal (Clause 1(2)(b)). The option price is set out in Clause 1(4) - it states that the sum of £29,820 has to be paid for the option and £5,000 towards legal, accountancy and valuation fees incurred in connection with the preparation and completion of the agreement. In Clause 3, various rights of access are granted to Wates. Clause 4 states that the option is exercisable at any time on or after 1 August 1983. It enabled Wates "to purchase the subject land or such part or parts thereof as shall enjoy the benefit of planning permission or permissions whether outline or detailed acceptable to [Wates] for the consideration." The option had to be exercised by notice under Clause 4(2).

11. Once a notice had been served, Clause 5(1) defined the purchase price as "15% of the total sale price of all the buildings." Two deductions then had to be made, i.e. the amount of Abnormal Infrastructure Costs actually incurred and the sum of £29,820 (being the sum originally paid for the option). It was then provided that the actual purchase price should be a minimum payment representing £50,000 for each developable acre. Once the conveyance was completed Wates had to pay 50% of the purchase price as estimated at the date Wates exercised the option. The purchase price was to be estimated by Wates (Clause

5(2)(a)). There was then a provision concerning disputes between the parties about the purchase price (Clause 5(2)(b)). Clause 5(3)(a) required Wates to pay on account of the balance of the purchase price, 5% of the sale price of all the buildings on the land sold or leased. Clause 5(3)(b) allowed the parties to have the purchase price re-estimated at each anniversary of the date of the conveyance of the land. Once the development completion date was reached Wates had to pay all the purchase price. If the purchase price was not paid in full it had to be secured by way of legal charge on the land (Clause 5(6)). Wates agreed that all sales of the buildings would be at arms length (Clause 5(7)).

12. On 14 November 1983 Wates applied to Tewkesbury Borough Council for outline planning permission to develop 11.3 hectares of land at Manor Farm. The application was for residential development at a density of about 11.5 units per acre.

13. On 29 July 1985 Wates assigned the benefit of the option to Alfred McAlpine Homes West Ltd ("McAlpine") and Canberra Developments Ltd ("Canberra").

14. On 12 November 1985 Tewkesbury Borough Council granted outline planning permission for residential development on 11.3 hectares of land forming parts of Manor Farm, including the construction of a new estate road and methods of disposal of foul and surface water.

15. On 18 November 1985 McAlpine and Canberra exercised the option in relation to that part of Manor Farm which was the subject of the outline planning permission granted by Tewkesbury Borough Council referred to above.

16. On 19 February 1986 the land which was the subject of the exercise of the option was transferred to McAlpine and Canberra for a consideration of £714,500. Of that total £528,482.57 was paid by McAlpine and the balance of £186,017.43 was paid by Canberra.

17. Interest of £3,138.16 was added in respect of the McAlpine land and £1,034.32 in respect of the Canberra land making a total payment of £718,672.48. Part of that sum was applied to the benefit of the Newman family as follows:

Mr Denis Newman £255,000

Roger £ 85,000

Colin £ 85,000

Daphne McGovern £ 85,000

Marion A Newman £ 85,000

Irene Tomlin £ 85,000

Total £680,000

18. The balance of £38,672.48 from the total of £718,672.48 is accounted for by a deduction of £29,820 plus £5,000 which had already been paid when the option was granted and £3,852.48 for legal and accountancy fees.

19. On 24 February 1986 McAlpine and Canberra entered into a transfer by way of partition by which some 5 acres of the land which they owned was transferred to Canberra in fee simple and the remainder of the land consisting of some 14.5 acres was transferred to McAlpine also in fee simple.

20. On 21 May 1986 McAlpine entered into a legal charge to pay to Mr Denis Newman, Roger and Colin all the moneys outstanding under the option agreement of 9 July 1982. The mortgage included the following Clause 4(iii):

"The developer (McAlpine) will pay and discharge all existing and future rent, rates, taxes, duties, charges, assessments, impositions and outgoings whatsoever (whether imposed by deed or statutes or otherwise even though of a wholly novel character) now or at any time during the continuance of the security payable in respect of the Property or any part or parts thereof or by the owner or occupier for the time being thereof."

21. On 30 May 1986 Mr Denis Newman, Roger and Colin released Canberra from some of its obligations under the option agreement in return for a payment by Canberra of £175,000 together with interest of £938.25. Part of that sum was applied in the following manner:

Mr Denis Newman £ 64,500

Roger £ 21,500

Colin £ 21,875

Daphne McGovern £ 21,500

Marion A Newman £ 21,500

Irene Tomlin £ 21,500

Total £172,375

The difference between £175,000 and £172,375 amounting to £2,625 is accounted for by legal and accountancy fees. £820.95 of the interest on the moneys paid by Canberra for the release was divided as follows:

Mr Denis Newman £351.83

Roger £117.28

Daphne McGovern £117.28

Marion A Newman £117.28

Irene Tomlin £117.28

Total £820.95

Colin was not paid a share of the interest, which accounts for the difference between the amount deducted and the total amount of interest.

22. Canberra was released from its obligations to make payments under the terms of the option and from its obligation to enter into a legal charge until the purchase price had been paid in full.

23. Negotiations for the release of McAlpine from its obligations under the option agreement broke down and McAlpine continued to rely in all respects upon the option agreement terms.

24. On a date unknown prior to 25 September 1987 a hold over gain claim pursuant to section 79 of the Finance Act 1980 in respect of the deeds of gift dated 7 July 1982 was delivered to Mr Denis Newman's tax office, Cheltenham 2 District. It purported to be signed by Mr Denis Newman, Roger and Colin. Although the claim referred to a deed of gift dated 15 July 1982 rather than 7 July 1982, it was accepted by the Inland Revenue as referring to the gifts made on the latter date. A letter dated 17 April 1984 addressed to the Inland Revenue Capital Taxes office by accountants acting for Roger alone states as follows:

"We thank you for your letter of 11 April and are now able to enclose copies of the trust deed dated 7 July 1982 and the deeds of gift which we note were actually dated 7 July rather than 15 as we originally thought."

A copy of the hold over gain claim is attached to this decision as an Annex.

25. On 25 September 1987 a meeting took place between Colin and his wife and Mr I M Paterson, HM Inspector of

Taxes, to discuss the capital gains implications on the disposal of the land at Up Hatherley. Reference was made by the Inspector to the hold over election claim and neither Colin nor his wife claimed that the signatures to it were forgeries or denied that the claim had been made. Mrs Newman pointed out that the date of 15 July 1982 was incorrect and produced the Deed of Gift to Colin dated 7 July 1982 to Mr Paterson for inspection. His response was "that he was not disputing that the deed existed and the incorrect date put on the section 79 election did not really affect things as his interest in this was only that the capital gain was to be rolled over and was that the intention of the Newmans to argue against this treatment and they stated it was not their intention."

26. The following amounts appeared in Colin's tax returns:

1985/86 Nil

1986/87 Nil

1987/88 £27,696 (CGT)

1988/89 £15,257.16 (settlements)

1989/90 £105,829.52 (settlements)

1990/91 £7,443.68 (settlements0

1991/92 £18,071.77 (settlements)

27. There were no corresponding entries in Roger's returns. However, the following amounts have now been returned for him in the letter of 17 July 1992 from his accountants Messrs Hazlewoods to HM Inspector of Taxes Cheltenham 2:

1985/86 £85,000 (CGT)

1986/87 £21,500 (CGT)

1987/88 £15,257 (CGT)

1988/89 £ 6,520 (CGT)

1988/89 £99,676 (section 776)

1989/90 £ 8,178 (section 776)

1990/91 £20,313 (section 776)

No capital gains tax assessment has been made for 1988/89 on Roger.

The contentions of the parties

28. Colin, who appeared for himself and his brother, submitted brief contentions in writing which he expanded orally before me. His written submissions were as follows:

"We have been wrongly assessed for the reasons as follows:

1. Denis Newman was sole beneficiary under 7 July 1982 settlement

2. Deed of Gift dated 7 July 1982 gifts net proceeds from Denis Newman

3. The un-dated note referring to hold over election is a forgery. No document gifting its shares in freehold land exists.

4. Legal charge dated 21 May 1986 (supplemental to 9 July 1982 option) states the developers will pay all liabilities. Although the names of the Appellants appear on this document the contents were not revealed until its discovery in January 1995 when CJ and RD Newman carried out a search at Land Registry Gloucester. A fee of £10 was paid in order to obtain a copy of same."

29. Mr Furness, who appeared for the two Inspectors, submitted a written skeleton argument, which will be available for the Court should these appeals proceed further. Briefly his contentions on behalf of the Inland Revenue were as follows:

1. For capital gains tax purposes the taxpayers are each liable for one-eighth of the gains attributable to the disposal of the land.

2. The date of the disposal of the land for capital gains tax purposes is the date on which the option was exercised, that is 18 November 1985.

3. The hold over election claim is genuine and is binding on the Appellants.

4. By reason of the decision in Marren v Ingles 54 TC 76, the value of the right to receive the further consideration must be added to the cash actually received on the disposal

in order to ascertain the disposal consideration for capital gains tax purposes. The right to receive those future sums is itself disposed of when the further payments are actually made.

5. The Revenue are content to accept that the value of the right to receive future payments under the option agreement should be equal to the difference between the amount of cash received on the date of the disposal and the minimum total consideration payable under the option agreement, (i.e. £50,000 per acre).

6. In relation to the income tax assessments:

(a) the option contract falls within the ambit of section 776 Income and Corporation Tax 1988 because

(i) the land was developed with the sole or main object to realising a gain from disposing of the land when developed

(ii) a gain of a capital nature was obtained from the disposal of the land and

(iii) the option contract is a scheme or arrangement within paragraph (ii) of the subsection

(b) there is no liability under this head in respect of the Canberra land because only moneys received by the taxpayers after the development has commenced are taxable pursuant to section 776. The section does apply to those payments made by McAlpine after the development commenced.

Conclusions

30. I will deal first with the question of the alleged forgery of the signatures of the Appellants to the undated hold over election claim a copy of which is annexed to this decision. Colin did not suggest who might have forged the signatures nor did he explain why they may have been forged. He stated merely that the signature which was alleged to be his was not his.

31. I received clear evidence from Dr Giles that in her opinion the signature of Mr Denis Newman to the election document is genuine. She also concluded that the signature of Colin to the election document is also genuine. In relation to the signature of Roger she concluded "that there is very strong support for the view that the signature Roger D Newman on the hold over relief claim is a genuine signature of Mr Roger Newman".

32. I also accept the evidence of Mr Paterson that when he

met Colin and his wife on 25 September 1987 there was no allegation of forgery made. Further Colin and his wife stated that it was not their intention to argue against hold over treatment.

33. I regard it as significant that had they claimed on 25 September 1987 that the hold over election was not genuine there was still opportunity for the Revenue to accept that position and to issue new assessments if appropriate. By the time of the hearing it was no longer possible for the Revenue to issue new assessments, in the absence of fraud, which is not alleged.

34. On the balance of probabilities and in the light of the evidence before me I find as a fact that the signatures to the hold over election claim are genuine and I reject the Appellants' submissions that the signatures were forgeries.

35. Colin has submitted that the assessments which have been laid on him and his brother are bad in view of the fact that neither he nor his brother ever owned any land. It is plain that until 7 July 1982 Mr Denis Newman was the sole owner and occupier of Manor Farm. On that date he vested the legal estate in trustees upon trust for sale and to hold the net rents and profits until sale upon trust for himself, Denis Newman absolutely. Immediately thereafter on the same day he gave one-eighth interests in the net proceeds of sale to each of his five children, retaining a three-eighths share for himself.

36. Bearing in mind the provisions of section 46(1) Capital Gains Tax Act 1979, it is not open to Colin or his brother to claim exemption from capital gains tax. That section provides as follows:

"46. Nominees and bare trustees

(1) In relation to assets held by a person as nominee for other 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 two 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 assets 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)."

Accordingly I reject Colin's submission that neither he nor his brother has any liability to tax by reason of the fact that they did not own any land.

37. Colin's fourth submission deals with the clause

contained in the legal charge dated 21 May 1986 requiring the developers, McAlpines, to pay all liabilities. Colin has contended that that clause placed an obligation on McAlpines to pay any capital gains tax levied as a result of the disposal of the land to McAlpines.

38. In an effort to substantiate that contention the Appellants requested the issue of a witness summons requiring a representative of McAlpines to appear before me with documents relating to Manor Farm. In response to that summons Mr Stanley Gerald Mills, a solicitor and the legal director of McAlpines, appeared before me and produced a very large number of documents. However, neither his oral evidence nor the documents which he produced proved relevant to the hearing of these appeals, which is the reason why I have not mentioned Mr Mills' appearance or his documents until now.

39. In my judgment the clause in the mortgage deed to which Colin has referred me is a perfectly standard clause contained in many mortgage deeds requiring the mortgagor to pay rates and other financial burdens laid on the land. It cannot, in my opinion, extend to require a mortgagor to pay or be responsible for payment of capital gains tax or income tax assessed on the mortgagee. In any event, were Colin to be correct in his submission, and had McAlpines paid his tax and his brothers', such actions would have served only to increase the Appellants' liability to tax. I reject Colin's fourth submission.

40. In cross-examination Colin has accepted that he has received the payments contained in the Inland Revenue's computations. He has also accepted that the value of Manor farm in 1965 was £7,000 for 41 acres. Finally he has accepted that the first intention date for development of Manor Farm was the date of the option, namely 9 July 1982.

41. At one point on the third day of the hearing Colin also accepted a valuation of £50,000 per developable acre in relation to the land actually developed but he resiled from that agreement after a short interval. Therefore in the absence of agreement that valuation must be determined by the Lands Tribunal at a further hearing.

42. There is one further question for my decision namely the amount of the legal costs attributable to the disposals of the developed land at Manor Farm. Such a question is normally easily resolved by reference to the Appellants' solicitors' bill of costs. However, that is not possible in relation to these appeals as Messrs Luttons, who acted for the Appellants submitted a composite bill in an amount of £102,087.49 dealing with many matters including the disposals relating to the land at Manor Farm. I have been supplied with a copy of Messrs Luttons' bill of costs and also copies of Counsel's fee notes and invoices relating to

other payments made on behalf of the Appellants.

43. Taking into account the fact that the development of Manor Farm was an operation which took place over a considerable period of time and that it was a complicated operation I am prepared to accept Colin's suggestion of a figure of costs of £10,000 per appellant which will be available to be used as deductions in the computation of their tax liabilities.

44. The outstanding questions in these appeals, in the light of Colin's refusal to accept the Inland Revenue's valuation figure, are the question of valuation of the right to receive future instalments for capital gains tax purposes and the value of the land at the first intention date. Those valuations, if not agreed must be determined by the Lands Tribunal and accordingly I cannot at this stage make final determinations of the taxpayers' liabilities.

It is clear however that the appeals fail and I make the following findings:

1. As stated above I have found as a fact that the hold over election was a valid election pursuant to section 79 of the Finance Act 1980 and accordingly the Inland Revenue is correct in computing each of the taxpayers' capital gains tax liabilities on the basis that the election was valid.

2. In relation to the Inland Revenue computations of the taxpayers' liabilities, both in relation to capital gains tax and in relation to income tax assessable pursuant to section 776, I find, insofar as such computations relate to factual issues and hold, insofar as such computations relate to questions of law, that such computations by the Inland Revenue are correct, subject only to the substitution of my figure for legal costs in place of the figures adopted by the Inland Revenue and subject also to determination of the value of the right to receive future instalments for capital gains tax purposes and the value of the land at the first intention date.

45. I adjourn these appeals in order that the valuations may be agreed or determined and on their being reported to me I will make final determinations in relation to each of the assessments except in relation to the assessment on Roger for the year 1985/86 pursuant to section 776. That assessment is in the sum of £50,000 and it is common ground that Roger had no liability in relation to income tax

pursuant to section 776 during that year. Accordingly, I discharge that assessment.

T H K EVERETT

SPECIAL COMMISSIONER

Released : 5th June 2000

Authorities cited but not referred to in the decision

Kidson v Macdonald 49 TC 503

Harthan v Mason 53 TC 272

Page v Lowther 57 TC 199

SC 3056-57/96