CAPITAL GAINS TAX – taper relief – disposal of shares – periods when shares qualified consecutively as non-business assets and as business assets – how to apportion gain between the two periods – expert evidence as to valuation – paragraphs 3 and 21 of Schedule A1 Taxation of Chargeable Gains Act 1992

FIRST-TIER TRIBUNAL
TAX CHAMBER

TC07269

Appeal number: TC/2014/00397 & 00399

BETWEEN

(1) RICHARD LEE
(2) NIGEL BUNTER **Appellants**

-and-

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

TRIBUNAL: JUDGE GUY BRANNAN

Sitting in public at Taylor House, London on 12 June 2019

Amanda Hardy QC and Oliver Marre, instructed by Bristows LLP for the Appellant

Timothy Brennan QC and Christopher Stone, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

INTRODUCTION

1. "Taper relief" was a relief for the purposes of capital gains tax on gains realised by individuals, trustees and personal representatives – it did not apply to corporations. The relief was applicable for the tax years 1998/99 to 2007/08 inclusive. Taper relief operated by reducing chargeable gains by reference to the length of time that the asset had been held after 5 April 1998. A greater reduction was afforded to "business assets" (as defined) than to "non-business assets".

2. This appeal concerns how the apportionment of a gain in relation to shares held by each of the appellants, Mr Lee and Mr Bunter (together, "the appellants"). For part of the period, i.e. from 6 April 1998 to 5 April 2000, it is common ground that the shares were non-business assets for taper relief purposes. Similarly, it is common ground that in the period 6 April 2000 to 12 March 2003 the shares were business assets for the purposes of taper relief. I shall refer to these periods as the non-BATR and the BATR periods.

3. The major issue in this appeal is how the gain that arose on the disposal of the shares on 12 March 2003 should be apportioned in respect of the period when the shares were consecutively a non-business asset and a business asset i.e. the period 6 April 1998 to 12 March 2003. In short, the appellants argue that most of the gain should be allocated to the period when their shares qualified as business assets. Their evidence was that there had been a dramatic increase in the value of the shares after April 2000 and that on a "just and reasonable" basis most of the gain should be attributed to the period after April 2000. HMRC dispute this arguing that the gain should be time apportioned over the relevant period of ownership with the result that the amount of the gain allocated to the period when the shares were non-business assets is greater than would be the case on the appellants' argument.

4. The main facts, save as regards certain valuation issues, were not in dispute. The parties asked me to decide the apportionment issue in principle, leaving the detailed calculations to follow from that decision.

THE FACTS

The course of the dispute

5. The first appellant, Mr Lee, is the settlor of the R A Lee 1997 Settlement established on 10 February 1997. Mr Lee had an interest in possession in his settlement. He appealed to the First-tier Tribunal ("the Tribunal") on 16 January 2014 against a closure notice issued on 27 August 2013, which amended his 2002/03 tax return. The original closure notice stated that the additional tax due was £11,155,314.30. This was amended on review to £7,474,060.40 and again, after correspondence, to £5,505,497.20.

6. The second appellant, Mr Bunter, is the settlor of the N S Bunter 1997 Settlement established on 10 February 1997. Mr Bunter had an interest in possession in his settlement. He appealed to the Tribunal on 16 January 2014 against a closure notice issued on 27 August 2013, which amended his 2002/03 tax return. The original closure notice stated that the additional tax due was £11,152,235.20. This was amended on review to £7,470,980.40 and again, after correspondence to £5,502,417.20.

7. The appellants' appeals were directed to be heard together. The hearing as to liability took place between 19 and 23 September 2016. Judge Bishopp released his decision on 7 April 2017.[1]

[1] *Lee & Bunter v HMRC* [2017] UKFTT 279 (TC)

8. The Tribunal's decision was a decision in principle on the underlying taxability of the appellants and found that tax was payable. The second ground of appeal for each of the appellants was, however, that HMRC had incorrectly applied the taper relief provisions and that the chargeable gain realised by each appellant should be made on the correct statutory computation including, in particular, the granting of the correct amount of taper relief. The FTT declined to give guidance on this issue and therefore the matter has now come before me for decision.

9. The parties have agreed the periods during which, under the taper relief provisions, the gain qualified for business asset taper relief ("BATR") and non-business asset taper relief ("NBATR").

10. The parties have not, however, been able to agree how, under the relevant statutory apportionment provisions, apportionment should be carried out between the BATR and NBATR periods. Accordingly, the parties have asked me to determine that remaining question, in principle, so that quantum can be determined.

The factual background

11. In September 1996, the appellants concluded heads of agreement with the Ford Motor Company's mobile telephone business in the UK. This was essentially a management buy-out.

12. In the same month the appellants became the directors of a recently formed UK off-the shelf company, which later changed its name to Cellular Operations Ltd ("COL"). Two further companies were subsequently incorporated in Guernsey: Le Bunt Holdings ("Le Bunt") in October 1996 and FB Holdings Limited ("FB Holdings") in March 1997. The subscribers for the shares in each were two Guernsey nominee companies (together "the Nominee Companies").

13. In February 1997, the appellants each established a trust, also in Guernsey. These were the R A Lee 1997 Settlement and the N S Bunter 1997 Settlement. The first appellant was the settlor of, and had an interest in possession in, the former, and the second appellant was the settlor of, and had an interest in possession in, the latter. The initial trust fund was, in each case, cash of £2,500 provided by the settlor. The trustee of each of the Settlements was the Spread Trustee Company ("STC"), also a Guernsey company, held the issued shares in Le Bunt and FB Holdings.

14. On 27 March 1997, several transactions took place between the various companies, together with another company at arm's length to them, Telecom Securicor Cellular Radio Limited ("BT Cellnet"), which resulted in the issued shares in COL being held by BT Cellnet, Le Bunt and FB Holdings.

15. On the same day COL completed the purchase of Ford's mobile telephone business for £5,185,093 together with the assumption of certain liabilities. The purchase was partially funded by a loan from Cellnet to COL of £4 million. COL thereafter traded in the mobile telephony business.

16. In March 2000, when another off-the-shelf company was acquired, it changed its name to Cellops Limited ("Cellops"). LeBunt and FB Holdings each held 50% of the shares in Cellops and the appellants were its directors.

17. Accordingly, by March 2000, the Settlements were the beneficial owners of LeBunt and FB Holdings and, through those companies, of COL and Cellops.

18. In June 2000, BT Cellnet sold its stake in COL to Cellops for £4.5 million plus a further contingent sum, and BT Cellnet ceased to have any further involvement in the management of the company. The contingent consideration was never paid.

19. In February 2001 STC, as trustee of the Settlements, entered into call option arrangements with Vodafone UK Limited ("Vodafone") for the possible sale to Vodafone of the entire shareholdings in LeBunt and FB Holdings: the real targets of the acquisition were, in fact, the underlying shares in COL. The agreements provided for a corresponding put option which could be exercised by the Settlements if Vodafone failed to exercise the call option. The consideration paid by Vodafone to each of the Settlements for the grant of the option was as much as £5 million, almost all of which was distributed to the appellants (from their respective Settlements) in early 2002; the consideration for the grant of the put options, by contrast, was only £1. The price to be paid for the shares, should one of the options be exercised, was not specified in advance but was to be determined by reference to a formula set out in the option agreement. The agreements assumed, absent specified contingencies for which they provided, that one or the other of the options would be exercised in April 2003. In the absence of some significant unforeseen event a sale would be certain to take place.

20. The formula used by Vodafone recognised the importance and value of loyal customers, the rate at which subscribers disconnected and the total number of subscribers from time to time.

21. On 28 March 2002 STC resigned and was replaced, in each case, by DTOS Limited ("DTOS"), the Mauritian equivalent of a trust corporation, of Port Louis, Mauritius. DTOS was owned by the Mauritius office of Deloitte & Touche, as it then was. On the same day a novation agreement transferred STC's rights and obligations under the option agreements with Vodafone to DTOS.

22. Almost exactly a year later, on 12 March 2003, the parties entered into a commercial variation agreement which advanced the possible date for the exercise of the option and replaced some parts of the formula for the calculation of the price with fixed figures. Vodafone gave notice of the exercise of the option on the same day, and completion of the transaction took place immediately. The consideration paid was approximately £56 million. The appellants also resigned, as was envisaged by the agreements, as directors of Cellops and COL.

Liability to tax

23. Judge Bishopp, in the FTT Decision, found that:

(1) The UK/Mauritius Double Tax Convention applied to determine taxing rights on the sale of the shares in Le Bunt and FB Holdings by DTOS as trustee of the Settlements. (FTT Decision [92])

(2) The tie-breaker in the UK/Mauritius Double Tax Convention (which provides for a Settlement to be UK resident for treaty purposes. (FTT Decision [81])

(3) Therefore, the gain on the sale of the shares in Le Bunt and FB Holdings was taxable in the UK and, accordingly, under section 77 of the Taxation of Chargeable Gains Act ("TCGA") deemed to be taxable on the appellants.

THE EVIDENCE

24. The appellants filed witness statements and were cross-examined. In addition, Mr Ian Brewer of Valuation Consulting LLP, a witness for the appellants, gave expert evidence in relation to the valuation of the shares in COL owned by the appellants in June 2000. He too was cross-examined.

25. Mr Nicholas Laird, an employee of COL between 1999 and 2003, also provided a witness statement on behalf of the appellants. Mr Laird, however, was not required for cross-examination.

The evidence of Mr Lee

26. Mr Lee's evidence was that in the period 1997-2000 COL was quite profitable. It acted as an agent for BT Cellnet connecting more than 90% of its new customers to the BT Cellnet network. COL received a bonus from BT Cellnet for each subscriber that it connected to BT Cellnet's airtime. The customers, however, were not COL's customers and in the mobile telephones industry it was having a customer base that created value. After an initial connection bonus, amounts payable to COL were limited to small fixed monthly management fees plus 6% of the airtime bill.

27. The relationship with BT Cellnet became increasingly strained and, in the spring of 2000, the appellants suggested that either BT Cellnet should buy them out or *vice versa*. BT Cellnet then suggested that the appellants should acquire its shares in COL.

28. Negotiations between the parties took place and on 5 April 2000, the BT Cellnet board approved a sale of its stake in COL, which was completed on 28 June 2000, for a cash consideration of £4.5m plus a further contingent amount, up to £6.5m (which was conditional on COL failing to make the requisite number of "Company Connections", as defined in the underlying Sale and Purchase Agreement). Despite failing to meet the requisite number of "Company Connections", no further consideration was in fact requested or paid. BT Cellnet's shareholding was acquired for a total consideration of £4.5m by Cellops.

29. As regards the contingent consideration, this was a total amount of £6.5m payable on 31 July 2001 but, as I have explained, the amount payable would be reduced or eliminated to the extent that Cellops/COL made the requisite amount of "connections" (i.e. connecting new subscribers to BT Cellnet's network on particular tariffs). In cross-examination, Mr Lee explained that the market had moved significantly towards prepaid mobile phones but BT Cellnet refused to supply these to COL. It was clear from the outset that BT Cellnet would not supply prepaid mobile phones and were also refusing to supply adequate levels of connection bonuses. During the negotiations and before the agreement was signed, Mr Lee's evidence, which I accept, was that it was unlikely that the contingent consideration obligations would ever be enforced by BT Cellnet. Mr Lee, after such a lengthy interval of time, could not remember by what margin Cellops/COL had fallen short of the requisite connections target.

30. Mr Lee said that until the purchase of BT Cellnet's shareholding, COL was almost entirely reliant for its profitability on BT Cellnet's bonuses. These could be varied with little or no notice. Thus, because COL did not "own" its own customers, its profitability relied entirely on BT Cellnet's bonuses and that COL's value as a company was therefore limited.

31. COL entered into a new Service Provider Agreement with BT Cellnet which meant that, thenceforth, any new customer contracts were "owned" by COL. This was a fundamental change in COL's strategy.

32. COL was successful in producing new connections and in managing its customers. An option agreement was entered into with Vodafone. Vodafone provided COL with loans to fund the growth of its subscriber base and established a formula to value the company if and when Vodafone exercised its option. The formula provided a method of valuing COL's subscriber base. It was the application of this formula to the rapid growth in COL-owned customer contracts that, according to Mr Lee, drove the large increase in the value of COL from mid-2000, when the value of the company was £11.25m, based on the purchase price of BT Cellnet's 40% shareholding, to March 2003 when Vodafone exercised its option and bought COL for approximately £56m.

33. COL's change in strategy in 2000 was reflected in the company's annual accounts. It had lost the large upfront connection bonuses paid by BT Cellnet and, instead, invested in acquiring

new customer contracts owned by the company. Thus, COL went from showing healthy pre-tax profits to an increasingly large loss. However, as those losses increased, the number of customer contracts owned by COL increased substantially from around 4,880 in June 2000 to around 395,000 by March 2003. In the Directors' Report for the year ended 31 March 2001 the directors valued COL's customer base at approximately £26.5m. The corresponding figure in the Directors' Report for the year ended 31 March 2002 was £49.3m.

34. Mr Lee acknowledged in cross-examination that it was always contemplated that he and Mr Bunter would act together and either stay together in the business or exit together.

The evidence of Mr Bunter

35. Mr Bunter's evidence was to much the same effect as that of Mr Lee. He described how the relationship with BT Cellnet had broken down and by June 2000 a negotiated agreement was reached with BT Cellnet for the acquisition by Cellops of BT Cellnet's shareholding in COL. Thereafter, it was decided that COL should embark on a new business strategy whereby COL would own its customer contracts. but this came at the cost of significant adverse cash flow.

36. Mr Bunter explained that Vodafone subsequently approached Cellops/COL offering to provide loans to enable the business to be developed in return for put and call options under which Vodafone could buy the business. The price under the options concentrated on: the number of customers (the total subscriber base), the average spend per customer, customer bad debt and the number of customers which had moved away expressed as a percentage of the total customer base. This focused the attention of Cellops/COL on these four factors. Organisationally, the business was now aligned in accordance with this new focus.

37. As regards the contingent consideration payable to BT Cellnet under the 5 April 2000 agreement, this was not paid because Cellops/COL were not given the financial backing by the network operator to be competitive in the market and Cellops/COL were not supplied with prepay mobile telephones, which were then the dominant new connections in the mobile phone business. It would have been impossible for Cellops/COL to have made those targets. In cross-examination, Mr Bunter was asked:

> "Q. Is the position this; that you signed up on a basis of a cash consideration plus a contingent consideration, but that in the events that happened and because of the way BT chose commercially to behave, you were prevented from signing up enough people but BT did not in the event pursue the contingent consideration?
>
> A. I think that is fair, yes."

38. Mr Bunter said that when Vodafone exercised its call option Cellops/COL had made progress, particularly since 2000 when BT Cellnet's shareholding stake had been purchased. The decision, after BT Cellnet's departure, to change the business strategy had been a risky one, but ultimately it paid off as shown by Vodafone's purchase price in 2003 of approximately £56m versus the value in 2001 of £11.25m (a valuation based on the £4 .5m paid for BT Cellnet's shareholding).

The evidence of Mr Laird

39. As I have explained, Mr Laird's evidence was accepted and he was not required for cross examination. In essence, Mr Laird confirmed Mr Lee's evidence about the way in which COL's business had changed after BT Cellnet's shareholding stake had been bought by the appellants in 2000 and the impact that this had on the company's value.

The expert evidence of Mr Brewer

40. Mr Brewer is a partner in Valuation Consulting LLP, a firm specialising in the appraisal of any financial asset that does not have a ready market valuation. Mr Brewer was asked by the appellants to give his opinion as to the value of COL at 5 April 2000 and, in particular, the value of each of the appellants' shareholding in COL at that date. Mr Brewer gave evidence as an independent expert witness on behalf of the appellants.

41. Mr Brewer recorded the facts as he understood them, which were broadly similar to those recorded in the evidence of Mr Lee. He noted that Cellops paid £4.5m for BT Cellnet's shares in COL. He noted:

> "3.9 The agreement between the parties also provided for a further contingent sum to be paid to BT Cellnet but this never became payable, and BT Cellnet ceased to have any further involvement in the management of the company, although the majority of customers continued to be contracted with BT Cellnet.
>
> 3.8 In the period following BT Cellnet's departure from the business, the Appellants decided that COL's strategy going forward should be to grow the Company's value by acquiring and owning its own customer contracts as this was clearly where any value lay in the mobile telephony market. The agency arrangement with BT Cellnet had been terminated on 28 June 2000 and, increasingly, the Company's focus was on its relationship with Vodafone.
>
> 3.9 Under that relationship, COL operated as an independent service provider. Although this arrangement meant that the up-front bonus for connecting a new customer to the network was low, COL obtained a much higher share of all call spend during the length of the customer relationship and, more importantly, COL owned the customer contract. The new fee arrangement meant that COL was in a negative cash flow position at the start of the customer relationship, but the hope was that this would reverse over the life of that relationship.
>
> 3.10 COL was eventually sold to Vodafone in March 2003 for approximately £56 million with Vodafone effectively buying COL's customer base."

42. Save as regards the contingent consideration payable to BT Cellnet, there was no challenge to Mr Brewer's summary of the facts.

43. Mr Brewer reviewed the different valuation methodologies which could be adopted in order to value COL on 5 April 2000. In Mr Brewer's opinion the correct methodology was what he described as the "market approach" which considered how the market viewed the business or asset concerned. There was no challenge to the methodology adopted by Mr Brewer, save as mentioned below.

44. Mr Brewer's report stated as follows:

> "4.17 If there have been recent transactions on the subject business or asset, then this can provide a good indication of the value which the market places on that business.
>
> 4.18 In this case we have the very strong evidence of an actual sale approved by the BT Cellnet board precisely on our valuation date and completed on 28 June 2000, when BT Cellnet sold its holding of 60,000 ordinary shares in COL to Cellops (a company owned 50-50 by the Appellants).
>
> 4.19 The consideration for the transaction was
>
> - £4.5m cash upon completion; and

- A further sum of up to £6.5m if COL did not make the requisite number of "Company Connections" (as defined in the underlying sale and purchase agreement).

4.20 It is my understanding that at the point of completion, the acquirer did not have a realistic expectation that any element of the contingent consideration would ever be paid. This is evidenced by the eventual outcome, with no contingent consideration being paid notwithstanding COL failing to make the specified "Company Connections". As such, the total consideration value remained at £4 .5m.

4.21 I have also been informed that at the time of the negotiations, at no stage was it considered that the agreed price took into account that this was a minority holding. It was always considered that the amount was a pro rata share of the total value of COL.

4.22 Having considered the Articles of Association of COL I also conclude that there was no significant difference between the rights of the "A" and "B" Shareholders and thus no reason the "B" Shareholding owned by BT Cellnet would command a higher or lower price.

4.23 I would also comment that at the time of the sale BT Cellnet was part of the BT Group Plc and is part of a public company would have been duty-bound to achieve the best price possible for its shares irrespective of the nature of its relationship with the purchaser.

4.24 I therefore conclude that a Market based approach is suitable for current valuation purposes

My Approach

4.27 For my valuation of COL as at 5 April 2000 I have adopted the Market Approach is the most suitable valuation method based on the arm's length transaction between BT Cellnet and Cellops Ltd. For the reasons I have given I do not believe either an Income Approach or a Cost Based methodology to be suitable in the present circumstances My calculations are set out in Section 5.

5. VALUATION

5.1 For the valuation of COL I have used as my starting point the £4.5m paid by Cellops for 60,000 ordinary shares in COL. This value is a total 150,000 shares in issue at £11.25m (based on £4.5m equating to £75 per share).

5.2 My valuation of COL as at 5 April 2000 is therefore £11.25m

5.3 A total value of £11.25m implies a value for each of the Appellant's [sic] interests in 45,000 COL shares of £3.375m. However, 45,000 shares represents a minority interest in an unquoted trading company and, as is HMRC practice, it needs to be discounted by 40% to 50% to reflect that fact. A discount of 40% to 50% gives a revised value for a holding of 45,000 shares of between £1,687,000 and £2,025,000.

5.4 My valuation of each of the Appellants' 45,000 shares in COL as at 5 April 2000 is therefore between £1,687,500 and £2,025,000."

45. In cross-examination, Mr Brewer stated that in his discussions with the appellants prior to the production of his report, the appellants indicated that when the deal with BT Cellnet was negotiated it was never considered that the contingent consideration would become payable. Mr Brewer said that given the intended change of business model he did not consider that there was enough certainty or enough even possibility that the contingent payments would be made and, therefore, he attached no value to the contingent consideration. Mr Brewer further said

that on the basis of the information provided to him by the appellants (viz that at the time it of the agreement with BT Cellnet it was considered very unlikely that the contingent consideration would actually be paid) he considered it appropriate to value the contingent consideration at nil. This was borne out by the fact that the contingent consideration was never paid.

46. Mr Brewer also considered, when cross-examined by Mr Brennan, that the fact that Mr Lee and Mr Bunter acted together or in collaboration was irrelevant for valuation purposes. Mr Brewer explained that when he had been a valuer at HMRC he had been involved in share valuations in relation to the 1982 market value rebasing of chargeable assets. In that case taxpayers wanted to establish as high a value as possible in order to achieve a high re-based base cost. There were many cases in which family companies were concerned and taxpayers frequently argued that family members acted together and that a discount to reflect an individual family member's minority stake was unrealistic. Mr Brewer said that HMRC never accepted this argument. The correct position, he said, was that the shares had to be valued on the basis of a transaction between a hypothetical purchaser and a hypothetical vendor.

THE STATUTORY PROVISIONS DEALING WITH APPORTIONMENT OF GAINS FOR TAPER RELIEF PURPOSES

47. There were two relevant statutory provisions in Schedule A1 TCGA 1992 which, together, provided rules for apportionment in such cases. First, paragraph 3 of Schedule A1 TCGA 1992 provided:

> "(2) Where –
>
> (a) a chargeable gain accrues to any person on the disposal of any asset,
>
> (b) that gain does not accrue on the disposal of an asset that was a business asset throughout its relevant period of ownership, and
>
> (c) that asset has been a business asset throughout one or more periods comprising part of its relevant period of ownership,
>
> a part of that gain shall be taken to be a gain on the disposal of a business asset and, in accordance with sub-paragraph (4) below, the remainder shall be taken to be a gain on the disposal of a non-business asset.
>
> (3) Subject to the following provisions of this Schedule, where sub-paragraph (2) above applies, that part of the chargeable gain accruing on the disposal of the asset that shall be taken to be a gain on the disposal of a business asset is the part of it that bears the same proportion to the whole of the gain as is borne to the whole of its relevant period of ownership by the aggregate of the periods which –
>
> (a) are comprised in its relevant period of ownership, and
>
> (b) are periods throughout which the asset is to be taken (after applying paragraphs 8 and 9 below) to have been a business asset.
>
> (4) So much of any chargeable gain accruing to any person on the disposal of any asset as is not a gain on the disposal of a business asset shall be taken to be a gain
>
> on the disposal of a non-business asset."

48. The second relevant provision is paragraph 21 of Schedule A 1 TCGA 1992 ("General rule for apportionments under this Schedule") which provided:

> "Where any apportionment falls to be made for the purposes of this Schedule it shall be made –

(a) on a just and reasonable basis; and

(b) on the assumption that an amount falling to be apportioned by reference to any period arose or accrued at the same rate throughout the period over which it falls to be treated as having arisen or accrued."

THE ISSUE

49. It was common ground that there were qualifying periods for BATR and non-BATR purposes of approximately four and five years respectively. Taper relief was, therefore, available in respect of the disposal is made by the Settlements from the date when the taper relief legislation came into force i.e. 6 April 1998.

50. Section 2A TCGA 1992 applied Schedule A1 TCGA 1992. It was also common ground that gains accruing after 6 April 1998 therefore accrued in what the Schedule described as the "relevant period of ownership" – which in this case began on 6 April 1998 and ended with the disposal on 12 March 2003.

51. Further, it was common ground that:

(1) for the period from 6 April 2000 until 12 March 2003 the appellants were entitled to BATR; and

(2) for the period from 6 April 1998 to 5 April 2000, the appellants were entitled to non-BATR.

52. The percentage of taper relief available depended on the length of the "qualifying holding period" of the assets from 6 April 1998. However, as regards non-BATR, the length of this period was extended by an extra year ("the free year") in cases where the assets disposed of had, as in this case, been held before 17 March 1998.[2] Again, this was common ground between the parties.

53. I was informed, and it was common ground, that the percentage reduction in the chargeable gain apportioned to the BATR period was 75% i.e. only 25% of the gain was chargeable. The corresponding percentage reduction for the chargeable gain apportioned to the non-BATR period was 25% i.e. 75% of the gain remained chargeable.

54. Put shortly, therefore, the greater the amount of gain apportioned to the non-BATR period the greater the amount of tax payable by the appellants and *vice versa* as regards the amount of the gain apportioned to the BATR period.

SUBMISSIONS IN OUTLINE

Introduction

55. Ms Hardy QC, appearing with Mr Marre for the appellants, submitted that the gain should be apportioned on a just and reasonable basis pursuant to paragraph 21(a) of Schedule A1 TCGA 1992. As we have seen, the appellants' evidence was that most of the growth in value of the shares occurred in the BATR period. Thus, if Ms Hardy's submission was correct most of the gain would be eligible for the more favourable BATR.

56. Mr Brennan QC, appearing with Mr Stone for HMRC, submits that the gain should be time-apportioned pursuant to paragraph 3(3) of Schedule A1 TCGA 1992 and that there is no scope for an apportionment on a "just and reasonable" basis. On this approach, the appellant's evidence on valuation was irrelevant.

[2] This was unaffected by the apportionment of the gain into separate BATR and non-BATR periods: see paragraph 3(5)(a) and (b) of Schedule A1 TCGA 1992.

Submissions for the appellants in outline

57. Ms Hardy drew attention to the introductory language in paragraph 3(3) which provided that that paragraph was "subject to" paragraph 21. Thus, paragraph 21 "trumped" paragraph 3.

58. It was therefore just and reasonable for the majority of the gain to be attributed to the BATR period because the growth in value of the COL shares had taken place in that period.

59. Moreover, Ms Hardy argued that the "just and reasonable" approach in paragraph 21(a) was not inconsistent with paragraph 21(b). That would be the case where the just and reasonable approach would be simply to apply a straight line time apportionment of a gain across the whole "relevant period of ownership". That did not remove the requirement to apportion under paragraph 21(a). In other cases, however, the apportionment of a gain between BATR and non-BATR periods would need to be carried out on some other basis in order to be "just and reasonable". Thus, in Ms Hardy's submission, once a just and reasonable apportionment had been made between BATR and non-BATR periods under paragraph 21(a), then paragraph 21 (b) provided that "an amount falling to be apportioned [under paragraph 21(a)] to any period" would be treated as accruing "at the same rate throughout the period over which it falls [under paragraph 21(a)] to be treated as having arisen…."

60. Ms Hardy referred to the decision of the First-tier Tribunal ("FTT") in *Jefferies v HMRC* [2009] UKFTT 291 (TC) (Judge Short and Mr Earle) ("*Jefferies*"). That case involved the question of how to apportion a gain between the period when a business asset qualified for taper relief and a period when, because of the manner in which it was used, it was disqualified for relief under separate provisions of Schedule A1 TCGA 1992 (those provisions not being relevant to this appeal). The FTT held that to ignore the "just and reasonable" requirement of paragraph 21 would be wrong and that the result would be "at best anomalous" (at [40]). The FTT said:

> "41. There is a specific requirement in the taper relief legislation that any apportionments should be done on a just and reasonable basis (Paragraph 21 of Schedule A1). We cannot agree with HMRC that applying the apportionment in paragraph 9 such that only 35% of the chargeable gains should be treated as eligible for business asset taper relief is just and reasonable in these circumstances.
>
> 42. In the Tribunal's view the just and reasonable apportionment which should be made under paragraph 9, Schedule A1 is to apportion the chargeable gains on the basis that there is no proportion of the use of the asset which is a non-qualifying use.
>
> 43. Taking this approach, the whole of each Taxpayer's chargeable gain in respect of the asset remaining after the application of PRR should be treated as eligible for business asset taper relief."

61. Ms Hardy submitted that in the present case it would be "at best anomalous" to ignore paragraph 21 and insist that the "real world" growth in value of COL should be ignored and replaced by a percentage which bore no resemblance to the true factual position. The authorities in relation to the interpretation of tax statutes indicated that a statutory provision should be construed in its statutory context and applied to the facts viewed realistically (*UBS AG & Deutsche Bank Services (UK) Ltd v HM Revenue & Customs* [2016] UKSC 13 at [64] and [66] and *The Pollen Estate Trustee Company & Another v HMRC* [2013] EWCA Civ 753 at [24]). In the present case the "real world position" was set out Mr Brewer's valuation.

62. Ms Hardy cited a passage from the well-known speech of Lord Wilberforce in *Aberdeen Construction Group Ltd v IRC* [1978] UKHL, 52 TC 281 at 296.

63. It was therefore important, argued Ms Hardy, to construe the relevant legislation in this case to tax the real gain, not an artificial arithmetical gain. Moreover, a deeming provision should not be relied upon to the extent that it leads to "injustice and absurdity" (*Marshall v Kerr* [1994] UKHL 67 TC 56).

Submissions for HMRC in outline

64. Mr Brennan submitted that the authorities in relation to the interpretation of tax statutes supported HMRC's submissions. Paragraph 3(2) of Schedule A1 TCGA contained a specific rule for apportioning a chargeable gain between periods when the asset disposed of was a business asset and periods when it was a non-business asset. Parliament's intention was that the specific rule would apply to the present case.

65. Parliament's intention that taper relief should be applied not by reference to the profile of how the gain in fact accrued over time was indicated, for example, by paragraph 2(2). That provision restricted the relevant period of ownership over which taper relief could apply to 10 years ending with the disposal of the asset – that was so even if the actual period of ownership over which the gain had accrued was substantially longer.

66. In relation to the appellants appeals to "real-world" considerations, Mr Brennan referred to the judgment of Briggs LJ (with whom Patten and Longmore LJJ agreed) in *Blackwell v HMRC* [2017] EWCA Civ 232, [2017] STC 1159 at [22].

67. Next, Mr Brennan submitted that the appellants' reliance on *Marshall v Kerr* was misplaced. Paragraph 3(2)-(4) of Schedule A1 was not a deeming provision but, rather, a specific rule setting out the calculation that should be used to apportion periods of ownership.

68. The purpose of those provisions, Mr Brennan argued, was to provide an administratively simple arithmetical fractional apportionment of the gain when asset was not a business asset throughout the period of ownership. Paragraph 3(2)-(4) addressed the situation, relevant to this appeal, in which an asset was a business asset for some periods but a non-business asset for other periods. It avoided the need for expensive expert valuations, differences of opinion and it operated in all relevant circumstances.

69. Mr Brennan distinguished the present situation in which the asset was a business asset in some periods but a non-business asset in others from the situation where there was a "mixed-use". In the case of "mixed-use", business and non-business uses may be simultaneous and differentiated otherwise than by time. For example, a taxpayer may own an asset which is partly used for trade and partly for a non-trade purpose (thus, it might be necessary to determine whether a building was partly used as an hotel and partly for private purposes). In a mixed use, rather than a temporal, situation it is clear that a different method from time apportionment needed to be used and it is that type of situation which was envisaged by paragraph 21(a).

70. Mr Brennan submitted that "apportionment" in Schedule A1, properly understood, required the exercise of judgement. Paragraph 3(3), contained a formula or a rule for determining whether a gain was a gain on the disposal of a business or a non-business asset. It did not make an apportionment. Paragraph 3(3) did not make an apportionment, instead it applied a rule or formula for deciding when a chargeable gain was a gain on the disposal of a business asset, for all purposes.

71. It was possible for an asset to be eligible for BATR in one period, then become eligible for non-BATR in the next period and then once again become eligible for BATR in the third period. The difficulty with the appellants' submissions was that it was necessary to have an expert valuation each time an asset "popped" in and out of eligibility for BATR in order to determine what was just and reasonable.

72. Thus, Mr Brennan submitted that the introductory wording of paragraph 21 ("Where any apportionment falls to be made for the purposes of this Schedule") was not satisfied – no apportionment fell to be made for the purposes of the Schedule. Paragraph 3 (3) provided the taxpayer with a rule for deciding whether the gain is a gain on the disposal of a business asset or a non-business asset – no apportionment was required.

73. Put shortly, Mr Brennan argued that it was possible to have paragraph 21 applying in a paragraph 3 case (e.g. "mixed use") but it was not possible to have paragraph 21 "deleting" paragraph 3, with the result that every case required an allocation on a just and reasonable basis: this would deprive paragraph 3 of any significant function.

74. The appellants' approach, according to Mr Brennan, fundamentally misunderstood the function of paragraph 3: it did not require an apportionment to be made for the purposes of Schedule 1A, it made a temporal distinction between business and non-business use by reference to a period of time.

75. Finally, Mr Brennan submitted the "relevant period of ownership", defined in paragraph 2 (2) of Schedule A1 was itself an artificial construct involving a limited period of 10 years, and that therefore Ms Hardy's appeals to commercial reality rang hollow.

DISCUSSION

76. The concept of time-apportioning gains for the purposes of capital gains tax has been a common feature of the capital gains tax regime since it was introduced in the Finance Act 1965. Gains arising on the disposal of certain assets held prior to 6 April 1965 were time apportioned. In relation to one of the best-known exemptions from capital gains tax, the principal private residence exemption, gains are time apportioned between periods when the property was used as a principal private residence and those periods when it was not so used.

77. Thus, the use of time apportionment as a method of allocating gains between different periods of time is not a novel concept in the context of capital gains tax.

78. In this case, paragraph 3(3) of Schedule A1 provides a method of time apportioning a chargeable gain where the asset was not held as a business asset for the whole of the relevant period of ownership.

79. The introductory words of paragraph 3(3), however, state that the provision is: "Subject to the following provisions of this Schedule…." In my judgment, the clear words of the statute indicate that Parliament intended paragraph 3(3) to be subject to, *inter alia*, the provisions of paragraph 21.

80. I reject Mr Brennan's argument that paragraph 3(3) is not a provision which requires an apportionment to be made, so that paragraph 3(3) falls outside the scope of the wording in paragraph 21: "Where any apportionment falls to be made…." It seems to me that the language of paragraph 3(3) does require an apportionment of the gain to be made to be made and gives an instruction as to how that apportionment is to be made. That provision states:

> "… the part of the chargeable gain accruing on the disposal of the asset that shall be taken to be a gain on the disposal of a business asset is that part of it that bears the same *proportion* to the whole of the gain as is borne to the whole of the relevant period of ownership…." (Emphasis added)

81. Nonetheless, I am not persuaded that paragraph 21 has the effect that the gains accruing to the appellants must be apportioned on a basis other than time apportionment. It seems to me clear that paragraph 21(b) expressly envisages that the apportionment of an amount over the relevant period of ownership should be done on the basis that the gain accrued at the same rate throughout the period. Effectively, this reinforces the view that, when a gain must be apportioned over a period of time, a time apportionment method is the correct method to use.

From this it also follows, in my view, that a time apportionment of the gain between the BATR period and the non-BATR period cannot be regarded as being unjust or unreasonable.

82. In other words, I accept the substance of the submission by Mr Brennan that paragraph 21(a) usually operates to apportion gains in circumstances other than allocation between time periods such as "mixed use" (paragraph 9 of Schedule A1). As Mr Brennan observed, there may be certain circumstances where the general rule in paragraph 21 may be applied when considering an apportionment under paragraph 3. Mr Brennan gave the example of an asset which was not used at all for a period of time because of the seasonal nature of the taxpayer's business. Such an asset would not be treated as a business asset but that treatment would not necessarily be just and reasonable in the context of a seasonal business – paragraph 21(a) may then apply to ensure that no adjustment was required for the non-use of an asset on account of the seasonal nature of the business. I accept that analysis.

83. Ms Hardy submitted that paragraph 21 had to be applied in two stages: first, a just and reasonable apportionment was applied under paragraph 21(a) and then, secondly, the assumption made by paragraph 21(b) was to be applied. The difficulty with that submission was that Ms Hardy was unable to explain the purpose that was served by applying paragraph 21(b) after paragraph 21(a). Once a part of the gain had been attributed to a period under the "just and reasonable test" in paragraph 2(a), in the manner contended for by Ms Hardy, it is hard to see why it would be relevant that the gain so attributed should be deemed to accrue evenly during the period. Moreover, there is nothing in the language of the provision that suggests such a sequential approach.

84. Furthermore, although it is a rough and ready method of apportionment, time apportionment is relatively simple and allows taxpayers under the self-assessment system to calculate their tax liabilities with certainty without having to resort to expensive valuation arguments.

85. Ms Hardy drew attention to the well-known *dictum* of Lord Wilberforce in *Aberdeen Construction Group Ltd v IRC* [1978] UKHL 52TC 281 at 296:

> "The capital gains tax is of comparatively recent origin. The legislation imposing it, mainly the Finance Act 1965, is necessarily complicated, and the detailed provisions, as they affect this or any other case, must of course be looked at with care. But a guiding principle must underlie any interpretation of the Act, namely, that its purpose is to tax capital gains and to make allowance for capital losses, each of which ought to be arrived at upon normal business principles. No doubt anomalies may occur, but in straightforward situations, such as this, the courts should hesitate before accepting results which are paradoxical and contrary to business sense. To paraphrase a famous cliché, the capital gains tax is a tax upon gains: it is not a tax upon arithmetical differences."

86. Mr Brennan in response relied on the words of Briggs LJ (with whom Patten and Longmore LJJ agreed) in *Blackwell v HMRC* [2017] EWCA Civ at [22]:

> "While I accept that the capital gains tax legislation, and words, phrases and concepts used in it, including those in s.38, are generally to be interpreted on a basis consistent with business common sense, it by no means follows that there will in any particular instance be a conflict between business common sense and a careful juristic analysis of particular provisions. Even if there is, the clear language of statutory provisions by which gains are to be computed, and deductions allowed, may nonetheless prevail, even where the outcome might appear to be one which a businessman might find surprising."

87. It seems to me with respect that, more than 50 years after the introduction of capital gains tax, the observations of Briggs LJ accurately reflect the present position. In those 50 years capital gains tax has undergone many substantial changes and the conceptual logic behind the tax has often been unclear. When capital gains tax was introduced in 1965 it was initially a tax on long-term gains (with short-term gains made within 12 months being charged to income tax under Schedule D Case VII – a charge abolished in 1971). The tax was substantially changed in 1982 with the introduction of indexation relief whereby the gain charged to tax was the difference between the disposal proceeds and the base cost adjusted by reference to an index of retail living costs. That index often bore no relationship to the increase in value of the actual asset. The basis of the tax changed again in 1988 with the introduction of an indexed base cost founded on a 1982 market value. In 1998, indexation relief was replaced by taper relief (but taper relief did not apply to companies) but taper relief was limited to a period of 10 years. Taper relief itself was an abolished with effect for tax years following 2007/2008.

88. Capital gains tax has, therefore, often been charged on the basis of artificially calculated gains and that whilst, as Briggs LJ indicates, its provisions should generally be interpreted in line with business common sense, that principle must yield to the clear words of the statute.

89. In my view, the statutory provisions in this case are clear and require time apportionment even though the greater part of the gain in this case arose from the growth in value during the BATR period. I therefore consider that, in principle, the gains in relation to this appeal should be time apportioned in accordance with paragraph 3(3) and paragraph 21(b).

90. For these reasons, it is not strictly necessary for me to decide upon the correct valuation of the shares of COL 5 April 2000. Essentially, I accept Mr Brennan's submission that in the light of what I consider to be the proper construction of paragraph 3(3) of Schedule A1 when read with paragraph 21, the valuation issue is irrelevant. Nonetheless, because the point was argued before me and I heard evidence from the witnesses on this issue I shall summarise my conclusions briefly.

91. In short, I accept Mr Brewer's valuation. His valuation was based on the statements of the appellants about the belief, at the time of the contract with BT Cellnet, that the contingent consideration would never be payable. I accept the appellants' evidence (particularly that of Mr Lee) on this point. Therefore, in my view, Mr Brewer was entitled to take the view that the maximum amount of £6.5 million of the contingent consideration could be ignored. Furthermore, I also accept Mr Brewer's evidence that a discount for a minority shareholding of between 40%-50% was appropriate. It is standard practice to discount the value of a minority shareholding in a private company (see, for example, *Erdal v Revenue & Customs* [2011] UKFTT 87 (TC) and the cases therein cited). There seemed to me to be no justification for Mr Brennan's argument that because the appellants were acting in concert their shares should be valued without any minority shareholding discount. Indeed, it was notable that HMRC did not produce their own valuation evidence. Therefore, had it been necessary to decide the valuation issue, I would have accepted Mr Brewer's valuation.

92. As it is, however, for the reasons I have already expressed, I decide the apportionment issue in principle in favour of HMRC.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

93. 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.

GUY BRANNAN
TRIBUNAL JUDGE

Release date: 17 July 2019