[2016] UKFTT 154 (TC)

TC4940

Appeal number: TC/2013/04121

CAPITAL GAINS TAX – Tax avoidance scheme – Whether loan notes were converted to qualifying corporate bonds by deed of variation – If so, when should they be valued – Effect of Ramsay principle on meaning of 'market value in s 116 Taxation of Chargeable Gains Act 1992 – Effect of drafting error – Whether HMRC entitled to issue discovery assessment under s 29 TMA – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

EXECUTORS OF WILLIAM CONNELL **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS

Sitting in public at the Royal Courts of Justice, London, on 15 and 16 February 2016

Michael Firth, Counsel, instructed by Slater and Gordon (UK) LLP, for the Appellant

David Yates, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This appeal concerns a 2004 tax avoidance scheme to reduce the capital gains tax liability on the redemption of loan notes by converting them from non-qualifying corporate bonds ("NQCBs") into qualifying corporate bonds ("QCBs"), at a time when their market value had been artificially depressed, amending their terms by way of a deed of variation.

2. The late Mr William Connell, having taken advantage of such a scheme, submitted his 2003-04 tax return, on time, on the basis that there was no capital gain. No enquiry was opened by HM Revenue and Customs ("HMRC") within the statutory "window". However, on 30 March 2009, as the efficacy of the scheme was not accepted, a discovery assessment in the sum of £397,188.80 was issued, under s 29 of the Taxes Management Act 1970 ("TMA"), on the executors of Mr Connell who had died on 30 May 2008.

3. This appeal is being pursued by the executors who are represented by Mr Michael Firth. Mr David Yates appears for HMRC.

4. Two issues arise, first whether a capital gain arose in respect of the Loan Notes in 2003-04 (the "substantive issue"); and secondly whether HMRC were entitled to make a discovery assessment (the "discovery issue"). Both issues, and indeed the same tax scheme, were considered by the Tribunal (Judge Brannan and Ms Redston (as she then was)) in *William Blumenthal v HMRC* [2012] UKFTT 497 (TC). Also, although considered, it has not been necessary to mention every argument advanced on behalf of the parties in reaching my conclusions on these issues.

5. As in *Blumenthal* I shall consider the substantive issue first. Not only was this the order adopted by the parties, but as the Tribunal in *Blumenthal* observed, at [4]:

> "… the substantive issue most naturally comes first since a full understanding of the substantive issue sheds light on the issues in relation to the discovery issue, viz the appropriate level of disclosure on the Appellant's 2003-2004 tax return."

The Substantive Issue

Background

6. In 1998 the late Mr William Connell owned shares in Ever 1199 Limited. During the course of 1998-99 these shares were acquired by Telecom Securicor Cellular Radio Limited (which later became O2 (UK) Limited ("O2")) for £2,098,293 "A" O2 loan notes and £381,500 "B" O2 loan notes and £242,638 cash. This appeal is concerned with only the "A" O2 loan notes (the "Loan Notes") which were issued "subject to and with the benefit of" certain conditions.

7. Those conditions to which I was referred included:

1. DEFINITIONS

1.1 in this Loan Stock (including these conditions) the following expressions have the following meanings:

"Quarter Day" 25 March, 24 June, 29 September or 25 December in any year

…

3. REPAYMENT

3.1 Unless previously repaid pursuant to this Condition 3, the Series A Loan Stock will be repaid on 30 June 2006 together with interest up to (and including) such date (less tax where deduction thereof is required by law).

3.2 A series A stockholder shall be entitled to call for immediate repayment of any of his Series A Loan Stock at par together with accrued interest (less income tax where deduction thereof is required by law) if:

3.2.1 the principal amount of, or any interest on, such Series A Loan Stock shall not have been paid in full within 30 days following the due date; or

3.2.1 a winding up petition is presented and served on the Company and not fully discharged within ten days or an effective resolution is passed for the winding up of the Company (other than a members' voluntary winding up previously approved by an Extraordinary Resolution of the Stockholders).

3.2.3 any encumbrancer shall take possession or a receiver shall be appointed of the undertaking property and assets of the Company or any part thereof, and any such appointment is not discharged within 21 days;

3.2.4 a distress execution or other process shall be levied or enforced upon or against any of the material assets of the Company and shall not be discharged within seven days of being levied or enforced;

3.2.5 the Company is unable to pay its debts within the meaning of s 123(1) Insolvency Act 1986;

3.2.6 a meeting of the Company is convened for the purpose of making or proposing to make or entering into any arrangements of composition with or assignment for the benefit of its creditors; or

3.2.7 the Company ceases or threatens to cease to carry on business, except as part of a solvent reconstruction or amalgamation.

3.3

3.3.1 A Series A Stockholder may require the Company to repay the whole or any part of his Series A Loan Stock (in the latter case only in amounts or integral multiples of £50,000 or

remaining balances on any Quarter Day (arising after the date six months after the date hereof) provided that each Series A Loan Stockholder is entitled to one annual repayment of £7,500, by giving the Company in each case a written notice (a "repayment notice") not less than 30 days prior to the repayment date specified in the repayment notice provided that each repayment date must be a Quarter Day or the next following Business Day and the first repayment date may not be earlier than six calendar months from the date of issue of the relevant Series A Loan Stock.

…

4. US DOLLAR REDEMPTION OPTION

4.1 The Company may at any time not more than three months and not less than one month prior to the date on which the Loan Stock are due to be repaid under Clause 3.1 (the "Redemption Date") give notice to the Noteholder of the Company's intention to repay the principal amount of the Loan Stock falling due for redemption on the Redemption Date (the "Redemption Amount) in US Dollars instead of in Pounds Sterling, and in such cases the provisions of clauses 4.2 to 4.6 shall apply

4.2 The rate of exchange applicable to the Redemption Amount shall be the closing mid-point spot rate for the purchase of US Dollars as stated in the first London edition of the Financial Times on the Business Day which is three business days prior to the Redemption Date (the "Redemption Exchange Rate").

4.3 On the Redemption Date the following calculation shall be made:

$$F = E/S$$

where:

E is the Redemption Exchange Rate; and
S is the closing mid-spot point for the purchase of US Dollars as stated in the first London edition of the Financial Times on the Redemption Date.

4.4 If, in relation to a Redemption Date, F exceeds 1.01 or is less than 0.99, the Loan Stock falling due for redemption on the Redemption Date shall be redeemed in sterling as if notice under 4.1 had not been given.

4.5 Payment of the Redemption Amount made in US Dollars pursuant to this clause 4 shall constitute a full discharge to the Company of the Redemption Amount.

4.6 Any interest payable on a Redemption Date shall be payable in Sterling notwithstanding that the principal amount may be payable in US Dollars.

…

13. EXTRAORDINARY RESOLUTIONS

13.1 The terms hereof shall not be subject to amendment in any respect save with the sanction of an extraordinary general meeting of Series A

> Stockholders passed by a majority consisting of not less than three-fourths of the persons voting thereat upon a show of hands or if a poll is demanded on the resolution then by a majority of not less than three-fourths in principal amount of the Series A Loan Stock for the time being outstanding and the provisions of Schedule 1 shall apply to any such extraordinary general meeting.

8. The relevant provision in Schedule 1 is paragraph 19, "Resolutions in writing" which provides:

> A resolution in writing signed by the holder of at least 100% of the principal amount of the Loan Stock then outstanding who are for the time being entitled to receive notice of meetings in accordance with the provisions herein contained shall for all purposes be valid and effectual as an Extraordinary Resolution passed at a meeting of Stockholders. Such resolution in writing may be contained in one document or in several documents in like form each signed by one or more of the Stockholders.

9. It is not disputed that, because clause 4 of the Conditions permitted O2 to redeem the Loan Notes in US Dollars by reference to the exchange rate three business days before redemption, the Loan Notes were NQCBs (see s 117(1)(b) and (2)(b) of the Taxation of Chargeable Gains Act 1992 ("TCGA")). As such, by virtue of s 127 TCGA, no gain arose on the disposal of the Ever 1199 Limited shares.

10. Around November 2003 Mr Connell, like all other O2 Loan Note holders, was approached by Deloitte with a proposal to redeem the Loan Notes by using a deed of variation to vary their terms and convert the Loan Notes from NQCBs to QCBs. On 12 November 2003 Mr Connell, along with other Loan Note holders, including Mr Blumenthal, attended a conference with leading tax counsel who had settled the deed of variation and who had been instructed, by Deloitte, to consider the following sequence of transactions aimed at mitigating the capital gains tax payable on redemption of the Loan Notes:

(1) The issuing company would agree to vary the terms of the Loan Notes issued to the individuals.

(2) The deed of variation would introduce a three month long period during which the company could redeem Loan Notes at a fraction of their value. This option to redeem would not apply where the note holder owned a specific asset.

(3) To remove the current note holder from the potential pool of purchasers, he would enter a deed of covenant to give to charity two times any consideration received for the Loan Notes.

(4) Following the steps above, the market value of the loan notes would be reduced in the hands of any person other than the current note holder.

(5) The deed of variation also would include a provision to amend the foreign currency clause as a result of a contingent event.

(6) Assuming that the contingency is met, the Loan Notes would convert from NQCBs to QCBs.

(7) The chargeable gain would be computed when the Loan Notes were converted to QCBs. As the market value at this time would be heavily discounted, the gain would be small. The gain would be taxed at the point of conversion but would be deferred until redemption of the Loan Notes.

(8) The Loan notes would be redeemed. At this point, the frozen capital gain would be brought into charge.

If the planning was successful the rate of capital gains tax on redemption of the Loan Notes would be reduced to an estimated 1%.

11. On 9 February 2004 Deloitte wrote to all O2 Loan Note holders enclosing a letter from O2, also dated 9 February 2004. That letter stated:

> I am writing to inform you that O2 (UK) Limited has received a request from a number of the Series A Loan Stock holders to vary the terms of their Loan Stock. The proposed variation would be effected by way of a Deed of Variation in the form attached. If the proposed variation is implemented, the terms of the Series [A/B] Loan Stock held only by those holders to execute the Deed of Variation will be amended, thereby creating a new series of loan stock for those holders. The Terms of the Series A Loan Stock held by all other holders who do not execute the Deed of Variation will remain unchanged.
>
> We are writing to all holders of the Series A Loan Stock to determine whether or not they wish to participate in the proposed variation and to seek their consent to the proposals. The proposed variation will not be implemented unless all the holders of the Series A Loan Stock consent to the proposals (regardless of whether or not they decide to participate in the proposed variation).
>
> If you consent to the proposals, please would you sign and return the attached form indicating whether or not you wish to participate in the proposed variation. If you are in any doubt about the action you should take, we recommend that you seek your own professional advice. O2 (UK) Limited will not be responsible to any holder of Series A Loan Note Stock holders in relation to the proposed variation."

The “attached form” which all Loan Note holders were requested to “sign and return” stated:

> "I confirm that I am a holder of Series A Loan Stock created pursuant to resolution of the Board of Directors of O2 (UK) Limited passed on 24 February 1999.
>
> I refer to your letter of 9 February 2004 setting out the proposed variation of the Series A Loan Stock as set out in the Deed of Variation attached to the letter.
>
> I confirm that:
>
> 1. I do/do not*wish to participate in the proposed variation, as set out in the Deed of Variation, in respect of my holding of Series A Loan Stock.

2. I consent to the proposed variation, as set out in the Deed of Variation, of the terms of the Series A Loan Stock held by all holders who wish to participate in the proposed variation.

…

*Please delete as applicable."

12. Consent was obtained from all of the Loan Note holders (including those who did not wish to participate in the Deloitte scheme). This had the effect of a resolution within the meaning of paragraph 19 of Schedule 1 to the Loan Note conditions. On 13 February 2004 Mr Connell entered into a deed of variation with O2 (as did all other Loan Note Holders, including Mr Blumenthal, who wished to take advantage of the scheme).

13. The deed of variation included the following terms:

2. Variation

The parties hereto hereby agree that with effect from the date of this Deed of Variation the terms of the [Loan] Notes and Conditions shall be varied in accordance with the terms set out below and this variation shall be effective from the date of this Deed

<u>Interpretation</u>

First Relevant Period means the period beginning three days after the date of the Deed of Variation and ending 33 days after the date of Deed of Variation.

Relevant Loan Note Holder means any registered holders of the Notes as at 31 December 2003 and their respective personal representatives, with the exception of [a named Loan Noteholder being a person other than the Appellant]

...

Relevant Event means an exchange rate of movement of not less than plus or minus 1.5% of the purchase price of US dollars with Sterling during the First Relevant Period, obtained by taking the spot rate for the purchase of US dollars with Sterling certified by the Company as prevailing at the close of business on the first day of the First Relevant Period and comparing that exchange rate with the certified spot rate for the purchase of US dollars with Sterling at the close of business on each day throughout the First Relevant Period.

Second Relevant Period means the period beginning three days after the date of Deed of Variation and ending on 21 March 2004.

<u>Redemption</u>

After clause 3.3.2 there shall be inserted:

3.3.3 In respect of the repayment date of 25 March 2004, the Company will accept a written notice (a "repayment notice") not less than 3 days prior to the repayment date as being a valid repayment notice for the purposes of the this clause 3.3,

notwithstanding the relevant notice set out in clause 3.3.1 above.

After clause 4.6 there shall be inserted:

4.7 If the Relevant Event occurs during the First Relevant Period, then with effect from the first Business Day after the date on which the Relevant Event occurs, this Condition 4 shall apply with the following modifications:

i) in clause 4.1 the words from "the provisions of clause 4.2 to 4.6 shall apply." to the end of clause 4.4 shall be deleted and shall be replaced by the words "the rate of exchange applicable to the Redemption Amount shall be the mid-point spot rate prevailing at the time of repayment of the Notes."

ii) for the avoidance of doubt, clauses 4.2 and 4.3 and 4.4 above shall be deleted in their entirety.

After the above clause 4.7 there shall be inserted:

4.8 The provisions of this clause 4.8 shall apply during the Second Relevant Period and not otherwise.

4.8.1 If it any time during the Second Relevant Period a Noteholder (or the beneficial owner of any Note (s) held by a Noteholder) is not a Relevant Loan Note Holder, the Company may by notice given at any time in the Second Relevant Period elect for this clause 4.8 to apply in relation to such Note(s).

4.8.2 If at any time during the Second Relevant Period a Noteholder (or the beneficial owner of any Note(s) held by a Noteholder) is also a Relevant Loan Note Holder and if more than three of the Relevant Persons are deceased, the Company may by notice given at any time in the Second Relevant Period elect for this clause 4.8 to apply in relation to such Note(s).

4.8.3 If this clause 4.8 applies, then the amount payable on redemption or repayment of such Note(s) shall not be par or any other amounts mentioned in these Conditions but shall instead be 3% of par or of such other amount, as the case may be.

14. On 15 February 2015, Mr Connell (like all other participants in the Deloitte scheme) entered into a deed of covenant that provided that if he acquired any Floating Rate Unsecured Series A Guaranteed Loan Stock 1999/2006 issued by O2 for less than par Mr Connell would have to pay twice the difference to a specified charity. The purpose of the deed was to remove Mr Connell (and his wife) from the pool of potential purchasers of the Loan Notes at the time when their value was artificially depressed.

15. On 27 February 2004 the Sterling-US Dollar exchange rate moved by 1.5% or more, the “Relevant Event” as defined in clause 2 of the deed of variation. At that time the market value of the Loan Notes was estimated to be £44,724 against a base cost of £249,579.

16. The Loan Notes were redeemed on 25 March 2004.

17. Mr Connell's completed 2003-04 self-assessment return, which was required by s 8 TMA to be filed by 31 January 2005, was received by HMRC on 25 January 2005. It showed that Mr Connell had disposed of 1450794 Loan Notes and that the disposal proceeds were £44,724. The return also stated, in the box (the "white space") asking for a description of "each transaction" in shares or securities:

> 24.6.03 Redemption of "B" loan notes O2 (UK) Limited
>
> See attached note
>
> 25.3.04 Redemption of 1450794 A Loan Notes, O2 (UK) Limited
>
> See attached note

18. The "attached note" set out the history of Mr Connell's holdings in O2 including included the Loan Notes. It also showed the proceeds of the disposal (redemption) of the Loan Notes to be £44,724 and that Mr Connell had made neither a gain nor loss on their redemption. Also stated in the white space was the following:

> The chargeable loss shown in box 8.10 of this tax return arose as a result of my redemption of £1,490,794 Loan Notes in O2 (UK) Limited on 25 March 2004.
>
> The loan notes were non-Qualifying Corporate Bonds when originally issued. However, on 13 February 2004 a deed of variation was entered into by the parties to the loan note, which in certain circumstances would vary its terms and the price at which it could be redeemed. The loan notes were converted into Qualifying Corporate Bonds on 27 February 2004, at a time when their open market value was estimated to be £44,724. This is the value that the issuer had the ability to repay the loan notes for at that time on any transfer in the open market. No independent valuation has been obtained. The chargeable loss was calculated at the time of the conversion but falls to be taxed at the date of redemption in accordance with s.116 (1) TCGA 1992."

19. Although no enquiry was opened into the return it would appear, from correspondence between HMRC and Mr Connell's accountants and solicitors after he had died, that sometime in 2008 HMRC had become aware that Mr Connell had "implemented a marketed tax avoidance scheme" in connection with the redemption of the Loan Notes and, on 30 March 2009, the discovery assessment was issued.

20. The following issues arise in relation to the Substantive Issue:

(1) Whether the deed of variation converted the Loan Notes from NQCBs to QCBs;

(2) If there was a conversion, when should the Loan Notes should be valued;

(3) Whether the application of the *Ramsay* principle to the concept of "market value" in TCGA excludes artificially reduced values; and

(4) The effect of a drafting "flaw" in the deed of variation.

21. I shall consider each in turn, but before doing so should mention that the Tribunal in *Blumenthal* very helpfully sets out an overview of the relevant statutory

provisions applicable to the case at [6] to [18] and, at [19] to [26], explains their relevance to the transactions. As *Blumenthal* concerned the same scheme and transactions as in the present case I do not consider it necessary to do the same here but, if such an overview and explanation could be of assistance, would refer to and adopt that part of the decision in *Blumenthal*.

Whether Loan Notes were converted into QCBs

22. The relevant statutory provision, section 117 TCGA, insofar as material to the present case, provides:

> (1) For the purposes of this section, a "corporate bond" is a security, as defined in section 132(3)(b)—
>
> > (a) the debt on which represents and has at all times represented a normal commercial loan; and
> >
> > (b) which is expressed in sterling and in respect of which no provision is made for conversion into, or redemption in, a currency other than sterling,
>
> and in paragraph (a) above "normal commercial loan" has the meaning which would be given by [section 162 of CTA 2010 if for paragraphs (a) to (c) of subsection (2) of that section there were substituted the words "corporate bonds (within the meaning of section 117 of TCGA 1992).
>
> (2) For the purposes of subsection (1)(b) above—
>
> > (a) a security shall not be regarded as expressed in sterling if the amount of sterling falls to be determined by reference to the value at any time of any other currency or asset; and
> >
> > (b) a provision for redemption in a currency other than sterling but at the rate of exchange prevailing at redemption shall be disregarded.
>
> ...
>
> (7) Subject to subsections (9) and (10) below, for the purposes of this Act, a corporate bond—
>
> > (a) is a "qualifying" corporate bond if it is issued after 13th March 1984; and
> >
> > (b) becomes a "qualifying" corporate bond if, having been issued on or before that date, it is acquired by any person after that date and that acquisition is not as a result of a disposal which is excluded for the purposes of this subsection, or which was excluded for the purposes of section 64(4) of the Finance Act 1984.
>
> …

23. Section 117(1) TCGA was considered by the Court of Appeal in *Harding v HMRC* [2008] STC 3499 in which the issue before the court, as in this appeal, was

whether NQCBs had been converted into QCBs. In that case an option to redeem loan notes into either US dollars, Canadian dollars or deutschmarks had lapsed.

24. Lawrence Collins LJ (giving the judgment of the Court of Appeal) described the issue in the following way:

> "30. The principal point on this appeal arises from Mr Harding's contention that the Loan Notes, which it is common ground were non-QCBs upon acquisition, changed their status upon the lapse of the currency conversion option on January 23, 1995, ten days after acquisition and about five months before redemption.
>
> 31. If that change in status occurred, then two consequences would flow. The first consequence is that the roll-over regime would not apply because there is no statutory provision for a charge to tax upon the disposal constituted by the redemption of what would by then be a QCB. The second consequence would be that the frozen gain regime would not apply because the Loan Notes were not QCBs upon acquisition, and did not change their status so as to become QCBs by virtue of any transaction for the purposes of section 116 [TCGA]".

25. He went on to say:

> "55. In my judgment the key to the interpretation of section 117(1)(b) is the word "provision". If one were to ask whether, on the date of issue, provision is made "in respect of" the security (meaning for this purpose the agreement represented by the Loan Notes and the terms embodied in them) there would, of course, be no doubt on any possible view.
>
> 56. But if the same question were to be asked at the date when the currency conversion right lapsed or when the Loan Notes were redeemed there would, in my view, be the same answer, namely that "provision" is made for conversion, even though the right can no longer be exercised. In my judgment the word "provision" is a reference to the terms of the agreement, and not simply to subsisting rights. There was no need for section 117(1)(b) to have the phrase "at all times" because it was looking to the terms of the agreement and not to rights which may have existed under it from time to time."

26. *Klincke v HMRC* [2010] STC 2032 concerned the redemption of loan notes which, because they contained a term which allowed them to be redeemed in a currency other than sterling, were NQCBs. An extraordinary meeting of the note holders took place and passed an extraordinary resolution cancelling the foreign currency right of the issuing company.

27. As the Upper Tribunal (Newey J and Judge Gammie QC) explain:

> "10. The extraordinary resolution that was proposed and passed at the meeting was in the following terms—
>
> > "THAT the terms of an instrument dated 20th August 1993 made between the Company and Lloyds Bank plc constituting £3,503,004 Loan Notes and the rights

attached to the Loan Notes constituted by the said instrument be and are hereby modified and abrogated by the deletion of Clauses 4.2 and 4.3 of the said instrument and that a proposed Deed of Amendment to be made between the Company and Lloyds Bank plc effecting such amendment, a draft of which was produced to the meeting and initialled by the Chairman for the purposes of identification, be and is hereby approved."

11. Later on 17 October 1995, following the meeting, the deed of variation was executed by Rubicon and Lloyds Bank plc (as guarantor of the Notes) giving effect to the extraordinary resolution. The deed recited in full the terms of clauses 4.2 and 4.3 20 of the loan note instrument and recited the extraordinary resolution of Noteholders approving the deletion of these clauses. The operative provisions of the deed were as follows—

"NOW IT IS HEREBY AGREED AND DECLARED by and between the parties as follows:

1. To modify and abrogate the wording of the Loan Note Instrument and the rights attached to the Loan Notes constituted thereby by deleting clauses 4.2 and 4.3 of the Loan Note Instrument in their entirety.

2. That subject to the modification and abrogation set out in clause 1 above all the terms and conditions of the Loan Note Instrument and the rights attached to the Loan Notes constituted thereby shall remain in full force and effect and shall be binding on all the parties.

3. That this Deed is Supplemental to the Loan Note Instrument."

28. After citing the above passage from *Harding* the Upper Tribunal went on to say:

"25. The difference between a note that has been issued on terms that provide for redemption in a foreign currency but where that term has lapsed and a note where the terms have been amended to excise the foreign currency redemption option is in our view critical. In the first case the foreign currency option remains one of the terms on which the note is held even though it is no longer operative or effective. In terms of construing the definition of a QCB in section 117 it seems unlikely that Parliament envisaged that the status of a note (and the character of the gain that the note might reflect) would automatically alter (without any change in the terms on which it was issued and held) according to whether a particular term was currently or prospectively operative or had lapsed. On the other hand, if the issuer and the noteholders take the positive step of changing the terms of the notes the character of the notes is to be determined according to the provisions as amended. The amendment may lead to the loan note instrument being reissued in amended form, re-executed or left to be read with a deed of variation.

> In any of those cases, however, the note no longer contains any provision for conversion into, or redemption in, a currency other than sterling. This may be contrasted with the situation in *Harding*, where the loan notes did include a provision to that effect but in the circumstances the provision had lapsed.
>
> 26. Accordingly, we have concluded that the Notes became QCBs following their amendment on 17 October 1995."

29. Having considered both *Harding* and *Klincke* in relation to the scheme in that case (which is identical to the scheme in the present case albeit with differently numbered clauses in the deed of covenant) the Tribunal in *Blumenthal* said, at [87]:

> "In our view, the effect of the Deed of Variation and the resolution in writing signed by each Loan Note Holder was, on the occurrence of the Relevant Event, to delete (for participating loan Note Holders such as the Appellant) the foreign currency redemption option where the exchange rate was calculated three days before redemption and to substitute an exchange rate calculated on redemption. The drafting of Clause 9.7(ii) of the Deed of Variation in relation to the B Loan Notes makes this clear. From that time, the Loan Notes owned by the Relevant Loan Note Holders did not contain a provision for redemption in a currency other than sterling at a rate of exchange calculated at redemption for the purposes of section 117(1)(b) TCGA. The facts in the present appeal are, therefore, much closer to those in *Klincke* than to *Harding*, and we find that the foreign currency conversion option would not continue to exist in this new class of loan notes, after the Deed of Variation had been implemented."

30. Mr Yates submits that the Tribunal in *Blumenthal* came to the wrong conclusion and that the circumstances in *Blumenthal*, and therefore the present case, is analogous to the situation in *Harding* rather than *Klincke*. He says that whereas the terms of the extraordinary resolution in Klincke stated that the rights under the loan notes under the original loan note agreement were "hereby modified and abrogated by the deletion of Clauses 4.2 and 4.3" (which was sufficient to convert the loan notes from NQCBs into QCBs) the words used in the deed of variation in the present case, "shall be deleted and shall be replaced", provide for a clause to be inserted into the Loan Notes which would vary the ability to redeem in US Dollars only if the Relevant Event, a future event occurred. Therefore, Mr Yates submits, unlike in *Klincke* the effect of the deed of variation is that the foreign currency option remains one of the terms on which the Loan Notes are held even if, following the occurrence of the Relevant Event are no longer operative and similar to the lapsed option in *Harding*.

31. However, as Mr Firth contends and the Tribunal in *Blumenthal* recognised, the effect of the deed of variation and resolution signed by each Loan Note holder was to "delete" the foreign currency option on the occurrence of the Relevant Event with the result that the Loan Notes no longer contained such a provision. Like the Tribunal in *Blumenthal*, and for the same reasons, I consider the situation in the present case to be much closer to those in *Klincke* than to *Harding*

32. As such, I find that the Loan Notes were converted into QCBs

Time of Valuation

33. Having found that the Loan Notes were converted into QCBs it is necessary to consider whether they should be valued as at 27 February 2004, the date of the Relevant Event (as Mr Firth contends) or as at 13 February 2005, the date the deed of covenant was executed or shortly after (as Mr Yates contends).

34. This issue was not considered in *Blumenthal*. Nevertheless Mr Yates referred me to the following passages from the Tribunal's decision in that case:

> "36. Although designed to be outside the control of the Loan Noteholders, Ms Paul's evidence was that in the period from 5 January to 16 March 2004 the Sterling/US Dollar exchange rate moved by 1.5% or more on 40/50 days. Mr White estimated the risk of the Relevant Event not occurring to be one in four, although he produced no supporting evidence to reinforce this analysis. He also said that the likelihood of it occurring was "unlikely not impossible." In any event, Mr White was a witness in fact and not an expert witness. For this reason, we prefer Ms Paul's evidence. In any event, Mr Way said that the insertion of this contingency was not necessary for the success of the Appellant's tax planning.
>
> …
>
> 97. The Relevant Event (the 1.5% currency exchange contingency) was designed solely to "*Ramsay*-proof" the series of transactions from being regarded as a set of transactions which were highly likely to have been carried out. It served no commercial purpose and, to use Lord Nicholls's phrase in *IRC v Scottish Provident Institution* [2005] STC 15 at [23], was simply a "commercially irrelevant contingency." Lord Nicholls said:
>
> > "We think that it would destroy the value of the *Ramsay* principle of construing provisions such as s 150A(1) of the 1994 Act as referring to the effect of composite transactions if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned."
>
> 98. We consider that these comments can apply to the Relevant Event. Accordingly, the transactions entered into by the Appellant in February and March 2004 in relation to the Loan Notes should be viewed as transactions which were intended to be (and were) carried out as a whole. They should be viewed together."

35. Having regard to the observations of the Tribunal in relation to the tax scheme used by both Mr Blumenthal and Mr Connell, Mr Yates contends that, given the

artificiality of the exchange rate condition (Clause 4.8 of the Loan Notes) and if viewed realistically, the conversion of the Loan Notes from NQCBs into QCBs was brought about solely by the deed of variation of 13 February 2004 and therefore, for the purposes of s 116 TCGA (the material parts of which I set out below), the Loan Notes should be valued as at 13 February and not 27 February 2004. Such an application of the *Ramsay* principle is, he says, consistent with a realistic and purposive approach.

36. Alternatively Mr Yates contends, in an argument he describes as "light touch *Ramsay*, that the effect of the conditions of the Loan Note as amended by the deed of variation (particularly Clauses 4.7 and 4.8) is that by 17 February 2004 it was clear that the first realistic date for redemption of the Loan Notes was 25 March 2004 and not before and, as such, 17 February 2004 was he appropriate date for valuation of the Loan Notes.

37. In *Carrerras Group Ltd v Stamp Commissioner* [2004] STC 1377 the Privy Council considered provisions of Jamaican law analogous to s 16 TCGA. Lord Hoffman said:

> "7. Their Lordships agree that the question is whether the relevant transaction can be characterised as a reorganisation of share capital as defined in the Act, that is to say, as an issue of a debenture in exchange for shares. They also accept that if the relevant transaction is confined to what happened on 27 April by virtue of the agreement executed on that date, there can be no doubt that it fell within that description. On the other hand, if one is allowed to take a wider view and to treat the terms of the debenture and its redemption two weeks later as part of the relevant transaction, it looks very different. From this perspective, the debenture is only a formal step, having no apparent commercial purpose or significance, in a transaction by which the shares in Jamaica Biscuit were exchanged for money.
>
> 8. Whether the statute is concerned with a single step or a broader view of the acts of the parties depends upon the construction of the language in its context. Sometimes the conclusion that the statute is concerned with the character of a particular act is inescapable: see *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311. But ever since *Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 the courts have tended to assume that revenue statutes in particular are concerned with the characterisation of the entirety of transactions which have a commercial unity rather than the individual steps into which such transactions may be divided. This approach does not deny the existence or legality of the individual steps but may deprive them of significance for the purposes of the characterisation required by the statute. This has been said so often that citation of authority since *Ramsay's* case is unnecessary."

He continued:

> "14. Their Lordships would however endorse the remarks of Anderson J in which he drew attention to the need for legislative consideration of the wisdom of using the United Kingdom capital gains tax provisions

> for the purposes of transfer tax. In the present case, the exchange and redemption of the debenture were plainly a single transaction and, as the Court of Appeal held, fell to be taxed as such. But there may well be cases in which the facts do not justify such a conclusion and transfer tax will be avoided without there being any ultimate charge (as there would be under paragraph 11(2) of the United Kingdom schedule) on the redemption of the debenture: compare *Craven v White* [1989] AC 398.
>
> 15. Mr Goldberg [counsel for the appellant] submitted that a factual inquiry into what constituted the relevant transaction for the purposes of paragraph 6(1) would give rise to uncertainty. He was disposed to accept that if the representative of Carreras had handed the share certificates over the desk in exchange for the debenture and the representative of Caribbean had then handed it back in exchange for a cheque, it would be hard to say that the relevant transaction should not be characterised as an exchange of shares for money. But what if the debenture had been redeemed a year later? Why should a fortnight be insufficient to separate the exchange from the redemption?
>
> 16. One answer is that it is plain from the terms of the debenture and the timetable that the redemption was not merely contemplated (the redemption of any debenture may be said to be contemplated) but intended by the parties as an integral part of the transaction, separated from the exchange by as short a time as was thought to be decent in the circumstances. The absence of security and interest reinforces this inference. No other explanation has been offered. In any case, their Lordships think that it is inherent in the process of construction that one will have to decide as a question of fact whether a given act was or was not a part of the transaction contemplated by the statute. In practice, any uncertainty is likely to be confined to transactions into which steps have been inserted without any commercial purpose. Such uncertainty is something which the architects of such schemes have to accept."

38. However, Mr Firth contends that *Carrerras* does not assist HMRC's case as it did not involve deeming something to happen at a time other than when it did happen. The Privy Council did not suggest that the debentures should have been treated as having been redeemed two weeks before they were redeemed, the question was whether the two steps should be regarded as part of a composite whole. Although Mr Firth accepts that once Mr Connell entered into the deed of variation the Relevant Event, and therefore the conversion of the Loan Notes from NQCBs into QCBs, was bound to happen he says that it did not follow that the conversion happened on 13 February 2004 and to ascertain the correct time for valuation it is necessary to consider the relevant statutory provisions, namely s 116 TCGA.

39. Insofar as it applies to the present case s 116 TCGA provides:

> (1) This section shall have effect in any case where a transaction occurs of such a description that, apart from the provisions of this section—

(a) sections 127 to 130 would apply by virtue of any provision of Chapter II of this Part; and

(b) either the original shares would consist of or include a qualifying corporate bond and the new holding would not, or the original shares would not and the new holding would consist of or include such a bond;

and in paragraph (b) above "the original shares" and "the new holding" have the same meaning as they have for the purposes of sections 127 to 130.

(2) In this section references to a transaction include references to any conversion of securities (whether or not effected by a transaction) within the meaning of section 132 and "relevant transaction" means a reorganisation, conversion of securities or other transaction such as is mentioned in subsection (1) above, and, in addition to its application where the transaction takes place after the coming into force of this section, subsection (10) below applies where the relevant transaction took place before the coming into force of this section so far as may be necessary to enable any gain or loss deferred under paragraph 10 of Schedule 13 to the Finance Act 1984 to be taken into account on a subsequent disposal.

…

(4) Where the qualifying corporate bond referred to in subsection (1)(b) above would constitute the new holding for the purposes of sections 127 to 130, it is in this section referred to as "the new asset" and the shares or securities which would constitute the original shares for those purposes are referred to as "the old asset".

(5) So far as the relevant transaction relates to the old asset and the new asset, sections 127 to 130 shall not apply in relation to it.

(6) In accordance with subsection (5) above, the new asset shall not be treated as having been acquired on any date other than the date of the relevant transaction or, subject to subsections (7) and (8) below, for any consideration other than the market value of the old asset as determined immediately before that transaction.

(7) If, on the relevant transaction, the person concerned receives, or becomes entitled to receive, any sum of money which, in addition to the new asset, is by way of consideration for the old asset, that sum shall be deducted from the consideration referred to in subsection (6) above.

(8) If, on the relevant transaction, the person concerned gives any sum of money which, in addition to the old asset, is by way of consideration for the new asset, that sum shall be added to the consideration referred to in subsection (6) above.

(9) In any case where the old asset consists of a qualifying corporate bond, then, so far as it relates to the old asset and the new asset, the relevant transaction shall be treated for the purposes of this Act as a disposal of the old asset and an acquisition of the new asset.

(10) Except in a case falling within subsection (9) above, so far as it relates to the old asset and the new asset, the relevant transaction shall be treated for the purposes of this Act as not involving any disposal of the old asset but—

(a) there shall be calculated the chargeable gain or allowable loss that would have accrued if, at the time of the relevant transaction, the old asset had been disposed of for a consideration equal to its market value immediately before that transaction; and

(b) subject to subsections (12) to (14) below, the whole or a corresponding part of the chargeable gain or allowable loss mentioned in paragraph (a) above shall be deemed to accrue on a subsequent disposal of the whole or part of the new asset (in addition to any gain or loss that actually accrues on that disposal); and

(c) on that subsequent disposal, section 115 shall have effect only in relation to any gain or loss that actually accrues and not in relation to any gain or loss which is deemed to accrue by virtue of paragraph (b) above.…

40. As Mr Firth contends, the deed of variation was not itself a disposal and cannot benefit from s 116(10) TCGA, but if it rather than the conversion from NQCBs to QCBs is the relevant transaction, the conversion cannot be treated as "as not involving any disposal of the old asset". In addition, s 116(6) TCGA, which is not a deeming provision provides that "the new asset **shall not be treated** as having been acquired on any date **other than the date of the relevant transaction**" (emphasis added). Also, if the argument advanced by HMRC is correct, as s 116(10)(b) TCGA deems the gain or loss to accrue on the disposal of the new asset, there would be a gap in time between the "relevant transaction" and acquisition of the new asset. Moreover, where Parliament intends to enact a deeming provision it does so expressly as, for example, in s 28 TCGA where a disposal under a contract is treated as occurring at the time of the contract (see *Jerome v Kelly (Inspector of Taxes)* [2004] STC 887).

41. However, in *Schofield v HMRC* [2012] EWCA Civ 927 the Court of Appeal considered the following transactions as described by Sir Andrew Morritt C:

"2. …

(1) On 17th January 2003 Mr Schofield and KBPB entered into an International Swap Dealers Association Master Agreement. It provided, so far as relevant, that:

(a) "all transactions are entered into in reliance on the fact that this Master Agreement and all confirmations form a single agreement between the parties.." (clause 1(c)), and

(b) with certain limited exceptions, neither party might transfer any interest or obligation thereunder to a third party without the consent of the other party (clause 7).

(2) On 7th February 2003 Mr Schofield and KBPB entered into four European Style options, expiring on 7th April 2003, consisting of

two pairs. The first pair (Options 1 and 2) were bought by Mr Schofield from KBPB and were to be settled in cash, the second pair (Options 3 and 4) were sold by Mr Schofield to KBPB and were to be settled by physical delivery of the underlying stock. The basic terms of the options were:

(a) a put option over £333m FTSE 100 Index at a strike price of 3389.91 at a premium of £12,037,617 ("Option 1");

(b) a call option over £333m FTSE 100 Index at a strike price of 3390.4 at a premium of £12,141,846 ("Option 2");

(c) a put option over £333m 7.25% Treasury Stock 2007 at a strike price indicated by a formula related to the movement of the FTSE 100 index at a premium of £12,153,834 ("Option 3"); and

(d) a call option over £333m 8.5% Treasury Stock 2007 at a strike price indicated by the like formula at a premium of £11,915,073 ("Option 4").

The difference of £110,556 payable by Mr Schofield to KBPB was the fee payable by the former to the latter.

3. The letter of advice from PricewaterhouseCoopers to Mr Schofield dated 13th February 2003 explained:

"1. The first possibility is that the index does not move sufficiently for any Option to be exercisable, in which case both cash Options are closed out on 4 April and you will have lost £11.8 x 2 = £23.6 million. This amount will be a capital loss available to set against your current gain leaving £11.8 million to be set against future gains. The exempt options are both closed out at the same time giving rise to a non-taxable gain of £23.6 million.

2. The second possibility is that the FTSE index falls below 94.2 per cent. The put options become valuable and exercisable, but the call options are not exercisable. You will close out the call option showing the loss on 4 April i.e. in this tax year, thus generating a loss of £11.8 million for tax purposes. You will close out at the same time the equal and opposite call over the gilts which will give rise to a non taxable gain of the same amount. On 7 April, which is in the new tax year the other two put options expire. These give rise to a taxable gain and non-allowable loss. However, as you will be non-resident and outside the scope of United Kingdom tax in that year, there will be no charge to capital gains tax.

3. The third possibility is that the index moves above 103.5 per cent and the call options become valuable and exercisable. In this case the same process is followed in that the put options which are not exercisable are closed out on 4 April giving an allowable loss and a non taxable gain for the current year. The valuable call options are deferred until the new tax year when they expire giving a taxable gain and a non allowable loss. However, as you will be non resident no tax will be payable in this situation it is likely that you will realise a commercial profit of about €50,000."

> 4. Mr Schofield left for Spain on 29th March 2003. He stayed there for the five or so years needed to establish non residence. In the event the FTSE 100 Index went up. On 4th April 2003, when it stood at 3814.30, Options 1 and 3 were closed out giving rise to a loss on Option 1 of £11,305,017 and a gain on Option 3 of £11,416,239. As indicated in the advice letter, the loss, if allowable, was available to be set off against the gain which had already accrued to Mr Schofield on the redemption of the loan notes issued to him as consideration for the sale of his shares in P.L.Schofield Ltd. At this stage the closure payments passing between the parties resulted in a balance in favour of Mr Schofield of £4,995.
>
> 5. On 7th April 2003 Option 2 was exercised by Mr Schofield and Option 4 by KBPB. FTSE 100 Index then stood at 3935.8. The results were:
>
> > (a) in respect of Option 2 KBPB paid Mr Schofield £19,487,605 yielding a profit to him over cost of £7,354,759;
> >
> > (b) in respect of Option 4 the £333m nominal 8.5% Treasury Stock 2007 Mr Schofield was obliged to deliver to KBPB was acquired by him from another company in the same group resulting in a loss to him of £7,522,570.
>
> Mr Schofield was, accordingly, entitled to receive from KBPB £49,962. The gain was not chargeable if, as assumed, Mr Schofield was not resident in the UK for tax purposes in the year 2003/04.

42. The First-tier Tribunal had found that the "transactions followed a pre-ordained path which involved the Appellant becoming non-resident and implementing the necessary steps required by whichever of the three known scenarios existed on 4 April 2003. All three scenarios guaranteed a loss of at least around £12 million which the Appellant would claim by deducting it from his chargeable gain. There was no prospect of a party departing from the pre-ordained path. The sole aim of the transactions was to avoid tax. The transactions were bereft of a commercial purpose. The implementation of the scheme achieved the desired result." It concluded there had not been an allowable loss and dismissed the appeal and its decision was upheld by the Upper Tribunal.

43. The argument for the taxpayer in *Schofield* has similarities with that in this case, as the Chancellor said:

> "21. The basic argument of counsel for Mr Schofield is to the effect that both the First Tier and Upper Tribunal were wrong in failing to recognise that each option was a separate transaction giving rise to four separate assets. Options 1 and 2 were assets of Mr Schofield. Options 3 and 4 were assets of KBPB but liabilities of Mr Schofield. He pointed out that undertaking a liability does not involve the debtor in the acquisition (or disposal) of an asset, but the grant of each of Options 1 and 2 did. He submitted that Options 1 and 2 were assets within the clear words of s.21 as well as s.144 and each of them was clearly disposed of on 4th and 7th April respectively.

> 22. How, he asked forensically, can these undoubted facts be ignored or merged into a nullity or void? He illustrated the absurdity, as he contended, of the position of HMRC and both Tribunals by analogy with equivalent transactions conducted in a betting shop. If he bet on two horses in a race there were undoubtedly two bets either might win or both might lose. If one of them won the winnings were real even if the profit was reduced by the bet on the horse that lost. So, he submitted, in the case of these options; each was a separate transaction and must be regarded as such when applying the provisions of TCGA. Only Options 1 and 2 involved any asset of Mr Schofield; the disposal of Option 1 realised a loss but the disposal of Option 2 generated a gain. The only difference was that the loss on the disposal of Option 1 was an allowable loss but the gain on Option 2 was not chargeable because it occurred in a year of assessment when Mr Schofield was not resident in the United Kingdom."

44. After considering three of the authorities relied on by counsel for Mr Schofield (*Aberdeen Construction Group Ltd.* v. *IRC* [1978] AC 885, *Whittles v Uniholdings* (1996) 68 TC 528 and *Garner v Pounds Ltd* [2000] 1 WLR 1107) the Chancellor continued, at [39]:

> "Where the *Ramsay* principle does apply the conclusion may be expressed in a number of different ways; for the purposes of ss.1 and 2 TCGA no asset, no disposal, no loss or all three. Counsel for HMRC contended that the relevant transaction was the four options together and such a transaction does not constitute a disposal to which ss.1 and 2 TCGA apply. This accords with the conclusion of Lord Fraser in Ramsay itself, see p.339G, and I am content to accept it."

45. However, s 116 TCGA is not a deeming provision and, as Mr Firth reminds me, *Ramsay* is a general principle not just restricted to tax avoidance. This was recognised by the Upper Tribunal (Newey J and Judge Hellier) in *HMRC v Blackwell* [2015] UKUT 418 (TCC) when it said, at [55]:

> "We accept that the Ramsay principle is one of universal application, not restricted to tax avoidance."

I consider HMRC's argument (that if viewed realistically, the conversion of the Loan Notes was brought about solely by the deed of variation when it became certain that the conversion would happen) could create real practical difficulties. For example, if a deed of variation provided for a conversion in 12 months time it would follow that the NQCBs must be valued at the time of the deed of variation with the result that any gain (or loss) between the date of the deed and conversion would be left out of account.

46. In the circumstances, I find that the Loan Notes should be valued as at the date of the Relevant Event, 27 February 2004.

Application of the Ramsay principle to an artificially depressed market value

47. The arguments in relation to the application of the *Ramsay* principle to an artificially depressed market value were carefully considered by the Tribunal in *Blumenthal*. It recognised in that case (as indeed is true of the present case) that:

> "104. It was an essential feature of the tax planning in this appeal that the value of the Appellant's Loan Notes was depressed immediately before the conversion of the Loan Notes from NQCBs to QCBs. On his 2003-2004 tax return the Appellant stated the value of his Loan Notes on conversion was £9,866, yet a month later these Loan Notes were redeemed for a total amount of £328,860."

Before continuing:

> "108. The *Ramsay* principle requires us to construe the relevant statutory provisions – sections 116(10) and 272 TCGA – purposively and to take an un-blinkered view of the facts. We must interpret those provisions in order to determine whether the transactions in this case, viewed realistically, fall within the statutory provisions so interpreted.
>
> 109. Purposive interpretation plainly requires that a provision should be interpreted in its statutory context. There are over 200 references to market value in TCGA. It would be wearisome to go through every example but, for example, transactions between connected parties (section 18), bargains otherwise than at arm's length (section 17), deemed disposal by non-residents (section 25), value shifting (section 29), persons becoming entitled absolutely to settled property (section 71) all involve disposals or deemed disposals at market value. It is evident that in most of these cases Parliament intended that the requirement that a disposal be treated as occurring at market value should capture the true economic value of the asset, resulting in chargeable gains or allowable losses being assessed on the value. This is particularly so where because of some relationship (e.g. between connected persons) or circumstances surrounding a transaction (e.g. bargains otherwise than at arm's length) the value at which the transaction takes place is capable of manipulation. It is against this statutory background that we now turn to the two provisions in question.
>
> 110. The purpose of section 116(10) TCGA is plainly to preserve (and "freeze") the real gain inherent in the securities which are being converted into QCBs. The gain is to be calculated according to the market value of the securities immediately prior to their conversion and that gain is realised on the ultimate redemption or other disposal of the QCBs. In our view, sections 116(10) and 272 TCGA seek to calculate real economic gains and losses: the reference to market value in both provisions is an attempt to calculate the real worth of the securities in question so that the gain or loss on the eventual disposal of the securities reflects their true worth at the time of conversion. This is, in our view, what Lord Cooke in *IRC v McGuckian* [1997] STC 908 at 921 described as "the discernible intent of the taxing Act" or (at 920) "the purpose and spirit of the legislation."

111. In this case, the Appellant sought artificially to depress the value of his Loan Notes to £9,866 for a limited period of time – a month later the Appellant received £328,860 on redemption of those Loan Notes.

112. Construing sections 116(10) and 272 TCGA purposively, the references in those provisions to "market value" and the "price which those assets might reasonably be expected to fetch on the sale in the open market" do not refer to a value or price which has been artificially manipulated, solely for tax purposes, in a wholly un-commercial fashion to produce a temporarily depressed value. There was no commercial or economic reason why the value of the Loan Notes should have been reduced to £9,866. The value thus manipulated is not the value or the price which the relevant statutory provisions, construed purposively, envisage.

113. There seems to us no good reason why the *Ramsay* principle should not apply to a valuation process mandated by statute. We were not convinced by Mr Way's reliance on the dichotomy between legal and commercial concepts referred to by Lord Hoffmann in *MacNiven v Westmoreland Investments Limited*. Lord Nicholls in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 (at paragraph 38) said:

> “MacNiven shows the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute. In the speech of Lord Hoffmann in *MacNiven* it was said that if a statute laid down requirements by reference to some commercial concept such as gain or loss, it would usually follow that elements inserted into a composite transaction without any commercial purpose could be disregarded, whereas if the requirements of the statute were purely by reference to its legal nature (in *MacNiven*, the discharge of a debt) then an act having that legal effect would suffice, whatever its commercial purpose may have been. This is not an unreasonable generalisation, indeed perhaps something of a truism, but we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts *a priori* as either 'commercial' or 'legal'. That would be the very negation of purposive construction: see Ribeiro PJ in *Arrowtown* at paras 37 and 39 and the perceptive judgment of the Special Commissioners (Theodore Wallace and Julian Ghosh) in *Campbell v IRC* [2004] STC (SCD) 396.

114. In any event, the concept of market value or the price which an asset would fetch on the sale in the open market seems to us to be commercial rather than legal concepts. As such, they seem ideally

suited to the purposive approach to statutory construction embodied in the *Ramsay* principle.

115. For these reasons, we do not consider the Deeds of Variation and the Deeds of Covenant were successful in reducing the market value of the Loan Notes for the purposes of sections 116(10) and 272 TCGA."

48. Section 116(10) TCGA to which the Tribunal referred is set out at paragraph 36, above. Section 272 TCGA, which defines "market value" for the purposes of the TCGA, insofar as material to the present case, provides:

> (1) In this Act "market value" in relation to any assets means the price which those assets might reasonably be expected to fetch on a sale in the open market.
>
> (2) In estimating the market value of any assets no reduction shall be made in the estimate on account of the estimate being made on the assumption that the whole of the assets is to be placed on the market at one and the same time.
>
> …

49. Mr Yates argues that the reasoning of the Tribunal in *Blumenthal* was not only correct but corresponds with that of the Court of Appeal in *Astall & Edwards v HMRC* [2009] STC 137 the facts of which were out by Arden LJ, at [4]:

> "Mr Astall and Mr Edwards set up trusts to which they lent money in return for a security. Mr Edwards endowed his trust with the sum of £7,000 and subscribed the sum of £5,278,276 in consideration of the issue to him of £6,228,366 zero coupon loan note notes. Mr Astall endowed his trust with the sum of £2,700 and the trustees issued to him £2,489,851 zero coupon loan notes for £2,117,428. Under the terms of issue, there were two occasions when the securities could potentially be redeemed for a deep gain for the purposes of paragraph 3(3) of schedule 13 (set out in para. 11 of this judgment). Those occasions were (1) on notice given within two months of the date of issue for a premium of 100.1/118 of the principal amount of the notes (condition 3.2/3), amounting in Mr Edward's case to £5,278 and in Mr Astall's case to £2,638; and (2) on the final redemption date (condition 3.1). This was normally fifteen years after the date of issue. However, the terms of issue also provided that the holder could, subject to a further condition ("the market change condition"), transfer the security to a third party (condition 3.9). The third party either could redeem the security at approximately 5% of the issue price (or its then market value) or redeem the securities after 65 years (which then became the final redemption date)."

In a conclusion, with which Keene and Sullivan LJJ concurred, she said:

> "61. … It follows from the purposive interpretation accepted above that there has to be a provision which might give rise to a gain capable of being subjected to income tax. In my judgment, it is outside the statutory purpose and thus outside the statutory definition of "deep gain" purposively construed if the term relied on does not on the facts

> entail any real gain to the holder and has been inserted merely to obtain a tax advantage.
>
> 62. Moreover, the court is entitled, as in *Carreras*, to have regard to the full sequence of the transaction. Vital elements of it were not at arm's length. Accordingly the court can take into account the fact that the appellants are no better off under the transaction if the right of early redemption is exercised. They therefore made no overall gain. What the holder of the security no doubt wished to achieve was a means of unwinding the transaction if the transfer was not to proceed. That was a substantial reason but it could not provide a reason for the premium."

50. HMRC relied on *Astall* in *Mayes v HMRC* [2011] STC 1269, which concerned a tax avoidance scheme involving the second-hand insurance policies ("SHIPS 2"). In that case Mummery LJ said:

> "18. The relevant transactions may, for forensic purposes, be rudely labelled as "schemes" or "devices" or "dodges", or be analysed less crudely as "circular" or "self-cancelling" or "pre-ordained" or "artificial", or be paraded in the more presentable garb of legitimate "tax efficient arrangements." However the transactions are labelled, analysed or presented, the question that the court has to decide in the contest between the state and the citizen is mainly mundane: do the tax-shy transactions actually succeed in reducing the size of the tax bill under appeal?
>
> 19. The answer to that question depends entirely on the language of the legislation, properly construed according to its purpose and context, and its application to the transactions, properly analysed according to their terms and context. Ribeiro PJ neatly extracted the essence of the legal techniques in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 66 at [35]:
>
> > "…the ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."
>
> If the taxpayer succeeds and HMRC and Parliament do not like the result, the law can be re-adjusted for the future in a Finance Act preceded by public debate and passed by democratic legislative processes. Even if the courts do not like the result, they have no means at their disposal to amend a law enacted by Parliament. Their sole function is to decide the case on their best understanding of the relevant transactions and the applicable law, whatever that may be. Whether or not the courts approve of the outcome is beside the point. It is not for judges to shoulder the law-making responsibilities of Parliament."

51. Having referred to the "instinctive reaction" that such an obvious scheme should not succeed to which Proudman J had sympathised, Mummery LJ continued:

> "68. The reaction to SHIPS 2 noted by Proudman J was instinctive and initial. Instinct informed by experience plays a role in decision-making, but does not relieve the court of the duty to reach a decision that is based on a proper understanding of the meaning of the legislation and

> of the facts that make up the transaction. Instinct has to be checked by the processes of construing the scope of the ICTA provisions and analysing SHIPS 2."

He continued:

> "74. First, *Ramsay* did not lay down a special doctrine of revenue law striking down tax avoidance schemes on the ground that they are artificial composite transactions and that parts of them can be disregarded for fiscal purposes because they are self-cancelling and were inserted solely for tax avoidance purposes and for no commercial purpose. The *Ramsay principle* is the general principle of purposive and contextual construction of all legislation. ICTA is no exception and is not immune from it. That principle has displaced the more literal, blinkered and formalistic approach to revenue statutes often applied before *Ramsay*.
>
> 75. The essence of the principle applicable to this case is that the ICTA provisions on the taxation of life insurance policies are to be given a purposive construction in order to determine the nature of the transaction to which they were intended to apply. The court then has to decide whether the actual transactions (in this case Step 3 and Step 4) answer to the statutory description, having taken account of their overall effect as elements of SHIPS 2 that were intended to operate together. To put it another way along the lines stated in *Mawson* (paragraph 32): analyse the facts of SHIPS 2, in particular Step 3 and Step 4, and then ask whether the requirements of ICTA are satisfied for the creation of corresponding deficiency relief.
>
> 76. Secondly, HMRC are not, in my view, in fact submitting that there is a special doctrine. They were told in *Mawson* that revenue jurisprudence was not "governed by special rules of its own." (paragraph 34). *Mawson* made it clear that under the *Ramsay principle* there were two stages in the application of the statutory provisions-a purposive construction of the statute to see, on a "close analysis", what transaction will answer to the statutory provision and a realistic analysis of the transaction to see whether it answers to that description-and that it was wrong to elide the two stages by "sweeping generalisations" about disregarding for fiscal purposes elements that were only inserted for fiscal avoidance reasons and had no commercial purpose. As I understand the HMRC case, it is that, on the application of the *Ramsay principle*, as a principle of statutory construction, Step 3 and Step 4 of SHIPS 2 do not fall within ICTA provisions relied on for the creation of corresponding deficiency relief.
>
> 77. Thirdly, on the proper construction of the ICTA provisions for the taxation of life policies, the statutory requirements as to the transactions to which the provisions were intended to apply were far removed from the kind of case in which the focus is simply on an end result, such as a loss. In this case the all- important corresponding deficiency relief available under s. 549 was the product of real premiums paid at an earlier stage for real life policies and real surrenders made at an earlier stage. Although the corresponding deficiency was created solely to save tax, that alone does not entitle the

court to disregard the fiscal consequences of payment of premium and the partial surrender which led to its creation.

> 78. Fourthly, it would be an error, which the judge did not fall into, to disregard the payment of a premium at Step 3 and the partial surrender at Step 4 simply because they were self-cancelling steps inserted for tax advantage purposes. It was right to look at the overall effect of the composite Step 3 and Step 4 in the seven step transaction in the terms of ICTA to determine whether it answered to the legislative description of the transaction or fitted the requirements of the legislation for corresponding deficiency relief. So viewed, Step 3 and Step 4 answer the description of premium and partial surrender. On the true construction of the ICTA provisions, which do not readily lend themselves to a purposive commercial construction, Step 3 was in its legal nature a premium paid to secure benefits under the Bonds and Step 4 was in its nature a withdrawal of funds in the form of a partial surrender within the meaning of those provisions. They were genuine legal events with real legal effects. The court cannot, as a matter of construction, deprive those events of their fiscal effects under ICTA because they were self-cancelling events that were commercially unreal and were inserted for a tax avoidance purpose in the pre-ordained programme that constitutes SHIPS 2. It follows that a corresponding deficiency relief is available to Mr Mayes."

52. Although Mr Firth accepts that facts should be realistically considered and legislation purposively applied he contends that it is the Tribunal's duty to apply the legislation to the facts and not decide what is fair and just or to strike down tax avoidance unless specifically instructed to do so by statute. He submits that the Tribunal in *Blumenthal* failed in this regard and points to the absence of any statutory authority or general rule to enable Courts or Tribunals to disregard things that are done or inserted for tax reasons or to substitute any other value if market value is to be disregarded because it has been artificially manipulated.

53. Mr Firth further submits that the definition of market value in s 272 TCGA includes a value that has been artificially manipulated for tax avoidance purposes and cites the employment-related securities code ("ERS Code") in support of his argument, in particular ss 421 and 446A(1) of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA").

54. Section 421 ITEPA provides:

> In this Chapter and Chapters 2 to 5 "market value" has the same meaning as it has for the purposes of TCGA 1992 by virtue of Part 8 of that Act.

Therefore, says Mr Firth, the definition of "market value" in s 421 ITEPA for the purposes of the ERS code is the same as that for s 116(10) TCGA.

Section 446A(1) ITEPA provides:

> This Chapter applies in certain cases where the market value of employment-related securities…is reduced by things done otherwise than for general commercial purposes."

The use of the words "done otherwise than for general commercial purposes" envisages a market value that has been artificially reduced or manipulated for tax reasons (see s 446A(2)(a) ITEPA)

55. However, Mr Yates submits that reliance on the ERS code is "misconceived" arguing that just because Parliament in the ERS code has given specific provision for securities with an artificially depressed value it does not follow that the *Ramsay* principle cannot apply to the definition of "market value" in the TCGA, which predates ITEPA.

56. While *The Cape Brandy Syndicate v The Commissioners of Inland Revenue* (1921) 12 TC 358 is authority for using subsequent legislation as an aid to interpreting earlier statutes dealing with the same subject matter I do not consider the ERS code to be of assistance in the construction of s 272 TCGA. Although similar the subject matter of the provisions is not identical, as they were in *Cape Brandy* and therefore, in relation to using subsequent legislation as aid to interpreting earlier statutory provisions, I prefer the more recent comments of Lawrence Collins LJ in *Harding* where he said, at [58]:

> "For completeness I should mention (although the point was not pressed on the appeal) that I agree with the judge that the 1997 amendments do not assist in the construction of the legislation as it was in 1995. Even if the amendments were enacted on a precautionary basis, it does not follow that they were introduced because a construction along the lines propounded on behalf of Mr Harding was considered to be correct, still less that the amendments would affect the true construction of the legislation in its form before the amendments."

Clearly the ERS code was not introduced because the construction of s 272 TCGA as advanced by Mr Firth was considered to be correct.

57. That said, I accept Mr Firth's argument that there is not any general rule that enables Courts or Tribunals to disregard things that are done or inserted for tax reasons or statutory provision which enables another value to be substituted. However, the Tribunal in *Blumenthal* did not substitute another value but, after full consideration of the *Ramsay* principle and applying a purposive construction to the relevant legislation (ss 116(10) and 272 TCGA) found that it did not refer to an artificially reduced value and in the circumstances merely applied the par value of the Loan Notes.

58. As in *Blumenthal* there was no commercial or economic reason why the value of the Loan Notes should have been artificially manipulated and reduced to £44,724 in the present case. Therefore, despite Mr Firth's efforts to convince me otherwise, I do not agree that the Tribunal came to the wrong conclusion in *Blumenthal*. For the reasons given by the Tribunal in that case I find that by applying the *Ramsay*

purposive approach to the legislation the deed of variation did not in reduce the market value of the Loan Notes for the purposes of ss 116(10) and 272 TCGA.

Effect of drafting error

59. It was not disputed that there was a drafting error in Clause 4.8 of the Loan Notes, which had been inserted by the deed of variation. It provides:

> The provisions of this clause 4.8 shall apply during the Second Relevant Period and not otherwise.

By use of the words "not otherwise" it can only apply during the Second Relevant Period. Accordingly, because the Loan Notes would not be redeemed in the Second Relevant Period, O2 would never be able redeem the Loan Notes at 3% as Clause 4.8.3 (which permits redemption at 3%) would, by virtue of Clause 4.8, cease to apply once the Second Relevant Period had ended and the artificial depression in value could not happen.

60. The same drafting error was considered by the Tribunal in *Blumenthal* and the appellants arguments primarily, based on the construction of the documents in the light of *Investors Compensation Scheme v West Bromwich Building Society and others* [1998] 1 WLR 896 and *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900, were rejected. However, in this case both Mr Firth and Mr Yates have adopted the approach endorsed by the Court of Appeal in *Law Debenture Trust Corporation Plc v Elektrim SA* [2010] EWCA Civ 1142 which considered the interaction between questions of law and questions of valuation.

61. Arden LJ (giving the judgment of the Court) said:

> "44. He [Sales J] accepted that he had to assess what conclusion a third party would be likely to reach in relation to the valuation of the PTC shares but said that it was very little different from deciding the consequences of a negligent solicitor failing to issue proceedings before a limitation period expired or allowing a client's action to be struck out. He said (para 173):-
>
>> "In this type of case, the court hearing the negligence claim usually makes a single broad assessment of the value of the opportunity which has been lost, assessing the legal merits for itself and allowing an appropriate discount to take account of contingencies which might have affected the claimants' prospects of winning at trial. The court does not usually try to assess a range of different possible judgments on the legal merits which might have been given by the notional trial court, and then produce a table of probabilities in respect of the possibilities in that range and aggregate the resulting values. Rather, the court draws on its own legal knowledge and expertise to produce the best assessment it can of the legal merits, with a discount primarily to take account of contingencies and

> uncertainties in relation to the evidence which might have been called in the case."
>
> He further decided following the decision of Neuberger J (as he then was) in *Harrison v Bloom Camillin* [2001] PNLR 195 para 101 that where a point or points of law were in issue the court should be ready to determine whether a claimant would have succeeded or failed on it. Since the points in the present case were primarily points of law the judge proceeded to decide them and he decided that approach (iii) was correct and that no discount from that was necessary.
>
> We endorse the judge's approach. …"

62. More recent confirmation of the approach can be seen in the decision of HHJ Keyser (sitting as a High Court Judge) in *Altus Group (UK) Ltd v Baker Tilly Tax and Advisory Services LLP* [2015] EWHC 12 (Ch) where he said, at [62]:

> "The fact that the efficacy of the claimant's hypothetical conduct in achieving a benefit or avoiding a risk would have turned on a point of law does not by itself make the "loss of a chance" approach inappropriate, although in a suitable case the appropriate course might be to resolve the point of law. This appears from Neuberger J's discussion in *Harrison v Bloom Camillin* at 230-1, which may conveniently be set out at length:
>
> > "… I should like to discuss how the court should deal with a pure question of law which might have arisen in the action. For instance, in a case such as the present, assuming that the claimants establish that, on the balance of probabilities, they would have maintained the action against Touche Ross, and that there was a real chance of recovering substantial damages from Touche Ross in the action, the question whether a certain head of damage would have been recoverable from Touche Ross may well turn on whether, as a matter of law (if all the relevant facts are clear) a certain head of damage would have been recoverable. Should the court assessing the damages for the loss of the chance resolve that issue of law or, provided that it is satisfied that there is a real argument both ways on the issue, should the court award something for loss of this particular head of damage, but, because there was a prospect of the head of damage failing in law, should a further discount be applied to that head of damage?
> >
> > In my judgment, the proper approach to the court to an issue of law which would have arisen in the action, which the claimant has been deprived of the opportunity to bring, is the same as in relation to an issue of fact or opinion which the claimant would have established in the action. However, at least in general, the court should in my judgment be far more ready to determine that the

> claimant would have failed or succeeded on a point of law than to determine that the claimant would have failed or succeeded on a point of fact or, even, opinion. That conclusion appears to me fair and practical, as well as consistent with the approach of the Court of Appeal in the three cases to which I have referred (albeit that they are not, as I have mentioned, determinative of this issue).
>
> …
>
> Because the issue did not arise, there is little assistance on this point in any of the cases to which I have referred. It is true that in *Mount*, the claim failed because the court formed the view that the claimant would have failed in his action as a matter of law, but, as I read the judgments, the court would have reached that conclusion on either approach (bearing in mind that, even if the court was considering the issue on the 'loss of a chance' basis, it was of the view that the claimant's prospects of success were so poor that, in the event, he did not lose anything of value).
>
> However, it is, I think, arguably implicit in the third and fourth numbered principles in the judgment of Simon Brown LJ in *Mount* that, at least in an appropriate case, it is right to assess damages on the 'loss of a chance' basis even where the issue in the action would be one of law. …"

This suggests that the correct approach will generally be to assess the chance of the scheme succeeding or failing upon a challenge, although there may be cases where it is appropriate to determine the legal point."

63. Therefore, rather than consider, as the Tribunal did in *Blumenthal*, whether the flaw can be fixed by contractual interpretation the relevant issue is whether the drafting error would have had an effect on the price that a purchaser in the open market would be prepared to pay for the Loan Notes at the time in question namely 27 February 2004 assuming that such a purchaser would have all the information which a prudent prospective purchaser of the Loan Notes might reasonably require were he buying them from a willing vendor by private treaty at arm's length.

64. Mr Firth contends that the legal advice that such a hypothetical purchaser would have received was that, either by contractual interpretation or rectification, O2 would have been able to be able to redeem the Loan Notes at 3% and would not have paid any more than that. However, Mr Yates contends that, given the plain and unambiguous words used in the Loan Notes, no such advice would have given.

65. It is therefore necessary, as is apparent from *Law Debenture Trust v Elektrim* and *Altus v Baker Tilly*, to apply my "legal knowledge and expertise to produce the best assessment" of the advice that a hypothetical prudent purchaser of the Loan Notes would have received in February 2004. Clearly there is an error in the drafting of the Loan Notes as amended by the deed of variation and as a result O2 could not

redeem the Loan Notes at 3%. The issue is whether as a result of construction of the documents or rectification a hypothetical purchase of the Loan Notes would have paid more for the Loan Notes.

66. Taking construction first; the principles by which contractual documents should be interpreted were considered by Lord Hoffman in *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 at 912-913 in which he made his "general remarks about the principles by which contractual documents are nowadays construed" and adumbrated his five principles of construction.

67. These were considered by the Court of Appeal in *JIS (1974) Ltd v MCP Investment Nominees 1 Ltd* [2003] EWCA Civ 721, which would clearly have been available as a recent authority when advising a hypothetical purchase in February 2004. It concerned the interpretation of a lease with the following terms:

> In the rent review Schedule paragraph 2 was in the following terms:
>
> "For the purposes of this Schedule only, the expression 'the demised premises' excludes the Units."
>
> Clause 5 of the lease contained an option for the tenant to determine the lease. This is at the heart of the present dispute:
>
> "Option to tenant to determine at sixteenth year
>
> 5 (a) The tenant may at any time within the twenty-eight day period (in respect of which time shall be of the essence) commencing on the date of determination of the yearly rent payable for the demised premises for the rent period commencing at the end of the fifteenth year of the term hereby created serve notice upon the Landlords in writing specifying a date not later than six months after the date of service of the notice upon which the Tenant will give vacant possession of the demised premises to the Landlords whereupon the succeeding provisions of this clause will take effect.
>
> (b) Upon the date specified in such notice as aforesaid the Tenant shall pay to the Landlords an amount equal to one year's yearly rent (determined as aforesaid) and shall surrender the demised premises and yield the same up to the Landlords in accordance with the provisions of Clause 2 (6) of this Lease ..... "

68. Carnwath LJ (as he then was) giving the judgment of the Court of Appeal set out the above clauses and continued:

> "9. The judge [Hart J] summarised the issue between the parties:
>
> > "As we have already seen, the definition of the demised premises in the lease expressly includes the shop units, save for the purposes of the rent review provisions. Given the subsistence of the underlease, this presents an apparently insuperable problem for the tenant. The vacant possession condition in the option cannot be satisfied unless the tenant can first determine the underlease and

obtain vacant possession of the shop units with a view to delivering those up to the landlord.

The contention of the claimant is that, although this is the literal meaning of the words used, this cannot have been intended by the parties. What the parties meant to say was that the vacant possession condition applied only to the office parts of the building, or that it applied to the demised premises with the exception of the shop units. Accordingly, for the purposes of clause 5, the expression 'the demised premises' should be read as excluding the shop units .....

The defendants' answer to that point, put shortly, was that, since the parties had clearly spelled out their meaning by the use of a defined term, there could be no doubt what they intended by it. 'The demised premises' clearly and unequivocally included the shop units, and that was an end of the matter on the question of construction."

…

11. Here the language of the contract is all too clear. "Demised premises", for the purposes of the break clause, are defined as including the shop units. To put it beyond doubt, the schedule says that they are excluded *only* for the purpose of the rent review. That is what the language says, and no amount of background evidence will change that stark fact. For the same reason, there is no room for implying terms, since it is a basic rule that an implied term must not contradict any express term of the contract.

12. The only tenable argument for the claimants is based on the court's power to correct an obvious error. Mr Brock [counsel for the appellant] says that it is obvious that the parties made a mistake in relation to the break clause. It can be corrected simply in the definition of "demised premises", to which I have referred. There is already a parenthesis excluding the shop units in relation to the rent review provisions; this exclusion, he says, should also apply to the break clause.

13 No doubt the court has power in certain circumstances to correct obvious errors as part of the exercise of construction rather than rectification. That was recently affirmed by the House of Lords in *Homburg Houtimport BV and Others v Agrosin Private Ltd and Another* [2003] 2 WLR 711, [2003] UKHL 13, where Lord Bingham said at paragraph 23:

"I take it to be clear in principle that the court should not interpolate words into a written instrument, of whatever nature, unless it is clear both that words have been omitted and what those omitted words were ..... "

Lord Millett put it a little more broadly. He said at paragraph 192:

"The clause does not make grammatical sense as it stands, and it is obvious that words have been omitted. The court must, therefore, supply the omission by implying at least the minimum necessary for the clause to make

> grammatical sense. This is what all the judges below did. But the authorities show that in a proper case the court will go further. Where it can see, not only that words have been omitted, but what those words are, then it is its duty to supply them. It is not necessary that the court should be certain precisely what words have been omitted; it is sufficient that it knows their gist. The process is one of construction, not rectification ..... "

14. The high point of Mr Brock's argument on this point is by analogy with the decision of this court in *Holding & Barnes Plc v Hill House Hammond Ltd (No 1)* [2002] L & TR 7, 103. It is necessary to see what was said in that case in the context of the facts. It related to the sale of an insurance business under which there were to be granted seven leases, two of which related to complete buildings and five to parts of buildings. All seven leases contained landlord's repairing covenants. One of the leases of a complete building ("The Ilford lease") contained a covenant in the following form:

> "to keep the structure and exterior of the property in good and tenantable repair and condition."

The other lease of a whole building had a different form of covenant:

> "4.3 ..... to keep the structure and the exterior of the building (other than those parts comprised in the property) in good and tenantable condition."

The problem was that the lease defined "the property" as the whole building, with the result that, read literally, the clause meant there was an obligation to keep in repair the exterior of the property, other than the property. Not surprisingly, the court held that was an obvious nonsense and it was corrected. Lord Justice Peter Gibson said at paragraph 50:

> "The problem which arises is a good illustration of the dangers of the use of the word processor to produce a draft which is then copied to provide other drafts to be adapted for the purpose of other cases."

He went on to say that looking at the leases together it could be seen that there was an obvious error and -

> "What the parties plainly intended was a repairing covenant in the same form as that of the Ilford lease ..... "

Clearly what had happened was that the draftsman of the particular lease had taken by mistake a covenant from one of the leases of a part building. Sir Martin Nourse referred to this as "an obvious clerical error" which the court could correct.

15. Mr Brock relies on the statements in the leading judgment of Lord Justice Clarke with which Lord Justice Peter Gibson also agreed. Lord Justice Clarke referred to the recent cases on interpretation of contracts, including *BCCI v Ali* (above) and the statement of principles by Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912-913. Those

cases emphasise the importance of looking at contracts against the background as known to the parties. Lord Justice Clarke then referred to the cases on rectification, in particular, the judgment of Lord Justice Brightman in *East v Pantiles Plant Hire Ltd* [1982] 2 EGLR 111 at 112 where he said:

> "It is clear on the authorities that a mistake in a written instrument can, in certain limited circumstances, be corrected as a matter of construction without obtaining a decree in an action for rectification. Two conditions must be satisfied: first, there must be a clear mistake on the face of the instrument; secondly, it must be clear what correction ought to be made in order to cure the mistake. If those conditions are satisfied, then the correction is made as a matter of construction. If they are not satisfied then either the claimant must pursue an action for rectification or he must leave it to a court of construction to reach what answer it can on the basis that the uncorrected wording represents the manner in which the parties decided to express their intention."

Lord Justice Clarke concluded:

> "Those principles must, of course, now be read in the light of the principles of construction set out in cases like the ICS case. However, Mr Cherryman correctly accepts that where it is obvious to a reasonable man with the relevant knowledge that there has been a mistake, it is appropriate to correct that mistake by a process of construction."

16. Following that guidance, the judge in the present case said:

> "Accordingly, I proceed on the basis that, if it can be shown on the language of the document, construed in the light of the relevant background, that there has been a clear mistake, and that it is clear what correction has to be made to cure the mistake, then it is permissible to construe the document as if it contained that correction."

17. As I said, it is important to see the judgments in *Holding & Barnes* in the factual context. The clause as it stood was an obvious nonsense on its face. Whether one describes that as a clerical error, whatever precisely that means, or, perhaps its more modern equivalent, a word processing error, it was clearly a nonsense and it was also clear what the alternative should be. Although Lord Justice Clarke referred to the need to take into account the background knowledge of the parties, the background knowledge to which he was referring was in fact very limited. It simply involved a comparison with the other leases, and the knowledge that they were all entered into at the same time as part of the same transaction. By comparison with the other lease, it was quite clear what was intended.

18. In my view that does not help Mr Brock in this case. The break clause is not obvious nonsense on its face. The complaint is that, when one analyses the lease and the underlease in more detail, one can see that the clause is practically inoperable. The tenant can only give

> vacant possession of the shop units to the landlord if either it can first buy the underlease back from the landlord/underlessee, or if it comes to an end for some other reason. Neither, it is said, would have been a possibility which was in the contemplation of the parties. The former would imply that the landlord could, in effect, prevent the exercise of the option by refusing to sell. The latter was very unlikely because of the intrinsic value of the underlease, and contrary to the intention of the parties who contemplated the underlease extending effectively for the same period as the lease.
>
> 19. This argument is powerful and certainly relevant to rectification. However, in my view the problem is quite different from the obvious nonsense which was corrected in *Holding & Barnes*. The task of interpretation does not allow the court to rewrite the contract."

69. In the present case the words used are plain and unambiguous. However, Mr Firth says that the two conditions of Brightman LJ in *East v Pantiles Plant Hire* to which Carnwath LJ referred in *JIS* are met. The "clear mistake" is the use of the words "and not otherwise" in Clause 4.8 of the Loan Notes and the deletion of those words would cure that mistake and therefore the correction can be made as a matter of construction.

70. However, the background to Clause 4.8 is that the deed of variation which inserted it into the Loan Notes was drafted by leading tax counsel to provide a finite period in which the Loan Notes could be redeemed at 3%, it required the written consent of all Loan Note holders (see paragraph 11, above) to whom the same terms applied before it was brought into effect. There is no obvious nonsense on its face and in such circumstances, as Carnwath LJ recognised, that although the court has power to correct obvious errors as part of the exercise of construction, the task of interpretation does not allow the contract to be rewritten which is what Mr Firth seeks to do in relation to the Loan Notes.

71. I therefore find that a hypothetical purchaser of the Loan Notes would have been advised in 2004 that he could not rely on an argument based on their construction.

72. Turning to rectification; this was also considered by the Court of Appeal in *JIS*. As Carnwath LJ said, at [25]:

> The principles for rectification are not in dispute. They are conveniently summarised by Lord Justice Peter Gibson in *Swainland Builders Ltd v Freehold Properties Ltd* [2002] 2 EGLR 71, [2002] EWCA.Civ 560 at paragraphs 33 to 34. He said:
>
> > "The party seeking rectification must show that:
> >
> > (1) the parties had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the instrument to be rectified;
> >
> > (2) there was an outward expression of accord;

> (3) the intention continued at the time of the execution of the instrument sought to be rectified;
>
> (4) by mistake, the instrument did not reflect that common intention.
>
> I would add the following points derived from the authorities:
>
> (1) the standard of proof required if the court is to order rectification is the ordinary standard of the balance of probabilities:
>
> .....
>
> (2) While it must be shown what was the common intention, the exact form of words in which the common intention is to be expressed is immaterial if, in substance and in detail, the common intention can be ascertained .....
>
> (3) The fact that a party intends a particular form of words in the mistaken belief that it is achieving its intention does not prevent the court from giving effect to the true common intention ..... "

73. Carnwath LJ continued:

> "31. The main point made by Mr Lewison is that that evidence does not go far enough. It shows what the parties would have done if they had thought about it. It does not show any shared intention to do anything about it at the time, still less any agreement or accord to that effect. He relied on the familiar passage in *Frederick Rose Ltd v William Pim & Co Ltd* [1953] 2 QB 450 where, at the top of page 462, Lord Justice Denning said:
>
> > " ..... I am clearly of opinion that a continuing common intention is not sufficient unless it has found expression in outward agreement."
>
> "Outward agreement" today should be read, I think, as "outward accord", as Lord Justice Peter Gibson said in his summary.
>
> 32. Mr Lewison also relies on the decision of this court in *Kemp v Neptune Concrete Ltd* [1988] 2 EGLR 87 at 90G where Lord Justice Purchas explained the first criterion for rectification:
>
> > "First, there must be a mistake by the party seeking relief in executing the deed which does not translate that party's subjective intention at the time of the execution of the deed. I distinguish this from an intention which the party would have formed if either he or she had been properly advised, or had even applied their minds to the problem. In those circumstances it is clear that, from the passages I have already cited, the moment of time at which the subjective intention of the party seeking relief must be determined is at, or immediately before, executing the deed. Thus, no ex post facto intention can be admitted in such circumstances."

Mr Lewison says that, here as there, all one has is evidence of what the parties would have done if they had applied their minds to the problem.

33. The judge considered the very similar arguments as put to him. He noted that, as Mr Brock conceded, shared intention was not enough, at least as the authorities stand, unless there was some "outward expression" of that intention. He continues as follows:

> "As it seems to me, I must apply, for the purposes of this application for permission to appeal, the accepted English doctrine. As indicated, the contrary has not been argued. However, the requirement is essentially directed to a question of evidence about the communication by one party to the other of his intention. A particular intention may be, as it seems to me, as a matter of the general nature of human discourse, be communicated by one party to another without express words necessarily being used. It may therefore sometimes be possible for the court to conclude there has been sufficient outward evidence of the accord of the parties' intentions in relation to a particular term of their bargain without either party having actually spelled out to the other that term in so many words. It may be like an implied term in a contract, something which, in the context of the particular discourse, is so obvious that it need not be stated."
>
> He referred to Mr Lewison's submission that implied accord was not enough:
>
> " ..... I do not think that can be right. There are many occasions in ordinary human exchange in which something can be implied and, without being expressly stated, perfectly understood by the other party, and the communication of which can be supported by objective but indirect inferential evidence."
>
> Then he continued:
>
> "In any event, even if I am wrong about that, it seems to me that it would be wrong, in a case of this kind, where all the persons who were concerned on either side in relation to the transaction can be shown to have had precisely the same intention and a precisely shared view of the object which they were seeking to achieve, to shut the claimant out, at this stage of the proceedings, from seeking to prove that that coincidence of intention was not either the result of, or reflected in some contemporary communication sufficient for the purpose of the doctrine."

34. Thus he had two grounds of decision: the first that an outward expression of the common intention may not be necessary, if it is so obvious that it need not be stated; and the second that, on the facts of this case and on the state of the evidence, it would be wrong to shut it out without going to trial. It has to be borne in mind, as Mr Brock urges upon us, that we are at a very early stage where there has not been disclosure of the documents which may be in the defendants'

> possession. Of the two points, I can see room for argument about the first ground. For my part, I would not exclude the possibility of their being some development of the strict *Rose v Pim* principles to cover the case where there is an obvious common assumption, as the judge suggested. However, it is unnecessary to decide whether the case for rectification would succeed. It is enough to find, as I do, that the judge's second ground of decision represents an entirely proper exercise of his discretion."

74. In the present case given that all Loan Note holders, including those who did not participate in the Deloitte scheme consented to the deed of variation drafted by leading tax that counsel it is not at all clear even if there was mistake between those Loan Note holders who participated in the scheme, those who did not and O2 at the time the deed of variation was executed or of their common intention at that time. Having regard to all of the circumstances the position in the present case would appear to me to be nearer to that described by Purchas LJ in *Kemp v Neptune Concrete Ltd* as to what the parties would have done if they had been properly advised or even applied their minds to the problem.

75. As such, I consider that a hypothetical purchaser of the Loan Notes would not have been advised that it was likely that he could rely on rectification, itself a discretionary remedy.

Discovery Assessment

76. Insofar as it applies to the present case s 29 TMA provides:

> (1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—
>
> > (a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
> >
> > (b) that an assessment to tax is or has become insufficient, or
> >
> > (c) that any relief which has been given is or has become excessive,
>
> the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.
>
> …
>
> (3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—
>
> > (a) in respect of the year of assessment mentioned in that subsection; and
> >
> > (b) . . .in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

…

(5) The second condition is that at the time when an officer of the Board—

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

(b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if—

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer, whether in pursuance of a notice under s.19A of this Act or otherwise; or

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above—

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

77. It is accepted that there has been a discovery for the purposes of s 29(1) TMA. The issue is whether the condition in s 29(5) TMA has been satisfied, ie whether the officer could not have been reasonably expected, on the basis of the information provided by Mr Connell in the white space of his 2003-04 tax return and the accompanying documents, to be aware of the insufficiency of tax. It is for HMRC to establish that this condition has been met (see *Burgess and Brimheath Ltd v HMRC* [2015] UKUT 578 (TCC))

78. The same issue was considered by the Court of Appeal in *HMRC v Lansdowne Partners Ltd Partnership* [2012] STC 544. As Sir Andrew Morritt C said, at [56]:

"In the end, this part of the appeal boils down to a very short point. The question, to adopt the formulation used by Auld LJ, is whether the hypothetical inspector having before him those three documents and the note of the meeting held on 22 February 2006 would have been aware of "an actual insufficiency" in the declared profit. I would answer that question in the affirmative. He could see from those documents:

"(1) The income of LPLP consisted of management and performance fees.

(2) There had been deducted from that income what was described as 'rebates.'

(3) 'Rebates' had been paid to limited partners.

(4) Arthur Young had established that all payments to partners should be included in gross income and were not, generally, deductible for tax purposes.

(5) There was no indication on the face of the accounts or in Mr Tai's letter to suggest any special treatment of 'rebates' paid to limited partners either by omission from the gross income or in their deduction therefrom."

I do not suggest that the hypothetical inspector is required to resolve points of law. Nor need he forecast and discount what the response of the taxpayer may be. It is enough that the information made available to him justifies the amendment to the tax return he then seeks to make. Any disputes of fact or law can then be resolved by the usual processes. For these reasons I would dismiss the appeal of HMRC."

79. In the present case Mr Firth says the following information was available to the hypothetical inspector:

(1) The Loan Notes were acquired in 1999 and valued at £1,490,794 at the time (£2,098,294 less the disposals on the following page).

(2) At the same time, £381,500 of "B" loan notes in the same company were acquired.

(3) In the 2003-2004 tax year, the remaining 50,000 of "B" loan stock was redeemed at par [D/3/30].

(4) It can reasonably be inferred from (3) that O2 was not financially distressed/was able to pay its debts.

(5) Very shortly before redemption the parties entered into a deed of variation.

(6) That the deed of variation would vary the terms and the price at redemption if certain circumstances arose.

(7) Even closer to redemption, the Loan Notes were converted from a taxable asset (NQCBs) to an exempt asset (QCBs).

(8) The reasonable interpretation/inference is that that conversion occurred as a result of the deed of variation. This is, in particular, because the paragraph

commences by stating that the Loan Notes were NQCBs and uses the connection "however" to lead into the deed of variation and its alteration of the terms.

(9) At the time that the conversion occurred the issuer had the ability to repay the loans at 3% of their par value (44,724/1,490,794 x 100).

(10) The reasonable inference is that this ability to repay at 3% was as a result of the deed of variation which, it was disclosed, varied the price at which the Loan Notes could be redeemed.

(11) There was no consideration paid to Mr Connell to induce him to enter into the deed of variation (any such consideration would have been returned as a part disposal of the Loan Notes).

(12) The reasonable inference is, therefore, that the deed of variation was for the benefit of Mr Connell, even though it permitted redemption at 3%.

The only reasonable conclusion to be drawn from this information, Mr Firth submits, is that Mr Connell has participated in a tax avoidance scheme, the nature of which including the manipulation of the market value tax reasons could have been ascertained by the hypothetical officer and an assessment justified on the basis of a *Ramsay* argument.

80. However, I agree with Mr Yates that a challenge to a discovery assessment is not a licence for a taxpayer to argue that a hypothetical inspector could and should make inferences of fact. The question is as stated by Lewison J (as he then was) whose decision in the High Court in *HMRC v Lansdowne Partners Ltd Partnership* [2011] STC 372 was upheld by the Court of Appeal. He said, at [46]:

> "In *Langham v Veltema* [2004] STC 544 the Court of Appeal considered section 29 and discovery assessments. In my judgment that case establishes the following propositions:
>
> (i) "Awareness" is the officer's awareness of an actual insufficiency in the self-assessment in question, rather than an awareness that he should do something to check whether there is an insufficiency (§ 33);
>
> (ii) The test whether an officer could reasonably have been expected to be aware of an actual insufficiency is an objective test (§ 33);
>
> (iii) The sources of information referred to in section 29 (6) are the only sources of information to be taken into account in deciding whether an officer ought reasonably to have been aware of the actual insufficiency (§§ 36, 51);
>
> (iv) The information in question must clearly alert the officer to the insufficiency of the assessment (§ 36)."

81. As the Upper Tribunal (Norris J and Judge Berner) in *HMRC v Charlton, Corfield & Corfield* [2013] STC 866 said, at [60]:

> "We accept, as a general proposition, that the more complex the case the more information that might be required to be provided to give rise to a reasonable awareness of the insufficiency. But in our view that

illustrates the correct focus of s 29(5): that it is on the quality and extent of the information made available, and not on the qualities of the hypothetical officer."

Under the sub-heading "information made available by inference" the Upper Tribunal concluded:

> 78. The correct construction of s 29(6)(d)(i) is that it is not necessary that the hypothetical officer should be able to infer the information; an inference of the existence and relevance of the information is all that is necessary. However, the apparent breadth of the provision is cut down by the need, firstly, for any inference to be reasonably drawn; secondly that the inference of relevance has to be related to the insufficiency of tax, and cannot be a general inference of something that might, or might not, shed light upon the taxpayer's affairs; and thirdly, the inference can be drawn only from the return etc provided by the taxpayer.
>
> 79. As we have described, the balance provided by s 29 depends on protection being provided only to those taxpayers who make honest, complete and timely disclosure. That balance would be upset by construing s 29(6)(d)(i) too widely. Inference is not a substitute for disclosure, and courts and tribunals will have regard to that fundamental purpose of s 29 when applying the test of reasonableness."

82. In *Sanderson v HMRC* [2016] EWCA Civ 19 the Court of Appeal considered the sufficiency of information provided in the white space of a tax return in relation to a marketed tax avoidance scheme. Patten LJ (with whom Briggs and Simon LJJ concurred) said:

> "22. It is important to emphasise that the decision in *Lansdowne* did not involve any qualification of what Auld LJ in *Langham v Veltema* identified as the question posed by the second s.29(5) condition. The hypothetical officer must, on an objective analysis, be made aware of an actual insufficiency in the assessment by the matters disclosed in the s.29(6) information. This is made clear by the Chancellor at [55] of his judgment in *Lansdowne*. The sole dispute in that case was whether the disclosures made by the taxpayer's accountants were sufficient to cause the hypothetical officer to conclude that there was an insufficiency.
>
> …
>
> 25. I do not accept that ss.29(1) and (5) import the same test and that the Revenue's power to raise an assessment is therefore directly dependent on the level of awareness which the notional officer would have based on the s.29(6) information. The exercise of the s.29(1) power is made by a real officer who is required to come to a conclusion about a possible insufficiency based on all the available information at the time when the discovery assessment is made. Section 29(5) operates to place a restriction on the exercise of that power by reference to a hypothetical officer who is required to carry out an evaluation of the adequacy of the return at a fixed and different point in time on the basis of a fixed and limited class of information.

> The purpose of the condition is to test the adequacy of the taxpayer's disclosure, not to prescribe the circumstances which would justify the real officer in exercising the s.29(1) power. Although there will inevitably be points of contact between the real and the hypothetical exercises which ss.29(1) and (5) involve, the tests are not the same.
>
> …
>
> 27. In essence, Mr Gordon's [counsel for the appellant] submission on this scenario is that the disclosure in the tax return was sufficient to engage the notional officer's knowledge of the *Ramsay* principle and to lead him to conclude that the Scheme would be open to challenge on that basis. The disclosures made by the return revealed (1) the disparity between the size of the loss claimed (£1,825,663) and the income derived from the Castle Trust (£16.04); (2) the fact that the loss claimed was comparable in amount to (and therefore cancelled out) the taxable gain; (3) that the loss could be seen to be derived from an asset which Mr Sanderson had held for only a day; (4) that the loss was part of a very large round sum (£1bn); and (5) that the £1bn loss was attributable to the disposal of a derivative."

After considering the *Ramsay* principle, in particular the guidance of Lord Nicholls in *MacNiven*, Patten LJ continued, at [32]:

> "Even if the notional officer can be supposed to have read these passages in deciding whether to challenge Mr Sanderson's self-assessment, he is likely to have concluded that a *Ramsay*-based challenge would require a careful analysis of all the component parts of the Scheme and that no one aspect of it was likely to be determinative. The tax return failed to disclose the simultaneous entry into the counter-option; the termination of the in the money contract on 4 April 1997 which created the gain that largely funded the liabilities on the out of the money contract and the change from Guernsey to UK trustees on 7 April 1997."

83. In the present case although the information mentioned above (in paragraphs 17 and 18) was included in Mr Connell's tax return the disclosure is identical to that in *Blumenthal* (which is not surprising as it involves the same scheme and advisers who were responsible for the words used in the disclosure).

84. As in *Blumenthal*:

> "198. … the white space disclosure estimated the open market value to be [£44,725], describing this as the value that the issuer had the ability to repay the loan notes for at that time on any transfer in the open market. But it gave very little detail concerning the Deeds of Variation – there was no description of the key terms of those Deeds and the temporary nature of the depression in value was not revealed. The Deeds of Covenant were not mentioned. This means that there was no explanation of the techniques employed by the Deeds of Variation to reduce, temporarily, the market value of the Loan Notes, and a hypothetical Inspector could not therefore have evaluated the effectiveness of those techniques.

> 199. We also noted that the white space disclosure said that the Deed of Variation operated on the Loan Notes so that (italics added) "in certain circumstances [it] would vary its terms and the price at which it could be redeemed". Not only was there no explanation of the "circumstances" but there was also no statement that the variation had, in fact, been triggered. Moreover, although the Deed did vary "the price at which [the Loan Notes] *could* be redeemed" (our italics) the circumstances in which O2 could redeem the Notes at that lower market value were not explained, and as a question of fact, the key relevance of this lower value was not on redemption but on conversion from NQCBs to QCBs."

85. Although the Tribunal in *Blumenthal* did not have the benefit of the subsequent decisions of the Court of Appeal in *Lansdowne* or *Sanderson* or the Upper Tribunal in *Charlton* I agree with and adopt its conclusion, at [206], that:

> "The white space disclosure seems to us, in summary, to be a disclosure which should have alerted an Inspector of the need to make further enquiries. It was not, however, a disclosure in respect of which it would be reasonable to expect an officer to be aware of an insufficiency. On the authority of *Veltema* we conclude that the condition in section 29(5) TMA has been met, allowing HMRC to make a discovery assessment under section 29 (1) TMA in the circumstances of this case."

Summary of Conclusions

86. In conclusion, although I have found that the Loan Notes were converted from NQCBs into QCBs and should be valued as at 27 February 2004, the date of the Relevant Event, because of the application of the purposive *Ramsay* approach to the legislation the deed of variation did not have the effect of artificially reducing their market value and, as such, a capital gain arose on their redemption which HMRC were entitled assess by way of a discovery assessment.

87. Accordingly I dismiss the appeal.

Right to Apply for Permission to Appeal

88. 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.

JOHN BROOKS
TRIBUNAL JUDGE

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