

**UPPER TRIBUNAL (LANDS CHAMBER)**



**UT Neutral citation number: [2018] UKUT 0071 (LC)**

**Case Number: TMA/49/2017**

**TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007**

**Tax - Inheritance Tax - valuation under s160 Inheritance Tax Act 1984 - maisonette - whether hope value for extension to be taken into account - analysis of comparables - value of appellant's undivided share determined at £1,603,930 - appeal allowed in part**

**IN THE MATTER OF A NOTICE OF REFERENCE OF AN APPEAL UNDER SECTION 222 OF THE INHERITANCE TAX ACT 1984**

**BETWEEN:**

**PETER PALLISER**

**Appellant**

**and**

**HER MAJESTY'S REVENUE AND CUSTOMS**

**Respondent**

**Re: 12B Wedderburn Road**

**London**

**NW3 5QG**

**Before: A J Trott FRICS**

**Sitting at: Royal Courts of Justice, Strand, London WC2A 2LL**

**on**

**10 January 2018**

Ms Sally Hutchings, of Morrisons Solicitors LLP, for the Appellant

Ned Westaway, instructed by HMRC, for the Respondent

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The following case is referred to in this decision:

Inland Revenue Commissioners v Gray [1994] STC 360

**DECISION**

**Introduction**

1.

This appeal concerns the deemed disposal for the purposes of Inheritance Tax of an 88.4% share in what the parties describe as the freehold interest <sup>1</sup> in a maisonette known as 12B Wedderburn Road,

London NW3 5QG (“the Property”) that was owned by Mr Arthur Palliser who died on 19 June 2012 (the valuation date). The appellant is Mr Peter Palliser, the son and personal representative of the deceased.

2.

On 13 December 2016 a Notice of Determination was served on the appellant by Her Majesty’s Revenue and Customs (“HMRC”) under section 221 of the Inheritance Tax Act 1984 (“the 1984 Act”) under which the deceased’s freehold interest was valued at £1,829,880. This valuation was upheld by HMRC on review on 31 March 2017. Mr Palliser appealed this decision to the First-tier Tribunal (Tax Chamber) on 28 April 2017, saying that the correct valuation was £1,113,840. The appeal was referred to the Tribunal under section 222 of the 1984 Act on 26 May 2017 to determine the valuation dispute.

3.

Ms Sally Hutchings, a solicitor with Morrisons Solicitors LLP, appeared for the appellant and called Mr Peter Palliser as a witness of fact and Mr James Bush BSc (Hons) Est Man, MRICS, a Director of Woodward Chartered Surveyors, as an expert valuation witness.

4.

Mr Ned Westaway of counsel appeared for the respondent (HMRC) and called Mr Chris Ore Dip Est Man, MRICS, of the Valuation Office Agency, as an expert valuation witness.

5.

The appeal was heard under the Tribunal’s simplified procedure although evidence was given under oath.

## **Facts**

6.

The parties did not agree a statement of facts and issues. I therefore determine the facts from the evidence.

7.

The Property is located on the north side of Wedderburn Road in a well-established and attractive residential area. It is within walking distance of Hampstead High Street, Hampstead Heath, Belsize Park, Belsize Village and Swiss Cottage. It has good access to shops and other local amenities and is close to four underground stations and two main line stations.

8.

The Property is a second and third floor maisonette in a converted, four-storey, semi-detached, late Victorian house. There are two other flats in the building on the ground and first floors. There is no lift and access to the Property is from a flight of some two dozen steps on the eastern flank of the building which leads to a first floor hallway and a further ten (covered) steps up to the Property.

9.

The second floor accommodation comprises an entrance hall, three bedrooms (all at the rear of the Property, facing north; one with an en-suite shower), a lounge (facing south), a kitchen, a bathroom/WC and a separate WC. A staircase leads from the entrance hall to the third floor where there is what is described as an attic room by the appellant and a bedroom by the respondent. There are also two separate areas described as “eaves storage”, part of each of which has a restricted height due to the

sloping roof. I accept Mr Palliser's evidence that at the valuation date there were a number of water tanks located in the eaves storage areas.

10.

There was confusion about the gross internal area ("GIA") of the Property with a number of figures being put forward. At the hearing both Mr Ore and Mr Bush adopted the GIA used by Knight Frank in their August 2013 sales particulars for the Property:

GIA excluding eaves storage space on third floor: 2,442 sf

Area of unrestricted height eaves storage space: 551<sup>2</sup> sf

Area of restricted height eaves storage space: 412 sf

Total: 3,405 sf

11.

The third floor accommodation is said by Mr Bush to have been a loft conversion undertaken in the late 1970s. The planning history of the Property shows that planning permission was granted for "the formation of a new room in the attic" on 2 March 1967.

12.

There is no garage and no off-street car parking. On-street parking is by resident's permit. The owner of the Property has the shared use of a communal garden at the rear of the building (north facing).

13.

The Property was dated and unmodernised and required major refurbishment at the valuation date.

### **Statutory provisions**

14.

The Property is to be valued in accordance with section 160 of the 1984 Act which defines market value as "the price which the property might reasonably be expected to fetch if sold in the open market at [the valuation date]."

### **The case for the appellant**

15.

Mr Palliser explained the history of the appeal. He instructed Mr Bush to value the Property for probate purposes and on 14 August 2012 Mr Bush submitted a written report valuing the shared freehold at £1.4m. Mr Arthur Palliser's interest (at 88.4%) was £1,237,600.

16.

In April 2013 an offer of £1.4m for the Property was made by Mr Nick Fox, a developer and the son of the owners of the first floor flat at 12 Wedderburn Road. The offer was not accepted.

17.

In July 2013 the Property was placed on the market with Knight Frank. Mr Palliser said that he "pushed the agents for the highest possible asking price and to provide the largest living space possible in their marketing materials". Mr Palliser said that he had encouraged Knight Frank to market the property at £2.75m. It was eventually sold for £2.525m in March 2014.

18.

In his expert report Mr Bush maintained a valuation of £1.4m, the same figure as his probate valuation. Mr Bush based his valuation on the assumptions that:

(i)

The valuation was to be undertaken in accordance with the current RICS Red Book which did not mention hope value. He said “for this reason, our valuation did not reflect any hope value for future development or change of use.” In any event Mr Bush thought that because the Property had already been extended into the loft space following the grant of earlier planning permissions, there was no further scope for extending the floor space given the construction and layout of the building. He did not think anybody would extend it further. He said such a prospect was “clearly unquantifiable.”

(ii)

There were a significant number of “negatives” to take into account in the valuation. Mr Bush listed 13 such negative factors in his report. There was no reference to any positive factors other than a description of “an awkwardly accessed shared communal north facing garden.” But during examination in chief Mr Bush identified four other positive factors.

(iii)

It was difficult to analyse comparable sales by reference to their value per sq foot, as Mr Ore had done, because the Property “has so many negatives, different aspects and was in such a poor condition.” (Mr Bush emphasised that, unlike Mr Ore, he had inspected the site shortly after the valuation date.) Mr Bush said that Mr Ore’s approach was not one adopted by local agents. They, and he, took what Mr Bush described as “a holistic approach” to valuation.

(iv)

Knight Frank had “got lucky at a good time for the market” by marketing the Property at a higher level than other local agents would countenance. Mr Bush did not believe that the Property had been sold at the correct price in March 2014.

(v)

Indexation of post-valuation date comparable sales was an unreliable valuation method with indices either not relating to the specific type of property or location or being of use only when valuing prime property. Ms Hutchings supported this point in her submissions by reference to a comparative study of house price indices published by the Institute for Fiscal Studies <sup>3</sup>

19.

Mr Bush relied upon comparable sales of flats and maisonettes in Wedderburn Road (three properties); Belsize Park Gardens (two); and Maresfield Gardens (four). In his expert report he described each comparable, including its size, condition, facilities, date of sale or exchange of contracts and price. Mr Bush did not undertake an explicit analysis of each sale by quantifying the differences between the comparable and the Property. Instead he took what he described as “a more rounded approach”.

20.

Mr Bush did not produce a hierarchy of comparables in his expert report. But during examination in chief he said he gave most weight to the following comparables:

Flat 5, 19 Maresfield Gardens: sold for £1.7m in August 2012

Flat 4, 15 Maresfield Gardens: exchanged for £1.5m in October 2012

Flat 6, 17 Maresfield Gardens: exchanged for £1.415m in December 2012

Flat 6, 16 Wedderburn Road: exchanged for £1.3m in November 2012

21.

Mr Bush concluded that the comparables amply supported his valuation figure of £1.4m. He reviewed this figure against the asking price of £2m-£2.5m for the Property suggested by Benham & Reeves who were one of the agents Mr Palliser invited to pitch for the sales instruction. Mr Bush estimated that the cost of refurbishing the Property to a good standard would be £0.5m. Allowing for a profit margin Mr Bush said these figures suggested going to the market at between £2m - £2.1m, very similar to the range proposed by Benham & Reeves.

### **The case for the respondent**

22.

Mr Ore valued the entirety share of the freehold interest in the Property at £2.3m as at the valuation date.

23.

In arriving at this figure Mr Ore relied upon the comparative method of valuation and, like Mr Bush, he looked at comparables in Wedderburn Road, Maresfield Gardens and Belsize Park Gardens. The experts had six comparables in common. Mr Ore also looked at comparables in Netherall Gardens, Hampstead Hill Gardens and Thurlow Road as well as the sale of the Property in March 2014.

24.

Mr Ore analysed the comparables to give a range of values from £835 psf to £1,227 psf (unadjusted for time). He considered there was development potential to extend the Property and referred to the previous planning permissions in the late 1960s and to the planning permission granted subsequent to the sale of the Property in 2014 (subsequently amended in 2015). Mr Ore said that the hope value of extending the floor space should be taken into account as an element of market value.

25.

Mr Ore allowed for the fact that the Property needed modernisation and had no lift. He thought the appropriate valuation rate per square foot for the GIA excluding the eaves storage space (2,442 sf) was £850 - £900 psf and he adopted the lower figure. This gave a value of £2.075m (rounded). Mr Ore then valued the additional 550 sf of unrestricted height eaves storage space which he assumed could be incorporated into an enlarged third floor. He valued this space at £500 psf to reflect costs of £200 psf (obtained from the Building Cost Information Service) and an element of planning risk. This gave an additional £0.275m and a total of £2.35m.

26.

Adopting what he described as an alternative methodology Mr Ore compared the value of the Property when extended and modernised (£1,100 psf) with its existing use value (£850 psf). He derived the former figure from two of the modernised comparables. Taking the extended floor space at 3,000 sf gave a gross development value when modernised of £3.3m and an existing use value of £2.075m, a difference of £1.225m. From this figure Mr Ore deducted costs of £0.6m (3,000 sf at £200 psf) to give an uplift of £0.625m. He took hope value at 50% to give £312,500 which he added to the existing use value to give a total of £2.3875m.

27.

Mr Ore supported his figures in two ways. Firstly, he added the sale price of the third floor Flat 6, 16 Wedderburn Road to the offer price for the second floor Flat 5, 16 Wedderburn Road, to give a combined value of £2.7m for an area of 2,640 sf or £1,020 psf. (Presumably, although not stated in terms by Mr Ore, the combined value of these two flats is taken to represent the value of the Property.) Applying this rate to the proposed floor area of the Property gave approximately £3.0m from which Mr Ore deducted costs (as before) of £0.6m to give £2.4m, which he said supported a figure of £2.3m.

28.

Secondly, Mr Ore said the Property's sale price of £2.525m in March 2014 was approximately 10% above his valuation of £2.3m as at the valuation date. The increase in house prices over that period shown by the Savills House Price Index and the Land Registry House Price Index was 7.35% and 16.5% respectively which Mr Ore considered supported his valuation.

29.

Using his two valuation methods Mr Ore obtained values of £2.3m and £2.3875m. He adopted the lower figure as the value of the Property at the valuation date.

### **Discussion**

30.

I deal firstly with the question of hope value which Mr Bush says cannot be taken into account in principle and does not exist in fact. I think he is wrong on both counts. This is a statutory valuation which is to be made in accordance with section 160 of the 1984 Act. That provision requires the determination of the price which the Property might reasonably be expected to fetch if sold in the open market. If the market is prepared to pay a price which includes the prospect of an enlarged floor space then that must be taken into account. Mr Bush relied upon *Inland Revenue Commissioners v Gray* [1994] STC 360 as authority for his view that the Property must be valued as it actually existed even if in reality the vendor would most likely make changes or improvements before putting it on the market. But that is not to the point; the Property is being sold in its actual condition but with the potential for improvement. Insofar as that potential has not been crystallised by a planning permission its value will be hope value rather than development value, but either way it is not an element of value that falls to be ignored under section 160 of the 1984 Act. Mr Bush's reference to the RICS Red Book is misplaced; that does not affect the principles of the statutory assessment with which this appeal is concerned. Indeed Mr Bush conceded during cross-examination that in principle the hope value of enlarging the Property could be taken into account.

31.

Was there in fact any hope value of extending the Property at the valuation date? Mr Bush says "no" because the Property had already been extended considerably following the grant of earlier planning permissions and the opportunity for further extension was limited by the sloping roof and the restricted headroom. Mr Ore says "yes" because the earlier planning permissions did not appear to fully exploit the development potential and because the purchasers subsequently obtained planning permission for a major reconfiguration of the maisonette with four bedrooms (two en-suite) and a family bathroom on the second floor and with the third floor converted to an open plan living/dining/kitchen area with a decked terrace formed by an inset into the pitched roof at the rear of the Property and the installation of a number of windows and roof lights. There is no evidence about the gross internal area of the proposed redevelopment but from the plans it appears that most of the eaves storage space has been taken into use although there are still some areas shown as "void".

32.

In my opinion the Property clearly required modernisation and refurbishment at the valuation date and was obviously ripe for a major reconfiguration and improvement of a type that the purchasers subsequently pursued. Mr Bush acknowledged as much in his report where he said that the Property “required a planned scheme of full modernisation, total re-configuration and renovation to include an upgrade of the services...” The development potential of the Property had not been exhausted by the implementation (at least in part) of the previous planning permissions and there was scope to exploit more of the floor space on the third floor. The Property was marketed on the basis of its need for modernisation and the “great potential” that it offered. Insofar as that potential constitutes hope value, it falls to be included in the assessment of market value.

33.

The objectivity of Mr Bush’s written evidence is immediately thrown into doubt by his reference to “Negatives” in the section of his report headed “Approach to Valuation” but which made no corresponding reference to the Property’s positive attributes; an approach which suited his client’s position. The Property’s positive features were only elucidated when Ms Hutchings asked Mr Bush about them in examination in chief. That should not have been necessary.

34.

Mr Bush provided very little analytical assistance when discussing his comparables, confining himself to a nebulous holistic approach which he described as a “qualitative analysis”. Whatever that may mean it does not seem to include a careful comparison of the elements of value other than broad descriptions of condition such as “tired”, “average”, “well-presented”, “superbly presented” etc, a summary of accommodation and facilities and a statement of the floor area.

35.

I do not understand how Mr Bush has applied his “more rounded approach” to take account of the different size of his comparables. Mr Bush says he did not value on a per square foot basis because that would ignore such factors as gardens, balconies, terraces, the number of bathrooms, configuration, condition etc. But in examination in chief he said that he was not suggesting that the per square foot approach was wrong. I think he was right to make that concession. A rate per square foot approach need not ignore any of those (or other) factors; it depends whether the valuer has made specific adjustments. A rate per square foot has the advantage of taking direct account of the size of the comparable being analysed which is something that Mr Bush’s holistic approach fails to do in terms. Most of Mr Bush’s comparables are much smaller than the Property. Only Flat 4, 15 Maresfield Gardens comes close at 2,195 sf. The other eight comparables range from 1,001 sf to 1,797 sf, an average 1,408 sf or 42% less than the GIA of the Property. It is not clear how Mr Bush takes this significant size difference into account, if at all.

36.

The rate per square foot of the comparables relied upon by Mr Bush (excluding Flat 5, 16 Wedderburn which was not sold) ranges from £683 psf to £1,227 psf with an average of £921 psf. The lowest figure was in respect of the sale of the leasehold interest in Flat 4, 15 Maresfield Gardens which was the closest comparable in size to the Property. Mr Bush’s valuation of the Property at £1.4m indicates a rate of £573 psf (using the GIA of 2,442 sf).

37.

Mr Bush said his valuation of £1.4m was consistent with the valuation of the Property undertaken in July 2013 by Benham & Reeves. Mr Bush appeared to think that Benham & Reeves’ figure of £2m -

£2.5m was a valuation of the Property in its improved and reconfigured state. But that is not the case. Benham & Reeves valued the Property in its existing state as an apartment which “offers an incoming purchaser the opportunity to create a magnificent home”. Mr Bush added £500,000 of refurbishment costs plus a profit margin to his valuation of £1.4m and said this supported an asking price of £2m-£2.1m, i.e. the same level as the Benham & Reeves valuation. But that misunderstands the position; Benham & Reeves were saying that the Property was worth £2m-£2.5m before any money was spent on its improvement. Mr Bush accepted this point when I put it to him at the hearing.

38.

Mr Ore analyses his comparables on a per square foot basis and provides a qualitative commentary on the differences between them and the Property. But he does not attempt to quantify those differences, e.g. there is no estimate of the effect on value of, say, having a lift, a balcony, a garden, physical condition or of being on the ground floor instead of on the second and third floors. There are no time adjustments for the respective dates of sale.

39.

Mr Ore’s range of values is £835 psf to £1,227 psf. He values the Property as existing (2,442 sf) at £850 psf and as improved (3,000 sf) at £1,100 psf. He takes refurbishment costs at £200 psf (which appears to be a similar figure to that of Mr Bush, except Mr Ore does not allow a separate profit element). Mr Ore calculates hope value at £312,500 (see paragraph 26 above) which he combines with the existing use value of £2.075m to give a total value for the Property of £2.3875m. I place no weight on Mr Ore’s attempt to support this valuation by hypothetically combining the sale of Flat 6, 16 Wedderburn with an offer a year earlier for Flat 5, 16 Wedderburn. The fact that these independent flats are on the second and third floors does not in itself make them comparable to the Property.

40.

Mr Ore also supported his valuation by reference to the sale of the Property in March 2014. I consider that sale to be useful evidence, the main benefit of which is that it is not necessary to make any adjustments, whether qualitative or quantitative, in respect of any of the property’s comparative attributes. The only adjustment required is for the change in the market from the valuation date to the date of sale. Mr Bush accepted in cross-examination that the sale of the Property was a relevant open market transaction to which significant weight could be attached in hindsight. I think Mr Ore’s use of 10% to represent the change in value between the valuation date and the date of the offer in December 2013 was realistic, based as it was upon two local property indices. The time adjusted value of the sale is £2.3m or £942 psf based on the GIA of 2,442 sf.

41.

That figure reflected the hope value of extending the amount of useable floor space which Mr Ore took to be an additional 558 sf. As I have said above there is no stated floor space figure for the development which subsequently received planning permission (and was then further amended) and it is not clear from the approved plans that the additional floor space would be as much as Mr Ore suggests. A significant area of internal floor space was to be converted into a decked, north facing inset terrace. Nevertheless the potential for some expansion of the floor space was evident and I consider it should be reflected in the value of the Property at the valuation date.

42.

None of the evidence supports a value as low as Mr Bush’s adopted figure of £573 psf which is some 16% less than the lowest other figure (£683 psf at Flat 4, 15 Maresfield Road). I accept the evidence of Mr Palliser and Mr Bush about the Property’s condition since they were the only witnesses to have



seen it as at the valuation date, or at all. But the Property was an attractive refurbishment project, with potential for a limited extension of floor space. I acknowledge there are some permanent negative factors affecting the value of the Property, e.g. a semi-detached building, the lack of a lift, an unusual walk up access arrangement, no off-street car parking etc. Nevertheless the comparable sales strongly indicate that Mr Bush's valuation is significantly too low and I do not think he has valued the Property in a fair and balanced way, focusing as he does on the problems of an existing layout that would be resolved (at least in large part) upon refurbishment to a modern design and standard.

43.

The Property when refurbished is said by Mr Ore to be worth £1,100 psf (based on comparables sold on either side of the valuation date). This figure was derived from modernised comparables which had the advantage of a lift. In my opinion a lower figure would be appropriate to reflect the permanent disadvantages of the Property and I adopt £1,000 psf. I think the hypothetical purchaser would consider a small extension of the floor space was possible and, allowing for the loss of some floor space to the external terrace, I take the GIA of the Property when refurbished to be 2,750 sf, an increase of 308 sf. The value of the Property when refurbished would therefore be £2.75m.

44.

Adopting a figure of £200 psf for the cost of refurbishment gives a refurbishment cost of £0.55m and a net value of £2.2m. I do not agree with Mr Ore's assessment of hope value which he says is based on the difference between the value of an extended and modernised flat and the existing use value of the current floor space. I see no reason to assume that the increase in value of the existing space upon refurbishment should be discounted by 50%. There is no planning risk in simply refurbishing and reconfiguring internally what is already there. The risk is to being able to extend the floor space and alter the roof line to provide more windows and a decked terrace. But if it was not possible to extend the Property I would reduce the modernised value to £950 psf to reflect the reduced scope to improve the sub-optimal layout and fenestration. I would not add a profit allowance to the costs because I think owner-occupiers would be in the market for this type of refurbishment opportunity and would be likely to outbid developers.

45.

This analysis gives the following valuations:

(i) The value upon refurbishment if GIA extended to 2,750 sf: £ 2,750,000

Less refurbishment costs at £200 psf: £ 550,000

Total: £2,200,000

(ii) Value upon refurbishment without extended GIA: 2,442sf

@ £950 psf (rounded): £2,320,000

Less refurbishment costs at £200 psf (rounded): £ 488,000

Total: £1,832,000

The difference between these two figures (£368,000) is the additional development value of the Property at the valuation date assuming planning permission for an extended maisonette was granted. Mr Ore takes the hope value of such planning permission at 50% and I do not think it would be less than this. Taking 50% of the price difference as representing the hope value of extending the floor

area of the Property gives £184,000. Therefore the market value of the Property, including hope value is £2.016m.

### **Determination**

46. The value of the long leasehold interest in the Property with a one-third share in the freehold of the building in which it is located is £2.016m.

47. The appellant's share of that value at 88.4% is £1,782,144.

48. There is no dispute that there should be a 10% reduction in value to reflect the undivided share. This gives a value of £1,603,930 for the purposes of section 160 of the 1984 Act and I so determine. The appeal is therefore allowed in part.

49. The appeal was heard under the Tribunal's simplified procedure which is not a procedure under which costs are normally awarded unless either party has behaved unreasonably or the circumstances are in some other respect exceptional. I do not consider that either party acted unreasonably or that there are any such exceptional circumstances. I therefore make no order as to costs.

Dated: 16 March 2018

A J Trott FRICS

Member, Upper Tribunal (Lands Chamber)

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<sup>1</sup> In fact the interest to be valued is an 88.4% share in the long leasehold interest in the Property together with a one third share of the freehold of the building in which it is located.

<sup>2</sup> Knight Frank produced alternative (earlier) figures of 588 sq ft for unrestricted height eaves storage space and 375 sq ft for restricted height eaves storage space.

<sup>3</sup> "Measuring House Prices: A Comparison of Different Indices" by David Chandler and Richard Disney, May 2014.