Foreign currency mortgages and UK capital gains (Rawlings v HMRC)

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Private Client analysis: The taxpayers purchased a property in Switzerland in 2006 with a mortgage denominated in Swiss francs. By the time the property was sold a decade later, the change in exchange rates had substantially increased its value in sterling. HMRC assessed the taxpayer to capital gains tax (CGT) on the difference (broadly) between the sterling equivalent of the sale proceeds in 2016 and the sterling equivalent of the acquisition cost in 2006 under the rule in Bentley v Pike. This meant that the 'real' gain in Swiss francs on the disposal was effectively taxed at 67%. The First-tier Tax Tribunal (FTT) upheld HMRC's assessment, rejecting the taxpayer's argument that the appreciation in the mortgage's value by the time it was repaid should be taken into account. For practitioners, the case is a reminder of the importance of considering the tax implications of even the most apparently straightforward cross-border transactions, particularly where foreign currency amounts are involved. Written by Hugh Gunson, partner, and Guy Bud, associate barrister, at Charles Russell Speechlys LLP.

Rawlings and another v Revenue and Customs Commissioners [2022] UKFTT 32 (TC)

What are the practical implications of this case?

Although it cannot be said to establish a new principle, *Rawlings v HMRC* highlights a long-standing 'trap' in the calculation of capital gains where amounts are paid/received in foreign currencies. This was first observed by the High Court as long ago as *Bentley v Pike* [1981] STC 360 and later reaffirmed by the Court of Appeal in *Capcount Trading v Evans* [1993] STC 11.

Under this rule, base cost and disposal proceeds must be assessed by reference to their value in sterling and this means the exchange rates in force at the relevant time. Although reasonable-sounding in principle, the rule has the potential to manufacture artificial capital gains where there has been a depreciation of sterling relative to the local currency between the point of acquisition and disposal. Given the particular hit taken by sterling against many global currencies, particularly in 2015 and 2016, this is likely to be an issue facing many taxpayers who previously purchased or inherited property overseas.

In *Rawlings v HMRC*, the issue was whether the enhanced sterling value of a foreign currency mortgage at the point of repayment could be taken into account for capital gains purposes. Perhaps unsurprisingly, the FTT rejected this argument and concluded the capital gains treatment of an asset is not affected by how a taxpayer chooses to structure its acquisition. Bound by the authority of *Bentley v Pike* and several successor cases, it reaffirmed that it had no discretion to change the treatment set out in statute and binding authority—'even where the results in some situations appear absurd'.

What was the background?

The dispute arose in relation to the purchase of a buy-to-let property in the Swiss ski resort of Zermatt. The taxpayers, who were UK resident, purchased the property in 2006 with a deposit and a mortgage denominated in Swiss francs (CHF). At the time, 1 CHF was worth £0.43. After selling the property in 2016, the couple repaid the mortgage in full. By this time, there had been a substantial depreciation in the value of sterling and 1 CHF was worth £0.78 meaning that the property's value in sterling was substantially higher than a decade earlier.

In calculating the CGT payable on the disposal, the couple established that the disposal proceeds of the property had been £560,000 at 2016 exchange rates. Against this, they off-set their original deposit (£120,000) and various mortgage repayments (£350,000) and transaction fees at the

exchange rates in force at the time these costs were incurred. On their analysis, the result was a joint gain of £39,000.

HMRC disagreed. They argued that the only way to assess the capital gain was to deduct the purchase price (and other costs) from the disposal proceeds, each assessed at the relevant exchange rates in force at the time. Above all, this meant that the taxpayers were prevented from taking account of the increase in the sterling value of the mortgage between 2006 and 2016. On this basis, HMRC determined their joint capital gain to be £267,000 and raised assessments.

What did the court decide?

Dismissing the taxpayers' appeal, the FTT conceded that the result was 'unfair' as the unrepresented taxpayers had forcefully argued. In spite of this, it noted that capital gains are calculated in a 'mechanistic way' prescribed by statute and past cases and not on a subjectively 'fair' or 'reasonable' basis.

As the FTT observed, 'the statutory provisions are limited and require a comparatively simple calculation to be undertaken: the cost of acquisition and incidental costs incurred wholly and exclusively in connection to both acquisition and disposal are to be deducted from the consideration received on the disposal of an asset to establish the gain accruing from ownership of it.'

In this context, *Capcount Trading v Evans* [1993] STC 11 established that a capital gain must be calculated in sterling alone. As such, it was necessary to assess the price of purchase or sale solely in sterling—at the exchange rate applicable at the time. As well as being a well-established principle in its own right, the case was also binding on the FTT even though the factual context was, the FTT admitted, very different.

The FTT also proceeded to examine the FTT decision in *Unger v HMRC* [2020] UKFTT 37 (TC) in which it was held that mortgage redemption payments could not be taken into account for the purposes of assessing the amount of consideration given by the purchaser of a property for capital gains purposes. Although a different line of argument, the FTT concluded that it was clearly correct that a purchaser's decision to use a mortgage should not be able to change the analysis of the asset's value for tax purposes.

Case details

- Court: First-tier Tribunal (Tax Chamber)
- Judge: Judge Amanda Brown QC and Patricia Gordon
- Date of judgment: 01 February 2022

Hugh Gunson is a partner, and Guy Bud is an associate barrister, at Charles Russell Speechlys LLP, and they are members of LexisPSL's Case Analysis Expert Panels. If you have any questions about membership of these panels, please, please contact caseanalysiscommissioning@lexisnexis.co.uk.