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Miller's Tales III

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TM Collins v HMRC SpC 00661

This case concerned a sale of shares by the shareholders, including Mr Collins, to a third party. Mr Collins wanted the majority of his share of the consideration to be paid into his pension fund. However, if the company paid a pension contribution before being sold, the value of all the shares would be reduced, to the detriment of all the shareholders. And if Mr Collins merely paid a pension contribution out of the proceeds of sale, the company would not get any tax deduction. So Mr Collins' share of the consideration was structured so that the purchaser paid £15,267 directly to him and £95,179 into the target company. The company then made a pension contribution of £120,480 on behalf of Mr Collins. On obtaining a tax deduction for the contribution, the company was then to pay the tax benefit, £25,301, to Mr Collins.

Mr Collins accounted for both the £15,267 and the £25,301 in his capital gains computations. But HMRC contended that the £95,179 paid into the target company was also part of the consideration for the sale of his shares. Mr Collins, of course, appealed.

Both parties relied on the principles laid down by Lightman J in *Spectros International plc v Madden* [1997] STC 114:

> 'What is the relevant consideration may depend upon the terms and form of the transaction adopted by the parties. The parties to a proposed transaction frequently can achieve the same practical and economic result by different methods … The law respects the freedom of the parties to a transaction to frame and formulate their agreement as they wish and suit their own legitimate interests (taxation and otherwise) and, so long as the form adopted is genuine, and not a sham, honest, and not a fraud on someone else and does not contravene some established principle of public policy, the Court will give effect to the method adopted. If the question is what method has been adopted and the transaction is in writing, the answer must be found in the true construction of the document or documents read in the light of all the relevant circumstances. If the terms of the documents are clear, that is the end of the question.'

In short, the actual transaction can only be impeached in very specific circumstances. Neither party suggested that any such circumstances were present and both relied on the phrase 'If the terms of the documents are clear, that is the end of the

question'. HMRC contended that 'the £95,179 was a consideration received by Mr Collins because it was paid at his direction and he then benefited from that payment because it enabled the company to pay the pension contribution', so that was 'the end of the question'. Mr Dougal Powrie, of Powrie Appleby, contended for Mr Collins that 'although the £95,179 was only payable by the purchaser when Mr Collins directed it should be paid it was nonetheless a payment by the purchaser to the company and under the clear terms of the document Mr Collins had no right to direct that the payment should be of any other amount or that it should be paid to any other person' and that was, therefore, 'the end of the question'.

The Special Commissioner, Richard Barlow, agreed with Mr Powrie. Mr Collins never received £95,179 and the documents specifically required the payment to be made 'on completion'. Indeed, there was no need for the payment to be made at Mr Collins's direction to obtain the required result. 'I hold that the plain wording and effect of the document was that Mr Collins did not receive the £95,179 and his role was only to trigger the payment between the purchaser and the company.'

Mr Barlow also noted that the *Spectros* principles required him to construe the relevant documents in terms of what they say, their context and 'business sense and reality', so as to identify and give effect to the transaction which the parties had entered into. In this case, he said that the precise nature of the transaction was clear from the documents, so he did not need to consider 'business sense and reality'. However, even if he were required to do so, he would find for Mr Collins, as 'the rationale for the form of the transaction … re-enforces [sic] the interpretation of the document itself and does not contradict it.'

Comments

In this case a comparatively simple piece of planning was undertaken, with a reasonable commercial rationale, as well as with tax efficiency in mind. HMRC was unable to undermine the planning, as the transaction document achieved the required end and that end was not in any way extraordinary. One might argue that this is in line with the *obiter* of Lord Tomlin in *Duke of Westminster v CIR* 19 TC 490: 'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be … however unappreciative the Commissioners of Inland Revenue or his fellow tax payers may be of his ingenuity, he cannot be compelled to pay an increased tax.'

John George Burt v HMRC SpC 00684

This case was concerned with whether the variation of an agreement meant that a new agreement had been entered into at a different time and hence with different tax consequences.

Mr Burt agreed to resign from his employer company and to sell the company his shares for a total of £245,000, in August 1997. In February 1999 Mr Burt accepted that the company was unable to pay this sum and agreed to accept £139,000 instead. He eventually received £139,000 from the company's employee benefit trust (EBT) in August 1999. Mr Burt contended that the disposal of his shares was in 1997/98, when retirement relief was due. HMRC said that the shares were sold by a new agreement in 1999/00, so that no retirement relief was due.

The arguments centred on whether the original agreement had been replaced by a new agreement by novation. According to *Chitty on Contracts*, a novation would have required an agreement between the parties (in this case, Mr Burt, the company and the EBT), with appropriate consideration given for the novation. The Special Commissioner, Julian Ghosh, found that there was no evidence for such agreement and that the evidence suggested that there had, instead, been an equitable assignment by the company of its benefits under the contract to the EBT.

Mr Ghosh also considered whether the agreement to accept £139,000 instead of £245,000 was a mere variation of the original contract or was sufficient to constitute a rescission and replacement of that contract. For there to be an enforceable variation, consideration would have to have been given by the company. The company had not given any consideration for the change of price, so this was not a variation of the original contract.

But a rescission and replacement of that contract also required consideration, in the form of the release of the parties from the original agreement. Neither party was released from that agreement, so the Special Commissioner's view was that this was a gratuitous and unenforceable undertaking by Mr Burt to forgo part of the consideration agreed under the original contract. But it was sufficient for Mr Burt's case that 'no consideration was given by the company for the rescission of the original contract and, hence, no rescission can have taken place'. As a result, the original contract had been neither novated nor rescinded and replaced and the disposal took place in August 1997, to Mr Burt's benefit.

As an aside, one of Mr Burt's arguments was that the originally agreed £245,000 was made up of £139,000 representing the market value of the shares and further sums representing unpaid profits and unpaid income. Therefore, when Mr Burt agreed

to receive just the £139,000, he was not varying the agreement at all, as he would still receive the market value of the shares. The Special Commissioner, however, said that it was not important how the figure of £245,000 was made up, it still constituted the sum agreed for the sale of the shares, so that the agreement to accept only £139,000 was a variation. However, as we have seen, HMRC was unable to make the case that the original agreement had been replaced by a new one.

Comments

Reading between the lines of the decision, neither the company nor Mr Burt had any of the legal aspects of novation or rescission and replacement in mind as they negotiated the share sale. Nor was there any tax planning in mind, so it is fortunate for Mr Burt that none of their actions was sufficient, in Mr Ghosh's view, to replace the original February 1997 contract with another one made in August 1999.

PJ Underwood v HMRC [2008] EWHC 108 (CH)

Our third case is a High Court decision about transactions in land. Mr Underwood bought some land in 1990 for £1.4 million. Property prices fell and on 2 April 1993 he sold the property to a company, Rackham, for about £400,000, claiming an allowable loss of £1.174 million for 1992/93. There was also an option whereby Mr Underwood could buy the property back for £400,000 plus 10% of any rise in value to the time of exercise.

By November 1994 the transaction had still not completed. By this time, Mr Underwood wanted to sell the property to a company with which he was connected, Brickfields, for £600,000. The simplest approach might have been for Mr Underwood to exercise the option and to sell the property on to Brickfields.This should have required payments of £400,000 by Rackham to Mr Underwood, of £420,000 by Mr Underwood to Rackham, and of £600,000 by Brickfields to Mr Underwood.

Instead, Mr Underwood's solicitor arranged that the position between Mr Underwood and Rackham could be resolved by a payment of £20,000 to Rackham. This would prevent the transfer of the legal interest in the property from Mr Underwood to Rackham and back, and the consequent charges to stamp duty (NB: Stamp Duty Land Tax was not enacted until 2003). There was therefore only one legal transfer of the property, to Brickfields, which completed in November 1994.

The capital gains position depended on whether there had been a disposal of the property on 2 April 1993 and a subsequent repurchase in November 1994. Mr Underwood contended that both transactions had effectively been completed and that he had accrued an allowable loss of £1.174 million in 1992/93. HMRC said that the April 1993 contract had never been completed, so that no loss was available to him to shelter his capital gains of that year.

The Special Commissioners had found that the payment of £20,000 by Mr Underwood could be accepted as being in lieu of the payments of £400,000 by Rackham to him and the payment of £420,000 by him back to Rackham. But they then said that there had never been a transfer of beneficial ownership in the property to Rackham, as the payments had been simultaneous, so that there was never a moment in time (or *scintilla temporis*) when Rackham had beneficial ownership in the land.

Mr Justice Briggs considered the legal arguments about whether this was consistent with various activities that are accepted as effective for capital gains purposes. Mr Underwood's Counsel referred the judge to 'bed and breakfast' transactions, where an asset is sold with a view to almost immediate reacquisition; and to forward sale transactions, where a person purports to sell an asset that he doesn't yet own. Both analogies were rejected by his Honour, although he found more merit in the argument that, in receiving £420,000, Rackham had clearly turned a valuable asset to account.

In the end, though, Briggs J said that these arguments were based on the predicate that the original sale contract and the option had both been completed. But his Honour said that his analysis of what happened was rather different. He said that by 29 November 2004 the parties had 'abandoned any intention to proceed to completion of either contract. Performance by transfer of the property was simply abandoned. Indeed, it seems to me unlikely that there was ever an intention actually to complete or perform the 1994 contract.' Instead, 'all that happened was that the two contracts were settled by payment of a £20,000 difference, without any substantial performance of either of them … There was no performance of either contract, there was therefore no transfer of the beneficial interest in the property under either contract, or at all. There was therefore no disposal of the property under the 1993 contract, so that there was nothing upon which section 28(1) could bite so as to deem there to have been a disposal in the 1993 year of account. It follows that, for reasons different from those of the Special Commissioners, this appeal must be dismissed.' So HMRC won its case.

Again, as an aside, there was an interesting analysis in this case about the transfer of beneficial ownership. In the case of land transactions, the position is complicated by the analysis of the rights of the parties between the date of the agreement and the date of completion. Previous jurisprudence had established the proposition that, from the moment of the contract, the vendor becomes in certain respects a trustee for the purchaser (*Lysaght v Edwards* (1876) 2 Ch D 499, 506). In *Jerome v Kelly* [2004] 1 WLR 1409, Lord Walker said that in such circumstances 'Beneficial ownership of the land is in a sense split between the seller and buyer on the provisional assumptions that specific performance is available and that the contract will in due course be completed'. Vitally, he also pointed out that these 'provisional assumptions may be falsified by events'. And this is possibly one of those cases, as the arguments were about whether the contract ever proceeded to completion.

In any case, this level of analysis was not required for tax purposes, as Briggs J noted, because in these cases TCGA 1992, s 28 fixes the date of disposal for capital gains tax purposes only so long as there is actually a completion.

Comments

In contrast to our first case, *Collins v HMRC*, there was here some ambiguity about the position and intention of the parties in November 1994. This ambiguity clearly permitted the judge to infer from the evidence what he thought had actually happened, rather then what Mr Underwood said had happened. It is also interesting to consider whether the judge's view was coloured by the fact that there was an intention to mitigate the exposure to stamp duty.

Conclusion

All three cases show the importance of the legal agreements in the tax analysis of transactions. But they also demonstrate that the agreements must reflect the intention of the parties. In *Collins* and in *Burt*, the agreements were clear and also reflected the intention of the parties. In *Burt*, however, the changing intentions of the parties led to a dispute as to whether the original agreement still stood, an argument that might have been avoided had the parties been aware of the possibility of challenge by HMRC and taken advice to ensure that the original agreement was unimpeachable. In *Underwood* the desire to save some stamp duty led to ambiguity over the intention of the parties and, by inference, over the legal position, allowing the court to find that the original agreements had never been completed.

As a practical point, taxpayers should always ensure that their legal documents agree with their actual intentions and that the tax position is secure and unambiguous as well. This is particularly important where agreements are being varied, given the impact this can have on the tax position.

By the Way … GC Trading v HMRC SpC 00630

Readers will recall that I commented on this case in Miller's Tales II (*The Tax Journal*, Issue 923, 3 March 2008). The company subsequently applied to the Special Commissioners for costs, on the grounds that HMRC had acted unreasonably in bringing the case. The Special Commissioners refused the company's application for costs, finding that HMRC had 'acted wholly reasonably in connection with the hearing of the appeal' (see SpC 00686).

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