TC03452

Appeal number: TC/2013/00600

Petroleum taxation – Supplementary Charge – Whether extending to chargeable capital gains – Yes – Sections 501A, 502(1) and (1A) ICTA 1988 (as at 2008) – Appeal refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

WINTERSHALL (E&P) LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE KENNETH MURE, QC
MR SCOTT RAE, LLB, WS

Sitting in public at George House, 126 George Street, Edinburgh on Friday 7 February 2014

Jonathan Peacock Esq, QC instructed by Ernst & Young LLP, for the Appellant

Miss Elizabeth Wilson, of Counsel, instructed by the Office of the Advocate General for Scotland, for the Respondents

DECISION

Introduction

1. In this appeal Mr Peacock appeared for the Appellant company and Miss Wilson for HMRC, the Respondents. Helpfully they both submitted Skeleton Arguments in advance then in turn addressed us.

2. At the outset Mr Peacock explained the background giving rise to the appeal. The Appellant, Wintershall, was part of the Palace Group of companies, which was owned by a US parent. In 2006 the parent had transferred its 29% interest in the Broom Oil Field, which is situated 100 miles north west of the Shetlands, to the Appellant. This transfer was an intra-group disposal within Section 171 Taxation of Capital Gains Act 1992 and thus did not give rise at that stage to a charge to Corporation Tax on the capital gain arising. The Appellant was involved in oil exploration and extraction on the Continental Shelf. In 2008 the Appellant was sold by its US owner to a new owner, the Revus Group. As a consequence of the Appellant's leaving the Palace Group a chargeable capital gain was triggered in respect of the earlier disposal of the 29% interest. The chargeable gain was £6.2m approximately. It was chargeable to Corporation Tax at the "ring fence" rate of 30%.

3. However, HMRC seeks to charge the gain to also the special Supplementary Charge of 20%. Liability is disputed by the Appellant. This is the nub of the dispute. The Appellant seeks to argue that Corporation Tax and the Supplementary Charge have different chargeable regimes. Clear words were necessary, Mr Peacock submitted, to impose the Supplementary Charge on this capital gain. The sense of a very short statutory provision, which has since been amended, is in issue, viz whether between 2002 and 2012 chargeable capital gains were liable to the special Supplementary Charge.

The law

4. A joint List of Authorities was produced. This is reproduced as Appendix 1. Particular reference may be made to Section 501A of the Income and Corporation Taxes Act 1988 which provides –

> "*Supplementary charge in respect of ring fence trades*
>
> (1) Where in any accounting period beginning on or after 17 April 2002 a company carries on a ring fence trade, a sum equal to 20% of its adjusted ring fence profits for that period shall be charged on the company as if it were an amount of corporation tax chargeable on the company.
>
> (2) A company's adjusted ring fence profits for an accounting period are the amount which, on the assumption mentioned in subsection (3) below, would be determined for that period (in accordance with this Chapter) as the profits of the company's ring fence trade chargeable to corporation tax.

(3) The assumption is that financing costs are left out of account in computing–

(a) the amount of the profits or loss of any ring fence trade of the company's for each accounting period beginning on or after 17 April 2002; and

(b) where for any such period the whole or part of any loss relief is surrendered to the company in accordance with section 492(8), the amount of that relief or, as the case may be, that part.

(4) For the purposes of this section, "financing costs" means the costs of debt finance."

5. Section 502(1) defines *ring fence profits* as having the meaning given by subsection (1A) therein, or in any case where that subsection does not apply, it means ring fence income.

6. Section 502(1A) provides –

"Where in accordance with section 197(3) of the 1992 Act a person has an aggregate gain for any chargeable period, that gain and his ring fence income (if any) for that period together constitutes his ring fence profits for the purposes of this Chapter."

The Facts

7. A Statement of Agreed Facts was settled by the Parties, which explains the factual background in which the disputed liability arises and the amendment of the Appellant's tax return. This is set out as Appendix 2.

Submissions: Appellants' argument

8. Mr Peacock explained that Wintershall was accountable to Corporation Tax in respect of its profits, being both income and chargeable gains. He noted Sections 6 and 12 ICTA 1988 and Section 8 Taxation of Chargeable Gains Act 1992. There was, he continued, a distinct treatment in terms of Section 171 TCGA for capital gains arising from *intra group* transfers. These were deemed to have been done on a "no loss/no gain" basis. However, by virtue of Section 179, if the transferee leaves the group within six years, a tax charge is triggered. Hence, in the present case, the latent chargeable gain, which arose in 2006, triggered a consequential liability in 2008.

9. Mr Peacock then considered the *ring fence* regime affecting petroleum extraction. Section 492 ICTA deems such an activity to be a separate *ring fence* trade. A consequence is that *ring fence* losses can only be set against *ring fence* profits. Thus a separate computation of *ring fence* profits or losses is necessary.

10. He then noted the several definitions contained in Section 502. *Ring fence profits* is defined as extending to both income and capital gains: Subsection (1A). He

then noted the term "profits of the ring fence trade" in Section 494AA(3), which was introduced in 1999.

11. That then led to Section 501A ICTA, which is material to this appeal. Its terms, so far as relevant, are set out in para 4. This introduced the Supplementary Charge on *ring fence* trades and that with effect from 2002. This charge, Mr Peacock submitted, was separate from other liabilities and had its own tax base. It was equivalent to 20% on *adjusted ring fence profits*. Mr Peacock argued that it was significant that no reference was made in Section 501A to chargeable gains. There was provision in Subsection (3) for leaving out financing costs in computing profits. *Adjusted ring fence profits* was a new concept dating from only 2002, he suggested.

12. Crucial to Mr Peacock's argument is that Section 501A, introducing the Supplementary Charge, does not extend to chargeable gains. He argued in support of that proposition that the draftsman had deliberately referred to "profits of the company's ring fence trade" in Subsection (2), and not to "ring fence profits". Both concepts he suggested were distinct. Profits of a trade, he asserted, had a well-established sense in Revenue Law, viz income, not capital, profits. The *ring fence* charge to Corporation Tax introduced in 1975 had not extended to gains until FA 1984. Section 79 thereof, now Section 197 TCGA, had included both chargeable gains and income as "ring fence profits". (The Tribunal would observe that its terms state that *aggregate gains* and *ring fence income* constitute *ring fence profits*, each of the concepts in our italics bearing to be distinct.)

13. Section 494AA(3) in 1999 was, Mr Peacock stated, the first occasion when the term "profits of a ring fence trade" was used.

14. Mr Peacock then addressed in detail the implications of the substitution by Section 182 FA 2012 of the term "company's ring fence profits" in place of "profits of the company's ring fence trade" in Section 501A (which had become Section 330 Corporation Taxes Act 2010). Why, he queried, had the substitution been made only in that provision and not also in Section 494AA (now Section 288 CTA). The answer was obviously that these were two different concepts.

15. He then turned to principles of statutory interpretation. These were not the subject of controversy. He noted firstly the decision in *Ramsay* per Lord Wilberforce, that tax liability depended on "clear words" and regard had to be paid to the context, scheme, and purpose of the legislation. He referred then to the opinions of Lords Bingham and Nicholls in *R v S of S for the Environment ex parte Spath Holme Limited*. Parliament's intention had to be derived from the words used and tax liability depended on clear words. Thirdly, he noted *Westminster City Council v National Asylum Support Service* and the observations of Lord Steyn on the matter of reference to Explanatory Notes. In particular (para 5) these could be used to establish the context of the statute and identify the mischief at which it is directed.

16. Applying these principles in the present case Mr Peacock stressed that Corporation Tax on *ring fence* profits did not apply to all chargeable gains. Section 197 extended to *material interests* as defined. He urged us to view the

Supplementary Charge as a distinct levy, with its own structure. The base was *adjusted ring fence profits*. However, the reference to *profits of a ring fence trade* denoted a distinct concept, that of trading profit or income. There was nothing contained in Section 501A directing that the Supplementary Charge included chargeable gains too, nor was there any reason in principle why it should. The draftsman elected to use the term *profits of a ring fence trade* rather than *adjusted ring fence profits*.

17. There was, of course, the alteration by FA 2012. That, Mr Peacock argued, did not assist the Respondents. As noted *supra* it affected the terms of Section 501A (now Section 330 CTA) but not the now Section 288 CTA (formerly Section 494AA ICTA). There was no economic cause to imply the inclusion of capital gains in the Supplementary Charge. The burden of establishing that the charge extended to chargeable gains lay on the Respondents, and could not be discharged.

18. The Explanatory Note (tab 16) did not assist the Respondents, Mr Peacock stated, as it makes no reference to the treatment of gains. It did not indicate the intention of the Government, far less that of Parliament.

19. Accordingly, Mr Peacock submitted, the appeal should be allowed.

Respondents' argument

20. Miss Wilson then addressed us on behalf of HMRC, the Respondents. The Supplementary Charge, she submitted, extended to the ring fence profits chargeable to Corporation Tax adjusted for financing costs. That adjustment was the difference between the scope of the Supplementary Charge and the charge to Corporation Tax. Section 501A(2) applied to ring fence profits. The provision fell to be construed in its statutory context, directed at the relevant mischief, and chargeable gains were included accordingly. "Adjusted" in this context meant merely "tweaked", not "re-written". The term *ring fence profits* was defined for the whole of Chapter 5 of ICTA 1988, including Section 501A.

21. *Ring fence profits* had been introduced in 1984 to bring into charge Section 197 chargeable gains. *Ring fence profits* was the total of two figures, income and chargeable gains. Subsection (3) of Section 501A affected the deduction of financing costs of both the taxpayer and the surrendering company within a Group. Financing costs could not be used to reduce the Supplementary Charge.

22. *Ring fence profits* for the purposes of Section 501A(2) fell to be construed in accordance with Chapter 5 of ICTA. That included income and chargeable gains in terms of Section 197. There was nothing in that subsection which tended to restrict the Supplementary Charge to only trading profits in terms of Schedule D, Miss Wilson argued.

23. Miss Wilson contrasted Section 494AA(3). There, in referring to the profits of the *ring fence trade*, the significant qualification was made, viz "for the purposes of Schedule D". (The reference to Part 3 of CTA 2009 was substituted for "Schedule D" in that Act.) By contrast that provision referring to Schedule D was not contained in

Section 501A. Accordingly there was nothing to restrict its scope to only Schedule D income. Construing Section 501A in the context of Chapter 5 required the inclusion of chargeable gains in *ring fence profits*, she submitted. She noted as supporting (she said) her argument the observations of Lord Nicholls in *Dextra*, at para 18.

24. Miss Wilson noted finally the amendment of Section 501A(2) by FA 2012, Section 182. That alteration was not necessary. In her submission it merely clarified rather than changed the existing law.

25. For all of these reasons Miss Wilson invited us to dismiss the appeal.

26. In reply Mr Peacock maintained his stance that the Supplementary Charge extended to only *income*. The decision in *Dextra*, he considered, was unhelpful to HMRC: effect had to be given to the words used by Parliament. Had Parliament intended that the Supplementary Charge should extend to chargeable gains, there would have been express provision for that. The matter of financing costs was neutral, he continued. Section 492(8) allowed trading losses, not capital losses, in calculating group relief.

27. While the statutory provisions refer to *ring fence income* and *ring fence profits*, the latter could only relate to *income*. The term *profit* meant variously *income* or *income and gains*. The terms of Section 501A did not assist.

28. Profits of a *ring fence trade* and *ring fence profits* were two different terms and deliberately distinct Mr Peacock argued. If the legislation did not expressly provide for the inclusion of capital gains, there had to be a sound basis to imply that. The Explanatory Note (tab 16) seemed to suggest a charge on income only (paras 1 and 15). There was no principle or policy justifying the extension of the Supplementary Charge to chargeable gains.

Decision

29. We were grateful to counsel for their detailed submissions. Ultimately we have preferred a fairly straightforward approach to the interpretation of the terminology in contention, and that laying stress on the statutory context in which it is used. We consider the argument that the two terms "profits of a *ring fence* trade" and "*ring fence* profits" necessarily diverge in their scope, the former extending only to income but not capital gains, to be strained and artificial. That means that our view of Section 182 FA 2012 is that its effect is simply to clarify rather than alter fundamentally the charging provisions.

30. The issue for the Tribunal is quite simply whether Subsection (2) of Section 501A TA 1988 (as at 2008) extended to chargeable gains as well as income. There are no factual aspects in dispute. We refer to the narrative in the introduction and the Statement of Agreed Facts. The charge is imposed on the profits of a *ring fence* trade. What is the correct interpretation of that phrase? *Profit* is a familiar term in Revenue Law. Its sense has changed over the passage of time and depends much on the context in which it is used. Pre-1965, before the advent of Capital Gains Tax, it denoted ordinarily *income* profit. Profits of a trade in that context meant income.

However, for Corporation Tax purposes *profits* are defined statutorily (Section 6(4)(a) TA 1988 – now re-enacted as Section 188(1)CTA 2010) as including both income and capital gains.

31. The dictionary sense of the term denotes any benefit or advantage. *Profit* is habile to include *income* and/or *capital*. We consider that the exact sense must depend on the context in which it is used, here the charging provisions of the Supplementary Charge. Significantly in our view Subsection (2) makes express reference to Chapter 5 TA 1988. Further in the provisions of Section 502 reference is made variously to *income*, *profit*, and *chargeable gains*. It is reasonable to assume that these terms were chosen deliberately by the draftsman, and we consider that they should be viewed distinctly. Chapter 5 TA extends to both income and capital gains. The definition section (Section 502) describes *income* and *profit* distinctly, the latter extending to capital gains as well as income. We note the contrasting context of Section 494AA. The wording ie "profits of a ring fence trade" is used there, as in Section 501A(2) but crucially in our view there is the important qualification that these profits are in the context of Schedule D. Schedule D would denote income alone, unlike the scope of Chapter 5 which extends to both income and chargeable capital gains.

32. We consider Miss Wilson's argument to be well-founded and compelling. This Appeal therefore falls to be refused.

Expenses

33. This Appeal has been categorised as *complex*. Both Parties in their Skeleton Arguments sought an award of expenses in the event of success. However, the Appellant had in April 2013 opted out of the expenses regime. It is accepted that that election governs the matter. In view of that we consider that no award of expenses should be found due to or by either party.

34. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

KENNETH MURE, QC
TRIBUNAL JUDGE

RELEASE DATE: 31 March 2014