



An option to dispose of property does not necessarily give rise to a taxable disposal



By **Duncan Hubbard**
Partner | Real Estate



By **William Lo**
Associate | Real Estate

In the appeal case of *Krishnamohan v HMRC* [2024] UKFTT 346, the UK's First-Tier Tribunal ("FTT") determined that an agreement titled "Option Agreement" that was entered into to dispose of certain properties, does not, for capital gains tax purposes, constitute the grant of an option to dispose until the grantee's right to exercise the option is no longer contingent on events within the taxpayers control.

The case involved the financing of a property acquisition, with the future option to sell certain other existing properties serving as security for the loan.

Background

The appellant in the case (the "Borrower") owned a property portfolio, and sought to acquire another property that required funding. To secure the funding for the new property, the Borrower entered into an agreement titled "Option Agreement" with a finance provider (the "Lender"). This agreement granted the Lender with the option to purchase certain other properties (the "Properties") from the Borrower's portfolio if the Borrower failed to repay the loan amount, together with additional fees, within a twelve-month period.

The Borrower repaid the loan amount plus the additional fees within the specified period, and the option to purchase the Properties was not exercised.

The issue

HMRC argued that the agreement resulted in the grant of an option over the Properties, thus constituting disposals that should be subject to capital gains tax under section 144 of the Taxation of Chargeable Gains Act 1992 ("TCGA").

The Borrower appealed against this, arguing that no option had been granted, given that the Lender was never in a position to act under the agreement. The

Borrower maintained that if the person granting the option could revoke it at will before it could be exercised, then there is no binding option existing until the time for which exercise arose.

HMRC argued that, notwithstanding the fact that it was revocable by the Borrower, an option had been granted. They emphasised that the Borrower's ability to "unbind" themselves from the agreement was immaterial.

The Borrower appealed against HMRC's decision.

FTT Decision

The FTT allowed the appeal. It was determined that, despite the misleading title of the agreement, the Lender would ultimately only have the right to buy the Properties if the Borrower did not repay the loan amount and the additional fees within twelve months. As such, the agreement was to only grant an option if the twelve-month period had passed, at which point such option would still then be further subject to certain other conditionalities. The FTT therefore concluded that the control retained by the Borrower was crucial.

While the FTT agreed with HMRC that an option need not be immediately exercisable to result in a disposal, they highlighted the importance to consider whether the grantor of an option can control the events that must occur for the grantee to exercise the option. In this case, since the Borrower had control over these events, no option was granted when the agreement was made. If the option period had ended without the repayment of the necessary funds, the option would have been granted at that point. Since this did not occur, no option was granted.

It is worth noting that the Borrower also argued that the option should be conveyed as security rather than a disposition, thus not constituting a chargeable disposal under the TCGA. The FTT did not, however, address this argument, as it was unnecessary for the determination of the appeal.

Closing thoughts

This decision from FTT is a worthy reminder of the significance of substance over title in agreements, not just to the contracting parties but to all interested parties. HMRC's own guidance manuals state that an option is "*an offer which is irrevocable during the option period*" and "*gives rise to a binding contract to keep the offer open*" (HMRC Manual CG14275). The misleading title of the "Option Agreement" may have prompted HMRC to examine the situation, but it is the revocable nature and conditionality of the option that ultimately led to the FTT's decision.